Franchising as a Strategy for Combining Small and Large Group Advantages (Logics) in Social Entrepreneurship: A Hayekian Perspective

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Abstract

This article develops a Hayekian perspective on social franchising that distinguishes between the end-connected logic of the small group and the rule-connected logic of the big group. Our key claim is that mission-driven social entrepreneurs often draw on the small-group logic when starting their social ventures and then face difficulties when the process of scaling shifts their operations toward a big-group logic. In this situation, social franchising offers a strategy to replicate the small group despite system-wide scaling, to mobilize de-centrally accessible social capital, and to reduce agency costs through mechanisms of self-selection and self-monitoring. By employing a Hayekian perspective, we are thus able to offer an explanation as to why social franchising is a suitable scaling strategy for some social entrepreneurship organizations and not for others. We illustrate our work using the Ashoka Fellow Wellcome.

INTRODUCTION

Dialogue in the Dark and Wellcome are examples of social entrepreneurship ventures that use franchising to scale. Social entrepreneurship uses innovative means to solve social problems (e.g., Dees, 1998) that are otherwise unmet by market or state (e.g. Squazzoni, 2009).

With this paper, we aim to contribute to the literature on social entrepreneurship, social franchising, and nonprofit organizations by introducing a new theoretical perspective on social franchising i.e. franchising as means to increase impact (Mueller, Nazarikan, Volkmann, & Blank, 2011). In so doing, we show why social franchising is a suitable scaling strategy for some organizations, particularly volunteer organizations, and not for others.

To shed new light on these questions, we develop a Hayekian perspective on social entrepreneurship, scaling, and social franchising. We draw on Hayek's (1988) often-neglected distinction between the small-group logic of the microcosm (e.g. family) and the big-group logic of the macrocosm (e.g. capitalist markets). We argue that this distinction helps generate new insights to the question raised above. First, from a Hayekian perspective, social entrepreneurship particularly draws on the end-connected logic of the small-group. Second, applying this Hayekian perspective to the issue of scaling, we argue that conflicts between the microcosm and macrocosm logics are prone to arise when a mission-driven small-group social venture tries to scale up to the macro societal level. Third, in Hayekian terms, social franchising can be understood as the attempt to separate and then recombine the distinct logics of the small group needed for the local delivery of mission-driven services and the big-group logic driving the scaling process to the social system level.

We develop this argument in five steps.

First, we look at the general issue of scaling in social entrepreneurship. Second, we shift the focus toward conventional theories for explaining the use of franchising—resource scarcity and agency theory. The article then identifies open questions regarding the concept of social franchising. Third, we develop our Hayekian perspective on social franchising. The key claim is that mission-driven social entrepreneurial start-ups are firmly rooted in a Hayekian small-group logic. While scaling such ventures is difficult, social franchising offers a possible solution. We show that a Hayekian perspective can be usefully combined with the established explanations for franchising provided by resource scarcity and agency theories. Fourth, we illustrate our conceptual discussion using the case of Wellcome, a German nonprofit social venture that has scaled up to more than 200 franchisees. In the fifth and last step, the article concludes and spells out some important implications of our argument.

SOCIAL FRANCHISING AS SCALING STRATEGY IN SOCIAL ENTREPRENEURSHIP

Social entrepreneurs and their organizations seek to solve societal problems (Dees & Anderson, 2006) that are otherwise unmet by market or government (Squazzoni, 2009). Therefore, their social mission is central to their organization (Zahra, Gedajlovic, Neubaum, & Shulman, 2009). Due to the recent increased attention on social entrepreneurship, there are numerous understandings in circulation. Whereas some define social entrepreneurship from an innovation perspective (e.g. Dees & Anderson, 2006), others define social entrepreneurship as profit-generation models of nonprofit organizations (e.g. Bagnoli & Megali, 2011; Cooney, 2010; Dart, 2004; Herranz, Council, & McKay, 2011). For the purpose of this paper, we follow the former understandings so as to talk to all potential organizational forms regardless if they are social enterprises or nonprofit organizations rooted in voluntary work.

Because the very *raison d'être* of social entrepreneurs is to create social change, scaling seems unavoidable as social change can only occur when a large number of people alter their behavior (e.g. Schram & Giardeli, 2006). Therefore, most practitioner handbooks offer in-depth advice on scaling strategies (e.g. Brooks, 2008; Durieux & Stebbins, 2010). Moreover, in many conversations with practitioners or in practitioner-focused events, the issue of scaling is nearly always a dominant theme.

However, despite its practical importance identified in the literature (Bloom & Smith, 2010; Bradach, 2003; Mueller et al., 2011), to date, little scholarly work explicitly deals with scaling in the context of social entrepreneurship (see for example: Ahlert et al., 2008; Bradach,

2003; Dees, Anderson & Wei-Skillern, 2004; Grant & Crutchfield, 2007). Therefore, more research is needed (Mueller et al., 2011).

So far, various scaling strategies have been identified (e.g. Dees, 2008). Table 1 provides an overview of these strategies that differ in the degree of control the original organization has over the scaling of its idea. Thus, if social entrepreneurs follow a branching strategy, it has the highest level of control. Here, the headquarter has more control over the activities of its subsidiaries as the managers are employees. This option is often chosen in areas where control is necessary e.g. to ensure quality or where extensive training is a prerequisite. In contrast, control is lowest if an open-source-style replication strategy is chosen.

