Master Thesis in Management November 22, 2012

Master of Science in Business and Economics

Stockholm School of Economics

Elaboration of a Franchising Strategy

- The Strategy Behind the Choice of a Franchising Agreement -

Alexandre Mignault

- 40070 -

Abstract

While substantial research has taken place on the antecedents of franchising, very little research has looked at the finer details of how franchising actually takes place. The aim of this thesis is to bridge this gap by identifying the types of franchising agreements that are used and the factors that lead to the choice of a specific franchising agreement by a franchisor. I found that the companies studied did not restrict themselves to the usual franchising agreements, instead choosing to tailor these agreements to their situation. Franchising agreements that are traditionally used mostly look at the size of the franchise and at the rights of the franchisee. This study found that companies customize franchising agreements by also considering the role they will play in the financing of the franchise. The interviewees helped identify a certain number of factors that had an impact on whether an outlet would be company-owned or franchised, as well as on the type of franchising agreement used. I found that the factors that affected the two companies' decisions were closely linked to the three main theories on the antecedents of franchising (resource scarcity, agency theory and plural form). However, there were slight difference in terms of the factors considered by the two companies. Although this thesis did not try to compare the two companies, my hypothesis is that the differences in terms of factors affecting the type of franchising agreement chosen came from the different stages of the business cycle at which the two companies were.

Keywords: Franchising, Franchising Agreements, Company Ownership, Organizational Form

Presented in: December 2012

Supervisor: Ingela Sölvell

Researcher at Center for Advanced Studies in Leadership

Stockholm School of Economics

Table of Contents

Introduction

While McDonald's is perhaps the best known franchisor in the world, some will be surprised to know that McDonald's is not the inventor of franchising. Indeed, it is actually Isaac M. Singer who usually gets the credit for the modern use of franchising in the United States (Bannister, 2012). Singer had improved an existing sewing machine and wanted a wider distribution for his product but lacked the money to increase manufacturing. People also wouldn't buy machines without training, which retailers were not able to provide. His solution was to charge licensing fees to people who would have the right to sell his machines in certain areas and provide training (FranChoice, History of Franchising).

According to a report published in 2005 by the International Franchise Association, the impact of franchised firms on the United States' economy totals $2.31 trillion per year, which represents approximately 11.4% of the private sector (Combs et al, 2011). Indeed, franchising has enjoyed tremendous popularity in the United States, especially in the quick service restaurant industry. According to a report published by the International Franchise Association in 2007, franchised quick service restaurants have accounted for 68.5% of all jobs in the quick service restaurant line of business (PriceWaterhouseCooper, 2008).

McDonald's, Subway, Pizza Hut and Taco Bell are all good examples of multinational corporations that used franchising as a way to grow their business. The story of how McDonald's used franchising to grow its business is particularly telling. The story begins in 1954 with a milk shake maker salesman called Ray Kroc. Kroc had received a huge order for 8 multi-mixers from a small restaurant in San Bernardino, California called McDonald's. Surprised to see one restaurant order so many milk shake makers, Kroc decided to investigate. He found a small but successful restaurant run by brothers Dick and Mac McDonald and was stunned by the effectiveness of their operation. Kroc had never seen so many people served so quickly. He was so impressed with the business concept that he decided then and there that his future would be in hamburgers. He learned that the McDonald's brothers had been looking for a nationwide franchising agent. Inspired, he pitched the idea of opening several restaurants and they accepted (McDonald's, 2009).

A year later, Kroc founded the McDonald's Corporation and opened his first restaurant in Des Plaines, Illinois. In 1965, McDonald's already numbered 700 restaurants. By 1988, that number had grown to more than 10 000 restaurants (McDonald's, 2011). Today, there are more than 33,000 restaurants worldwide, employing 1.7 million people and serving 68 million people in 119 countries every day. Nearly 80% of those restaurants are franchised (McDonald's 2012). This story shows that franchising can be a very effective way to grow a business.

Background

Franchising is a business arrangement under which a firm (the franchisor) collects up-front and on-going fees in exchange for allowing other firms (the franchisees) to use its processes and offer its products and services under its brand name (Combs et al, 2011). The resource scarcity theory posits that this sort of business arrangement is interesting for the franchisor because he gets the opportunity to build his organization quickly as new outlets are funded and managed by franchisees. This is an important advantage for new firms as they often lack capital and have a hard time competing for skilled labor (Combs et al, 2004). Fast growth gives the franchisor access to economies of scale in purchasing and marketing which ultimately enhances his likelihood of success. Agency theory, on the other hand, posits that firms use franchising because it reduces their monitoring costs. Franchisees have stronger incentives than managers therefore they need less monitoring. After all, a franchisee's income is directly tied to his efforts in improving the store's performance (Combs and Ketchen, 2003). On the other hand, the incentives to over-perform are not as strong for a manager because the additional profits go to the franchisor.

As for the franchisee, he gets the opportunity to own his own business under the umbrella of a tested business concept which is already known to customers (Combs et al, 2011). The franchisee is more likely to succeed in his endeavor because customers already know and trust the brand, therefore they are more likely to go to that store rather than to competing stores that have yet to make an impression with them. This phenomenon is partly due to a concept in psychology called loss aversion which refers to the fact that people prefer avoiding losses to acquiring gains. Applying this concept to restaurants, customers generally prefer eating at a restaurant whose food they know they enjoy rather than taking a chance on a new business whose food might not be as good. The franchisee also benefits from the economies of scale in purchasing generated by the organization.

Franchising clearly presents huge advantages for both the franchisor and the franchisee therefore it is no wonder that it has enjoyed such popularity. It should be noted that the concept of franchising has evolved quite a bit over the past few decades and there are now several types of franchising agreements from which companies can choose once they have made the decision to franchise. Four types of franchising agreements are generally mentioned in research and by franchising associations. Brief descriptions of these types of franchising agreements can be found in the table below.

Table #1: Description of the Various Types of Franchising Agreements

Franchising Agreement	Description
Single-Unit Franchisee	Franchisee may operate one franchise. Franchisee may have a small radius of exclusive territory to operate within.
Multi-Unit Franchisee	Franchisee may operate more than one outlet. There is usually no exclusive territory where the franchises must be opened.
Area Development Licenses	Area development licenses grant the franchisee the right to open a certain number of franchises within a given area. The franchisee has exclusive rights to this area as long as he opens the agreed upon number of outlets during the agreed upon time period.
Master Franchises	Master franchises grant the right to open a certain number of franchises within a given area. The master franchisee also has the right to sell franchises, multi-unit franchises and area development licenses. He has exclusive rights to this area as long as he opens the agreed upon number of outlets during the agreed upon time period. He also receives a part of the ongoing royalties paid by each franchisee.

(FranStop, Types of Franchise Agreements)

The most common type of franchising agreement is the single-unit franchise. According to FranData research, more than 4 franchisees out of 5 (82%) are single-unit operators (Johnson, 2007). Single-unit franchisees control 51% of all franchised units. Single-unit franchising is typically the way most franchisees enter the world of franchising. It gives the franchisee a chance to understand the franchising system while also giving the company the opportunity to evaluate his performance and see whether he is ready for additional franchises. Another 15% of all franchisees own between 2 and 5 units, controlling 24% of all franchised units, and finally 3% of all franchisees own more than 5 units, controlling 24% of all franchised units.

Problem

Once a firm has chosen to add new stores, there are still many decisions that have to be made. Should the store be company-owned or should it be franchised? Which franchising agreement should be used? Are there lesser known types of franchising agreements to consider? Under what circumstances should these franchising agreements be used? These are all important questions for the franchisor yet very little research has been conducted on the subject. It would be useful for franchisors to have a better understanding of the various types of franchising agreements that exist as well as understand what factors lead to those types of franchising agreements being used by companies today.

Purpose

The purpose of this thesis is to add knowledge to the research field of franchising by making explicit the experiences of two widely different companies when they have to decide on the type of franchising agreement they will use when adding new stores. To do so, I will give an overview of the various franchising agreements that these companies use and explain what factors lead them to choose one over the other.

In order to understand under why certain factors lead to specific franchising agreements being chosen, I will draw from three theoretical perspectives, two in particular. The two main theories that this thesis will draw from are agency theory and resource scarcity theory. To a lesser extent, the plural form in franchising is also going to be used. I have chosen to use these three theoretical perspectives because they are complementary and only using one theory would have led to a weaker analysis. None of the three theories "is able to explain the full franchising occurrence, but each theory explains different parts of the franchising phenomenon, so they should be perceived as complementary theories" (Diaz-Bernando, 2012). Similarly, Eisenhardt (1989) recommended that agency theory be used with complementary theories, as "agency theory presents a partial view of the world that, although it is valid, also ignores a good bit of the complexity of organizations. Additional perspectives can help capture the greater complexity". Hence, all three theoretical perspectives are going to be outlined in my theoretical framework.

This thesis' main contribution will be to enhance knowledge as to what factors companies consider when deciding which franchising agreement to use, as well as how each factor affects the decision. Seeing as two companies are going to be studied, the end result is going to be a list of factors that affect the companies' decision to franchise or own an outlet, a framework that shows which conditions must be met for the companies to choose franchising instead of company-ownership, as well as subsequent frameworks that show how each factor affects the type of franchising agreement chosen.

I chose to include company ownership in the framework of this thesis because company ownership is always an option which is studied alongside the various franchising agreements. After all, franchisors often have "first right of refusal", meaning that if the franchisee wishes to sell his franchise he must offer it to the franchisor before selling it to someone else. Additionally, few chains completely stop having company-owned stores even if they have chosen to use franchising as their main growth strategy. Looking at the table below, it seems that out of fifteen major quick service chains, thirteen chains increased their proportion of franchised stores but only three reduced their number of company stores to zero. Six companies increased their number of company-owned stores.

Table #2: Variation of Franchised Stores in Quick Service Chains

Chain	Company Stores		Franchised Stores		% Franchised	
	1988	**1997**	**1988**	**1997**	**1988**	**1997**
McDonald's	1758	1798	6149	10582	78%	85%
Pizza Hut	2770	3823	2937	4875	51%	56%
Burger King	758	514	4454	7025	85%	93%
Kentucky Fried Chicken	1262	1850	3637	3270	74%	64%
Domino's Pizza	1370	766	3665	3543	73%	82%
Wendy's	1076	1140	2445	3435	69%	75%
Hardee's	1038	863	2038	2081	66%	71%
Taco Bell	1691	2149	1187	4619	41%	68%

Subway	30	0	2828	11165	99%	100%
Little Caesar's	488	1265	1636	3560	77%	74%
Arby's	209	0	1840	2925	90%	100%
Long John Silver's	1007	909	462	486	31%	35%
Dunkin' Donuts	16	0	1427	3436	99%	100%
Church's	998	480	283	590	22%	55%
Denny's	1001	884	233	708	19%	44%
Sources: The 1988 and 1997 Technomic Top 100						

Before listing the factors that affect the choice of a franchising agreement by these companies, I will list the types of franchising agreements that the companies use. This will have the effect of providing the reader with an understanding of the types of franchising agreements used by the two companies. Additionally, this will provide the reader with visibility on the franchising agreements that the two companies have found to be most relevant to their business, because we may find that some of the agreements they use have yet to be identified by academics.

To summarize, this thesis will result in two contributions:

- A comparison between the types of franchising agreements identified in the literature and the types of franchising agreements that are used by the two companies studied.
- A framework that shows what leads to company ownership along with frameworks that show how each factor affects the companies' propensity to use one type of franchising agreement over the others.

Research Question

In order to fulfill the purpose of this thesis, the following research question has been formulated:

> *What factors are taken into consideration by companies in their choice of an outlet's organizational form?*

By providing an answer to this question, this thesis will add knowledge to the field of franchising, in particular to the agency and resource scarcity theoretical perspectives, by giving academics valuable insight into current managerial practices. Additionally, this research will support informed decision-making in the future through an investigation of this fundamental yet under-researched question.

Research Objects

In this section, I briefly introduce the companies that are going to be used in this study with the purpose of providing the reader with a basic conception of what the companies do and in which context they find themselves.

Two companies are going to be studied in the course of this case study. The first one, which we will call FoodChain for the sake of anonymity, is a large quick service company with operations all over the world. The second company, which we will call Art4Everyone for the sake of anonymity, is a small company which owns art galleries in Europe, North America and Africa. The fact that there are important differences between the two companies will allow me to illustrate the same problem from different empirical positions while maintaining depth, which is paramount (Siggelkow, 2007).

The quick service company is one of the world's largest chain of quick service restaurants with operations all over the world. Over the last 55 years, FoodChain has truly established a worldwide presence with restaurants in more than 100 countries. The company has a particularly important presence in North America where more than 60% of its restaurants are located. Most of the persons that are going to be interviewed for the purpose of this study work for the Canadian subsidiary of this large quick service chain.

FoodChain's menu is adapted to local tastes and customers to some extent. For example, the company would have difficulty selling hamburgers in India because Hindu people don't eat beef. Therefore, the Indian subsidiary sells burgers made of lamb as well as vegetarian burgers. The fact that the company is willing to adapt to the local culture is a big part of its success worldwide. Another part of the locally-relevant restaurant experience that the chain wishes to provide comes from the fact that the majority of its restaurants worldwide are independently owned and operated by local men and women. Of all FoodChain restaurants worldwide, 60% are conventional franchises, 20% are licensed to foreign affiliates or developmental licensees, and 20% are company-operated.

The second company, Art4Everyone, is fairly young and its business model is quite innovative. In short, photographers all over the world can take photographs and submit them to the company. If the company likes ones of the photographs then it purchases the rights to it from the artist and prints a certain number of copies. The photographs are exclusive to the company and cannot be found anywhere else.

The idea is to make great pictures more easily available to people all over the world. The company prefers to sell many copies of a picture at a lower price then to sell just a few copies at a higher price. The entire collection of photographs can be found on the company's website. The company is growing quite fast with more than 30 galleries already and another half-dozen slated to open in late 2012. Most of the galleries are located in Europe but the international expansion has started and galleries are opening in the United States, Canada, Russia, Mexico and more. Approximately 15 of the galleries are owned by franchisees and the rest are owned by the company.

Delimitations and Limitations

Certain delimitations have been identified to provide this study with the desired amount of focus. The first delimitation is that this study will not try to prove that one of the franchising agreements is better than the others. I am of the opinion that every franchising agreement can be best under certain circumstances, not that a certain franchising agreement is always best. What this study will do is try to understand what circumstances lead to a franchising agreement being used by the companies. Similarly, there is a distinction to be made between the "best" franchising agreement and the franchising agreement that is actually used by the company. Circumstances outside of a firm's control may force it to use a franchising agreement which it would not necessarily have used otherwise. Hence, this thesis will try to identify what circumstances would generally lead a company to choose one type of franchising agreement over another. Looking at what leads to franchising agreements being used, rather than what makes a certain franchising agreement the best gives this thesis a more practical, realistic approach as in real life events happen that force companies to adjust their strategy, and use plan B or C.

The second delimitation of this study is that no attempt will be made to list all of the special circumstances that could lead a company to use a certain type of franchising agreement over another. Instead, the study will attempt to capture the circumstances that happen the most frequently according to the interviewees. This is for the sake of conciseness as well as due to time constraints.

Finally, the last delimitation of this study is that the factors affecting the two companies' decisions are going to be analyzed separately; no attempt will be made to compare them. Attempting to analyze and integrate information about such different companies into a single framework would be very messy and would lead to a loss of the particularities of each company's franchising strategy.

These delimitations, in turn, bring certain limitations to this study. The first limitation of this study is that because of the time limit and the need to go into depth, only two firms are going to be studied (FoodChain and Art4Everyone). Studying more firms would have been too time consuming and would not have allowed for as much depth, which would have negatively affected the usefulness of this study.

This leads to the second limitation, that the results may not be generalizable to other companies or industries. Unfortunately, one of the limitations of case studies is that they are not recognized as being representative of the general population as they only involve a few individuals (or entities). Case studies are a descriptive method more so than an explanatory one, though they have strength in interpretation. Without controlled conditions, conclusions about cause-and-effect relationships can't be drawn with certainty. However, I believe that they can tell us about situations beyond the case under study. Hodkinson (2001) adds that "case studies can provide provisional truths, in a Popperian sense". He argues that the best theory thus far should stand until contradictory findings or better theorizing has been developed.

Thesis Structure

This paper consists of an introduction (of which this paragraph is a part of) and five other chapters. The following chapters are organized as follows: First, the agency theory, resource scarcity theory and plural form in franchising literature will be reviewed. Next, the choice of a research object and research design, along with the research method are going to be explained in more details. In the following section, the empirical findings are going to be shared. Then, those findings will be analyzed and discussed in the analysis and discussion section. Finally, conclusions from the study are drawn, theoretical and practical implications for franchisors and academicians are extracted from the results and recommendations are made for future research opportunities.

