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VERTICAL INTEGRATION IN FRANCHISE SYSTEMS: AGENCY THEORY AND RESOURCE EXPLANATIONS

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The ownership strategies of 128 retail franchising systems are examined in the light of existing agency and resource scarcity explanations of this organizational form. Findings suggest that franchiser ownership strategies are more heterogeneous than previously recognized, and that neither explanation, alone accounts for observed ownership patterns. A path model of franchiser ownership patterns embodying agency and resource scarcity elements is developed that is consistent with empirical findings.

INTRODUCTION

What determines the extent of franchising in firms that franchise? A franchising firm rarely franchises all the units (retail stores, restaurants, etc.) that carry its identity. Franchising offers a firm the benefits of vertical control over retail units without the investment in assets required by full integration. Still, franchisers often do own and operate a significant proportion of their retail units. Simultaneously owning and franchising is a form of tapered vertical integration (Harrigan, 1985). Such an arrangement suggests that neither comprehensive vertical integration (ownership), nor comprehensive contractual market exchanges (franchising) are desirable organizational arrangements from the point of view of the franchiser. Why do some franchisers own and operate a significant proportion of retail outlets, while others rely to a much greater extent upon the franchise relationship?

In the tradition of Williamson (1985), we believe a comparative approach to hybrid organizational and market phenomenon generates new insights which may otherwise lie neglected, or undetected. Franchising can be viewed as both a hybrid organizational form (Brickley and Dark, 1987, Norton, 1988a) and a hybrid capital instrument (Jensen, 1989). As a hybrid capital instrument, franchising possesses interesting ownership and control features relative to capital supplied through public equity markets. As such, franchising may be a comparatively efficient source of capital for the organizational needs of a franchiser.

In this paper, we outline two competing theories of franchising. Each perspective is driven by a different set of causal factors, and is found in a separate body of literature. To marketing and retail system scholars, franchising is a means of delimiting organizational and financial constraints upon a firm's growth. In contrast, agency theorists focus upon the efficiency incentive features of the franchise relationship. Our analysis of 128 Canadian franchise systems indicates that neither theory alone accounts for the observed patterns of franchiser ownership. Rather, the findings suggest a more accurate portrayal of franchising is obtained by incorporating elements from both theories. To do this, we

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outline a path, or history dependent model (Arthur, 1988) in which the relative influence of resource constraints and efficiency factors varies with the age and size of a firm.

In the next section, we describe two theories of franchising and the predictions each makes about franchiser vertical integration. Next, empirical findings are presented which indicate that the franchisers pursue more heterogeneous ownership strategies than has been previously recognized. Subsequently, we offer an interpretation of the observed ownership patterns in the light of existing theories. Finally, we propose a path-dependent model of franchising which appears to reconcile existing theories and provides guidance for future research.

FRANCHISER OWNERSHIP PATTERNS AND EXPLANATIONS OF FRANCHISING

Among the U.S. firms that franchise, 70 percent of retail outlets are operated by franchisees. The remaining 30 percent are corporately owned and operated (*Franchising in the Economy*, 1987). There is some sectoral variation in franchising. For example, fast food restaurants rely on franchising (corporate ownership = 20 percent) more than convenience grocery stores (corporate ownership = 63 percent). Unfortunately, little is known about intra-sectoral variation because there have been so few studies which have examined ownership patterns at the firm level.[1]

Anecdotal and aggregate evidence (Oxenfeldt and Kelly, 1969; Luxenburg, 1985) suggests a trend towards greater franchiser ownership. Hunt's (1973) study based upon sectoral data finds that the mean size of franchise systems is positively related to company ownership. As well, he finds that mean sales per unit are higher in company owned outlets. Further, evidence suggests franchiser owned units are located in highly populated urban areas. On the other hand, franchised units are predominantly located in less populated rural areas (Caves and Murphy, 1976; Rubin, 1978).

The ownership pattern which has been inferred from these stylized facts is that; (i) firms will grow via franchising, but will buy back, or open corporate owned units once a particular size, or critical mass has been achieved; and (ii) the owned units will have higher than average sales, and will be located in cities (Oxenfeldt and Kelly, 1969). The ownership pattern has been advanced as a life-cycle explanation of franchising (e.g. Hunt, 1973; Lillis, Narayana, and Gilman, 1976). We suggest it would be more appropriate to refer to this explanation as the resource scarcity (RS) thesis since it is the lack of financial and managerial resources which is imputed as the cause for the high reliance upon franchising in a firm's early development.

The resource scarcity thesis

The (RS) view emphasizes the importance of brand name capital and economies of scale in promotion, which are both a function of retail system size. The competitive imperative for small chains is to grow faster than their rivals as a means of gaining an advantage. While franchisees are a source of capital and managerial expertise, growth by full ownership is limited by capital and managerial constraints (Oxenfeldt and Kelly, 1969; Hunt, 1973; Caves and Murphy, 1976). As such, it is suggested that small chains will franchise in order to ease resource constraints in their pursuit of promotional economies. However, once a critical mass, or optimal market coverage has been achieved: 'emphasis usually shifts toward operating efficiencies and market development—both of which can be best attained through the tight control permitted by ownership' (Oxenfeldt and Kelly, 1969: 74).

Through a period of growth, franchisers learn the profit and sales potential of individual units. As contracts expire, franchisers will exercise their option to repurchase the most profitable outlets. Generally, these attractive units will be located in high traffic, populous areas. Franchisers will continue to franchise less attractive units in rural areas, as well as in new market territories where they have little local market expertise and are attempting to establish another critical mass of

[1] Caves and Murphy (1976) explain sectoral variation in terms of the relative importance of brand-name capital vs. tangible goods. Brickley and Dark's (1987) differentiation is based on the importance of 'repeat customers'. Both analyses suggest a dichotomy resting on subjective criteria. In both cases, we believe that the level of aggregation for these factors is inappropriate. The importance of brand-name capital is likely to be franchise-system specific, while the repeat customer ratio is likely to be unit specific.

outlets. The implicit assumption is the franchiser, having achieved a particular size, now experiences positive cash flows and develops operational experience which delimits the resource constraint. Free from this resource constraint, franchisers will be able to own a greater number of outlets.

The RS explanation is consistent with data aggregated at the sectoral level, and has a compelling face validity, but is not supported by the results of studies conducted at the firm level (Brickley and Dark, 1987). Further, the RS thesis has been criticized in the light of modern capital theory (Rubin, 1978) which suggests franchising is an inefficient way of raising capital. As a consequence, the Administrative Efficiency (AE) thesis has emerged as a counterpoint to the (RS) explanation.

The administrative efficiency thesis

A growing number of writers (Rubin, 1978, Mathewson and Winter, 1985; Klein, Crawford and Alchian, 1978) analyzing franchising from the perspective of agency theory have identified several agency problems associated with this organizational form. Of these agency problems, the costs of monitoring manager performance in owned units have attracted the most attention (Mathewson and Winter, 1985; Brickley and Dark; 1987; Norton 1988a,b). Indeed, it is the problems associated with monitoring managers which motivates the AE theory. According to the AE perspective, managers (agents) in owned units do not have a strong incentive to perform efficiently because a proportion of their compensation is a fixed salary which is determined independently of unit performance. This form of compensation constitutes a low powered incentive (Williamson, 1985), because it encourages managers to shirk, or deliver reduced effort.

A moral hazard problem is faced by franchisers. While the firm can easily inspect the financial performance of a unit by observing periodic accounting data, the franchiser cannot reliably know whether to attribute performance levels to managerial effort, or to other factors outside the agent's control. Consequently, unit managers must be monitored, or observed directly by field staff whose task it is to ensure managers are performing to agreed-upon standards. Direct monitoring, however, constitutes an administrative cost to the franchiser which can be reduced through the use of more suitable high powered incentives (Williamson, 1985).

Franchising as an aligned incentive

Franchising represents a high powered incentive because a franchisee's compensation varies directly with unit performance. That is, a franchisee appropriates unit net income. Consequently, the franchisee has an incentive to manage unit variable costs tightly. As a result, the need for monitoring is reduced as franchisee effort is self-enforced. Moreover, in a franchising relationship the incentive is symmetrical. The franchiser, whose revenue from a unit is contractually predetermined as a fixed percentage of unit sales, has an incentive to maximize unit sales through the effective management and promotion of the franchise concept.

