

The Dissonance of the Bakery Industry and the Franchising System in the Food Retail in Brazil

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Abstract:

This study addresses the franchising system as a business expansion strategy and investigates the factors that create the bakery segment against the success experienced by other food retailers. The bakery industry has remained dissonant to this success and, despite its relevant numbers for the economy, it still does not have a large offer of franchised brands or a large national player. To understand the causes, Agency Theory and the Resource Scarcity Theory were used to assess ten in-depth, semi-structured, and open interviews with professionals working on franchising in the food sector and bakery industry. From the thematic analysis of the interviews, it was concluded that the causes of high dispersion in the local industry are related to cultural specificity, operational challenges, capital investment, and human resources management. Theoretical and practical contributions show ample avenues for improving the franchising system in intricate business models.

Keywords: franchising, business strategy, retail.

Track: Marketing Strategy & Theory.

1. Introduction

The evolving dynamics of today's competitive market landscape compel a growing number of companies to explore and implement expansion strategies to establish and maintain a leading position in their respective domains. Formulating and executing these strategies pose substantial challenges, especially in the face of increasing competition. Managers and executives are thus engaged in a continual effort to navigate the complexities associated with the growth and expansion of their operations (Park et al., 2019). Franchising has emerged as a key strategy in this context, facilitating efficient market expansion coordination with relatively modest investments (Sun & Lee, 2018).

According to the 2022 Franchising Performance Survey (Brazilian Franchising Association, ABF), Brazil's franchising sector comprises 3,077 brands across 184,354 units, contributing to over 1,500,000 formal jobs. Notably, the food sector, representing more than 24% of the franchising sector's total revenue in Brazil, is a significant segment. However, the bakery market within this sector is highly fragmented, predominantly consisting of micro and small enterprises. This study seeks to understand the factors driving the bakery market's fragmentation in Brazil and the challenges in adopting franchising as a business expansion model. This research applies Agency Theory (Jensen & Meckling, 1976) and the Theory of Resource Scarcity (Oxenfeldt & Kelly, 1968) as foundational frameworks to conduct an exploratory analysis. Through in-depth, semi-structured interviews with bakery industry professionals, the study aims to delve into the reasons behind the significant fragmentation of Brazil's bakery segment and assesses the feasibility and challenges of the franchising system within this specific market.

2. Theoretical Framework

2.1 The Adoption of the Franchising System

The franchising system can be conceptualized as a practice through which a company, franchisor, assigns to a third party, franchisee, the rights to its trademark, patents, products, services, or technology. A company develops a business model and then sells the right to run a branch of the business to a stakeholder using the parent company's brand and operating procedures (Rogers & Haywoode, 2018). According to the International Franchise Association, there are approximately 733, 000 franchised establishments in the United States that are responsible for generating 7.6 million jobs.

Some advantages of franchising are the possibility for the franchisor to establish the

presence of its brand in the market more quickly, to block the market position for similar products or services, to obtain important sources of revenue through payment by the franchisee of the initial fee and monthly royalties, in exchange for the continued support and licensing of the use of the brand, along with lower capital and management costs than those incurred in the company's own establishments (Gompers, 2017). Franchising is suitable for companies whose know-how is codifiable and where processes can be provided for and contractually specified (Alon et al., 2020). Formatting and standardization are essential to ensure the same quality standards in all franchised units. Standardization compliance is critical to achieving the benefits of economies of scale as well as achieving and maintaining the desired image during the franchise's growth stage (Chiou & Droge, 2015).

2.2 Agency Theory

One of the theoretical tenets of the franchising system is the reasoning for opting for expansion through third parties since it is more profitable (Dermonde et al., 2023). Agency Theory (AT) is used to explain this relationship, in which one of the parties hires a third party – the agent – to, under their observation, perform a job, delegate to him a certain decision-making power, and share with him part of the results of that service. In this way, the franchisee, as an agent, carries out an activity granted by the franchisor, the principal, and, as consideration, pays it with an initial fee and a percentage of the results obtained in that operation. A franchisee has a lower cost of control and monitoring of franchised units than it would have with its own units (Aguar et al., 2017).