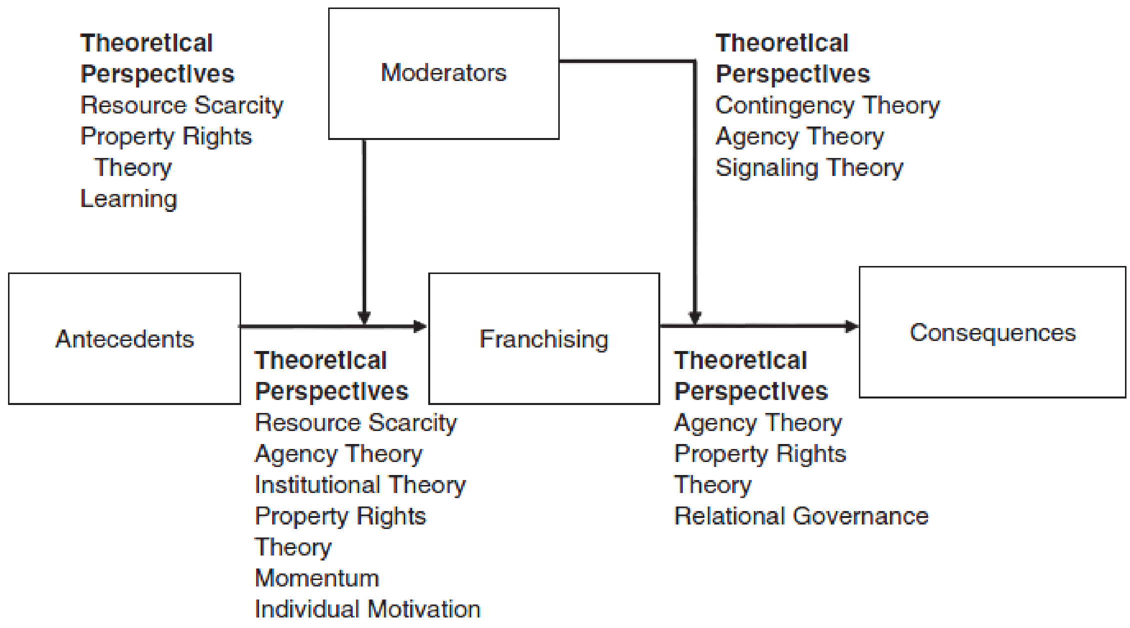
Theory

Literature Review

During my literature review, I found that very little research had taken place on the different types of franchising agreements used by companies as well as on the conditions that lead franchisors to choose one over the others. While researchers have looked at the reasons that lead companies to choose franchising over company ownership, they have not really looked closely at the rationale behind the choice of specific franchising agreements. The four main themes in recent franchising research are the following, as shown in the conceptual map of franchising research shown below:

- Antecedents to franchising (what leads to franchising being used)
- Consequences of franchising (determinants of firm performance and success or failure as well as direct consequences of franchising on franchisees and franchisors)
- Moderators of the franchising relationships (factors that influence the nature and strength of the antecedents–franchising relationship as well as conditions under which franchising enhances outcomes)
- Evolution of franchising and its use in different national contexts

Table #3: A Conceptual Map of Franchising Research



(Combs et al, 2011)

Seeing as there is a gap in research when it comes to the different types of franchising agreements that exist and the conditions under which franchisors choose one agreement over the others, this thesis will endeavor to enhance the knowledge in those areas. The following section will summarize the theories that are going to be used in the discussion and analysis section to explain why certain factors may be considered by franchisees as they decide which organizational form they wish to use. First, the resource scarcity theory is going to be summarized. In the second section, agency theory is going to be described. Then, a brief summary of the plural form in franchising will be given as this theoretical perspective is mostly going to be used as a support. Finally, an overview of what we currently know about factors affecting a franchisor's propensity to use a specific franchise agreement is going to be summarized.

Resource Scarcity Theory

The resource scarcity theory, initially proposed by Oxenfeldt and Kelly in 1969, is often used to explain franchising decisions. It begins with the premise that franchising is used early in a firm's existence to promote rapid growth to create economies of scale in advertising and purchasing. This leads to two predictions. The first is that franchising is used as a way to overcome limitations to growth. The second is that once economies of scale have been attained, franchisors will maintain ownership over the most profitable outlets and eventually repurchase all but the least profitable outlets.

In their analysis, Oxenfeldt and Kelly (1969) described two conceptual frameworks that suggested the basic forces that tend to encourage successful franchisors to move strongly, over time, toward ownership of their more profitable outlets: the "push-pull" model and the "life-cycle" framework. First, I will start by summarizing these two conceptual frameworks. Then, I will summarize the predictions made by the resource scarcity theory as well as the extent to which they have found support thus far.

Push-Pull Model

Oxenfeldt and Kelly (1969) claim that "to explain and predict change, one should search out the forces that induce the parties to change their existing situation - difficulties that push them to make a change, and those that attract the parties to another situation - and pull them toward the new." They use the push-pull model to describe the factors that lead firms to try and repurchase franchises as well as the factors that lead franchisees to sell profitable businesses. Oxenfeldt and Kelly (1969) identify four basic underlying forces that could lead a firm to purchase a franchise: goals, resources, opportunities and frustrations.

<u>Goals</u>: The main reason why companies decide to repurchase franchises is because ultimately they believe that doing so is going to create the most value for shareholders over the long term.

<u>Opportunities</u>: Another factor that pushes franchisors toward ownership is the fact that opportunities (such as technological change) that call for remodeling and updating of operations sometimes come up and it's easier for the franchisor to grasp those opportunities and apply them to the outlets if he owns them.

<u>Resources</u>: Scarcity of capital or managerial talent may lead the franchisor to rely on franchising to reach a critical size more rapidly (which allows for the enjoyment of economies of scale in information systems, advertising, purchasing and more). Once resources are not scarce anymore then the franchisor, who does not need to rely on franchisees anymore, is free to repurchase franchises.

Frustrations: Maintaining consistent quality and service standards is of critical importance to the success of a franchisor. Unfortunately for the franchisor, it is difficult to exercise close control over independent franchisees. Oxenfeldt and Kelly (1969) state that "failure to get franchisees to adapt their actions to the franchisor's overall programs can be very damaging to the success of these programs". This can push franchisors toward converting franchises to company ownership.

As was just explained, there are plenty of reasons why a company could decide to purchase an outlet from a franchisee but one could wonder why a franchisee could want to sell a profitable business. Oxenfeldt and Kelly identify four basic underlying forces that could lead a franchisee to sell a profitable franchise: goals, resources, opportunities and frustrations.

Goals: One of the factors that could push a franchisee toward the sale of his franchise is a desire for independence. A common characteristic of franchisees is their goal of working on their own.

Resources: Another factor that could lead a franchisee to sell is the attractiveness of the selling price and the capital it places at the franchisee's disposal.

Opportunities: Linked to resources, the franchisee may have more attractive uses for the capital, which would heighten the wish for change.

Frustrations: If the franchisee feels frustrated by the franchisor's policies and control system then this would definitely serve as a motivator for change.

Once the decision has been made to sell, it is much easier for the franchisee to sell back to the franchisor than to anyone else for many of reasons. First, he may be contractually obligated to do so. Even if he isn't, the franchisor may have the power to veto his choice based on the buyer's failure to meet the franchisor's requirements. Selling to the franchisor minimizes the problems and costs linked to the transfer of ownership, such as advertising costs, issues of trust, valuation of the franchise and more.

Life-Cycle Model

Oxenfeldt and Kelly use the life-cycle model to explain why, as time progresses, the goals, opportunities and capabilities of the franchisor and franchisee may change which can explain why a firm could choose to sell a franchise early on and then repurchase the same franchise a few years down the road.

The franchisor's primary objectives remain the same at all stages (profitability and growth), but other objectives which may change over time. First, some franchisors may wish to run a wholly-owned operation from the start but initially lack the resources to do so. Hence, they franchise to penetrate the market as widely and rapidly as possible. "Once the desired initial coverage is attained, their emphasis shifts toward operating efficiencies and market development, both of which can best be attained through the tight control permitted by ownership" (Oxenfeldt and Kelly, 1969).

The capabilities and resources of the franchisors also change as time progresses. At first, the franchisor is largely ignorant about local conditions and frequently lacks capital and skilled management. In time, he usually manages to overcome these deficiencies. His capital position and ability to raise additional funds improve with success and knowledge of local conditions is gathered through their contact with the franchisee. His ability to recognize the key characteristics required for his personnel also grows. He can also reduce his dependence on local personnel by centralizing activities that were initially carried out locally (Oxenfeldt and Kelly, 1969).

The franchisor's opportunities also change over time. Initially, he is faced with the opportunity of preempting attractive territories. He seizes this opportunity by enlisting franchisees to his cause, which allows him to overcome his capital shortage. Eventually, he exhausts this line of expansion and finds himself facing increasing competition which puts pressure on profits. In response to this development, he acquires some outlets (the most profitable ones) and leaves the less profitable ones to franchisees (Oxenfeldt and Kelly, 1969).

Just as the franchisor's goals, capabilities and opportunities change as the business matures, so do the franchisee's. Initially, the franchisee may be primarily interested in obtaining an outlet which would provide some security while also giving him partial autonomy. As he prospers, his monetary needs become less pressing while his desire for identity grows. As he becomes more established, he starts seeking more independence.

Several forces may move him to sell out such as the desire for the easy life or the lack of a successor.

The franchisee's capabilities also change over time. At first, his major strengths may be his ambition, willingness to work hard, local knowledge and finances. At that point in time, he may initially welcome the close attention and training provided by the franchisor. Through time, as his managerial skills improve, his self-esteem grows. This increase in self-esteem, combined enhanced financial capabilities, makes him start resenting the constraints placed upon his actions by the franchisor. In the maturity stage, he finds that he no longer has the drive or stamina to work long hours. This development is an additional motivation to sell.

The opportunities facing the franchisee also change over time. "At first, he seizes the opportunity to own a franchise that could lead to good profits in exchange for taking on a little risk and investing some of his money. As he makes money during the growth and prosperity stages, his opportunities for investment elsewhere expand if for no other reason that his increased resources" (Oxenfeldt and Kelly, 1969). They add that the more attractive other investment opportunities are and the more likely the franchisee will be likely to sell out.

Oxenfeldt and Kelly (1969) conclude by adding that when a franchise is purchased back by the franchisor, it reflects a match between the franchisor's and the franchisee's goals, opportunities and resources.

Predictions made by Resource Scarcity Theory and Recent Insights

Taking the push-pull model and the life-cycle model and combining them brings us to the two predictions made by resource scarcity theory. First, resource scarcity theory predicts that firms will turn to franchising to build outlets and supply needed managerial expertise and local knowledge (because firms do not have the capital to do so and because they wish to benefit from economies of scale in advertising and purchasing). At its core, this prediction suggests that franchising is a way to overcome internal limitations in terms of capital and in terms of the time it takes to train managers. These limitations are highly correlated with Aldrich's and Auster's work on the liabilities of smallness (Aldrich and Auster, 1986). In short, the argument was made that small companies have difficulties raising capital, major disadvantages in competing for labor with larger organizations and limited abilities to obtain benefits from specializations and economies of scale (Freeman and Hannan, 1983). Hence, franchising could be seen as a way to overcome some of the liabilities of smallness. This is quite important as the rate of failure for new ventures is much greater than it is for mature firms, therefore franchising could be a way to reach maturity more quickly which would increase their chances of survival. According to the Small Business Association (SBA), 30% of new businesses fail during the first two years of being open, 50% during the first five years and 66% during the first 10. Only 25% of new businesses make it to 15 years or more (Small Business Association, 2011).

The second prediction of resource scarcity is that once economies of scale have been attained, franchisors will maintain company ownership over new outlets and eventually repurchase all but the least profitable franchised outlets (a phenomenon also known as ownership redirection) (Oxenfeldt and Kelly, 1969). Hence, franchising could be seen as a way to overcome the liabilities of smallness and once those liabilities are overcome the franchisor will prefer to go back to a wholly-owned system.

While the first prediction of resource scarcity has found support, the second prediction of resource scarcity has been contested by many academics (Combs and Ketchen, 2003). The results of research conducted on the subject have been quite mixed (Combs et al, 2011). Early evidence actually pointed toward a reduction in the use of franchising among large firms (Hunt, 1973) and within maturing industries (Caves and Murphy, 1976). However, Martin (1988) found that the balance between company-owned and franchised outlets does not appear to approach full-ownership over time. The results of several studies actually contradicted the second prediction of resources scarcity. For example, Dant and Kaufmann (2003) found no evidence of ownership redirection when examining changes in the overall proportion of franchised outlets among 109 franchisors while Lafontaine and Shaw's (2005) analysis of a 17-year panel of over 5,000 franchisors found that a firm's proportion of franchised outlets stabilizes after about 6 years and remains steady.

However, some studies did find that a subset of established franchisors were actively converting franchised outlets to company ownership (Combs, Ketchen, and Hoover, 2004). One of the implication of these findings is that since some found evidence of ownership redirection and some didn't, one could propound that there are certain conditions that can lead to ownership redirection taking place. This led academics to try and identify some of those conditions, some of which have already been identified. For example, Windsperger and Dant (2006) found that ownership redirection is more likely to take place when what the franchisee brings to the relationship is contractible. Combs and Ketchen (1999) found that foreign expansion, asset specificity and capital scarcity have a positive impact on the degree of franchised units, while specific knowledge has a negative impact on the degree of franchised units. Additionally, Bürkle and Posselt (2008) posit that franchising shifts the risk to the franchisee, but that the benefit of franchising for the franchisor declines as the proportion of outlets grows. This declining benefit offers an incentive for ownership redirection.

To summarize, many studies have been conducted to see if the predictions made by resource scarcity theory would hold. The first prediction, that firms franchise to grow and build economies of scale in purchasing and advertising, has found some support. However, the second prediction, which is that once economies of scale have been attained, franchisors will maintain company ownership over new outlets and eventually repurchase all but the least profitable franchised outlets, has been contested by many academics.

Agency Theory

"The directors of such [joint-stock] companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honor, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."

- Adam Smith (1776)

Many aspects of organizational theory developed by modern economists were actually derived from Adam Smith's "Wealth of Nations" in 1776. Agency theory is no exception to this, as the quote shown above summarizes very well what agency theory is about. An agency relationship is "a contract relationship in which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent." If both parties in the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal (Jensen and Meckling, 1976). Seeing as the agent's and the principal's interests may diverge, the principal has to identify the lowest cost arrangement that will align the agent's interests with his own (Combs et al, 2011).

There are two problems linked to agency theory. First is the agency problem which arises when the desires or goals of the agent differ from those of the principal and when it is difficult or expensive for the principal to verify what the agent is doing (because in that case the agent can act in his own interest without the principal's knowledge). Second is the problem of risk-sharing which arises when the principal and the agent have different attitudes toward risk which means that they could favor different actions due to their different risk preferences.

Agency theory is then interested in determining the most efficient contract governing the principal-agent relationship. More specifically, agency theory is interested in determining whether a behavior-oriented contract (salary, etc.) is more efficient then an outcome-oriented contract (commissions, stock options, etc) without shifting risk unnecessarily to the agent. Agency theory can be applied to a variety of organizational phenomena. Overall, the domain of agency theory is relationships that mirror the basic agency structure of a principal and an agent who are engaged in cooperative behavior, but have differing goals and differing attitudes toward risk (Eisenhardt, 1989).

Two Streams: Positivist Agency Theory and Principal-Agent Research

Taking a deeper look at the agency literature, there are actually two different streams: Positivist Agency Theory and Principal-Agent Research. First, positivist research has focused on identifying situations in which the principal and agent are likely to have conflicting goals and then describing the governance mechanisms that limit the agent's self-serving behavior (Eisenhardt, 1989). Two governance mechanisms that can solve the agency problem have been identified. The first is the use of outcome-based contracts, which can be effective in curbing agent opportunism because they coalign the preferences of agents with those of the principal because the rewards given to the agent depends on the attainment of objectives set by the principal. The second proposition is the use of information systems, which curbs agent opportunism by allowing the principal to verify agent behavior, lessening the likelihood of the agent acting against the principal's interests. The theory is almost exclusively focused on the principal-agent relationship between owners and managers of large corporations. The positivist stream is most concerned with describing the governance mechanism that solve the agency problem.

The second stream in the agency theory literature is the principal-agent research stream, which is concerned with a general theory of principal-agent and has a much broader focus than the positivist stream. The focus of the principal-agent literature is on determining the optimal contract (behavior-based or outcome-based contract) between the principal and the agent. The heart of principal-agent theory is the trade-off between the cost of measuring behavior and the cost of measuring outcomes and transferring risk to the agent (Eisenhardt, 1989).

Agency Cost

Jensen and Meckling (1976) define agency costs as the sum of the monitoring expenditures by the principal, the bonding expenditures by the agent and the residual loss. In other words, agency costs are costs which come from the separation of ownership and control. These costs would not be necessary if ownership and control resided within the same people's hands. Since that is not the case, those three costs must be borne by the principal and agent.

Monitoring expenditures are incurred by the principal when he attempts to monitor the actions of the agent. For example, he may put in place a board of director to whom the agent will have to answer to, or he could set up an IT system which would give him more visibility on how the business is run. Bonding costs are incurred by the agent as he commits to contractual obligations that may limit or restrict his activities. For example, he may have to agree to forego other potential employment opportunities. Finally, residual losses are the costs incurred from divergent principal and agent interests despite the use of monitoring and bonding.

The Plural Form in Franchising

The plural form is a concept that was initially proposed by Bradach and Eccles (1989). Most of the work in the economic theory of organizations asks which organizational arrangement is optimal under given circumstances. This question is generally answered by the author saying that one structure is found to do better than the others. The idea behind the plural form is that sometimes, a combination of organizational arrangements may actually be better than the use of a single organizational arrangement, because those organizational arrangements may possess a synergism when used simultaneously (Lewin-Solomons, 2000).

Lewin-Solomons posits that chains value their franchisees because franchisees exercise initiative in their stores. Some of the initiatives lead to increased efficiency and to innovative ideas which can be spread to the chain as a whole. However, there is a potential conflict here because franchisees care about profits while franchisors care about revenues, as the royalty fee is based off of revenue. Since the royalty paid by franchisees depends on revenues alone, a firm might be biased in favor of innovations that are good for revenues, even if overall profits suffer, while franchisees would prefer innovations that decrease costs or that increase revenues in relation to costs. By maintaining a certain proportion of company-owned stores, the corporation can show franchisees that it is not asking them to implement innovations which it is not willing to implement itself (Lewin-Solomons, 2000).

