

# **Growth Strategies in the Australian Health and Fitness Industry: Franchised vs Company-Owned Outlets**

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**Submitted in partial fulfilment of the requirements for the degree of  
Doctor of Business Administration**

**Victoria Graduate School of Business  
College of Business**



# Declaration

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I, Andrew Stephen Haug, declare that the Doctor of Business thesis entitled *Growth Strategies in the Australian Health and Fitness Industry: Franchised vs Company-Owned Outlets* is no more than 60,000 words in length including quotes and exclusive of tables, figures, appendices, bibliography, references and footnotes. This thesis contains no material that has been submitted previously, in whole or in part for the award of any other academic degree or diploma. Except where otherwise indicated this thesis is my own work.

Signature:



Date: 16<sup>th</sup> January 2017

# Dedication

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I wish to dedicate this thesis to my two wonderful children, Matt and Anneliese. You have been my inspiration and motivation from the day you both were born, I love you both so incredibly much.

# Acknowledgements

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I would like to express my sincere gratitude and acknowledge some very special people whose invaluable support and assistance made the completion of this doctoral thesis possible.

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# Abstract

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## *Growth Strategies in the Australian Health and Fitness Industry: Franchised vs. Company-Owned Outlets*

Businesses seeking to expand their operations must evaluate what organisational strategy might be the most beneficial in driving growth, while satisfying the organisation's particular circumstances. This study examines growth modes and the different choices for firms in the Australian health and fitness industry. This might mean growth through company-owned entities or outlets, or external growth through franchised outlets. Company-owned growth refers to a firm expanding primarily through the maintenance of its ownership or equity in all or parts of legal entities of the expanding business. This form of organisational growth is considered an attractive method of expansion as it guarantees greater levels of control without company culture and management style being compromised. However, the use of franchising or the setting up of franchised outlets is becoming an increasingly popular alternative organisational form. Franchising allows for rapid expansion while addressing any of the resource scarcity issues that are often associated with young expanding firms.

This study addresses a gap in the research literature relating to growth-oriented businesses in the Australian health and fitness industry. Specifically, this study investigated the applicability of Dant's (1995) franchising decision framework in expanding firms in the Australian health and fitness industry. Dant suggested that access to vital resources pushed expanding firms to adopt franchising. These resources include capital, managerial staff and market information, efficiency outcomes and agency relationships. Employing a qualitative

approach, the study investigated firms that grew through franchised outlets as well as those that grew through company-owned outlets. The factors identified by Dant (1995) were significant for fitness firms choosing the franchised outlets route. The study findings also revealed that while all cases were motivated to expand their business, each case group differed in the degree and scale of desired expansion. Those that desire larger expansion (geographically and in number of outlets) would tend to adopt franchising because of the substantial resource requirements. The age of the firm and entrepreneurial traits of the business owners were also observed as factors that influenced the choice of the organisational growth form.

Resource constraints and agency related issues proved to be significant factors for each of the cases. The study found that the lesser the access to financial, managerial and informational resources particularly for those seeking substantial growth the greater the propensity to expand through franchised outlets. While efficiency justifications were considered important by each of the business owners, they were not significant enough to influence the choice of organisational growth mode.

One practical contribution of this study is the detailed narration of the hardships faced by growth-orientated fitness businesses and the interesting ways by which they overcame such challenges. These narratives provide valuable and inspirational lessons to businesses in similar situations, navigating their journeys to sustainable growth. In particular, helpful information is provided to businesses contemplating the best organisational growth option, i.e. franchised outlets or company-owned with differing shareholding percentages of the principal company. The detailed investigation of struggling businesses also provides ample material to guide policy makers and service providers to more effectively provide support to make expanding businesses achieve success quicker.

Future research possibilities have been identified in firstly, expanding the study from merely businesses in Victoria to include those based in other states of Australia. Other related service businesses could be investigated with the same approach. Perhaps more interesting would be investigating whether the findings on the importance of Dant's franchising factors will be borne out in service businesses with a substantial production content, e.g, fast food chains.

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# Chapter 1

## INTRODUCTION

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### 1.1 Introduction

In today's globalised economy, small businesses are widely recognised as a vital factor in contributing to economic development, job creation and the general health and welfare of economies both within Australia and internationally (Morris & Brennan 2000). Small business represents a valuable and significant proportion of the world's economy with small businesses representing 99.7 per cent of all businesses in the United States (Small Business Administration 2012).

Findings of the Australian Bureau of Statistics highlight a similar trend here in Australia, for example the ABS (2009) report indicated that the vast majority of Australian businesses were small (defined as those that employed less than 20 staff, including those that did not employ any staff) with a turnover of less than \$2 million annually. Of the 2,051,085 businesses actively trading in Australia as at June, 2009 there were 1,961,337 listed as a small business, a figure of 95.6 per cent (Australian Bureau of Statistics 2009).

Prominent economist Milton Friedman (1988) once argued that the sole purpose for a firm is to generate profits for its shareholders. Friedman argued not only is the chief purpose of business to generate profits but those firms pursuing other missions would be far less

competitive resulting in fewer benefits to their owners, employees and society (Friedman 1988).

Today's successful firms provide more than a financial profit to their owners. These firms are innovative and growing thus generating economic development and employment that deliver important benefits to society (Baumol 2004; Baumol & Strom 2007; Christensen & Raynor 2003). Firm growth is crucial to society with even the smallest of differences over an extended period of time leading to enormous differences in industrial capacity and people's standard of living (Ahlstrom 2010). Sustained economic growth generates significant increases in per capita income and acts as an indicator of the health of a society's industry (Baumol 2004; Maddison 2007).

Businesses can grow internally or through relationships with other organisations. The method a firm ultimately selects is dependent on a number of factors including its financial position, access to capital, competitors in the market and government regulation. Common internal growth methods include market penetration, market development, product expansion and diversification (Ansoff 1965). Growing a firm through relationships with external firms can also include acquisitions.

Businesses seeking to expand their operations face the task of evaluating what growth strategy may be most beneficial and robust in the long term. As different growth strategies require different resources, there is a compelling need to explore how entrepreneurs make strategic choices to achieve growth (Kor, Mahoney & Michael 2007). The question of whether to expand an organisation organically through company-owned sites or through franchised outlets, or a mix of both, confronts many organisations following the start-up stage of their life-cycle.

This study examined and investigated the key aspects of growth strategies in the Australian health and fitness industry. Research was conducted into the factors that entrepreneurs in the industry considered and the context they were in when evaluating the most beneficial growth strategy for their expanding organisation.

This study specifically provides a greater understanding of the motivations for favouring franchising as a growth strategy, thus identifying and clarifying decision-making processes surrounding organisational form choice.

## **1.2 Expansion through company ownership: organic growth, acquisitions and joint ventures**

A business can expand through the maintenance of company ownership in all aspects of the business' operations. Expansion can take one of three forms: organic growth, acquisitions or joint ventures.

Organic growth refers to an organisation expanding using its own internal resources and capabilities (Chen, Zou & Wang 2009). It occurs without the use of mergers and acquisitions or the takeover of external parties' business and / or customer base (Dalton & Dalton 2006). Organic growth typically involves increasing revenue internally by attracting more customers, increasing transaction values or sales volume. Angwin (2014) suggests that organic growth strategies have five main advantages over other organisational growth modes; (i) organic growth improves a company's knowledge through its direct involvement in the development of new markets or technology; this provides an in-depth, practical knowledge that is likely to be internalised in the company (ii) investments required into any such strategies can be spread over time, allowing for a reduction in any upfront commitments, making any necessary adjustments easier if conditions change; (iii) a third benefit relates similarly to availability

of suitable acquisition targets or potential alliance partners; (iv) a fourth advantage of organic growth is strategic independence, which provides a firm with less restrictions that may be necessary in an alliance; (v) the fifth benefit Angwin (2014) states refers to the possibility of new activities being established within the existing cultural environment, reducing the possibility of a culture clash – a common occurrence when external parties with different cultures need to be integrated.

An expanding business may however find it more economical to expand by acquiring another business rather than going through the time-consuming process of building themselves up to achieve the desired increase in market share. Another possibility would be for a company to merge with another business, establishing part ownership of the new combined business entity. Mergers and acquisitions as a growth strategy have been extensively used by firms for centuries and still remains as an effective method of rapid business expansion (Angwin 2014).

Among the many benefits a merger or acquisition might offer is the expansion of the business by increasing the scope of a firm through new products, services, markets or territories. Mergers and acquisitions can be used to increase market power by reducing competition, increase efficiency by consolidating costs and sharing resources and increasing production efficiency and economies of scale through greater bargaining power in terms of supplier costs and commercial terms (Angwin 2014).

A further possibility would be for the business to enter into an agreement with another business to form a separate new entity, creating a joint venture in which both business parties maintain part ownership. Joint ventures provide opportunities for firms with limited resources to access capabilities in terms of marketing, production and distribution and grow more rapidly than would otherwise allow through internal growth alone (Koryak et al. 2015). Such a growth strategy Mowery et al., (1996) believe is particularly advantageous for transferring

and integrating implicit knowledge from employees since many employees from the previous firms are now working together. With both firms making substantial investments and being largely dependent upon the performance of the other, the commitment to the newly created joint venture is seen and viewed by each as a long-term relationship (Kogut 1988).

Maintenance of company ownership in the different forms described above is often associated with the maintenance of control in whole or in part over the expanding business. The need for control could be motivated by wanting to preserve corporate values or business reputation. In a licensed or franchised operation described in the following section, the company does not have any ownership of a new operation or outlet. Consequently, despite contractual agreements, there may be a level of uneasiness amongst the original business owners associated with things not going as planned. This may put company reputation at risk and affect other parts of the company's business.

### **1.3 Expansion through franchising**

Franchising is an organisational form in which a company (the franchisor), with a market-tested business package, enters a contract or legal business agreement with an individual or another company (the franchisee) and grants the franchisee the right to do business in a prescribed manner (Mendez et al. 2014). The franchisee operates under the franchisor's trade name to produce or market goods or services according to the format specified by the franchisor (Elango & Fried 1997; Stanworth & Curran 1999).

Business format franchising in Australia has been growing since the 1970s when the United States (US) fast-food systems of KFC, Pizza Hut and McDonalds were first introduced into the country (Franchising World 2007). Over the last two decades, franchising in Australia in

its contemporary business format mode has developed into a vibrant and dynamic business activity that has expanded to include practically every product and service. Australia has become one of the most highly franchised nations in the world (Weaven, Frazer & Bodey 2012).

Franchising has proven so successful in this country due to its ability to service niche markets, meet the ever-growing demand for convenience and standardised quality, and provide support to operators in an increasingly diverse and demanding business environment (Franchise Council of Australia 2014). As noted on the Franchise Council of Australia (2014) website 'The tremendous growth and popularity of business format franchising has transformed franchising from a specialised marketing technique into a highly competitive, innovative vehicle for expansion of retail product and service industries'.

Grünhagen and Mittelstaedt (2001) suggested that the expansion of franchising globally may be attributed to several developments, including new forms of franchising, the encroachment of franchising practice in to non-traditional areas and, more specifically, the emergence and increase in the number of franchise owners with multiple units.

Those who favour franchising perceive it as an effective growth strategy for leveraging the intellectual capital of a company. This generates new revenue streams, market opportunities and profit centres at a relatively fast pace (Franchising World 2012). Supporters of franchising also believe it offers an organisation a solution to both financial and managerial constraints (Gillis & Castrogiovanni 2012). These are the two main reasons often cited by organisations for seeking to adopt franchising as a growth strategy (Gillis & Castrogiovanni 2012). Further theories, including operational efficiencies and economies of scale, together

with increased market share and brand equity, have been propounded to justify the appeal of franchising to the expanding organisation. While franchising has proven a popular mode of organisational growth amongst entrepreneurs, it remains a controversial topic within the literature. Disadvantages of franchising as an organisational growth strategy are discussed in the section below 1.3.1.

### **1.3.1 Disadvantages of franchising as a growth strategy**

Despite the widespread popularity of franchising as a business growth strategy, important questions regarding why and when franchisors select franchising over company-owned outlets still exist (Combs et al. 2011). In spite of the positive expectations franchising is said to deliver, failure rates of new franchise initiatives are high. An estimated 50-80% of all franchise initiatives in the USA fail (Shane & Foo 1999). A large amount of fragmented literature highlights significant disparity in the strategic and operational success of franchises (Nijmeijer, Fabbrocetti & Huijsman 2014). While some studies comparing franchising to alternate organisational modes of growth emphasise superior performance (e.g. Aliouche & Schlenrich 2009) others show lesser or equal performance regarding financial performance, efficiency and survival (e.g Benjamin et al. 2006; Grünhagen & Dorsch 2003). Further specific negative aspects regarding the organisational form choice of franchising include relinquishing control over the firm; free-riding and opportunistic behaviour whereby franchisees are motivated by the pursuit of its self-interest and fail to act in the best interests of the franchisor.

### 1.3.2 Franchising in Australia

Franchising is an important and growing sector within the Australian economy. As a distribution system franchising has shown steady growth throughout the last decade in Australia (Weaven, Frazer & Bodley 2012). It is estimated that there were more than 1,160 different types of business format franchise systems operating within Australia in 2014, 86 per cent of which were Australian-based franchise systems. From the 1,160 different types of franchise systems an estimated 79,000 franchises were operating in 2014. This estimated number of units represents an increase of 8.2 per cent since 2012 (Frazer, Weaven & Grace 2014). The growth in franchising in Australia over the past two decades reflects a confident regulated franchising sector in a strong local economy. Such an increase in franchise systems indicates that entrepreneurs continue to favour the use of franchising as a means of market penetration (Frazer, Weaven & Grace 2014). The Australian franchising sector comprises enterprising entrepreneurs as franchisors and franchisees employ an estimated 460,000 Australians (Frazer, Weaven & Grace 2014).

The Franchising Australia (2014) report, endorsed by Griffith University and authored by the Asia-Pacific Centre for Franchising is sponsored by the Franchise Council of Australia biennially and provides the most comprehensive profile of the Australian franchise sector. The 2014 report showed that it had become common for businesses to be piloted for a median of three years before adopting a franchise model. This allows time to establish some track record of success thus enhancing marketability. The tendency to commence franchising early within their business life-cycle is said to be largely due to the desire of franchisors to achieve rapid market expansion and therefore growth (Frazer, Weaven & Grace 2014).

Despite holding one of the highest levels of franchisors per capita in the world, numerous challenges continue to play a part in determining the level of growth for many Australian

franchisors. Among the reasons impacting franchise sector growth are contracting and retaining suitable franchisees. Key findings of the Franchising Australia (2014) report indicate that growth within the industry sector continues to be compromised by access to suitable franchisees with available finance and access to affordable sites (Frazer, Weaven & Grace 2014). Maintaining integrity of the franchise system and the brand, together with the requirement to maintain standards and system compliance were among the next set of challenges faced by franchisors (Frazer, Weaven & Grace 2014).

#### **1.4 Overview of the Australian health and fitness industry**

Businesses falling within the Australian health and fitness industry include those operating as health clubs, fitness centres or gymnasiums (IBISWorld 2015). These businesses typically offer a range of fitness activities and services, such as use of fitness equipment and cardio exercise machines and the offering of group fitness classes including aerobics, pilates and yoga together with personal training instruction. The primary revenue stream for these businesses comes through membership fees, paid weekly, fortnightly or monthly.

The structure of the Australian health and fitness industry has changed significantly over the past five years with the emergence of budget 24-hour fitness chains driving substantial increases in establishment numbers. A total of 2,854 businesses operating in the health and fitness sector now contribute to an estimated \$1.3 billion industry revenue (IBISWorld 2015). Fitness Australia is the industry peak body that represents almost 30,000 registered fitness professionals, fitness service providers and industry suppliers. The inaugural Australian Fitness Industry (2012) report that 30 per cent of businesses were privately owned, 20 per cent were public or not-for-profit, while 45 per cent were either company-owned or operated as a franchise (Deloitte Access Economics 2012).

The Australian health and fitness industry is in the maturity phase of its lifecycle and approaching saturation. With industry establishment numbers expected to remain stable, diminishing returns for the industry are expected over the next five years through to 2020 (IBISWorld 2015).

The Australian health and fitness industry landscape has seen a rationalisation of industry operators. The smaller-sized 24-hour gyms, together with lower operational costs have made finding suitable locations easier compared to previous years. This has reduced the barriers for new entrants and generated industry growth. The increase in the number of franchise outlets continues to expand the ratio of fitness centres to enterprises (IBISWorld 2015). Industry data reveals that in the 2015 financial year there were 3,606 fitness centres or establishments operating in Australia compared with 2,455 10 years before in the financial year 2005 (IBISWorld 2015). A summary highlighting current industry data is depicted below in table 1.1.

**Table 1.1: Australian Fitness Industry data (IbisWorld, 2015)**

| <b>Industry Data</b> |                      |                                   |                       |                    |                   |
|----------------------|----------------------|-----------------------------------|-----------------------|--------------------|-------------------|
|                      | <b>Revenue (\$m)</b> | <b>Industry Value Added (\$m)</b> | <b>Establishments</b> | <b>Enterprises</b> | <b>Employment</b> |
| 2005-06              | 1,013.6              | 598.6                             | 2,455                 | 1,996              | 17,646            |
| 2006-07              | 1,093.0              | 638.3                             | 2,528                 | 2,049              | 18,534            |
| 2007-08              | 1,191.1              | 703.6                             | 2,639                 | 2,128              | 19,275            |
| 2008-09              | 1,053.9              | 541.6                             | 2,613                 | 2,187              | 18,278            |
| 2009-10              | 1,113.8              | 595.4                             | 2,818                 | 2,310              | 18,461            |
| 2010-11              | 1,174.2              | 631.7                             | 3,101                 | 2,503              | 18,849            |
| 2011-12              | 1,245.2              | 675.5                             | 3,368                 | 2,670              | 19,132            |
| 2012-13              | 1,290.2              | 706.3                             | 3,527                 | 2,762              | 19,476            |
| 2013-14              | 1,320.3              | 715.6                             | 3,588                 | 2,834              | 19,573            |
| <b>2014-15</b>       | <b>1,309.8</b>       | <b>701.2</b>                      | <b>3,606</b>          | <b>2,854</b>       | <b>19,279</b>     |
| 2015-16              | 1,278.7              | 675.3                             | 3,563                 | 2,779              | 19,434            |
| 2016-17              | 1,284.9              | 686.5                             | 3,551                 | 2,785              | 19,336            |
| 2017-18              | 1,278.5              | 706.8                             | 3,591                 | 2,804              | 19,104            |
| 2018-19              | 1,293.3              | 712.9                             | 3,625                 | 2,827              | 19,257            |
| 2019-20              | 1,280.4              | 697.4                             | 3,582                 | 2,790              | 19,565            |
| <b>Sector Rank</b>   | <b>10/14</b>         | <b>5/14</b>                       | <b>3/14</b>           | <b>1/14</b>        | <b>3/14</b>       |
| <b>Economy Rank</b>  | <b>475/787</b>       | <b>369/786</b>                    | <b>182/787</b>        | <b>167/786</b>     | <b>186/786</b>    |

Recent years have seen increasing trends within the fitness industry for mergers and acquisitions, with large overseas conglomerates entering the Australian market seeking to expand through local affiliations and takeover strategies. The traditional scenario of single site owner-operated centres has given way to either large national company-owned or franchised chains.

In the annual Australian fitness survey (2015) administered by industry service provider, Ezypay, 315 business owners operating a business in the fitness industry addressed a series of questions relating to that industry. The survey revealed that their most concerning challenge was the threat of competition. A total of 21.7 per cent of respondents said that both internal competition (competing facilities within the industry) and external competition (competition from all substitute forms of exercise) posed the greatest threat. IBISWorld (2015, p. 18) confirmed the survey findings reporting ‘that the fitness industry is highly competitive, based on price, location and the quality of facilities and services’. Businesses operating within the industry also face indirect competition from external sources, such as organised sport, instructors and personal trainers, or from those who ‘do-it-yourself’ exercise by jogging or cycling (IBISWorld 2015).

Retaining current members and achieving membership growth were two priorities that rated highly amongst owner concerns. Membership retention (20.4 per cent) and membership sales (17.8 per cent) rated second and third respectively. Owners completing the survey also recognised the importance of effective marketing campaigns (9.6 per cent) as the fourth most identified issue of concern facing clubs. The issue of finding and retaining good quality staff, which had an impact on the success of the business completed the top five challenges facing owners, with seven per cent selecting this as the most important factor facing the industry.

## **1.5 Prior research and literature and the proposed research model and aims**

The choice of franchising as a business growth strategy has been little researched and understood, receiving relatively limited academic attention. The clear exception would be the work of Rajiv Dant, which began in the 1990s when franchising became a popular business expansion avenue for many entrepreneurs. His conceptual and empirical publications now span more than twenty years.

Early franchising literature focussed on three broad areas: the societal implications of franchising (Castrogiovanni, Justis & Julian 1993; Hadfield 1990; Brickley, Dark & Weisbach 1991); franchise operational systems (Hunt & Nevin 1974; Carmen & Klein 1986); and franchising relationships (Caves & Murphy 1976; Carney & Gedajlovic 1991).

In recent years, much of Australian franchising research has centred on topical issues including multiple unit franchising (Weaven & Frazer 2007); current trends (Frazer, Weaven & Bodley 2012; Frazer, Weaven & Grace 2014); and international franchise expansion (Merrilees & Frazer 2006). In 1998, the Franchising Australia surveys commenced and continue today on a bi-annual basis. The survey's ninth edition, released in 2014, is the most recent and provides an extensive source of information regarding the Australian franchise sector (Frazer, Weaven & Grace 2014).

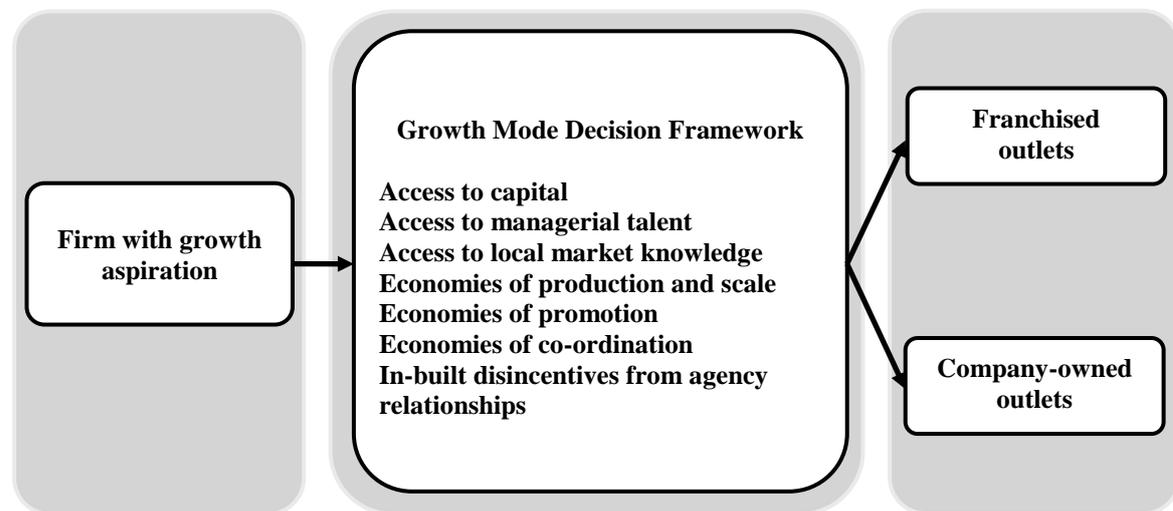
Dant's research throughout the last two and a half decades has seen a rich stream of theory development within the franchising field, from ownership redirection in franchised channels (Dant, Kaufmann & Paswan 1992; Dant et al. 1996) through to the structural and strategic dynamics in franchising (Dant & Kaufmann 2003; Dant, Risen & Gerard 2008).

On the particular domain of franchising as a growth strategy, Dant (1995) summarised franchising research and identified what factors are likely to drive successful, growth-orientated organisations in the direction of franchising: (1) Access to capital; (2) Access to managerial talent; (3) Access to local market knowledge; (4) Economies of production and scale; (5) Economies of promotion; (6) Economies of coordination; and (7) In-built disincentives from agency relationships. Through empirical investigations, Dant (1995) sought to ascertain the relative importance of these factors and found that economic motivations together with idiosyncratic motivations drove the franchise route choice.

The notion that franchising is motivated by the franchisor's lack of capital is among the earliest explanations for franchising. Kirby and Watson, (1999) separated motivations for franchising into two distinct categories: resource scarcity and agency or transaction costs. Proponents of the resource scarcity view (Ayling 1988; Golisano & Worth, 1989) suggested that the selling of franchises offers a small firm, particularly those with limited financial resources, a useful method of acquiring capital to fund expansion.

Apart from resource scarcity, the existence of franchising is explained by agency / transaction theory. Various authors (Mathewson & Winter 1985; Brickley & Dark 1987) suggest that managers are likely to shirk their responsibility to the firm because their compensation is fixed. This shirking results in high monitoring costs for the firm to ensure that the managers act in the firm's best interest (Elango & Fried 1997). Thus, franchised units are seen by supporters of agency theory as likely to perform more effectively than company-owned outlets because the business arrangement between the franchisor and the franchisee is designed to keep both sides' financial interests closely aligned.

Dant's franchising decision framework, as provided in Figure 1.1, serves as the conceptual framework for this study. It features the seven primary reasons that push successful growth-orientated businesses in the direction of franchising.



**Figure 1.1: Dant's Decision Framework**

To date little research has been conducted in regards to the adoption of the franchised business system within the Australian health and fitness industry. Thus, this research project examined expansion through franchising or company-ownership within the industry. Investigation was conducted into the importance of the key factors cited within Dant's decision framework to justify a company's growth strategy either organically, through company-owned or operated outlets, or through the franchising route.

The specific aims of this research project were to:

1. Evaluate the seven key criteria identified by Dant within the franchising literature to determine if they are relevant to Australian growth-orientated organisations in the Australian health and fitness industry.
2. Determine how applicable Dant's franchising decision framework may be for explaining growth strategy choice in the Australian health and fitness industry.

The research questions the study sought to answer were:

1. How relevant is each of the seven factors identified by Dant for health and fitness firms that choose to grow via franchising?
2. What could account for the importance attributed to each factor?
3. Are there other factors that will motivate a business owner to franchise their business as an organisational growth strategy?

## **1.6 Research methodology**

Employing a qualitative approach, research was conducted into the factors that business owners considered when evaluating the most beneficial growth strategy for their expanding organisation. The research incorporated case studies of five Australian fitness club businesses that pursued growth opportunities. There were two groups of cases: the first consisted of two case businesses that adopted franchising as their growth vehicle; while the other three opted for company ownership as their preferred organisational form.

The multiple case study analysis allowed for an in-depth examination of the similarities and differences within and between the case groups. Semi –structured interviews were conducted with each of the participating respondents to elicit the greatest detail in responses to questions. Data from the different cases was then collated and evaluated taking care throughout the research process to ensure reliability and validity. Data analysis involved the coding of the case study data which included the identification, linking and analysis of emerging themes.

## **1.7 Research contribution and importance**

While past research focussing on organisation expansion strategies has studied primarily the relationship between franchising and growth (Carney & Gedajlovic 1991; Martin & Justis 1993; Norton 1988; Shane 1996), few studies have investigated the motivations or the circumstances surrounding the organisational form adopted by the growing business. To date little research has been conducted regarding the creation of franchise businesses within the Australian health and fitness industry. This study therefore contributes to filling the aforementioned gaps.

The health and fitness industry continues to grow and evolve. There are an estimated 3,606 businesses reportedly operating as a health and fitness centre or gymnasium in Australia (IBISWorld 2015). With more than 19,279 employees, health and fitness is an industry that, in 2015, generated a reported total annual income of \$1.31 billion (IBISWorld 2015). This study provides managers and fitness industry leaders with valuable narratives and lessons to inform their decisions, particularly in relation to growth and organisational forms.

## **1.8 Thesis structure**

Following this introductory chapter, a review of organisational growth literature including the alternatives and motivations behind a firm's decision to expand is presented. Chapter 2 explores the breadth of literature surrounding the importance of organisational growth as a field of study. The chapter then highlights a review of the literature that describes organisational modes of expansion, business growth and life-cycle stage models. A critical review of franchising as a method of organisational expansion is also provided.

Chapter 3 discusses the qualitative research methodology adopted to evaluate the question of what motivations and factors bear on entrepreneurs when evaluating the most beneficial growth strategy for their expanding business. The design of the study, the case study sample and the sources of data collection are described in detail together with the data analysis procedures used in the research.

Chapter 4 presents the results of each of the interviews conducted as part of the overall study across the five cases.

Chapter 5 presents a discussion of the findings from each of the entrepreneurs interviewed. Emerging themes common within each of the entrepreneur responses and their motivations for expansion were explored and reported. Additionally, reason for choice of growth strategy and the expansion alternatives each evaluated were explored, with any irregularities or individual approaches highlighted.

Chapter 6 provides a summary of the research undertaken, particularly the relevance of Dant's model as observed in the Australian health and fitness industry. Suggestions for further research studies are also provided.

# Chapter 2

## LITERATURE REVIEW

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### 2.1 Introduction

This chapter presents a review of organisational growth literature. Its objective is to explain various aspects of business growth, including motivations behind business expansion. The chapter also investigates the alternative organisational approaches adopted when businesses expanded either through company-owned or franchised outlets. Specifically, key criteria are investigated to determine the factors influencing the decisions that growing businesses face when determining which organisational growth strategy to pursue.

Buederal, Preisendoerfer and Ziegler (1992) claimed that organisational growth contributes to a higher likelihood of survival because it helps new ventures overcome challenges of newness and smallness in the early stage of their business life-cycle. Choosing the most suitable expansion strategy is an important decision facing the entrepreneur of a growing organisation (Gilbert, McDougall & Audretsch 2006). The growth strategy selected can have a significant impact on an organisation in terms of its financial structure and, ultimately, its performance.

While predictors of new venture growth are abundant within the existing research literature, little academic attention has been paid to the complex decision process associated with different strategic choices for new venture growth (Gilbert, McDougall & Audretsch 2006). In particular, questions need to be asked about how firms grow, why they grow based on

different growth patterns, and how the decisions about whether to grow or not are made (Clarysse, Bruneel & Wright 2011). Chen, Zou and Wang (2009) wrote that such a gap in the literature is concerning given the range of expansion opportunities available to new ventures.

This chapter is set out to first explain various aspects of organisational growth. Sections 2.2 and 2.3 examine measures of firm growth, motivations for growth, characteristics of high-growth entrepreneurial firms, slow-growth firms, and achieving growth for expanding organisations. Literature focused on the influence of the industry and organisational life-cycle, as well as firm age on business growth are then reviewed in Sections 2.4 and 2.5 respectively.

Sections 2.6 to 2.13 present a discussion on organisational modes of expansion and a critical review of franchising as a method of organisational expansion.

## **2.2 Measures of firm growth**

Organisational or business firm growth has been described using several measures. Murphy, Trailer and Hill (1996) wrote that growth may occur through a number of business operations, including cash flow, net income, increased customers, sales and market share.

Weinzimmer, Nystrom and Freeman (1998, p. 26) claimed that ‘the most common measures used in empirical studies on firm growth are the total sales and number of employees’. Such measures, they claimed, are easily accessible and provide a set of parameters most commonly relied upon by Chief Executive Officers (CEOs) and entrepreneurs to appraise and measure their firm’s growth (Weinzimmer, Nystrom & Freeman 1998). Davidsson and Delmar (1998) supported this statement, adding that if only one single growth measure were to be utilised then sales growth would be the preferred measure. Sales growth indicators offer an effective

measure of growth and are, in fact, the primary indicator used by managers of small firms (Barkham et al. 1996). Flamholtz (1986) asserted that sales precede other growth indicators. Increases in sales growth demands an increase in assets and employees, thus resulting in rising profits or market share. Numerous authors however have stated that very few managers see employee growth as an effective stand-alone measure (Robson & Bennett 2000; Wiklund 1998). With the growing number of firms outsourcing their staffing needs, employment growth may not necessarily be related to sales growth (Delmar, Davidsson & Gartner 2003).