Insert Table 1 here

In social entrepreneurship practice, it is particularly the strategy of franchising that enjoys special prominence. Many successful social entrepreneurs choose this strategy (see Table 2 for examples). So far, there are various case studies on social franchise systems available in literature (e.g. Kistruck, Webb, Sutter, & Ireland, 2011; Tracey & Jarvis, 2007; Volery & Hackl, 2010). Yet, some more fundamental questions remain unanswered. Why is franchising such a prominent strategy for scaling in the field of social entrepreneurship? Why does social franchising seem to work very well for some social ventures while others refrain from this practice? Before offering our Hayekian answer to these questions, the next section looks at the conventional literature on franchising and its established theories.

Insert Table 2 here

Theories of (Social) Franchising

Franchising is a way of growing an organization without necessarily increasing its size. A franchise consists of two parties, the franchisor (original organization) and the franchisee (license taker), that enter a relationship based on a contractual agreement (Jensen & Smith, 1985; Ketchen, Short, & Combs, 2011). Franchising has been a growth strategy in the commercial sector for more than 80 years (Ahlert et al., 2008). Accordingly, there is a vast body of literature on franchising, albeit limited in scope (Stanworth & Curran, 1999) and in need of more thorough theoretical grounding (Ketchen et al., 2011).

In a nonprofit or social entrepreneurship context, there are two different understandings of franchising. One refers to franchising as means to generate profits (e.g. Netting & Kettner, 1987); the other attempts to transfer knowledge from commercial franchising to the nonprofit sector as a means to increase impact (Montagu, 2002; Volery & Hackl, 2010). As this paper looks at scaling, we follow the second understanding.

In the following, we show how the two main theoretical explanations in franchising scholarship—*resource scarcity* and *agency theory* (Combs, Ketchen, & Short, 2011)— can be transferred to social entrepreneurship franchising.

Resource Scarcity Theory

According to resource scarcity theory, organizations wishing to expand their geographical range franchise to overcome problems of scarce resources (Nga & Shamuganathan, 2010) that hinder the rapid growth needed to secure market share and organizational survival in a competitive environment (Oxenfeldt & Kelly, 1969). These resource scarcity problems derive from an organization's liability of newness and smallness.

Social ventures seem to encounter similar challenges of scarce resources (Ahlert et al., 2008; Hoffman & Preble, 1991). They are often underfinanced due to operating in unchartered institutional environments (Mair & Martí, 2009), which increases their liability of newness. Therefore, as in the private sector, using a franchise can help in accessing important capital. Moreover, scaling through franchising is cheaper than branching, as the excising concept "only" needs to be scaled through others (Ahlert et al., 2008). Therefore, resource scarcity theory seems to also apply to social franchising.

Agency Theory

Generally, agency theory analyzes the difficulties that arise when a principal hires an agent to perform a task in the principal's interest. Given conditions of incomplete and asymmetric information, the agent could then use this for their own interests and at the principal's cost (Jensen & Meckling, 1976; Eisenhardt, 1989). Agency theory looks at how different contractual arrangements deal with this problem of moral hazard. Moral hazard occurs when agents abuse their information advantage (e.g. regarding potential quality) to increase their own benefits by for example holding back essential information. However, no contract, no matter how costly, can cover in advance every possible situation that might occur (Alchian & Woodward, 1988).

As a result, agency theory emphasizes the agency costs and benefits of alternative governance arrangements for delegating tasks from a principal to an agent.

In the context of franchising, agency theory focuses on the relation between the owner of the original company (principal) and the person running a local subsidiary (agent). There are two basic options for managing this principal-agent relation (Brickley & Dark 1987): hiring a local manager or franchising (Tracey & Jarvis, 2007). From an agency perspective, this decision depends on the respective (dis)advantages of both alternatives thus, on tradeoffs in agency costs (Brickley & Dark, 1987).

Franchising offers a company two fundamental advantages when managing a principal-agent relationship. The first advantage involves the ex-ante problem of hidden characteristics and intentions. When recruiting highly talented staff to run a subsidiary, it is difficult to know whether the applicant is motivated, skilled, and experienced enough. However, since becoming a franchisee is costly, time consuming, and only lucrative if one works hard, only those with the required characteristics are likely to apply. This self-selection mechanism allows an organization to recruit highly skilled and motivated entrepreneurs to run a subsidiary at limited agency costs (Hoffman & Preble, 1991).

The second advantage of franchising addresses the ex-post problems of hidden action, hidden information, and moral hazard. Once a contract has been entered, the organization wants to be sure that the local entrepreneur will act in its interest. A salaried manager might not work as hard as desired. Franchisees, in contrast, have strong incentives to maximize the revenues of the subsidiary because they have a personal stake in them. This additional motivator can lead to lower monitoring costs (Norton, 1988).

Franchising, however, is not a perfect solution for principal-agent problems. For example, a franchise system cannot fully reduce information asymmetries and moral hazard. More generally, franchising can incur agency costs in terms of free-riding effects i.e. the agent either uses resources such as brand, knowledge or materials of the principal without adequately paying for them or even abuses them. This is not only the case when franchisees free ride on (and thus reduce) overall system quality (Michael, 1991); it can also occur if a franchisee utilizes the knowledge and training received from the franchisor, terminates the contract, and starts up a competitor (Brickley & Dark, 1987).

In sum, however, agency theory suggests that franchising often incurs fewer agency costs than hiring a local manager (Brickley & Dark, 1987) and that this advantage explains why franchising is such a popular growth strategy.