The differences between franchises and company stores are mostly related to how such stores are run. Franchisees will be much more motivated to find ways to increase profits because they get to keep all of the profits (minus the royalty fee). A salaried manager's incentives, on the other hand, are much weaker because additional profits resulting from over performance go to the company, for the most part. Also, going off the beaten path could work against his objective of advancing within the corporate hierarchy where one must focus on obeying to authority and not making waves.

Companies generally give franchisees a lot more leeway than company managers because they know that franchisees can be trusted to make good decisions because "basically their whole life is at stake, in terms of what they do in their restaurants, so they seem to be a little more calculated in their risk-taking, whereas company managers "don't own the building, the business" and are therefore more willing to take irresponsible risks (Lewin-Solomons, 2000).

To summarize, the plural form believes that the use of both company-owned stores and franchises could be justified, since the attributes of franchises and the way franchisees run them can be leveraged by company-owned stores and vice versa.

Gaps in Previous Research

So far, little research has taken place on factors that affect the type of franchising agreement used. The three theories described in this section look at what leads to franchising being used by firms. These theories do not go so far as to explain specifically which type of franchising agreement will be used by those firms. In fact, it seems that even research that has taken place on specific franchising agreements has overlooked the ownership strategy. For example, Hussain and Windsperger (2010) found that while several empirical studies have been published on multi-unit franchising, the research deficit primarily results from the lack of theoretical foundation of this ownership strategy.

Following Hussain and Windsperger's study, some academics looked into factors that led franchisors to choose multi-unit franchising over single-unit franchising using agency theory as their main theoretical perspective. For example, Gomez, Gonzalez and Vázquez (2010) identified certain factors that affected the franchisor's decision to grant units to existing franchisees (therefore using multi-unit franchising) or to grant units to new franchisees (hereby using single-unit franchising). Their main conclusion was that they related the use of multi-unit franchising to the existence of agency problems in the franchisor-franchisee relationship. They proposed that franchisors use multi-unit franchising as an incentive mechanism to reduce the adverse selection risk and the moral hazard risk. They found that geographical concentration, size of the network and a non-repetitive customer base had an effect on the usage of multi-unit franchising. Additionally, Hussain and Windsperger (2011) found that franchisor's multi-unit franchising strategy can be explained by monitoring costs, franchisee's transaction-specific investments, franchisor's system-specific assets, and franchisor's financial resources scarcity. Hussain et al. (2012) found that transaction cost explanations can complement the agency cost explanation of multi-unit franchising.

While some research has started taking place on how certain factors can lead companies to use multi-unit franchising instead of single-unit franchising, there is a gap in research as studies so far have overlooked other types of franchising agreements. Additionally, the main theoretical perspectives that have been used so far are agency theory (primarily) and transaction cost explanations but other important theories seem to have been overlooked.

I firmly believe that my investigation can make a valuable contribution to the field because it will give an alternative perspective on the topic. First, my investigation will not only take into consideration single-unit and multi-unit franchising but also other types of franchising agreements used by corporations. While single-unit and multi-unit franchising are the types of franchising agreements that are most commonly used by companies, other types of franchising agreements are also used by firms. In fact, I believe that it would be particularly interesting to understand what leads franchisors to go off the beaten path and use other types of franchising agreements. Studies that have only tried to compare what leads companies to choose multi-unit over single-unit franchising have probably overlooked factors that lead companies to choose other franchising agreements. Additionally, this thesis will consider company-ownership alongside of the various franchising agreements as companies do not necessarily stop owning outlets once they start franchising. Company-ownership always remains an option. Finally, the main theoretical perspectives that have been used so far by academics are agency theory and transaction cost explanations, but other important theories seem to have been overlooked (particularly resource scarcity theory). I will cover the topic using the agency theory, resource scarcity and plural form theoretical perspectives.

Research Methodology

In this chapter, I start by explaining why I chose to do exploratory research instead of causal or descriptive research. I then explain why it is that I chose to do a multiple-case study and describe how it is that the two companies were selected as research objects for this thesis, as well as how the empirical study was conducted. More specifically, I describe how I chose to do a qualitative explorative study and how the empirical data was gathered and analyzed. I conclude the chapter by describing alternative research methods that I considered and by listing the main limitations and delimitations of this study.

Research Method

The purpose of this study is to close the gap that has been found in research in terms of what factors affect the elaboration of a franchising strategy in order to provide readers with valuable insights into current managerial practices as well as support informed decision-making in the future. Indeed, academics have focused on the antecedents, consequences and moderators of franchising but some subjects still remain under-researched. I will try to enhance knowledge on the answer to a question which has been overlooked so far in research: *What factors are taken into consideration by companies in their choice of an outlet's organizational form?*

Once the choice had been made to answer this research question, the question of how to conduct this study emerged. The first step was to decide which type of research this study represented: causal, descriptive or exploratory. Causal research is undertaken to find out whether any relationship exists between two variables. Descriptive research is when a problem has already been identified and the researcher knows precisely what has to be studied and where to find the solution. Finally, exploratory research is when the researcher does not know what the problem is (or if there even is a problem) and he mostly tries to gather information and enhance knowledge on a topic which has thus far received very little attention from other academics.

I chose to undertake exploratory research as this research question has been under-researched and I currently do not know what the problem is or if there even is one. This thesis will try to enhance knowledge on the factors affecting the choice of a specific organizational form for an outlet (company ownership or specific types of franchising agreements) so that in the future descriptive research and causal research can take place without starting from scratch.

Research Design

Once I had chosen the research question and made the decision to research it from an exploratory stand point, the logical next step was to decide upon which research design to use. The benefit of having thoroughly evaluated different alternatives and their benefits and drawbacks can be described as providing a framework for the collection and analysis of data (Bryman & Bell, 2007).

According to Bryman and Bell (2007) there are five different types of research designs: experimental design, cross-sectional (or social survey) design, longitudinal design, comparative design and case study design. In order to figure out which one I would use, I used the process of elimination. First, I eliminated the longitudinal research design, arguing that it cannot be applied properly to my particular study. Normally, longitudinal studies involve repeated observations of the same variables over many years. This was not feasible as I had a limited amount of time to write this thesis. I also found that an experimental design simply did not really apply to my particular choice of focus as it requires a level of control that is hard to establish when dealing with organizational behavior (Bryman and Bell, 2007). A cross-sectional research design also had to be eliminated as it was not suitable for the topic of this thesis. The data collected using cross-sectional designs is generally quantitative (or quantifiable). The topic that will be under study is much more qualitative than it is quantitative. This left me with two main options: case-study design and comparative design.

I ultimately chose to use a case study design because I felt that this type of design was better suited to explorative research than a comparative design (which I feel is best used when more is known about a phenomenon). I contemplated using a single-case study approach but ultimately decided not to, following advice from my thesis supervisor. Using only one company for the study meant only being of interest to companies similar to that company and I wanted the study to be of interest to a broad audience. I also knew that a multiple case study would allow me to paint a much more complete picture of the phenomenon while also ensuring a more balanced approach to my object of study (Grix, 2001). The single-case study design should only be when the case under study is extreme, unique, revelatory, or representative. The case should be an "object of interest in its own right, and the researchers [should] aim to provide an in-depth elucidation of it" (Bryman and Bell, 2007). Additionally, practical limitations such as the difficulty of finding a company willing to let me conduct approximately 20 interviews with its employees, finally led me to conduct a multiple case study. I briefly considered studying more than two companies but I ultimately chose not to do so as the time requirement on my part would have been enormous and the companies and their processes would have been studied in less depth.

Case studies have received quite a bit of criticism over the past few decades. As Hamel (1993) observes, "the case study has basically been faulted for its lack of representativeness and its lack of rigor in the collection, construction, and analysis of the empirical materials that give rise to this study." In defense of case studies, Shields (2007) argues: "The strength of qualitative approaches is that they account for and include difference--ideologically, epistemologically, methodologically--and most importantly, humanly. They do not attempt to eliminate what cannot be discounted. They do not attempt to simplify what cannot be simplified. Thus, it is precisely because case studies include paradoxes and acknowledge that there are no simple answers, that it can and should qualify as the gold standard." Flyvberg (2006) also argues in favor of case studies. He argues that universals can't be found in the study of human affairs, hence that context dependent-knowledge is more valuable than general knowledge. He adds that formal generalization is overvalued as a source of scientific development and that the force of a single example is underestimated.

Choice of a Research Object

Once the choice had been made to do a case-study with two companies, the appropriate next step was to come up with a list of criteria that the companies had to meet to make sure that the thesis added the most value for academics and managers. To come up with this list of criteria, I started by looking at the research question that I had chosen to see what sort of company would be able to give input on this matter:

What factors are taken into consideration by companies in their choice of an outlet's organizational form?

My first thought was that to give insight into the elaboration of their franchising strategy, a company needed franchising experience.

- Hence, my first criterion was that the company needed to currently have a certain number of franchises.

Second, I absolutely needed to have easy access to someone whose job had to do with their franchising strategy and who would be able to give me access to people and documentation. After all, "the biggest problem students have with interviews is access to individuals, companies or institutions" (Grix, 2001).

- Hence, my second criteria was that I needed to know someone in the company who worked on some aspect of the company's franchising strategy and who would be able to refer me to the right people.

Also, seeing as I wanted the study to be relevant to many people (academics and owners), the companies had to be different enough from each other that many companies outside of this study could identify themselves to the companies in the study to some extent.

- Hence, my third criterion was that the companies had to be different from each other in terms of size and age.

Using the above three criteria, I created a short list of companies that I could approach to see if they would be willing to answer my questions. After approaching them and assessing the extent to which I believed they would be willing to give me access to sensitive information, I ended up choosing two companies with widely different backgrounds. Both of these companies were willing to let me go through confidential documentation as well as interview several people within the organization as long as they were allowed to keep their anonymity. Consequently, certain details about the companies and the respondents will be removed or replaced with slightly different information to ensure that their anonymity remains complete. Of course, any information that could have a material effect on this thesis' findings will be kept as is.

The first company that is going to be studied in this case study is a large quick service company with operations all over the world. For the purpose of this study we will call this company "FoodChain". FoodChain met all three criteria mentioned above. First, the company has a lot of franchising experience. Indeed, the company has thousands of franchised stores and it is still expanding. The company uses company ownership as well as a variety of franchising agreements, meaning that interviewees will be able to provide information on various types of franchising agreements, as well as what makes them choose one franchising agreement over the others. FoodChain also met the second criteria, which was that I had to know someone in the company whose work was related to franchising and who would be able to give me access to people and documentation. Seeing as I had a good relationship with someone who just happened to be in an upper management position and actually used to be in charge of the franchising aspect of the business, using FoodChain for the case study made perfect sense.

The second company that is going to be studied in this case study is a smaller company based in France which owns approximately 35 art galleries in Europe, North America and Africa. For the purpose of this study, the company will be called Art4Everyone. Despite being a fairly young company (approximately 5 years old), the company is currently expanding aggressively internationally using a combination of franchising and company ownership. Art4Everyone also met the second criteria, which was that I had to know someone whose work was related to franchising and who would able to give me access to documentation and people. I personally knew the person in charge of negotiating the franchising agreements with potential franchisees in North America. He will be able to provide me with a lot of insight on the factors that lead him to choose one type of franchising agreement over another as well as give me access to people who helped elaborate the franchising strategy or who apply it in other regions.

The final criterion was that the two companies had to be different enough that this thesis would be of interest to companies of different sizes, ages and operating in different industries. This is the case as FoodChain is a large, mature quick service company with operations all over the world while Art4Everyone is a young company with a few dozen outlets in the art industry.

The fact that these companies are quite different makes this thesis a lot more interesting to academics and owners in general as the topic of franchising agreements is going to be covered both from the point of view of a large, mature multinational corporation and from the point of view of a smaller, more entrepreneurial organization in its infancy. Had a single company been studied, the target audience would have been much smaller as the findings would have been applicable to fewer companies.

Qualitative Approach

On a conceptual level, there are two overarching kinds of research strategies: quantitative and qualitative research methods. There are several distinctions between the two, and it's important to understand that they each have their strengths and their weaknesses and that one is not necessarily better than the other.

A common way to distinguish the two types of research strategies broadly is to define a quantitative strategy as one that uses statistical methods to analyze the collected data while a qualitative strategy involves using other methods to analyze data (Bryman & Bell, 2007). The most important parameter to consider when choosing which strategy to use in a particular study is to look at the kind of data that needs to be analyzed that could help answer the research question in the most satisfying way.

According to the stated distinction between a quantitative and a qualitative study, the study I have proposed would fall under the label of a qualitative study. My proposed research question, *what factors are taken into consideration by companies in their choice of an organizational form for an outlet*, does not have a quantitative component at all and there is no numerical data available, thus it would not make sense to use quantitative study methods. A qualitative research strategy is much better suited to my study as it allows me to use in-depth interviews as my primary source for data collection (Mack and Woodsong, 2005).

Ritchie and Lewis (2003) add that "the aims of qualitative research are generally directed at providing an in-depth and interpreted understanding of the social world by learning about people's social and material circumstances, their experiences, perspectives and histories" (Richie and Lewis, 2003) and that is precisely what I am trying to achieve with the chosen research question.

Data Collection

When collecting exploratory primary data, a researcher can use a number of different methods. Interviews, observations and internal documents are examples of commonly used sources of primary information. In order to answer this research question, it made more sense to rely mainly on interviews to answer the research question as I wish to provide an in-depth understanding of what factors affect the elaboration of a franchising strategy and that can only be done by gathering and sharing the thoughts of the people in charge of elaborating and applying the two companies' franchising strategies. I will complement these interviews with internal documentation that will be made available by the interviewees.

Yin (2003) identified six sources of evidence that can be collected during case studies, each having their own strengths and weaknesses, two of which I chose to use in this case study. First, I chose to use interviews because there are especially good when trying to reach in-depth understanding (my main objective) within a limited timeframe (my main limitation) (Eisenhardt and Graebner, 2007). They are also quite useful for gaining insight and context into a topic and they allow respondents to describe what is important to them. Interviews can also provide information that is not printed or recorded elsewhere and are particularly useful in interpreting complex decisions. The second is documentation, which I have chosen because it is a very good source of background information and it is unobtrusive (Yin, 2003). It is also stable, meaning that it can be reviewed repeatedly, and exact. It was important for me not to use interviews as the sole method in my study but rather to use interviews in conjunction with other methods of enquiry. Looking at this phenomenon from different angles will ensure a more balanced approach to my object of study (Grix, 2001).

Interviews

Once I made the decision to use interviews as a way of gathering information, I looked at the various types of interviews to better understand what their respective strengths and weaknesses were, and how I could maximize the quality of my findings. I found that there are four main types of interview techniques that can be used: structured, semi-structured and unstructured interviews as well as group interviews. The following paragraphs will break down the reasons why I chose to use a mix of semi-structured and unstructured interviews.

First, I should mention that I started out by eliminating group interviews because I felt that group interviews didn't apply as well to the research question as the other type of interviews. I felt that group interviews would be difficult to use because many of the interviewees that I identified were not local so the group interview would have to be conducted over the phone. I also didn't think that group interviews were the best use of the interviewees' time. After all, most FoodChain executives were only willing to grant me between 30 minutes and an hour of their time and I figured that one-on-one discussions with them would add a lot more value than holding a group interview in which most wouldn't speak more than just a few words.

Then, I decided to rule out structured interviews because that they are much less flexible than other types of interviews, which could lead me to miss out on important information due to the fact that the questions in structured interviews are usually closed and the technique is not designed to cope with the unexpected. They are also generally used to generate quantitative data, which is not the type of data that I wish to collect.

I liked the idea of starting out with unstructured interviews at the beginning of my research to let the interviewees talk about how franchising takes place in general. I figured that this would open up avenues of investigation that I could have missed out on otherwise. I would then move on to use semi-structured interviews that would let me investigate questions which had been left unanswered during previous unstructured interviews. I did not want to use only unstructured interviews as I feared that the data gathered from the various interviews would be difficult if not impossible to compare. The main advantage of semi-structured interviews is that it allows for the pursuit of unexpected lines of enquiry during the interview yet the findings from those interviews can still be compared.

I felt that using a mix of semi-structured and unstructured interviews would help me get the best of both worlds. On one hand, the unstructured interviews would open up avenues of investigation that I may have missed out on if I had only used semi-structured interviews. On the other hand, semi-structured interviews would allow me to gather information on specific topics and make it much easier to compare this information.

Yin (2003) argued that interviews were the most importance source of evidence in case studies but mentioned that there were four main weaknesses to interviews. I will have to develop a strategy that allows me to mitigate these weaknesses if I am to maximize the quality of the inputs and outputs.

The first weakness of interviews is that there is a possibility of a response bias, which is when interviewees tells the interviewer what he wants to hear, or when his personal agenda makes him answer differently. To mitigate this weakness, I will grant the interviewees (and the company) anonymity which will lessen the likelihood of their personal agenda influencing their answers in order to protect themselves.

Second is that there are inaccuracies that could be due to poor recall - interviewees sometimes don't remember precisely how they acted, what they thought or said and why. In order to mitigate this risk, I will use other data collection methods (such as reading internal documentation ahead of time to bring up information from the documentation when necessary). I will also interview multiple people to get different perspectives. If the information gathered during interviews differs then I will be able to ask for clarifications.