It is argued that the monitoring cost of owned units increases with unit dispersion and is positively related to the distance of a unit from the franchiser's headquarters. While franchising economizes upon monitoring costs, it is not absolutely efficient. The use of high powered incentives gives rise to three other agency problems; inefficient investment, free-riding and quasi-rent appropriation. The franchiser must trade-off these agency costs against the monitoring benefits of franchising (Brickley and Dark, 1987). It is this trade-off which leads the franchiser to own and operate their outlets in a discriminating way.

Inefficient investment

Inefficient investment stems from a problem of concentrated risk. Since franchisees have a large proportion of their wealth tied-up in a single unit, they are forced to consider the full risk of undertaking any marginal investments. On the other hand, the owner of multiple units need only consider the systematic risk of a particular investment (Brickley and Dark, 1987). Consequently, a rational franchisee should be expected to under-invest in certain assets. For example, local advertising campaigns and promotions have spillover effects on other system units. Such spillovers mean individual franchisees will not appropriate the full return to their investment. As a result, any such investments will be forgone and may be left to others.

Generally, when units are geographically concentrated, investment spillovers will be common. It is in these circumstances that the appropriate unit of investment is a group, or block of proximate, or interdependent units. Moreover, concentrated groups of units are more easily and economically monitored. In short, geographically concentrated units should be collectively owned and operated in order to facilitate optimal investment decisions and efficient monitoring.[2] This is a similar prediction to the RS thesis, but the rationale behind it differs. In the RS thesis, city ownership is attributable to larger sales volume and greater profitability rather than adminstrative efficiency.

The free rider problem

The second agency problem inherent in franchising is the potential for free riding. A franchisee has an incentive to shade product quality if the gains from such activities can be internalized and the costs externalized. The danger of free riding is greatest where repeat customers constitute a small proportion of unit sales (eg. tourist areas, or near major highways) (Norton, 1988a). Under these circumstances, the franchisee may lure customers in on the basis of an established brand name, but deliver an inferior quality product or service. Such a practice may be beneficial to individual franchisees who do not rely upon 'repeat customers'. However, this practice may pass a burden on to other system outlets in the form of devalued brand reputation. Since salaried managers in company-owned outlets have no incentive to shade quality, the AE prediction is that franchisers will own units which serve a large proportion of mobile, or non-repeat customers.

Quasi-rent appropriation

The third agency problem is the potential for quasi-rent appropriation (Klein *et al.*, 1978). A quasi-rent is the value of an asset over its salvage value. If quasi-rents are high, the franchisee risks appropriation by the franchiser. The impact of quasi-rent appropriation is similar to inefficient risk bearing. That is, franchisees should demand higher rates of return, or returns that permit them to fully depreciate the value of their franchisee specific assets over the duration of a contract. The practical implication is a franchiser will have difficulties attracting franchisees under such circumstances. Brickley and Dark (1987) suggest the risk of quasi-rent appropriation is likely to be greatest when there is a high initial investment required to establish a franchise. The problem of quasi-rent appropriation is particularly relevant to franchising. Much of the investment a franchisee makes is in dedicated assets (e.g. a uniquely designed building) with no alternative use and low salvage value. Therefore, all other things being equal, high initial investments will lead to greater company ownership of retail outlets.

In short, the AE thesis presents a symmetrical explanation of franchising. Counterbalancing advantages and disadvantages of franchising relative to corporate ownership determines firm ownership patterns. Franchising is administratively efficient when the monitoring costs associated with ownership are high. When monitoring costs are insignificant, there are few efficiency gains to be made through franchising. Under these circumstances, agency problems favor corporate ownership.

A critique and review of the resource scarcity thesis

The RS and AE perspectives both appear to be plausible explanations of franchising. However, the AE framework has been offered as an alternative to the RS thesis by agency theorists who claim the RS thesis rests upon the assumption of imperfect capital markets and that this is grounds for deep suspicion of it.

Rubin (1978) points out a franchisee's invest-

[2] One solution to the problem of managing proximate outlets is to permit contracts for multiple unit ownership with exclusive territory provisions. Brickley and Dark (1987) point out that this has: (i) undesirable risk bearing features and (ii) that this simply moves the monitoring problem down one level (i.e. the franchisee becomes either a sub-franchiser or faces the monitoring costs of full ownership).

In addition, this form of contract runs the risk of creating powerful franchisee empires who may develop great leverage over the original franchiser. Luxenberg (1985) describes several instances of this in the early days of franchising and notes that the policy has been dropped by most successful franchisers.

An alternative solution is to grant single unit franchisees exclusive territory. This may be quite effective for mature franchisers which have established near optimal penetration in a region, but creates rigidities for growing franchisers who have not yet reached a desirable level of market coverage.

ment in a unit typically represents a large portion of his wealth. As a consequence, the franchisee's investment contains a significant amount of diversifiable risk which could be costlessly reduced by investing in the chain as a whole. As such, a rational franchisee should demand a higher rate of return to reflect this diversifiable risk. The higher, risk adjusted rate of return means many profitable ventures are not undertaken. In other words, franchising is an inefficient means of raising capital, because it would be more efficient to sell shares in the chain as a whole. Further, franchising is not a very effective way of sharing risk[3] because it concentrates risk in the hands of the franchisee. Such a risk sharing arrangement is ineffective for both parties because the franchiser must somehow compensate franchisees for their assumption of greater personal risk.

As a consequence, Rubin (1978) contends that neither lack of capital, nor lack of managerial resources adequately explains why firms franchise. He argues that a firm can simply hire the required expertise if it has access to financial resources. Rubin concludes that owing to the inefficiency risk sharing structure of franchising, other factors must account for the wide spread use of this organizational form.

While Rubin and others reject the lack of capital argument as a motive for franchising, one must accept that a franchisee is a source of capital. In fact, it may be viewed as a hybrid form of capital which allocates residual rights (Alchian and Demsetz, 1972; Grossman and Hart, 1986; Hart, 1988) and decision rights in unique ways. Franchise capital is a form of private equity (Jensen, 1989) embedded in a contract which has efficient bonding and incentive features. Franchisee supplied capital is also hybrid in the sense that it bundles the supply of capital with labor (often in the form of the same person). Norton (1988b) contends,

> The fact that entrepreneurial skills and capital are jointly supplied means that the joint supply price of those inputs is less than the sum of the competitive prices times the quantities of those two inputs separately. . .attributing the contractual economies solely to the entrepreneurial component of the franchisee's joint supply could be misleading. . .capital and entrepreneurial skills are bundled precisely because it is costly to find talented, non-shirking managers as a firm tries to expand rapidly. . .(Norton, 1988b: 213)

A consideration of the hybrid nature of franchisee supplied capital highlights the fact that the RS explanation need not be premised on an assumption of market inefficiency. Indeed, this consideration suggests franchisee-supplied capital is comparatively efficient to public equity for the purposes of franchising.

Moreover, since franchise contracts are not homogeneous, the terms under which franchisees supply capital will likely differ from firm to firm. There is also likely to be a historical pattern to contractual arrangements. For any given firm, the clauses and content of the franchise contract will likely change over time in order to reflect improvements in the product market position of the franchiser.[4] In order to obtain franchisee-supplied capital and managerial expertise, the young, or small franchiser may have to offer softer terms than their more established counterparts. Given that a franchisee leases a franchiser's brand-name capital, it is surprising that the sensitivity of changes in the value of that asset to the terms of the franchise contract has received so little attention.

A critique of the administrative efficiency thesis

The chief limitation of the AE thesis is its ahistoric perspective. A key assumption made by the AE perspective is: 'Companies involved in franchising generally have identifiable brand names that help to assure customers of uniform product quality' (Brickley and Dark, 1987: 403). In fact, many small and young franchise systems are not well endowed with brand name capital. Many such franchisers do not possess the organizational capacity to ensure uniform product quality. Both brand-name capital and technical expertise are firm specific assets (Rubin, 1973; Wernerfelt, 1984) which require managerial efffort to develop.

Second, the AE thesis ascribes a narrow role to

[3] For a full survey of this and related issues see Holmstrom (1979), Levinthal (1988), and Eisenhardt (1989).

[4] For instance, Norton (1988b) notes that at one time Wendy's international actively sought multi-unit franchisees. However, once Wendy's had fully penetrated the U.S. market, it abandoned this policy for a single-unit franchising policy.

managers, one of guarding against shirking and quality shading (Perrow, 1986; Donaldson, 1990). Managers in franchise systems also perform other functions such as problem solving, and training franchisees in proprietary techniques. These managerial functions may be performed in different ways. For example, problem solving tasks can be dealt with through direct managerial intervention, or through the application of organizational routines (Nelson and Winter, 1982).

