Strategic Interactions in Franchise Relationships

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Abstract

This paper aims to grasp the complexity of how and why franchise partners as strategic alliance partners respond to each other given March's exploration-exploitation paradox (March 1991). A research model is presented which distinguishes five types of responses that partners may adopt in their relationships. The empirical part consists of a case study which focuses on two 'strategic change trajectories' (SCTs) in a franchise system in the Dutch drugstore industry. During these SCTs the franchisor tried to implement strategic changes in its franchise system. This paper discusses what responses franchisees adopted in a reaction to the introduction of these SCTs by the franchisor, the responses the franchisor adopted toward these franchisees in turn, and why both partners adopted these responses. The paper concludes with adding a new response type to the current response typology (which is also relevant for other alliance forms), providing insight in why franchise partners adopt certain responses and with discussing the relevance for franchisors and franchisees.

1 Introduction

This paper considers franchise relationships as a specific form of strategic alliance. In recent years, researchers have slowly started to recognize that different strategic alliance forms have different capabilities and limitations. According to Osborn and Hagedoorn (1997), this differentiation among forms is also accompanied by a broader view on alliance functions and motivations. Koza and Lewin (1998) divide the different motivations that alliance partners may have into two categories: a motivation to *exploit* existing resources ('exploitation alliance') and a motivation to *explore* new opportunities ('exploration alliance'). This distinction of exploration and exploitation is based on March (1991). *Exploration* includes issues such as search, variation, risk taking, experimentation, play, flexibility, discovery, and innovation. *Exploitation* includes aspects such as refinement, choice, production, efficiency, selection, implementation, and execution. March argues

[1] I would like to thank prof. dr. D. Jacobs, prof. dr. mr. Kneppers-Heijnert and dr. M.J. Brand for their comments.

that firms should try to find a proper balance between exploration and exploitation in order to survive and prosper in their environments both in the short and the long run. Organizations that engage in exploration resulting in the exclusion of exploitation may find that they suffer the costs of experimenting without gaining a great deal of its benefits. On the other hand, organizations that engage in too much exploitation might become inert and unable to adapt to their environments in the long run.

This paper focuses on how franchisors and franchisees respond to each other given the abovementioned paradox. A great deal of franchising literature views franchise relationships from narrowly defined perspectives and merely considers 'exploitative' aspects of franchising, such as fee calculation or efficient governance structures. The literature often also considers franchise relationships as static relationships with franchisees as passive partners, which is too simplistic. Therefore, the *main objective* of this paper is to grasp the complexity of *how* franchise partners as strategic alliance partners respond to each other given the exploration-exploitation paradox and *why* they adopt these responses. The basic questions of this paper are:

1) How does the exploration-exploitation paradox manifest itself in franchise relationships?
2) How do franchisors and franchisees respond to each other in dealing with this paradox, and why do they adopt these responses?

A preliminary study was conducted to establish how the exploration-exploitation paradox is present in franchise relationships and to develop a research model for understanding franchise partners' responses toward each other. The preliminary study consisted of a literature review of alliance and franchising literature, a review of specialist magazines and exploratory interviews among franchisors and franchisees in various industries. This paper is part of a larger study in which four in-depth case studies in four different franchise systems in the Dutch drugstore industry were conducted. Each case study focused on two so-called 'strategic change trajectories' (SCTs) in which the exploration-exploitation paradox became very apparent for the franchise partners. During these SCTs the franchisor introduced strategic changes to the system which resulted in various responses by its franchisees. For each SCT, the franchisor started with the introduction of the SCT to the franchisees, the franchisees adopted different responses in a reaction to it and the franchisor in turn adopted responses toward these franchisees, resulting in interactions between the partners. The case studies discuss *what responses* both franchise partners adopted during these SCTs and *why* they adopted these responses. This paper focuses on one of the four case studies, namely the Dutch DA-system with its two SCTs.