The third and fourth weaknesses are interlinked. There is reflexivity which is when an interviewee tells the interviewer what he wants to hear and there is a chance of bias due to poorly constructed questions. Ensuring that questions are well constructed should go a long way towards minimizing reflexivity on the interviewee's part. By ensuring that the questions are well constructed, perfectly neutral and do not take anything for granted, I should be able to minimize reflexivity.

As long as I remain aware of the weaknesses of interviews and that I follow the plans laid out above to mitigate each of these weaknesses then I believe I should be able to minimize their impact and the extent to which they occur.

Documentation

I wanted to have more than one data collection method to look at this phenomena from different angles in order ensure a more balanced approach to my object of study (Grix, 2001) therefore I looked at the various sources of information that I could use along with interviews. After eliminating archival records, participant-observation and physical artifacts, I was left with documentation and direct observation as my main options. Direct observation could have been added a lot of value to this thesis seeing as I would have been able to observe what actually takes place in real life and what aspects are particularly important in the choice of a franchising agreement. However, it would not be feasible for me to be present at meetings partly due to the fact that I work full-time, not to mention that the decisions are made over the span of several meetings and phone conversations. I also do not think that I would have been granted this type of access, not to mention that the time commitment would have been enormous.

Hence, I came to the conclusion that using documentation as my secondary source of information made the most sense. I also knew that the companies would have documentation on the various franchising agreements that they use. Yin (2003) found that documentation has four main strengths. First, it is stable: it can be reviewed repeatedly and it never changes. Second, it is unobtrusive: it was not created as a result of the case study; it was there before the case study ever took place. Third, it's exact: it contains exact names, dates, references and details of an event. Finally, documentation has a very broad coverage: information is collected over a long span of time, and many events and settings are covered. Since documentation is totally unbiased, it helps minimize the weaknesses of interviews, in particular the weakness related to response bias.

I also found that the weaknesses of documentation that Yin (2003) found actually didn't apply in my case. Blocked access, irretrievability and reporting bias could be problematic for some but in this case my two sponsors both have access to the documentation that I need therefore it should not be an issue. An advantage of the research question that has been identified earlier in this thesis is that the answer is not something that could compromise either organization. There is nothing to hide because the type of franchising agreement used does not have a negative effect on franchisees, shareholders or clients therefore there is no reason why access would be blocked, especially considering the fact that the companies' anonymity will be preserved.

Research Approach

It's also quite important to determine the proper relationship between theory and research (Bryman and Bell, 2007). One has to make a decision between an inductive and a deductive research approach.

In the deductive approach, one starts by formulating hypotheses which are then tested against empirical scrutiny. The outcome is then used to either confirm or reject the initial hypothesis. On the other hand, the inductive approach starts with the empirical findings which are then analyzed and explained using theory. In other word, it can be said to be a choice between theory before research or research before observations (Ghauri and Grønhaug, 2005).

In this study, I chose to employ an inductive research approach. I will start by conducting interviews and looking at internal documentation on the various types of franchising agreements. I will then analyze those findings and link them to existing theory.

Validity and Reliability

Important in any research project, academic or non-academic, is to make sure that whatever conclusions are drawn from the study can be considered to be a reflection of the data examined. In evaluating research, two separate measurements are usually used: reliability and validity.

Reliability is normally concerned with whether the findings can accurately be replicated by other researcher in similar cases (Bryman & Bell, 2007). One has to be very careful when using interviews as a method for collecting data because the interviewer and interviewee come from different backgrounds and don't necessarily see things the same way which could lead to misunderstandings. The advantage of semi-structured interviews is that they allow the interviewer to ask clarifying questions to make sure that the interviewee and the interviewer both understand each other. By asking for clarifying examples and by having the interviewee review my interview notes, I will minimize the chance that our different educational backgrounds and experiences could lead to misunderstandings. In qualitative research strategies, there is always a risk that data or information is either misinterpreted or not understood correctly by either the interviewee or the interviewer. The fact that the source of information is individuals will always suggest that there is a concern in regards to reliability. However, I believe that through my understanding of the sources of reliability issues and the precautious actions I will take to minimize them, this study will not give rise to any considerable levels of reliability related problems.

The second aspect of the quality of research is validity. In its general form, validity is concerned with the outcome and conclusions of the study (Bryman & Bell, 2007). There are many different aspects to validity, not all of which apply to qualitative studies. Over the next few paragraphs, I will account for those argued to be the most applicable to a qualitative study (Bryman & Bell, 2007).

Starting with internal validity, it is the form of validity that is concerned with the causality between two identified factors. If the conclusion is drawn that x causes y, internal validity would be the measure that captures the flaw if that would not be the case (Bryman & Bell, 2007). Thus, internal validity is concerned with whether a conclusion derived from a causal relationship between different variables can be said to hold water. The second type of validity that applies to my study is the external validity. It deals with whether a study's findings can be generalized, i.e. are the result and conclusions coming out of the study relevant and applicable to a greater context or not (Yin, 2003).

It is only after conducting my interviews and entering the phase of analyzing the data that internal validity comes into play. To what extent can I be certain that what I interpret as a conclusion coming from quote x really is an effect or a factor? To avoid this as much as possible, cross checking and getting the data as well as the conclusion verified is one tool to use. This can first of all be done with the interviewees during follow up sessions as well as with my supervisor. Part of my agreement with my interviewees was that I would send to them every part of my thesis that concerned them (empirical findings, analysis, conclusion, etc.) so that they could read it and make sure that every word written was accurate therefore this should help with ensure the total accuracy of my reporting.

By verifying my data and conclusions with the interviewees in follow-up interview sessions, I will be given the opportunity to make sure that I haven't missed something just due to the fact that the interviewee only answered the actual questions I asked. Therefore, asking clarifying follow-up questions of more open character should limit this potential pitfall. By verifying my reasoning in regards to a particular conclusion with my supervisor, I can also ensure that I haven't neglected a factor or underestimated the impact of another factor, which in turn would affect the internal validity of my study.

External validity, on the other hand, deals with whether a study's findings can be generalized, i.e. are the results and conclusions coming out of the study relevant and applicable to a greater context or not. Neither single nor multiple-case studies are generally expected to allow for statistical generalization (Yin, 1994). However, analytical generalization (which is generalization from empirical observations to theory, rather than to a population) should be possible using a multiple case study approach. That is why, following advice from my thesis advisor, I chose to use a multiple-case study as my research design.

Empirical Findings

This section has two main objectives. The first is to give the reader a better overview of how the information was gathered and how the data was handled. The second, and main, objective of this section is to share the information that was provided by the interviewees during the interviews in regards to the different franchising agreements that are used by the company as well as the factors that lead to the use of each.

Source and Handling of the Data

Regarding the selection of the respondents, I mostly relied on my sponsor in each company to provide me with a list of people who were involved (or who had been involved) in the process of deciding which franchising agreement should be used for a specific location. I knew that they had much better understanding of the roles of the various persons in the company as well as knowledge of whom had occupied the role in the past and that they would be able to provide me with a good list.

In total, 21 interviews were conducted with 14 respondents. Nine of the respondents worked for FoodChain and the other five respondents worked for Art4Everyone. Five interviewees may seem like a low number to put a company's franchising strategy on paper but Art4Everyone is a small company and additional interviews would not have added value as all of the people that were involved in the elaboration of the company's franchising strategy or that are responsible for putting it in practice were interviewed. The interviews lasted between 30 minutes and two hours and were conducted either in person or over the phone. In additional to the interviews themselves, there were also a few instances where I called one of the respondents for a 5 or 10 minutes conversation to clarify something that had been mentioned by during an interview. In general, the perspectives of the respondents within each company were very similar. I would say that the only differences in terms of what the interviewees mentioned were that sometimes an interviewee would forget to mention something that another interviewee had mentioned. Once I brought-up these differences in follow-up interviews or in quick conversations over the phone to clarify aspects that were mentioned, the respondents always said that it was an aspect that they considered but that they had forgotten to mention in the interviews. Hence, there were no actual discrepancies between what the respondents within a company said, only oversights.

Additionally, data came from internal documents that described the franchising process and the types of franchising agreements used. FoodChain had official documentation on each type of franchising agreement while the only documentation that Art4Everyone had was the documents that they send to people who are considering opening an Art4Everyone franchise.

The following sections on FoodChain and Art4Everyone's franchising strategies only contain raw data which has been reorganized for the sake of coherence. The reasoning of the respondents has been included but my reasoning and analysis are totally absent as that is going to be covered in the discussion and analysis part. The information gathered about FoodChain and Art4Everyone is described in separate sections for the sake of clarity. These sections are divided in two subsections; the first describing the types of franchising agreements that the company uses and the second listing and briefly describing the factors that affected the choice of a specific franchising agreement over another.

Franchising Strategies

FoodChain Franchising Strategy

Types of Franchising Agreements Used

FoodChain uses four main types of franchising agreements: the traditional franchising model, business facility leases (BFL), joint venture model and development licenses. They also use other models but I chose not to include them as they were very slight variations of the above models due to country-specific regulations.

<u>Traditional Franchising Model</u>: The first type of franchising agreement is the traditional franchising model. Under this agreement, the franchisee leases the land and the building from FoodChain. The franchisee will generally acquire one (or more) restaurants. Initially, the franchisee will pay a franchise fee which will give him the support of the corporation and the right to use the company's business model. The franchisee then has to pay rent each month, which is used by the corporation for its general and administrative expenses as well as other costs of the system (such as research and development). Franchisees also have to pay a marketing contribution which the

corporation combines with other franchisees' marketing contributions which allows the leveraging of the company's buying power to pay less and have a greater impact.

Business Facility Lease: The second type of franchising agreement used by the company is the business facility lease (BFL). One of the differences with the traditional franchising model is that in addition to the land and building, the franchisee also leases the equipment, signs, seating and decor in the restaurant which leads to a greater rent. The franchisee is typically given a conditional option to purchase the facilities and to convert the BFL franchise to a conventional franchise. BFL's are typically 3 years in duration. They can also be renewed but FoodChain's objective is to have option exercised by the franchisee to convert the BFL into a conventional franchise. The advantage of the BFL for the franchisee is that he doesn't have to provide additional capital for the restaurant, nor does he have to provide capital for the yearly reinvestment. Indeed, the company pays for additional equipment or improvements to the building during the BFL term and the franchisee agrees to reimburse FoodChain once he exercises the option to convert the BFL.

Joint Venture: The third type of franchising agreement used by FoodChain is the joint venture model. Under the joint venture model, the company partners with a franchisee to open or acquire restaurants. The percentage allocated to each party varies but FoodChain generally owns a greater percentage of the restaurants than the franchisee. A legal agreement will be created which will put conditions for the investments and the management of the restaurants. A small joint venture board will be created with the franchisee and a representative from the company. This board will review the financial statements of the restaurant each month and have a formal review every three months. After some time, the franchisee can buy FoodChain's share of the restaurants (or the other way around). The way the restaurant is going to be valued once one of the partners wants to buy the other out is already established from the start in terms of which variables are going to be taken into account, though the actual amount is not fixed. This type of franchising agreement is interesting for FoodChain because the franchisee remains the face of the franchise while the company receive part of the profits.

Development License: The fourth type of franchisee agreement is the development license (DL). Under this type of agreement, FoodChain generally grants a franchise to a person for a specific country or market and relies on that person to develop the market. The person does not have to operate every restaurant on his own; he has the right to grant franchises within his territory. In exchange for giving the businessman the right (and duty) to open a certain number of restaurants within a certain number of years as well as the right to use FoodChain's system and intellectual property, FoodChain receives royalties. The company gets to collect royalties and increase revenues without any investment. There is a DL business review conducted every two years which covers the performance of the DL's entire organization. The objective of the review is to determine whether the DL can be renewed, to make sure that the brand and business initiative are aligned and to determine if the holder of the DL will be allowed to open additional restaurants. The DL is evaluated upon 7 criteria: operational standards, customer satisfaction, restaurant development and reinvestment, financial, people and organizational development, sales and market share and the involvement of the development licensee. Development licenses are fairly uncommon. FoodChain has only granted one development license.

Factors that Affect the Franchising Agreement Used

The type of franchising agreement that the company decides to use depend on several factors: the growth that is anticipated by the company, the proportion of outlets that should be franchised, the number of qualified applicants available, financial considerations, portfolio optimization, ownership preference and special circumstances.

Growth Anticipated by the Company

First, what may be the most important discussion that FoodChain executives have during the strategic planning process relates to what type of growth the company anticipates over the next five years and what sort of market the company operates in. The franchising model used in a market where the company wishes to grow aggressively could be quite different from the model used in a market in which the company anticipates slow, organic growth.

Part of the reason behind this is the importance of the human capital part of expansion. No matter what model the company wishes to use, having the right partner is paramount. Not only does training a franchisee take time, the process is also very selective; not everyone has the potential to become a good franchisee. A strong candidate will demonstrate that he has the right leadership and team work competencies and that he is an entrepreneur at heart who is able to function autonomously. Yet, he also has to be able to live within the limits of the system. He will also have the financial means to purchase a franchise and the willingness to participate actively in the day-to-day of the business as required by the organization. Ideally, the candidate will also have experience managing personnel and delegating, as some stores are open 24 hours a day, seven days a week therefore he won't always be in the store. The training process lasts between 12 and 18 months depending on how fast the candidate is able to go through it. No guarantees are offered to the candidate and the company has the option to end the training program at any time without providing any compensation. FoodChain is even more demanding when looking for joint venture partners and development license holders.

Keeping the above into account, the growth that the company wishes to achieve and the market in which it operates will definitely impact which franchising agreement is chosen by the organization. If the organization operates in a mature market where growth is somewhat limited then using the traditional franchising model along with the BFL franchising model should support the growth well enough. However, if the organization is looking at developing aggressively in a country where it already has a presence then perhaps a joint venture approach would work better, given that a partnership with an existing operator could be established and growth could be supported by the corporation financially. Again, if the corporation is developing a new country, and pending the speed and level at which it wishes to grow and the complexity of growing in a given area (in terms of government involvement, for example) then it might make sense to consider a development license. Development licenses are an interesting approach to fast growth as they allow the organization to leverage somebody else's capital.

Proportion of Outlets that Should be Franchised

Another important discussion that FoodChain executives have during the strategic planning process relates to the proportion of their outlets that should be owned by franchisees. This is an important consideration as the choice isn't only between the different types of franchising agreements; there is always a possibility that the company could choose to own the store. The answer that FoodChain executives came to is that they believe a model that has both franchises and company-owned restaurants has merits.

On one hand, company-owned restaurants enable the "people pump", the production of people that will eventually become supervisory personnel in the system. Having the ability to develop strong operations consultants and business consultants that understand the business carefully is paramount in being able to guide new franchisees. Seeing as these workers have experience in company-owned restaurants who follow best practices, they will have an easier time evaluating franchisees' performance and giving them advice. If the company didn't own any restaurant then supervisory personnel would have to be found outside of the firm. The supervisory personnel would also start from scratch as they wouldn't know how a FoodChain outlet is expected to be run. Having never done it before, the supervisory personnel would have much less credibility, thus much less impact on franchisees. It's also easier from a testing stand point where the company can assume its own risk in a very controlled environment.

Also, having company-owned restaurants gives the organization credibility in the franchisees' eyes as the decisions that are made not only affect it as a corporation; they also affect the organization on the restaurant side of the business. Since the royalty paid by franchisees depends on revenues alone, it might be advantageous for a firm to get franchisees to implement programs or innovations that are good for revenues even if they have the potential to lead to reduced profitability. By maintaining a certain proportion of company stores, the corporation can show franchisees that it is not asking them to implement innovations which it is not willing to implement itself. This results in a greater buy-in from franchisees and a stronger company overall where everyone pushes in the same direction.

Finally, owning restaurants also allows the company to leverage opportunities for future growth if it makes sense in a given geography without having to necessarily wait for the right franchisee candidate to come along.

With that said, only having company-owned stores may not necessarily be the best utilization of corporate funds. The main advantage of franchises is that they allow FoodChain to leverage others' investments and still collect royalties and create a real estate margin by collecting rent. It's one way of getting greater returns as a percentage of your overall investment. It is also a necessity to have franchisees as you will be better represented by people that live in the same communities in which they operate as these people are the closest to the market. They have a better understanding of what's important to their customers.

Hence, both company-owned restaurants and franchised restaurants are important to the success of FoodChain. Depending on the desired proportion of franchised outlets, an existing store owned by the company could be sold to another franchisee if the strategic plan called for less company-owned restaurants and more franchises, just as an existing franchise being sold by a franchisee could be repurchased by the company if the strategic plan called for a greater proportion of company-owned stores.

Availability of Qualified Applicants

Another element that needs to be taken into account is the status of the company's pipeline of registered applicants. If a franchisee is retiring and the company's pipeline is empty then the company's only options are to either buy the restaurant, or sell it to an existing franchisee. This highlights the importance of having an ongoing dialogue with existing franchisees. Any organization who wants to ensure a smooth transition to qualified candidates should make sure it has a good idea of what level of turnover it can expect within its franchisee community. For instance, if the organization knows that over the next three years, five or six of its franchisees are going to retire then it will need franchisees to take over those businesses. Training franchisees takes time and finding the right candidate is paramount therefore the company should always make sure it has candidates in the pipeline, ready to take over those businesses so that the company doesn't have to. I should add that a lot of emphasis was placed by the interviewees on the selectivity of the recruitment process and how important it is to make sure that restaurants are run by qualified people with the right attitude. The company always makes sure that every time it sells a restaurant it's given to the franchisee who is the strongest. It could make sense to give it to a new franchisee if he is stronger than the one that is on-site.