Due to the difference in the incentive structure between a franchisee and a manager, the franchisor mitigates the incidence of moral hazard and adverse selection, as franchisors and franchisees share the risks of the business and pursue the same objective, that is, to make a profit through this principal-agent relationship (Khairatun, 2019). This theory separates the ownership and operational control of the company, and it becomes easier and faster for the company to expand its activities by delegating part of its operations, while the franchisee, as an agent, has the right to exploit that business model (Sanfeliu & Puig, 2017).

2.3 Resource Scarcity Theory

The Scarcity of Resources Theory, in turn, emphasizes that the adoption of the franchising system as a strategy for business expansion is explained by the lack of resources fundamental for business growth and is the main factor behind the adoption of franchising (Beckmann & Zeyen, 2014). The company does not have the financial power and knowledge to promote, by itself, the expansion of its activities at the speed it would like, posing further

difficulty in achieving an economy of scale, with franchisees emerging as a more attractive source of resources for the business group (Bitti et al., 2019). Franchising is a growth vehicle that helps companies scale their operations, as it allows them to increase their network of points of sale without investing their own capital while receiving royalties based on the sales of franchised stores (Madanoglu & Castrogiovanni, 2018). The system also increases the visibility of its brand using both the financial capital made available by the franchisee and the knowledge that the franchisee has about the local reality (Gigliotti, 2022).

A company will adopt the franchising system more strongly during the beginning of its expansion, precisely to overcome the scarcity of resources, and after a certain degree of maturity and with the consolidation of the brand, the franchisor may not renew the franchise contracts of units that are more profitable (Gillis & Castrogiovanni, 2012). However, the standardization of processes and the construction of a solid and collaborative relationship between franchisors and franchisees are the backbones of the system (Seid & Mazero, 2017).

3. Methodology

Given the specificity of the main question raised in this study and due to the lack of scientific publications on the subject, it was decided to conduct an exploratory study, through which we sought to investigate answers to the research question. To this end, it was decided to carry out qualitative research since there are no well-defined hypotheses. The experiences and answers obtained based on qualitative research are more relevant and have a greater probability of presenting hypotheses and effective answers to the problem than quantitative data, since the qualitative research method is related to meanings, motivations, aspirations, beliefs, and attitudes that cannot be quantified (Minayo, 2014).

Qualitative data were collected using a semi-structured script, through which the interviewees had the possibility to discuss the proposed theme, namely, (a) the franchising system as a business expansion strategy, (b) factors that lead to the success of a business in the franchising system, (c) factors that may lead to the failure of the adoption of this system, (d) the advantages and disadvantages of the adoption of the franchise system in food retail, (e) the causes for the high fragmentation of the bakery market, (f) the expansion of a company in the bakery segment, and (g) reasons for the low adhesion of this segment to the franchising model. However, it should be noted that these scripts were used as a guide, and throughout the interviews, they were adapted as new questions and directions emerged.

The main criterion for choosing a participant for the interview was their participation, directly or indirectly, in projects and areas related to business expansion strategies, in the

franchising system, in food retail, and in the specific segment of bakeries, in addition to customers – individuals – in the segment. The researchers conducted ten interviews with respondents ranging from 30 to 65 years of age and six to 20 years of experience. The interviews lasted an average of 40 minutes and were conducted via videoconference using either Zoom or Google Meet software. Audio recordings were recorded and transcribed for data analysis and interpretation. Data associated with the meaning attributed by each participant to the central theme of the research, obtained by the researchers through spoken discourses or written texts, were used in the subjective analysis (Rosa & Mackedanz, 2021).