The structure of the paper is as follows. First, section 2 discusses the research model. Section 3 deals with the methodological choices. Section 4 introduces the DA-system and its two SCTs and discusses which responses both franchise partners adopted and why. Section 5 summarizes the most important conclusions for this paper and some practical implications.

2 The research model

During the preliminary study a research model for understanding responses of alliance partners in general was developed first. In a later phase of the preliminary study this model was specified for franchise relationships. Fig. 1 presents this research model for franchise relationships from the franchisee's perspective. The model can be reversed to the franchisor's perspective. This is not presented here because it is the same model but only the FRE's and FRO's are changed. The model in itself is not dynamic; it represents a 'snapshot' of the relationship from one partner's perception of the independent variables and his response at a certain point in time. In the case study, several 'snapshots' were made on the basis of this model to create a more dynamic picture of the franchise relationship over time. The details of this approach are discussed in section 3.

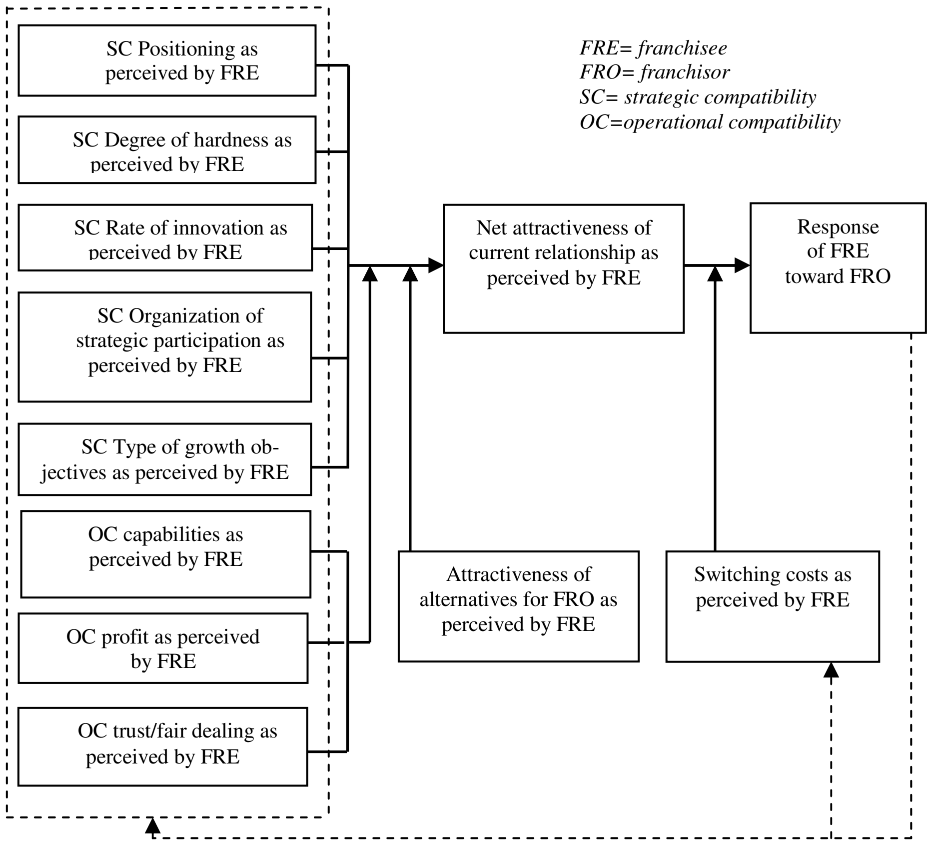

Fig. 1. Understanding the response of FRE toward FRO at a certain point in time

The model[2] distinguishes five 'franchise system characteristics' on which franchisors have to make strategic decisions in managing the exploration-exploitation paradox in their franchise systems. These five franchise system characteristics are proposed to influence both franchise partners' perceptions of *strategic compatibility (SC)*. 'Strategic compatibility' refers to the strategic value that partners ascribe to their relationship (Niederkofler 1991). The five franchise system characteristics are:

- Positioning. This refers to the way the system is positioned in the market; is the business format a high-price, high-quality format or does it have a 'pile-it-high-sell-it-cheap' positioning with relatively lower quality and prices? The positioning of the system can vary from very low in the market to very high in the market.
- Degree of hardness. This refers to the room franchisees have for local exploration. In a 'hard' system virtually every aspect of a unit's operations is formulated in operating manuals and procedures that the franchisee is obliged to follow. In a 'soft system' there are fewer rules and procedures and franchisees therefore have more room for local exploration. A system's degree of hardness can vary from very soft to very hard.
- Rate of innovation. This refers to how quickly adaptations are made to the business format. Adaptations can take place on three levels: adding new products to the business format, adding new product groups and/or services, and adapting the business format as a whole. A system's rate of innovation can vary from very low to very high.
- The organization of franchisees' strategic participation. This refers to the degree to which the franchisees' involvement in strategic decision making for the franchise system is organized. This mainly concerns the presence of a Franchise Board, its rights and procedures. The organization of franchisees' strategic participation can vary from very low to very high.
- Type of growth objectives. This refers to in what way the franchisor wants the franchise system to grow. Growth objectives can vary from 'mostly quantitative' to 'mostly qualitative'. Through quantitative growth, the franchisor aims to grow by means of adding more units to the franchise system, with relatively less concern for the performance of individual units. Through qualitative growth, the franchisor mainly aims at growing by means of improving the performance of existing units and/or by attracting units that fit certain criteria.

These five franchise system characteristics result in five types of strategic compatibility: strategic compatibility regarding positioning (SC pos), strategic compatibility regarding degree of hardness (SC hard), strategic compatibility regarding rate of innovation (SC innov), strategic compatibility regarding the organization of franchisees' strategic participation (SC org) and strategic compatibility regarding

2 Croonen (2004) discusses this model in more detail; however, the names of some variables have slightly changed. The most drastic name change was the change of 'entrepreneurial orientation' in Croonen (2004) to 'rate of innovation' in this paper.

type of growth objectives (SC growth). The types of strategic compatibility were expected to influence the franchise partners' responses toward each other.

Next to strategic compatibility, the partners' perceptions of *operational compatibility (OC)* were proposed to influence the franchise partners' responses. 'Operational compatibility' refers to partners' perceptions of the way in which the relationship is implemented (Niederkofler, 1991). Regarding operational compatibility, a distinction was made in the following three factors:

- Operational compatibility regarding capability (OC capa). This refers to each partner's capability to carry out its role in the relationship as perceived by the other partner. From the franchisee's perspective these capabilities refer to the franchisor's capabilities regarding managing the franchise system. Important capabilities of the franchisor are: the degree and quality of supporting its franchisees, purchasing prices, automation, logistics, communication, and information provision. In the eyes of the franchisor, franchisee capabilities are the franchisee's capability to fulfill his financial obligations toward the franchisor, such as the payment of royalties.
- Operational compatibility regarding the profitability of the relationship (OC profit). This concerns the net returns for both franchise partners in the relationship. From the franchisee's perspective, the profitability of the relationship is the result of the franchisee's turnover of his unit(s) achieved by applying the business format minus the costs of operating on behalf of this business format. These costs consist of the fees and royalties that have to be paid to the franchisor. From the franchisor's perspective, the profitability of a specific franchise relationship depends on the fees/royalties the franchisor obtains from the franchisee and possibly income from wholesaling activities.
- Operational compatibility regarding trust and fair dealing (OC trust/fd). This is about the degree to which the franchise partners trust each other. According to Nooteboom, 1999, p.30): '*To have trust in the narrow sense, or "real" intentional trust is to accept or neglect the subjective probability that a partner will not utilize opportunities for opportunism even if it is in its interest to do so*'. Opportunism entails actions against the interest of a partner and against the letter or intent of an agreement, if necessary by cheating or concealment of the truth. In short, the research model states that when one franchise partner trusts the other, it means that the franchise partner believes that the other is likely to cooperate, even if he is not coerced to do so and has no direct material interest (Nooteboom 1999). Ring and Van de Ven's concept of 'fair dealing' is very close to trust (Ring and Van de Ven 1994). A partner perceives a certain degree of fair dealing when it has the impression that in the relationship with the other partner his benefits are proportional to his investments. This concept is related to trust because it requires the partners to represent the costs and revenues of the relationship truthfully.