Growth strategies involve processes that seek to increase an organisation's operations as well as overcome resource deficiencies to enable business expansion (Shelton 2005). Thus, another measure of growth would be new investments made (Miller & Miller 2008). Miller and Miller (2008) described companies seizing opportunities for growth as those that 'require profound long term investments which may fall within different categories depending on the competitive advantage that a firm is pursuing' (p. 45). Investments may be in the way of new product and service development, new channels of distribution, new processes or technologies and untapped markets (Lumpkin & Dess 1996). Firms may also invest in employees, as higher quality talent is required by firms to develop unmatched competencies that capitalise on growth opportunities (Miller 2003). Additional investments might include alliances with other firms or institutions that assist a firm in leveraging their competencies. Such investments will facilitate the growth of a firm while enhancing the competitive position of the company (Davidsson, Delmar & Wiklund 2002).

While each of the above growth measures has merit, indicators focussing solely on revenue or employee growth were not deemed suitable for the purpose of this study. Increases in such measures do not automatically correlate to an increase in overall profit which enable firm growth. Similarly, investments focussing specifically on new product development, new channels of distribution or technologies were not seen as an effective measure of growth for

the context of the health and fitness industry. of this study. For this study the per cent change in outlets was deemed the most appropriate measure in determining firm growth (Michael 2000).

Additional investments might include alliances with other firms or institutions that assist a firm in leveraging their competencies (Miller 2003). Such investments will facilitate the growth of a firm while enhancing the competitive position of the company (Davidsson, Delmar & Wiklund 2002).

### **2.3 Motivations for growth**

Achieving growth is driven by the degree of motivation possessed by the business owners (Wright & Stigliani 2012). The literature has identified distinct characteristics of high-growth and slow-growth firms and their underlying motivations. Numerous authors agree that the reasons for, and circumstances behind, a firm's growth are not consistent (McKelvie & Wiklund 2010; Shepherd & Wiklund 2009). Firms grow in a variety of differing ways, for different reasons and with different results.

Business start-ups can be categorised according to their growth ambitions. Growth expectation does not always equate to growth and aspirations do not always materialise as planned, growth however rarely occurs by accident or without aspiration (Autio 2007). An individual's decision to launch a new venture is affected by a number of factors including the entrepreneur's environment together with their personal circumstances (Autio 2007). Shane (2000) affirms opportunity and related growth expectation are not defined by the environment alone, rather the match between the opportunity and the personal characteristics of the individual.

Although considered an important area of study, absent from existing literature is research surrounding how entrepreneurs undertake decisions to grow or not grow their firms, and of which factors (internal – the business owner and the business, and external – the environment) may impact such decisions (Wright & Stigliani 2012). This study sought to identify and investigate other factors that are likely to motivate a business owner to adopt franchising as a business growth strategy. As such investigation into the motivation for growth as a factor in the growth mode adopted in the fitness industry was conducted.

### 2.3.1 High-growth / entrepreneurial firms

In contrast to small business in general, high venture growth firms may start small but are intended to grow rapidly, often requiring a team of partners or managers to handle the growth (Katz & Green 2014). High-growth ventures have been described as those that ‘aim to achieve growth rates of 25 per cent or more a year, with sales of more than \$1 million’ (Katz & Green 2014, p. 9). High-growth firms amongst other characteristics seek external sources of funding and pursue high levels of professionalism (Katz & Green 2014). A summary of small business and high-growth characteristics is identified below in table 2.1.

**Table 2.1: Differences between small business and high-growth ventures (Katz & Green 2014).**

| <i>Differences between small business and high-growth ventures</i> |                         |                         |
|--|-------------------------|-------------------------|
|  | Small Business          | High-growth firms       |
| Preferred funding source   | Owner’s own money       | Other people’s money    |
| When the firm is in trouble  | Cut costs               | Sell more               |
| What’s more important  | Sales                   | Marketing               |
| Personal control preference  | Retain autonomy         | Involve key others      |
| Focus  | Efficiency              | Effectiveness           |
| Metastrategy   | Imitation               | Novelty                 |
| External control preference  | Control firm            | Control market          |
| Grow   | When necessary          | When possible           |
| Human Resources  | Personalise             | Professionalise         |
| Acceptance   | Personal validation     | External legitimacy     |
| What limits growth   | Loss of control         | Market response         |
| Delegation orientation   | Delegation is difficult | Delegation is necessary |

Several authors have commented that firms that experience high growth rates during a certain period within their life-cycle could be considered entrepreneurial (Davidsson, Delmar & Wiklund 2006; Stevenson & Gumpert 1985). These high-growth firms persistently deploy new combinations of both resources and economic knowledge (Laglois 2007; Drucker 1985), and grow the firm utilising resources that can be acquired or accessed within the marketplace (Hart, Stevenson & Dial 1995). Davidsson and Delmar (2001) suggested that high-growth firms, regardless of environmental conditions, will find a way to reach their growth goals. This, they asserted, was in distinct contrast to other firms whose fortunes fluctuate with the rise and fall of the economy.

Research has shown conflicting opinions regarding the identification and qualification of high-growth firms. Differing views regarding measures used to gauge firm growth from sales, employees, the length of time to consider, and the degree of growth that qualifies a firm, have been just as varied amongst scholars (Delmar, Davidsson & Gartner 2003; Moreno & Casillas 2007; Weinzimmer 2000).

The Australian Government Department of Industry, Innovation and Science define high-growth businesses as those with ‘average annualised growth in sales or employment (i.e. number of employees) per annum greater than 20 per cent over a three-year period (Australian Innovation System Report (2016, p.26). This definition is consistent with the Eurostat – OECD Manual on Business Demography Statistics (2007) and is widely recognised within the literature as the basis for defining high-growth enterprises. The report also suggests that both employment (number of employees) and turnover should be used to study the phenomenon of enterprises (Eurostat 2007).

A significant amount of research highlights that high-growth firms extensively use resources owned by external organisations to grow beyond limits set by internally-controlled resources (Stevenson & Jarillo 1990). These external resources include financial capital, managerial capabilities, and market knowledge through long-lasting or newly-established inter-organisational relationships (Freel 2000). The various ways in which firms benefit from other firms / new investors and stakeholders involve equity and non-equity modes. These are discussed in Sections 2.8 to 2.10.

Entrepreneurial traits seen in high-growth firms have been defined as the ability to search, identify and exploit new business opportunities (Shane & Venkataraman 2000; Stevenson & Jarillo 1990; Venkataraman 1997). Several authors (Ardichvili, Cardozo & Ray 2003; Casson 1990; Covin & Slevin 2002; Shane & Venkataraman 2000) have argued that the number one priority of any entrepreneur is to build and grow the business, thus entrepreneurs are more willing to take calculated risks, are proactive in identifying opportunities and creating new products and are more inclined to innovate with new processes and procedures. Researchers (Covin & Slevin 1998; Daily et al. 2002; Miller 1983) suggest that this combination of qualities and characteristics could be called 'entrepreneurial orientation'.

Baron and Ward (2004) argued that a central aspect of entrepreneurship and entrepreneurial cognition is opportunity recognition. Cognitive structures are the frameworks used to organise information. Such structures 'rely on comparative thinking to make connections, find patterns and relationships and generate rules and abstract generalisations which apply to more than the immediate situation' (Wright & Stigliani 2012, p. 6).

Recent research surrounding entrepreneurial cognition focuses on the processes underpinning opportunity recognition, opportunity evaluation and decision-making (Wright & Stigliani 2012). Further, research has attempted to understand if these cognitive structures are used

differently between entrepreneurs and non-entrepreneurs (Fiske & Taylor 1991). Baron and Ward (2004) claimed research surrounding entrepreneur cognitive structures is based on the hypothesis that entrepreneurs and non-entrepreneurs differ greatly in the structures they use and the way in which they are used.

The level of entrepreneurship that may exist within a firm can be assessed according to its entrepreneurial orientation (Rigtering et al. 2014). Among the conceptualisations of entrepreneurial orientation is one showing three separate influencing dimensions: innovativeness, risk-taking propensity and proactiveness (Lumpkin & Dess 1996).

Proactiveness refers to a firm's propensity to anticipate the market, take initiative and implement new opportunities in order to compete aggressively against competitors (Entrialgo, Fernandez & Vazquez 2000). Thus, by anticipating future market changes and having a greater forward-looking perspective, firms that are proactive often create a competitive advantage (Hughes & Morgan, 2007). A firm's innovativeness refers to its willingness to explore and engage in new idea generation, development of creative processes and thinking that may result in the launch or introduction of new products, systems or services (Lumpkin & Dess 1996). Risk-taking involves a firm's propensity to commit a large amount of resources to an uncertain project that may pose a significant level of risk. Morris, Kuratko and Covin (2008), however, described successful entrepreneurs who engage in risk-taking initiatives as guided by calculated actions as opposed to uncontrolled risk-laden endeavours.

### **2.3.2 Slow-growth firms**

Contrary to popular notions, limited or slow firm growth is not always due to an organisation's inability to grow, but rather to the lack of desire or motivation on the entrepreneur's behalf to expand the firm. Numerous studies have highlighted that many firms

will not seek to grow their business during their life-span. Wiklund, Davidsson and Delmar (2003) found that many firms are not interested in growth. Thus, growth is not always an efficient indicator of success as not all organisations will share the same willingness to expand their operations. These studies indicate that the majority of firms will start small and remain small (Birley & Westhead 1990; Gimeno et al. 1997). Thus, the majority of firms will never embark on a growth trajectory (Aldrich 1999).

Reynolds, Bygrave and Autio (2003) observed that the majority of businesses are ‘copy-cat’ or ‘me-too’ firms operating in mature industries serving local markets and, as such, do not have great potential for growth. Justifications for firms not wanting to grow include the impact on the well-being of operators, loss of independence from other stakeholders, and the firm’s ability to manage growth, together with concerns of survival (Wiklund, Davidsson & Delmar 2003).

Small firms seeking rapid growth provides a significant field of research. Prolific researcher David Storey, in his role as Director for the Centre for Small and Medium sized enterprises at the University of Warwick is widely recognised for his research in the small business sector. Through his research, Storey (2000) found that while rapidly-growing firms make up only a small percentage of the small firm population they make a major contribution to job creation. While most firms do not wish to grow, even in an ideal economic environment, those that exhibit low or negative growth have significantly higher failure rates than high-growth firms (Storey 2000). Factors influencing firm growth included the background / resources of the entrepreneur, the nature of the firm and the strategic decisions undertaken by the owners all of which need to be combined appropriately for growth to be achieved (Storey 2000 p. 158).

It has been stated that few SMEs are seriously interested in growth, with many electing autonomy and independence over any financial motives (Gray 1998). Research findings through an analysis of a national UK survey confirmed that the dominant motivation that inspired SMEs was the desire to be independent and was seen as significantly more important than financial gain (Small Business Research Trust 1999). Further analysis within the survey showed the non-economic and lifestyle decisions dominate the motivations and strategic objectives of SMEs (Small Business Research Trust 1999). Household related objectives including building assets for the family, achieving improved standard of living and supporting a preferred lifestyle are personal concerns of the business owner and have been determined to be most prevalent of motivations (Gray 2002). Table 2.2 below summarises the main strategic objectives of SME's within the study.

**Table 2.2 SME strategic objectives 1990-1999 (Adapted from Gray 2002, p. 66)**

|  | 1990  | 1996 | 1999  |
|--|-------|------|-------|
| Support preferred lifestyle (per cent)         | 30    | 35   | 33    |
| Build assets for the future/ family (per cent) | 16    | 15   | 21    |
| Increase profits (per cent)                    | 21    | 21   | 17    |
| Improve personal standard of living (per cent) | 16    | 8    | 9     |
| Innovate/develop new products                  | -     | 7    | 5     |
| Increase sales (per cent)                      | 7     | 6    | 5     |
| Other (per cent)                               | 10    | 7    | 9     |
| Sample size (n)                                | 1,349 | 753  | 1,121 |

Grey (2002) supports the notion that the most important constraint on SME growth lies in non-growth career expectations and the individual owner's personal motivations. If owners expectations are to earn no more than a living either as an individual or a household then growth past that certain level of income is unlikely (Grey 2002). In this setting, many business decisions will be based on non-business criteria with links to personal lifestyles associated with youth, family commitment and retirement concerns. Organisational complexities, non-economic and personal lifestyles motivations appear to present real barriers to entrepreneurial behaviour and SME growth (Grey 2002).

Another determinant in limiting the growth of a firm are the barriers to entry to the industry in which the organisation operates (Vermeulen & Barkema 2001). When barriers to entry are low, firms operating within the industry have less protection from new entrants that increase competition for the resources required by existing firms to achieve growth (Weinzimmer 2000). Thus, firms operating in an industry with low barriers to entry are expected to achieve limited or a slower rate of growth when compared to firms operating in an industry with higher entry barriers (Weinzimmer 2000).

Entrepreneurs are said to recognise more opportunities than non-entrepreneurs. The latter are more worried about consequent additional costs and greater risks (Vecchio 2003). In addition, some entrepreneurial activities associated with firm growth are avoided by individuals not because of a lack of ability, but rather their belief that they do not have such ability (Wright & Stigliani 2012). Self-efficacy studies help rationalise why some businesses grow while others do not. Vecchio (2003) claimed that business owners with insufficient self-efficacy to cope with definite tasks will decide not to grow their firms.

### **2.3.3 Achieving growth**

Understanding the factors that facilitate organisational growth is important for the design of enhanced strategies and processes to stimulate business growth. Business growth seems to be an important performance indicator for the survival of small firms. Brush and Vanderwerf (1992) believed that differing growth strategies may be required for different environments based on the identification of growth constraints and opportunities. Kylaheiko et al. (2010, p. 508) believed that 'firms reach for growth by launching new products, attracting new customers or effecting a combination of both'.

One of the first frameworks describing new venture growth was developed by Penrose (1959), based on the dynamic theory of economic development and human motivation. The foundations of Penrose's work, now widely known as the 'Penrose effect', were based on the premise that the growth of a firm is limited only by administrative problems, especially managerial capability within an organisation (Lockett & Wild 2013). Penrose's belief was that there are no external limits to the growth opportunities of firms. Lockett and Thompson (2004) believed, however, that Penrose's views were a product of her time, the 1950s, considered a period of stable economic growth. Lockett et al. (2011) calls for a re-examination of Penrose's ideas, applying them to a contemporary context of slower economic growth in more competitive environments.

Despite being more than 50 years old, Ansoff's (1965) matrix (set out in Figure 2.1) still serves as a valuable analytical framework to describe the diverse pathways that new ventures could follow to achieve growth. The four primary growth strategies are:

*Market Penetration* – (Involving existing products in existing markets). Through this strategy, an organisation will seek to increase its market share, typically either by attracting new customers from competitors or increasing the product usage rate of existing customers.

*Market Development* – (Involving new products in existing markets). Organisations adopting this strategy will seek to identify or create new segments for their current product offering.

*Product Development* – (Involving new products in existing markets). Ventures seek growth through launching new products in existing markets.

*Diversification* – (Involving new products in new market segments). The venture adopting a diversification strategy looks for growth by launching new and quite often related products in new markets or customer segments.

|         |          | Products           |                     |
|---------|----------|--------------------|---------------------|
|         |          | Existing           | New                 |
| Markets | Existing | Market Penetration | Product Development |
|         | New      | Market Development | Diversification     |

**Figure 2.1: Ansoff's product-market matrix (1965)**

Ansoff's product-market model proposes marketing strategy options that clearly establish direction to guide the expansion of the enterprise (Moreno & Casillas 2008). Johnson & Scholles (1984, p.9) state 'although corporate strategy typically refers to joint ventures, mergers, acquisitions and diversification it is also associated with the sort of strategic decision that most organisations face when considering the widening of a range of products or services or a move into geographical areas. Gibbons & O'Connor (2005) state that these strategic options are not only applicable for large conglomerates but could be particularly useful to describe the expansion processes in the case of small and medium enterprises.

Apart from Ansoff's product-market model this study considered the possibility of using Porter's Value Chain Analysis framework (Porter 1985) and the Five Forces (Porter 1980).

The Value Chain model refers to the vertical and / or horizontal integration which are not common to the Fitness industry, thus the model was not taken in.

Moreno and Casillas (2008) suggest that decision making on growth is mainly situated at corporate level while the resulting strategies of leadership in cost and differentiation from the Five Forces model are meant to develop competitive advantage and are more geared toward the objective of profitability than that of firm growth. For these reasons Ansoff's (1965) corporate level strategy was deemed most appropriate to the objective of this study.

## **2.4 Industry and organisation life-cycle**

Firm growth as a focus within entrepreneurship scholarship has attracted much attention. McKelvie and Wiklund (2010) highlighted that much of this focus has been dedicated to understanding the reasons surrounding how much firms grow and why some (particularly new ventures) grow more than others. One theoretical thread of discussion involves the industry as well as the organisation life-cycle.

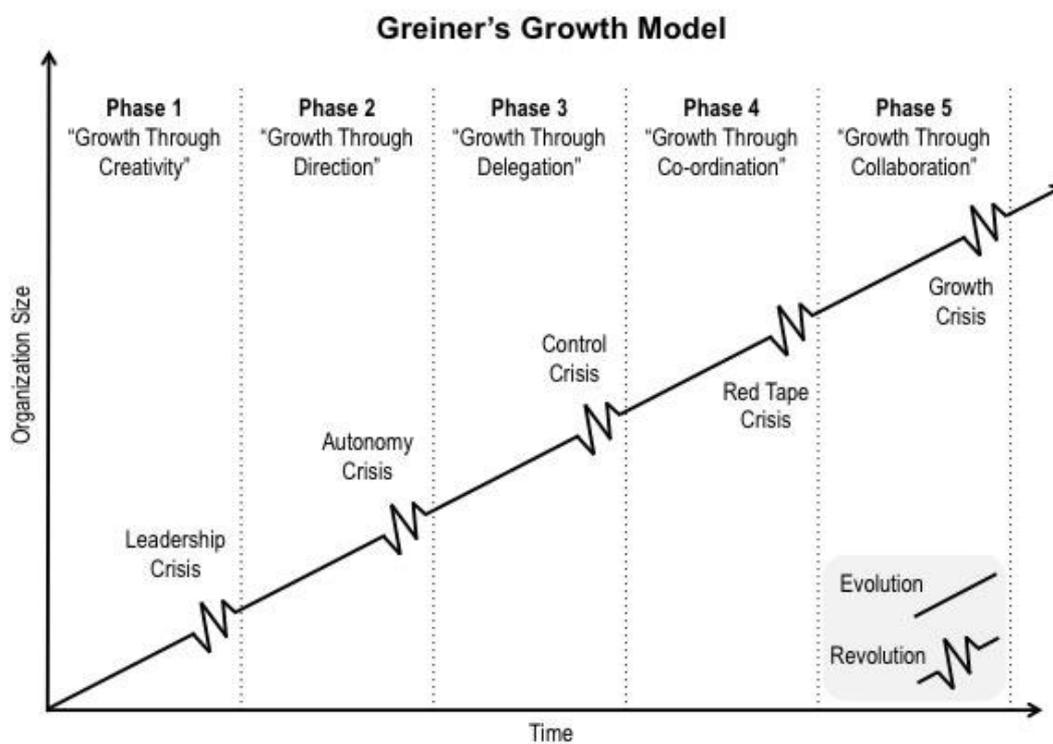
Although some variations exist within life-cycle models (Coad & Rao 2008), the different stages an organisation will go through during its life-span remain relatively similar. Prior research has explored the role of the industry context and the current stage of the industry life-cycle, specifically whether the industry is emerging, growing, is in the maturity phase or declining (Bamiatzi & Kirchmaier 2012; Gilbert, McDougall & Audretsch 2006). The most widely used framework for studying enterprise growth has been the life-cycle analysis developed by Gupta, Guha and Krishnaswami (2013). Entrepreneurs make decisions regarding organisation growth strategies based on their motivations and the current stage of the industry in which they operate (Eiriz, Faria & Barbosa 2013).

An organisation's growth rate is closely related to the growth rate of its industry (Kotha & Nair 1995). Weinzimmer (2000) added that when a firm is in a growing industry, resources should be aggressively allocated to exploit growth opportunities. When a firm is in a growing environment, investment into the industry will lead to organisational growth (Weinzimmer 2000). By contrast, as industry growth rate slows, firms should decrease their commitment to allow for the reallocation of resources.

Apart from the industry life-cycle, one additional stream of research characterises firm growth through the identification of organisational life-cycle stages (Gupta, Guha & Krishnaswami 2013). The popularity of business growth stage models has been evident throughout the research literature since one of the first models was introduced by Greiner (1972). In this model, Greiner proposed that organisations grow through the following five evolutionary and specific stages: creativity, direction, delegation, coordination and collaboration.

The creativity phase is associated with firms that are young and relatively small. During this phase, companies are driven by the creative force of the founder and the development of new products and services. As firms mature and progress through the direction phase, middle managers are appointed with the task of controlling processes and ensuring standards are set and maintained. During the delegation phase, the business owner communicates less frequently with lower-tiered staff, delegating more important business tasks to middle management. The fourth stage of growth refers to coordination during which previously isolated business units are re-organised into product groups and service practices. Firms that have matured and reached the final stage of collaboration are no longer managed through rigid systems. Formal and complex approaches once adopted by the firm now give way to simpler processes, with an increased emphasis on communication with managers to solve any critical issues.

Greiner's work on business life-cycle models remained one of the most cited studies due to its intuitive appeal and robust explanation of the phenomenon of growth (Eiriz, Faria & Barbosa 2013). The standout feature of Greiner's business life-cycle model is that after each stage there is a revolution that explains the emergence of the following stage. Thus, the model provides a rationale not only for growth at the firm level but also an understanding that firms innovate and evolve throughout their life-cycle (Eiriz, Faria & Barbosa 2013).

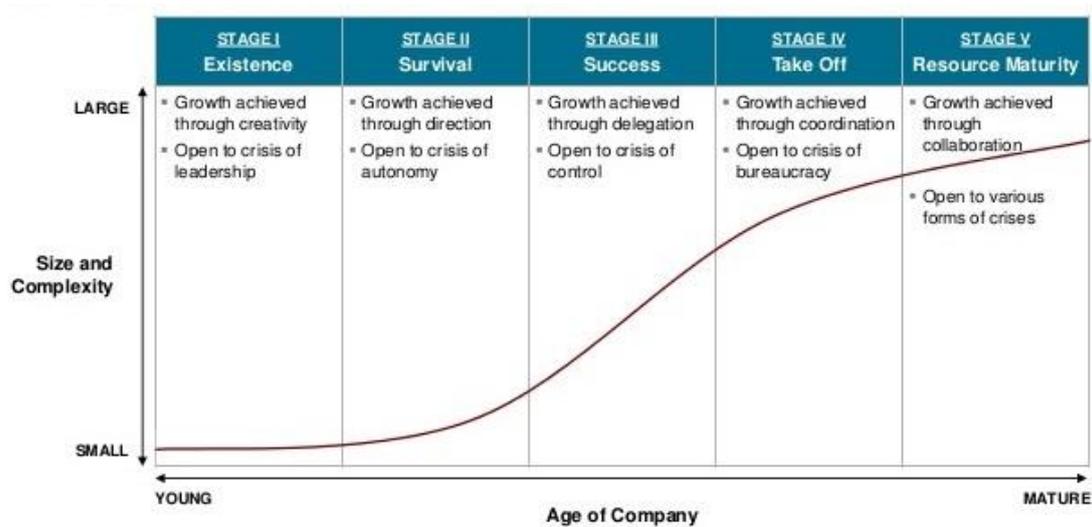


**Figure 2.2: Greiner's Growth Model (1972)**

Churchill and Lewis (1983) developed a business growth model based on Greiner's and similarly delineates five stages of firm development. The stages of development identified are: (1) existence--concerned with generating more customers and delivering the product or service well enough to become a viable business; (2) survival--firms have demonstrated that they are workable business entities, but the key problem shifts from mere existence to the

relationship between expenses and revenue, in order to meet breakeven requirements and remain in business; (3) success--here the decision facing owners is whether to exploit the company's accomplishments and expand or keep the company stable and profitable, providing a base for alternative owner activities; (4) take-off—stage focuses on how to grow the firm rapidly and how to finance this growth; and (5) resource maturity--companies have the advantages of size, financial resources, and managerial talent and will be a formidable force in the market if they can consolidate and control their entrepreneurial spirit (Churchill & Lewis, 1983).

‘To date no attempt has been made to apply business growth models to franchise system growth and development, nor has any model been developed specifically for franchising’ (Hoy & Stanworth 2003, p. 190). The underlying proposition however is that despite the considerable differences in sizes, sectors and capacity for growth that franchise systems experience collective problems at similar stages to that of small business growth (Churchill & Lewis 1983). Churchill & Lewis’ model of growth is provided in table 2.3 below.



**Figure 2.3: Churchill & Lewis Model (1972)**

Another significant contribution in life-cycle stage models was the analysis and evaluation of ten separate models by Hanks et al. (1993). Comparing the models through a sample of 126 organisations, these authors derived a configuration of four growth stages: start-up, expansion, maturity and diversification. Firms in the start-up growth stage were described as young and small, with simple organisational structures and processes. The expansion phase was the stage of growth in which a firm's processes become more complex, with the simple structures once part of the start-up phase now becoming more functional. Firms that enter the maturity growth phase were seen as larger and more formal, with less centralisation. The final growth stage of diversification supposed that firms have larger structures based on divisions with more organisational levels (Hanks et al. 1993).

There are numerous opinions in existing research regarding stage models and life-cycle theories, suggesting that scholars do not agree on definitions of the stages of firm growth. For example, Gupta, Guha and Krishnaswami (2013) suggested that firms do not necessarily follow linear models and this makes it difficult to determine when firms move from one stage to another. Firms can grow, decline and stagnate at any time, in any order, hence growth can be achieved quickly, slowly or not at all (Blundel & Hingley 2001). As firm growth is very much determined by the growth aspirations and growth-enabling factors of an enterprise, it is not possible to consider growth as a norm or even as a progression of an organisation (Blundel & Hingley 2001). As Spilling (2001) suggests, the status of being a growth firm may be temporary.

Multistage life-cycle models have been criticised within literature because of their extreme simplification of reality and their neglect of the differences in the impacts of different growth strategies. In certain situations not all stages of firm development are evident while some stages may occur several times or in irregular order and little empirical evidence exists to

support the theories (Gibb & Davies 1990; Bridge et al. 1998; Eggers et al. 1994, Birley & Westhead 1990; Miller & Friesen 1983; Vinnell & Hamilton 1999; Dodge et al. 1994).

## **2.5 Firm age**

Among the many differing theories identifying significant factors of firm growth is that which refers to the age of the firm. Research surrounding the connection between firm age and entrepreneurial strategies is well documented, with the theory that younger firms are more entrepreneurial than older firms (Luo, Zhuo & Liu 2005; Markman & Gartner 2002). Anderson and Eshima (2013) asserted that younger firms are more likely than their older counterparts to possess structures and an organising context that allows for greater flexibility and responsiveness.

Hartarska and Gozalez-Vega (2006, p. 195) stated that ‘younger firms face higher information costs and their expansion is more dependent on the availability of internal funds than that of older firms’. Thus firm age is often a significant determinant in a firm’s reliance on resources in order to expand. Young firms may exhibit greater dependency on innovativeness and risk-taking to achieve improved performance compared with older firms that may be more reliant on greater autonomy (Lumpkin & Dess 1996).

Managers of young firms with a lack of significant business experience are said to be more likely to engage in excessive ‘trial and error’ behaviour, resulting in a reduced capacity to link strategy to performance outcomes (Slevin & Covin 1997). However, as Hill and Rothaermel (2003) explained, the lack of well-defined routines and the presence of more established structures, better position younger firms to generate radical innovations with the greatest potential for growth.

Older firms are said to benefit however benefit from established routines and processes that facilitate competitive advantage. However, Leonard-Barton (1992) added that the established routines and processes more likely to be seen in older firms often evolve into core rigidities that hamper managerial willingness to pursue new entrepreneurial opportunities.

Recent literature adds another perspective, suggesting that older firms may be better at using knowledge for entering new geographical territories as they are more inclined to rely on structures and planned processes regarding knowledge management (Naldi & Davidsson 2014). Thus mature firms can be said as more able to build upon established structures and planned processes to innovate more effectively.

Coad, Segarra and Mercedes (2016) argue older firms will have more experience and a greater foresight in respect to the business environment in which they operate, providing them with greater planning horizons which in turn lead to smoother growth plans with fewer surprises. Further evidence in the support of the positive effects older firms offer include superior organisational outcomes (Argote 1999), new product development (Sivadas & Dwyer 2000) and innovative outcomes (Tripsas & Gavetti 2000).

Despite the purported benefits offered, mature firms may suffer from a number of drawbacks. The discussion above suggests while mature firms rely heavily on existing structures and processes that ultimately such reliance will diminish the ability of older firms to capture value from entrepreneurial strategies in the form of superior growth (Anderson & Eshima 2013).

In agreement with authors Anderson & Eshima (2013) regarding the influence of firm age in relation to growth, this study recognises while mature firms are able to draw upon a greater scope of market knowledge in developing their entrepreneurial strategies (Cohen & Levinthal 1990) such knowledge is heavily path dependant (Henderson 1999) and likely based on an

understanding of market conditions that is growing increasingly outdated (Sorensen & Stuart 2000).

## **2.6 Organisational strategies and growth challenges**

The unprecedented rate of change and rivalry in the contemporary business environment emphasises the need for firms to establish the necessary resources to grow and become more robust (Das & Teng 2000). Developing such resources internally, to maintain and improve their competitive advantage, is becoming increasingly more difficult for firms. Speakman et al. (1998) suggested that the creation of strategic alliances is becoming more relevant (i.e. firms join forces and combine strengths to reap benefits that may otherwise have been unachievable). These alliances involve collaboration between partners, with an inter-firm legal and organisational arrangement established to capitalise on the exploitation of resources in the respective firms.

Some studies have indicated that alliances are often a preferred method of organisational growth when compared to acquisitions, mergers or organic growth. This is due to the lower transaction costs, adverse selection risks or potential opportunistic behaviour involved (Piskorski 1999). The rationale for strategic alliances or other forms of organisational collaboration is provided by two theories: transaction-cost and resource-based. These are discussed below.

Transaction-cost economic theory was first brought to our attention when Coase (1937) suggested that minimising transaction and production costs was a key element in a firm's organisational and operational set-up. One of the many aims within transaction-cost theory is to economise on business transaction costs, which could include coordination and contracting costs, not just market prices. For example, the decision to outsource activities rather than

keeping them in-house would be based on production costs for outsourcing being lower than the combined purchase costs, and coordination and implementation costs of the in-house option. Thus, cost advantages drive organisational collaboration decisions.

Resource-based theory is premised on the principle of maximising the value of a firm by pooling and utilising its resources to achieve growth, profitability and competitiveness. The resource-based view is that creating competitive advantage (otherwise unavailable) could be achieved through garnering resources of others through strategic alliances and merger and acquisition strategies (Das & Teng 2000). Resources in this context include financial assets, borrowing capacity, business and market knowledge, and a capable workforce. Reviewing strategic alliances from the resource-based view, Eisenhardt and Schoonhoven (1996) found that collaborations were more likely to be formed when firm partners are either in need of resources or are in a strong position with resources to share.

## **2.7 Growth modes**

Another aspect of business growth is growth modes or the organisational forms that expanding companies adopt to achieve their goals. Companies that grow by themselves are said to be in an organic growth mode. Other companies expand through acquisitive growth or the take-over of existing entities, assimilating their operations with that of the original business.