Social franchising is also theorized to be a feasible strategy for recruiting entrepreneurial talent to operate and run a local subsidiary (Tracey & Jarvis, 2007). However, some striking differences have been identified. In their case study of Dialogue social Enterprises, Volery and Hackl (2010) found that despite the existence of contracts, both sides—franchisor and franchisee—highlighted that if problems occurred, they would rely on their trust to solve them. Such findings might be interpreted as evidence that the key motivations for both social franchise parties are different from those of commercial franchises (Ahlert et al., 2008).

If this interpretation were correct, one could argue that the principal-agent dilemma does not occur in social entrepreneurship franchising as the common mission orientation of both parties makes potential information asymmetries irrelevant: both are striving for the same good and thus have no conflicts of interest.

Yet, this interpretation can neither explain why franchising is used instead of open-source strategies nor why some social entrepreneurs use it with great success and others don't. We therefore follow the call by Ketchen et al. (2011) for new theoretical approaches to franchising and now introduce a Hayekian perspective.

HAYEK'S TWO WORLDS, SOCIAL ENTREPRENEURSHIP, AND FRANCHISING

The Austrian social philosopher Friedrich August von Hayek is a famous figure in the theoretical fields of innovation, entrepreneurship, and market evolution. In this section, however, we draw on a lesser-known aspect of Hayek's work that we believe offers a fresh perspective on social entrepreneurship, scaling, and social franchising. We develop our argument in three steps. The first step introduces and illustrates Hayek's (1988) distinction between the microcosm of small groups and the macrocosm of big groups. The second step applies this distinction to the field of social entrepreneurship. The third step shifts the focus to social franchising and discusses our Hayekian perspective on social franchising as complementary to the perspective of resource scarcity and agency theory.

The Hayekian Distinction Between the Microcosm and the Macrocosm

In his work *The Fatal Conceit*, Hayek (1988) sketches an evolutionary perspective on modern society. Hayek distinguishes two paradigmatic forms of social order. On the one hand, there is the logic of the small group or microcosm. This microcosm focuses on social interactions characterized by face-to-face personal relationships and informal norms. For Hayek, small groups are end-connected: their coordination relies on all group members striving for one shared goal. In Hayek's perspective, this small-group dynamic was the dominant logic that shaped man during the Stone Age when people lived in small groups of hunters and gatherers. Imagine a Stone Age tribe hunting a mammoth. Each tribe member participates equally as otherwise they could face social segregation due to strong face-to-face relationships. For Hayek, altruism and solidarity are remnant instincts of this heritage. The logic of the microcosm is still relevant to-

day in small groups such as the family where we still share a strong collective identity and interact based on personal face-to-face-relations.

Despite the continuing relevance of the microcosm, Hayek argues that modern society is built on the very distinct logic of the macrocosm. The "macrocosm" encompasses the complex and manifold interactions that take place in the larger society. Here, individuals follow their own pluralistic objectives, but do so within a framework of formal and informal rules. Such big groups are thus not end-connected but rule-connected. Their coordination does not rely on personal relationships but on impersonal or even anonymous interactions. A case in point is modern capitalist markets. In global markets, millions and millions of people interact in complex ways, often without knowing each other. And yet, there is order and coordination. This environment is not founded in the collective pursuit of shared goals, but in the pursuit of individual goals coordinated by rules. Table 3 summarizes the Hayekian distinction between microcosm and macrocosm.

Insert Table 3 Here

For Hayek (1988), a key challenge for modern man is to simultaneously live in both kinds of "cosm." We need (or want) to be able to both live in families *and* interact in anonymous markets. Hayek emphasizes that frictions arise if one logic is inappropriately applied to the domain of the other. He forcefully warns that if we apply the small-group logic to society and try to plan, say, the economy like a family meal and directly decide who gets how much of the pie, we will destroy the workings of efficient markets. And, vice-versa—we will destroy our

intimate small groups if we try to run, say, our family life the same way we order our markets through prices and anonymous auctions.[i]

In short, Hayek points out that there are different logics of coordinating social interactions. Each logic is appropriate for a certain context but tension will arise if one logic is inappropriately applied to the domain of the other.

Social Entrepreneurship, Scaling, and the Small-Group/Big-Group Distinction

Hayek's distinction provides an interesting lens with which to look at scaling in social entrepreneurship. The key idea is that many social entrepreneurship ventures systematically build upon a microcosm logic when founded and then experience difficulties when the process of scaling moves the organization toward macrocosm dynamics.

While not only social ventures follow a small group relationship-driven logic (Kreutzer & Jager, 2011), it is important to bear in mind the key differences between commercial and social entrepreneurship, differences that significantly magnify the microcosm nature of the social venture.

First, business entrepreneurs have commercial goals; social entrepreneurs have a social mission (e.g. Dees, 1998). When starting a social venture, they rally resources and people around a shared social goal and thus set up an end-connected small group. In comparison to a business start-up where private interests in the business such as equity shares are also important, social entrepreneurs often recruit people who primarily contribute resources (e.g. volunteer time or funding) based on the shared mission.

Second, the strong social mission of the small group not only helps social ventures recruit resources, but also to coordinate them. People in a small group motivated by a shared ethical goal build strong social relationships (Kreutzer & Jager, 2011)[ii] the importance of which for entrepreneurial success is explicitly highlighted in literature (e.g., Unger, Rauch, Frese, & Rosenbusch, 2011). Moreover, the shared goal can serve as focal point (Schelling, 1960) for coordinating people. However, this is possible only if the group is of limited complexity and everyone can see and understand what the others do thus, personal face-to-face-relations also act as a monitor and potentially lower sanctioning costs (North, 2005). This is nicely illustrated by the mammoth-hunting example. While engaged in the hunt, men could communicate with each other and oversee the entire process. Anyone noticed to be not participating could be excluded from the meal. As a consequence, both in terms of monitoring and in terms of enforcing norm compliance, sanctioning is easier than in anonymous relationships.