Financial Considerations and Portfolio Optimization

Another very important factor that affects what franchising agreement is going to be used are the financials. Some of the models are more profitable than others. Some models are also more capital-intensive than others from the company or the franchisee's point of view. For example, a BFL is generally less profitable for the company as the company owns the assets and has to make the capital contribution towards reinvestments each year. The traditional franchising model from that standpoint makes sense as the organization collect royalties on the business while the franchisee owns the assets and is the one who has to make the capital contribution each year. The organization also collects a "career rental margin" which is the difference between the rent that the organization collects and the rent the organization pays out, minus the carrying cost of that investment (i.e. interest and amortization) so that is an important consideration as well.

The organization is always looking at increasing the value for the shareholders and externally analysts look at the notion of free cash flow to value the future earnings of the company. As such, corporate locations are more capital intensive than franchised locations as you need to invest in them so for corporate locations free cash flow is the operating cash flow minus the general and administrative expenses required to support those locations minus the average reinvestment.

Obviously, that drives the need to have high-performance company-owned restaurants otherwise the organization could find itself in a situation where it has negative free cash flow from some of its corporate locations. This triggers the notion of portfolio optimization. FoodChain quintiles its portfolio and over time tries to dispose of its fifth quintile and purchase top quintile restaurants. Hence, the performance of a restaurant being sold by an existing franchisee could impact the franchising model used as well as the likelihood of the restaurant being repurchased by FoodChain or sold to another franchisee.

Another element related to portfolio optimization is that as part of the franchising agreement, FoodChain has the ability to exercise first right of refusal on any outlet that goes on sale. If the franchisee decides that he wants to sell his stores then the company has approve the buyer. The company has to right to buy any restaurant that becomes available and transform it into a corporate restaurant.

Ownership Preference

Another factor that could affect the franchising model used is the fact that from a restaurant ownership standpoint, its FoodChain's preference that all their franchisees own more than one restaurant. There are several reasons for this preference. First, FoodChain wants stability for its franchisees. The notion of having more than one restaurant gives the franchisee the opportunity to "hedge his bets". If a franchisee's only restaurant were to face a temporary challenge such as a road closure then the situation would be a lot more difficult for him to bear than if he operated multiple outlets. Multiple locations also bring operational efficiencies. For example, the franchisee's salary and as well as general and administrative experiences can be divided amongst multiple restaurants instead of only one. This could be important for a franchisee, especially in a situation where margins were to become smaller due to circumstances out of his control such as an increase in the costs of global commodities. Having multiple locations allows the franchisee to hedge his bets and to maintain a decent income even if margins or sales become smaller for a reason or another.

Having more than one restaurants also makes it easier for the franchisee to expand for several reasons. First, having more than one restaurant builds equity much faster than having only one restaurant. It also generates borrowing capacity for the franchisee which gives him the opportunity to expand. If a franchisee only owned one restaurant and then came an opportunity to buy 5 or 6 restaurants the franchisee may simply not have the financial capabilities to buy these locations. The ramp-up would also be much more difficult going from 1 restaurant to 6 than from 2 or 3 to 6, as the franchisee would already have experience dividing his attention amongst multiple restaurants therefore he would already know how to ensure that the quality of the offering remains high despite the fact that he can't be everywhere at the same time.

Once a franchisee is brought into the system, it's the company's preference to start with a single restaurant and then in time grow to multiple locations. The transition is much easier for the franchisee this way than when the person has to absorb several restaurants at once, which is far more challenging. Of course, there are circumstances under which the company doesn't have a choice. For example, if the original owner in a remote market has 5 restaurants and wants to retire then obviously it's not possible to sell them one at a time, so the company won't have a choice and it will need to transition the 5 restaurants all at once. In these circumstances, the company will support the transition more aggressively with its field service team to ensure a smooth transition.

In terms of whether a conventional franchise is going to be awarded to an existing franchisee or to a new franchisee, there are several factors that affect this decision. First is the future growth that the company expects in the area. If the company believes that it's going to be their only new restaurant in the area for a long time then in this case they would prefer to sell it to an existing franchisee, as it would probably be a new franchisee's sole restaurant otherwise. The exception to this would be if the company believes that the existing franchisee is at maximum capacity, so to speak. On the other hand, if the market has a lot of potential future growth then it could make sense to introduce a new franchisee in the area knowing that in time the market will grow beyond one restaurant. What the company tries to do is avoid long-term single ownership as it may restrict the ability to ensure financial stability for the franchisee.

Special Circumstances

There are also a few special circumstances which will lead the company to use a specific model. First, in a situation where the company isn't certain if it will be able to keep operating the restaurant beyond the duration of the building lease, BFLs are often going to be used because they make more sense from everyone's standpoint seeing as otherwise the franchisee would have to purchase brand new equipment, seating, signs and decor that would only be used for the remainder of the lease. If the lease is almost up and the company isn't certain that it's going to be possible to renew it then BFLs are typically the preferred franchise model.

BFLs can also be used in situations where the financial means of a good franchisee and somewhat limited but the company would like to entrust him with more restaurants. For example, if the company wanted to sell 3 restaurants but the person only had the capital for two then the company could sell him 2 restaurants using the traditional franchising model and one using the BFL franchising model. The franchisee would then have the option of converting the BFL to a conventional franchise at some point in the future.

Another set of special circumstances is when a restaurant is not very profitable but there is a clause to the rental contract which states that the company has to keep operating the restaurant. In a situation such as this one it can be better to use a BFL than to use internal resources to run the restaurant.

The joint venture model is generally used in existing markets who have chosen to accelerate their growth and who have good candidates with the money for two or three restaurants but not enough to purchase all the restaurants that the company would like to sell. The company will then co-invest with the franchisee who will later have the option of buying out the company.

Art4Everyone Franchising Strategy

Types of Franchising Agreements Used

Art4Everyone uses three main types of franchising agreements: junior franchises, master franchises and joint-ventures.

Junior Franchise: The first type of franchising agreement is the junior franchise model which is the way Art4Everyone calls the traditional franchising model. Franchisees that use this type of franchising agreement may own one or more outlets. Initially, the franchisee will pay a franchise fee which will give him the support of the corporation and the right to use the company's business model. He also pays for the inventory upfront and then pays to replace the inventory once it has been sold. The franchisee then has to pay rent each month which pays for the general and administrative expenses of the corporation as well as other costs of the system. The company makes money by selling art to the franchisee as well as getting a percentage of realized sales at the end of the month.

Master Franchise: Master franchises are granted the right to open a certain number of franchises within a given area. The master franchisee also has the right (and is actually expected by the company) to sub-franchise. He has exclusive rights to this area as long as he opens a certain number of franchises during a certain period. Master franchisees have the advantage of receiving royalties from online sales. However, they are also more expensive than junior franchises. Also, a franchise fee must be paid for each franchise opened by the master franchisee (or one of his franchisees). While the company does grant master franchises, the rights that come with the master franchise are only officially granted when the franchisee has proven that he can meet commitments. The franchisee has to achieve certain sales targets and open a certain number of outlets before actually getting exclusive rights to the area as well as getting the right to sub-franchise. Once he has achieved the targets set by the company in terms of sales and in terms of number of outlets, he has to pay the rest of the franchise fees and then every aspect of the master franchise is unlocked. This way, the company can make sure that the franchisee really understands how the business has to be run before being given the rights of a master franchisee. Master franchises are a good way for the company to achieve a high level of growth at low risk and with little supervision (which is essential for a small company which doesn't have the supervisory system in place to micromanage individual franchises all over the world). Granting master franchises has the added benefit of reassuring investors by showing them that strong growth is going to be achieved over the next few years because they know that the franchisees are going to fulfill their part of the contract since they don't want to lose the master franchise license.

Joint Venture: The third type of franchising agreement used by Art4Everyone is the joint venture model. Under the joint venture model, the company partners with the franchisee (existing or to be) to open or acquire restaurants. The percentage allocated to each party varies but Art4Everyone generally owns a greater percentage of the restaurants than the franchisee. The way the restaurant is going to be valued once one of the partners wants to buy the other out is already established from the start in terms of which variables are going to be taken into account, though the actual amount is not fixed.

Factors that Affect the Franchising Agreement Used

Knowledge of the Market and Market Risk

One of the main factors considered by Art4Everyone when determining the type of franchise agreement used is how knowledgeable the company is about the market. If the company knows a lot about a particular market then there is less of a risk of the company undervaluing how much a master franchise in that market is worth. In cases where the company is not able to evaluate the market's potential, the company generally prefers to sell a few junior franchises. After the first franchises are built, it's much easier for the company to understand how much potential there is in a particular market seeing as the company will be able to compare the sales of the franchises in that region with sales in other regions. The company can then set a fair price to the master franchise.

An aspect that is strongly linked to the knowledge of the market is the market risk. While the company prefers owning stores rather than selling franchises in markets where there is a low amount of risk, it is difficult to know how much risk there is in a given market without actually having stores there. The error margin is razor thin for a new company with little capital so every company-owned outlet that it opens has to be a success. One way to enhance Art4Everyone's knowledge of a given market is to grant junior franchises there to see how much success they have. Once the company has a good idea of the income that it can expect from owning stores there, it then becomes easier for the company to make the decision to invest in company-owned stores in that country.

Financial Considerations

Financial considerations also affect the type of agreement used. For example, if investors are willing to put in a lot of money to jointly own a store in a good market then it could be interesting for Art4Everyone to set up a joint venture with the investors as the company would get a good value for the store. Obviously, the availability of financial capital for Art4Everyone has a huge impact on whether the company can afford to own a store or if it has to franchise it instead.

Availability of Qualified Personnel

Another aspect is the availability of qualified personnel. In France, a country where Art4Everyone has been operating for a few years now, there is a pool of qualified personnel which could potentially run art galleries therefore the company does have the option to open company-owned stores there. However, in countries where it doesn't have stores or in countries where it only has franchised stores, it is quite difficult to open company-owned stores as the company has no qualified personnel there hence the only option is to sell franchises. That being said, Art4Everyone is not that selective in terms of who is allowed to become a franchisee. The main criterion used to measure someone's worthiness is the amount of money he is willing to put in play. If he has enough money to pay for the franchise then that is sufficient for the company.

Ownership Preference

Another aspect is the fact that the company prefers selling master franchises instead of junior franchises, as master franchises are much more independent. The fact that Art4Everyone is still fairly small and does not have a large number of supervisory personnel makes it difficult to supervise a large number of individual franchises located in many countries. Hence, it's much easier from a performance management standpoint to support a few master franchises than it is to support many junior franchises. This explains why the company has a preference for selling master franchises. Master franchises are much more independent. They can solve small problems on their own and discuss large issues with the company. Junior franchises, on the other hand, are more likely to require constant attention for small issues that are store specific and that may not be worth the company's time. The size of the company does not presently allow it to micro-manage a large number of individual franchisees.

Proportion of Outlets that Should be Franchised

Another fairly important aspect is the proportion of outlets that should be franchised according to the management team. The company's current objective is to franchise about half of its outlets and own the other half. According to the person in charge of the franchising in North America for Art4Everyone, company-owned stores are generally more profitable than franchises in this industry, which explains why the objective is to own at least half (50%) of the outlets. The 50% figure is a minimum; it allows the company to diversify its portfolio. If the stores aren't doing well in a certain region then they may be doing better in other regions. It also allows the company to retain a certain amount of control over the brand and on the franchisees in order to maintain its brand image. The person in charge of franchising claims that in an ideal world, every store would be company-owned (giving them perfect control and greater revenues).

The reason why the company doesn't aim for 100% ownership is that the time-to-market would be negatively affected. The company doesn't want competitors to copy its business model so it needs to grow as fast as possible for brand recognition and to acquire prime locations. However, it doesn't have the capital needed to grow fast enough. Plus, there is an advantage that comes with local franchisees: they bear the financial risk, they have experience doing business in the country, they speak the language and they have the network.

The contracts between the company and its franchisees are renewed automatically every seven years, as long as the franchisees meet the objectives that have been set (number of outlets, total sales, etc.). If they don't meet those targets then Art4Everyone has the option of repurchasing the franchise at a predefined price (usually a multiple of the franchise' EBITDA). The interviewee did mention that they would be looking at this option every time a contract was up for renewal, if the objectives hadn't been met.

Analysis and Discussion

In this section, I will analyze and discuss the information that was gathered in the interviews. The analysis is divided in two sections. The first section looks at the types of franchising agreements that were identified in interviews and compares those with the four types of franchising agreements that are most commonly identified by academics. The second section looks factors that are taken into consideration by the two companies when trying to decide which type of franchising agreement should be used. The second section is divided in two subsections; one for FoodChain and one for Art4Everyone.

The analysis was done in the following manner. In the first section, the franchising agreements that were identified by interviewees were cross-referenced against the franchising agreements that were generally mentioned in research and by franchising associations. In the second section, factors that were identified by interviewees were acknowledged and links were made between the interviewees' explanations and various theoretical perspectives that were explained in the literature review.

Analysis and Discussion

Types of Franchising Agreements

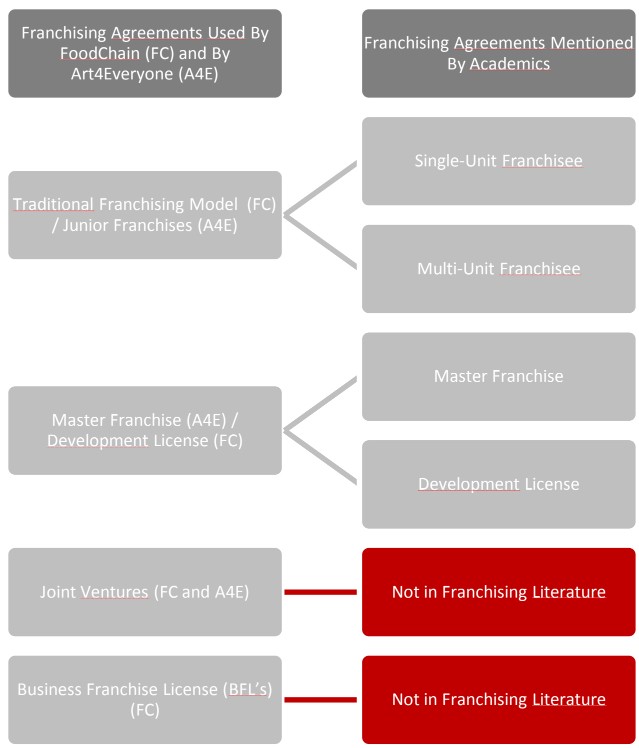
The first thing that stands out following the interviews that were conducted at FoodChain and Art4Everyone is that there are discrepancies when we compare the franchising agreements that are mentioned in the literature and the ones that are actually used by corporations.

First, academics seem to make distinctions that are not necessarily made at the corporate level. For example, academics made a distinction between single-unit franchising and multi-unit franchising but actually both fell under the same label for FoodChain (traditional franchising model) and Art4Everyone (junior franchises). Franchisees kept the same label no matter the number of outlets under management. The distinction that academics made between single-unit and multi-unit franchising did not exist for FoodChain, nor for Art4Everyone. That being said, it should be noted that FoodChain did make a slight difference between the two in the sense that the company preferred multi-franchise ownership to single-franchise ownership. For example, while franchisees are generally given responsibility for a single store when they join FoodChain, there is a natural transition which takes place towards multi-unit ownership because strong franchisees make for a strong company.

Also, FoodChain and Art4Everyone did not differentiate between development licenses and master franchises. FoodChain used the label *development license* but the holder of the license also had the right to grant franchises which would have made it a master franchise according to academics, as holders of development licenses do not have the right to grant franchises. Similarly, Art4Everyone did not make a difference between development licenses and master franchises, as they only sold master franchises (with the right to sell franchises). They did not use development licenses at all.

Also, the interviews that were conducted with people from FoodChain and from Art4Everyone highlighted some types of franchising agreements that were generally not mentioned by academics. Looking at the franchising agreements that were mentioned by FoodChain, Business Facility Leases (BFL) and Joint Ventures were never mentioned in the literature. The franchising concepts in the literature all implied full ownership by the franchisee. In reality, I found that FoodChain sometimes co-owned franchises (Joint Venture) and owned outlets that were under management by franchisee (BFL's). As for Art4Everyone, they used joint ventures to some extent. Neither BFL's nor Joint Ventures were found in franchising literature.

The following chart summarizes this thesis' findings regarding the types of franchising agreements used by companies versus those that are mentioned by academics:



It seems that franchising literature has mostly considered the size (one or more franchises) and rights (exclusive territory, right to grant franchises) associated with franchising agreements. However, while Art4Everyone and FoodChain used these agreements, they also used franchising agreements that were not described in the franchising literature. The types of franchising agreements used by Art4Everyone and FoodChain also looked at the financing behind the franchising agreement and whether part or all of the franchised outlet would be financed and owned by the company.

Factors that Affect the Organizational Form of the Outlet

Following the interviews with FoodChain and Art4Everyone executives, a number of factors that affect the type of franchising agreement used were identified: the growth anticipated by the company, the proportion of outlets that should be franchised, the expected level of franchisee turnover, financial considerations, portfolio optimization, ownership preference, availability of qualified personnel, market knowledge, market risk and special circumstances. Many factors held importance for both FoodChain and Art4Everyone executives, but there were also factors which were unique to one of the two companies. Seeing as the factors did not always have the same impact on the type of franchising agreement that be used by the company, I decided to consider FoodChain and Art4Everyone separately as doing otherwise would have made for a very messy model.