### **2.7.1 Organic growth**

At the most basic level, organic growth occurs when a company grows from within. Thus, companies that grow organically do so through their own internal resources without relying, in whole or in part, on external resources, such as product lines or customer base, from any

mergers or acquisitions (Dalton & Dalton 2006). Organisations that grow organically do so as a result of expansion through acquired customers, an increase in sales, or a combination of both (Hirvikorpi & Swanljung 2008). The authors defined organic growth as the natural growth of sales and personnel occasioned by the increase in sales of services or products (Hirvikorpi & Swanljung 2008).

Kling, Ghobadian and O'Regan (2009) referred to organic growth as representing positive changes in market share derived internally through the coupling of an organisation's competencies and capabilities. Beijerse (2000) and Kautz and Thaysen (2001) supported this definition, suggesting that organic growth strategies require the organisation to leverage their core competencies and capabilities to focus on customer needs.

Organic growth may be achieved through the development and execution of an effective marketing strategy. Day (2003) asserted that marketing plans provide firms with a greater anticipation of market opportunities and calibration of risks, faster adjustments to shifting market needs and competitive moves, and winning and retaining customers. Brush and Chaganti (1999, p. 295) supported the concept of planning and coordination, stating that 'the configuration of new venture resources enables the firm to pursue its growth objectives in an efficient manner'.

Growing organically is often considered an intelligent form of expansion, with authors recommending such a strategy for smaller and newer firms (Delmar, Davidsson & Gartner 2003; McKelvie, Wiklund and Davidsson 2006; Penrose 1995). Firms that grow organically will most likely generate a smoother growth pattern over time than what could be achieved with firms that have grown primarily through acquisitions (Penrose 1995).

### 2.7.2 Acquisitive growth

Acquisition is the process of taking over another firm either through the purchase of its shares or assets. Acquisitive companies are also described as being focussed on external growth methods. Through acquisitions, firms can expand their service offerings or extend their reach into new markets without having to do so just by themselves (Gilbert, McDougall & Audretsch 2006). By purchasing an existing business, a firm will not only benefit from the reputation the acquired firm established but will naturally increase its market share on settlement of the acquisition (Banbury & Mitchell 1995). Some authors have listed several significant benefits of acquisition, such as the reduction of business risk, gaining new knowledge and other resources, and the capability to overcome barriers to entry and enter new markets quickly (Vermeulen & Barkema 2001; Empson 2000; Birkinshaw 1999).

Focussing on the growth and performance of SMEs, Pasanen (2007) conducted a study on the differentiating factors of two types of firm growth: organic and acquisition. Drawing from a sample of 20 acquisition growth SMEs and 90 organic growth SMEs, the study revealed some noteworthy differences between the two groups, particularly from the scale of operation. Pasanen (2007) found that acquisition growth SMEs were larger in size in regard to full-time employee numbers than their organic growth counterparts. Furthermore, the number of establishments was greater with the acquisitive growth organisations, with an average of 3.7 sites compared to 2.0 among the organic growth SMEs. A similar trend showed that firm age was significantly greater amongst acquisitive growth firms, which had operated for an average of 32 years compared to 16 years amongst organic growth SMEs. Additionally, the study found having multiple founders was more typical of organic growth (79 per cent) than that of acquisition growth SMEs (45 per cent) (Pasanen 2007).

Acquisitions offer numerous benefits but this expansion strategy also comes with drawbacks. Specifically, Friedman (2003) claimed that the merging of two separate and distinct cultures of personnel could pose a significant challenge and lead to failure. Another potentially adverse effect was the potential impact on the customers of the acquired company, as marketing and customer service approaches could change.

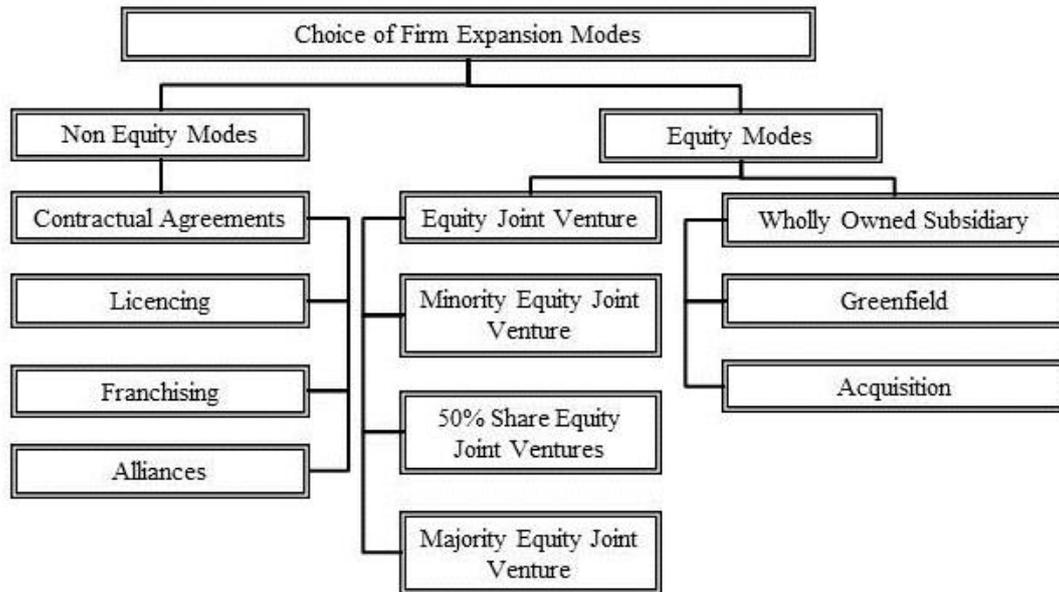
### **2.7.3 Hybrid modes of growth**

Hybrid modes of growth are neither acquisitive nor organic, but rather lie somewhere in between, often combining elements of each (McKelvie & Wiklund 2010). Examples of hybrid growth forms include: licensing, franchising or joint ventures and strategic alliances. These organisational forms allow firms to address limited managerial capacity issues (Shane 1996). Strategic alliances or joint ventures offer the attractive proposition of being able to draw upon the shared resources of the collaborating businesses (Agnihotri 2014).

Literature surrounding these hybrid modes of growth suggests that leveraging resources through such partnerships often allow firms to grow more quickly and less expensively (McKelvie & Wiklund 2010). Pearce and Hatfield (2002) added that, compared to organic or acquisition growth, strategic alliances and joint ventures provide less risk and are a less costly method of growing a firm.

## **2.8 Equity vs non-equity expansion modes**

Yet another method of classifying growth modes is distinguishing whether the original firm, in carrying out their expansion plans, is injecting equity capital or not. Pan and Tse (2000) introduced this concept, with firm expansion modes classified as either equity modes or non-equity modes. This is illustrated in the classification diagram shown in Figure 2.2 below.



**Figure 2.4: Adapted from Pan and Tse (2001)**

### **2.8.1 Equity mode: wholly-owned subsidiary**

Under equity expansion modes, are variants of either a wholly-owned subsidiary or an equity joint venture. Businesses pursuing equity mode expansion understand that achieving a greater focus in terms of human and financial capital will sometimes require the set up and establishment of a separate subsidiary. This could also provide tax benefits. Thus, an acquired business could either be integrated into the acquiring or parent company or continue operating as a subsidiary if advantageous.

Incorporated companies are distinct legal entities with their strategic policy-making and company operations being managed by their directors, acting on behalf of owners or shareholders. Companies seeking to expand their operations might develop and build new sites themselves, or may wish to grow by acquiring other businesses in the same or similar industries. Both these strategies offer a number of distinct advantages, including maintaining a high degree of control and flexibility over the entire expansion process.

Companies expanding through the development of wholly-owned branches or through the development of greenfield sites or by way of acquisition, retain the rights to all management, timing, employment, price and customer decisions (Friedman 2003). However, such expansion comes with a number of risks and disadvantages: (i) development of new sites or acquisition comes with considerable capital expense; (ii) all the potential risk of loss is borne by the company if the new sites are not successful; and (iii) company managers or employees may not have the same incentive or motivation as that of a franchisee or licensee (Friedman 2003).

Equity alliances provide partners with a greater degree of ownership than that of a contractual arrangement. Joint ventures, when compared to contractual arrangements, offer more opportunities for the transfer of resources. They are more common within companies whose main objective is to gain knowledge from their partners and resources that are not easily appropriated by others (Comino, Mariel & Sandonis 2007; Das & Teng 1998)

### **2.8.2 Equity mode: joint ventures**

Equity joint ventures are classified as shared equity arrangements through which partners contribute capital and contribute resources in the separate business. Das and Teng (2000) suggest that equity joint ventures provide a workable opportunity to acquire the individual partners' implicit knowledge and other resources. With equity binding members together, equity joint ventures are typically considered more effective than non-equity alliances in curbing opportunistic behaviour (Das & Teng 1996; Gulati 1995). They are also quite effective in the transfer of knowledge between partners due to the extent to which partners are exposed to or interact with each other (Kogut 1988).

Pekar and Margulis (2003) classified equity alliances in two distinct and separate categories, partial acquisitions and cross-equity arrangements. Partial equity acquisitions could be described as a company purchasing a minority equity stake in another firm. Cross-equity transactions entail each partner becoming an equity stakeholder in the respective firm of the other (Pekar & Margulis 2003).

If the equity held by the subject company within a joint venture is less than 50 per cent, the joint venture is termed minority-owned (Makino & Beamish 1998). It is also possible to have more than one minority equity company in a joint venture (Das & Rahmn 2009). Firms entering minority equity joint venture agreements may hold as little as a five per cent equity stake within the new entity.

Das and Teng (1996) suggested that shared equity positions help control opportunistic behaviours. Given the complicated nature of both establishing and getting out of such an arrangement, equity alliances are typically entered into for a longer period of time compared to non-equity arrangements. This longer duration provides greater incentive for partners to behave honestly and resist opportunistic behaviour (Das & Teng 2000). Firms that expect a longer lasting relationship will be more careful about taking advantage of their partners (Heide & Miner 1992; Joskow 1987; Axelrod 1984).

Ownership within a joint venture equal to that of 50 per cent may be termed as co-owned or a 50 per cent equity joint venture (Makino & Beamish 1998). According to Hauswald and Hege (2009), approximately two-thirds of two-partner joint ventures adopt the 50:50 equity joint venture structure. It has been noted however, that with shared ownership comes an increase in governance costs compared to those of regular enterprises (Osborn & Baughn 1990). Fifty per cent equity joint ventures often imply shared decision-making, which can complicate the process and reduce the flexibility of a firm (Das & Teng 1996).

Joint venture equity ownership has typically been characterised by the percentage of equity held by the subject company (Makino & Beamish 1998). When the subject company has greater than 50 per cent ownership the joint venture is known as a majority-owned joint venture (Makino & Beamish 1998). This conventional measurement pre-supposes that the size of the equity investment is relative to the degree of control each partner has within the joint venture (Makino & Beamish 1998).

### **2.8.3 Non-equity modes and alliances**

Non-equity modes or alliances are business arrangements that do not involve an equity investment of the subject firm. Non-equity arrangements offer greater flexibility for partners, require less commitment, involve less risk and are usually for a shorter term than those of equity alliances (Hagedoorn 1993; Hagedoorn & Narula 1996). They can provide efficiency when requiring explicit simple arrangements that are often negotiated quickly (Gulati 1995).

Non-equity modes may however fail because the contracts written under such agreements can sometimes offer inadequate control (Hennart 1988). Das and Teng (1998) believed that the only way firms could manage for contingencies and deter unreasonable or unfair conduct by other parties, would be to adopt rigid contractual control. These types of control measures may be achieved through governance structures, contractual specifications or managerial arrangements (Das & Teng 1998). This practice usually coincides with a low level of trust between parties in the alliance. Kogut (1989) and Gulati (1995) suggested that if firms enjoyed a previous relationship then trust may already be established. This may act as a form of control.

Alliances are formed to facilitate a formal collaboration between organisations to leverage and draw upon the resources of the respective parties (Koryak et al. 2015). Common beliefs

within existing literature suggests that strategic alliances, as with joint ventures, are established to acquire resources and capabilities that firms do not originally have access to and would need to develop (Das & Teng 2000). Leveraging of each other's resources allows firms to grow more quickly and less expensively (McKelvie & Wiklund 2010).

### **2.8.3.1 Non-equity mode: licensing**

Licensing is a non-equity mode of growth that addresses any resource deficiencies. It allows licensee firms to grow at a quicker rate than through any internal modes of growth (McKelvie & Wiklund 2010). Under a licensing arrangement, the licensor allows for the licensee to manufacture, use, distribute or sell products or processes that fall within the scope of its intellectual property (Friedman 2003).

Licensing may be seen as an attractive mode of revenue growth for the licensor, as it provides an opportunity to receive additional income without any associated investment (McKelvie & Wiklund 2010). Licensing has been purported to be beneficial in the start-up phase of firms, providing quick access to capital and addressing any lack of complementary assets, particularly if dealing with larger more established businesses (Arora, Fosfuri & Gambardella 2001). Gans, Hsu and Stern, (2002) stated that the benefits of licensing allow a licensor access to greater levels of experience and knowledge about market entry and customer needs.

Licensing could be rewarding but there are also potential disadvantages when compared to other modes of growth. With this type of relationship comes a loss of control and the inability to capitalise on any goodwill generated by the licensee's business activities (Friedman 2003). Furthermore, licensing may provide contractual challenges, including opportunities for leaking information or intellectual property theft (Teece 1988).

### **2.8.3.2 Non-equity mode: franchising**

Another non-equity mode of expansion is through franchising which occurs when an organisation (the franchisor), sells to another (the franchisee) the right to distribute its branded product or service offering according to the format specified by the franchisor (Gillis & Combs 2009).

While definitions of franchising vary significantly, common to most definitions are five consistent elements: branding of a name; an operating system; grant of the right to use that brand name and system; the payment of a consideration to the franchisor, either directly or indirectly; and the ownership of, and investment in, the franchised business by the franchisee (Mendelsohn & Bynoe 1995).

Franchising provides expanding businesses with beneficial cashflow and allows for a quicker rate of expansion (McKelvie & Wiklund 2010). In addition to the initial up-front payment, franchisors are often enticed by the ongoing royalty and revenue stream common with franchising. The regular recurring income streams provide an even and consistent cashflow with which franchisors can operate and grow their business. Ongoing royalty fees are set by the franchisor either as a fixed rate or percentage of franchisee turnover. When royalty fees are set as a percentage of turnover, franchisors are motivated to provide significant head office support to help franchisees increase sales, resulting in increased revenue for the franchisor.

Franchising as an organisational form differs from other modes of governance, such as equity joint ventures and strategic alliances. Combs, Michael and Castrogiovanni (2004) described franchising contracts that allocate specific responsibilities, rights and obligations between a

centralised principal (franchisor) and decentralised agents (franchisees) as the key characteristics that distinguish franchising from other organisational forms.

Despite non-equity firm expansion modes sharing several similar features, a number of characteristics distinguish each organisational form. Business owners adopting franchising as a growth strategy over licensing are likely to do so for reasons centred primarily on greater control of the brand and the operational processes of the contracted parties.

Thus, maintaining brand reputation stands as a significant criterion for entrepreneurs in deciding to franchise rather than resort to the licensing of the business. Franchisors recognise that monitoring franchisee performance together with system compliance is critical in growing the brand, attracting new customers and potential franchisees to the system. Franchisors intent on growing the brand and the number of outlets believe relinquishing control (through licensing) would eliminate or impede any future growth, giving the owner little or no control (Combs, Ketchen & Short 2011).

Another significant difference between franchising and licensing lies in the granting of rights. In direct contrast to licensing, where multiple non-exclusive licenses are sold in often competing territories, franchising offers the entrepreneur the benefit of developing a strategic expansion plan by granting exclusive rights in pre-determined geographical locations. Combs, Ketchen and Short (2011) described this strategy as not only providing the greatest benefit to the franchisor, but also ensuring individual franchisees and territories are not cannibalised by opening multiple outlets in close proximity to one another.

## **2.9 Franchising as a growth strategy**

The last forty years has seen a revolution in franchising with researchers characterising it as an effective and popular organisational form (Garg, Rasheed & Priem 2005). Through franchising, an expanding organisation can tackle financial and managerial constraints, which would ordinarily inhibit growth.

Franchising is often recognised as an attractive means of expanding a business, predominantly explained by two theoretical perspectives: agency theory and resource scarcity (Combs, Michael & Castrogiovanni 2004). Resource scarcity suggests franchising would help expanding firms alleviate any financial and human capital resource constraints. Agency theory by contrast relates to the principal-agent relationship and potential opportunism and control issues. As franchisees have invested financially into their franchise, their goals are much more likely to be congruent with those of the franchisor (Shane 1996). Thus, franchisees are less likely to act irresponsibly or risk damaging corporate reputations and the franchisor's brand (McKelvie & Wiklund 2010).

Previous literature has suggested that firms selecting franchising as a mode of organisational growth can be subject to the same learning growth curve challenges that affect other organisational forms (Shane 1996). However, the franchise mode choice has been found to generate greater firm growth, create effective economies of scale and increase survival rates (Shane 1996).

Economies of scale refer to the cost advantages that firms obtain when the scale of the operation is increased (Long & Wijeyaratne 2013). By spreading costs across a larger number of goods or services, the lowering of the per-unit cost is achieved Long and Wijeyaratne

(2013) added to this, stating that traditional economic theory posits that by decreasing their average costs firms will become more efficient, thus ensuring their competitiveness.

An increase in market share is well known to provide economies of scale for firms. Among the reasons why increasing market share is an attractive strategy are: the superior advertising rates, preferred supplier rates and market power that allows a firm to increase margins and raise prices (Michael 2003). Scale economies may also exist in a franchise network where monitoring costs are lowered, making hierarchy less expensive by granting rights to individual franchisees (Alston 1981).

Franchisees provide an expanding organisation with both financial and human capital and it is seemingly this 'bundling' effect that results in franchising being favoured by organisations looking to adopt a specific growth strategy. The assembling of these resources allows for entrepreneurs to develop rapid expansion and create large chains often through first mover advantage (Michael 2003). Numerous authors discuss first mover advantage as an often-recommended entrepreneurial strategy (Covin, Slevin & Heeley 2000; Dollinger 1999).

Franchising as a method of rapid expansion is a critical strategic decision alternative for the expanding firm with limited resources (Michael 2003). Franchising establishes first mover advantage, enabling firms to gather the people, sites and money needed to penetrate the market as quickly as possible. Competitors are therefore deterred from entering the market (Oxenfeldt & Kelly 1968). Rapid expansion can be necessary in order to develop more sites, gain a broader base of customers and secure desirable real estate to discourage any potential imitators (Michael 2003). Growth and market share increase when multi-unit outlets are encouraged by the franchisor. Shane (1996) stated that franchising allows for firms to reach a critical mass, reaching economies of scale more quickly, generating greater market share when compared to their counterparts under other forms of governance.

As previously indicated, franchising is favoured by entrepreneurs as an effective growth strategy, providing access to significant resources that are in short supply in the initial stages of the company's life-cycle (Dant & Kaufmann 2003). But over time, successful franchise systems can gradually become corporate-owned systems with the reacquisition of franchisee sites by the more powerful and resource-flush franchisors. This phenomenon is known as the ownership redirection hypothesis (Dant & Windsperger 2006).

Dant et al. (1996) claimed that the ownership redirection debate has been a long standing one, first brought to our attention by Oxenfeldt and Kelly (1968). The premise of the theory is that franchising as a growth strategy may only be a short-term strategic decision adopted by companies. When viewed from a resource scarcity perspective, young firms resort to franchising to overcome scale economies (Oxenfeldt & Kelly 1969). This premise is based on the view that as firms age, their requirement to franchise is reduced (Gillis & Castrogiovanni, 2012). Once additional financial and human capital, together with local market intelligence, are obtained and no longer seen as barriers to expansion, franchisors will adopt a more conventional method of expansion through company ownership (Castrogiovanni, Combs & Justis 2006).

Oxenfeldt and Kelly (1969) first stated that, initially, many franchisors establish franchises in order to penetrate the market as widely and rapidly as possible. Once the desired initial coverage is attained, their emphasis usually shifts toward operating efficiencies and market development. During the initial stages of the organisational life-cycle, the mix of the number of franchised to company-owned outlets is high due to the financial, managerial and informational resources available through franchising. Such needs diminish as the franchise system grows in the later stages of the life-cycle, thereby fostering a deliberate strategy to convert the previously franchised outlet into a company-owned site (Dant & Windsperger 2006).

The proportion of company-owned outlets can vary in the early stages of the firm's life-cycle and is greatly dependent on the franchisors access to financial, managerial and informational resources. Dual distribution franchise systems refer to franchisors who have elected to expand their number of outlets simultaneously through a mix of both company-owned and franchised outlets (Seshadri 2002).

### **2.9.1 Value creation through franchising**

Franchisees themselves are a critical component in the overall success of the brand and play an integral role in the value creation of the franchise system (Gillis & Combs 2009). Specifically, the individual local market knowledge that each franchisee brings, together with their strong profit motivation, helps franchisors innovate and adapt to the external environment (Gillis & Combs 2009). In an attempt to more effectively meet the needs of local market preferences, franchisees often adapt, amend or introduce new product and service offerings that differ from those of head office. Gillis and Combs (2009) asserted that the changes franchisees make to pricing structures, operational procedures and hours of operation often bring with them new innovations that, when adopted by the franchisor, help improve system-wide efficiency across the chain. This innovation is in direct contrast to the approach of employee-managers in company-owned outlets (Gillis & Combs 2009). In this setting, proposed changes to operating processes or promotional campaigns are implemented without complaint. Because employee-managers are typically remunerated by salary and any bonus structure being tied to their ability to force standards, managers in this environment lack any incentive to challenge regional managers or head office (Gillis & Combs 2009). Thus, while standardisation and adaptation are both essential value creating activities, it is adaptation that is more easily achieved through franchising (Gillis & Combs 2009).

### **2.9.2 Regulatory framework for franchising**

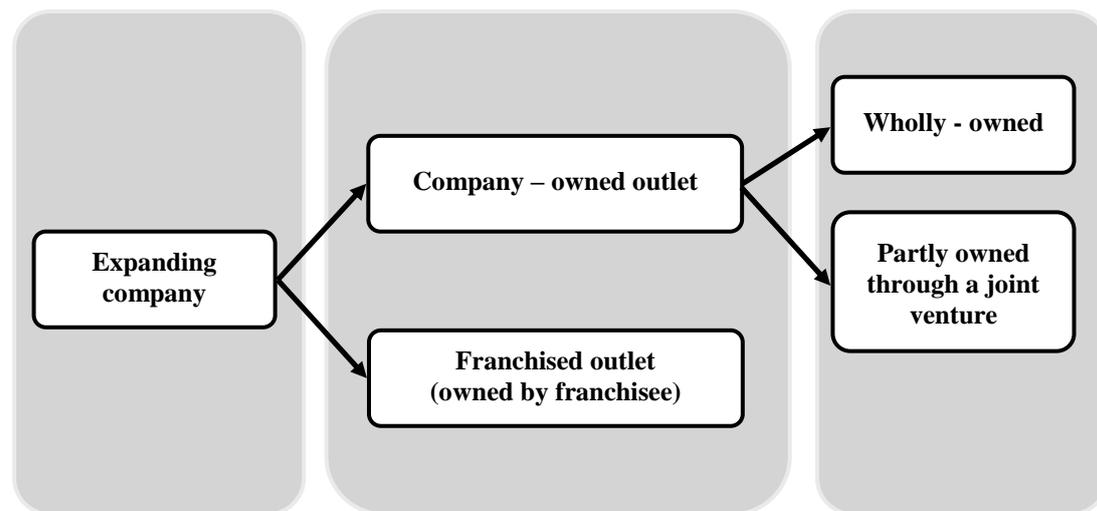
The Australian Franchising Code of Conduct (1998) (the 'Code') was introduced as a national industry code of practice and spells out certain prescribed minimum standards of disclosure, dispute resolution and associated issues. Thus, once largely unregulated, the franchise industry is now governed by a framework of competition and sector-specific rules designed to provide franchisees and those considering entering a franchise agreement with certain protections, both prior to and after signing any such agreements (Schaper 2013).

The Code provides a comprehensive definition of franchising, as an agreement consisting of four explicit elements. Specifically, a franchise agreement must take the form in whole or part of a written, verbal or implied agreement. Secondly, it must include the granting by one person (the franchisor) to another person (the franchisee) the right to conduct the business. The third element requires that the operation of the business is substantially or materially associated with a trade mark, advertising or commercial symbol. The final element qualifies the validity of an agreement by requiring the franchisee to pay, or agree to pay, the franchisor an initial capital investment fee through a payment for goods and services or a fee based on a percentage of the franchisee's gross income (Castrogiovanni, Combs & Justis 2006).

Franchising and the regulatory framework in which it operates have evolved over time (Schaper 2013). The introduction of the franchise code has resulted in a solid history of effective regulation in this country, but the industry itself continues to evolve (Schaper 2013). This is evident in its history, starting in 1863 when the Singer Sewing Machine company introduced franchising. Singer sold their products to the company's own sales force who in turn were required to find markets for them. Many large US companies followed suit, with General Motors in 1898 then Hertz Rent-A-Car in 1921.

## 2.10 Company-owned vs franchised outlets

The growth of franchised business in the fitness industry is normally associated with an increase in the number of gyms, fitness centres, or outlets where fitness services are provided to customers. These outlets can either be company-owned or operating under a franchise arrangement. Figure 2.5 below illustrates the different possibilities described above.



**Figure 2.5: Company expansion through company-owned or franchised outlets**

With company-owned outlets, the principal company can own the outlet wholly or in part. For example, the principal company might enter into a joint venture arrangement with another party to establish and operate the outlet. Thus forms of company-owned outlets vary according to percentage shareholding of the principal entity and can be classified as an equity mode of expansion (Pan & Tse 2000).

Earlier discussion of the work of Friedman (2003) revealed advantages and disadvantages of wholly-owned and joint venture ownership models. Wholly-owned branches offer the advantage of retaining the rights to all management, employment, price and customer decisions. However such an expansion mode may pose a number of disadvantages and risks including managers or employees not having the same motivation or incentive as that of a

franchisee. Similarly with joint ventures adverse effects may arise when customers of the acquired company are impacted due to any potential shifts or changes in the marketing or customer service approaches (Friedman 2003).

With a franchised outlet, however, the principal company (acting as a franchisor) does not have any ownership of the outlet as it is owned by a franchisee and therefore falls under a form of non-equity expansion mode (Pan & Tse 2000).

## **2.11 Dant's research and the franchising decision criteria framework**

Dant (1995) examined research-based arguments explaining why successful businesses might choose franchising as a growth strategy over other alternatives. Based on an extensive review of franchising literature, Dant pointed to seven primary reasons that were expected to drive successful, growth-orientated organisations in the direction of franchising, as shown in Figure 1.1. Dant (1995) evaluated theoretical arguments for franchising and provided some sense of the relative importance of these reasons. Dant's findings indicated that both economic motivations together with idiosyncratic (i.e. context-related) motivations drove the franchising choice. The factors explaining why expanding businesses select franchising as a growth strategy could be classified into three distinct categories: (i) resource constraint arguments; (ii) efficiency justifications; and (iii) agency related reasons (Dant 1995).

### **2.11.1 Resource constraint arguments**

Resource scarcity or resource constraints theorists view franchising as an option for easing any financial and managerial restrictions on growth. Among the factors identified by Dant are access to capital, to managerial talent and local market knowledge (Dant 1995).

The hypothesis that franchising is motivated by the franchisor's lack of financial capital is among the earliest explanations for franchising. Initial finance required to establish a business may come from the entrepreneur's own funds or borrowings from relatives (Berger & Udell 1998). However, the amount of financing required to grow the business to the level required is often beyond what can be secured through banks or personal networks (Gilbert, McDougall & Audretsch 2006). Franchising provides a significant financial benefit to franchisors as franchisees pay an upfront fee to purchase franchise rights (Castrogiovanni, Combs & Justis 2006). This investment by the franchisee results in a substantial cash inflow while avoiding the diversion of developing new outlets (Combs & Ketchen 1999; Kaufman & Dant 1996). Thus, the selling of franchises offers a SME, particularly those with limited financial resources, a useful method of acquiring capital to fund further development and expansion (Ayling 1998; Golisano & Worth 1989). There is evidence within existing franchise literature to show an increase in franchising in response to a firm's capital scarcity (Combs & Ketchen 1999). Resource scarcities are presumed to be at the greatest among young, small growing firms, thus the extensive use of franchising as a growth mode (Gillis & Castrogiovanni 2012). Norton (1988) and Shane (1996) suggested that franchising offered an entrepreneurial firm a solution to resource constraints, particularly during periods of rapid expansion.

Oxenfeldt and Kelly (1968) were amongst the first to propose the resource constraint theory. They suggested a life-cycle model of franchising in which a young company in its early stages, with a limited supply of capital, adopts an intensive use of franchising as a growth strategy to utilise the franchisees capital to expand. However, this stage is often followed by a relatively high proportion of company-owned outlets during the maturity phase of the organisation, as the firm grows and acquires sufficient capital to expand in their own right (Castrogiovanni, Combs & Justis 2006).

Dant (1995) studied 37 franchisors and found that the majority agreed with the statement ‘franchising saves money by delivering capital and labour from the same source’ (Kirby & Watson 1999, p. 342). Thus, access to local market knowledge and access to managerial talent were among the seven motives identified by Dant (1995). In support of this, Mahoney (2005) reported that expanding firms that franchise early in their life-cycle will overcome three scarce resource constraints: access to capital; access to local market knowledge; and access to managerial talent. Franchising is said to provide an effective solution to addressing any adverse employee selection (Shane 1996). Within franchise settings, franchisors grant the right of franchise to suitably qualified and experienced individuals. With would-be franchisees paying significant capital to invest in their own business, only those confident of their success would signal their interest in becoming a franchisee (Gillis & Castrogiovanni 2012). Thus, this managerial selection process is said to reduce the cost and alleviate any adverse employee selection when determining whether employee outlet managers have the necessary skills and experience required (Gillis & Castrogiovanni 2012). McKelvie and Wiklund (2010, p. 274) asserted that ‘this method of growth allows firms to overcome any limitations to managerial capacity and saves all the time and effort required when recruiting competent managers’.

These newly appointed managers bring with them a wealth of local market knowledge, allowing the franchise system to identify more suitable locations (McKelvie & Wiklund 2010). This local market knowledge extends to tailored local marketing approaches by leveraging off any existing community and corporate networks the franchisee may have.

### **2.11.2 Efficiency justifications**

Franchisors are enticed by the advantages realised through franchising, namely (1) economies of production and scale; (2) economies of promotion; and (3) economies of coordination

(Dant 1995). Oxenfeldt and Kelly (1968) first suggested that firms will favour the franchising mode of growth when the need to achieve economies of scale pressures them to expand at a rate beyond what is possible using only internally-generated resources. Economies of scale bring cost advantages through a more substantial business base (Chandler, Amatori & Hikino 1997). As some firms grow, a reduction in a per-unit cost occurs as it increases the production of a given good or service (Besanko et al. 2010).

Shane (1996) suggested that hybrid organisational forms, such as franchising, increase a new firm's likelihood of survival by allowing for a more rapid development of economies of scale. Many franchisors require their franchisees to purchase business equipment and materials directly through them. Franchisors offer the required equipment and materials to franchisees not only on the premise of quality and consistency but also competitive pricing (Weaven & Frazer 2007). As the franchise system grows, administration and other operating overhead costs are spread out over an expanded revenue base. Further production and scale economies are achieved when franchisors establish distant outlets in close proximity to one another. Costs of franchisor supplied resources are reduced by dividing expenditure across multiple units located within close proximity (Ehrmann & Meiseberg 2010).