Two other independent variables were hypothesized to influence the franchise partners' responses, namely the *attractiveness of available alternatives* and the costs of switching to such an alternative *(switching costs)*.

The dependent variable of the model is represented by the responses that each franchise partner can adopt in the relationship at a certain point in time. In the literature responses in relationships are often based on the work of Hirschman (1970), who makes a distinction between two general options for dealing with problematic situations in firms, organizations and states: 'exit' or 'voice'. The exit option refers to ending the relationship, while the voice option refers to actively expressing and discussing one's problems with the intent of trying to improve conditions. Hirschman argues that the presence of 'loyalty' makes exit less likely. Loyalty refers to remaining silent and confident that the problematic conditions will get better by 'giving things some time'. Based on research on customer relationships, Ping (1993) adds a fourth option for dealing with relationship problems: neglect, which means passively allowing the relationship to deteriorate by 'letting things fall apart'. In a research on employer-employee relationships, Hagedoorn et al. (1999) argue that the category of voice responses is considered too homogeneous and needs to be differentiated further. Therefore, they distinguish between aggressive voice and considerate voice. Considerate voice consists of attempts to solve the problem concerning one's own concerns as well as those of the other partner. Aggressive voice is more destructive than considerate voice, but less destructive than exit. A partner who adopts this response wants to win, without considerations for the concerns of the other partner. This response can be seen as a 'cry for attention' between a destructive and constructive response. In sum, this results in five possible responses that (franchise) partners can adopt in their relationship: considerate voice ('covo'), loyalty ('loy'), neglect ('negl'), aggressive voice ('agvo') and exit ('exit') (see Fig. 2).

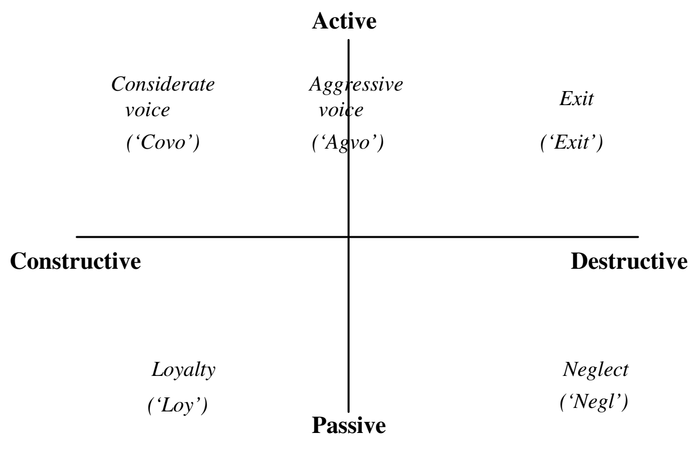

Fig. 2. Typology of responses in relationships (based on Hagedoorn et al. 1999)

I emphasize here that partners in a relationship can perceive responses different from how the other partner intended it. For example, a partner intends to actively construct the relationship, while the other partner may perceive this response as an aggressive one and react accordingly. Moreover, as will be shown in Section 4, responses may change over time. The case results will show several examples of relationships in which a franchisee started with a constructive response in a reaction to the introduction of an SCT, but when he found out that this was not effective he eventually switched to a destructive response.