It should be noted that the various franchising agreements were not only compared amongst themselves, they were also compared against the possibility of keeping the outlet as a company-owned store. It was important to compare the various franchising agreements with the possibility of the store being company-owned, as owning a certain number of outlets is an important part of both companies' strategy. Excluding company-owned stores would have meant ignoring one of the key "solutions" that the companies had found to certain market factors. Hence, the analysis of each company is divided in two parts. First, we will look at criteria that can have an effect as to whether the outlet is going to be company-owned or if it is going to be franchised. Then, the factors that affect the company's decision as to which franchising agreement it will use are going to be discussed.

Analysis of FoodChain's Franchising Strategy

Factors that Lead Outlets to Become Company-Owned

The three main factors that lead FoodChain to choose company ownership over franchisee ownership are the proportion of outlets that the company believes should be franchised, portfolio optimization (which is when a company simultaneously sells a company-owned store and repurchases a more profitable franchise, hereby replacing the store it just sold) and financial considerations.

First, the **desired proportion of company-owned outlets** is one of the main factors that can lead to company ownership. For example, if the company's strategic plan states that the number of company-owned locations is too low then this could lead to profitable franchises that are on sale being repurchased by the company instead of being sold off to other franchisees. On the other hand, if the company's strategic plan states that the company needs to increase its number of franchised locations then that could lead to current company-owned locations being sold to franchisees or franchises currently on sale by franchisees being resold to other franchisees.

One implication that comes from the idea that a company would target a certain proportion of company-owned stores is that it means the company thinks it is better off with both types of locations than with only one type. Academics call this the plural form in franchising. The idea behind this concept is that a combination of organizational arrangements may actually be better than the use only one organizational arrangement, because those organizational arrangements may possess a synergism when used simultaneously (Lewin-Solomons, 2000). There was a lot of support for this concept during the interviews with FoodChain executives, as numerous benefits to having both company-owned and franchised stores were mentioned. For example, a synergy that was proposed by a FoodChain executive is that having company-owned stores gives the company more credibility in the eyes of the franchisees as it show franchisees that the company has "skin in the game", that it has something to lose. This way, it's much easier for the company to convince franchisees to implement their programs or innovations. By maintaining a certain proportion of company stores, the corporation can show franchisees that it is not asking them to implement innovations which it is not willing to implement itself (Lewin-Solomons, 2000). The result is a greater buy-in from franchisees and a stronger company overall.

Another advantage of having a combination of company-owned and franchised stores that was not mentioned in the franchising literature but that was mentioned by some of the interviewees is that company-owned stores are a source of supervisory personnel that can, after a few years, go up the corporate ladder and start supervising franchised stores and giving advice to new franchisees.

To summarize, FoodChain executives found that maintaining a certain proportion of company-owned stores was important as it generates a greater buy-in from franchisees and it's a source of qualified supervisory personnel. Should executives believe that more company-owned locations are needed then this will definitely have an impact on whether an outlet will be franchised or company-owned.

The second factor that stood out that could lead to a store becoming company-owned is **portfolio optimization**. Portfolio optimization refers to the idea of selling not-so profitable stores that are currently owned by the company and replacing them by stores that are currently owned by franchisees and that are more profitable. This is particularly interesting as it relates directly to the second prediction of resource scarcity theory, which is that once economies of scale have been attained, franchisors will maintain company ownership over new outlets and eventually repurchase all but the least profitable franchised outlets (Oxenfeldt and Kelly, 1969). While it is true that FoodChain quintiles its portfolio and tries to sell bottom-quintile outlets and replace them with top-quintile outlets, that is still a far cry from what was proposed by Oxenfeldt and Kelly. Oxenfeldt and Kelly believed that companies would stop franchising and start re-buying the majority of their franchises. FoodChain is optimizing its portfolio by selling stores that are less profitable and purchasing stores that are more profitable. The company is not trying to own every single profitable store, it is simply trying to make sure that the stores it owns are as profitable as possible. As one of the interviewees mentioned, the company does not want to find itself in a situation where it has negative free cash flow from some of its corporate locations

This also comes back to the concept of plural ownership in franchising and how it may not make sense to repurchase every profitable franchise. The concept of the plural form in franchising is in stark contrast with the second prediction of ownership redirection in that it supports the idea of having both franchises and company-owned stores due to synergies that can be derived from having both organizational forms.

Finally, the third factor that had a strong effect on whether an outlet would be owned by the company or by a franchisee through one of the franchising models is **financial considerations** (including **availability of capital**). For example, there are large differences between company-owned outlets and the various franchising models in terms of how profitable and capital intensive they are to the company. For example, a BFL is generally less profitable for the company as the company is owning the assets and it has to make the capital contribution towards reinvestments each year. The traditional franchising model from that standpoint makes sense as the organization collect royalties on the business while the franchisee owns the assets and is the one who has to make the capital contribution each year. Of course, the most capital-intensive organizational form of all is company-owned outlets.

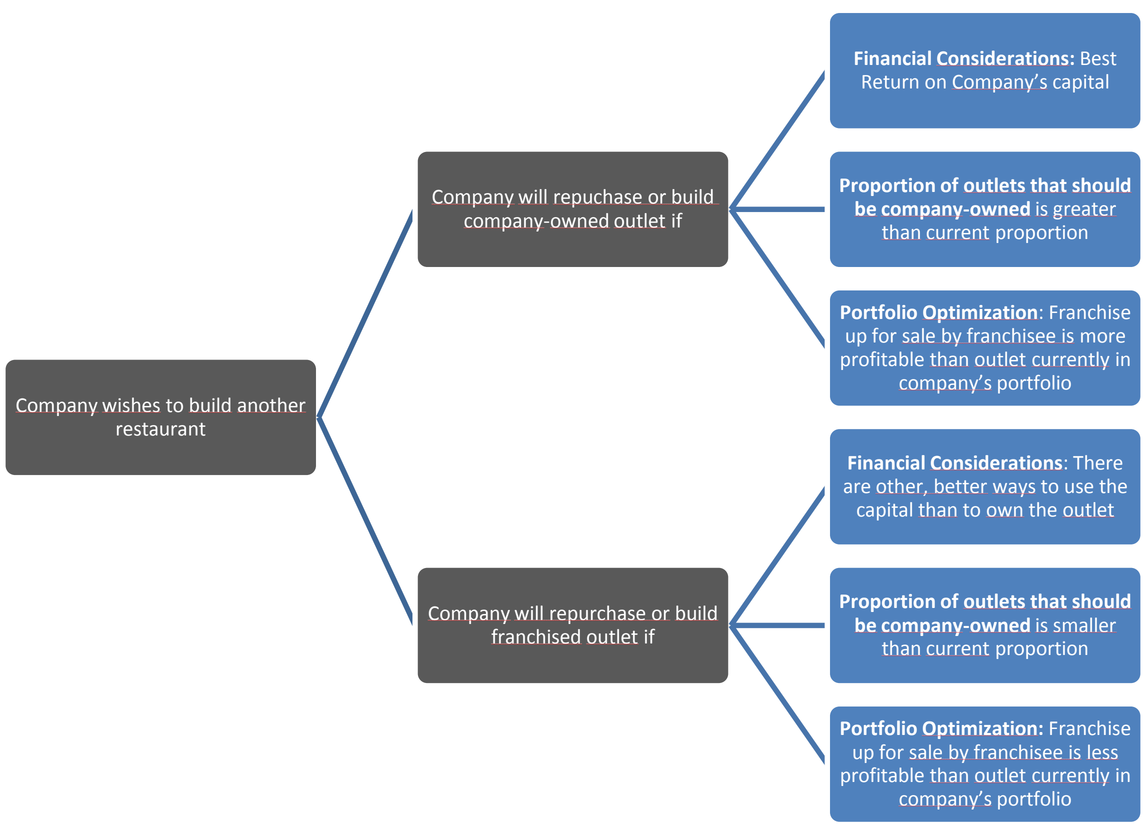
There is a strong link to be made between financial considerations and the first prediction of resource scarcity which states that franchising is used as a way of overcoming internal limitations to growth. The limitations to growth that are mentioned in literature by Oxenfeldt and Kelly (1969) are labor and capital. FoodChain is a mature company with a healthy level of cash on hand. Hence, an argument could be made that it could definitely fund its own growth if it wished to. While that is a valid argument, an aspect to consider is whether the company would want to do so. As was mentioned by an interviewee, "it may not be the best utilization of corporate funds".

One of the issues that I have with the resource scarcity theory is that it begins with the premise that franchising is used early in a firm's existence as a way to overcome limitations to growth. Using the information that was provided by the interviewees, it has become clear in my mind that franchising is not only used early in a firm's existence. FoodChain is a prime example of this as it has been around for over 60 years and nearly 80% of its outlets are franchised. I would also argue that franchising is not necessarily used to overcome limitations to growth (lack of capital and needed managerial expertise). Again, FoodChain is a prime example with close to $2.5B of cash and cash equivalents on hand, according to its latest balance sheet. The company could easily repurchase hundreds if not thousands of outlets if it wished to.

I would argue that franchising is also used later on by mature firms because while they may have enough capital to keep growing without franchising, it's more profitable for them to use this capital in other ways therefore they choose to franchise instead. Oxenfeldt and Kelly believe that over time, successful franchisors will overcome internal limitations in terms of capital and in terms of the time it takes to train managers and repurchase the most profitable franchised outlets. While it's understandable why a company could have interest in purchasing a profitable outlet, one could wonder why a franchisee could wish to sell a profitable venture. Oxenfeldt and Kelly explain that there are several factors that could lead a franchisee to sell the franchise back to the franchisor. Using the life-cycle model, they explain that the franchisee's opportunities (along with his goals and capabilities) change as time progresses and that such changes ultimately lead him to sell the franchise. For example, "as the franchisee makes money during the growth and prosperity stages, his opportunities for investment elsewhere expand (if for no other reason that his increased resources)" (Oxenfeldt and Kelly, 1969). They add that "the more attractive other investment opportunities are and the more likely the franchisee will be to sell out".

This is where, I believe, there is a slight contradiction in what Oxenfeldt and Kelly say. They believe that other, more attractive opportunities are going to present themselves to the franchisee that could lead him to try and sell the franchise, but they don't mention how more attractive opportunities could also present themselves to the franchisor which could make him want to use the capital in other ways. It is true that as times goes by, opportunities are going to present themselves to the franchisee which could make him want to sell the franchise back to the franchisor but that the same could be said for the franchisor: more attractive opportunities are going to present themselves. If the franchisor were to buy back every franchise then he would miss out on a lot of other opportunities. As one of my interviewees at FoodChain said, "[...] only having company-owned stores may not necessarily be the best utilization of corporate funds. The main advantage of franchises is that they allow FoodChain to leverage others' investments and still collect royalties and create a real estate margin by collecting rent." As such, corporate locations are more capital intensive than franchise locations for the corporation, seeing as it needs to pay for the general and administrative expenses as well as for the yearly reinvestment. Having franchises allows the company to leverage somebody else's capital and to use their own capital for other, more rewarding uses. For example, the company could have to make a decision between purchasing a franchise or building 3 or 4 restaurants in prime locations which it can then sell to franchisees and collect additional income from.

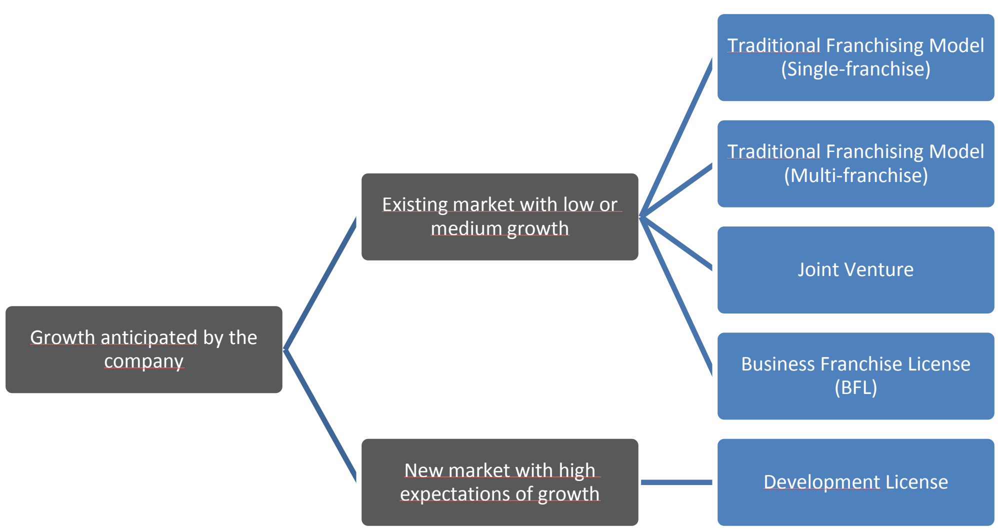
That is why I posit that some of the reasons that lead firms to franchise early on in their existence do not totally go away, particularly capital scarcity. Capital is always scarce, as there is always an opportunity cost. Firms don't have the capital to do everything at once, so they have to choose the best way to use their capital. One of the main reasons why a type of franchising agreement is going to be chosen over another is how profitable a venture is for them, and how capital intensive it is. Companies will choose the type of franchising agreement that will be the most profitable relative to how capital intensive it is. Hence, financial considerations play a large role in terms of whether an outlet is going to be franchised or if it is going to be company-owned. Only having company-owned stores may not be the best way to maximize profits and cash flow over the long term. This was supported by the comments made by one of the senior executives at FoodChain, who explained that corporate locations were much more capital intensive than franchised locations as they generate general and administrative expenses and necessitate yearly reinvestments. The following graph shows the conditions that must be met for FoodChain to make the decision to build a company-owned outlet.



Factors that Lead Companies to Choose One Franchising Agreement over the Others

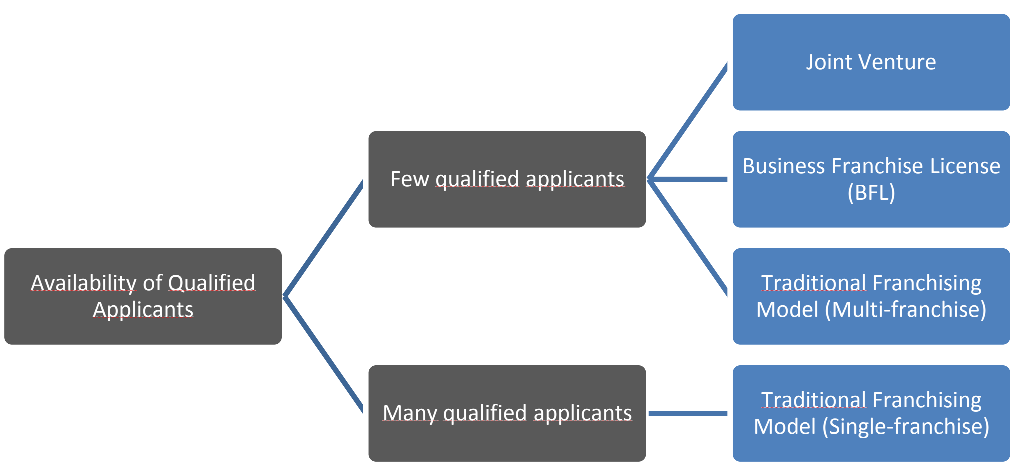
Once FoodChain has chosen to franchise, a few factors affect which type of franchising agreement is going to be used: the growth that is anticipated by the company, availability of qualified applicants, ownership preference and special circumstances.

First, one of the main factors that affect the type of franchising agreement used is the **growth that is anticipated by the company** over the next few years in that market. For example, the argument that was made by FoodChain executives was that if a lot of growth is anticipated in the coming years in an underdeveloped market then a development license could make a lot of sense as it allows the company to leverage someone else's capital for growth and conditions can be placed on the agreement as to how many stores have to be opened every year. If, on the other hand, the company is evolving in a mature market and has plans for slow and steady growth then "a mixture of traditional franchising model and BFLs should suffice". The graph below shows the types of franchising agreements that are going to be favored according to the type of market and expected growth of the market itself. It should be noted that development licenses are only used in new markets where a lot of growth is anticipated. Development licenses are not going to be part of the analysis going forward as high growth is the only factor that could lead to the use of a development license.



Another aspect that affects the type of franchising agreement used is the **availability of qualified applicants** (including **expected franchisee turnover**). As was mentioned earlier, one of the aspects that affect the type of franchising agreement that is going to be used is the growth that is expected over the next few years. This, in turn, affects the number of franchisees that are going to be needed to own these locations. The number of franchisees that are going to be needed in the following years is a combination of three factors: expected franchisee turnover, anticipated growth for the next few years and desired proportion of franchised outlets. The company has to make sure that the pipeline of registered applicants is able to handle the company's needs in terms of franchisees because otherwise it may be forced to either take over the restaurant or overload certain franchisees. The concept of the plural form in franchising supports the idea of having both franchises and company-owned stores as it is possible to derive synergies form having both organizational forms (Lewin-Solomons, 2000).

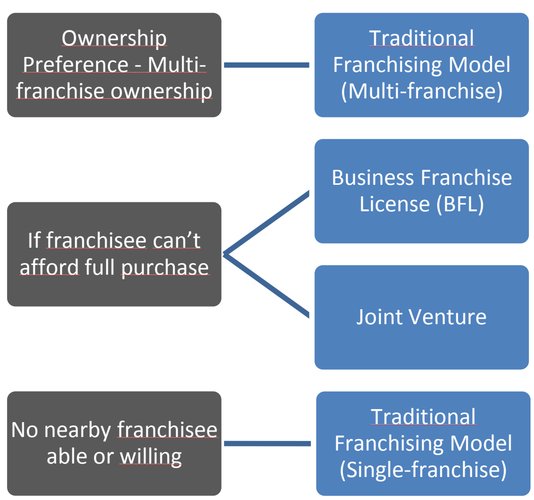
If the pipeline of qualified applicants is empty then this is going to have ramifications on the type of franchising agreement used. If you have enough qualified applicants then you can sell them individual franchises. On the other hand, if you don't have enough qualified applicants then you have to find ways to build the stores without having access to franchisees' capital. There are a few ways to do this: sell the franchise to an existing franchisee, invest with a current franchisee who doesn't have enough money on his own to purchase the outlet (joint venture), or simply own the restaurant but get a franchisee to run it, using a business facility lease (BFL). Once the three years are over, he will hopefully have accumulated enough equity to convert the BFL into a conventional franchise.