Promotional economies can be realised when the firm capitalises on centralised regional or national marketing and promotional activity. Group promotional economies allow for group buying rates, offering a franchisor reduced costs for any marketing activity, together with all promotional and advertising material. Caves and Murphy (1976) and Combs and Castrogiovanni (1994) suggested that to compete effectively against the more established firms, rapid expansion may be essential for an organisation to build economies in purchasing and advertising.

The survival of growing firms is dependent on the ability of the organisation to reach the number of outlets required to benefit from a competitive cost structure before experiencing any cashflow challenges (Carney & Gedajlovic 1991). Increasing an organisation's size offers significant reduction in costs relating to purchasing, marketing and the monitoring of franchisees on the part of the franchisor (Kaufmann & Eroglu 1999). Co-ordination or operational efficiencies are also encouraged with franchisees, due to the correlation between their earnings and unit level performance (Weaven & Frazer 2007).

### **2.11.3 Agency related reasons**

First conceptualised by Jensen and Meckling (1976), agency theory analyses the relationship that develops in an economic exchange, when a business owner (referred to as the principal) contracts staff (referred to as the agent) to run a business under their name. The wealth of the principal under such an arrangement is benefited by any good decisions adopted by the agent (Cuevas-Rodriguez, Gomez-Mejia & Wiseman. 2012). However, the agency problem arises when the goals of the agent are not congruent with those of the principal.

The two most common problems that may arise from an agency relationship are adverse selection and moral hazard (Gillis & Castrogiovanni 2012). Adverse selection refers to a situation in which the principal faces the risk of selecting individuals who do not have the ability to perform the work for which they are being paid (Manna, Smith & Synowka 2006). Moral hazard refers to the risk that principals face when they appoint individuals who withhold effort or misappropriate firm resources (Lubatkin et al. 2005).

The fundamental problems of adverse selection and moral hazard give rise to the notion of fixed wage and incentive based contracts between principals and agents (Manna, Smith &

Synowka 2006). Perhaps, as Manna, Smith and Synowka (2006) explained, this is why franchising is so effective.

Proponents of franchising believe that one of its most widely recognised attractions is that it addresses the agency problem between the franchisor and individual outlet operators (Gonzalez-Diaz & Solis-Rodriguez 2012). Franchised units are often seen to perform more effectively than company-owned sites because the contract between the franchisor and the franchisee is designed to keep their financial interests closely aligned. In franchised systems, independent operators invest their own capital to purchase a franchise. Because profit from their investments is directly dependant on their performance, franchisees are said to have a stronger incentive to perform than employee-managers (Barthelemy 2011). As franchisees are self-driven, the need to monitor them is significantly reduced. This is in direct contrast to the view of managers of firm-owned business, who franchisors believe are likely to shirk their responsibility to the firm because their compensation is fixed (Gillis & Castrogiovanni 2012). This shirking results in high monitoring costs to ensure that managers act in the firm's best interest (Elango & Fried 1997).

Among the most commonly cited factors that increase company monitoring costs is geographic dispersion. As firms enter geographic markets that are far removed from the organisation's head office, the cost of monitoring managers' pay rises, not to mention the additional travel expenses required to access remote sites (Carney & Gedajlovic 1991). Combs and Ketchen (2003) agreed that dispersion may also contribute to an increase in monitoring costs. Firms entering new, unfamiliar markets will face additional costs in evaluating the quality of the local decision-making.

As McMahon (2007) stated, significant out-of-pocket costs in maintaining an agency relationship may include greater financing costs, costs related to overcoming information

asymmetries to achieve better monitoring of agents' activities, transaction costs in order to establish and execute formal contractual arrangements with agents, and any costs related to incentive payments to agents. The agency costs ultimately borne by the owners must be weighed up against the perceived benefits, such as the access to capital and managerial expertise that an agency relationship would provide.

## **2.12 Disadvantages of franchising as a growth strategy**

Challenging the findings of those in support of franchising, Kirby and Watson (1999) believed that while the strategy can offer an organisation numerous advantages, there are also a number of potential disadvantages facing would-be franchisors. Possible issues include loss of managerial control and legal disputes.

Managerial control has become an important issue for franchisors due to the difficulties of dealing with independent business owners rather than employees of company-owned outlets. 'As franchisees are quasi-independent they are responsible for the actions of their own franchises' (McKelvie & Wiklund 2010, p. 274). This means that any changes in policies, procedures and strategies might involve considerable consultation, as opposed to simply mandating to employees. Communicating with, monitoring, and controlling these independent business owners are complex tasks. A firm using a combination of company-owned and franchised outlets can get around this by trialling new systems and policies in company-owned outlets before rolling them out in franchised units (Kirby & Watson 1999).

Despite the popular notion that franchising provides an effective vehicle for business growth and success, failure rates particularly for new franchise initiatives are high. Shane (1996) suggested that new franchise systems have a high probability of failure within the first four years and that potential franchisees should be wary of buying into systems yet to reach their

fourth anniversary. Lafontaine and Shaw (1998) observed that while a significant number of growing firms are entering into franchising, just as many are exiting the system after trying it for a few years. This has led to a growth rate that is, at best, in line with the wider economy.

Shane and Foo (1999) and Bates (1998) reported that between 50 and 85 per cent of franchising initiatives in the US fail. Statistics within the UK tell a similar story. Stanworth and Purdy (1995) monitored an initial 704 separate franchise listings and found that only 464 (66.3 per cent) were still operating after two years. Poor financial performance, together with poor efficiency, low survival and franchisee satisfaction rates have been reported as evidence that franchising may not be the superior organisational form that some believe it to be (Benjamin et al. 2006; Stanworth et al. 2001).

Commenting on franchising as a strategy for organisational growth Sherman (2004) commented that not every expansion via the franchising mode is successful. He cited the main reasons for franchise system failure to be directly related to the conditions necessary for a successful franchise business. Such reasons included: (i) lack of leadership by the franchisor (ii) lack of assistance and control for franchisees (iii) complicated or irrelevant business standards (iv) inappropriate franchisees' selection and (v) ineffective business and strategic planning.

Small businesses wishing to establish themselves as viable franchise operations are more likely to be subjected to the greater work pressures and financial strains typically associated with business growth (Stanworth 1995). Thus, Price (1996) emphasised the importance of piloting a franchise so that the franchisor may develop a viable working model and the suitable infrastructure to support the franchised network's growth. Stanworth et al. (2004) also argued that potential franchisors underestimate the investment required by organisations,

both in terms of finances and time, and that the adoption of franchising may in fact impede survival and growth.

### **2.12.1 Free-riding**

Free-riding amongst franchised outlets refers to situations in which franchisees might act improperly by offering lower quality products or services. This happens more commonly if the outlet does not depend on repeat customers (Gillis & Castrogiovanni 2012). Free-riding could have serious implications for the franchise, so controlling against it requires some degree of monitoring (Dant 1995). Individual franchisees providing poor service and reduced customer experiences that significantly differ from the chain's standards, pose a real threat to the franchise (McKelvie & Wiklund 2010). Free-riding amongst franchisees could damage the franchise brand image and reputation (Michael 2000). Customers who receive poor quality service at an independent franchise outlet will associate any such negative experiences with the entire chain (Brickley & Dark 1987). Any damage to the brand would make it increasingly difficult to attract new franchisees into the system. A franchisor might choose to franchise less and move toward a greater number of company-owned outlets in an attempt to overcome free-riding (Gillis & Castrogiovanni 2012).

### **2.12.2 Partner opportunistic behaviour**

Another challenge facing franchisors relates to partner opportunistic behaviour. Das and Rahman (2009) defined partner opportunism as behaviour by a partner firm that is motivated by the pursuit of its self-interest, even with deceit and at the expense of others. Franchisors might face future operational efficiency and profitability costs through franchisee opportunistic behaviours (Weaven & Frazer 2007). For example, with the purchase of any additional sites by a franchisee comes a reduced level of power for the franchisor (Grunhagen

& Mittelstaedt 2002; Lafontaine & Kaufmann 1994). Franchisees may carry out this strategy deliberately for them to account for an increased percentage of revenues within the group thus enhancing their balance of power vis-a-vis the franchisor (Grunhagen & Mittelstaedt 2002). This compromises a franchisor's ability to implement system-wide change, thus resulting in operational inefficiencies (Weaven & Frazer 2007).

### 2.13 Support for Dant's framework

Kirby and Watson (2003) conducted a qualitative research study to uncover the reasons behind founders adopting franchising as a growth strategy. The research highlighted that the majority franchised their business for financial reasons, preferring or needing to utilise the franchisees' capital to fund the expansion. Agency related reasons proved a significant factor within the responses also with strong support shown for motivation and commitment with 11 founders believing franchisees to be more committed / motivated than salaried managers (Kirby & Watson 2003). The findings of Kirby and Watson's (2003) research are highlighted in table 2.3 below.

**Table 2.3: Reasons for selecting franchising (Adapted from Kirby & Watson 2003, p. 66).**

| <i>Reasons for selecting franchising</i>            | <i>Number of times selected<br/>(n=21)</i> |
|---|--|
| Ability to use other people's capital               | 18   |
| Franchisees believed to be more Motivated/committed | 11   |
| Personal service/market knowledge                   | 9  |
| Control (Agency problems controlled by monitoring)  | 3  |
| Growing a network quickly                           | 2  |
| Improve performance at outlet level                 | 1  |
| Fashionable at time                                 | 1  |

Kirby and Watson (2003) investigated a sample size of 39 founders, representing a significant cross range of sectors. The reasons favouring franchising mirror that of Dant's decision

criteria of resource scarcity, efficiency achievement and agency related concerns. Thus Dant's framework has been deemed robust and adequate to investigate the decision of expanding firms in the fitness industry to grow via a franchised network rather than organically through company-owned outlets.

## **2.14 Chapter summary**

This chapter has presented a review of the literature relating to the factors that define, motivate and facilitate organisational growth. Growing firms can launch new products or attract new customers or do a combination of both. Once a business strategy is developed, expanding firms need to decide on a suitable organisational mode to execute their growth. The literature suggests that companies will expand due to either resource constraints, efficiency justifications, agency related reasons, or a combination of all three. Ultimately, the method of expansion selected is dependent upon a number of factors, including firm age, planned rate of expansion and availability of resources.

A discussion explored measures of firm growth, the most common of which are annual sales and number of employees. It has also been suggested that investments made are another helpful measure, probably related to imminent sales growth. Understanding that firms grow in a variety of ways, and for different reasons, was discussed in Section 2.3. Two different types of growth firms - high growth / entrepreneurial firms and slow growth firms - were then discussed in Sections 2.3.1 and 2.3.2 respectively.

Achieving business growth and the factors that facilitate growth were outlined in Sections 2.3.3 to 2.6, including a discussion of Ansoff's (1965) product-market matrix and the four primary growth strategies within this model. Expanding businesses have alternative methods of organisational growth modes, including organic growth, acquisitive and hybrid modes.

These were discussed in Sections 2.7 to 2.7.2. Sections 2.8 to 2.8.3.2 then examined the equity vs non-equity expansion modes and several variants in each, as described by Pan and Tse (2000). The regulatory framework for franchising was highlighted in section 2.9.2.

Sections 2.11 to 2.12.2 examined Dant's (1995) summary of the franchising literature and the factors determining why a firm would choose franchising as a method of organisational growth. These factors are classified as either relating to obtaining access to the resources required by a growing business (e.g. capital, managerial talent or market knowledge), achieving greater efficiencies through economies of production and scale, promotions and coordination or mitigating agency relationship concerns. Two widely recognised theories, resource constraint theory and agency theory, provide the underlying justification for Dant's identified franchising factors.

The chapter concluded with an examination of some of the disadvantages associated with franchising, such as loss of managerial control, legal disputes and the problem of free-riding or dysfunctional franchisees.

This chapter had two main purposes. The first was to provide a summary of the literature surrounding firm growth and organisational form choice. The second purpose was to provide a backdrop for the research project, which sought to evaluate Dant's (1995) key factors influencing the adoption of franchising vs company-owned outlets in growing fitness businesses.

The chapter identifies the constraints small firms seeking growth face. Analysis of the literature suggests that while firms primarily franchise their business as a means to overcome financial constraints on growth, agency-related reasons also proved to have considerable

influence. These findings provide a useful foundation for developing the research instrument in this study and understanding relevant factors that inform the study's research questions.

Chapters four and five report on studied cases and the subsequent analysis, to determine how applicable Dant's franchising decision framework might be for explaining growth strategy choices in the Australian health and fitness industry.

# Chapter 3

## METHODOLOGY

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### 3.1 Introduction

The objective of this research was to investigate the adoption of organisational growth strategies in the Australian health and fitness industry. Adopting a qualitative approach, research was conducted into the factors that entrepreneurs considered when evaluating the most beneficial growth strategy for their expanding organisation.

As discussed earlier, little research has been conducted into company growth strategies within the Australian health and fitness industry and very few multi-faceted decision models exist to explain the rationale used by entrepreneurs to expand their operations. In agreement with Bryman & Bell (2011) this study recognises the importance an individual's position of reality (ontology) and appreciation of what they consider acceptable knowledge (epistemology) plays in identifying their rationale for research. The starting point for this research was therefore based upon the premise that personal perspectives and how data is processed will ultimately determine the research process.

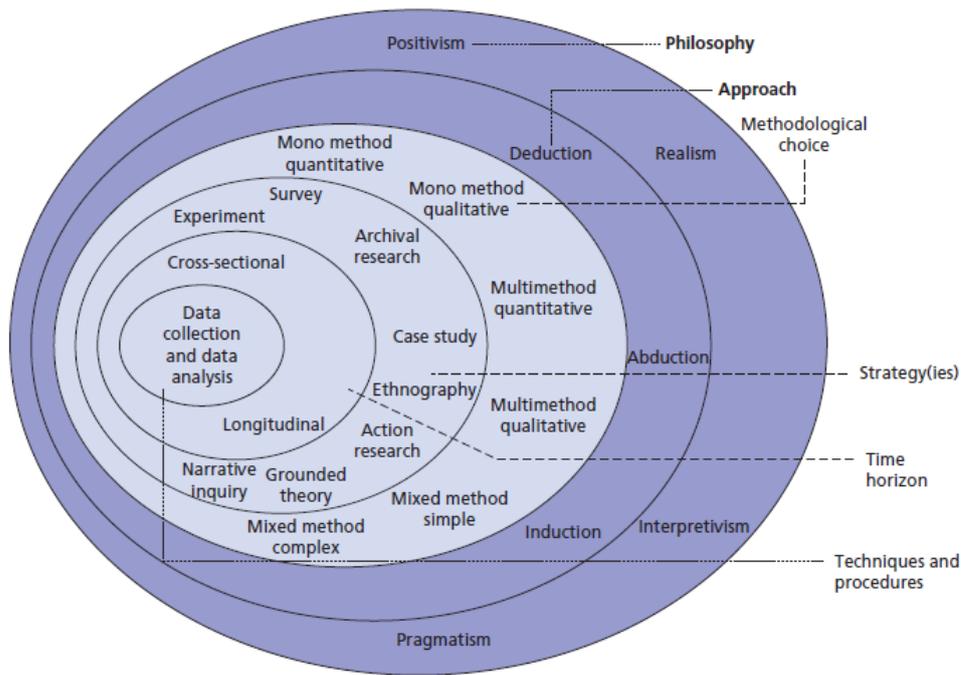
The researcher in this study is neither removed nor entirely objective due to extensive experience working within the industry. Such intimate industry knowledge allowed for an inductive research approach to be adopted whereby a chain of known premises are used to generate untested conclusions. The inductive research approach was deemed most suitable due

to the researcher's favour to interact and engage in dialogue with participants preferring to work with the qualitative data provided.

As stated above this research aimed to investigate the adoption of organisational growth strategies in the Australian health and fitness industry and evaluate the seven key criteria, as identified by Dant, that potentially drive expanding firms to franchise. Specifically, it focused on determining if these criteria are relevant to growth-orientated organisations in the Australian health and fitness industry. This therefore results in the following research questions being posed:

1. How relevant to the expansion strategy adopted is each of the seven factors identified by Dant?
2. What could account for the importance attributed to each factor?
3. Are there other factors that will motivate a business owner to franchise their business as an organisational growth strategy?

The methodology used in this study is based on the research onion model proposed by Saunders, Lewis and Thornhill (2011) and is presented below in Figure 3.1. The layered model suggests that in addressing a study's research questions, the choice of data collection, analysis techniques and procedures is aligned firstly with the determination of the research philosophy, approach, methodological choice, research strategy and time horizon. This chapter describes alternatives at each methodology layer and explains the choices made for this study. A description of the data analysis process is also described.



**Figure 3.1: Saunders, Lewis and Thornhill’s research onion (2011, pp. 160)**

### 3.2 Research process and philosophy

Cross (1999, p. 9) provides a distinct rationale as to what criteria is to be met to be recognised as research:

‘To be recognised as academic research the practice must be integrated within a strategy that is purposive (based on the identification of an issue or problem worthy and capable of investigation), inquisitive (seeking to acquire new knowledge), informed (conducted from an awareness of previous related research), methodical (planned and carried out in a disciplined manner) and communicable (generating and reporting results which are testable and accessible by others)’.

Understanding the differing philosophies or paradigms that form the foundations for research is critical to understanding the overall research process. Guba and Lincoln (1994) described

philosophies or paradigms as belief systems or world views that influence a researcher's choice of methodology and research. In the research onion model (Saunders, Lewis & Thornhill 2011), philosophy forms the basis of the research process and could be either positivism, realism, interpretivism or pragmatism.

With positivism, the independent researcher (a positivist) seeks law-like generalisations by conducting value-free research to measure social phenomena (Wahyuni 2012). Positivists, 'see the world as a collection of observable events and facts which can be measured' (Williamson 2002, p. 27). Positivism is usually characterised by a focus on quantitative methods of collecting data, through questionnaires or experiments, and subsequently employing statistical methods of analysis (Elshafie 2013).

On the other end of the spectrum, interpretivism is more concerned with observation and description and generating hypotheses (Silverman 2010). Researchers adopting this paradigm seek to uncover meanings of the people and interrelationships they are researching (Elshafie 2013). Thus, interpretivist research relies heavily on the people being studied and their individualistic behaviours to provide individual explanations of their own situation and behaviours (Veal 2005). Although quantitative measures may also be adopted through this paradigm, interpretive researchers generally focus more on qualitative methods, which provide a rich description of social conduct (Wahyuni 2012).

Researchers adopting a pragmatism approach recognise that there are many differing ways in which to undertake research. They believe that 'no single point of view can give the entire picture and that there may be multiple realities' (Saunders, Lewis & Thornhill 2011, p. 130). In order to more effectively understand social reality and address the research problem, pragmatists will select the optimum method or methods that will provide credible, well-founded, reliable and relevant data (Saunders, Lewis & Thornhill 2011).

Realism is another philosophical position, which assumes a scientific investigation to the development of knowledge. Bryman and Bell (2011) contended that realism is based upon the hypothesis that social and natural sciences should share the same approach to data collection and explanation.

This study lent itself to an interpretivist approach in which the researcher's objective was to gain a greater understanding of the topic, without imposing pre-existing expectations (Patton 1990). Following the collection and analysis of data, the interpretivist approach allowed for the researcher to 'develop concepts, insights and understanding from patterns in the data' (Reneker 1993, p. 499) by delving into unique cases of growth-orientated firms in the health and fitness industry.

### **3.3 Research approach**

The next layer in the Saunders, Lewis and Thornhill (2011) research onion model is the research approach. There are three types of research approaches that could be adopted: deduction, induction or abduction. Table 3.1 provides a summary of the characteristics of each.

**Table 3.1: Research approach (Saunders, Lewis & Thornhill 2011, p. 144)**

|                         | <b>Deduction</b>   | <b>Induction</b>  | <b>Abduction</b>   |
|-------------------------|--|---|--|
| <b>Logic</b>            | In a deductive inference when the premises are true the conclusion must also be true         | In an inductive inference known premises are used to generate untested conclusions                              | In an abductive inference known premises are used to generate testable conclusions   |
| <b>Generalisability</b> | Generalising from the general to the specific  | Generalising from the specific to the general   | Generalising from the interactions between the specific and the general  |
| <b>Use of data</b>      | Collection of data used to evaluate propositions or hypotheses related to an existing theory | Data collection is used to explore a phenomenon, identify themes and patterns and create a conceptual framework | Data collection is used to explore a phenomenon, identify themes and patterns, locate these in a conceptual framework and test this through subsequent data collection |

If the aim of a study is to test theory, a deductive approach would be utilised. Deductive research strategies start with an explanation or theory followed by the collection of data to validate or contradict the specific theory (Saunders, Lewis & Thornhill 2011). The deductive approach would normally involve quantitative methods where statistical analysis is employed to conclude that the data collected validates (or indicates as correct) the subject theory. This approach was not adopted in this study.

With the abductive approach, data is collected to explore theories, identify themes and explain patterns to generate new or modify an existing theory. The abductive research approach requires the identification of emerging patterns or themes and, subsequently, these findings are tested through additional rounds of data collection. The process described in the abductive approach was not employed in this study.

Alternatively, if a research strategy is based on the process of explanations being induced from the data, the research method is said to be utilising an induction strategy. Inductive research

commences with observation and data collection, moving to the analysis process and finishing with explanation and / or hypothesis theory (Veal 2005).

The research strategy adopted within this study could be described as an inductive approach. Saunders, Lewis and Thornhill (2011) explained how, in the inductive approach, the research project is data-driven. During the inductive research process a topic is explored with a theoretical explanation developed as the data are collected and analysed to generate new theories (Saunders, Lewis & Thornhill 2011).

During the inductive research approach, the seven key criteria identified by Dant and the relationships surrounding each were explored together with an investigation into whether any additional factors not identified by Dant were present.

### **3.4 Methodological choice**

The next layer in the research onion model of Saunders, Lewis and Thornton (2011) refers to the methodological choice. Researchers determining the most suitable research method are first faced with a decision between single data collection techniques (either qualitative or quantitative), known as a mono method, or more than one data collection technique, known as mixed methods (Saunders, Lewis & Thornhill 2011).

#### **3.4.1 Mono method: quantitative**

Mono method research techniques are classified into two distinct approaches: qualitative and quantitative. Quantitative research generally demands a strong deductive approach to the theory – a research relationship in which the accent lies heavily in the testing of theories (Lee et al.

1999). Such methodology emphasises quantification in the collection and analysis of data. Quantitative evaluation assumptions or hypotheses are developed prior to data being collected, with the purpose of determining whether the assumption is supported by the data.

### **3.4.2 Mono method: qualitative**

Dobrovolny and Fuentes (2008) characterised qualitative research as not starting with hypotheses but rather as looking at the bigger picture and attempting to describe or understand the context and develop a sound base for further decision-making. Qualitative research focuses on gaining a greater understanding of underlying reasons or motivations behind a phenomenon, while uncovering any dominant trends from a small number of representative cases rather than a limited amount of information from a large number of people or organisations (Bluhm et al. 2011).

Bryman and Bell (2007) described a qualitative research strategy as one that typically emphasises words rather than the quantification in the collection and analysis of data. They argued that qualitative research aligns with an inductive approach to the relationship between theory and research in which the distinction is placed on the generation of theories.

With the aim of qualitative research to provide a depth and richness allowing researchers to probe the how and why questions (not to make generalisations), it was determined that the mono qualitative method would be the most effective in achieving the aims and objectives of the research questions in this study.

### **3.4.3 Mixed methods**

Mixed methods research involves a blending of qualitative and quantitative methods that allows for a holistic picture and a comprehensive analysis of a phenomenon (Lund 2012). Researchers adopting the mixed method approach are drawn to the benefits of the respective strengths of both the qualitative and quantitative approaches (Parylo 2012). The mixed method research approach is said to offer the promise of being more easily able to answer certain complex research questions when compared to the single data collection mono methods (Lund 2012).

Based on the above discussion, as no quantitative method was employed, this study can be described as utilising the mono method, qualitative approach.

## **3.5 Research strategy**

After evaluating the methodological choices and deeming a mono qualitative approach to be suitable, the next step was to determine the most appropriate qualitative research strategy. The fourth layer in the research onion model refers to the research strategy, with the following choices: action research, ethnography and case study methods (Saunders, Lewis & Thornhill 2011).

### **3.5.1 Action research**

Action research is a combined research and practical process deliberately designed to involve the researcher in the topic and be part of the overall process. Bryman and Bell (2011) defined action research as ‘an approach whereby the action researcher and a client collaborate both in the diagnosis of a problem and in the development of a solution’. Known as a type of interpretive approach (Galliers 1992), action research may take on a wide variety of

methodologies, including questioning and observational research. Action research has been labelled a particularly useful tool where the research is organisational or problem based. Furthermore, action research allows for both the organisation and researcher to implement theories, with techniques being actioned in response to identified problems and the effects monitored and evaluated (Nielsen 2016).

### **3.5.2. Ethnography**

Ethnography is a methodology based around extensive empirical research, with fieldwork at the heart of the research design (Fetterman 2010). The aim of ethnographic research revolves around the study of people or groups in their natural environment over a prolonged period of time. Ethnography is a qualitative research methodology most often used in interpretivist studies (Brown 2014). It seeks to build on the data collection from existing sources but with the addition of personal observation. Previous research (Klein & Myers 1999; Van Maanen 1988) has highlighted physical presence and full-time involvement in the field over a long period of time as distinctive features of ethnography. Gobo (2008) stated that the very core of an ethnographic methodology is observation. Ethnography allows for a greater level of detail to be obtained, typically not available through other methods of data collection. Hence the analysis and documenting of results rely heavily on the contribution and choices of the researcher (Brown 2014).

All research is guided by the beliefs of the researcher about ontology and epistemology. Ontology refers to the nature of social reality, or what exists and the forms that it can take. Epistemology refers to what constitutes knowledge and, in a thesis, how it is formed. A researcher with a positivist perspective will typically have the view that the world operates independently of humans (ontological perspective) and that it can be measured independently (epistemological viewpoint). However, the interpretive researcher has the view that the world

should be viewed through the lens of interpretation and subjectivity and that reality is constructed by individuals and/or groups (Williamson & Johanson 2013). The latter is the viewpoint that guides the methodological approach adopted in this research.

### **3.5.3 Case study**

The qualitative case study method offers effective resources for researchers to study complex phenomena within their contexts (Baxter & Jack 2008). When applied correctly, it becomes a valuable method to develop theory, evaluate programs and develop interventions (Baxter & Jack 2008). According to Yin (2003), a case study design should be considered when: (1) how and why questions are the focus of the study; (2) the behaviour of those involved in the study cannot be manipulated; (3) contextual considerations are required to be covered because they are relevant to the phenomenon under study; or (4) the boundaries between the phenomenon and the context are not clear. The research context, aims and questions posed in this study meet these criteria, as will be elaborated in the following section discussing the case study design.

Case study research provides the most appropriate method of investigation, using a systematic way of collecting data, analysing information and reporting results (Russell et al. 2005). Case study methodology allows for multiple sources of data to be sought through each separate case, providing a more comprehensive, in-depth investigation. Case study methodology provides the opportunity to compare findings to a frame of reference in order to analyse the case study data. This type of research was considered the most effective method of investigation for this research project.

### 3.5.4 Case study design

There are many established methods to gather insights into a variety of phenomena. In this study, the approach was to examine expanding firms in the health and fitness industry via an in-depth case study approach involving multiple cases. This research used a qualitative research methodology to more effectively understand the motivations behind an organisation's decision to expand their business, either through franchising or organically through the existing corporate set-up or an extension of such (Pan & Tse 2000). The research incorporated an investigation of cases through studies that involved empirical inquiries on contemporary phenomena but within real-life contexts (Yin 2003). The phenomena investigated were the specific growth strategies and company motivations for fitness centre operators in the expansion of their business. The significance of studying a case was described by Miles and Huberman (1994, p.25) as a 'phenomenon of some sort' occurring in a bounded context. The individual Australian health and fitness centres, in their specific contexts, were each a case and formed the unit of analysis in this study.

A single case study approach with multiple embedded units enables the researcher to explore the case while looking at sub-units situated within the case. Looking at sub-units that fall within a larger case is a powerful analytical method. Analysis of data can occur within the sub-units separately (within case analysis), between the different sub-units (between case analysis) or across all the sub-units (cross-case analysis) (Yin 2003).

While there is no ideal number of cases, Eisenhardt (1989) suggested that a number between four and ten cases works well. With fewer than four cases, generating theory with significant complexity is often difficult and its empirical grounding is likely to be unconvincing.

Determining the case study sample was based on having representatives from the two different groups in this case study of expanding fitness firms. The sample was made up of two firms that grew their business through franchising and three firms that chose to expand organically through company ownership. This approach is described as purposive sampling in which purposeful cases are selected on the basis of the groups that the research addresses (Shakir 2002).

### **3.6 Time horizon**

The fifth layer in the research onion model relates to two time horizon perspectives: cross-sectional and longitudinal (Saunders, Lewis & Thornhill 2011). Cross-sectional designs can use qualitative and quantitative research and can measure an aspect or behaviour of many groups or individuals at a single point in time. Cross-sectional research is designed to obtain information on variables in different contexts, but occurring at the same time. Cross-sectional studies are often employed by researchers when seeking to describe the incidence of a phenomenon or how factors may be related in different organisations (Saunders, Lewis & Thornhill 2011). This typically means the collection of data on more than one case at a point in time.

Longitudinal designs study events and behaviours using concentrated samples over a longer period. The study may use qualitative and quantitative research. Research adopting a longitudinal strategy examines a variable group of subjects over time with the aim of investigating the dynamics of a problem or phenomenon. Repeated observations are taken with a view to revealing the relative stability of the phenomena. One of the many benefits of longitudinal research is its capacity to study change and development (Saunders, Lewis & Thornhill 2011).

The nature of the research questions and aims of this study led to the decision to utilise the cross-sectional strategy in the research process. The context with all cases is that the business expansion had already been carried out, either through franchising or organic growth through company ownership. Consequently, the cross-sectional point in time was similar for all cases (i.e. post initial expansion).

### **3.7 Data collection**

The data collection method employed for this study was influenced by the numerous steps decided on using the research onion model. The sources of data were the business owners of the five expanding fitness clubs. As previously discussed, a qualitative evaluation purposefully selects a small sample of individuals or data sources from which to conduct an in-depth study (Krahtwohl 1998; Mason 1996). Morse (1991) wrote that a qualitative study may draw upon only as many individuals as are necessary to identify any consistent themes or patterns. The owners were deemed to possess sufficient knowledge to address the research questions for their respective businesses. The researcher also had access to these owners through his work and industry contacts.

Typically, three kinds of data collection are used with qualitative research: interviews and focus groups, observations and written documents (Patton, 1990). The data collection in this study was mainly through in-depth participant interviews. Publications appearing in the media regarding the business and their owner were obtained and data therein were noted and discussed in the interview.

### 3.7.1 Interviews

One of the most valuable data gathering tools for qualitative researchers is the interview. DiCicco-Bloom and Crabtree (2006) suggested that the qualitative research interview could provide a deep contribution to knowledge that is conceptual and theoretical, as well as being based on the meanings that life experiences hold for the interviewees.

The interview may take on several forms, which might include open-ended questions in either a structured or non-structured setting. The use of semi-structured, individual in-depth interviews allows for a general series of questions to be provided to interviewees in advance of an interview. In addition, the in-depth interview affords the interviewer some latitude to ask further questions in response to the interviewees' tangents of thought and / or in response to what may impress as significant replies (Bryman & Bell 2007; Cooper & Schindler 2006).

Interviews have often been acknowledged as disadvantageous because of interviewer bias. This poses threats to validity and can result in inaccurate accounts of reality. Poorly-worded interview questions, with pre-suppositions assuming outcomes, can add to biased information and inaccurate recordings. In discussing biased and poorly-worded questions, MacNealy (1997) provided the following example: rather than asking 'What kind of problems did you encounter?' a better question would be 'Did you encounter any problems?' or, one step further, asking the interviewee 'What happened?'