Developing franchise system assets

Marketing scholars argue that an important feature of franchising is that it permits rapid market penetration compared to full ownership (Lillis *et al.*, 1976). The timing of market entry is particularly important because an innovative retail concept may be emulated by rivals. Teece (1986) suggests a firm can protect the rents arising from an innovation under weak appropriability regimes[5] by investing in co-specific assets. The investment in co-specific assets reduces the ability of a rival to emulate an innovation. Brand-name capital is such a co-specific asset and its early accumulation represents a first-mover advantage (Lieberman and Montgomery, 1988).

The process of establishing brand capital in retailing is partly a geographic phenomenon (Meyer and Brown, 1979). To generate economies of scale in promotion, a firm must establish a critical mass of units in discrete geographical areas (Bush, Tatham, and Hair, 1976). In franchise systems, the need to establish a critical mass of units results in certain trade-offs.

The initial concentration of units in a discrete market is characterized by positive revenue externalities on existing units, but at a saturation point, the externalities become negative. That is, at some point, additional units cannibalize sales in existing outlets. Since a franchise system's revenue is a function of aggregate sales, the franchiser will have an incentive to continue adding units well past the point where cannibalization occurs. In contrast, a franchisee's income is dependent solely on unit revenues.

As a consequence of the cannibalization problem, the symmetrical incentives of the franchise relationship are only robust when both franchisee revenue growth, and franchiser income growth are both positive (i.e. in the pre-saturation phase of growth). In order to maintain symmetrical incentives, a franchiser must either expand beyond local markets, or integrate into existing units.[6]

The preceding discussion suggests that; (i) there is a relationship between the location of units and the creation of brand name capital; and (ii) to protect a franchise concept, there is an incentive to build brand name capital faster than rivals. As Teece (1986) notes, if firms are resource constrained, then hybrid organizational arrangements represent ways of gaining access to co-specific assets.

The limitations to growth in young and small chains are likely to stem from lack of managerial resources as much as, or more than capital constraints. Contrary to the AE assertion that management can be hired given sufficient capital, there is reason to believe managerial expertise cannot be effortlessly absorbed. Managerial expertise is often an organization specific asset (Williamson, 1985) which accumulates in value over time (Penrose, 1959; Rubin, 1973; Wernerfelt, 1984). Moreover, a small and young organization will lack detailed organizational structures and routines (Child, 1972). As Nelson and Winter (1982) point out, organizational routines constitute accumulated management expertise and are a product of organizational learning processes. Also, routines permit the easy replication of organizational sub-units (Usher, 1989).

Together these factors reinforce the economies of scale in promotion argument which suggests small franchise systems will be geographically concentrated. In the absence of routines, a franchiser will need to respond to the novel organizational problems frequently encountered by new franchisees through personal intervention. If the stock of managerial assets is limited, it is important they are not spread too thinly over a wide geographic area. Therefore, in the early stages of development, franchised units should be located close to system headquarters in order to facilitate managerial intervention.

Over time, and with the addition of new units, organizations generate routines as a result of managerial learning. To the extent that this

[5] A franchise concept cannot be patented and as such is 'weakly appropriable' in Teece's (1986) terms.

[6] For a broader discussion of the cannibalization problem, and a model of this sort of conflict see Zeller, Achabel and Brown (1980).

occurs, a franchiser may consider locating units further from its headquarters because established routines reduce the need for managerial intervention. For example, franchisees will face fewer 'problems', as recurring situations have been encountered before and the solutions to them have now been embodied in operational routines.

DATA DESCRIPTION AND ANALYSIS

Archival ownership data on 128 franchise systems was supplied by the *Institut National Sur le Franchisage du Quebec*, a non-profit research and information institution which conducts biennial surveys of franchisers operating in Quebec. The reference group used in this study was drawn from the institute's 1988 survey. Approximately 10 percent of the firms in this sample are the Canadian subsidiaries of U.S. based franchisers. Eight percent are Canadian firms whose corporate headquarters are not located in the province of Quebec. The remaining firms (82 percent) are based in Quebec. The franchisers under study serve a diverse spectrum of product market segments and range in size from small start-ups with three units, to large multinational franchise systems with over 750 outlets.

There are two factors about this sample which suggest the AE theory should apply strongly to these firms. First, the large absolute geographic distances between population centres in Canada suggest monitoring costs might be expected to play a strong role in determining ownership patterns. Second, the existence of favorable provincial government taxation and investment policies toward Quebec-based firms implies these firms face a softer capital constaint. These government policies should help mitigate their resource scarcity problem relative to franchisers in general.

Sample level correlation analysis (Appendix 1) offers little support for the RS thesis. For instance, the RS explanation suggests we should observe a negative relationship between franchise system size (TOTOUT) and the proportion of units franchised (FRANOUT). This negative relationship is expected because the RS predicts that as a franchise system grows, its capital constraint is alleviated. As a consequence, the more mature franchiser experiences positive cash flows and will choose to own and operate a greater proportion of outlets for control and efficiency reasons.

In contrast to the RS prediction, preliminary results show a weak, and non-significant positive relationship between size and ownership. Further, ownership does not appear to be associated with the age of the franchise system.

However, there is only mixed and tentative support for the AE thesis at the sample level. Due to problems associated with quasi-rent appropriation, the AE thesis predicts a strong negative association between franchising and franchisee investment requirements. Preliminary results show a non-significant relationship between these two variables. On the other hand, the observed negative relationship between franchising and geographic concentration ($r = -0.22$, $p < 0.01$) does offer some support for the AE thesis. That is, the greater the geographic dispersion, the greater the use of franchising.

These ambiguous findings, our general knowledge of many of the firms in the sample, and the diversity of product market segments served led us to believe a variety of vertical integration strategies might be favored. These factors also suggest that sample-wide statistical analysis presents an inappropriate level of analysis which may be obscuring potentially insightful relationships.

Conventional multivariate techniques such as multiple regression analysis suffer from two serious drawbacks in this context. First, an inherent assumption of regression analysis is that predictor variables are independent. As such, regression coefficients denote relationships between predictor and criterion variables under *ceteris paribus* conditions. Regression coefficients may be highly significant, but provide no indication of the 'central thread', or 'internal logic' of the relationships between various independent variables in terms of meaningful, or interpretable strategies (Hambrick, 1980).

A second inherent assumption in the interpretation of regression coefficients is that relationships between variables are linear and can be generalized over an entire sample. Variance left unexplained by the fitted model is characterized as error. Miller and Friesen (1977) suggest that instead of treating such unexplained variance as error, researchers should be prompted to search for better explanations of the underlying associations by attempting to identify potentially

insightful, but unspecified contingency factors which may facilitate, or inhibit associations between variables. One manner of accomplishing this task is to segment the sample in order to evaluate whether relationships between variables differ from one part of the sample to another.[7]

Factor analysis is a statistical technique useful in identifying inter-relationships between variables that are not directly observable (Tabachnick and Fidell, 1989) and provides a useful means of segmenting a sample into relatively homogeneous segments. An orthogonal rotation of the factor matrix ensures factors represent unidimensional constructs. In the context of this research, these factors represent franchiser ownership strategies which are readily discriminable from one another. Factor loadings highlight the components of each strategy, so that the composition and construct validity of each is established constitutively (Kerlinger, 1986).

Inductive taxonomic analyses are often criticized as blind empiricism. So there is some need to defend this analytical approach. First, each variable considered for analysis has been previously implicated as being a material element of franchiser ownership strategies by one, or both of the existing explanations of franchising. Consequently, the choice of measures is theoretically grounded. The 13 measures employed can be grouped along 7 dimenions: size, ownership, dispersion, growth, franchisee investment requirements, contractual provisions, and timing and age considerations (Appendix 2).

Second, a taxonomic approach to the operationalization of strategy has been described as a mid-range initiative (Hambrick, 1984) offering a compromise between more extreme fine and coarse grained methodologies (Harrigan, 1983). Fine grained, contingency methodologies suffer from generalizability and replicability problems. On the other hand, coarse grained studies may have broad generalizability, but their highly aggregated samples may be too broad to rigorously investigate strategic phenomena (Harrigan, 1983).