Another difference between commercial and social entrepreneurship is that success measurement in commercial entrepreneurship is more clear-cut than in social entrepreneurship (Bagnoli & Megali, 2011). Even commercial start-ups are strongly embedded in the institutional structures of the market macrocosm. These market rules provide guidance for social coordination and agreed-upon outside focal points. Prices and profits, for example, provide informative signals as to whether the venture is “on track.”

In contrast, the social entrepreneur strives for social betterment. To this end, the social entrepreneur may follow a combination of strategies from the private, the nonprofit, and the public sectors. Furthermore, to increase their impact, social entrepreneurs often do not charge market prices for their products. Put differently, social entrepreneurs initially often operate in an ambiguous institutional environment (Mair & Martí, 2009), and thus neither give nor receive the

clear signals of success that are so established in the big-group logic of functioning markets and bureaucratic structures.

In short, social entrepreneurial start-ups often are particularly characterized by the microcosm. What is more, for some social entrepreneurs, their “business model” is actually based on a small-group logic. In these cases, important resources are not mobilized through the big-group price mechanism; rather, people voluntarily contribute personal resources because they follow a shared end. For a mission-driven start-up, the small-group logic of the microcosm thus can be vital.

In light of the predominance of the small-group logic in social entrepreneurship, it is easy to see why the process of scaling poses such a challenge for these ventures. If scaling means creating an organization that reaches thousands of customers in completely different places, then the process of scaling puts stress on the microcosm of the social venture. To grow the organization, more division of labor and specialization is needed, thus making personal interaction less central. As complexity increases, it becomes less obvious how each person is contributing to the shared mission. Instead of being end-connected, the mechanisms of coordination need to more strongly rely on rules and hierarchy. Such a development can lead to a clash of cultures. The very process of scaling thus may threaten the stability of the venture. Moreover, if the venture’s business model is based on small-group interactions, turning into a big-group organization will be difficult when e.g. personal interactions are the key element of motivation for volunteers (Garner & Garner, 2011).

The challenge of organizational growth is not unique to social ventures. Any start-up or family business that grows experiences the tensions that arise when an organization reaches the

point where informal rules no longer suffice to manage the business appropriately (Cressy, 2006). Nevertheless, the problem can be far more severe in a mission-driven group of people who have created or joined the organization based on the very premise of following an over-arching goal. Given these difficulties, the next section looks at social franchising as a potential solution.

A Hayekian Perspective on Social Franchising

We believe that Hayek's distinction between small-group and big-group logic offers a fresh perspective to discuss social franchising as an interesting scaling strategy for at least three reasons: (1) franchising allows scaling without forcing organizational growth; (2) it addresses specific resource scarcity challenges; and (3) it can mitigate certain agency problems.

Social Franchising as a Means of Scaling Without Organizational Growth

Social franchising provides social entrepreneurs with a means of scaling without forcing organizational growth. Social franchising duplicates the original organization thereby replicating small-group conditions locally. Figure 1 illustrates this point.

Insert Figure 1 Here

Note, in Figure 1, the differences between a subsidiary and the original social venture. A hired subsidiary manager is much more integrated into an impersonal rule system. Also, local volunteers and employees have less ownership and a weaker group identity. With the central

organization being responsible for much of the decision making, face-to-face relations in the local subsidiary become less important and hierarchy and impersonal elements become more so.

A social franchise can be used to separate the small-group and big-group logic into two distinct arenas. While the local franchise continues to be based on small-group interactions, the overarching franchise system can establish rules that allow reaping the efficiency advantages of a growing, impersonal organization that follows a big-group logic. As a result, social franchising offers a strategy for social entrepreneurs to scale their impact without experiencing the cultural tensions of organizational growth. Social franchising allows reduced complexity and increased transparency in the local venture, even while the complexity and impact of the overarching organization increase. If the social entrepreneur's value creation model largely depends on a small-group culture, a systematic separation of small-group and big-group logics can be the key to successful scaling.

In short, duplicating and preserving small-group logics through social franchising can be of great value. The next two sections show that this idea has interesting implications for resource scarcity and agency theory.

Social Franchising and Resource Scarcity

Like any other venture, social ventures need capital to grow. Since many social ventures are underfinanced, social franchising has been discussed as a means of overcoming this (Tracey & Jarvis, 2007). The focus of traditional resource scarcity theory, however, is largely on scarce financial capital (Oxenfeldt & Kelly, 1969). This is an undeniably important aspect, but our Hayekian perspective shows that it is possible to further amend resource scarcity theory.

In those social ventures that operate according to a small-group logic, a key asset is *social capital*. People cooperate in the small group not (only) for pay, but because they share a common group identity and believe in the same mission (Kreutzer & Jager, 2011). Like any other capital, social capital is scarce. Amending Oxenfeldt and Kelly's (1969) resource scarcity theory, we suggest that social franchising can be a way of overcoming the scarcity of social capital. In fact, it is very difficult for a centrally operated organization to find, mobilize, or build up social capital when scaling an organization to, say, another city. In like vein, we argue that, similar to financial capital in commercial franchising, a social franchisee would be willing to start a subsidiary only if they were already familiar with the local environment, already involved in social networks, and thus able to institute the small-group logic from the start.