A number of steps were undertaken throughout the interview process in an attempt to reduce the overall risk of bias. During the questionnaire design process, specific attention was paid to removing any leading questions, pre-suppositions and wording bias. Furthermore, the order in which the questions were presented formed an integral part of the process and was given significant attention. Question order bias can occur when interviewees are influenced by specific words or ideas that

impact upon their thoughts or feelings in preceding questions. Thus, careful consideration was given to both the questions asked and the specific order in which they were asked.

The research design for this study focussed on semi-structured interviews which, as Qu and Dumay (2011) described, involve prepared questioning guided by identified themes with probes designed to elicit more elaborate responses. With each semi-structured interview, careful attention was given to avoiding summarising responses and elaborating on the interviewee's answers, which could potentially influence the direction and outcome of the conversation. Any subsequent follow-up questions were asked using the interviewee's own language, being mindful not to subconsciously use body language or tone of voice to influence responses skewed towards the researcher's own beliefs, values or opinions.

### **3.8 Data collection process**

The data collection in this study followed a seven-step process, as follows: choice of data collection method (interviews versus alternatives); development of the interview protocol; pilot and pre-testing of the questions; ethics approval; contacting the participant; conducting the interview; and the recording and capturing of data.

#### **3.8.1 Use of interviews**

One of the first considerations in the data collection process is to determine the most efficient method of gaining a thorough insight into the experiences and context of the subject participants in order to best answer the research questions. Although conducting interviews in a group setting (i.e. focus groups) has been deemed an effective means of gaining information, for this study it was not considered a suitable alternative to the chosen in-depth personal interview

approach. The research strategy required looking into each individual case's context, with the flexibility of asking case-specific questions plus the ability to respond to the participant's answers to those questions. Only in-depth personal interviews could meet these strategy requirements.

### **3.8.2 Development of the interview question guide**

All the interview questions developed were directly mapped to the research problems identified for this study, based on Dant's (1995) franchising decision framework. The interview could be conducted using one of two possible approaches: unstructured and semi-structured. While a totally unstructured interview strongly encourages interviewees to reveal real-life experiences and social complexity, it can be time-consuming in comparison to a more structured approach. The unstructured interview is also often prone to digression, with the potential for much of the data being rendered worthless.

A semi-structured interview design was considered most appropriate in studying individual cases. This approach uses pre-determined, open-ended questions but still allows the interviewer to follow through and delve deeply into the question or issue as it pertains to the subject business case. This type of interview is the most widely used interviewing format in qualitative research (DiCicco-Bloom & Crabtree 2006), particularly when it is important to understand a phenomenon and the context in which it occurs. The semi-structured interview is adaptive, allowing the interviewer to identify additional or probing questions to pursue topics of interest according to elicited responses.

The question design was supported by follow up questions asked to each owner in an endeavour to draw out any challenges and motivations faced during the expansion process. In agreement with Qu & Dumay (2011), the focus of the interview design was to establish a set of broad

themes to help direct the conversation interposed with probes to elicit more elaborate responses. As Kvale and Brinkmann (2009) suggest the style of semi-structured interview is often the most effective and efficient manner of gathering information. Qu and Dumay (2011, p.246) suggested that semi-structured interviews allow for a more flexible, adaptable approach to asking questions whereby a skilful interviewer can adapt the ‘style, pace and ordering of questions to evoke the fullest responses from the interviewee’.

Numerous questions relating to Dant’s decision framework were asked during each of the five interviews with responses often eliciting further probing questions as a result. As an example, in order to get a sense of the owner’s availability of access to capital the question was asked: *What was the level of profit at the time you decided to expand through additional outlets? and what was your annual turnover the year the company expanded?* If further clarity or greater detail was required supplementary questions were asked to gain a greater in-depth response.

In order to uncover the owner’s motivation for selecting the growth strategy that each owner adopted, Dant’s seven decision criteria were presented with each owner asked to agree or disagree while stating the level of importance to them in the decision process. Referring to Dant’s framework, each owner was able to express their story about the challenges and motivations faced. Themes and linkages to Dant’s decision criteria framework were uncovered during this narrative of each owner. The aim of the semi-structured interviews with owners of the five fitness business cases was to explore the circumstances and motivations behind the path chosen for each firm's expansion.

To address the third research question and determine if any other factors exist that might motivate a business owner to franchise their business a number of questions surrounding strategy evaluation were asked of each owner. Questions designed to uncover any such motivations included asking ‘what were the reasons for selecting either franchising or company

ownership as the organisation's growth strategy?". Follow up questions delving deeper into any hidden or uncovered motivations were asked as a result of each interviewee.

Reliability and validity are two factors that any qualitative researcher should be concerned about while designing a study, analysing results and judging the quality of a study (Patton 2001). Reliability and validity are critical in the research process, allowing studies to be open to critique and evaluation. Ensuring rigor in qualitative research necessitates a basic strategy of systematic and self-conscious research design, data collection, interpretation and communication (Mays & Pope 1995). To ensure reliability and validity in this study, the steps described below were undertaken.

### **3.8.3 Pilot testing**

All proposed questions were pre-tested with three senior executives of firms that were not part of the research sample. The insights from each of the three executives provided a valuable source of appraisal, as well as a factual sense of how senior executives were likely to receive and respond to the questions. All three executives were briefed on the requirements and expectations of the questionnaire, so each was well-positioned to fulfil the task of evaluating the questions. One of the three executives was himself a founding owner of a medium size company-owned fitness chain operating within Victoria.

The executives were well known to the researcher. The purpose of the pre-testing was to prepare for any difficulties or challenges that may arise as part of the interviews using the proposed questions. Issues identified by the pre-testing participants were taken on board and used to reword or rephrase questions to achieve improved clarity.

Rowley (2012) proposed that the starting point to ensure questions are understood by interviewees is to examine interview questions carefully for jargon that the interviewee might not understand. Pre-testing allowed for the identification of any questions that may have been confusing or misinterpreted by interviewees or seen as leading questions or with implicit assumptions.

This process resulted in several changes being made, particularly in the question ordering. As an example, the question regarding the financial position of the business was moved later in the interview questionnaire. Moving this type of sensitive question provided time to develop greater rapport with the interviewee, which in turn generated an increased likelihood of such questions being answered. Additionally, several questions thought not to be congruent with the research questions were removed from the questionnaire. As an example, questions regarding types of fitness classes offered, class timetables or information regarding the centre's instructors were no longer asked.

Removing such questions results in less clutter in the data collected, allowing clearer interpretation, with themes and links that address the research problem more directly. Although conducting pre-testing is considered a time-consuming activity, well-structured and clear interview questions are a critical component in ensuring reliability within the research.

#### **3.8.4 Ethics approval**

It is Victoria University policy that all research involving or impacting on humans is performed in an ethical manner. The research must also comply with relevant legal requirements. Before data collection it was mandatory that ethical approval for this study was sought. An application was lodged with, and the approval granted by, the Human Ethics Research Committee at Victoria University. In conducting this research and throughout the interview process, a number

of key arrangements were put in place in order to ensure both the overall credibility of the study and confidentiality. Specifically, these arrangements were:

- (a) To provide an information sheet to prospective interviewees, explaining the purpose of the study and inviting participation. It was emphasised in the information sheet that all interviews were being conducted on a voluntary basis and interviewees could withdraw at any time prior to publishing of the study.
- (b) To ensure the confidentiality of the interviewee responses and participant anonymity, codes were used (rather than interviewee names) throughout the project records and all published reports of this study.

Copies of the information sheet, consent form and pre-tested questions sent to invited participants are provided in Appendices A, B and C, respectively.

### **3.8.5 Contacting participants**

The researcher started the task of establishing a suitable list of subject cases and corresponding interviewees by preparing a broad list of potential firms. As the researcher possessed a thorough knowledge of the health and fitness industry, a short list of firms identified as either a franchised or company-owned operation was established. This was followed by determining whether someone within the business could provide the insights needed to help address and answer the research questions. Silverman (2010) described such purposive sampling as the selection of respondents on their ability to address the research objectives. The last step in finalising the short list of potential participants was to determine the business owner's willingness to participate in the study, as well as their availability.

The number of founders who established and grew their fitness centre businesses by opening additional outlets is limited. Thus, the sample size for this study was restricted to five founders of fitness centres in the Australian health and fitness industry. Every effort was made to select the sample to include a cross-section of fitness centre founders.

Having finalised the short list of potential participants, owners of each of the respective organisations were contacted. Each of the owners were sent a letter outlining the research project, what prospective participants would be asked to provide, how the information would be used, together with an invitation to participate. All information received by prospective participants was on official Victoria University letterhead, which included the contact details of both the researcher and the thesis supervisor.

Follow-up phone calls were made to each of the five prospective participants to confirm that introduction letters had been received and to ascertain any interest in participating in the study. After confirming a willingness to participate in the study, a suitable time was agreed upon to meet with the owners at their preferred choice of location. The site of the interview was an important consideration, with each of the research interviews being conducted onsite at one of the fitness centres owned by the participant. A pre-determined time was set to minimise any potential distractions and interruptions to day-to-day operations. This was designed to ensure the greatest level of convenience for participants.

### **3.8.6 Conducting the interviews**

Conducting personal interviews often runs the risk of researcher bias and subjectivity, which could impact on validity. Other such challenges may arise associated with the recording or transcribing of data, such as with interviewees who may respond in idiosyncratic ways, making any comparison inherently difficult (Hannabuss 1996). The second means of ensuring validity

was through audio-recording of the interviews (an arrangement to which individual participants agreed). This resulted in having a record that could be listened to and verified repeatedly as necessary during the data analysis phase. Through this arrangement, the results reported could include verbatim quotes to support observations. Thus, validity was served, providing assurance that the study reported the observed outcomes correctly.

At the commencement of each of the interviews, the objectives of the study were again discussed with interviewees and consent forms completed and signed. Participants were reminded that there was no right or wrong answer, but that the purpose of the research was to elicit specific information regarding their experiences in relation to the questions that the study sought to understand better. Each interview lasted between 50 and 70 minutes.

Critical to the success of the interview is the need for the researcher to develop a rapport with each interviewee (DiCicco-Bloom & Crabtree 2006). The intention is to establish trust and respect between the parties in the sharing of information. The researcher had an intimate knowledge of the industry so credibility and rapport were easily established. This made each interviewee feel comfortable and at ease, allowing them to feel free to respond without much reservation.

While probing questions were administered as follow-ups to explore responses in more detail, care was taken at all times not to pursue any aspect that made the participant uncomfortable. All interviews started with conversations regarding the participant's background, including their experience within the fitness industry, together with their current responsibilities within the organisation.

Additional data obtained through individual company websites, together with autobiographies and articles in various publications gathered before the interviews, helped inform the nature of the probing questions that were asked. This is an important element in any case study.

Although time-consuming and often difficult to administer and analyse, open-ended questions can have an inviting quality and encourage authentic detailed narratives and responses from interviewees. Open-ended questions used in the interviews for this study allowed for questions to be asked in a clear, neutral and sensitive manner, a characteristic that has been identified as important for this type of data collection. As Patton (1990, p.173) stated, 'The purpose of open-ended interviewing is not to put things in someone's mind, but to access the perspective of the person being interviewed'.

All interviews for this research project were conducted on a voluntary basis, with consent obtained from each participant prior to their interview being recorded. Following each interview the recording was checked for audio quality and then transcribed. Full transcripts were written from each of the five interviews, including questions asked and casual chat in between questions. Additional summary pages were written from each transcript to highlight key findings within each of the interviews.

### **3.9 Data analysis procedures**

Qualitative research studies produce significant amounts of data which must be systematically analysed to gain a greater understanding of the phenomenon studied. Noble and Smith (2014, p.2) categorised qualitative data analysis as 'an interactive process, where data are systematically searched and analysed in order to produce an illuminating description of phenomena'. Coding and thematic analysis, as described below, were employed in conducting data analysis.

### **3.9.1 Coding**

Coding is the first process for qualitative data analysis, providing researchers with a means to define and categorise data collected. The process of coding starts with naming sections of data with a label or name. Liamputtong (2009, p. 134) explained that codes are often presented as a word or short phrase that ‘symbolically assigns a summative, salient, essence-capturing or evocative attribute for a portion of language-based data’. In this research project, coding started with the business name (e.g. 1F, 2C) and was structured according to the following categories: scale of planned expansion, motivation for expansion, type of expansion pursued, as well as Dant's (1995) franchising factors and their relevant circumstances.

### **3.9.2 Thematic analysis**

Bryman and Bell (2003, p. 476) stated that ‘One of the commonest approaches to qualitative data analysis is undertaking a search for themes in transcripts or fieldnotes’. Thematic analysis or interpretive thematic analysis is based on the principle of identifying, analysing and linking patterns or themes that emerge from the data. Liamputtong (2009) stated that there are three main steps in undertaking thematic analysis. The first is making sense of the interview data then examining the transcript and subsequently making sense of what is being said by the participants as a group.

An integral component of thematic analysis involved the process of initial identification of keywords or phrases within the data. Once the data had been collected, the second stage was to identify any recurring themes or patterns that may provide a revealing and informative description of the phenomenon (Noble & Smith 2014). In this study, emerging themes within the data were linked and matched against the seven key criteria identified by Dant.

### **3.10 Chapter summary**

This chapter has described the processes and underlying principles of the data collection and data analysis methodology employed in this study. Adopting an interpretivist research paradigm, an induction research approach and a case study strategy, an investigation was conducted into the factors that entrepreneurs in the health and fitness industry consider when deciding on a suitable organisational growth strategy for their expanding business. Data for this study was collected through in-depth semi-structured interviews from the selected sample, creating a rich source of information to address the study's research questions. The processes undertaken included several steps, such as pre-testing interview questions and audio-recording interviews, to ensure the reliability and validity of the data collected.

Chapter 4 presents the results from the interviews in the cases studied. An analysis of these results in relation to this study's research questions is then presented in Chapter 5.

# Chapter 4

## RESULTS

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### 4.1 Introduction

This chapter presents the data gathered from the five cases of expanding firms in the health and fitness industry. Two cases were firms that had adopted franchising as a growth mode, while three cases were firms that stuck to company ownership using some equity-based organisational form to carry out their growth.

Semi-structured interviews with the founder of each of the five firms provided the primary sources of data. As explained in the Chapter 3, the individual interviews were supported by secondary data gathered from publications regarding the individual businesses and owners, as well as information from the company's websites.

The results reported in this chapter provide an insight into the phenomenon of expansion within the context of different organisation growth modes. Responses obtained from each participant interview have been placed within a chronological narrative analysis framework allowing for the interviewee's stories to be accurately retold. In the process of narrative analysis, stories are examined for central elements, including time, place, plot and scene (Liamputtong 2009). Results from within each of the cases have been summarised in chronological order to report findings in a concise, logical and comprehensive manner.

## 4.2 Case study 1F

Recognised as a significant player in the health and fitness industry, case 1F is widely known as one of the large chains operating in Australia. According to their website, 1F is present in all states with a total of 77 sites. When the small fitness centre started, the 1F business owner never thought that one day it would grow to become a large national chain.

The 1F business owner was quite active within the community and enjoyed a strong position of well-established business and social networks. Such connections presented an opportunity to establish the initial fitness centre within the surrounds of an existing complementary business. The 1F business owner had this advice for business starters:

*“when such an opportunity knocked they had better open the doors and invite it in as it may not come around again”.*

The case 1F business owner had limited formal education. However, any shortfalls with regards to qualifications were overcome by a relentless, unwavering commitment to the business and a burning passion for the industry. The owner believed implicitly in the nobility of fitness and the associated benefits regular exercise provide the community.

Constrained by limited funds, case 1F relied heavily on word-of-mouth advertising to grow the business. The owner would work twelve or thirteen hours a day, every day of the week, looking after membership sales, providing fitness instruction through to administration, and even taking care of housekeeping tasks. The case 1F business owner did not draw a wage preferring to reinvest profits back in the centre to fund any required improvements. Such tireless effort and persistence soon paid dividends. After only six months of operation, the club outgrew its initial location and moved to larger premises.

After two years of operation the business was now a flourishing centre with more than 700 members attending the facility each week. The once small business with second-hand equipment and limited resources had evolved into a prosperous thriving operation, which the owner and partner now wished to expand. The business was profitable, with an established working model: operating systems, structures and policies were all in place. Sales staff were contracted to set up sales and membership systems. In addition, members were constantly being canvassed to gauge their interest and feedback.

Thinking of expanding their operation through a company ownership model, the case 1F owner was disconcerted not only by the price of rent in the major capital cities but also realising

*“how long it would take to raise the capital to actually open the club and make it successful”.*

The decision to expand was expedited when the case 1F owner learned of imminent and significant competition entering the Australian market. The owner heard this news from a visiting American speaker at a national industry conference. The visiting speaker commented that the Australian health and fitness industry landscape would change with independent owner-operators being bought out or folding as these large international chains entered the market.

Knowing the owner wanted to expand the business but uncertain how the capital would be raised, case 1F had an inspiration after reading about franchising in a magazine article. The business owner recalled their initial thoughts about franchising:

*“franchising is really the way to do this, because you have the owner operator there caring about their business, making sure that the members got the best service, getting involved in the local community doing all that, that you won't get staff to do and they have the money,*

*so they put the money in, they run the business and then the franchisor builds the brand and makes sure that it's all compliant and we get our revenue that way”.*

The concept aligned with case 1F owner’s thoughts. Franchising was deemed an effective solution to concerns about recruiting the right staff and constantly monitoring and managing their performance. Staff issues would be particularly challenging if the business were ever to grow to a national presence. The business owner was well aware of how the costs of staff supervision throughout multiple regional locations would bear down on the business. Having staff in multiple locations who shared their passion for the business seemed such a difficult prospect. The owner commented:

*“I would walk along the stairs and pick up a tissue where they would walk over it all day and never pick it up; it’s just a different mindset”.*

The business owner believed that an appointed franchisee would be motivated by the prospect of greater financial gain. The harder the franchisee worked, the more profit they could potentially make. However, it is important that the franchisee is a business-savvy person with a vested interest in the business and who is involved in the community, thus possessing local market knowledge. Such a set-up would not only help grow the franchisor’s brand but also assure consistent quality and professionalism in the franchise network.

In the 1F owner’s mind, the decision to franchise the operation addressed three significant requirements to grow their business: (1) it delivered the required financial capital needed to expand; (2) it provided qualified managerial personnel to run the new sites; and (3) as franchisees were involved in the community, they could be effective in building businesses at the grassroots level.

Having decided that franchising offered a suitable method of expansion, the case 1F owner contacted the author of the magazine franchising article as they also provided consultancy services for would-be franchisors. The 1F business owner appointed the consultant who was tasked with developing and writing all the company's franchise agreements and related documents. After the documentation was established, then came the challenge of recruiting and setting up the company's first franchisees. Rapid expansion for the group was seen as critical. The priority was to open as many fitness clubs as they could and reach critical mass as soon as possible. Overseas chains were entering the Australian market and sites and franchisees had to be secured quickly in order to establish traction in the selected locations.

During this franchise development period, the 1F group struggled financially as they had to continue investing in promoting the brand. The owner recalls:

*“for every dollar we got, we spent two; you were just fighting it all the time wondering where on earth the money is coming from; but you knew what you had to do, so you would do it”*.

Doubts about the business and its viability also arose during the initial period of franchising. Often the entrepreneurs worried about not being able to find the right operator or that they might not make a success of their business. Concerns also arose about the ability of case 1F to educate franchisees on how to develop a profitable business.

The case 1F owner was aware of the risk and the detrimental effects rapid growth could have on the business. However, the priority during this time was to create a critical mass of operating clubs and achieve first-to-market advantages. The owner described their mindset during this period as:

*“to get the number of clubs open generating revenue... which gave us revenue to give them the service and marketing support they needed to run their business as a brand”.*

Building credibility within the industry was as important for 1F as building their revenue stream:

*“we had to get credibility behind our brand because back then the Fitness Industry wasn't well respected”.*

While 1F was expanding through franchising, the health and fitness industry was experiencing a turbulent time. The industry was rife with clubs going into receivership and closing their doors. Critical to the 1F business owner was the development of the company brand. It was hoped that they could redefine the industry and overcome negative perceptions in the market about fitness centres.

The Australian health and fitness industry was then well-known for selling up-front memberships for a period of one, two or even five years. As part of case 1F's endeavours to rebuild credibility within the industry, a fortnightly ongoing direct debit membership option was introduced and implemented throughout the clubs. The 1F owner observed this system during an industry visit to the US. It was believed the introduction of part payment memberships would mitigate the concerns with the target market that fitness centres could close shop after having collected membership fees in advance.

The case 1F owner believed that, if faced the same situation again, she would still choose a franchising strategy. However, pursuing franchising had not been without problems. The greatest challenge was the franchisees themselves. Difficulties came up regarding franchisees adhering to what had been prescribed by the case 1F system. The franchisor commented that the franchisees would at times become

*“critical of the franchisor, wanting to do it their own way”.*

However, compliance was not a major concern with the rapid expansion in the first few years. The development of as many clubs as they could and ensuring their success were overriding priorities. The case 1F owner was unsure if they could have adopted a different strategy in terms of franchise compliance, as she explained:

*“I would do it differently in respect of compliance but then again having said that it’s not easy when you’re one single business, you’ve got to be lenient, you’ve got to get to where you need to and you can’t... it’s a relationship you’ve got to have with these people”.*

When asked about franchisee selection, the franchisor commented:

*“I’ve had it mentioned by other franchisors they call them the dirty dozen, the first twelve you get you take just to get the show on the road and make it happen”.*

With case 1F, many of the initial franchisees were selected based on their financial capacity rather than a rigorous test of their suitability. However, it could be said that a certain part of the company’s growth and success must be attributed to many of the company’s franchisees. The individual successes of specific franchisees played a significant part, in the development of the chain, as the franchisor recognised:

*“their feedback is paramount to how you run the business, in a corporate world if we were a chain and we owned all of the clubs we would be making decisions that were not necessarily the right ones because we wouldn’t be on the ground whereas if we make a wrong decision here we’ll hear about it from the franchisees”.*

By 2016 the chain had been operating for 27 years and had a combined total of more than 68,000 members and 2,200 employees. The group is widely recognised as the largest of its kind

in Australia and regularly appears on the BRW (Business Review Weekly) list of most successful private businesses.

At the time of interview, the well-established franchised group had no immediate plans for further expansion, either domestically or internationally. Overseas investors were once sought to take on appointments as master franchisees. A master franchise contract allows a person to purchase the rights from the franchisor to develop the system within a specified territory, typically metropolitan or regional locations or specific states. The master franchisee can sign up franchisees on behalf of the franchisor, but the master franchisee would enjoy the franchise fees and royalties collected from the area franchisees. This strategy was shelved after the global financial crisis (GFC) hit in 2008. The emergence of a number of overseas chains has also played a part in the group's decision not to aggressively grow the network. With their established position within the Australian health and fitness industry the chain today adopts a more reactive attitude on club development and new openings.

Pertinent data collected from the 1F case is summarised in Table 4.1.

| Case 1F<br>Business background            | Interviewee background  | Expansion process   | Future plans and prospects   |
|---|---|---|--|
| <b>Year started:</b><br>1996              | <b>Founding owner:</b><br>Yes   | <b>Years operating prior to expansion:</b><br>5 years   | <b>Clear strategy of expansion moving forward:</b><br>There was no clear strategy after the decision to expand however there were plans to sell the master franchisee rights into international markets prior to the GFC |
| <b>Structure:</b><br>Franchise            | <b>Position of interviewee:</b><br>Managing Director  | <b>Decision maker for business expansion:</b><br>Founding owner with business partner   | <b>Would consider the same method of expansion today:</b><br>Yes, they believed franchising addressed their lack of resources and provided a solution to staffing concerns   |
| <b>No. of sites:</b><br>77                | <b>Shareholding:</b><br>50% Interviewee<br>50% Business partner   | <b>Reason for considering expansion:</b><br>Fear of overseas competitors entering the Australian market   | <b>Exit strategy in place:</b><br>None - No definite strategy but they would like to sell the business in the foreseeable future   |
| <b>States of operation:</b><br>Nationally | <b>Role prior this business:</b><br>Fitness centre member   | <b>Sought advice regarding the expansion:</b><br>Contracted an external franchise consultant to gain further information about franchising and help set up the systems once the decision had been made. |  |
|   | <b>Circumstances leading to becoming an owner of a fitness centre:</b><br>Interest was ignited as a member of a gym and saw an opportunity to establish her own centre. | <b>Strategy in place prior to expanding:</b><br>There were no strategies in place regarding expansion. The case 1F owner was unsure how they were going to expand without access to any resources       |  |
|   |   | <b>Reason for selecting expansion method:</b><br>Didn't have the required capital but wanted quick expansion into new markets   |  |
|   |   | <b>Alternate organisational modes considered:</b><br>None - Didn't consider alternate growth modes as they believed franchising would offer them a better product                                       |  |
|   |   | <b>Had access to capital and qualified staff at the time of expansion:</b><br>Had no access to either financial capital or qualified staff  |  |

Table 4.1: Summary of key details for case 1F

### 4.3 Case study 2F

At the time of leaving secondary college, the business owner of case 2F believed he would be a town planner. After leaving school he was offered a university place in a town planning course and had enrolled in a tertiary degree. However, he deferred for a year, during which time he competed in a number of triathlons while working several part-time odd jobs. It was during this time that he considered enrolment in a leisure management course, which seemed more aligned with his strong interest in sports.

The leisure management course was scheduled as a 12-month full-time program for the first year, then part-time for the final year. Six months into the course, the case 2F owner began gaining a greater understanding of the health and fitness industry and the way in which centres within it operated. This exposure to the industry highlighted to him that there were few available full-time positions in fitness centres. Furthermore, he believed establishing a high-level income in the industry would be difficult, if not impossible, to achieve. This was during the late nineties and the fitness industry was well-known for its preference for hiring casual employees rather than full-time staff.

In an attempt to get qualified as quickly as possible, the owner completed a certificate III in fitness, in conjunction with the leisure management course. This certification allowed the owner to seek and undertake work experience as part of the national accreditation process. The owner was fortunate enough to be granted work experience at two separate fitness centres, gaining valuable experience within the industry.

After completing his work experience, the owner was offered a full-time position working with one of the fitness centres. Over the next 16 months the owner learnt as much as he could, as quickly as possible, undertaking all the various fitness centre functions from aerobics classes, fitness assessments and front desk duties.

The case 2F owner enjoyed working in the industry but saw a high turnover of staff due to the long hours and poor pay. Wanting more of a career, and believing there was nowhere to go, he approached the owner of the centre with a proposal to run his own personal training business within it. During these negotiations he was approached by a small franchise chain to manage one of their company-owned sites, where he had previously been employed on a part-time basis. So, in 1997 the owner commenced as manager of one of the eight sites that were being run as a combination of franchised and company-owned sites.

After working six months as the centre manager, the case 2F owner recognised the opportunity the centre represented and bought the site as a franchisee. Some six months later, when a further opportunity to purchase a second underperforming club within the small group arose, the case 2F owner took full advantage of the situation.

With the owner now operating two separate sites, the franchisor approached him to run the business as the group's Chief Executive Officer. The case 2F owner was more intent on running his own business rather than being an employee of the group. However, seeing the opportunity, he came up with a proposal to purchase the business. After some negotiation, the franchisor agreed, turning over ownership of the whole business to the case 2F owner.

With a mixed model of franchised and company-owned centres, the owner of this poor performing business was faced with deciding what method of expansion the business should adopt. He believed that although the business was under-performing, it had distinct potential if the right strategy was adopted. Having worked within the business as a franchisee, he knew that finding good quality experienced managers who would run the business as their own was the key to the success of the chain. The franchise business model, he believed, was well suited to individual owner operators driving their own business and reaping the rewards.

Deliberating over expansion alternatives the owner considered licensing, company shares, joint venture partnerships and company ownership as some of the alternatives. He sought advice from both his accountant and lawyer, ultimately settling on franchising as the way forward for the group. The entrepreneur believed the low entry costs of between \$50,000 and \$100,000 to purchase a franchise would provide a large pool of suitably qualified franchisees in which to grow the business. The set-up costs for a new 2F centre were relatively low compared to those of the larger full facility fitness centres. When establishing a fitness centre one of the greatest expenses in the set-up and operation is the purchase or leasing of equipment. From the outset to the current day, all equipment required by franchisees to set-up their business is financed through the 2F head office (i.e. equipment is bought by the franchisor and offered through a franchisor finance arrangement).

The entrepreneur strongly believed in the importance of the outlet manager being the face and personality behind the club. The manager, he stated, needed to be:

*“very driven and very much incentivised to really grow the business and engage the members”.*

In the early stages of the business life-cycle, franchisees are required to put the hours in to ensure its success and growth at a reasonable rate. This was a policy that the business owner

was insistent upon from the outset. As a franchisee's business matures they are allowed to step out of the business, calling on their employees to do more of the daily operations. This model allows for a strong focus on high service levels, increased member retention and new member referrals.

As a business, case 2F is uniquely positioned in the marketplace, offering the consumer a distinct alternative to the competing full-size fitness centres that cater for 3,000 to 5,000 members. Part of the differentiation strategy of case 2F is to position themselves in between a fitness centre and a personal training service. The unique service offering caters for members who may not be able to afford often costly personal training sessions but still wants more than the limited service a fitness centre provides. This concept was particularly attractive to those who wanted to commence a fitness program like staff in hospitals and schools, thus the centres were located in these establishments.

Just as deliberate was the company's strategy to identify site locations in which to establish new centres. The business owner embarked on a specific strategy from the outset to secure low cost tenancies, often within complementary health service businesses. From very early on in the development of the business, the owner had a very definite strategy regarding the direction the business would take. He knew in which states and areas the group would expand and how they were going to operate and compete sustainably against competitors. Success for the owner of case 2F has been the result of establishing not only what is good for the business, but creating and developing the right model, allowing franchisees the best opportunities to build a profitable, low risk and successful business.

Geographical expansion was an important consideration as part of the company's overall strategy. With the chain initially established in South Australia, the business owner was intent on establishing a strong footing in the local market before embarking on additional states.

Victoria was ultimately selected as the first state of expansion due to the close proximity to South Australia. Here he felt his costs would be more manageable.

The owner recognised the importance of gathering some momentum and gaining traction in these two states before seeking development of new sites in New South Wales and Queensland. Rapid expansion was not a critical factor in the company's decision to expand. The case 2F owner stated:

*“I think you run a big risk not getting the right sites and the right franchisees and that hurts you both financially and it hurts your brand”.*

On average the company has grown at a rate of five or six new sites per annum and the business owner has no plans to move away from this measured pace. This adopted strategy has become an integral part of the company's growth policy, as the owner said:

*“We know between five and ten is the number we can manage well, get the right sites, the right franchisees and we are happy just ticking along doing that”.*

In selecting the franchising mode of growth, one of the most challenging factors confronting the business owner was the selection of the right franchisees. A great deal of time is invested by head office in locating and securing the right sites. With the equipment financed through head office, a significant capital investment is also made. Investing a significant amount of time and finance in the acquisition of sites demands careful franchisee selection. With the business reliant on the royalty fees from each of the franchises, the case 2F owner understood that without suitable franchisees running the business, he would not receive a return on his investment. Poor performing franchisees generate less income, with lower royalties and marketing levies going to

the franchisor as a consequence. Coupled with the overall damage that is often caused to the brand image of the company, unsuitable franchisees can have a disastrous impact on the franchisor.

Today, the case 2F owner insists that would-be franchisees commence working within another site as a trainer, learning the most critical elements of what is required to operate a franchise successfully prior to them being granted a franchise of their own. This strategy allows the business owner to determine the suitability of the would-be franchisee, thus mitigating the potential for an unsuitable owner-operator joining the group.