The taxonomic approach used here has been the hallmark of most strategic group research and has been adopted by a growing number of strategic management researchers in a variety of contexts (e.g. Miller and Friesen, 1978; Hatten and Schendel, 1977; Dess and Davis, 1984; Hawes and Crittenden, 1984; Primeaux, 1985, and Ryans and Wittink, 1985). A prime objective of this approach is the creation of a taxonomy of organizations in which the constituents of a particular group most resemble each other in terms of their strategies. In terms of strategic conduct, a setting is viewed to be comprised of heterogeneous organizations punctuated by strategic clusters of relatively homogeneous members. Porter (1979) defines such clusters as strategic groups, where firms in each cluster resemble one another in terms of their key strategic decision variables.

Five factors accounting for 71.8 percent of the variance in the design were extracted using principal components analysis (Table 1). The factor solution matrix was orthogonally (varimax) rotated to facilitate interpretation and significant loadings were evaluated.

In order to test the stability of the factor loadings, 15 separate random samples of 96 cases (i.e. 75 percent of the total data set) were drawn and factor analyzed. In 14 of the 15 trials, the factor loadings were virtually identical in terms of their pattern and magnitude.[8] These results suggest the original factor loadings are remarkably stable and can be interpreted with a fair degree of confidence.

Factor scores were calculated for each of the franchise systems studied and served as the basis

Table 1. Factor, eigenvalues, variance explained

Factor	Eigenvalue	Percentage of variance	Cumulative percentage
1	2.65790	20.4	20.4
2	2.15304	16.6	37.0
3	2.05245	15.8	52.8
4	1.43345	11.0	63.8
5	1.03595	8.0	71.8

[7] Stratification of the sample by product-market segment, and by chain size failed to uncover results which could be explained meaningfully.

[8] In the anomalous case, factors 1–3 were congruent with the other analyses, but loadings differed slightly on factors 4 and 5. The remainder of the trials were entirely consistent with the results obtained on the entire sample. In three cases, factors were interchanged (e.g. factor 2 and factor 3 changed positions twice), but the patterns and magnitudes of loadings were unchanged. In another case, the signs of the two variables loading on factor 5 were reversed.

for categorizing the firms. Franchise systems were considered to be pursuing a strategy by virtue of their most significant loading on a factor.[9] In order to assess the usefulness of this method of categorization, one Manova, as well as thirteen univariate F; and Scheffe multiple comparison tests were conducted (Table 2). This statistical treatment revealed statistically significant ($p < 0.001$) inter-group differences in terms of all 13 variables included in the research design. These results are suggestive of a high degree of inter-group heterogeneity. The observed between-group heterogeneity signifies that grouping firms on the basis of their most significant factor loading is an appropriate means of segmenting the sample.

The strategies

Table 3 lists the significant variables and their loadings on each of the five extracted factors (strategies). Variables which have lower loadings will also be used in the description of each strategy. Lower loadings, while not as pronounced, do in many cases help articulate and refine the description of individual strategies. Within-group Pearson correlation coefficients (Appendix 1) are discussed when they differ materially from those calculated for the study as a whole.

Rapid growers

Although the Rapid Growers have been franchising for the shortest time of any group studied (4.1 years), they have larger retail networks (156.7 units) than all but the Mature Franchisers (Factor 4). These franchisers have adopted a salient strategy of rapid growth. Reflecting this strategic orientation, Rapid Growers have waited a very short time (1.3 years) before making the transition from wholly owned store(s) to franchising. On average, they have opened 53.3 outlets a year since their inception and 58.6 franchised outlets per year since they began franchising. Scheffe results indicate these growth rates are significantly higher than all other groups. In terms of these growth measures, the Rapid Growers have been opening up new outlets 5.4 times faster than the study mean (9.9). Their franchise growth rate has been 4.5 times the study standard (13.1).

In their rapid growth franchising segment, franchise price appears to be a material determinant of network growth rate. While at the sample level, no significant relationship was found between pricing and growth measures, in this segment, franchise fees per year are strongly and negatively associated with outlet ($r = -0.58$, $p < 0.05$) and franchise unit ($r = -0.53$, $p < 0.05$) growth. Reflecting the price sensitivity of franchise sales, average total investment for franchisees ($125 K) is roughly two-thirds that of the study mean ($187.4 K). The expansion objectives of the Rapid Growers extend beyond the boundaries of their home province. Only 31.6 percent of their outlets are located in the province of Quebec, making them the most geographically dispersed retail systems studied.

The retail systems of the Rapid Growers are mainly comprised of franchised outlets (92.7 percent). To these franchisers, franchising appears to be used as an expedient for growth. While no significant relationship between age, and ownership is found at the study level, the Rapid Growers exhibit a positive relationship between the age of their franchise system and their degree of franchising ($r = +0.35$). The observed positive association between age and franchising indicates that the Rapid Growers are not at a stage of development where they might consider buying back franchised outlets. Rapid Growers become increasingly franchise-based as they age.

Conservative expensives

The Conservative Expensives price their outlets higher than any other group studied. The average investment required by Conservative Expensive franchisees ($397 K) is significantly higher than all other groups. Conservative Expensives also charge very high initial franchise fees. These fees average $44.1 K, and are more than twice the study standard ($21.6 K). Fees per year (5.8 percent of sales) and advertising fees per year (3.4 percent of sales) are also both well above study norms. In exchange for their capital outlays, franchisees are given contracts of long duration (12.9 years).

[9] Twelve of the franchise systems studied had negative, or very low loadings on all extracted factors. Consequently they were excluded from subsequent analysis.

Table 2. Significance of differences between groups

	Rapid growth franchisors (1) (n = 20)	Expensive conservatives (2) (n = 30)	Converters (3) (n = 21)	Mature franchisors (4) (n = 16)	Unsuccessfuls (5) (n = 28)	Mean	Std. Dev.	F	Scheffe $P < 0.05$
No. of Outlets	156.7	51.3	62.2	181.8	31.9	80.7	101.8	9.4[1]	4 > 5, 2, 3
% of Outlets franchised	92.7	71.5	72.5	77.0	92.1	81.3	22.2	5.2[1]	5 > 2, 3
% of Outlets located in Quebec	31.6	78.3	84.6	41.0	81.8	69.4	35.4	9.2[1]	1, 4 < All others
Outlet openings per year	53.3	4.6	1.6	9.4	4.8	9.9	24.9	10.4[1]	1 > All others
Franchise openings per year	58.6	6.5	12.4	7.4	6.3	13.1	25.5	10.9[1]	1 > All others
Average investment (000 $s)	125.0	397.0	95.6	188.5	128.1	187.4	208.8	8.2[1]	2 > All others
Franchise fee (000 %s)	21.7	44.1	15.8	15.5	13.9	21.6	27.4	5.3[1]	2 > 5, 4, 3
Franchise fee per year (% of sales)	7.3	5.8	4.5	3.8	2.2	4.2	3.0	9.3[1]	5 < 2, 1; 4 < 1
Advertising fee (% of sales)	1.3	3.4	1.2	1.4	0.9	1.6	1.5	12.1[1]	2 > All others
Contract length (years)	4.9	12.9	5.9	8.7	5.4	7.6	4.7	11.7[1]	2 > 1, 5, 3
Years since first franchise	4.1	6.1	5.6	19.2	5.9	8.0	5.0	30.9[1]	4 > All others
Years between inception and first franchise	1.3	6.0	29.5	2.9	2.1	8.4	7.2	62.4[1]	3 > All others
Years since inception*	5.4	12.0	35.1	22.1	8.1	16.4	9.0	40.6[1]	3 > All others; 4 > 1, 5, 2
Multivariate test of significance (Wilks)							12.3[1]		

Notes: [1] Significant at $P < 0.001$.
* Log(10) Transformation used for statistical purposes.