The analysis and interpretation of the collected data were performed through thematic analysis (Braun & Clarke, 2006), which was used to identify and report patterns (themes) and organize and minimally describe the set of collected data. One of the main reasons for the adoption of thematic analysis as a method of subjective analysis of the collected data is that it allows a general analysis, enabling the use of codes to make comparisons in different theoretical frameworks (Rosa & Mackedanz, 2021). However, despite being considered a flexible and easy-to-use data analysis technique, thematic analysis needs to be developed with respect to minimum methodological rigor (Garcia & Ferreira, 2022). This study followed six phases: familiarization with the data, generation of initial codes, searching for themes, review of themes, definition and naming of themes, and production of the report (Braun & Clarke, 2006). To minimize the difficulties and optimize the results of thematic analysis, Qualitative Data Analysis software (QDA) optimizes the work of the researchers. QDA was used in the coding of qualitative data, transcribing audios, allowing searches for words and combinations of words, and identifying, encoding, and linking standard data (Kuckartz & Rädiker, 2019).

4. Results

From the analysis of qualitative data collected through the interviews, convergent patterns were verified in the answers presented by the participants. With the coding performed through the transcriptions, it was possible to find four themes related to the problem presented in the research question: 1) cultural aspects, 2) operational aspects, 3) material resources, and 4) human capital.

1) Cultural specificities were mentioned with greater recurrence by the interviewees, relating to the cultural aspects inherent to business owners in the bakery sector and to customers in the segment, which interfered with the low adhesion of the sector to the franchising system as a strategy for business expansion. *The bakery market is mostly composed of family-owned businesses*, commonly managed and operated by family members,

who in most cases are also responsible for the manufacture of the products.

The daily presence and proximity of the owner in the operation of a family bakery generates a more welcoming perception of the customer, generating *personality and intimacy in the customer's relationship with the establishment*. This personal relationship between the customer and the local business generates a sense of belonging in the community, which leads to the perception of a welcoming milieu of personalized service. Brazil is a country with continental dimensions, with the base of its population formed by high racial miscegenation, which is a factor responsible for the emergence of regional consumption habits. Each region of the country has specific preferences and culinary habits, and in the bakery segment, this is no different, consisting of *regionality in consumption habits*. As interviewee #9 states “[...] the city I grew up in, despite being a capital, is a very parochial city [...] and the owners of that bakery saw me and my brother grow up, they knew which products we liked.”

2) Operational challenges were the second most common in the answers presented by the interviewees. For them, the bakery segment has specificities that make it difficult to replicate their activities and, consequently, their business expansion, with emphasis on characteristics such as: a) the complexity of the operation, b) the difficulty in standardizing processes and products, and c) the high perishability of most products. Traditional bakeries have a vast number of items of their own production, with emphasis on breads, cakes, sweets, and snacks; this high number of Stock Keeping Units (SKUs) makes it difficult to generate economies of scale and, consequently, the expansion of the company's activities. When choosing to invest in the franchise market, a franchisee expects to encounter fewer operational difficulties than they would in an independent own-of-business business. As explained by interviewee #8, "franchises seek simpler processes." However, most bakery's produced items are crafted depending on the skills and methods used by each professional. Finally, the low shelf life of the items produced and marketed by a traditional bakery, which in some cases is daily, also acts as a barrier to the expansion of a company in the sector. In the perception of interviewee #4: “[...] the highly perishable product makes it necessary to bring the entire operation together, making it mandatory to have a production site in each store.”

3) Capital investment refer to the high volume of material resources required for the installation and operation of a traditional bakery, which represents another challenge for the expansion of the business and for the adoption of the franchising system in this sector. The main characteristics identified in the interviews were a) high occupancy value, b) significant investments in commercial equipment and facilities, and c) logistics costs necessary to enable the expansion and branching of a company's activities in the segment. A traditional bakery

requires a commercial point with a considerable area of occupation and a space that is consistent and appropriate to the business model. As going to the bakery has become a daily habit of the vast majority of Brazilians, it is common for your customers to opt for convenience and practicality in their daily lives, choosing establishments close to their home, their place of work, or installed on the traffic routes, with a very high occupancy cost, as observed by interviewee #4 “[...] bakeries still has that concept of being in large properties, usually on street corners [...] and properties of 80 to 120 m² have much more limited assortment.” Specialized equipment and the logistics costs necessary for expansion and branching are very high. As interviewee #5 explained, “[...] products really need to be produced inside the store. Otherwise, the cost of distribution ends up being very high, sometimes higher than the selling price.”