Interestingly, this argument is in line with two empirical findings about social franchising. First, social franchisees typically already run a local organization and use the franchise as a complement (Montagu, 2002). This implies that they have already built up social capital that can then be accessed to sustain a small-group setting. Second, in a study by Zeyen & Beckmann (2011), almost all social entrepreneurs using social franchising reported that the franchisees had approached them proactively—thus indicating a strong self-selection effect.

In short, creating a separate small-group domain through social franchising can be an effective strategy for overcoming the problem of limited access to social capital. At the same time, it facilitates a self-selection process that helps social franchisors find qualified and motivated franchisees. Similarly, Chirico, Ireland and Sirmon (2011) have suggested that the small-group "familiness" of family business can be an important aspect for facilitating the matching process between family-run franchisors and franchisees.

Small Groups and Agency Theory

In commercial franchising, agency theory is employed to study the difficulties that arise due to conflicts of interests between franchisor and franchisee as both parties are considered self-interested and with conflicting private interests.

How can this agency perspective be transferred to social entrepreneurship? This is an interesting question because much of the literature on social entrepreneurship emphasizes that the social entrepreneur is not interested in personal gain but is motivated by a strong social mission (e.g., Dees & Anderson, 2006). Thus, one could argue that a social franchise will not face the same principal-agent problems as commercial franchises.

We take a more nuanced perspective on agency problems in social franchising by differentiating between the narratives about social franchising and the actual underlying incentives.

The founder of Dialogue Social Enterprises once stated that he does not run a franchise but a “friendchise” (Heinecke, 2011). Interestingly, the very term “friendchise” strongly implies that the franchise system is not characterized by impersonal relations and formal rules but by personal relationships typical of the microcosm. In effect, Heinecke is stating that his franchise is built on friendship.

According to this narrative, social franchisor-franchisee relations follow a small-group logic. And, indeed, Volery and Hackl’s (2010) empirical findings on social franchising seem to support this claim. They found that franchising contracts were rather short or covered only crude essentials (Volery & Hackl, 2010). This contract brevity is striking from an agency theory perspective. After all, these franchise systems often have complex high-quality products and considerable information asymmetry. So, in order to limit opportunistic behavior, agency theory

would predict that both parties would be willing to invest in relatively detailed contracts (Alchian & Woodward, 1988). Moreover, when considering the Dialogue Social Enterprise example, there are franchisees in 25 countries. How can such franchise systems work if the contracts are basic?

We suspect that the idea of "friendchising" is misleading if interpreted to mean that the franchise exclusively relies on the personal franchisor-franchisee-relationship. No doubt, personal and even friendship-like relationships play a significant role in these networks; however, in a complex social franchise system, there is too little contact and too little transparency for the small-group coordination to be fully effective. In addition, such large franchising systems would be inherently instable if they rested primarily on a friendship between the franchisor and the franchisees. What would happen if the franchisor became ill or left the organization?

We claim that the social franchise system has the potential to avoid opportunistic behavior but not (only) because social franchisees and franchisors are per se close friends. Rather, we conjecture that the small-group logic within the local venture serves as a functional equivalent to detailed contracts between the franchisor and the franchisee. The argument is simple. If the "business model" of a social franchise hinges upon mobilizing resources through a mission-driven small-group logic, then local employees, volunteers, and other supporters automatically act as strong control mechanisms. Endowed with local knowledge, they not only observe the franchisee's behavior on a daily basis. Moreover, they can also sanction any departure from the organization's mission through the feedback mechanisms of "exit" or "voice" (Hirschman, 1970). As a means of articulating criticism, people can either *exit* an interaction context—i.e. they may quit their jobs, stop buying the products, or terminate contracts with that organization—or *voice* their dissatisfaction by, e.g. hosting protest or complaining to the company.

Applying these options to a small-group social franchise, volunteers and either supporters can sanction a mission abuse either by leaving the organization (exit) or by contacting the original franchisor (voice) , hence ultimately threatening the venture's survival. A Hayekian small-group logic may thus create strong self-monitoring effects for a social franchise. Note how different this situation is from commercial franchising. If a McDonald's restaurant sold poor-quality burgers, the employees might not be happy about it, but few of them would want to report this breach of contact to the McDonald's headquarter (voice) or would quit their job (job). Even if some did, they could be easily replaced. However, if a social franchisee violated important mission ethics, it would drastically erode its legitimacy and lose critical resources that cannot be easily replaced.

In other words, the small-group logic can solve both ex-ante and ex-post agency problems. For one, the small-group logic helps solve the ex-ante problem of hidden characteristics and hidden intentions when recruiting franchisees. Due to the shared social mission, goal alignment can potentially be achieved more easily. After all, a non-profit organization that applies to become a franchisee of another organization in the same field of work (e.g. youth welfare) does so because it perceives both organizations' goals to be similar or at least complementary.

Also, the small-group logic addresses the ex-post problem of moral hazard and hidden action by establishing an effective self-monitoring mechanism that enjoys the lower sanctioning costs of the small group (North, 2005) by moving both monitoring and enforcement from the principal to local stakeholders. The essential element for avoiding and addressing principal-agent problems between the franchisor and the franchisee is, in other words, the small-group relationship between the franchisee and their local employees and volunteers, which acts as a functional equivalent to detailed contracts. This thus makes it easier for a big-group logic rela-

tion to evolve between the franchisor and the franchisee. The franchisor-franchisee relationship can then be rule-based (contract-based, more formal, and more anonymous) without compromising the motivation of volunteers or other essential small-group elements of the value creation model.