3 Methodology

This paper is part of a larger study with case studies in four different franchise systems. Within these franchise systems, I focused on eight SCTs in which the franchisor aimed to change one or more of the five franchise system characteristics. Therefore, these SCTs were expected to result at least in changes in the partners' perceptions of strategic compatibility and in certain responses. For each franchise system, two SCTs were selected: one SCT that occurred in the past (past SCT) and a contemporary SCT. Leonard-Barton (1990) points at the advantages of having such a 'dual methodology' for case studies. She argues that a combination of real-time longitudinal case studies with retrospective case studies about the same phenomenon is advantageous because specific strengths in one method compensate for weaknesses in the other. The most serious difficulty with a retrospective case study is the fact that it is difficult to define causes and effects (internal validity), while in a longitudinal study the researcher has a better opportunity to establish cause and effect. On the other hand, the past SCT made it possible to track developments for a longer period in time during the SCT, which was not possible with the contemporary SCT. Due to time restrictions the SCTs could not be studied with a 'real' longitudinal approach, but studying a contemporary process and interviewing participants while they are in the middle of it is likely to improve the validity of the study. In this paper SCT1 is a past SCT while SCT2 is a contemporary one.

During the preliminary study an overview was gained of important developments and SCTs in the franchise systems in the Dutch drugstore industry. On the basis of this four franchise systems were selected and for each of them two SCTs were selected. Around these SCTs data were collected about franchise relationships in which the franchise partners adopted different responses. The following data sources were used in the case studies: information from specialist magazines, year reports, franchise contracts, format handbooks, and most importantly, interviews with different managers from the franchisor's organization and interviews with franchisees.

Managers from the franchisor's organization were asked to estimate how their franchisees were divided over the five response types directly after the introduction of the SCT and to give a few names of franchisees for each response type. The aim was to interview at least two franchisees per response type for each SCT.

In the selection of franchisees to be interviewed, I monitored whether the selection of franchisees would not become too one-sided (i.e. focusing on certain types of responses), but for some SCTs this turned out difficult for the following reasons:

- It turned out that for some SCTs there were no or hardly any responses from a certain type so it was difficult to find franchisees who adopted such responses.
- For the past SCTs it turned out to be difficult for former managers of the franchisor's organization to recall the names of franchisees adopting certain responses. They mostly remembered franchisees who adopted covo responses because these were often the franchisees who had been involved in the 'Franchise Board' at the time and had been in close contact with management. Additionally, regarding the other active responses (agvo and exit) the managers could relatively easy come up with names, but for the passive responses this was more difficult. This only was a problem for the past SCT; for the contemporary SCT managers could easily mention several names. In some cases, it turned out that a manager argued that a franchisee had adopted a certain response, while in the end this turned out to be a different response. An example of this is that the management thought a certain franchisee was loyal, while in fact this loyalty was ambiguous (see Section 4).
- It turned out that franchisee responses were not static at all, which strengthened the idea of the necessity of the current study. Several franchisees had over time switched from one response to another, which made it possible to analyze these responses anyway. One example is for SCT1 (as the past SCT), where no franchisees were interviewed who initially adopted exit, but because several franchisees adopted exit in a later phase of SCT1 their motivations for exit could be studied anyway.

The franchisees were contacted and were asked whether they were willing to participate in the study by means of a structured interview with open-ended questions in his/her store. These interviews took about 75 minutes. Thirteen franchisees were interviewed for SCT1 and twelve franchisees were interviewed for SCT2. For understanding the franchisor's perspective, several members of management1 (SCT1) and management2 (SCT2) were interviewed.

As part of this study detailed analyses were conducted of what responses individual franchisees adopted and why during the SCTs, but it is out of the scope of this paper to discuss these analyses here in detail[3]. This paper only presents the most important results from the analyses. For both SCTs, the development in franchisee responses is presented in a figure (Fig. 4 for SCT1 and Fig. 5 for SCT2). In these figures, each number represents an individual franchisee. In the detailed analyses each response type ('X-response' as example) is discussed according to the same structure. The franchisees' responses are the point of departure here. The structure is as follows:

[3] The detailed descriptions of these analyses are available on request.