4) Human resource management was a serious challenge identified as a barrier to the expansion of bakeries. The direct involvement of owners with production is not only linked to the concern about not sharing recipes and manufacturing procedures, but also to the shortage of skilled labor. As interviewee #3 states “[...] it is increasingly difficult to find people interested in working in this industry.” Table 1 summarizes the thematic analysis and key points that emerged for the interviews.

Themes	Key Points
Cultural Specificity	The bakery market is composed mostly of family businesses, with the direct involvement of the owner and the family nucleus, making the business dependent on the figure and daily presence of the owner.
	Development of personal relationships between clients and the business owner, creating a relationship between personality and intimacy of the customer with the establishment and generation of a sense of belonging in the community.
	The presence of regional consumption habits, diverse preferences, and specific culinary habits has spread throughout the country.
Operating Challenges	Complex operations due to extensive opening hours and the large number of SKUs produced in a craft way by the establishment.
	The difficulty in standardizing processes and products, usually

	in craft manufacturing, is highly dependent on the skills and methods used by each professional.
	Low shelf life (high perishability) of items produced and marketed in a traditional bakery.
Capital Investment	High occupancy costs due to the location and physical space necessary for the operation of a company in the segment.
	A high investment is required for business equipment and facilities.
	Considerable logistics expenses for the supply of inputs and raw materials as well as the distribution of finished products.
Human Resource Management	Generation of dependency between the company and the professional who owns the knowledge and skills required to produce items marketed by the store.
	The lack of interest from franchisees, who generally seek more simplified operations and predefined processes, lower efforts, and dedication to manage a business.
	Shortage of skilled labor in the industry.

Table 1. Summary of the characteristics of each thematic dimension.

5. Conclusion

The theoretical framework justifying the choice of franchising as a business expansion strategy is directly linked to Agency Theory (AT) and Resource Scarcity Theory (RST). Of the four thematic dimensions that emerged from the data collected in the qualitative research, two were related to AT, and the other two were related to RST. Cultural Specificity and Human Resource Management are related to Agency Theory because the central idea is to delegate tasks and decisions to an agent, expecting them to act on their benefit and according to an alignment of expectations between them. However, the bakery market is mostly composed of family businesses, intricate by personality and intimacy in customer relationships, along with regionality in consumption habits, and a high dependence between professionals who hold technical knowledge of production, making it difficult to hire a third party to act on their behalf. Furthermore, Operating Challenges and Capital Investment are directly linked to the Theory of Resource Scarcity, which advocates a lack of capital and knowledge as resources, both fundamental for business growth. However, the high complexity of the operation and difficulty in standardizing processes and products make the

required investment for the installation and operation of a company to make the availability of these resources by a third party unfeasible.

This study becomes significant in view of the scarce theoretical lens of franchising intricate segments. Analysis and discussion of the themes and experiences of market professionals provided a theoretical basis for understanding the functioning of the bakery segment and the food retail and franchising sectors. It can also assist in the decision-making of managers of companies in the bakery sector who wish to expand their business, pondering, and analyzing the main causes that hinder or hinder the capillarization of these activities under the strategy of franchising. This understanding is of great value because it is based not only on speculative questions but also on the empirical knowledge of people with relevant experience in areas pertaining to the issues proposed here. Although no solutions have been proposed for the obstacles identified, this study allowed us to identify and understand them and may serve as a starting point for the investigation of solutions or even for the proposal of new business models. Finally, the interpretation of qualitative data makes it difficult to evaluate all internal aspects of the decision-making process for expansion by professionals linked to the bakery segment. In addition, while investigating a specific industry, this study is limited to the interpretation of the data collected and expansion of the results to other sectors.

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