With competing overseas chains entering and rapidly expanding in the Australian market, the decision to remain steadfast on the company's growth strategy and franchisee selection plan was often challenged. The case 2F owner recalled:

*“Often you’ll be thinking, should we be going quicker? So I suppose just not getting carried away with it all, rather sticking to our strategy and just keep doing what works for us”.*

The business owner's decision to adhere to a controlled growth strategy was a vital part of the development and sustainability of the organisation. Getting the balance right in terms of new sites, with the right people operating those sites, has always been top of mind for him. Effective franchisee selection made the company stronger and was a source of competitive advantage, thus determining the overall reputation of the company's brand.

Granting master franchise rights is a popular method employed by many Australian franchise systems. However, the 2F owner followed a strategy of not appointing master franchisees. He believed that doing so has allowed the group to retain a larger proportion of the company's revenue and maintain a greater level of control.

The chain's growth was recognised during a consecutive three-year period when in 2010 the group was named in BRW's Fast Franchise List (a list of the top 100 fastest growing franchises). The case 2F fitness franchise business has now been operating for close to twenty years with 65 sites now open across five Australian states (New South Wales, Queensland, South Australia, Tasmania and Victoria). Additional growth opportunities are currently being sought and expansion is set to continue into the Western Australian market in the not too distant future.

Today the chain operates purely as a franchised business, with no company-owned and operated sites in the group. Asked whether it was important to have any corporate-owned sites, the franchisor responded:

*"I was a franchisee for three years before I brought the group in 2000 and I think that is important. I think that it is important to have sat on the other side of the fence, so if you're a franchisor that hasn't done that then maybe it is important".*

The case 2F owner believed the main reason behind the high retention of franchisees is effective communication. He explained that many franchisees had been with the group for a number of years, with several franchise owners owning multiple sites. Communication with the franchisees was ongoing, open and regular. Extensive head office support was also provided to each of the franchisees. As part of the overall support, franchisees receive regular communication via phone calls and emails, together with the more formal monthly franchise meetings and annual conference. The business owner commented on the success of the company's retention:

*"It's a fun business, whereby we have a good culture, very open and transparent communication. I'm not a greedy person and our franchisees are not greedy, it's a balanced environment and they're generally passionate about the industry".*

Although there had been many rewarding periods during the company's growth, there had also been some tough times financially. During these periods the business owner would question the viability of the business and whether it had been worth all the effort. He often doubted if in fact the business would continue. Wiser for such experiences, the owner now understands the importance of seeking advice from the group's accountant or lawyer. He has even gone one step further, finding himself a mentor in the form of a business coach who provides a different perspective to the business.

For the owner of case 2F, the vision has been clear from the outset; franchising offered an effective solution to gaining access to qualified, experienced and committed managers. He believed franchising allowed for a franchisee to generate a greater income level than would otherwise be achievable as an owner of a company-owned site. The owner knew that while he could offer a manager a competitive salary, he could not afford to pay them enough to get them to do what was required to grow the business at the required rate each year. Today the franchised chain operates across five states of Australia and continues to grow. In selecting the growth mode and remaining steadfast to his strategy, the business owner demonstrated an innovative forward-thinking approach that created a significant competitive advantage for his business that he still enjoys today. The high level of entrepreneurial spirit shown by the case 2F owner is evident in the successful chain of 77 sites now operating across five states.

Professional development of staff is well entrenched in the company's operating plan with systems, structures and franchising documents all in place. The company is currently focussing on better aligning some of the key roles within the business to the strengths of individuals and sharing responsibility within the executive team. This policy diminishes the burden on the business owner to drive all parts of the business.

With a clear goal in sight, both in terms of financial turnover for the group and a targeted number of sites, the owner of case 2F has a clear vision not only of growth for the years ahead but also by way of an exit strategy. By maintaining a level of control over each of the franchisees and preserving a level of growth that was both achievable and sustainable, the owner has positioned the firm as an attractive, valuable acquisition for would-be investors, equity groups, another franchise chains or allied health care companies.

Pertinent data collected regarding the 2F case is summarised in Table 4.2.

| Case 2F<br>Business background                        | Interviewee background   | Expansion process   | Future plans and prospects  |
|---|--|---|---|
| <b>Year started:</b><br>1994                          | <b>Founding owner:</b><br>No   | <b>Years operating prior to expansion:</b><br>3 months  | <b>Clear strategy of expansion moving forward:</b><br>The group have plans regarding their growth strategy, with a clear goal of opening additional sites in new geographical locations |
| <b>Structure:</b><br>Franchise                        | <b>Position of interviewee:</b><br>Managing Director   | <b>Decision maker for business expansion:</b><br>Business owner had sole responsibility   | <b>Would consider the same method of expansion today:</b><br>Yes, franchising has allowed the owner to establish a very successful national business                                    |
| <b>No. of sites:</b><br>65                            | <b>Shareholding:</b><br>100% Owner   | <b>Reason for considering expansion:</b><br>Wanted to develop what he believed was a poorly-run business  | <b>Exit strategy in place:</b><br>The owner continues to position the business as an attractive acquisition for would-be investors or other equity groups                               |
| <b>States of operation:</b><br>NSW, VIC, SA, TAS, QLD | <b>Role prior this business:</b><br>Owner was undertaking a course while competing in Triathlons.  | <b>Sought advice regarding the expansion:</b><br>Sought advice from a lawyer and accountant   |   |
|   | <b>Circumstances leading to becoming an owner of a fitness centre:</b><br>The owner was a franchisee of the group when approached by the franchisor to become the CEO. This initiated discussions to purchase the business | <b>Strategy in place prior to expanding:</b><br>Once the decision to expand and the growth structure the owner would adopt was made, a clear expansion strategy was formulated as part of the overall plan for the group                  |   |
|   |  | <b>Reason for selecting expansion method:</b><br>The owner believed his model was reliant on independent owner / operators who would drive the business as their own  |   |
|   |  | <b>Alternate organisational modes considered:</b><br>Yes - Licensing and company ownership were evaluated as potential growth modes. Settled on franchising due to the business being an affordable opportunity for potential franchisees |   |
|   |  | <b>Had access to capital and qualified staff at the time of expansion:</b><br>Had access to capital but did not have a pool of qualified managerial talent  |   |

Table 4.2: Summary of key details for case 2F

#### 4.4 Case study 1C

The owner of this company-owned chain, case 1C, is considered one of the industry's pioneers. The owner established the first fitness centre more than 25 years ago. The business benefited from a strong reputation in the industry and is recognised as one of the most prestigious fitness centres in the country. The centre attracted many of Melbourne's high-profile personalities and business owners as clients. The owner furthered their reputation within the industry by sitting on industry governing bodies at various stages.

The purchase of the first fitness centre for the case 1C owner came about in fortuitous circumstances when the gym where she was training went bankrupt. Recognising the opportunity, this highly-driven business owner decided to purchase the gym with a business partner. It was their first foray into owning a fitness centre or any business for that matter. The owner set about growing their business knowledge and learning about the fitness industry.

The case 1C owner operated the centre for nine years. The opportunity to expand came about when the owner's then business partner bought a second fitness centre. The new centre took on their brand and continued to operate under the same company name. Over the next few years, the company grew, despite not having any formal strategy. Eventually the case 1C owner bought out their business partner and added a number of additional sites to the group, with the chain reaching up to a dozen sites.

The group grew entirely through unplanned circumstances. The case 1C owner was not proactively growing the number of sites, but rather reacting to the opportunities that were presented to them. Altruism played a significant role in the expansion process for the owner of case 1C, as outlets grew when the owner helped friends to enter the industry.

The owner provided financial assistance to friends who owned clubs that were struggling financially, entering into partnership arrangements with the case 1C business owner holding a majority share. On other occasions, the case 1C owner assisted friends who were looking to purchase their own site but did not have the required capital to do so in their own right.

The case 1C business owner knew growth for the organisation was very much dependent on surrounding themselves with like-minded partners - those who were committed to the maintenance of high standards across the group. The case 1C owner needed partners who shared the same passion for generating a vibrant, dynamic culture at the operational level and that would ensure their financial success. The establishment of each new site came through an existing relationship with someone the business owner had known for some time. Each of the partners offered a strong understanding of the industry, knew the local market well, were suitably qualified, and shared the same passion for the industry. As the business owner explained:

*“The people that always wanted to grow the business with me have worked with me for at least five or six years so I knew that in their heart they think the way I think. We had the ability to create this small business advantage of friendliness, contact and service with the big business model of notability, size equals reliability equals substantial”.*

The business owner was grateful for the unique positioning of the group and the niche in which they had found themselves. The owner believed that growing the right people in to the right roles had paid dividends. The business today has eight sites located centrally throughout Melbourne with each continuing to be recognised for its consistent high levels of customer service and a wide range of differing fitness classes each week.

Access to capital was not a barrier to growth. Acquiring additional sites was made possible financially by maximising the potential of each existing site, using the profits to embark on a

new site acquisition. The owner would also focus heavily on a market penetration strategy, generating as many new memberships as possible while retaining existing members across each site.

The business owner had now invested heavily in each business within the group and was determined to ensure their success. The initial centre had generated consistently high returns over a number of years. The case 1C owner wanted the new centres to generate similar returns. The owner worked tirelessly on developing marketing and advertising campaigns, creating billing systems, introducing the partners to equipment suppliers and establishing the clubs' programs.

There came a point however, when the owner of case 1C believed the business was under resourced. The business owner was not receiving any money either for the use of the brand or the work the owner was doing in each of the clubs. Part owners were not prepared to pay any royalty or management fees and this was a problem as greater resources were needed. This led to the establishment of a fee structure. However, still the minority owners were not willing to comply. As the owner explained:

*They didn't want to pay, they just wanted me to work for nothing and they wanted to get the brand for nothing and because I had given it to them and if you've given anything to anybody and they've enjoyed it for free it's very hard to turnaround after a year or two and say now you pay for what you got for free".*

The business owner found it difficult to convince her partners that more support and management could be provided to them through the new fee arrangement. This would, in turn, result in greater profits. The business owner even thought of franchising as a solution to generating the revenue stream required for additional support to the clubs. However as it

involved collecting on-going fees this would probably generate friction which the owner was not ready to deal with.

The decision was set for all clubs, including the three new clubs joining the chain, to pay a three per cent royalty fee to the business owner. Minority shareholders remained resistant to the idea, said the business owner, reacting with such comments as:

*“What are we getting for the money? I’m not getting value, why should we put the money in? If we pay franchise fees where’s the person coming down to help?”*

The greatest challenge for the business owner in expanding the business was to establish an effective organisational mode of growth. The less than formal business arrangement she had with each of her minority share partners made it exceptionally difficult to implement any new form of organisational growth mode structure. The existing loose financial understanding in place meant minority partners were averse to entering into any new business contract arrangements.

The case 1C owner had now established a brand that had a significant reputation throughout Melbourne and was still opening new centres. The owner believed that the widely-recognised brand within the marketplace was underpinning the success of the chain and this was largely due to her efforts. But being unable to introduce any formal business fee arrangement, due to the resistance faced, the owner looked for external help. The case 1C owner contacted a consultant to assist in establishing and implementing a license or franchise structure within the group. The situation was described as follows:

*“In the end nobody wanted to pay, we grew as a happy group and everyone was happy because they were receiving, but when I wanted to get something back nobody wanted to give back”.*

After spending several months and receiving twenty thousand dollars, the consultant wanted to do more research around franchise fees. The case 1C owner was not satisfied with this outcome and wanted advice on how fees could be built into the relationships with the partners. The business owner recalled what she told the consultant:

*“I know how much they should be paying, between three and six per cent is what they should be paying”. You don’t need to be spending twenty two thousand dollars of my money to work on a percentage”. That is not the issue, the issue is how do I get personal relationship and business expectation to marry?”*

The case 1C owner wanted the consultant to also educate the minority partners on the value of the brand. The owner felt none of them had a proper respect for the value of the brand. The minority partners did not believe the brand played a significant role in generating new enquiries and membership for the centres. They believed that changing the name of the centre and moving away from the business owner’s original brand name would not have an impact on their overall profit. Trying to establish a revenue stream for use of the brand and the support provided was proving a significant challenge, as the business owner explained:

*“When people start off they need you and have no worries about paying for the first six months, in the first twelve months there’s no problem paying me, the minute they’re on their feet and they’re teenagers and they don’t need you anymore they just say we’re not getting value and they forget about the time when they couldn’t walk and you helped them, they completely forget about it”.*

Abandoning the idea of introducing any variable franchise fees or royalties on sales, the business owner thought of a licence fee arrangement. As such the owner proposed a fixed \$1,000 per month licence fee. This arrangement would provide the minority partners with the rights to use the company’s brand, logos and group website without any formal commitment

from the business owner for any operational or marketing support. Extracting this regular fixed fee was unsuccessful.

The case 1C owner was no longer prepared to have arguments over money. The owner disliked the uncomfortable financial conversations, with the potential to destroy lifelong relationships and disaffect her passion for the industry. However, given the opportunity again, the owner would have established a formal business growth mode from the outset. The introduction of new fee structures after the business had begun operating had been quite frustrating, as the case 1C owner commented:

*“I have to accept there is not a business model that I’ve been able to produce that is a growth model beyond my existing partners”.*

On the option of franchising, the case 1C business owner was not convinced that this growth mode is suitable for the health and fitness industry. The owner believed fitness centres are not businesses that can be run purely by a standardised system of books and strategies. Each club and geographical area is different and what may work well in one, may not necessarily work well in the other. As a proponent of localisation, the business owner believed the minority partners should have every right to promote and set their own prices in the market in which they are familiar.

The case 1C owner had no immediate plans to expand the current business operation outside Victoria. The well-known chain has generated significant attention and interest from would-be investors looking to establish their own site. Each week numerous requests are received from these investors looking to form an alliance under the business owner’s brand. However, any further expansion for this chain will continue only through joint venture partnerships. These new partners would be either people the business owner knows or those who are currently working in the business.

Without any definite exit strategy in place, the case 1C owner continues to consider opportunities to attain additional sites and grow the brand. Asked about where the business may be in five years' time, the prospect of packaging three or four clubs together was raised as an option.

Pertinent data collected regarding the 1C case is summarised in Table 4.3.

| Case IC<br>Business background                              | Interviewee background   | Expansion process  | Future plans and prospects   |
|---|--|--|--|
| <b>Year started:</b><br>1996                                | <b>Founding owner:</b><br>No   | <b>Years operating prior to expansion:</b><br>9 years  | <b>Clear strategy of expansion moving forward:</b><br>No - Expansion is dependant on being approached and presented with opportunity to expand |
| <b>Structure:</b><br>Company ownership<br>Minority – Equity | <b>Position of interviewee:</b><br>Managing Director   | <b>Decision maker for business expansion:</b><br>Business owner had sole responsibility  | <b>Would consider the same method of expansion today:</b><br>No - The owner would licence the business from the outset                         |
| <b>No. of sites:</b><br>8                                   | <b>Shareholding:</b><br>50% Interviewee<br>30-40% Minority business partners   | <b>Reason for considering expansion:</b><br>Bought a competing fitness centre that was seen as a potential threat – attracting the owner's members                                       | <b>Exit strategy in place:</b><br>None – No consideration has been given to implementing any strategy to exit the business                     |
| <b>States of operation:</b><br>Victoria                     | <b>Role prior this business:</b><br>Fitness centre member  | <b>Sought advice regarding the expansion:</b><br>No advice was sought initially, although a strategist was appointed when the owner attempted to franchise the business                  |  |
|   | <b>Circumstances leading to becoming an owner of a fitness centre:</b><br>Was a member of the fitness centre when it went bankrupt and was put up for sale | <b>Strategy in place prior to expanding:</b><br>No, everything the owner did in terms of expansion was as a result of being approached by friends  |  |
|   |  | <b>Reason for selecting expansion method:</b><br>The owner had access to capital and invested financially to help friends purchase their own centre                                      |  |
|   |  | <b>Alternate organisational modes considered:</b><br>None - No alternate modes were considered initially. The owner did seek to franchise her business later in the company's life-cycle |  |
|   |  | <b>Had access to capital and qualified staff at the time of expansion:</b><br>The owner had friends approach her who were both well-qualified and experienced operators                  |  |

Table 4.3: Summary of key details for case IC

#### 4.5 Case study 2C

The owner of case 2C was emotionally committed on working within the fitness industry. He started as a cleaner at the gym in a small regional Victorian town. He then enrolled in the first ever fitness course in Victoria, which gave him the necessary qualifications to work in a fitness centre. After working for a couple of years in the gym as a fitness instructor, he was approached by the owner to purchase a share in the business. Rather than settling on a percentage of the business, the case 2C owner got some support from his father and made an offer to the vendor to purchase the whole business. The offer was accepted and at 21 years of age the case 2C owner had purchased his first business.

Over the next two years, the competitive nature of the market became apparent with a further seven fitness centres opening their doors in a region barely big enough for two. The region then had a population of fewer than 80,000 people. Adding to the challenge was the introduction of a women-only fitness centre, just metres away from the business owner's centre. The women-only fitness centre introduced an aggressive marketing slogan: "Don't be intimidated by men, come to us". The introduction of additional fitness centres had a significant impact on the business, resulting in the loss of a significant percentage of members to other clubs.

To prevent further financial loss caused by the reduction in memberships, the 2C owner decided to sell and approached one of the competing fitness centres in the region. He described the offer on the transfer of the business:

*"I'll give you my building, I'll sign over my remaining lease, you can have all my members as long as you honour their memberships and I'll walk away, so you'll lose your biggest competitor, double your membership and you'll get one of the best buildings in the region".*

The business owner's offer was accepted by his competitor. He then left regional Victoria and move to Melbourne with nothing but a truck of broken down second-hand fitness equipment. The owner was keen to start up a new centre but owed a large amount of money to creditors. He was \$200,000 in debt, most of which was mortgaged against his parents' home. He rented a small place (all he could afford) in the inner suburbs of Melbourne. With no existing members, the case 2C owner started to re-establish his business, opening the doors to his new centre on 8<sup>th</sup> April, 1996. Without a single member, any staff or money in the bank, the owner was uncertain if, in fact, he would make it through the week let alone the year. The business provided a very distinct offering, marketed at specific clientele. It aimed at attracting and servicing body builders, power lifters and other competitive sport members who focused their training on heavy weight lifting. The business owner endured some incredibly tough times financially as he began building his business in the Melbourne market. He recalled how difficult the early years were:

*“I think I had the power cut off just about every month, I had the phone cut off every month, we just couldn't make the rent. I had no members to start with and we got a hundred members in the first year and turned over a pretty shabby amount of money and I was constantly thinking is this ever going to work?”.*

In an attempt to cut costs, the owner slept on the couch in the gym for the first six months, constantly worrying that he was on the edge of closure. Without a house, car or any possessions, the business owner had sold all his assets just to have the power and the phone lines reconnected at the gym.

The owner persisted for two incredibly difficult years before the business finally turned the corner financially in 1996. A year later the gym had outgrown the existing premises. Putting every dollar earned back into the business paid dividends and by 1998 the business owner had paid all leases out and owned all the centre's equipment.

As a result, and with steadily increasing membership numbers, the owner looked for larger premises for the business. He found a new location near the existing fitness centre. Although he found what he believed was the ideal building, the business owner was unable to afford the full cost of the lease each month. Further he did not have enough fitness equipment to fill the entire building. As a solution to the challenges he was facing, the business owner decided upon a strategy to sublet the rear of the premises to a welder for the next two years.

The case 2C owner summarised his business philosophy on acquiring and retaining members as follows:

*“Our renewal rate here to this day is over seventy per cent, so I had this sort of idea at the time that if you had people come to the gym that really loved going to the gym, that used their membership all the time, well your gym would always be busy and then you wouldn’t have to be out getting new members all the time. And if you did your job really well then your members would bring their friends”.*

Potential members are welcomed to tour the facilities in a relaxed manner, without aggressive sales people employing high pressure tactics. As opposed to common practices in the fitness industry, prospects are not expected to make an instant decision but advised to 'go away and think about it'. The case 2C owner explained this marketing approach and confirmed how effective such a low-key strategy had been for the business:

*“To this day we’ve never advertised, we don’t do yellow pages, we don’t do promotions, we don’t do special or two for one’s. I don’t do telemarketing, I’ve never made one phone call, not even to see why someone didn’t renew, that was our MO to always remember people’s names, to give them great service which really drove our success”.*

The reputation of case 2C was steadily growing and the gym now had loyal members who were contributing to significant word-of-mouth advertising.

An option to purchase a second gym came in 2009, 15 years after originally setting up in Melbourne. This involved the potential takeover of an existing fledgling centre on the city outskirts. As the business owner's gym was now generating a solid revenue and profit stream, the case 2C owner was in a sound financial position to consider the feasibility of expansion. The purchase price for the second gym was affordable. The decision to expand was also driven by the case 2C owner's passion for the industry and belief that many people on 'the other side of town' would benefit from the club's service offering.

After purchasing the new gym, the business owner immediately set about increasing the gym's opening hours. The experienced owner identified numerous issues that needed to be addressed in order to increase the struggling concern's customer base and generate better returns:

*"I would go there at night, it was dull, it was badly lit and there was just no atmosphere in there, it was very unfriendly to walk in to".*

The business owner now had two established clubs operating and was starting to think about the next. He described the mindset as an 'opportunist sort of thing'. Shortly after, he was contacted by the owner of a city-based gym looking to sell. With well-established systems and structures in place, the business owner did not hesitate to open this third club. This was followed by an additional two locations added to the portfolio, both by way of acquisition.

The case 2C owner believed he had developed an effective formula to guide the businesses' future growth, confident that he had an ideal management model. He offered a small equity share of the business to the manager of each fitness centre outlet, making them partners and providing an opportunity for staff to grow and develop within the industry. He summarised his belief in the opportunity he provided:

*"They're not going to rip you off, they're not going to get greedy or jealous or anything like that. If you give somebody who hasn't had an opportunity a great opportunity they're the best business partner in the world, so each of the managers are involved in the business".*

Although the business owner briefly evaluated alternative growth modes, no serious consideration was ever given to any, including franchising. The case 2C owner had heard a number of ‘horror stories’ in relation to franchising and was therefore quite set against it. Loss of control and protecting his now well-established brand weighed equally in the business owner's mind. Appointing a manager who had a small ownership share in the business, he believed, represented the best growth mode as all would appreciate the value of the brand and would not risk damaging that brand. An aversion to losing control of the brand is highlighted by the business owner’s statement:

*“That’s why I would never put a stranger in”.*

Satisfied with the expansion strategy he chose, the case 2C owner was now looking to further strengthen his brand and increase the number of sites within the group. With such a well-established, recognised brand, he now fields a number of enquires each week from people looking to enter the industry by leveraging off his brand. In future, the expansion strategy might change but the emphasis on the selection process will not. This is critical to the company’s brand and reputation, as the owner explained:

*“I’ve got to find the right people, they would have to be handpicked and there would have to be a mutual agreement where they had a great opportunity to make a business work whereby our brand wasn’t compromised. I haven’t found that formula yet, but it’s definitely out there, I’ve got people with plenty of money behind them wanting to do a gym in Sydney, Adelaide, Perth and the Gold Coast”.*

For the case 2C owner, the opportunities to expand were presented to him rather than being proactively sought. His decisions were considered carefully, with no risk-taking or hasty behaviour, as he commented:

*“It was a big decision that took me like three months to decide. Honestly, I reckon I put more thought in to that than people put in to running for bloody government, I tortured myself over it”.*

The case 2C owner was still looking forward to further growth, perhaps in other Australian capital cities. This would probably still be achieved through the proven model, with managers of individual outlets required to invest in the centre as a minority partner owning a percentage of the business.

Pertinent data collected regarding the 2C case is summarised in Table 4.4.

| Case 2C<br>Business background                              | Interviewee background  | Expansion process  | Future plans and prospects   |
|---|---|--|--|
| <b>Year started:</b><br>1994                                | <b>Founding owner:</b><br>Yes   | <b>Years operating prior to expansion:</b><br>11 years   | <b>Clear strategy of expansion moving forward:</b><br>The owner has no specific growth strategy other than to focus on growing the membership and revenue at each of the centres   |
| <b>Structure:</b><br>Company ownership<br>Minority - Equity | <b>Position of interviewee:</b><br>Managing Director  | <b>Decision maker for business expansion:</b><br>Business owner had sole responsibility  | <b>Would consider the same method of expansion today:</b><br>While the owner was happy with the expansion strategy he chose he has not ruled out exploring licensing in the future |
| <b>No. of sites:</b><br>5                                   | <b>Shareholding:</b><br>90% Interviewee<br>10% Business partner   | <b>Reason for considering expansion:</b><br>Fear of overseas competitors entering the Australian market  | <b>Exit strategy in place:</b><br>None - no consideration has been given to any exit strategy for the case 2C owner  |
| <b>States of Operation:</b><br>Victoria                     | <b>Role prior this business:</b><br>Working in the fitness centre   | <b>Sought advice regarding the expansion:</b><br>The owner agonised over the decision to expand – consulting with his wife throughout the process  |  |
|   | <b>Circumstances leading to becoming an owner of a fitness centre:</b><br>He was working in the centre when the owner approached him to purchase the centre | <b>Strategy in place prior to expanding:</b><br>None - More of an opportunist. There was never a strategy behind the owner's expansion. Firm growth came about by being approached to purchase new sites                         |  |
|   |   | <b>Reason for selecting expansion method:</b><br>The owner was concerned he would lose control of his brand through any method other than company ownership. He also had access to capital and staff to choose company ownership |  |
|   |   | <b>Alternate organisational modes considered:</b><br>The owner briefly considered franchising but was turned off due to 'horror stories' he had heard  |  |
|   |   | <b>Had access to capital and qualified staff at the time of expansion:</b><br>Yes – At the time of expansion case 2C had both the staff and capital required to expand through a company ownership model                         |  |

Table 4.4: Summary of key details for case 2C

#### 4.6 Case study 3C

When he first decided to establish his own fitness centre, the case 3C owner was working in another company he owned. The business provided professional marketing and membership services to fitness centre owners. The company was widely recognised within the industry and the services it provided were well-utilised by centre owners across the country. The strong standing of the company was established through the achievement of large increases in membership and revenue for each of their clients over many years. Thus, the case 3C owner was widely admired amongst industry peers and was a much sought after speaker at industry events. The following provides an understanding of case 3C owner's background and how he achieved such respect in the industry.

After finishing a Commerce degree, the business owner left Australia to travel overseas. After spending some time in the United Kingdom (UK), he was offered a job selling membership and fitness related services to centre owners throughout London. The owner saw the direct impact the services he offered provided his clients. Targeted membership marketing programs had increased client numbers, improving cashflow and profits for his clients. When the opportunity presented itself to purchase a share of the Australian arm of the business, the owner seized it and returned to Australia as the co-company director. Although the business had been operating in Australia for some time, it was yet to be fully embraced by the market. Hard work turned this situation around and the business has now become the leading fitness marketing and membership service provider in the country.

The case 3C owner did not actively seek to move away from the company's core business. However, through his day-to-day business activities, he became aware of numerous centres that were struggling financially and could be bought at a good price. During this period the owner was also being approached by staff looking for career expansion. These were capable people,

each with a proven track record of aggressively marketing and growing revenue streams in fitness centres. The owner knew the value of a competent manager in establishing successful fitness centres, particularly those with good local market knowledge.

The owner described the impetus behind establishing the chain of fitness centres as follows:

*“The initial five clubs didn’t come from me writing a business plan, it came from the grass roots coming up pushing us on it and so we did.”*

The owner believed that systems run the business, but good quality people were required to operate the systems. Good people who could implement the processes and maintain standards were as much a competitive advantage as price or product. He also believed becoming an owner of a successful fitness centre enhanced his credibility in the industry, generating additional business for his marketing and membership services business. Moreover it provided the opportunity for professional development for staff wanting to build their careers.

Despite being presented with numerous opportunities to purchase existing fitness centres, the case 3C owner’s first centre came through developing a new site. The owner recalled how this came about:

*“I happened to be driving past ... there was no signage on it and I thought to myself that looks vacant. I spoke to the service station at the front and I said, mate who uses it? He said I do, I said what do you use it for? He said storage: I said what’s the rent? He told me and I shook his hand on the spot and that’s the way the deal was done. We then had the lease drawn up”.*

He consulted his business partner and they settled on the criteria to determine the location of each site. Centres would be established or bought in rural or outer suburban areas where the

accessible population was big enough to provide demand but not large enough to entice the large overseas competing chains. The owner's thinking in developing the model was to open mid-sized clubs, ranging between 300 and 500 square metres, that would generate a profit based on an average of 1,200 to 1,500 members each.

The 3C owner's Australian marketing services business was flourishing, so he had the financial means to purchase a fitness centre in his own right. He believed, however, that staff looking to enter the business should be asked to confirm their commitment by investing a reasonable amount into the business. The business owner referred to this as "hurt money" and decided managers of his clubs should be willing to wear any financial losses of the business as equally as they were prepared to accept any profit. Thus the case 3C owner offered a minority share structure, with the manager running the business making a significant investment (generally one-third of the business). With a sound mode of ownership in place and access to well-qualified, experienced staff, the owner believed he had an effective management and ownership model to acquire underperforming fitness centres. The business owner explained the opportunity offered to staff:

*"If you can put in enough hurt money to show that you're serious, we'll put in the rest of the money and we'll get you in a club and we'll do a partnership where we just split shares up, not a franchise, not a joint venture, just a standard share split up of a proprietary limited company, and we'll get you going that way".*

In-keeping with this strategy, the first club opened in the outer suburbs of Melbourne. After only six months the second club opened. The two clubs grew quickly and reached near capacity membership levels. Development of the chain however hit a plateau, with two years of dormant growth. During this period, other aspects of the marketing business were growing and additional business streams, new products and services were being developed, all of which added to the company's power to purchase and acquire new clubs. The owner explained:

*“By now we had another string to our bow, not only did we know the markets, and have a lot of good staff knocking on our door saying can we become partners? but we also had access to tier one equipment at wholesale rates”.*

This influence certainly contributed to the company’s strengthening. The following twelve months saw the business grow from two to seven clubs, all under the same company share ownership model. The expansion of the business and the strategy of opening new sites in rural locations continued through staff looking for career development opportunities. The owner summarised the development of new sites and the process that occurred as follows:

*“Staff would approach me and say; hey I’m from Horsham, I’m thinking of going home. Can we open a club there?”*

With seven clubs operating as part of the group, the owner put a hold on any further expansion. The owner’s attention had turned to yet another related revenue stream in the form of member fitness monitoring products and he did not want any distractions.

Each 3C outlet had a distinct advantage in the marketplace. Their service offering targeted the non-gym users and the fitness centres were able to establish their own footing in each of their respective local communities. Each fitness centre operated on a model of low staff and operating costs. Revenue for these clubs consistently reached \$600,000 per annum, with profit levels of approximately \$200,000.

The case 3C owner did consider franchising as an expansion mode. He was aware of the large chains of fitness centres entering the Australian marketplace and these were predominantly operating under a master franchisee or franchise relationship. However, he decided against franchising as a growth strategy for the business. While he recognised the obvious benefits of using other people’s capital to expand the business, the case 3C owner was turned off by what

he believed were the diminished financial returns a franchising structure would generate. He commented:

*“We wanted to employ the capital and we wanted to take the upside. Given that we weren’t scared of the risk, given that we had the capital and it had to go somewhere and given that we wanted the upside then ownership suited us”.*

While franchising would be helpful to a fitness centre business wishing to expand, the case 3C owner pointed out that rapid expansion for the group was not a priority. In any case he wasn’t reliant on the capital a franchisee would provide to fund new facilities. The case 3C owner stated that fitness centre franchisors operating in Australia today are receiving only \$800 or \$900 a month in royalties from each franchisee. The owner believed that a significant gap existed between the revenue he would receive through franchising when compared to that of company ownership. The owner’s calculation was validated by the above-industry average return on investment generated in the first few years by each centre.