Also, the company's **ownership preference** affects the type of franchising agreement used. FoodChain's preference is that all of their franchisees own more than one restaurant. One of the reasons for this is that it increases the franchisees' financial stability. Multiple locations also bring operational efficiencies and make it easier for the franchisee to expand further both in terms of capital and in terms of management capabilities (because he has built more equity and because he is already used to managing multiple locations).

FoodChain's first choice will be to grant the franchise to an existing, high-performing franchisee. If none of the franchisees operating in the same region as the outlet is able to purchase it due to financial constraints then the company could look at using a business franchise license (BFL) or a joint venture in order to make sure that the franchise goes to an experienced, talented franchisee. Should none of these options be feasible because the franchisees are all at maximum capacity, unwilling or unable to take on more restaurants then the company will look at granting the franchise to a qualified candidate.

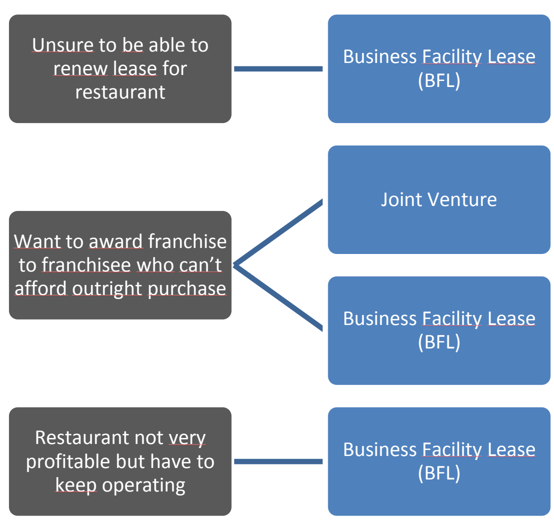
Agency theory proponents would add that having franchisees own multiple restaurants makes them less likely to shirk as owning multiple stores within the same geographical area means that a store's bad performance will affect the franchisee's other stores as well. The idea is that franchisees enjoy the full benefit of their shirking but share the costs with other franchisees (Caves and Murphy, 1976). Having more restaurants in the area means that the franchisee who does the shirking will be even more affected.



Finally, there are also some **special circumstances** which can have a large incidence on the type of franchising agreement used. For example, BFLs are often going to be used in situations where the company isn't certain if it will be able to keep operating the restaurant beyond the duration of the building lease. Using a BFL makes more sense from everyone's standpoint seeing as otherwise the franchisee would have to purchase brand new equipment, seating, signs and decor that would only be used for the remainder of the lease. If the lease is almost up and the company isn't certain that it's going to be possible to renew it then BFLs are typically the preferred franchise model.

Otherwise, BFL's and joint ventures are also used in situations where the financial means of a good franchisee are somewhat limited but the company would like to entrust him with more restaurants. For example, if the company wanted to sell 3 restaurants but the person only had the capital for two then the company could sell 2 restaurants to him using the traditional franchising model and one BFL. The franchisee would then have the option of converting it to a conventional franchise at some point in the future. Similarly, the joint venture model is generally used in existing markets who have chosen to accelerate their growth and who have good candidates with the money for two or three restaurants but not enough to purchase all the restaurants that the company would like to sell. The company will then co-invest with the franchisee who will later have the option of buying out the company's share.

Also, another example of a set of special circumstances is when a restaurant is not very profitable but there is a clause to the rental contract that states that the company has to keep operating the restaurant. In a situation such as this one it can be better to use a BFL than to use internal resources to run the restaurant.



Analysis of Art4Everyone's Franchising Strategy

The three main factors that lead Art4Everyone to choose company ownership instead of franchisee ownership are the knowledge of the market (and market risk), desired proportion of company-owned outlets, and availability of personnel and capital.

Factors that Lead Outlets to Become Company-Owned

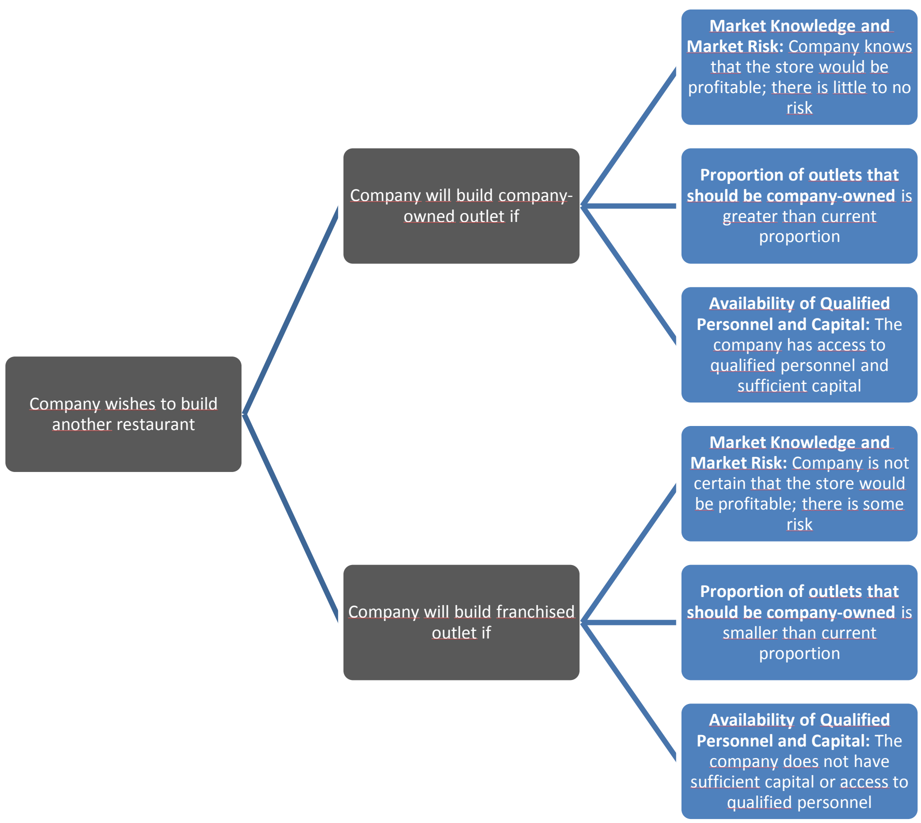
The company's **knowledge of the market** and **market risk** is one of the main factors that could lead to company ownership of an outlet. Having knowledge of the market gives Art4Everyone a better idea of the market risk. Seeing as the company is still in the early stages, any error could have a dire impact on the company's financial position. While the company prefers owning stores to selling franchises in markets where there is a low amount of risk, it is difficult to know how much risk there is in a given market without actually having stores there. The error margin is razor thin for a new company with little capital so every company-owned outlet that it opens has to be a success. If the company doesn't have a solid knowledge of the market and isn't certain that a store in that market would be profitable then the company can't currently afford to take that risk. On the other hand, knowing that the store is going to be profitable could lead to the company building and owning the store, assuming other conditions are met.

The second condition that must be met is that opening a company-owned store has to fit in the company's objective in terms of **proportion of company-owned restaurants**. The company's current objective is to franchise about half of its outlets and own the other half. According to the person in charge of the franchising in North America for Art4Everyone, company-owned stores are generally more profitable than franchises in this industry, which explains why the company's objective is to own at least half (50%) of the outlets. It's important for the company to have a certain amount of control over its brand and franchisees in order to maintain its brand image. This supports Oxenfeldt and Kelly's (1969) idea that one of the things that push the franchisor towards ownership is the frustration that stems from a lack of control on what franchisees do. The person in charge of franchising in North America claims that in an ideal world, every store would be company-owned (giving them perfect control and greater revenues). This is interesting as it directly contradicts the idea presented in theory on the plural form in franchising; that synergies could be derived from a combination of company-owned and franchised stores (Lewin-Solomons, 2000).

The reason why the objective is 50% is that a higher target is not realistic in the short term because the company doesn't capital to build stores without support, and it's important for the company to grow fast in order to prevent other companies from copying its business model and gaining the brand recognition. Hence, franchising is an interesting alternative because franchisees bear the financial risk, have experience doing business in the country, speak the language and have the network. Clearly this is in line with what was proposed by resource scarcity theory proponents; that people resort to franchising to overcome limitations to growth (Oxenfeldt and Kelly, 1969).

The second prediction of resource scarcity theory could also apply in this case, as the company has the option of repurchasing the stores if the objectives that have been set are not met by the franchisee. The interviewee mentioned that they would be looking at this option every time a contract was up for renewal, if the objectives hadn't been met. This is also in line with the resource scarcity theory, which predicted that once economies of scale had been attained, franchisors would eventually repurchase all but the least profitable outlets (Oxenfeldt and Kelly, 1969).

Finally, the third condition that must be met is the **availability of qualified personnel and capital**. In France, where Art4Everyone has been operating for a few years, there is now a pool of qualified personnel which could potentially run art galleries therefore the company does have the option of opening further company-owned stores there. However, in countries where it doesn't have stores or in countries where it only has franchised stores, it is quite difficult to open company-owned stores as the company has no qualified personnel there hence the only option is to open up a franchise. The company is quite limited in terms of capital seeing as it is just starting up, it does not have the financial flexibility necessary to open every single store it wants to therefore choices have to be made. If the personnel and capital necessary to open the store is not available then the company won't open it, even if the store fits in the company's long-term plans and even if the company is certain that the store is going to be profitable. There is a direct link between this factor and what is stated in resource scarcity theory which is that franchising is used as a way to overcome internal limitations in terms of capital and qualified personnel (Oxenfeldt and Kelly, 1969). If these limitations are present then the company does not have a choice but to franchise the store. On the other hand, if the limitations are not present then the company has the opportunity to choose if it wishes to own the outlet or franchise it. Seeing as company-owned stores are more profitable according to Art4Everyone executives, one could expect the company to build company-owned outlets in regions with little market risk, where it knows that the store is going to be profitable. This is linked to the pull-push model described by Oxenfeldt and Kelly (1969). Essential resources are not always available early on, but as time progresses they become available which then motivates the franchisor towards ownership.



Factors that Lead Companies to Choose One Franchising Agreement over the Others

Once Art4Everyone has chosen to franchise, a few factors affect which type of franchising agreement is going to be used: ownership preference, knowledge of the market, attributes of the candidate and financial considerations.

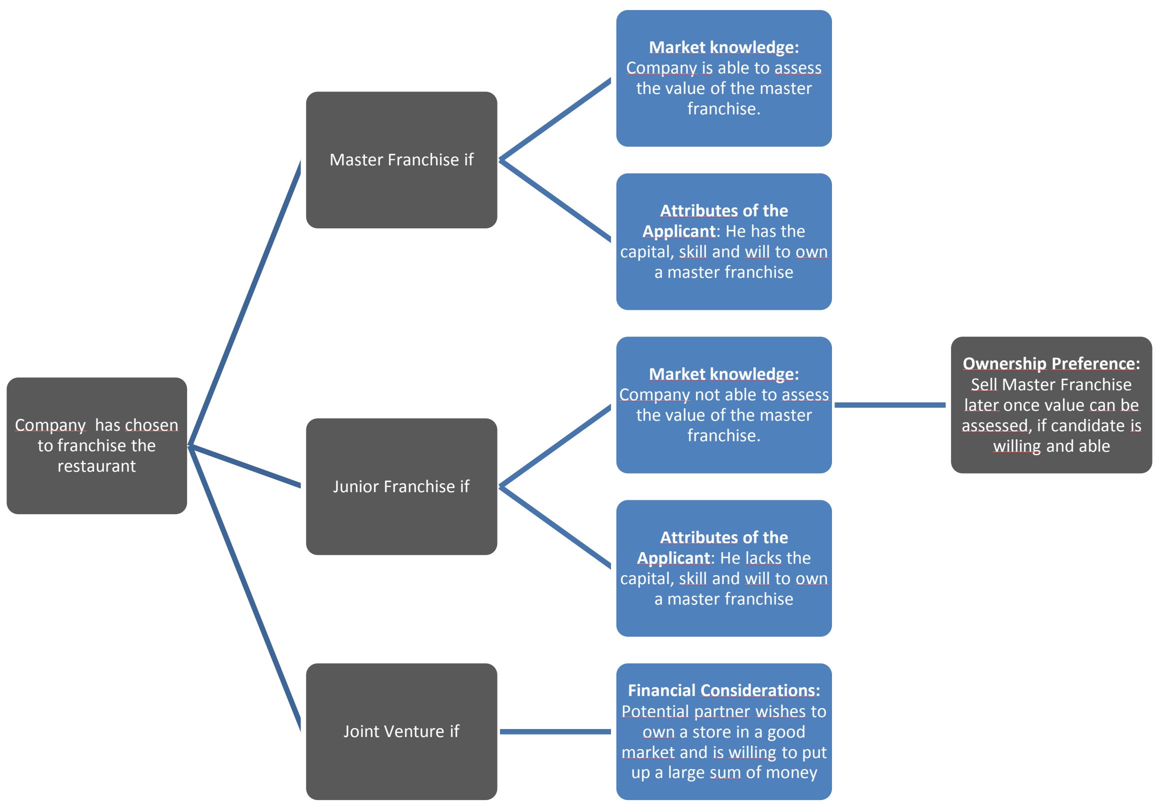
First, the company's **ownership preference** is one of the main factors that could lead the company to favor certain franchising agreements. It was stated by one of the interviewees that the company prefers selling master franchises instead of junior franchises because master franchises are more independent and require less support. The fact that Art4Everyone's organization is still fairly small and does not have much supervisory personnel makes it difficult to supervise a large number of individual franchisees located in many countries. Hence, it's much easier from a performance management standpoint to support a few master franchises rather than several junior franchises. Plus, agency theorist proponents would argue that junior franchisees have an incentive to "free ride" on the franchisor's brand-building efforts when they do not have other outlets because they receive all of the benefits of cost cutting but share the cost of having dissatisfied customers with other outlets (Caves and Murphy, 1976). By giving out master franchises, the likelihood of franchisees free riding can be reduced because every store in a region is owned by the same person therefore they receive most of the cost of having dissatisfied customers.

Another factor that can have a strong incidence on the type of franchising agreement that is going to be used is the company's **knowledge of the market**. The company does not want to undervalue the worth of a master franchise in a particular market. If the company knows a lot about the market then there is less of a risk of the company undervaluing the worth of a master franchise in a particular market. In cases where the company has a difficult time valuing the market's potential, the company generally prefers selling a few junior franchises. Once those junior franchises are built, the company can then see how the sales compare to sales in other regions. The company can then ensure to set a fair price to the master franchise.

Another factor that has a strong incidence on the type of franchising agreement that is going to be used is the **attributes of the candidate**. If the candidate who initially contacts the company only has the capital for (and interest in) opening a single store then the company will not even consider selling him a master franchise. On the other hand, if he shows interest in opening a large number of stores and he has the financial capabilities necessary to open enough stores within a given time period then the company will look into attributing him a master franchise (assuming that it is able to evaluate the fair market value of the master franchise).

Finally, the fourth factor that affects the type of agreement used is **financial considerations**. For example, if the right partner comes along and is willing to put up a lot of money to have a stake in a store in a good market then it could be interesting to set up a joint venture with that partner as Art4Everyone would get a good value for the store.

The following graph summarizes the various options that the company considers and the conditions that must be met for the company to use one type of franchise agreement over the others.



Conclusion

As a starting point, I conducted a literature study covering the three main theories related to the antecedents of franchising: agency theory, resource scarcity theory and the plural form in franchising. I found that while a lot of research has taken place on the antecedents of franchising, there was a clear need for further research on certain topics related to the antecedents of franchising, namely the types of franchising agreements that exist and the factors that lead to the use of one over the others. This led to the following research question:

- *What factors are taken into consideration by companies in their choice of an outlet's organizational form?*

In order to answer the above research question, a multiply case study was conducted with a mature, large company in the quick service industry (FoodChain) and a small company in the art industry (Art4Everyone). The information about the franchising agreements that these companies use and about the factors that affect the choice of a franchising agreement over another was collected through interviews and a review of internal documentation.

The conclusion will be divided in three segments. First I will answer the research question. Then, I will discuss the limitations, generalizability and managerial implications of this study. Finally, I will give suggestions on future research related to my findings.

Answer to The Research Question

In this section, I will first start by documenting my conclusions when it comes to the types of franchising agreements that are used by companies. Then, I will summarize my findings when it comes to what factors affect the type of franchising agreement used by companies.

Franchising Agreements Used by Companies

Before identifying the factors that affect the choice of a franchising agreement, I wanted to get a better understanding of the types of franchising agreements that were used by companies. I needed to have a good understanding of the types of franchising agreements that they were using to understand what leads these companies to choose one over the others.

When it comes to the various types of franchising agreements that were used by companies, I found that there were discrepancies between the types of franchising agreements that are commonly mentioned in research and what companies used in reality. The four types of franchising agreements that are the most commonly mentioned in research and by franchising associations are single-unit franchising, multi-unit franchising, development licenses and master franchises. The conclusions that I can draw from the interviews I conducted with employees of the two companies are as follows. First, the two companies did not make a difference between single-unit and multi-unit franchising, neither did they make a difference between development licenses and master franchises. Also, both companies used types of franchising agreements other than the four mentioned above: FoodChain used Business Franchise Licenses (BFL's) and Joint Ventures while Art4Everyone used Joint Ventures. The aspect that BFL's and Joint Ventures have in common is that these two franchise agreements both involve a certain amount of money coming from the company instead of the outlet being solely funded by the franchisee.