In short, replication of the small-group logic through social franchising can be an effective strategy for lowering agency costs. The stronger the small-group logic in the subsidiary, the lower the agency costs. This explains both the brevity of many social franchising contracts and Heinecke's idea of "friendchise." Given small-group logics, this somewhat idealist-sounding narrative is not just a façade but backed up by informal governance incentives.

In a final step, we now use the case of Wellcome to illustrate our arguments.

AN ILLUSTRATIVE CASE STUDY: WELLCOME

Wellcome is a German social venture founded in 2002 by Rose Volz-Schmidt. Wellcome's objective is to support young mothers directly after birth in order to better cope with the emotional and logistical stress of having a completely different daily routine. In a way, Wellcome volunteers are substitutes for a role more traditionally played by the baby's grandmothers or neighbors. As such, volunteers might watch the baby for an hour so that the mother can take a relaxing bath, share tips how to soothe the baby, or provide information about good pediatricians in the neighborhood. Volunteers stay in families for (usually) no longer than six weeks as this is the most turbulent time after birth. After six weeks, most new families have found their own routines and can cope on their own. Importantly, Wellcome is not a substitute for youth welfare services but taps into the gap of families that are not in "enough" trouble to be a case for youth welfare services but still struggle in their first weeks as parents. The service is available to all mothers (and fathers) and costs a small but affordable amount. Additionally, Wellcome started offering a new service to families with financial problems called "families in distress". Here, families receive financial aid from "godparents" who help them afford a new bike, pay the fees for the school outing, or refurnish the child's bedroom. These financial supports are not long-term but for specific small investments that the families, however, cannot afford themselves. The budget of Wellcome is shown in Figure 2.

Since 2002, the organization has expanded to more than 200 franchisees. The local Wellcome programs are embedded in existing social service delivery organizations that already deal with family issues (Wellcome, 2012). In 2011, Wellcome's 2,335 volunteers offered almost 60,000 hours of support to 3,332 families across 15 of the 16 Federal German states. In comparison, in 2004, Wellcome had only 150 volunteers supporting 250 families in two states (Well-

come, 2012). This enormous increase in locations, volunteers and supported families has been achieved through the mechanism of social franchising

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Insert Figure 2 Here

Wellcome is an interesting example for demonstrating how social franchising can be used to separate and re-combine elements of the two Hayekian logics. At its very heart, Wellcome is a volunteer organization that is firmly based in a small-group logic. In each Wellcome subsidiary, volunteers join with others who share the social mission to support young families in need of assistance. Furthermore, these women not only know each other personally, they also engage in peer-coaching. They meet regularly to talk about their volunteer experience and discuss how they can better assist young mothers. The volunteers do not receive any remuneration; they work for Wellcome because they believe in its mission. A Wellcome group thus strongly builds on the small-group logic characterized by a shared mission, personal relationships, and frequent face-to-face interaction.

How do you scale up such an organization to the national level? How do you mobilize resources for expansion? How do you find and commit local partners and, above all, the volunteers who are essential for Wellcome's work?

The case of Wellcome nicely shows how social franchising can be used to solve these problems. By partnering with local social service organizations as franchisees, Wellcome mobilizes not only financial capital but, even more importantly, much needed social capital. Each

franchisee brings in its social networks, local reputation, and the credibility needed to replicate the small-group logic in the local Wellcome subsidiaries.

Note, however, that the franchise system itself draws heavily on elements of a big-group logic. The relationships within the franchise system are not between people but mostly between organizations. If a particular person leaves a local venture, the franchising arrangement remains largely unaffected. The system thus does not rely on face-to-face contact—which Volz-Schmidt could hardly sustain with a total of 250 local partners. Rather, the franchise partners coordinate their behavior through a set of general rules. These rules include following the guidelines on brand usage and service provision laid out in the contract, paying an annual fee of 500 Euro (see "own income in Figure 2"), and attending biannual trainings. Given this rule-connected governance model, Wellcome was able to detach its scaling efforts from the single small-group, replicate its model widely, and increase its impact dramatically.

Just as we would expect for a small-group-based franchise system, Wellcome's franchising contracts are brief and selective (Ahlert et al., 2008). More interestingly, the franchising contract is strongly focused on defining the mission and establishing those rules that guarantee the small-group logic of the local subsidiary. Most notably, franchisees must agree not to have more than 15–20 volunteers (Volz-Schmidt, 2011). If the number of volunteers exceeds this specification, they are split into two new groups. Keeping the group small not only makes coordination simpler, it also ensures that all members will come to know each other, have the opportunity to actually engage in volunteer work frequently, and interact regularly with each other. Moreover, peer-coaching is mandated for each Wellcome subsidiary. In short, there are formal rules in the big-group logic contract that are specifically designed to protect the informal small-group logic of the local ventures.

The Wellcome franchise system is thus designed to strengthen and protect the small-group logic that serves as the very basis for its volunteer model. By so doing, it also addresses potential agency problems. In fact, the small size of each volunteer group and the principle of peer-coaching are effective mechanisms for ex-ante self-selection and ex-post self-monitoring. The social franchise model is thus a highly effective way of replicating and safeguarding the small-group logic in Wellcome's core service delivery. At the same time, it allows separating the small-group logic from more formal structures governing the big-group relations of a nation-wide franchise system, thus clarifying expectations and minimizing friction.