Table 3. Franchisor strategies and significant loadings

Strategy I (factor 1) rapid growth franchisers	Factors loadings
Franchise openings per year	0.96227
Outlet openings per year	0.91694
No. of outlets	0.50840
Percent of outlets in Quebec	−0.43840
Strategy II (factor 2) expensive conservatives	
Average investment	0.78392
Initial franchise fee	0.76023
Contact length	0.62560
Advertising fee (percent of sales)	0.60737
Strategy III (factor 3) converters	
No. of years between inception and Establishment of first franchise	0.98074
No. of years since inception	0.93292
Strategy IV (factor 4) mature franchisers	
No. of years since first franchise	0.87819
No. of outlets	0.70894
Percent of outlets in Quebec	−0.60472
Strategy V (factor 5) unsuccessfuls	
Percent of outlets franchises	0.79117
Fees per year (% of sales)	−0.73737

Conservative Expensives are apparently looking for a very particular type of franchisee, one who is able to make a substantial investment and presumably contribute to the image of the chain. If that variety of investor is not available, the Conservative Expensives will own and operate their retail outlets (28.5 percent). Reflecting their ability to attract more attractive franchisees as they become established, the Conservative Expensives become progressively more franchised based ($r = +0.4$, $p < 0.05$).

As the Conservative Expensives become larger, their pursuit of this strategy becomes more articulated. In a departure from the pattern observed at the study level, contract length is positively and strongly related to network size ($r = +0.52$, $p < 0.01$). Franchisee capital requirements are also positively associated with unit size. Franchise fees per year decrease with system size.

These seemingly contradictory findings can be explained in terms of these firms' conservative orientation. As the Conservative Expensives become larger, they can demand more 'up front' compensation, relying to a decreasing extent on less certain franchise unit revenue. This pattern effectively transfers a certain amount of risk from the firm to the franchisee. Of course, from the franchisee's perspective, a more established franchise is less risky. As a consequence, it is presumed the costs associated with transferring risk from the franchiser to the franchisee (in terms of contractual concessions) should be negatively related to chain size.

Compared to alternate channel forms, franchising is a relatively risk-free expedient for growth for the Conservative Expensives. This practice implies a sophisticated understanding of issues related to incentives, risk bearing and efficiency. In contrast with the Rapid Growers, the Conservative Expensives are not simply using franchising as an expedient for growth. The Conservative Expensives use franchising for administrative efficiency reasons as well.

Franchise converts

The Converts are the oldest retail systems in the study. On average, they have been in existence for 35.1 years. Converts typically begin operations as wholly owned chains, and after many years decide to begin franchising.

Relative to their total age, the Converts have not been franchising for a very long time (5.6 years). Converts average 29.5 years of operations before franchising. This latency period is 9.3 times longer than the average of all other groups of firms (3.17 years).

To the Converts, franchising appears to be an expedient for growth. Historically, these chains have not grown very quickly, opening up only 1.6 outlets per year since their inception. However, since the Converts began franchising, they have established an average of 12.4 franchises per year, a growth rate second only to the Rapid Growers. This radical transformation of their growth strategies may be explained by a change of management, or management philosophy in the light of a perceived threat posed by new entrants, or rapidly growing competitors, and a historic failure to capitalize on untapped growth potential through the establishment of company owned retail outlets.

The Converts are strategically similar to the Rapid Growers in that franchising is used as an expedient for growth. Converts price their franchises low to facilitiate their expansion plans. The average franchisee investment required ($95.6 K) is significantly below that which is required in all other groups. The major difference between the Rapid Growers and Converts lies in timing. While the Rapid Growers begin franchising concurrently with, or immediately following their inception, Converts begin operations as single, or multiple unit privately-owned chains for a long period before turning to franchising with a vengeance. Eighteen of the twenty-three converts studied waited over 20 years before franchising. In the most dramatic case, a single company-owned store was maintained for 64 years before the owners embarked upon an ambitious growth program based upon franchising.

Mature franchisers

Mature Franchisers have been franchising for a relatively long time, longer than organizations following any other dominant strategy. On average, Mature Franchisers have been franchising for 19.2 years, 11.2 years longer than the study mean (8 years). Perhaps as a product of their longevity, the Mature Franchisers comprise the largest retail systems in the study. In terms of total outlets (181.8), they are larger than firms following any other generic strategy.

As a consequence of their size and stage of maturity, the Mature Franchisers have expanded outside their saturated home territories. As compared to the study average of 69.4 percent, only 41.0 percent of Mature Franchiser outlets are based in Quebec. Another manner in which these franchisers strive for channel effectiveness in the light of problems related to saturation is the granting of exclusive territories to franchisees. This may take the form of area franchising where a particular franchisee is given the exclusive right to open up outlets within a particular geographic area. Mature Franchisers may also opt to 'buy back' established franchises in saturated areas in an effort to alleviate problems of cannibalization.

Correlation analysis suggests the Mature Franchisers may be pursuing buy back policies. While all other groups of firms display a positive relationship between chain size and franchisee ownership, the Mature Franchisers become progressively more company owned as they increase in size ($r = -0.27$).

Unsuccessfuls

Unsuccessfuls appear to have adopted a strategy of rapid franchising. Up-front franchise fees ($13.9 K), and fees per year (2.2 percent of sales) are the lowest of all groups studied. Advertising fees (0.9 percent of sales) are about half the study average. These low fee structures suggest Unsuccessfuls have not developed a successful market formula. That is, their business concept is not robust and the low prices charged for franchise opportunities reflects a poor competitive position. Unsuccessfuls have opted for expansion almost exclusively through franchising. 92.1 percent of their retail outlets are franchised (the second highest proportion of franchised units after the Rapid Growers).

Their attempted strategy of growth by franchising does not appear to be successful. Unsuccessfuls have opened only 4.8 new retail outlets per year since their inception and 6.3 franchised outlets per year since they began to franchise. Also, the Unsuccessfuls took a relatively short time to begin franchising (2.1 years), suggesting they began franchising before firming up their business concept.

The inter-group heterogeneity discussed above suggests a single explanation of franchising is insufficient to explain franchiser ownership strategies. High levels of aggregation may obscure meaningful distinctions which can shed light on why firms use franchising. Using factor analysis, five discrete franchiser types were identified. Franchising serves a distinct strategic role to each of these classes of franchisers. Not only do these classes of firms differ in terms of each of the 13 measures considered, but interrelationships between strategic variables vary substantially between groups, and consequently between the sample and group level.

A striking example of how interrelationships vary between groups is found in the observed associations between system size and percentage of outlets franchised (Table 4).

At the sample level of aggregation, it appears there is no relationship between size and franchising. However, by partitioning the sample, a fuller understanding of the relationship between these variables becomes apparent. Contrary to the RS thesis, three groups (i.e. the Expensive Conservatives, Converters and Unsuccessfuls) exhibit a positive and significant relationship between size and franchising. That is, these firms become increasingly franchise based as they grow. On the other hand, Mature Franchisers appear to shift from a strategy of franchising to that of opening up corporate owned stores as they become larger.

These two variables (i.e. Ownership and Size) which appeared to be unrelated when examined at the sample level, are in fact statistically significant in three of the five classes of franchisers identified. While not highly significant, the relationship between size and franchising in the case of the Mature Franchisers is important in two respects. First, it lends some support to the RS explanation of franchising. Second, it underscores the heterogeneity of franchiser-ownership patterns and delineates the source of unexplained variance in the sample level analysis.

These findings seem to corroborate Miller and Friesen (1977) and Harrigan's (1983) contention that many meaningful and interesting idiosyncrasies are lost in the error terms of statistical analyses.

Table 4. Pearson correlation coefficients, system size and percentage of units franchised

Sample	+ 0.02
Rapid growers	+ 0.14
Expensive Conservatives	+ 0.39**
Converters	+ 0.33*
Mature Franchisers	− 0.27
Unsuccessfuls	+ 0.31*

Notes: ** Significant at $p < 0.05$
* Significant at $p < 0.1$

DISCUSSION

Our findings suggest elements of both the RS and the AE theses enter into franchiser-ownership decisions. In a nutshell, the implication is that firms choose franchising as a means of achieving faster levels of growth by delimiting their resource constraints. However, where agency problems associated with franchising are strong, administrative efficiency considerations reduce the potential for growth through franchising. In other words, administrative efficiency mediates the franchise for growth relationship.

Our interpretation of the strategic behavior observed here suggests two groups (i.e. the Converters and the Rapid Growers) emphasize the growth objective over efficiency considerations.

The smallest group ($N = 12$) are the Rapid Growers. Rapid Growers appear to have discovered a successful business concept and are expanding quickly to establish a critical mass of units. Franchise fees per year (7.8 percent of sales) are the highest of any group studied, which suggests the Rapid Growers can command high rates for their franchises. Low average franchisee investments indicates the concept may be easily emulated by rival chains and franchisees are not required to make large investments in franchiser-specific assets. Low required investments suggest franchisees are not subject to hazards of quasi-rent appropriation. Another characteristic of the Rapid Growers is that they expand quickly out of their home province.