The business owner did not worry about their having a decentralised set-up, meaning that he did not get involved in each fitness centre’s business operations on a daily basis. He believed that standards and system compliance would be maintained due to the part ownership model he had implemented with each of the centre managers. Thus, he argued, the need for monitoring was not required. He commented on the remote management style by saying:

*“They are decentralised because we run them decentralised, the guy that owns a third of the store runs the store and therefore the passion is not a problem”.*

The business owner did concede that selecting the regional locations for sites proved a challenge in terms of attracting nationally qualified and recognised instructors. However, this had more to do with location than the method of expansion the company had chosen.

Another challenge the 3C owner was anticipating was the potential of minority partners wanting more of a business share in the future. He said:

*“The strategy we chose with the ownership structure is a lot like franchising, they’ve got their balls on the line and therefore they’ve got the passion. The downfall of our model is that these guys who are coming in at the age of twenty five, owning a third, is that enough for them when they are thirty five, ten years from now to be really satisfied given that they’ve got entrepreneurial flair? The answer is probably no”.*

The business owner also recognised that if the minority partner wanted to sell their share, this could get a bit “messy”. Overall, however, he did not regret his decision to expand via the staff / minority partner method. In the foreseeable future, he said he would be turning his attention to harvesting the profits from each of the businesses rather than re-investing back into new sites. The owner summarised his position by stating:

*“We went through so much growth in such a short period of time we just want to take a breath”.*

While each of the sites were profitable from the outset, they have not returned the initial investment made by the owner. He commented:

*“We just want to let them all go through pay back which is another three or four years”.*

Case owner 3C had no immediate plans to grow the number of sites either locally or into other states and territories within Australia. However, such expansion is not totally out of the question. The owner chose to focus on recouping the initial investments on each of the clubs. He describes the financial outlook as follows:

*“I don’t think they are very liquid to start with they’re certainly not blue chip shares or property. My view is if the clubs can pay themselves back in four years then year five through to ten, we can extract the dividends and put them into passive investments like property or shares then they’re doing their job”.*

Pertinent data collected regarding the 3C case is summarised in Table 4.5.

| Case 3C<br>Business background          | Interviewee background  | Expansion process  | Future plans and prospects   |
|---|---|--|--|
| <b>Year started:</b><br>2008            | <b>Founding owner:</b><br>Yes   | <b>Years operating prior to expansion:</b><br>6 months   | <b>Clear strategy of expansion moving forward:</b><br>The owner is focussing on growing the respective membership bases of each club and recouping his initial investment rather than developing new sites |
| <b>Structure:</b><br>Company ownership  | <b>Position of interviewee:</b><br>Managing Director  | <b>Decision maker for business expansion:</b><br>Founding owner with business partner.   | <b>Would consider the same method of expansion today:</b><br>Yes - The owner believes by offering staff a small minority share they have a vested interest to perform and grow the business                |
| <b>No. of sites:</b><br>7               | <b>Shareholding:</b><br>70% Interviewee<br>30% Business partner   | <b>Reason for considering expansion:</b><br>Expansion for the owner came about through being approached by existing staff from the primary business looking for career expansion                                     | <b>Exit strategy in place:</b><br>The owner has no immediate plans to sell or exit out of the business   |
| <b>States of Operation:</b><br>Victoria | <b>Role prior this business:</b><br>Managing Director fitness marketing company   | <b>Sought advice regarding the expansion:</b><br>Decision to expand was made in conjunction with his business partner  |  |
|   | <b>Circumstances leading to becoming an owner of a fitness centre:</b><br>Opportunity to purchase a club came about through the owner's core business | <b>Strategy in place prior to expanding:</b><br>None - The initial and subsequent purchases have been by way of a direct approach  |  |
|   |   | <b>Reason for selecting expansion method:</b><br>Had access to capital and well qualified staff.<br>Staff invest financially in to the club via a minority equity share  |  |
|   |   | <b>Alternate organisational modes considered:</b><br>None - With the owner having access to capital and qualified staff, no alternate modes were considered  |  |
|   |   | <b>Had access to capital and qualified staff at the time of expansion:</b><br>Yes - At the time of expansion the owner had access to both. This was further supported by staff investing financially into the centre |  |

Table 4.5: Summary of key details for case 3C

## **4.7 Chapter summary**

This chapter has provided a narrative for each of the five expanding fitness centre business cases studied. Two of these grew through franchising and three through different company-owned forms. Results have been presented and summarised according to the motivation for expansion and the time, location and other circumstances that characterised the growth mode decision process. Implicit within these summaries are business owner characteristics and situations, as well as other factors, that had an influence on expansion decisions. This includes inferences to Dant's (1995) franchising drivers, such as resource scarcity, efficiency outcomes and agency relationship concerns.

The next chapter analyses the results with specific reference to the research questions about the degree of motivation to expand and the influence of Dant's (1995) franchising drivers within each case.

# Chapter 5

## FINDINGS AND DISCUSSION

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### 5.1 Introduction

This chapter analyses data from the case studies presented in the previous chapter. Section 5.2 provides an examination of the motivations to expand the business in each case. A rating was provided based on the scale of planned expansion and the reasons behind the expansion plans were also identified. The subsequent sections provide an evaluation of the role of each of the seven factors contained in Dant's decision framework (access to capital, access to managerial talent, access to local market knowledge, economies of production and scale, economies of promotion, economies of coordination, and in-built disincentives pertaining to agency relationships). Thus, this chapter addresses the primary research questions by analysing the significance and relevance of each Dant factor in the subject cases' expansion mode choices. The analysis also identifies other contributory factors that influenced those choices.

Similarities and differences were investigated among and between the two groups of cases (i.e. those fitness firms that selected franchising; and those that opted to grow their business through company ownership whether through organic growth, acquisition or joint ventures). Any observed irregularities or individual approaches were highlighted and analysed.

## 5.2 Motivation to expand and growth strategy

The owners in all five cases were similarly motivated to expand their business. However, each case differed in the degree or scale of planned expansion. The primary driver or motivation for expansion also varied. This is summarised in Table 5.1 below.

**Table 5.1: Scale of planned expansion and motivation for expansion**

| Case | Scale of planned expansion | Motivation for expansion   | Type of expansion pursued                  |
|------|----------------------------|--|--|
| 1F   | Large                      | Pre-empt imminent competition.                                   | Market development                         |
| 2F   | Moderate                   | Saw opportunity as a result of unique business set-up.           | Market development                         |
| 1C   | Small                      | Altruism – wanting to help friends enter the industry.           | Market penetration /<br>Market development |
| 2C   | Small                      | Acted on an opportunity to purchase existing clubs.              | Market penetration /<br>Market development |
| 3C   | Small                      | Interest as a result of staff wanting to own their own facility. | Market penetration /<br>Market development |

After asking each interviewee numerous questions surrounding their expansion strategy including the direct question ‘How many sites did you set as an ideal target?’ a scale rating was determined based on the scale of planned expansion. A scale rating of ‘large’ for planned expansion was provided to any organisation that actively sought to expand the business on a national scale. In the case of 2F, a rating of ‘moderate’ was assigned to the organisation as their focus was initially to expand the business only within two states. For cases 1C, 2C and 3C, scale ratings of ‘small’ were assigned to these single-state operated businesses, which expanded more as a result of a take-over opportunities or through the direct approach of staff or friends wanting to open their own facility.

Each of the cases provided a different motivation for expansion. For franchise cases 1F and 2F both entrepreneurs knew their business was well suited to a franchise model, with the case 1F owner wanting to establish quickly a first-to-market position to hold off impending overseas entrants. In all cases, each of the entrepreneurs appeared to show a consistent commitment to the fitness industry and becoming a success within it. Their individual motivations varied however from a sense of altruism in helping people succeed through to their own intrinsic desire for achievement.

In each of the company-owned organisations, expansion came as a direct result of being approached by an existing business looking to sell, or a staff member or friend looking for ownership opportunities. They were not under any pressure to expand the business, so expansion happened when obvious opportunities presented themselves.

As discussed in Chapter 2, Ansoff (1965) provided a valuable framework to describe the new venture growth processes that expanding organisations would typically follow: (i) market penetration; (ii) market development; (iii) product development; and / or (iv) diversification. Typically, growth of a fitness centre is achieved by either growing the number of customers within an existing location (market penetration), opening additional outlets (market development), or a combination of both. In some cases, organisations may introduce additional services and offerings to their current members (new product development) in an attempt to drive additional revenue.

In order to capitalise on their first-to-market approach, the case 1F owner embarked on a distinct strategy of entering new geographical locations (market development). Similarly, the case 2F owner also chose market development as their preferred method of growth.

For cases 1C, 2C and 3C, which grew through the opening of new sites, their focus was centred more on increasing market penetration. Each organisation's intent was to grow their respective membership bases by winning customers from their competitors or signing up new gym members by converting received enquiries to membership contracts. Introducing members to ancillary services also played a significant part for cases 1C and 3C. These services included personal training programs or weight management classes, designed to increase their customers' overall spend within the business.

### **5.3 Entrepreneurial traits and behaviour**

The individual characteristics and level of entrepreneurial orientation shown by each of the business owners had a profound influence on both the method and degree of expansion. Each of the five case owners interviewed demonstrated an ability to recognise an opportunity and locate value in either new markets or through a unique means. Each business owner actively integrated the necessary processes, partnerships or strategies to exploit the respective opportunities that were either presented to them or which they proactively sought.

In terms of opportunity identification, a significant distinction was evident between the two studied groups (franchising versus company-owned growth). The business owners who adopted a franchising mode of growth had a greater forward-looking perspective and were more proactive. Both franchisors showed a greater ability than their company-owning counterparts to anticipate opportunities, being either first-to-market or demonstrating a more proactive approach to entering new markets and growing their business. The owners who elected to grow through a company ownership model did so as a result of being presented with opportunities or being approached by friends or family.

The level of risk that each of the business owners faced when expanding their business highlighted a noteworthy difference between the respective organisational modes. The owners of cases 1F and 2F took considerably more risk than their company-owned counterparts. Both franchisors entered into situations of uncertainty, with a high degree of in-built risk and unknown outcomes. Much of the case 1F franchise group's success was due to the entrepreneurial spirit and relentless determination of the owner. From the outset, this owner demonstrated an obvious willingness to take risks in an endeavour to grow the business. Their decision to embark on a franchising strategy without any significant capital behind her, and a relatively unknown brand to sell to would-be investors, brought with it a high degree of uncertainty and level of risk. However, the owner showed foresight in anticipating the market and competing aggressively against the overseas chains through their first-to-market strategy.

Similarly, the business owner of case 2F showed that he was not risk-averse, investing significant resources in to franchising a business that was struggling financially. Despite the risky venture, however, the business owner demonstrated a strong entrepreneurial spirit and commitment to expand the business.

The highlighted level of risk both franchisors faced was in distinct contrast to the choices of the company-owned group. They preferred to grow their businesses using a less risky approach, predominately through market penetration to acquire new members. In the case of the 2C owner, the increased risk he believed franchising would bring to his business limited growth options, particularly in terms of expanding the number of sites. This owner was averse to the risk of losing control of his brand, which he saw as a distinct possibility in franchising. The company-owned business owners also sought to reduce risk by offering managers a minority share of the company. They believed that if each outlet manager made a financial commitment, they would be less inclined to shirk responsibility. This would reduce the overall risk to the owner.

Another striking distinction between the two groups was the level of innovation shown. The case 1F owner recognised a gap in the Australian market for women and so capitalised on the opportunity to establish the first women-only fitness centre to operate anywhere in Australia. The entrepreneur of case 2F showed a similar propensity to innovate through his unique target market selection and service offering. By establishing his franchise in schools and hospital sites, he had entered a market previously untapped, or even considered, by others.

The next sections discuss the study's findings with regard to each of the seven factors that Dant (1995) identified as being a driver in an organisation's decision to expand. An analysis of the importance of each factor in the cases studied is discussed, together with any other contributory factors influencing the mode of growth choice.

#### **5.4 Access to capital**

A lack of financial capital is among the earliest identified explanations for expansion through franchising (Oxenfeldt & Kelly 1969). Dant (1995) reported that 22.6 per cent of entrepreneurs who ultimately elected for the franchising option nominated access to capital as their most compelling reason for choice of growth mode. This ranked second in Dant's (1995) identified list of motivations, behind market entry and growth within.

Table 5.2 provides a rating of the Dant factor of access to capital for each case. Cases with very little resources were given a low rating. These organisations were considered unable to fund the expansion of their organisations on their own or tap traditional finance providers like banks. Medium ratings were provided to cases that had a limited supply of capital and were able to fund their expansion through debt finance or new equity investors. A rating of high was attributed to companies that had sufficient internal funds to finance their expansion.

**Table 5.2: Access to capital**

| <b>Case</b> | <b>Access to capital</b> |
|-------------|--------------------------|
| 1F          | Low                      |
| 2F          | High                     |
| 1C          | Medium                   |
| 2C          | Medium                   |
| 3C          | High                     |

#### **5.4.1 Analysis of access to capital for franchising cases**

For the owner of case 1F, the adoption of a pre-emptive strategy characterised by quick expansion was critical. The news that a major overseas competitor was about to enter the Australian market was the prime motivator to expand the organisation quickly in target locations. Without significant funds to expand the business, this entrepreneur's choice regarding the method of expansion was certainly restricted. High property rental prices in new locations and the costs required to expand the business posed major financial obstacles. The 1F entrepreneur had an existing loan and during that period the banks were hesitant to loan money to unproven fitness centres. Franchising was seemingly the only growth strategy option. Thus, for case 1F, access to capital was completely relevant and played a significant part in the growth mode decision process.

For the owner of case 2F, availability of capital was not a significant factor in influencing the selection of an expansion method. This is because 2F's business model was built around establishing numerous smaller-sized facilities that were better suited to management by independent owner-operators rather than a single company management set-up. The model was unique to the Australian fitness market, akin to a boutique business sitting between a personal training studio and a normal-scale fitness centre. These facilities required lower establishment and ongoing costs and would be seen as an attractive investment proposition for potential

franchisees. It was this operational / management requirement that drove case 2F to opt for franchising, not a lack of access to capital. In fact, case 2F offered finance to its franchisees.

Table 5.3 provides a summary of access to capital for the entrepreneurs of franchised sites, together with the importance placed on the criteria.

**Table 5.3: Dant factor - access to capital and companies that expanded by franchising**

| Case | Access to capital | Importance to decision to franchise  |
|------|-------------------|--|
| 1F   | Low               | Yes. Wanted quick market expansion but did not have access to capital.   |
| 2F   | Medium            | No. Had access to capital and was even able to offer finance to franchisees. Management requirements were more important than access to capital. |

#### **5.4.2 Analysis of access to capital for company-owned cases**

Case 1C was known as Australia’s most prestigious health club. Its brand and exclusive image were renowned throughout the industry. This financially successful business came up with the required investment whenever the opportunity to purchase a new club presented itself. Thus, access to capital for this entrepreneur did not pose any barriers at the time of their expansion.

Like many fitness centre operators during the late eighties, the case 2C owner faced some tough financial times. After many years of financial struggle, the business started returning a consistently strong profit from the early 1990s. The timing of business expansion was certainly directly linked to limited access to, and availability of, capital. Franchising was however not viewed as a possible solution as the 2C owner had serious concerns about franchising, i.e. the potential risks on his brand reputation.

Prior to opening his first fitness centre, the entrepreneur of case 3C was operating another successful business. Consequently, access to the capital required to open his first fitness centre was not a problem. For this entrepreneur, quick expansion was not paramount. He settled on a strategy of getting managers appointed to a new outlet to contribute a third of all establishment costs. Thus, this entrepreneur reduced the capital requirement for expansion. The resulting company ownership model was therefore characterised by a minority partner-manager arrangement.

The expansion of all three cases of company-owned chains focused on increasing market penetration within their initial club. Increasing membership numbers allowed the entrepreneurs to build their revenue streams. This resulted in increased profit and the ability to pay down any existing debt. This strategy also provided each entrepreneur with a greater financial capacity to purchase new sites to expand their business. Financial capacity for these entrepreneurs was further enhanced by selecting a joint-venture mode of growth for the organisation. This allowed the employee or manager to purchase a small percentage of the new site, providing additional capital to the entrepreneurs.

Table 5.4 provides a summary of each company's capacity to access capital and the importance of this in relation to the decision to stay with company ownership.

**Table 5.4: Dant factor - access to capital and companies that expanded through company-owned outlets**

| Case | Access to capital | Importance to decision to stay with company ownership   |
|------|-------------------|---|
| 1C   | High              | The owner had adequate funds to finance their partner-friends who co-owned the first additional outlets.                                    |
| 2C   | Medium            | The entrepreneur was conscious of the financial requirement to expand, as such he did not expand until access to capital could be achieved. |
| 3C   | Medium            | Not really. Managers were required to put in some equity in the co-owned outlets, giving them a financial stake in the business' success.   |

### **5.4.3 Summarising the relevance of the access to capital factor**

There is a common belief that capital scarcity during periods of tight credit will encourage franchising (Combs & Ketchen 2003). This was the case at the time of expansion for case 1F. This was a young, growing firm that wanted quick market expansion but lacked the capital required. Their limited access to capital coupled with their desire for rapid expansion was the key driver for selecting the franchise option as a growth strategy. Franchising offered an effective solution to the challenge of how to grow the business quickly without putting up any capital of their own.

Employing meta-analysis on 44 research studies, Combs and Ketchen (2003), however, found little evidence to support the hypothesis that a firm's capital scarcity is positively related to the use of franchising. Capital scarcity may play a role in an entrepreneur's initial decision to franchise but not to expand the operation once the initial base had been established (Combs & Ketchen 2003). Our findings suggest that while lack of capital can drive a company to franchise, not all companies will franchise just because of a lack of capital, as with case 1F. While access to capital was a consideration for 2F it was shown not to be a driving factor in selecting the growth strategy.

None of the company-owned case studies sought quick market expansion. In addition, the acquisition of new sites was never a part of their agenda. At some point or at all stages of their expansion, the company-owned businesses raised capital and addressed any agency theory concerns by offering a minority share in the business to a manager who would effectively treat the business as their own. Thus, an alternative to franchising was chosen.

For the business owners who ultimately elected to maintain company ownership as their method of organisational growth, capital availability (or lack thereof) was not enough of a motivation to

drive them toward franchising. Their moderate growth ambitions required low capital investment, if additional funds were at all required.

## 5.5 Access to managerial talent

In addition to financial capital, qualified managerial personnel are another critical resource required by growing businesses. Dant (1995) found that the majority of the sample agreed with the survey statement: ‘franchising saves money by delivering capital and labour from the same source’.

Table 5.5 provides a rating against the Dant factor of access to managerial talent for each case. Cases with no immediate access to qualified, experienced staff at the time of expansion were given a low rating. Medium ratings were provided to cases that had limited access to managerial talent or could acquire a qualified pool of talent with ease. A rating of high was attributed to companies that had qualified, experienced staff at their disposal.

**Table 5.5: Access to managerial talent**

| Case | Access to managerial talent |
|------|-----------------------------|
| 1F   | Low                         |
| 2F   | Low                         |
| 1C   | High                        |
| 2C   | Medium                      |
| 3C   | High                        |

### 5.5.1 Analysis of access to managerial talent for franchising cases

For case 1F, prospective expansion sites extended well outside of their existing network. Therefore, it became clear that qualified managerial talent would need to be recruited by the company. However, the distance to the proposed sites made recruitment difficult. Once the decision to expand was made, attention quickly turned to the best mode of expansion. Opening new sites presented a formidable challenge, with limited capital available coupled with the inability to recruit qualified staff. For this operator, franchising presented an effective solution to lack of both capital and managerial resources.

For case 2F, the lack of available managers was a critical issue. Numerous managers were required for the many boutique-type fitness studios needed to generate sufficient revenue.

Table 5.6 provides a summary of access to managerial talent for the entrepreneurs of the franchised sites, together with the importance placed on the criteria in the decision to franchise.

**Table 5.6: Dant factor - access to managerial talent and companies that expanded by franchising**

| <b>Case</b> | <b>Access to managerial talent</b> | <b>Importance to decision to franchise</b>                         |
|-------------|------------------------------------|--|
| 1F          | Low                                | Critical. Wanted quick expansion but did not have access to staff. |
| 2F          | Low                                | Critical. Business model required managers to run numerous sites.  |

### **5.5.2 Analysis of access to managerial talent for company cases**

The case 1C entrepreneur had a number of existing qualified staff who could run the new business. Although the newly acquired site was well staffed with highly capable personnel, having access to a significant pool of qualified managerial talent from the existing centre offered a certain level of assurance. After the purchase of the new business, the staff of the newly acquired site were offered the opportunity to retain their existing positions under the new ownership.

In the case of 2C, the distance between the entrepreneur's first acquisition and his initial club was significant, at almost 50 kilometres. This meant that staff from the existing centre were unlikely to travel to the new site. Although the entrepreneur had access to some good quality, reliable staff, who would be more than capable of running the new acquisition, the difficulties of travel deemed this an unlikely scenario. Thus, the entrepreneur proposed to the existing manager of the newly acquired centre that he put a small amount of capital into the business and manage the site as a partner.

Already operating a related business with qualified, industry experienced professionals, the owner of case 3C had access to a significant pool of managerial talent looking to further their careers. These well qualified staff would ultimately run the business as their own.

Table 5.7 provides a summary of access to managerial talent for the entrepreneurs of the company-owned sites, together with the importance placed on the criteria.

**Table 5.7: Dant factor - access to managerial talent and companies that expanded through company-owned outlets**

| Case | Access to managerial talent | Importance to decision to stay with company ownership  |
|------|-----------------------------|--|
| 1C   | High                        | Takeover of existing site meant a pool of available talent were available.   |
| 2C   | Medium                      | Offering a minority partnership to existing staff meant the entrepreneur had immediate access to a hands-on manager. |
| 3C   | High                        | Had access to a pool of well-qualified, experienced staff.   |

### 5.5.3 Summarising the relevance of the access to managerial talent factor

Both franchising cases 1F and 2F did not have access to managerial talent and therefore needed to recruit additional managers / operators to run new outlets. Thus, the Dant factor of access to managerial talent was deemed critical in their decision to expand via franchised outlets.

As for the company ownership cases, cases 1C and 3C did not have difficulty in tapping into existing staff resources to operate new outlets. Thus, franchising in relation to providing a source of new outlet managers was not really considered. As for case 2C, the lack of managerial talent was addressed by offering the existing managers part-ownership of the business, thus assuring commitment to the company.

### 5.6 Access to local market knowledge

One of the resources often cited by entrepreneurs as a specific requirement for opening new sites is the need for human capital that could contribute a wealth of reliable local market knowledge (Dant 1995). For organisations expanding into new geographical locations, having access to well-connected, community-focused staff offers significant advantages. An

understanding and involvement within the local community may benefit an organisation through site selection, lease negotiations, community partnerships and cross-promotional opportunities. Thus, resource scarcity encourages franchising as franchisees who sign-up offer the expanding organisation valuable local market knowledge, allowing businesses to better identify suitable geographic locations and local market conditions (Minkler 1992).

Table 5.8 provides a scale rating for each of the five cases in regards to their access to local market knowledge at the time of expansion. A low rating was assigned to organisations that considered the factor important but did not have any access to such local knowledge. Medium ratings were provided to those organisations that could draw upon local market knowledge in a limited capacity. Organisations that recognised the importance of the resource and proved to have good access to local market knowledge were given a rating of high.

**Table 5.8: Access to local market knowledge**

| <b>Case</b> | <b>Access local market knowledge</b> |
|-------------|--------------------------------------|
| 1F          | Low                                  |
| 2F          | Medium                               |
| 1C          | High                                 |
| 2C          | Low                                  |
| 3C          | High                                 |

### **5.6.1 Analysis of access to local market knowledge for franchising cases**

For the case 1F owner, the growth of the brand relied heavily on the success of the individual businesses driven by independent owner-operators. This entrepreneur recognised that a strong connection and involvement with the local community was critical for business success. People who knew the area intimately and were involved in the local community would be ideal franchisees, attracting new members through local connections.

The founder of case 2F believed strongly in having local people with local market knowledge operating their own business. Supported by head office, the franchisees were encouraged to get involved in all aspects of the business from the outset. This included site selection, lease negotiations, centre fit out, presale marketing and local community engagement. These aspects were critical to the success of the business.

Table 5.9 provides a summary of access to local market knowledge for the entrepreneurs of franchised sites, together with the importance placed on the criteria.

**Table 5.9: Dant factor - access to local market knowledge and companies that expanded by franchising**

| Case | Access to local market knowledge | Importance to decision to franchise  |
|------|----------------------------------|--|
| 1F   | Low                              | Lacked this critical resource to achieve goal of rapid expansion. Franchising provided a solution.   |
| 2F   | Medium                           | Had a business development model that was dependent on an owner / operator who was well-connected within the community. Therefore this was of considerable importance in choosing franchising. |

### 5.6.2 Analysis of access to local market knowledge for company cases

As a stalwart of the fitness industry, the entrepreneur of case study 1C believed they knew the Australian fitness market intimately. The owner believed local market knowledge was important but it was not a mandatory requirement for the partnerships they developed. Having run one of the country's most successful centres, this entrepreneur believed that they would know intuitively what constituted an ideal location. The owner believed that entering into a partnership with someone who had significant local knowledge was not as important as managerial talent qualities and fitness industry experience.

For the owner of case study 2C, access to local market knowledge did not play a significant part in selecting the method of expansion. His strategy of having a manager who had financially invested into the business was, he believed, effective enough to create a successful pathway. Having invested financially into the business, the entrepreneur believed the manager would be significantly motivated to immerse themselves within the local and broader business community, enhancing the reputation of the business and developing partnerships and cross-promotional opportunities.

Prior to opening his first fitness centre, the owner of case study 3C had been running a fitness consultancy for many years. His business delivered sales and marketing services to centres across metropolitan and regional centres throughout Australia. Believing he knew the industry well enough to overcome any specific nuances in local market conditions, he placed little emphasis on the requirement for staff with specific local market knowledge.

Table 5.10 provides a summary of access to local market knowledge for the entrepreneurs of company-owned sites, together with the importance placed on the criteria.

**Table 5.10: Dant factor - access to local market knowledge and companies that expanded through company-owned outlets**

| Access to local market knowledge |        | Importance to decision to stay with company ownership  |
|----------------------------------|--------|--|
| 1C                               | Medium | Did not worry about this resource due to owner's experience and connections.                               |
| 2C                               | Low    | Did not worry about this as owner retained the existing manager to continue operating the acquired outlet. |
| 3C                               | High   | Not seen as important as owner had extensive and wide-reaching fitness industry experience.                |

## **5.7 Summarising the relevance of the access to local market knowledge factor**

Franchisees are often seen as a valuable source of local market knowledge, particularly when selecting an additional site in new geographic locations. For cases 1F and 2F, however, having access to managers with strong local market knowledge, particularly relating to community connections, was a critical factor in franchising their business. Both businesses believed in having a well-connected owner-operator who was involved in and knew the local community intimately. Local area marketing of their initial centres had proven successful for both operators and each knew the value local marketing and relationships would bring to the business.

In the company-owned cases, no significant emphasis was placed on appointing managers with local market knowledge and this was not a significant factor in determining the growth strategy. The resource was thought to be provided by the owners of case 1C's and 3C's industry experience, whereas with 2C, rehiring managers of acquired outlets addressed any deficiency. While each of the company-owned cases believed that community connection and local market knowledge was important, it was less important than appointing a manager with strong managerial, sales or marketing skills.

## **5.8 Economies of production and scale**

Franchisors recognise the value of production economies and, in many cases, insist that franchisees purchase certain items directly through the franchisor. This allows for production in larger scale, driving unit costs down.

### **5.8.1 Analysis of the economies of production and scale factor for franchising cases**

The economies of production and scale and the consequent generation of additional revenue streams did not appear to be important for 1F in selecting franchising. However, franchisees entering the system could leverage off the group's buying power to purchase equipment, merchandise and many retail products. For 1F, the introduction of their weight management products resulted in economies of production and scale benefits. Weight management drinks and related items were manufactured through head office suppliers, delivered to the franchisor and on-sold to the franchisees. These increased volumes created bargaining power, allowing for negotiation with suppliers for better pricing.

Economies of production and scale did not appear to be a primary consideration for case study 2F in choosing franchised outlets as the mode of growth. In both cases of franchised businesses, the companies were unsure of the extent and success of their expansion strategy, thus greater consideration was placed on other expansion criteria.

A summary of the availability of economies of production and scale is provided below in Table 5.11, together with the importance placed upon the factor regarding the decision to franchise. Note that previous tables referring to Dant's factors of access to resources included a column on the availability of the subject resource to each case. This is no longer appropriate with the other factors (efficiencies and agency relationship concerns) as their relevance are not related with current access or availability to the business but these factors' perceived impact to business success.

**Table 5.11: Dant factor - achieving economies of production and scale and companies that expanded by franchising**

| Case | Importance to decision to franchise  |
|------|--|
| 1F   | No consideration was given to this criterion. Other factors were deemed more important. However, the group benefitted from economies of scale with the introduction of sale of merchandise items. Bulk purchasing delivered some advantages. |
| 2F   | Did not play a part in their decision to franchise. It was overlooked at the time of expansion.  |

### 5.8.2 Analysis of the economies of production and scale factor for company cases

For case 1C, economies of production and scale were not really a consideration when choosing to stick to company-owned expansion. As for case 2C, business expansion was through the purchase of already established centres. Thus, with equipment in place, economies of scale with purchased items did not matter. There were also no ongoing consumable or merchandise items.

Case 3C was already an accredited fitness equipment dealer and benefited from the economies that this status provided. Case 3C enjoyed dealer rates and their purchasing power was enhanced with the establishment of new outlets needing to be equipped. This made their expansion through new outlets more feasible as equipment is the single largest expense in establishing a fitness facility.

Table 5.12 below provides a summary of the importance of economies of production and scale in staying with the company ownership mode.

**Table 5.12: Dant factor - achieving economies of production and scale and companies that expanded through company-owned outlets**

| Case | Importance to decision to stay with company ownership  |
|------|--|
| 1C   | Economies of production and scale did not play a part in the decision to grow the business via company ownership.  |
| 2C   | No consideration was given to this factor. It was not relevant due to the business model of purchasing already established outlets.  |
| 3C   | As a dealer of fitness equipment (the largest investment item), they did not require better costing as they already enjoyed preferential pricing. Their expansion increased their sales of equipment, thus enhancing their bargaining power. |

### 5.8.3 Summarising the relevance of the economies of production and scale factor

Oxenfeldt and Kelly (1969) first raised the debate over why firms franchise. They argued that young, small expanding firms will use franchising as a method of expansion until they reach the required size to generate economies of production and scale. When economies of scale already exist within an organisation, the incentive to seek franchising as a strategy for rapid growth is removed.

For the two businesses that selected franchising, economies of production and scale did not represent an important factor in the growth mode decision process. This was true even if they could have benefited through the greater scale of their expansion plans. With case 1F, their outsourced nutritional products benefitted from scale economics, but this came later, after the decision to franchise had been made.

No significant emphasis was placed on economies of scale by any of the cases interviewed in determining organisational form choice. Of the five cases, only case 3C benefited from any economies of scale at the outset of expansion. So, with very good costing already being

enjoyed, there was no incentive to look at a franchising option from an economies of production perspective.

While case 1F ultimately recognised the opportunity and potential for franchisees to buy nutritional products directly through them, they did not see such a strategy as an important factor in the initial growth mode selection.

## **5.9 Economies of promotion**

A variety of efficiency justifications have been said to entice entrepreneurs towards franchising as an effective business growth strategy for an expanding organisation. Economies of promotion allow franchisors to benefit from national promotional and advertising activity. Franchising makes possible the opening of more outlets in a relatively short period of time. Total promotional and advertising costs are therefore spread over a number of outlets thereby lowering the per outlet cost throughout the business. Company-owned outlets might also benefit from such cost savings, if they establish a large number of outlets in a relatively short time.