- Responses preceding the X-response (dashed lines in Figs. 4 and 5).
- The X-response as initial response (bold numbers in Figs. 4 and 5). This is the focal point of analysis where the 'determining variables' and the franchisees' perceptions on these variables were discussed to explain why they adopted the X-response. With 'determining variables' is meant which variables franchise partners take into account when adopting a response.
- Responses subsequent to the X-response (normal lines in Figs. 4 and 5).

In the detailed analyses, the franchisor's responses to the franchisee's responses are also discussed in detail, but this paper only presents the most important results.

4 Case study: Dutch druggists in distress

This section discusses the franchise partners' responses during SCT1 and SCT2 and their reasons for adopting these responses. As the title of this section already indicates, several DA-druggists were in distress about the changes during SCT1 and SCT2, which made it interesting to study their responses and those of the franchisor.

4.1 SCT1: 'Toward business-format thinking'

4.1.1 Introduction to SCT1

During the Second World War, in 1942, five Dutch druggists started a cooperative called 'Dienende Actie' (DA), which can be translated as 'Serving Action'. They were dissatisfied with the turnover of their businesses and the performance of their suppliers and decided to support each other. In its earliest years, the DA-druggists only focused on joint purchasing and the use of the DA-name on their stores. In 1947, the name 'Dienende Actie' was changed into 'Drogisten Associatie' ('Druggists Association'). In the years that followed, the group of DA-druggists grew rapidly and its activities became broader. In 1950, the DA-system already consisted of 150 druggists. In 1960, it had grown to 500 druggists and in 1982 even to 1000. Before and during SCT1, the organization went through several developments, but it is out of the scope of this paper to discuss them here in detail.

At the outset of SCT1, the DA-system was loosely organized, and DA-stores were very different from each other. The stores varied from small stores in villages, to medium stores in towns, to large and luxury stores in city centres. Management intended to develop different systems with distinguishable business formats that would be suited for these different types of stores. For each of these systems, management1 aimed at making each system more homogeneous in terms of stores, which would make a structured and standardized approach and therefore uniformity for each system easier. The most important change during SCT1 was the increasing degree of hardness. Management1 aimed to change DA from a very soft system to a hard system. Moreover, management aimed to adapt DA's positioning from relatively high in the market to a middle positioning and to increase DA's rate of innovation.

4.1.2 Franchisees' responses during SCT1

Fig. 4 presents the development in responses of the franchisees interviewed for SCT1. A limitation of Fig. 4 (and Fig. 5 in section 4.2.2) is that they do not indicate the time lapses between the switches of one response to another, while these varied from a few weeks or months to several years. For a better understanding of the development of responses, these time lapses are pointed out in the text (when relevant).