Together, these elements suggest Rapid Growers are not subject to severe agency problems which would favor ownership. Their high geographic dispersion indicates significant monitoring costs are likely. Therefore, franchising is a more efficient organizational arrangement than ownership. In addition, competitive factors may

more efficient organizational arrangement than ownership. In addition, competitive factors may exert a strong pressure to grow in order to pre-empt rivals. In other words, franchising to grow quickly is feasible and desirable on both efficiency and resource scarcity grounds and is selected as the dominant strategy.

The Converts are similar to the Rapid Growers in that they are not subject to severe agency problems (i.e. low investment and start-up costs). Inspection of the firms in this group shows them to be largely comprised of food retailers. These franchise systems have historically been wholly owned retail chains who have discovered the franchising concept quite recently and have adopted it as a means for growth.

The relatively high level of ownership among converts is attributable to timing. Having adopted franchising late in organizational life, Converts have a legacy of owned stores in their unit base. We would expect the proportion of owned stores to decline as the Converts enter more distant markets. The low geographic dispersion of units (i.e. 84.6 percent of outlets are located in Quebec) in these systems is probably due to logistical reasons. Retail units must be located close to a central warehouse.

For Converts, it is not administrative efficiency considerations which have created relatively high levels of ownership and historically low levels of unit growth, as is the case with the Conservative Expensives group (see below). Rather, it is the choice of organizational form (i.e. fully-integrated ownership) which has limited growth. The adoption of franchising in these firms unlocks the potential for growth.

The strategies of the Mature Franchisers are broadly consistent with the AE thesis. Growth opportunities appear to have tapered off. Compared to Rapid Growers, the Mature Franchisers rely less on franchising, but their wide geographic dispersion suggests franchising remains important as a means of reducing monitoring costs. In addition, investment costs while not absolutely high, are the second highest among the groups. These high costs suggest the presence of a moderate quasi-rent appropriation risk. Franchisees are given long contract terms (8.7 years) to compensate for the risk of quasi-rent appropriation.

Since Mature Franchisers are firmly established, successful organizations, many well qualified franchisees may actively 'self-select' themselves into these systems.[10] This self-selection process may have positive externalities for other unit managers. That is, the successful Mature Franchiser may benefit from demanding a high up-front investment since this may result in many highly qualified franchisees 'self-selecting' themselves into the system. Correlation analysis (Appendix 1) offers some support for this proposition. While the relationship between average investment required per franchise (AVGINV) and FRANOUT is negative for the sample as a whole (i.e. − 0.086), the relationship between these two variables is positive (+ 0.18) in the case of the Mature Franchisers. In other words, in the specific case of the Mature Franchisers, high initial investment is positively related to franchisee ownership. This may very well reflect self-selection dynamics.

The strategies of the Conservative Expensives provides strong support for the growth-efficiency trade-off argument. Conservative Expensives appear to have developed a successful business concept and command a high market price for the sale of a franchise. Under these conditions, there is significant investor risk and a strong hazard of quasi-rent appropriation for the franchisee. These factors are reflected in the fact that corporate ownership among these firms is the highest of any group studied.

The high regional concentration of the Mature Franchisers is not inconsistent with the AE thesis. In our view, the most striking characteristic of these firms is their low rates of growth despite their possession of a successful business concept and apparent growth opportunities. While growth may be desirable, the need to give operational and efficiency considerations a high priority limits the potential of franchising. Therefore, the growth potential of the Mature Franchiser is limited.

We have called the residual group of franchise systems the Unsuccessfuls. These small retail systems are largely franchised and located in their home province. Unsuccessfuls demand low investment requirements and command a small franchisee fee. Their young age, coupled with the fact they began franchising almost simultaneously with founding, suggests the low growth rate of

[10] We would like to thank the anonymous referee who brought the issue of self-selection to our attention.

the these firms can only be attributed to an unsuccessful business concept. For the Unsuccessfuls, the growth versus efficiency decision does not arise. However, it is conceivable that this residual category (the largest) contains a number of firms which are in the process of getting established and may yet become successful.

TOWARDS A SYNTHESIS

The findings reported here suggest that both RS and AE perspectives shed light on franchiser ownership patterns. Unfortunately, adherents to the AE view reject the RS thesis outright. Similarly, many proponents of the RS explanation ignore the incentive and administrative efficiency features of franchising. Our results suggest these competing perspectives both offer substantial insights, but ignore crucial elements contained in the other framework.

Any theory of franchising should be able to account for two conspicuous reasons why firms franchise. First, franchising is useful because in certain situations it has efficiency advantages over vertical integration. Second, franchising is also potentially useful as a means of delimiting resource constraints, as an expedient for growth. Existing explanations account for one of these features of franchising, or the other, but not both.

In this section, we propose a path, or history dependent model which synthesizes the existing dualistic lines of inquiry into a single framework. Further, it is shown that the strategies identified above can be located at points along the path (Figure 1). In doing so, a number of avenues for future research are suggested.

We see the fundamental decision as the choice between franchising in some degree and full ownership. Historically, the choice has been the latter (Chandler, 1977), but the spectacular growth of franchising over the past 30 years has led many formerly integrated chains to experiment with this organizational form. It is undoubtedly the case that of the firms that franchise, there is a significant proportion of firms that were once fully integrated.

An ahistorical approach fails to account for such organizational developments. The path model presented here accounts for the fact that franchisers begin from different starting points and these distinctive beginnings affect organizational outcomes (Stinchcombe, 1965). For example, our results indicate that once an integrated firm adopts franchising it will grow faster than before. Such findings stimulate broader questions about organizational adaptation and inertia (Hannan and Freeman, 1977). For example, do firms which adopt franchising late in life perform as well as firms which begin life as franchisers? Further, does the age at which a firm adopts franchising affect its ability to benefit from the organizational advantages of franchising?

Second, an ahistoric approach necessarily focuses upon surviving franchise systems. The comparative youth of the group we have called Unsuccessfuls reminds us that the decision to franchise does not guarantee success. Often overlooked is the crucial entrepreneurial role of designing and establishing a business format which can be sold in competitive franchise markets. In the Unsuccessful group are firms which will probably fail as well as some which will later succeed. Further research is warranted to distinguish between the types of strategies, organizational arrangements and franchise contracts which are associated with early failure and longer-term success.

Third, while the AE thesis focuses upon the relationship between ownership and geographic dispersion, the RS thesis highlights the relationship between ownership and growth. The link between growth and geographic dispersion needs greater attention. The results reported here suggest clearly that the smaller the franchise system, the greater the proportion of units located in Quebec. This may very likely reflect a franchiser's concern with the need to establish brand-name identity in discrete geographic areas prior to entry into more distant, remote markets.

If the investment features of a franchise favors high levels of ownership, then resource constraints limit the rate at which franchisers can expand their system (e.g. Conservative Expensives). As a consequence, these firms tend to remain local for a longer period of time while they establish brand name capital. In comparison, the Rapid Growers are not required by investment features to maintain high ownership levels, and may expand units through franchising at a relatively faster rate. In addition, Rapid Growers may be expected to generate organizational routines at a faster rate and consequently, may contemplate