### **5.9.1 Analysis of the economies of promotion factor for franchising cases**

The case study 1F owner realised the benefits of opening new sites in clusters to capitalise on economies of promotion, but this was not considered to be important in making the expansion mode decision. Ultimately, as the group and number of outlets grew, the franchisor would achieve these economies by reaping the benefits of group advertising rates within print, radio and electronic media.

The entrepreneur of case study 2F believed that individual owner-operators with local marketing knowledge provided the most appropriate means for setting-up his business sites. These independent franchisees would promote their business and drive membership at a local level. While not a factor in the initial stages of development, economies of promotion became more appreciated as the group expanded. The company benefited from economies of national promotion through a shared website, radio and print promotion.

Table 5.13 below provides a summary of the importance of economies of promotion as a factor in the decision to grow through franchising.

**Table 5.13: Dant factor - achieving economies of promotion and companies that expanded by franchising**

| Case | Importance to decision to franchise   |
|------|---|
| 1F   | Was not an initial consideration in the choice of growth mode.              |
| 2F   | Was not an initial consideration, other factors were deemed more important. |

### 5.9.2 Analysis of the economies of promotion factor for company cases

Similar findings were seen with the company-owned cases. Economies of promotion did not play an important part in the decision-making of the case 1C owner when expansion of the business presented itself. Reacting to opportunity rather than following a specific growth strategy, the case 1C business grew without deliberate long-term planning, motivated as it were by the entrepreneur wanting to help others enter the industry and start their own business. No consideration was ever given to promotion economies in determining organisation mode.

Similarly, economies of promotion played no part in the decision process for the method of growth for case 2C. Each new outlet was run on its own merits, with individual membership prices and their own separate marketing and promotional campaigns. Case 2C's marketing strategy was clearly focussed on the retention of existing members. Boasting a retention rate in excess of 70 per cent, the owner believed if members enjoyed and used their gym membership regularly, not only would his centres be constantly busy, but the ongoing chase for new members and extensive marketing would not be required. He believed member retention would remain strong and members would be likely to introduce their friends to the centre.

Prior to opening the fitness centres, the owner of case study 3C was operating a fitness marketing company, providing telemarketing and lead generation services to Australian fitness centres. Drawing on this related service, the owner was able to leverage economies of promotion by tapping into this telemarketing service. Further, quick expansion from two to seven clubs within twelve months allowed the business to capitalise on group promotion efforts and thus benefit from scale economies. Like the other two company-owned cases, however, this benefit did not play any part in the choice of growth method.

Table 5.14 below provides a summary of the importance of the economies of scale in staying for the three cases with company ownership modes.

**Table 5.14: Dant factor - achieving economies of promotion and companies that expanded through company-owned outlets**

| <b>Case</b> | <b>Importance to decision to stay with company ownership</b>     |
|-------------|--|
| 1C          | No consideration was given to such criteria.                     |
| 2C          | Factor was not a consideration in expansion.                     |
| 3C          | Knew and realised the benefits that group promotion could offer. |

### **5.9.3 Summarising the relevance of the economies of promotion factor**

Of the cases studied, only case 3C started their expansion with any thought of the possibilities that economies of promotion could offer the business. Operating a substantial lead generation and sales company, the entrepreneur was able to capitalise on these economies with existing benefits. While the case 1F owner did not expand the business with the idea of what promotional economies could bring the group, they did capitalise on such a strategy once a critical mass of group outlets was achieved. Cases 2F, 2C and 1C operated their businesses on a local basis, preferring to concentrate on local community marketing and promotion activities. Economies of promotion were not a driving factor for these entrepreneurs in deciding to expand their businesses or in selecting a growth strategy.

### **5.10 Economies of coordination**

Franchising is often seen as an effective method of governance, which minimises the cost of maintaining standards and quality control. While risks are present in any new business venture, franchising often limits some of the concerns independent businesses carry. The established brand awareness, franchisor operating procedures, and ongoing support assist franchisees in establishing their business under a successful business model. The appeal of buying an established system and operational procedures means franchisees are less likely to change or divert from the franchise system. This reduces any coordination costs for head office.

#### **5.10.1 Analysis of the economies of coordination factor for franchising cases**

Maintaining standards and quality control was not seen as an important factor for case 1F in the initial expansion of the business. Referring to the first group of franchisees as ‘the Dirty Dozen’, this entrepreneur wanted quick market expansion without much thought of potential risks. Thus

coordination (to govern properly) was not a priority. The entrepreneur recognised that the first of the group's franchisees were not necessarily the best operators, but he wanted to reach critical mass as soon as possible to ward off new entrants into the fitness market. Following the initial expansion, the entrepreneur knew that branding guidelines, quality control and compliance needed to become a critical focus for the group moving forward. This period of company growth saw the introduction and monitoring of a standards manual and a non-negotiable set of standards for individual operators. During this period, many sites changed hands, with several of the first 12 franchisees being bought out by head office.

With case 2F, the franchisees operated in more of a licence arrangement rather than a typical franchise system in terms of branding, systems and standards. Within the group there was no national blanket marketing, co-ordinated promotional campaigns or consistent pricing across each of the centres. Taking into account localisation, the individual owner operators were given a level of flexibility by the franchisor, to run the centre and their operation without any rigid protocols or compliance standards. Thus, coordination was not intensive and was not a great cost burden in the 2F system.

**Table 5.15: Dant factor - achieving economies of promotion and companies that expanded by franchising**

| <b>Case</b> | <b>Importance to decision to franchise</b>   |
|-------------|--|
| 1F          | Knew the benefits economies of coordination would bring the business, but was not a factor in decision to franchise. |
| 2F          | Factor was not a consideration in determining business growth mode.  |

### **5.10.2 Analysis of economies of coordination for company cases**

The business owner of case 3C knew that having qualified, experienced staff in their centres would help maintain their expected level of quality. With each of their managers making a small financial investment into the business, these franchisors knew that high monitoring costs, time-consuming centre visits, and ongoing management would not be necessary. For this business owner, the consideration of economies, while beneficial, was not an important factor in selecting their method of expansion.

Integrity of the brand drove the decision behind case 2C's choice of growth strategy. Not wanting to put 'strangers' into a club as a franchisee, control of the brand has been and remains one of the most critical factors behind all decisions regarding the business. With consistency of the brand being of such importance, this entrepreneur insisted that each manager not only had a financial stake in the new site but also served an induction or extensive training period under the entrepreneur's guidance. For this owner, maintaining control of the brand was paramount. Thus, economies of coordination were not a consideration or driving factor.

With no specific strategy behind expansion of the business, the entrepreneur of case 1C never directly considered the benefits of economies of coordination. Growth of the business came about through altruism and the development of partnerships and investments to assist those in need. While many years later the entrepreneur unsuccessfully attempted to establish the business as a franchise, economies of coordination were never realised or capitalised upon.

**Table 5.16: Dant factor - achieving economies of coordination and companies that expanded through company-owned outlets**

| <b>Case</b> | <b>Importance to decision to stay with company ownership</b>                                  |
|-------------|---|
| Case 1C     | Coordination economies were not a consideration and were overlooked at the time of expansion. |
| Case 2C     | Was aware of the factor but was not seen as important.  |
| Case 3C     | Did not play a part in the decision process.  |

### **5.10.3 Summarising the relevance of the economies of coordination factor**

Economies of coordination did not play an important role in selecting the method of growth mode for any of the company-owned cases. Coordination costs arise from coordinating outlet activities. For the company-owned outlets, each operated as a stand-alone business with an invested manager. This eliminated any need for ongoing quality control or managerial coordination.

For case 1F, as the organisation grew and the number of franchised units increased, the coordination by the franchisor also amplified. Head office ultimately oversaw the membership, IT and direct debit departments of the franchisees. The centralising of these key areas was made possible by the economies of coordination the business offered.

The owner of case 2F was content to let franchisees run their businesses like they would in a licence arrangement. Without any stringent compliance or branding requirements there was no need for head office to incur any high coordination costs.

## **5.11 In-built disincentives with agency relationships**

It is a common view that managers of company-owned businesses are likely to shirk their responsibilities because their compensation is fixed. This shirking results in high monitoring costs for the firm, to ensure that managers act in the firm's best interest (Elango & Fried 1997). Principals hire middle managers to ensure agents are acting in the principal's best interests (Jensen & Meckling 1976). If firms can keep these monitoring costs down, it is more likely they will open company-owned outlets (Gills & Castrogiovanni 2012).

The direct correlation between a franchisee's earnings and the profitability of the business is said to explain the motivation for franchisees to work hard. This, in turn, potentially eliminates any agent ignoring problems the owner may face or shirking their responsibilities.

This study investigated whether there were important concerns about responsibility avoidance and how this might influence the expansion mode choice.

### **5.11.1 Analysis of the factor of in-built disincentives with agency relationships for franchising cases**

For the owner of case 1F, one of the main reasons in selecting the franchising growth strategy was to address concerns of agent shirking. This entrepreneur could not see how they were going to manage staff in multiple regional locations. The owner worried whether they would have staff who shared the same passion and enthusiasm for the business. The owner believed that hired staff would naturally have a different mindset that might not be good for the business.

Case 2F knew that franchising was the way forward for his organisation. He knew such a growth strategy would provide the business with independent owner-operators, caring about

their business and making sure members got the best service. Franchisees would become involved in the local community, something that the entrepreneur believed staff within a company-owned environment would not do. This was because, effectively, the owner-operator would receive a return that was directly based upon how much they were putting into their business.

Table 5.17 indicates the level of concern the entrepreneur had about agent shirking, as well as the importance placed on this criterion in deciding to grow the business through the franchising growth mode.

**Table 5.17: Dant factor - disincentives with agency relationships and companies that expanded by franchising**

| Case | Importance to decision to franchise   |
|------|---|
| 1F   | Knew they needed committed operators and therefore saw franchising as a solution. |
| 2F   | Knew the business would perform better with franchisees as independent owners.    |

### **5.11.2 Analysis of the factor of in-built disincentives with agency relationships for company cases**

For the owner of case study 1C, the thought of agents shirking responsibility did not figure highly in selecting a method of expansion for the business. With each new site acquisition, the owner had a manager or business partner who had to invest financially into the business. Thus, through this strategy the owner was comfortable to expand their operations, knowing that the agent shirking problems that motivated many franchisors would not be present.

In considering expansion plans, the case 2C owner worried about the need for monitoring sites and staff across the country. Initially with only a small management team, the owner of case study 2C knew managing sites throughout multiple states and regional locations would be exceptionally challenging. Additionally, he believed his business model relied on the manager of the business being a strong personality within the centre. It was paramount, the entrepreneur believed, for the manager to have a stake or some ownership of the business. This would give them the extra incentive that would make the difference between people joining the centre or not.

For the owner of case study 3C, growth of the business came through staff of his existing business wanting to get involved in their own fitness centres. These staff members were satisfied with having a small ownership share and to run their own centre. This entrepreneur likened his ownership structure to franchising, saying:

*“they have invested financially, so they have the passion”.*

Agent shirking was a definite consideration for the entrepreneur of case study 2C. He knew the importance of having a manager who was as committed to the business as he was. With significant distance between the sites, this entrepreneur knew the challenges and high costs of monitoring an agent. The entrepreneur knew if the new business acquisition was to be a success, he needed a financially invested manager running each business outlet. Thus, he negotiated and settled on a minority partnership model that he believed would alleviate any agent shirking issues.

Table 5.18 provides a summary of the level of concern about agent shirking, together with its degree of importance in influencing the decision to stay with company ownership as a mode of growth.

**Table 5.18: Dant factor - disincentives pertaining to agency relationships and companies that expanded through company-owned outlets**

| Case | Importance to decision to stay with company ownership   |
|------|---|
| 1C   | Factor was neutralised through a partnership model that established a financial investment from the new outlet manager. |
| 2C   | The minority ownership structure was employed to avoid any shirking issues.   |
| 3C   | Part ownership model offered security against shirking by outlet manager.   |

### **5.11.3 Summarising the relevance of the in-built disincentives with agency relationships factor**

The ownership structure establishing a minority interest for the outlet manager was common with the company-owned sites. By offering a share of the business and establishing a partnership with each outlet manager, all the owners in the company-owned cases group were confident that shirking would be minimised. This eliminated the need to appoint any additional staff or intermediary to monitor manager behaviour and performance. As with franchised outlets, the manager would be driven by the success of the organisation as they would consider the outlet business as their own. These managers / partial owners could also be expected to work hard in maintaining quality standards to protect the group brand and overall business.

With the franchised businesses, the principal-agent challenges were an important consideration, although they may not have been the primary motivating factor for choosing the organisational form. Similarly, with the company-owned cases, it was an important enough factor that part ownership was offered to appointed outlet managers.

## 5.12 Other factors favouring expansion by franchising

The third research question in this study asks whether there are other factors apart from the seven in the Dant (1995) framework that will favour adopting franchising as an organisational growth mode. This study has determined that the scale of planned expansion in the cases studied showed a direct link with the choice of growth method. For the two organisations that selected franchising, both wanted moderate or large scale expansion, with outlets in multiple sites throughout Australia. This was in distinct contrast to businesses grown through company ownership, with owners generally content with limited geographical expansion. The current number of outlets is also revealing as to the extent of expansion ambition: 77 and 65 for the two franchised cases respectively and for the three with company-owned outlets, only eight, five and seven.

Results from the study also revealed an emerging theme centred on firm age for each of the five cases. The study showed that, on average, business owners who elected to franchise expanded their businesses earlier than those using the company-owned model. Franchisors expanded their businesses after an average of two and a half years. This was in distinct contrast to company-owned firms, which took, on average, more than eight years to expand their business through their first acquisition. The findings regarding firm age were consistent with several theories within the existing literature, which argues that younger firms may have a greater propensity to franchise while resources are limited. It was also found that younger firms tend to have more entrepreneurial characteristics, as suggested by the existing literature (Luo, Zhuo & Liu 2005) as elaborated on below.

One further emerging theme was that franchisors appeared to be more entrepreneurial than their company owner counterparts. The franchisors demonstrated a proactive and innovative approach to business development and expanding their firms. This was in contrast to the

company owners, who seemed merely to react to opportunities rather than creating them. They acted only as a result of being approached by staff, or wanting to help friends or competing business owners looking to sell their businesses. The risk-taking behaviour of franchisors when expanding their business seemed to be significantly more pronounced than that of company owners.

### **5.13 Chapter summary and addressing the study's research questions**

Dant (1995) summarised the seven primary reasons purported to direct growing businesses into franchising by categorising each into three distinct categories: resource constraint arguments (Oxenfeldt & Kelly 1968); efficiency justifications (Caves & Murphy 1976); and agency relationship concerns (Rubin 1978).

The first two of three research questions in this study refer to (1) the relevance of each of Dant's factors in driving growth-orientated fitness firms in adopting franchising and (2) possible explanations for the significance attributed to each factor.

Findings from this study are consistent with Dant's hypotheses indicating resource scarcity to be a significant factor influencing the choice of organisational growth mode. The study found that in general the less the access to financial capital, managerial personnel to operate the new sites and local market information, the greater would be the propensity to grow using franchised outlets. These resources must be in place if business expansion is to be successful. Those that adopted franchising were also focused on opening new sites (market development) and so these resources needed to be obtained within a shorter time frame.

For the franchised outlets cases, not all three resources needed to be lacking at the time growth was being planned. Access to capital was available with one of the cases but this company still adopted franchising as it provided the necessary managers which it did not have ready access to. Thus it seems that for companies seeking substantial growth in a shorter period of time (more on this expansion ambition factor later) an acute lack of access to one of Dant's resources in particular financial capital or managerial personnel to operate the new sites would be enough to push these businesses towards the use of franchising.

As for the company-owned outlets cases, it seems that in general the presence of Dant's resources reduced their propensity to consider franchising. They may not have the resource(s) at the time needed but they found a way to remedy the deficiency. For example, in case 2C, lack of managerial talent was addressed by the rehiring of the manager of acquired fitness centres.

The study found efficiency justifications were not a significant factor in driving the choice of growth mode. Although production and scale economies were eventually enjoyed to a certain extent particularly by 1F and 3C, with all cases the benefits of scale economies did not influence the decision to expand or the choice of growth mode. A possible explanation that could account for these findings would be related to the sample on which Dant (1995) identified efficiency justifications that favour franchising. Firstly, Dant's sample consisted of US franchised systems where the average number of franchised sites (150) was double than what was achieved by the two franchised fitness businesses (71). The samples may have been on different scale so that the substantial economies could not have been possibly contemplated nor possibly realised with the studied fitness cases.

Agency relationship disincentives, the third set of Dant (1995) factors, proved to be a significant concern with the franchised outlets businesses. The business owners recognised that it was

critical to recruit the right people who would drive the business as their own. The start-your-own-business promise of the franchising model therefore helped in recruiting franchisees which could be a challenge particularly for remote geographical locations, and importantly it also provided some assurance to the franchisors of outlet operators' commitment to business success.

Agency related disincentives were also a major worry for the owners of the company-owned sites. All three cases addressed the issue by offering outlet managers a share of the business. Through this arrangement, potential agent shirking issues could be avoided as operating managers have a financial stake in the success of the outlets.

In answer to the third research question, the following additional factors which were not in the Dant (1995) framework were found to be characterising those fitness businesses that opted for growing through franchised outlets:

1. Larger extent of planned expansion indicated by a much larger number of new sites and located not just in one city but throughout Australia;
2. Firm age on the eve of expansion, franchisors expanded earlier in their history;
3. A proactive, entrepreneurial attitude in seeking and exploiting growth opportunities, rather than simply reacting to incremental options that came up.

The next chapter presents the conclusion of the research.

# Chapter 6

## CONCLUSION

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### 6.1 Introduction

In this research, key aspects of growth strategies in the Australian health and fitness industry were investigated. Specifically, research was conducted into the factors that entrepreneurs considered when faced with the task of evaluating the most beneficial growth strategy for their expanding organisation.

The research approach was to evaluate the seven key criteria identified by Dant within the franchising literature to determine if they were relevant to growth-orientated organisations in the Australian health and fitness industry. The research questions the study sought to answer are:

1. How relevant is each of the seven factors identified by Dant in the choice of franchised versus company-owned outlets?
2. What could account for the significance attributed to each Dant factor?
3. Are there other factors that will drive a business owner to franchise their business as an organisational growth mode?

The thesis consists of six chapters. Chapter 1 presented an introduction to the study and provided the reader with an outline of the research project. Literature surrounding the

significance and alternate methods of organisational growth as a field of study were then highlighted and discussed in Chapter 2. Chapter 3 discussed the research framework used to address the research question. The chapter introduced the reader to Saunders, Lewis and Thornhill's (2011) research onion model, which provided the basis for the research methodology design.

Data collection was conducted using the established research framework established. Chapter 4 then presented the results of each of the five separate cases within the study and subsequently the findings of the study were presented in Chapter 5. The seven key criteria identified by Dant within the franchising literature were evaluated to determine if they were relevant to Australian growth-orientated organisations in the Australian health and fitness industry. This final chapter outlines the theoretical and practical contributions of the research, as well as the limitations of the study and future research recommendations.

## **6.2 Theoretical contributions**

A significant contribution of this thesis lies in the investigation of Dant's franchising decision criteria to determine their relevance and influence in the Australian health and fitness industry context. Summarising the franchising literature, Dant (1995) reported that seven primary reasons had been purported as motivators pushing growing firms in the direction of franchising. These seven reasons were thematically classified as: (i) resource constraint arguments; (ii) efficiency justifications; and (iii) agency related reasons. Within these classifications, motivations were listed as: (1) access to capital; (2) access to managerial talent; (3) access to local market knowledge; (4) economies of production and scale; (5) economies of promotion; (6) economies of co-ordination; and (7) in-built disincentives pertaining to agency relationships.

The study's theoretical contribution, could be described as the identification of the conditions by which the Dant factors become decisive drivers in the adoption of a franchised system as the vehicle of growth. For example, while the resource constraints were present with most cases, it was not only the deficiency of financial, managerial and informational resources that drove businesses to franchising, the extent of expansion ambition matters. Those that desire larger expansion (geographically and in number of outlets) perhaps because of the substantial resource requirements would tend to adopt franchising. This addresses the research question of identifying other factors in play that contribute to the influence of Dant's factors. Secondly, the firm age is a factor, with those which franchised being younger than their company-owned outlets counterparts. This has been attributed to younger firms possibly being more ambitious. Lastly, evaluating the entrepreneurial traits of the business owners showed that the more proactive and risk-taking the owner, the more likely the firms were to franchise their business.

The study also found that while efficiency justifications (economies of scale, promotion and coordination) were considered important to some extent by each of the business owners, they were not weighty enough to influence the choice of organisational growth mode. In the franchise cases, this sense of the factors' importance was only really appreciated when the expanded scale of business was reached.

Agency relationship disincentives were a concern for all cases. For the franchising cases, it was an important consideration in deciding their growth mode. For the company-owned cases, they addressed these concerns by establishing a minority interest scheme with their new outlets whereby an operating manager was required to put up a financial interest in the new site thus assuring their commitment to business success. This establishes that agency concerns are not possibly addressed by non-equity modes of growth alone such with franchising but through variations of equity-based arrangements such as majority-owned joint ventures.

To summarise the study's theoretical contribution lies in the qualification of Dant's franchising decision factors, evaluating how relevant these are as well as identifying and understanding specific circumstances when they will matter enough. These findings were made possible by the employment of qualitative methodology allowing in-depth investigation of cases studied and the particular history and circumstances that characterise each. The study also established that the growth mode alternatives are not just franchised or wholly-company owned outlets but also joint ventures where the principal company maintains majority ownership but directing operating managers of acquired or newly established sites to get past agency problems while enjoying profit benefits that franchised systems promise.

### **6.3 Practical implications**

As a contribution to practice, this study provided detailed narratives of owners of fitness businesses who tackled a range of personal and business challenges to grow their enterprises. Developing their business in a competitive environment and often struggling with lack of required resources, the owners in this study's cases provide inspiring lessons of perseverance to current and prospective business starters not only in the fitness industry but in general, to founders of entrepreneurial ventures. In addition, by describing the context by which growth decisions were made, practitioners could possibly view similar situations they face through a more informed perspective. For example, the study findings provide a greater understanding of alternate ownership and growth structure models for potential business owners considering entering the industry. The lessons may event be of value to entrepreneurs in other lines of business.

The hardship and challenges faced and surmounted by the cases in this study could provide policy makers and service providers with the information to better carry out their mission of

providing the necessary support to growth-orientated enterprises. For example, government policy makers could support educational programs to advise expanding businesses of their growth mode options that they may approach the situation with an informed and strategic perspective. Those businesses that are considering franchising should be trained on the advantages and disadvantages of franchising as well as best practices so that they could go about adoption in a proper, appropriate and effective way. Other initiatives could be about bringing principal companies in contact with potential franchisees or business through exhibitions or online forums.

Additionally service providers like banks are offered evidence in the study's cases that struggling businesses with potential not only require their financial support to grow but also their business expertise so that these businesses can survive and prosper in the shortest time possible. If these businesses investigated in this study could be successful without their deliberate support, what more could be achieved with the resources that they can bring to businesses similarly placed. The nurturing of start-ups and growth-orientated enterprises will play an important role and have a direct impact on economic growth and the creation of employment in a strong and prosperous national economy.

#### **6.4 Limitations of the study**

The landscape of the Australian health and fitness industry is ever-changing. Over the past five years the industry has seen many large overseas conglomerates enter the Australian market. Takeovers and mergers by private equity and publicly-listed companies are becoming more commonplace. The change in ownership structures presented a challenge in the selection of the case study sample for this research. The founders of some of the country's largest fitness chains were no longer employed within the business, thus limiting the number of these chains that could be included within the sample. As Dant (1995, p.11) himself said: 'as franchise systems

mature and progress through the organisational life-cycle, and the day to day management and operational control of franchises is increasingly shifted away from founders to professional managers, original motivations that prompted the franchising decision become correspondingly difficult to gauge’.

A further limitation of this study involved the format in which the research was conducted. Considering the research aims the semi-structured face-to-face interview was deemed the most suitable method of data collection. Thus, the cases included only Victoria-based businesses as it was not feasible due to the researcher's circumstances to include those centres that were founded and operating interstate.

Finally, the focus of this study is the Australian health and fitness industry and results may not be generalisable to fitness centres operating outside of Australia. Social, cultural and legal contexts will differ in different countries.

## **6.5 Future research**

Future research opportunities primarily revolve around the limitations discussed in the previous section. The sample size of the data set could be increased. This may be implemented by expanding the study to include a greater national representation of both company-owned and franchised chains. In addition, similar studies could be conducted within other fitness related businesses, such as personal training studios and swim schools operating in the Australian market. Indeed, other industries could also be investigated particularly those operating on larger scale and production intensive businesses such as fast food chains. Perhaps findings on the relevance of the economies justification factors proposed by Dant (1995) would be supported which was not the case in this study of fitness businesses.

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# **INFORMATION TO PARTICIPANTS INVOLVED IN RESEARCH**

## **You are invited to participate**

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You are invited to participate in a research project entitled “Growth Strategies in the Australian Health and Fitness Industry: Franchised vs Company-Owned Outlets”.

This project is being conducted by a student researcher Andrew Haug as part of a Doctor of Business Administration degree at Victoria University under the supervision of Professor John Breen from the Centre for Tourism and Services Research at Victoria University.

### **Project explanation**

The aim of this project is to identify the motivations for Australian fitness centres in adopting either franchising or company ownership as their growth strategy. The findings will be based on data gathered via in-depth interviews.

### **What will I be asked to do?**

Participants will be asked to respond to a series of questions regarding their business decisions and motivations.

### **What will I gain from participating?**

You will be contributing to further development and understanding of what variations of growth strategy may be most beneficial to the expanding health and fitness centre.

### **How will the information I give be used?**

The information will be used to help gain a factual sense of what motivations may prompt Australian fitness centres to select franchising or organic growth approaches as their key growth strategies. Information provided will be used in the research to further distinguish the boundaries between franchising and entrepreneurship. All information provided will be kept confidential and individual information will not be identified within the thesis.

### **What are the potential risks of participating in this project?**

There are no known or anticipated risks to you as a participant in this study.

### **How will this project be conducted?**

Data will be collected through taped interviews with entrepreneurs within franchised and company owned outlets, data will be analysed to identify the motivations behind their reasons for company expansion.

### **Who is conducting the study?**

The study is being carried out by Victoria University. The Principal Researcher is Professor John Breen [john.breen@vu.edu.au](mailto:john.breen@vu.edu.au) telephone (03) 9919 4641. The student researcher is Andrew Haug [andrew.haug@optusnet.com.au](mailto:andrew.haug@optusnet.com.au) mobile 0402 086 136.

Any queries about your participation in this project may be directed to the Principal Researcher listed above. If you have any queries or complaints about the way you have been treated, you may contact the Ethics and Biosafety Coordinator, Victoria University Human Research Ethics Committee, Victoria University, PO Box 14428, Melbourne, VIC, 8001 phone (03) 9919 4148.



# **CONSENT FORM FOR PARTICIPANTS INVOLVED IN RESEARCH**

## **INFORMATION TO PARTICIPANTS:**

We would like to invite you to be a part of a study into...

Growth Strategies in the Australian Health and Fitness Industry: Franchised vs Company-Owned Outlets.

## **CERTIFICATION BY SUBJECT**

I, \_\_\_\_\_

of \_\_\_\_\_

certify that I am at least 18 years old\* and that I am voluntarily giving my consent to participate in the study: "Growth Strategies in the Australian Health and Fitness Industry: Franchised vs Company-Owned Outlets.", being conducted at Victoria University by Professor John Breen.

I certify that the objectives of the study, together with any risks and safeguards associated with the procedures listed hereunder to be carried out in the research, have been fully explained to me by Andrew Haug and that by ticking the box below I freely consent to participation involving the below mentioned procedures:

Taped Interview

I certify that I have had the opportunity to have any questions answered and that I understand that I can withdraw from this study at any time and that this withdrawal will not jeopardise me in any way.

I have been informed that the information I provide will be kept confidential.

Signed:

Date:

Any queries about your participation in this project may be directed to the researcher John Breen on 03 9919 4641. If you have any queries or complaints about the way you have been treated, you may contact the Ethics & Biosafety Coordinator, Victoria University Human Research Ethics Committee, Victoria University, PO Box 14428, Melbourne, VIC, 8001 phone (03) 9919 4148.

**[\*please note: Where the participant/s are aged under 18, separate parental consent is required; where the participant/s are unable to answer for themselves due to mental illness or disability, parental or guardian consent may be required.]**

## **Appendix C – Interview questions**

### **Growth Strategies in the Australian Health and Fitness Industry: Franchised vs Company-Owned Outlets – case study interview questions.**

#### **Interviewee background**

1. What is your current position within the organisation?
2. What are your key responsibilities within this role?
3. How long have you been in this role / with this organisation?
4. What is the level of your experience within the fitness industry?
5. What roles have you previously held within the fitness industry?
6. What is your professional background outside of the fitness industry?

#### **Organisation background**

1. Tell me about the business and its history.
2. What was the age of the business when you decided to expand (either organically or through franchising)?
3. At what stage of the product life-cycle did you consider your business to be in at the time of expansion?
4. What were the staffing numbers at the time of expansion?
5. What was the level of profit at the time you decided to expand through additional outlets?
6. Did this have an impact on your decision to expand?
7. What was your annual turnover the year the company expanded?
8. What was the level of business growth prior to expanding the organisation?
9. What do you feel were the main contributors to this growth?
10. Did you have an effective CRM and member management system in place prior to expansion?
11. What was your predominant target market at the time of expansion?
12. Were you hoping to attract a different target audience through expansion?

#### **Expansion strategy**

1. Prior to evaluating expansion alternatives did the company have a clear expansion strategy?
2. Did your organisation have a clear expansion strategy of locations / states and number of outlets prior to expanding?

3. How many sites did you set as an ideal target?
4. Did you consult any external professional advisors?
5. If yes, what types of advisors did you consult with? In what capacity / length of time? What was the work done?
6. Were any staff involved in the decision-making process?
7. Who ultimately made the decision to expand through the medium you finally chose?
8. In reference to your company's expansion strategy did your business evaluate any of the alternatives below prior to choosing the company's current growth strategy?
  - Company-owned expansion
  - Selling shares to employees
  - Selling shares to others
  - Joint ventures
  - Management contracts
  - Licensing
  - Dealership and distribution
  - Sub-contracting
9. What were the reasons for selecting either franchising or company ownership as the organisation's growth strategy? Please list your reasons in order of importance.
10. A number of motivations for franchising have been identified within literature throughout the past thirty years. Describe your level of agreement with some of the following most common reasons amongst franchisors today for selecting the franchising option:
  - Provides quick access to capital
  - Provides quick access to qualified managers
  - Provides quick access to knowledge about markets
  - Provides rapid growth and expansion opportunities
  - Delivers economies of scale in production costs
  - Delivers economies of scale in promotion costs
  - Delivers economies of scale in agent supervision
  - Since franchisees earn more when their outlets make profits they are more motivated to work harder than managers.
  - Saves money by delivering capital and labour from the same source
11. What did you perceive to be the chief hurdles you had to overcome when choosing the strategy you did?

## **Strategy evaluation**

1. What are the main challenges you faced in selecting the strategy you did?
2. Would you choose the same growth option today?
3. Why / why not?
4. Have you achieved your goals which were set prior to expanding?
5. Why / why not?
6. How many sites are there within the organisation today?
7. Is it important to have any company-owned sites if the organisation is franchised? Why / why not?
8. If so, how many would be the optimal number?
9. Has the company ever bought back any previously franchised businesses?
10. Under what circumstances?
11. What is the total number of sites of the business?
12. What is the current annual turnover of the business?
13. How many members does the business have throughout the chain?
14. What are the future plans of the business in terms of growth?
15. Does the business have an exit strategy in place?