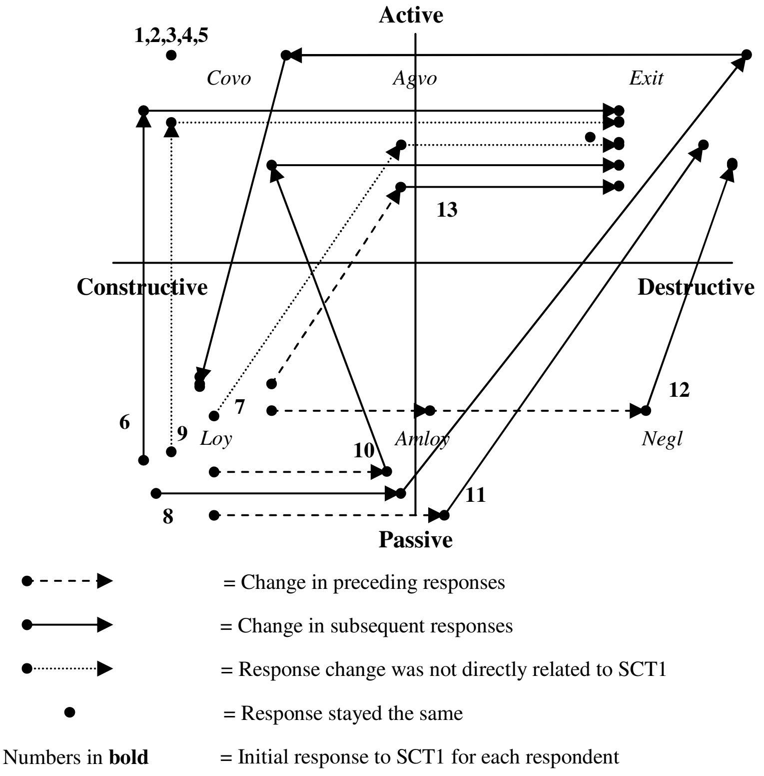

Fig. 4. Development of franchisees' responses for SCT1

First of all, Fig. 4 illustrates that franchise relationships are more dynamic than thus far assumed in the franchising literature. It shows that franchisees switched between responses in a reaction to the developments during SCT1 over time. The following insights about franchisee responses are based on the detailed analysis for SCT1:

1) Adapting the response typology.
2) Understanding franchisees' responses during SCT1.
3) Triggers of response switches.

1) Adapting the response typology

The analysis reveals the existence of a new response type (see Fig. 4). This is the amloy-response, which stands for 'ambiguous loyalty'. It refers to a response where a partner does not know how to react and therefore passively waits to see what happens before adopting any further responses. It is more destructive than loy but less destructive than negl, and therefore it is considered a separate response type. As Fig. 4 indicates, several franchisees (8, 10, 11 and 12) adopted such a response at some point in time during SCT1. For management1, these franchisees' ambiguous loyalty was difficult to detect; most of the time management considered these franchisees as loyal while in actual fact these franchisees' loyalty was ambiguous.

2) Understanding franchisees' responses during SCT1

From the detailed analyses, it turned out that for understanding *why* a certain franchisee adopted a certain response at a certain point in time the following factors are important:

A) The franchisee's 'determining variables' at that point in time.
B) The franchisee's perception on these determining variables and his future expectations on these determining variables.
C) The franchisee's thresholds on these determining variables.

2A) The franchisee's determining variables

With respect to determining variables the following results appeared from the analysis of individual franchisees for SCT1:

- It turned out that during SCT1 for almost all franchisees, OC profit (or OC profit/cost) was the most important variable. OC profit/cost is a variation on OC profit, because these franchisees emphasized their cost level as part of profitability. That is why I refer to this as OC profit/cost. These franchisees emphasized their cost level because they considered their turnovers as stable. These franchisees thought they could not improve their turnover and profitability by means of extra investments and costs[4]. For these franchisees, the increasing degree of hardness was undesirable because it would increase their cost level without increasing their turnover.
- SC hard was considered a very important variable by all franchisees. All of them had to deal with the tension between the desired degree of hardness and the cost level (and profitability). The DA-franchisees differed in the degree to which they considered a well-known brand name as important and therefore differed in their desired degree of hardness. Franchisees who did not consider a well-known brand-name as important mostly looked at the cost level of participating because they considered their turnover levels as stable. These franchisees perceived a decreasing SC hard and decreasing OC profit/cost during SCT1.

[4] This was mainly caused by their competitive circumstances. These franchisees often owned smaller stores in villages with relatively stable competitive circumstances.