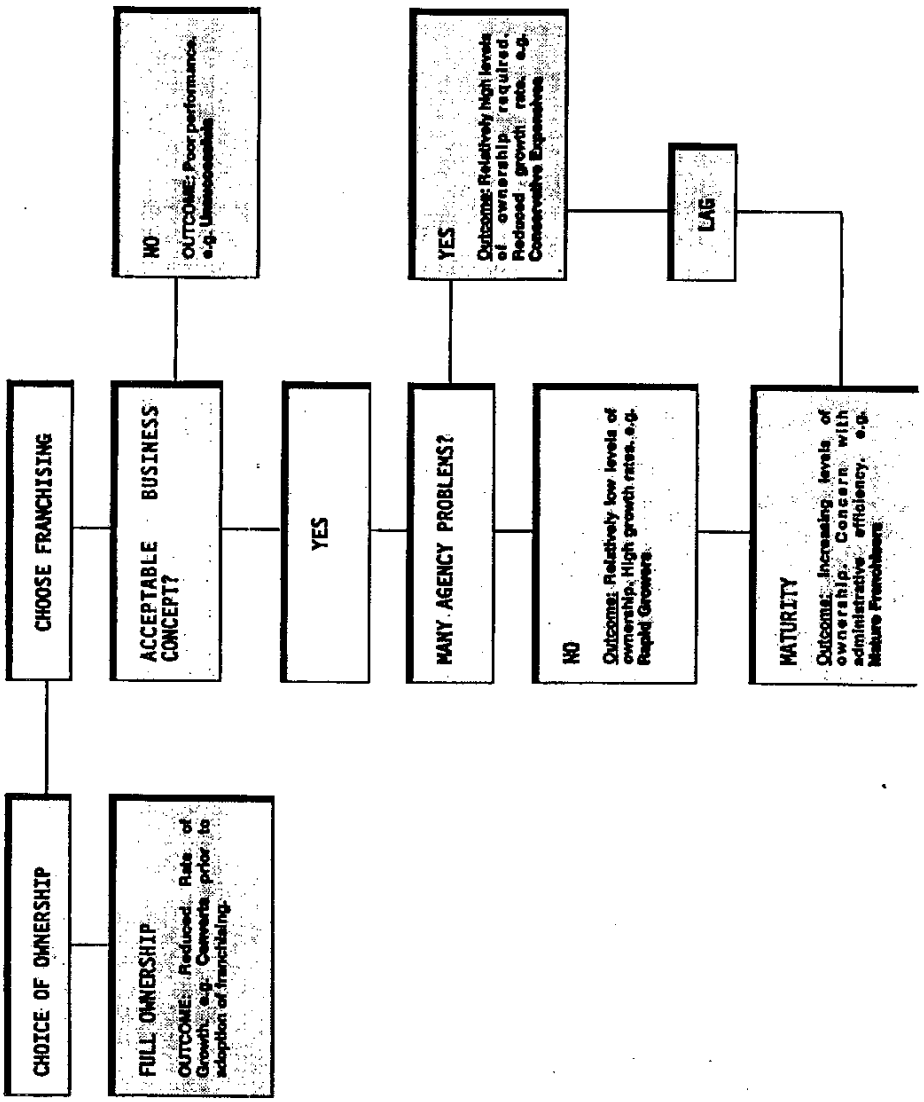

Figure 1. Path model of franchise ownership patterns

the establishment of units in more distant locations at an earlier age.

The path model reveals subtleties in the growth process which are obscured by cross sectional hypotheses. In the longer run, with high market penetration, the establishment of brand identity, and the creation of greater organizational capacity, administrative efficiency concerns come to dominate the ownership decision. The ownership patterns of the Mature Franchisers support this view and are consistent with the AE thesis.

Agency theorists contend an organization can be viewed as a nexus of contracts. Indeed, franchise systems appear to be an ideal terrain to explore this metaphor. Brickley and Dark (1987) have begun to do this from an efficiency perspective. An important issue yet to be addressed is the ways in which a nexus of contracts adapts to environmental disturbances, such as major product market changes. Williamson (1985) contends contractual relationships are not well suited to effecting large, or frequent adaptations. It is clear franchise systems do adapt to product market changes, but it is not clear how, or whether they manage such changes via contractual means. Case studies seem warranted on this front.

In this paper, we have used the stategy paradigm to integrate insights from finance, marketing and organizational theory. Given the hybrid nature of the franchise relationship, we believe a multi-disciplinary approach is crucial for conducting future research in this area.

The suggestion that franchising might be seen as a hybrid capital instrument gives rise to a number of research possibilities. It is quite apparent that the market for franchises is competitively organized. However, beyond this, little is known of the operations of these markets. For example, a close examination of the ways in which the leasing prices of brand-name capital are determined might shed light on the more general problem of the valuation of intangible assets which is an important issue in accounting research.

We have suggested the contractual provisions in franchise relationships are likely to change over time in order to reflect changes in the market value of a franchiser's brand-name capital and proprietary knowledge. Again, longitudinal and case-type studies seem warranted.

However, it is unlikely the structure of the franchise contract will be solely determined by market forces. The establishment and widespread growth of franchisee associations (i.e. franchisee 'trade unions' in mature franchise systems) which negotiate collective agreements probably reflects the need to readjust the balance of power between franchisers and franchisees. In this regard, insights from industrial relations may shed some light on how contractual arrangements are set in mature franchise systems.

The imputed causality in the AE thesis is that firms first establish units, and then decide upon ownership in consideration of monitoring costs. An alternative proposition is that firms first decide upon an ownership policy based upon investment features (e.g. mainly own, or mainly franchise) and then choose a location policy in consideration of organizational capabilities and the need to establish brand identity. According to this view, efficiency, brand-name capital accumulation and resource constraints are interdependent. Consequently, franchisers face several strategic trade-offs. The path-dependent model highlights the possibility that ownership strategies are time and firm size dependent. The Rapid Growers and Conservative Expensives suggest tentative support for this view. However, longitudinal studies are needed to lend further support to this proposition.

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APPENDIX 1

Pearson correlation coefficients; All groups

	TOTOUT	FRANOUT	QUE	G1	G2	AVGINV	FEE	FEEYR	ADVYR	CONLENG
TOTOUT	1.0000									
FRANOUT	0.0203	1.0000								
QUE	− 0.5269	− 0.2231	1.0000							
G1	0.4203	0.1126	− 0.3328	1.0000						
G2	0.4622	0.1905	− 0.3346	0.9038	1.0000					
AVGINV	0.0780	− 0.0860	− 0.0726	− 0.0313	− 0.0700	1.0000				
FEE	− 0.0707	− 0.0671	− 0.0698	− 0.0100	− 0.0123	0.5107	1.0000			
FEEYR	− 0.0714	− 0.1823	0.0012	0.0018	− 0.0163	0.0351	0.1555	1.0000		
ADVYR	0.0602	− 0.0014	− 0.1197	− 0.0098	0.0158	0.2774*	0.2888	0.1200	1.0000	
CONLENG	0.0202	− 0.1247	− 0.0398	− 0.0362	− 0.0783	0.3732	0.2664	0.0794	0.3087	1.0000
FRANAGE	0.4109	0.0105	− 0.2943	− 0.1009	− 0.1861	0.1037	− 0.1006	− 0.1905	− 0.0383	0.1596
FRANADT	− 0.0055	− 0.1227	0.1311	− 0.1701	0.0320	− 0.0702	− 0.0195	− 0.0385	− 0.0132	− 0.0058
TOTAGE	0.2052	− 0.1057	− 0.0294	− 0.2088	− 0.0656	− 0.0118	− 0.0695	− 0.1330	− 0.0317	0.0763

	FRANAGE	FRANADT	TOTAGE
FRANAGE	1.0000		
FRANADT	− 0.1218	1.0000	
TOTAGE	0.3991	0.8615	1.0000

Pearson correlation coefficients; Rapid growers

	TOTOUT	FRANOUT	QUE	G1	G2	AVGINV	FEE	FEEYR	ADVYR	CONLENG
TOTOUT	1.0000									
FRANOUT	0.1382	1.0000								
QUE	− 0.4749	0.1211	1.0000							
G1	0.6302	0.0571	− 0.3651	1.0000						
G2	0.6627	0.1226	− 0.4110	0.9663	1.0000					
AVGINV	0.1038	0.2978	− 0.2150	0.0001	− 0.0311	1.0000				
FEE	− 0.0817	− 0.1049	− 0.5151	0.0879	0.1567	0.0857	1.0000			
FEEYR	− 0.6825	0.2717	0.8131	− 0.5789	− 0.5297	− 0.2057	− 0.2424	1.0000		
ADVYR	0.0767	− 0.0793	− 0.5121	0.1325	0.0454	0.6961	0.0962	− 0.5903	1.0000	
CONLENG	0.3309	− 0.0035	− 0.5374	0.2728	0.3481	0.5719	0.5311	− 0.3624	0.4011	1.0000
FRANAGE	− 0.1524	0.3542	0.1996	− 0.5799	− 0.6477	0.1349	− 0.4852	0.1995	0.1479	− 0.4403
FRANADT	0.1415	− 0.3283	0.1047	− 0.2718	− 0.1358	− 0.3164	− 0.0712	0.0690	− 0.3542	− 0.0500
TOTAGE	− 0.0025	0.0061	0.2401	− 0.6711	− 0.6125	− 0.1540	− 0.4339	0.2109	− 0.1748	− 0.3818