The big-group logic is not only found in the franchisor-franchisee relationship but also between the Wellcome franchise and the new mothers. As mentioned earlier, the service is not free even though the volunteers are not paid. Having to pay for the service means that more parents use the program as many, especially the well-educated, are more comfortable paying for a service than receiving help from child care authorities (Volz-Schmidt, 2011). Employing the big-group logic of a priced service makes the program's users market customers instead of problem cases.

In sum, Wellcome is able to spread quickly while protecting the small-group logic necessary to the effectiveness of its volunteer work. At the same time, these small-groups help stabilize the big-group interactions between franchisor and franchisee. Moreover, Wellcome utilizes the big-group logic to reach even more new mothers than if it offered the services for free.

IMPLICATIONS AND CONCLUDING REMARKS

In this article, we developed a Hayekian perspective on social franchising that distinguishes between the end-connected logic of the small group and the rule-connected logic of the big group. Our key claim is that mission-driven social entrepreneurs often draw on the small-group logic when starting their ventures and then face difficulties when the process of scaling shifts their operation toward a big-group logic. In this situation, social franchising offers a strategy to replicate the small group despite system-wide scaling, to mobilize de-centrally accessible social capital, and to reduce agency costs through mechanisms of self-selection and self-monitoring.

This perspective has some interesting implications but is not without its limitations.

First, our argument implies that the more strongly the small-group logic characterizes the core of a social entrepreneurship "business model", the larger the benefits of social franchising. However, this argument is applicable only if the mission-driven small-group logic is critical for the actual *production* of the venture's goods and services. This could be the case where volunteers carry the business model or where key beneficiaries of the social venture contribute to the team production with Hirschman options. If, however, the production of a social venture does not necessarily hinge upon a small-group logic, our argument for the benefits of social franchising is not only inapplicable, rather social franchising might even be counterproductive. Take the case of micro-credits. Could micro-credits be provided by an organization that does not build upon a mission-driven small-group logic? The existence of for-profit micro-lenders shows they can indeed. In this situation, franchising the Grameen brand to third organizations without significant contractual control mechanisms would be highly risky: It could attract franchisees who

are only in it for the money and who would exploit not only the Grameen brand but also poor borrowers.

Second, if the small-group logic is important for the very operating model of a social venture, then scaling can be achieved by means of franchising that specifically strengthens the small-group logic in each local venture. As a policy recommendation for practitioners, franchising contracts—though still limited in length and complexity—could systematically include one or several of the following elements: (a) limitations on the size of the local group, (b) making peer-monitoring and peer-coaching elements mandatory, (c) increasing transparency and strengthening mechanisms for voice, and (d) investing in story-telling, shared branding, etc. to foster group identity and provide focal points for best-practice standards. In short, the idea is to use the formal big-group logic franchise system to promote the informal small-group logic on the ground. By doing so, it might help social ventures or nonprofit organizations to overcome conflicts of different identities (Kreutzer & Jager, 2011). Additionally, such contracts would support the "grassroots" link (Foreman, 1989) and provide governance structures to protect them.

Third, we believe we have answered the question of why so many successful social entrepreneurs seem to prefer social franchising to wholly-owned subsidiaries or open-source forms of replication. With regard to the former, social franchising allows social entrepreneurs to avoid the problem of strong intra-organizational growth threatening its small-group logic mechanisms of motivation and coordination. With regard to the latter, social franchising offers the advantage of setting succinct but effective standards for safeguarding the small-group logic and thus exerting a limited, yet sufficient degree of control.

Given our still limited knowledge about social franchising, these implications are necessarily preliminary, but they point out many avenues for future research. For example, our argument suggests that social franchising is not the optimal strategy for every social venture. To test and refine our claims, empirical research could look into what types of social ventures choose social franchising as a successful scaling strategy and analyze whether this correlates to specific small-group logic business models. This line of work would also open rich opportunities to more closely link research on social franchising with the discussion about the differences and similarities between social and business entrepreneurship. Moreover, it could be of great interest to nonprofit and volunteer research to investigate social franchising as a specific social context in the often under-researched volunteer experience (Wilson, 2012).

ENDNOTES

[i] As Hayek (1988, 18) argues: “Part of our present difficulty is that we must constantly adjust our lives, our thoughts and our emotions, in order to live simultaneously within different kinds of orders according to different rules. If we were to apply the unmodified, uncurbed, rules of the micro-cosmos (i.e., of the small band or troop, or of , say, our families) to the micro-cosmos (our wider civilization), as our instincts and sentimental yearnings often make us wish to do, *we would destroy it.* Yet if we were always to apply the rules of the extended order to our more intimate groupings, *we would crush them*. So we must learn to live in two sorts of world at once.”

[ii] Similar, yet slightly different ideas are discussed in the literature on reciprocity and cooperation. See for example Bowles & Gintis (2011) for an interesting discussion.