The main conclusion that I draw regarding the franchising agreements used by companies is that the current franchising literature has mostly considered the size (one or more franchises) and rights (exclusive territory, right to grant franchises) associated with franchising agreements. In reality, however, another variable seems to be used: the financing behind the franchise and whether part or all of it would be financed by the company.

Factors that Affect the Franchising Agreement Used

Through the interviews with FoodChain and Art4Everyone executives, I identified several factors that affect the type of organizational form used by these companies. The following factors were identified in interviews with both Art4Everyone and FoodChain executives:

- Growth anticipated by the company
- Proportion of outlets that should be franchised
- Financial considerations
- Ownership preference
- Availability of qualified personnel
- Availability of capital

The following factors were identified solely in interviews with FoodChain executives:

- Portfolio optimization
- Special circumstances
- Expected franchisee turnover

The following factors were identified solely in interviews with Art4Everyone executives:

- Market knowledge and market risk

Comparing my findings with findings of earlier literature on the choice of a franchising agreement, there are clear links to be made. The comparison is not perfectly straight forward as previous research used different terms to describe similar aspects but I believe that looking beyond the name and into characteristics of the factors described in earlier research allows us to identify points of congruence. Earlier research identified franchisor's financial resources scarcity which is clearly linked to two factors I identified in my study: financial considerations and availability of capital. Additionally, academics also identified monitoring costs as a factor, which can be linked to ownership preference (the difficulty of monitoring many individual franchisees was brought up by several Art4Everyone executives). That being said, it's difficult to draw conclusions about discrepancies between this study and previous research because the theoretical perspectives used to study this phenomenon in the past are largely different from those used in this study.

There are three main conclusions that I draw from this thesis regarding the factors that affect the type of franchising agreement used. First, it seems that both companies' decisions were affected by many of the same factors, even though they were of different sizes, in different stages of the business cycle and in widely different industries. The theories that seek to explain the antecedents to franchising (agency theory, resource scarcity theory and plural form in franchising) seemed to apply to both types of companies. In fact, there were clear links between these theories and the factors that were mentioned. For example, financial considerations and the availability of capital had a considerable impact on whether an outlet would be company-owned or franchised. These factors also had a substantial impact on the type of franchising agreement that would be used. Looking at the applicability of the three different theoretical perspectives used in the study, I believe that I made the right choice to focus on resource scarcity theory and agency theory and only use the plural form as a support. The plural form added the least value as the only moment it had an impact on the two companies decisions was when it came time to choose between only having franchised stores or keeping a certain proportion of company-owned stores. Even then, the findings were mixed as Art4Everyone executives actually stated that "in a ideal world, every outlet would be company owned".

Second, is that while some factors were common to both companies, there were also factors that were exclusive to one or the other. For example, the expected level of franchisee turnover and portfolio optimization were only factors for FoodChain, while market knowledge was only a factor for Art4Everyone. One could wonder if this difference is caused by the stage of the business cycle and the different situations in which these companies find themselves. As a mature company with outlets in more than 100 countries around the world, FoodChain already has a fairly good market knowledge of most countries and regions of the world therefore the fact that this factor is not really considered by the company should not come as a surprise. On the other hand, expected turnover and portfolio optimization are not factors that Art4Everyone considers because the company is still in its infancy. There has not been any franchisee turnover yet, people are bound by contracts, the company's portfolio is still in the process of being built and there are still plenty of good locations where the company can build. It makes more sense for the company to keep expanding than to start repurchasing franchises right away as that would slow the company's expansion. I can't draw definitive conclusions on this matter but I believe that this is a topic which is definitely worth researching further. My hypothesis, which is clearly supported by the above arguments, is that the factors that companies consider may be partly related to the stage at which the company is in the business cycle. I believe that a link could be made between this hypothesis and the life-cycle model in the resource scarcity theory as the main idea behind the life-cycle model is that a franchisor and a franchisee's goals, opportunities and capabilities maybe change over time and lead them to want different things than they may have wanted earlier in the existence.

The third and final conclusion that I draw is that some franchising agreements were specifically created to deal with special circumstances. For example, Business Franchise Licenses (BFL's) emerged because FoodChain absolutely wanted to grant franchises to talented franchisees even if they couldn't afford them completely, instead of lowering their standards for the personnel and granting the franchises to applicants that weren't as talented. Hence, the companies found innovative ways to grant franchises to the right people by looking at aspects beyond what was typically considered (size and rights).

Limitations, Generalizability and Managerial Implications

Unfortunately, case studies have limitations. Hodkinson (2001) found certain limitations to case studies to which this particular case study does not escape. First and foremost, case studies are not generalizable in the conventional sense. The sample is small and idiosyncratic, and the data is predominantly non-numerical which means that there is no way to establish the probability that the data is representative of some larger population. Another limitation is that there is so much data that it difficult to cover everything to the same extent, some information has to be omitted or at the very least summarized. Linked to this limitation is the fact that the complexity examined is difficult to represent simply. It's difficult to present pictures of the complexities of social situations in writing because writing is predominantly a linear form of communication but what case studies reveal is not like that. By writing about one aspect of an issue, other issues are often unintentionally concealed (Hodkinson, 2001).

As for the generalizability of case studies, Hodkinson (2001) believes that even though case studies cannot be representative and findings can't really be generalized, the information found in case studies can often tell us about situations beyond the actual case that was studied. He argues that "case studies can provide provisional truths, in a Popperian sense", that the best theory thus far should stand until contradictory findings or better theorizing has been developed. Following this thinking, the findings from this case study should be seen as a provisional truth until better theorizing has been developed. While the findings are not generalizable per say to other companies and industries, I believe that they are well supported by evidence and arguments. As long as the reader understands the strengths and limitations of the methods and approaches used, I believe that the findings can add value beyond giving information on the case that was studied and that there are aspects of the thesis that can serve companies in the future. For example, this study found that the two companies used franchising agreements that were sometimes different from those most often mentioned. It may not mean that every company uses heavily customized franchising agreements but it does mean that some do, and that it may be interesting for others to follow in this path.

In terms of managerial implications, I believe that there are two main implications. First is that companies should consider adapting franchising agreements to their specific situation in situations when the better known franchising agreements do not apply. This research gave franchisors a better idea of the characteristics of the various types of franchising agreements that are used. Second is that it would make sense to consider the various factors that were mentioned by the two companies because there is always a chance that they could apply to the reader's industry or company. Of course, the factors may not necessarily all apply. Still, this thesis gives academics and owners a better idea of under what circumstances certain franchising agreements were used by other companies. This information, which is not publicly available, can be particularly interesting for companies hoping to learn about other companies' experiences before elaborating their own process.

Future Research

In this final section of the final chapter, I give suggestions on future research connected to my findings and raise questions that have been raised by this case study.

Additional Exploratory Research

As I interviewed the executives from the two companies, there are several interesting questions that arose that I felt could be interesting to look into. For example, I wondered at the role of that the stage at which a company is in the business cycle plays on the factors that a company considers when choosing which franchising agreement it is going to use. While I believe that this should impact the factors that companies consider when deciding which franchising agreement is going to be used, it is not something that my interviewees mentioned. My guess is that it was not mentioned because the companies remained at the same stage over the duration of the study. After all, if it doesn't change over time then it will not affect their decisions differently, meaning that there is no point in paying attention to it. This could potentially be linked to the life cycle model mentioned in resource scarcity theory.

Additional studies could also try to identify other factors that impact firms' decisions, as well as other types of franchising agreements that are used by companies. I believe that a study which identified various types of franchising agreements used by companies and nuances between them could be interesting for owners as it might give them ideas which they would not have thought of otherwise. The best known types of franchising agreements look at the size (one or more franchises) and at the rights (exclusive territory, right to grant franchises). This study identified a third axis: how the franchise itself is financed. It could be interesting for a researcher to try to understand what other variables exist.

Looking at franchising from a slightly different angle, it is simply a partnership between two parties in which one party provides capital and personnel and the other provides intangible assets (processes, reputation, customer base, etc.). I believe that one could try to compare the various types of franchising agreements that exist with the types of partnerships that are used, because differences when it comes to the types of partnerships that exists could also potentially apply to franchises. For example, one of the aspects that is mentioned quite often when it comes to partnerships is liability. There is a chance that franchisors in certain industries handle liability differently than in other industries. Perhaps that aspect (or other aspects) could be used to invent new types of franchising agreements that are better suited to today's reality.

Writing this thesis was very challenging but also an incredibly rewarding experience. I believe that this thesis managed to enhance knowledge on how firms actually franchise. That being said, I think that there a lot of research will have to be done before the gap in research is fully bridged. It is my hope that researchers in the future will build on this thesis to try and shed more light on the rationale behind the choice of a franchise agreement.

Bibliography

Aldrich, H. E., & Auster, E. R., 1986. Even dwarfs started small: Liabilities of age and size and their strategic implications. *Research in Organizational Behavior*, 8, 165-198.

Bannister, Adam. "From Singer to Subway: The History of Franchising." *From Singer to Subway: The History of Franchising*. Elite Business Magazine, 18 Sept. 2012. Web. 05 Oct. 2012. <http://elitebusinessmagazine.co.uk/franchise/item/from-singer-to-subway-the-history-of-franchising>.

Bradach, J. et Eccles, R. C., 1989, "Price, authority and trust : from ideal types to plural forms",. *Annual Review of Sociology*, 15, p. 97-118.

Bryman, Alan, and Emma Bell. *Business Research Methods*. Oxford: Oxford UP, 2007. Print.

Bürkle, T. and Posselt, T., 2008, Franchising as a Plural System: A Risk-Based Explanation, *Journal of Retailing*, 84, 39 – 47.

Caves, Richard. E. and William F. Murphy II., 1976, "Franchising: Firms, Markets, and Intangible Assets", *Southern Economic Journal*, 42, 572-586.

Combs, J.G., Ketchen, D.J., Shook, C.L. and Short, J.C. 2011. Antecedents and consequences of franchising: Past accomplishments and future challenges. *Journal of Management*, 37, 99-126.

Combs, J. G. and Ketchen, D. J., 1999, Can Capital Scarcity Help Agency Theory Explain Franchising? Revisiting the Capital Scarcity Hypothesis, *Academy of Management Journal*, 42, 196 – 207.

Combs, J.G. and Ketchen, D.J., 2003. Why do firms use franchising as an entrepreneurial strategy? A meta-analysis. *Journal of Management*, 29(3), 443–465.

Combs, J. G., Ketchen, D. J. and Hoover, V. L., 2004, A Strategic Groups Approach to the Franchising-Performance Relationship, *Journal of Business Venturing*, 19, 877 – 897.

Combs, J. G., Michael, S. C. and Castrogiovanni, G. J., 2004, Franchising: A Review and Avenues to Greater Theoretical Diversity, *Journal of Management*, 30, 907 – 931.

Demski, J.S. & G.A. Feltham., 1978. Economic Incentives in Budgetary Control Systems. *The Accounting Review*, 53(2), 336-359.

Dant, R. P. and Kaufmann, P. J., 2003, Structural and Strategic Dynamics in Franchising, *Journal of Retailing*, 79, 63 – 75.

Diaz-Bernando, Ramon, 2012, An Analysis Of Three Confronting Theories To Explain Franchising Supply, Journal of Business & Economics Research, 10 (3), 167 - 170.

Eisenhardt, K., 1989. Agency theory: An assessment and review. *Academy of Management Review*, 14(1), 57-74.

Eisenhardt, K. M.; Graebner, M. E., 2007: Theory building from cases: Opportunities and challenges. *Academy of Management Journal*, 50 (1), 25-32.

Flyvberg, B. (2006). Five misunderstanding about case-study research. *Qualitative Inquiry*, 12(2), 219-245.

FranChoice. "History of Franchising." *History of Franchising*. N.p., n.d. Web. 03 Sept. 2012. <http://www.franchoice.com/franchise-information-guide/what-is-franchise/history-of-franchising>.

FranStop. "Types of Franchise Agreements." *Types of Franchise Agreements*. N.p., n.d. Web. 05 Oct. 2012. < http://www.franstop.com/franchise-resource-center/types-of-agreements>.

Freeman, G Carroll, M.T Hannan., 1983, "*The Liability of Newness*: *Age Dependence in Organizational Death Rates*", *American Sociological Review*, 48: 692-710.

Ghauri, Pervez N., and Kjell Grønhaug. *Research Methods in Business Studies: A Practical Guide*. Harlow [etc: Prentice Hall/Financial Times, 2005. Print.

Gomez, R. S., Gonzalez, I. S., & Vázquez, L. (2010). Multi-unit versus single-unit franchising: Assessing why franchisors use different ownership strategies. *The Service Industries Journal*, 30(3), 463-476.

Grix, Jonathan. *Demystifying Postgraduate Research: From MA to PhD*. Edgbaston: University of Birmingham, 2001. Print.

Hamel, J. (1993). Case Study methods. Qualitative Research Methods. Vol. 32. Thousand Oaks, CA: Sage.

Hodkinson, Phil and Hodkinson, Header. (2001, December). *The Strengths and Limitations of Case Study Research*. Paper presented to the Learning and Skills Development Agency conference, Cambridge.

Hunt, S. "The Trend Toward Company-Operated Units in Franchise Chains." *Journal of Retailing*, Summer 1973, 3-12.

Hussain, D., & Windsperger, J. (2010). Multi-unit ownership strategy in franchising: Development of an integrative model. *Journal of Marketing Channels*, 17(1), 3-31.

Hussain, D., Windsperger, J. (2011). "Multi-Unit Franchising: A Comparative Case Analysis." *The Journal of Applied Business Research*, 17(1), 103-112.

Hussain, D., Moritz, L. and Windsperger, J. (2012). " The Choice Between Single-Unit And Multi-Unit Franchising: Combining Agency And Transaction Cost Perspectives." *The Journal of Applied Business Research*, 28(5), 769-776.

Jensen MC, Meckling WH., 1976, Theory of the Firm*:* Managerial Behavior*,* Agency Costs *and.* Ownership Structure, *Journal of Financial Economics*, 3: 305–360.

Johnson, Darrell. *State of Franchising/Economic Overview*. Rep. FranData, 2007. Web. 3 Sept. 2012. <http://www.frandata.com/presentations/2007Multi-UnitConferenceSM.pdf>.

Lafontaine, F. and Shaw, K. L., 2005, Targeting Managerial Control: Evidence from Franchising, *Rand Journal of Economics*, 36, 131 – 150.

Lewin-Solomons, Shira B. *The Plural Form in Franchising: A Synergism of Market and Hierarchy*. Cambridge: University of Cambridge, Dept. of Applied Economics, 2000. Print.

Kaufmann, P. J., & Dant, R. P. (1996). Multi-unit franchising: Growth and management issues. *Journal of Business Venturing*, 11(5), 343-358.

Martin, Robert E., 1988, Franchising and Risk Management, *American Economic Review*, 78, 954-968.

Mack, Natasha, and Cynthia Woodsong. *Qualitative Research Methods a Data Collector's Field Guide*. Research Triangle Park, NC: Family Health International, 2005. Print.

McDonald's. "History of McDonald's Restaurants :: AboutMcDonalds.com." *History of McDonald's Restaurants :: AboutMcDonalds.com*. N.p., 2012. Web. 03 Sept. 2012. <http://www.aboutmcdonalds.com/mcd/our_company/mcdonalds_history_timeline.html>.

McDonald's. "The History of the Golden Arches." *Our History*. N.p., 2011. Web. 03 Sept. 2012. <http://www.mcdonalds.ca/ca/en/our_story/our_history.html>.

McDonald's. "The Ray Kroc Story." *The Ray Kroc Story :: McDonalds.com*. N.p., 2009. Web. 03 Sept. 2012. <http://www.mcdonalds.com/us/en/our_story/our_history/the_ray_kroc_story.html>.

Oxenfeldt, Alfred R. and Anthony O. Kelly., 1969, "Will Successful Franchise Systems Ultimately Become Wholly-Owned Chains?", *Journal of Retailing*, 44, 69-87.

PriceWaterhouseCooper. *The Economic Impact of Franchised Businesses: Volume III, Results for 2007*. Rep. International Franchise Association, 2008. Web. 3 Sept. 2012.

Ritchie, Jane, and Jane Lewis. Qualitative Research Practice: A Guide for Social Science Students and Researchers. London: Sage Publications, 2003. Print.

Small Business Association. "Frequently Asked Questions." *Frequently Asked Questions*. N.p., January 2011. Web. 03 Sept. 2012. < http://web.sba.gov/faqs/faqIndexAll.cfm?areaid=24>.

Shields, C. M. (2007, April). *Can case studies achieve the "Gold Standard?" Or when methodology meets politics*. Paper presented at the annual meeting of the American Educational Research Association, Chicago.

Siggelkow, N. 2007. Persuasion with case studies. *Academy of Management Journal*, 50: 20–24.

Windsperger, J. and Dant, R. P., 2006, Contractibility and Ownership Redirection in Franchising: A Property Rights View, *Journal of Retailing*, 82, 259 – 272.

Yin, Robert K. *Case Study Research: Design and Methods*. Thousand Oaks: Sage Publications, 1994. Print.

Yin, Robert K. *Case Study Research: Design and Methods (3rd Edition)*. Thousand Oaks: Sage Publications, 2003. Print.