	FRANAGE	FRANADT	TOTAGE
FRANAGE	1.0000		
FRANADT	− 0.2100	1.0000	
TOTAGE	0.6020	0.6535	1.0000

Pearson correlation coefficients; Conservative expensives

	TOTOUT	FRANOUT	QUE	G1	G2	AVGINV	FEE	FEEYR	ADVYR	CONLENG
TOTOUT	1.0000									
FRANOUT	0.3971	1.0000								
QUE	− 0.5992	− 0.3343	1.0000							
G1	0.4140	0.4170	− 0.0429	1.0000						
G2	0.6649	0.5149	− 0.5068	0.6917	1.0000					
AVGINV	0.1791	− 0.0589	− 0.1018	− 0.1557	− 0.0552	1.0000				
FEE	− 0.0334	− 0.0621	0.0070	− 0.1904	− 0.0381	0.5451	1.0000			
FEEYR	− 0.1972	− 0.3920	0.0867	− 0.1580	− 0.2273	− 0.1757	− 0.0655	1.0000		
ADVYR	0.2387	0.4045	− 0.3874	0.0943	0.2249	0.0154	0.0651	− 0.0879	1.0000	
CONLENG	0.5230	0.1562	− 0.1306	0.1793	0.3038	0.2445	0.0162	− 0.2620	− 0.3320	1.0000
FRANAGE	0.7093	0.4133	− 0.3710	0.1100	0.1342	0.2870	− 0.0582	− 0.2391	0.1302	0.4713
FRANADT	0.4564	0.0095	− 0.3993	− 0.2174	0.3817	0.3481	0.1614	− 0.2218	− 0.0253	0.5037
TOTAGE	0.7285	0.2465	− 0.4925	− 0.0870	0.3428	0.4082	0.0782	− 0.2927	0.0580	0.6231

	FRANAGE	FRANADT	TOTAGE
FRANAGE	1.0000		
FRANADT	0.2253	1.0000	
TOTAGE	0.7368	0.8247	1.0000

Pearson correlation coefficients; Converters

	TOTOUT	FRANOUT	QUE	G1	G2	AVGINV	FEE	FEEYR	ADVYR	CONLENG
TOTOUT	1.0000									
FRANOUT	0.3286	1.0000								
QUE	− 0.5198	− 0.4252	1.0000							
G1	0.9233	0.2784	− 0.6311	1.0000						
G2	0.9121	0.3001	− 0.3022	0.8092	1.0000					
AVGINV	− 0.1500	− 0.1200	− 0.1083	− 0.0651	− 0.2508	1.0000				
FEE	0.0124	0.3688	− 0.6426	0.1761	− 0.1565	0.2288	1.0000			
FEEYR	− 0.2934	− 0.1244	0.2956	− 0.1409	− 0.3218	− 0.0070	0.0828	1.0000		
ADVYR	0.3001	− 0.0714	− 0.0429	0.3266	0.3188	− 0.0566	0.1397	− 0.1060	1.0000	
CONLENG	− 0.3212	0.0409	− 0.0006	− 0.2628	− 0.2375	0.3012	0.1036	0.1020	0.2016	1.0000
FRANAGE	0.1145	0.1599	− 0.2432	0.1425	− 0.1752	0.2464	0.4130	− 0.0517	− 0.1195	− 0.4038
FRANADT	0.4489	0.2977	− 0.1121	0.2281	0.4371	− 0.0798	− 0.1201	− 0.3517	0.1243	0.0358
TOTAGE	0.4717	0.3378	− 0.1817	0.2648	0.3740	− 0.0044	0.0058	− 0.3583	0.0856	− 0.0852

	FRANAGE	FRANADT	TOTAGE
FRANAGE	1.0000		
FRANADT	− 0.0672	1.0000	
TOTAGE	0.2321	0.9549	1.0000

Pearson correlation coefficients: Mature franchisers

	TOTOUT	FRANOUT	QUE	G1	G2	AVGINV	FEE	FEEYR	ADVYR	CONLENG
TOTOUT	1.0000									
FRANOUT	− 0.2670	1.0000								
QUE	− 0.4315	− 0.2203	1.0000							
G1	0.8075	− 0.1412	− 0.4183	1.0000						
G2	0.4323	0.3993	− 0.2723	0.7354	1.0000					
AVGINV	0.2568	0.1758	− 0.1335	0.3752	0.5679	1.0000				
FEE	− 0.1806	0.3211	− 0.3387	− 0.1607	− 0.0068	0.0064	1.0000			
FEEYR	− 0.0540	− 0.0360	− 0.0845	0.0921	− 0.0142	− 0.3126	0.4021	1.0000		
ADVYR	0.0306	0.3663	− 0.3721	− 0.0150	0.1247	0.0367	0.3671	− 0.0890	1.0000	
CONLENG	− 0.1161	− 0.0349	− 0.2240	− 0.2316	− 0.2325	0.1083	0.4991	0.0712	0.3867	1.0000
FRANAGE	0.2227	− 0.1471	0.0150	− 0.1382	− 0.3015	− 0.1995	− 0.1841	− 0.4305	0.0090	0.2076
FRANADT	− 0.3803	0.0933	0.1210	− 0.4370	− 0.3422	− 0.0389	− 0.1050	− 0.0774	− 0.2757	− 0.0797
TOTAGE	− 0.0192	− 0.0686	0.0742	− 0.3346	− 0.4153	− 0.1783	− 0.2000	− 0.3813	− 0.1348	0.1236

	FRANAGE	FRANADT	TOTAGE
FRANAGE	1.0000		
FRANADT	0.1300	1.0000	0.6179
TOTAGE	0.8599	0.6179	1.0000

Pearson correlation coefficients: Unsuccessfuls

	TOTOUT	FRANOUT	QUE	G1	G2	AVGINV	FEE	FEEYR	ADVYR	CONLENG
TOTOUT	1.0000									
FRANOUT	0.3127	1.0000								
QUE	− 0.0028	− 0.1787	1.0000							
G1	0.3716	0.2559	− 0.2367	1.0000						
G2	0.5262	0.3439	− 0.1465	0.8448	1.0000					
AVGINV	0.2250	0.0403	− 0.1263	− 0.0105	− 0.1159	1.0000				
FEE	− 0.3770	− 0.2989	− 0.1378	− 0.1070	− 0.2399	− 0.0032	1.0000			
FEEYR	− 0.3030	0.1062	− 0.0991	− 0.2818	− 0.3479	0.3003	0.4161	1.0000		
ADVYR	0.0409	0.0926	0.0746	− 0.1517	− 0.0218	− 0.0654	0.2032	0.2539	1.0000	
CONLENG	− 0.2143	− 0.2031	0.2572	0.1497	− 0.0845	− 0.1029	0.2293	0.1440	0.0217	1.0000
FRANAGE	0.3844	0.1580	− 0.1553	− 0.2153	− 0.2803	0.2965	− 0.3471	− 0.1474	− 0.2008	− 0.0881
FRANADT	0.3348	− 0.0440	0.0619	− 0.1915	0.1487	− 0.1598	− 0.0321	− 0.0318	0.3853	− 0.1753
TOTAGE	0.4943	0.1035	− 0.0914	− 0.2791	− 0.1447	0.1517	− 0.2980	− 0.1366	0.0493	− 0.1674

	FRANAGE	FRANADT	TOTAGE
FRANAGE	1.0000		
FRANADT	0.0519	1.0000	
TOTAGE	0.8362	0.5911	1.0000

Note: For explanation of abbreviations see Appendix 2.

APPENDIX 2

Strategic dimensions and operationalized measures

A. Measures of size
   1. Number of retail outlets (TOTOUT)

B. Dispersion
   1. Percentage of outlets located in Quebec (QUE)

C. Measures of Growth
   1. Outlets established per year since inception (G1)
   2. Franchised outlets established per year (G2) since first franchise

D. Pricing
   1. Average investment required per franchise (AVGINV)
   2. Up-front franchise fee (FEE)
   3. Fee per year (percent of Sales) (FEEYR)
   4. Advertising fee per year (percent of Sales) (ADVYR)

E. Contractual Provisions
   1. Contract length (CONLENG)

F. Vertical Integration
   1. Percentage of total outlets franchised (FRANOUT)

G. Timing
   1. Years since inception (TOTAGE)
   2. Years since establishment of first franchise (FRANADT)
   3. Years between inception and establishment of first franchise (FRANAGE)