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FIGURES AND TABLES

TABLE 1

Scaling Methods in Social Entrepreneurship

	Full intra-organizational growth	Contracting as hybrid governance	Extra-organizational multipliers
Contractual control of the "rules of the game"	Yes	Yes	No
Actual control of the "moves of the game"/actual production process	Yes	No	No
Degree of control	++	+	0
Example	Setting up own branches	Franchising, licensing	Open source; sharing information

TABLE 2

Examples of Social Franchise Systems

	Brief Description
CASA – Care and Share Association*	- Provide home care solutions for those who do not wish to enter residential care
CORE Community Renewable Energy*	- Aim to increase the number of community-owned renewable energy systems
Dialogue Social Enterprise**	- Runs exhibitions, trainings, seminars and restaurants in total darkness or silence to change perspectives on disability
EcoKids*	- Provides education on environmental and sustainability issues to young children
FIETSenWERK*	-Provides bike mobility serves (rental, repair, etc.)
LeMat*	- Sustainable and small-business tourism
MyBank*	- Financial support and education service to youth between 11 and 25 years of age
Specialisterne	- Provides suitable workspaces for autistic people and uses their special skills in the IT industry

* www.socialfranchising.com (2012); Profiles of these organizations can be found on this website

** Volery & Hackl, 2010

TABLE 3

Hayek's distinction between microcosm and macrocosm

	Small-group logic	**Big-group logic**
Type of social structure	Microcosm	Macrocosm
Pattern of cohesion	End-connected	Rule-connected
Principle of social coordination	Informal norms focused on personal identity and group membership	Abstract rules with no regard for personal identity
Actor motivation	Shared group objectives	Pluralistic individual objectives
Quality of relationships	Personal	Impersonal, even anonymous
Degree of complexity	Low	Potentially very high
Size	Small group	Big group

(based on Hayek, 1988)

FIGURE 1

A Hayekian Perspective on Social Franchising

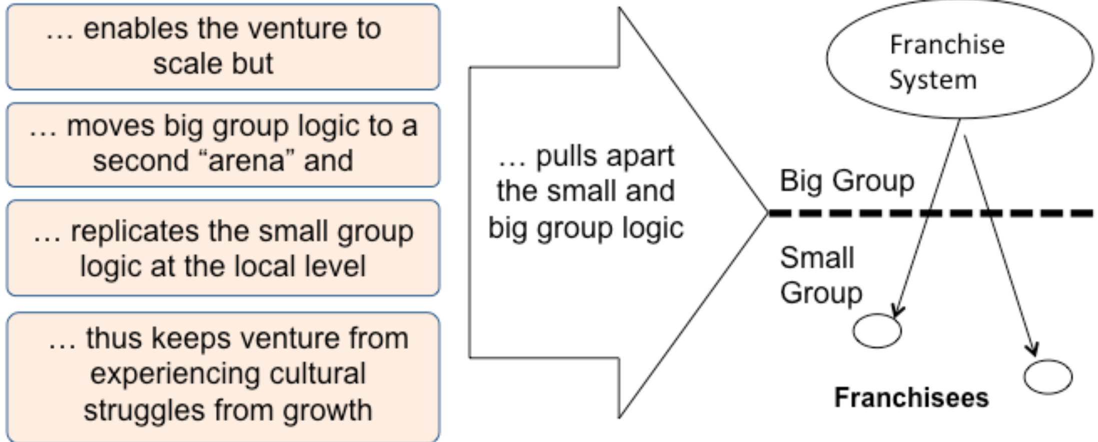
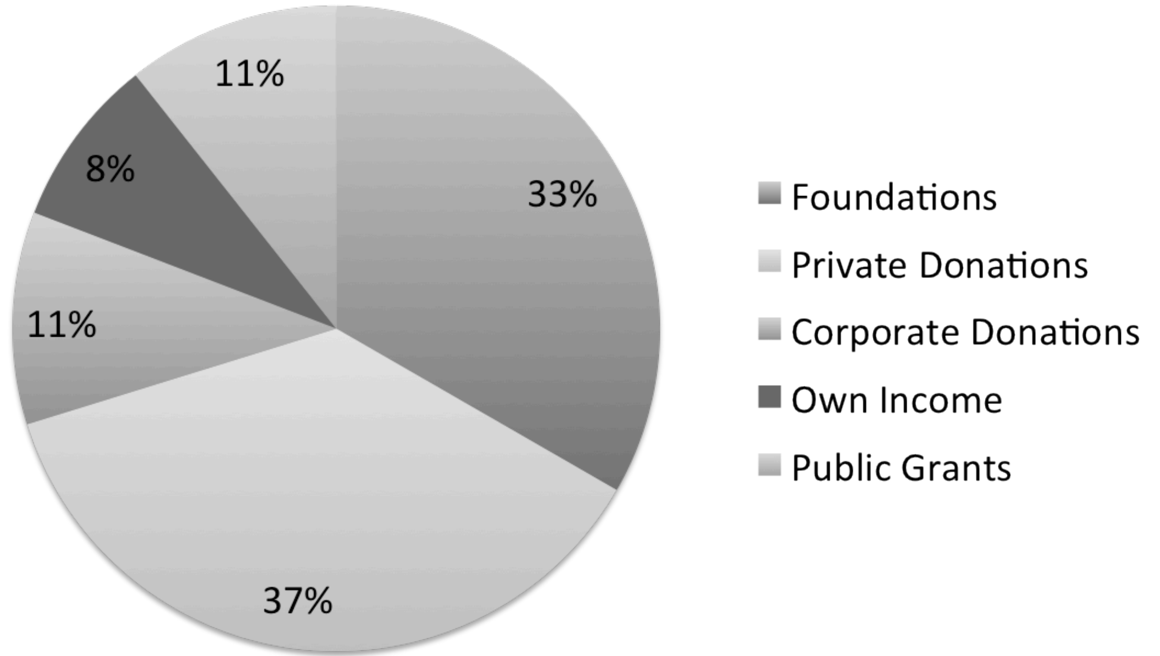


FIGURE 2

Composition of Wellcome's 2012 Budget of EUR1.4m



(Wellcome, 2012)