- For SC pos and SC innov, the analysis demonstrates that these became more important once the degree of hardness increased. During SCT1, some obligations on positioning and rate of innovation were introduced and therefore the franchisees considered it important to have a certain degree of strategic compatibility with the franchisor on these aspects.
- Because of the increasing obligations during SCT1 OC trust/fd and SC org had also become more important variables for the franchisees. OC trust/fd had become important because the franchisees felt they would become more dependent on the franchisor due to the increasing obligations. The franchisees therefore wanted to trust that the franchisor would not act opportunistically and that costs and benefits of the relationship would be divided fairly between the franchise partners. Before SCT1, several franchisees had had a low perception of OC trust/fd for a long time because they had the idea that the franchisor aimed to receive extra royalties by charging higher prices on purchasing, automation etc. The franchisees considered these 'implicit charges[5]' as very intransparant; they did not know what the real costs were and what the additional charges were. However, this low OC trust/fd became a problem only after several obligations were introduced because from that time franchisees were obliged to purchase certain goods and services from the franchisor (to which the 'implicit charges' applied). The same applies to SC org. The largest part of DA-druggists perceived a low SC org due to a lack of procedures. The DA-Boards[6] did not have any decision rights and the majority of franchisees perceived a high degree of unfairness in the selection of franchisees to be involved in these Boards. Most franchisees had perceived a low SC org for several years, but this only became a problem once obligations were introduced and the franchisees felt that they became more dependent on the organization of franchisees' strategic participation.
- During SCT1, there were few obligations for franchisees for which they depended on the franchisor's capabilities and there were no obligations due to growth objectives. Therefore, OC capa and SC growth were not determining variables during SCT1.
- The attractiveness of alternatives and switching costs were not determining variables. The franchisees first evaluated the attractiveness of their current relationship based on their perceptions of strategic and operational compatibility. Only after a franchisee evaluated the relationship as 'unattractive' he started to evaluate alternatives and switching costs. Sometimes franchisees adopted a not so attractive alternative, mostly

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5 According to Caves and Murphy (1976), 'implicit charges' are an instrument for franchisors to appropriate rents from franchisees. However, in the DA-case this resulted in a low perception of OC trust/fd on the part of the franchisees.

6 During SCT1, there was not one Franchise Board, but there were various commissions and working groups of franchisees. For the sake of simplicity, I refer to them as 'Boards'.

when they felt ‘forced’ to exit. In other words, the attractiveness of alternatives was not a determining variable for these franchisees. The same applied to switching costs: because they felt forced to exit, the height of switching costs was relatively unimportant.

2B) The franchisee’s perception on determining variables and future expectations

- The analysis shows that not only the franchisees’ perceptions on the determining variables influenced their responses but also the franchisees’ *future expectations* for these variables. Several franchisees knew that their objectives differed from the ones of the franchisor and therefore expected lower degrees of compatibility on certain aspects in the future. However, during SCT1 management1 did not really dare to enforce several obligations (see section 4.1.3) and therefore franchisees still perceived a great deal of freedom in running their businesses and therefore did not feel the need to respond actively.
- It was already pointed out that OC trust/fd and SC org only became important when the degree of obligations increased. It is interesting that most franchisees perceived both these variables as low, except from the franchisees adopting covo. These ‘covo-franchisees’ perceived OC trust/fd as high because they were closely (and personally) involved with management1 because of their membership. With respect to SC org most covo-franchisees perceived this as high because by means of their membership of one of the Boards they were involved in strategic participation while the other franchisees perceived this as low.
- It is interesting that the covo-franchisees perceived the attractiveness of alternatives as very low. This is interesting because this highly differs from the other franchisees (especially the ones who adopted negl and agvo) who saw the attractiveness of alternatives as medium or high. There are two explanations for this. First, the covo-franchisees did not really consider possible alternatives because they perceived a high attractiveness of their current relationship and therefore they had never seriously considered alternatives. Second, the covo-franchisees considered other types of alternatives as relevant compared to the negl- and agvo-franchisees who considered a well-known brand name as less important. Because the covo-franchisees wanted to operate under a well-known brand name and a certain identity in the market, they had a restricted range of alternatives to choose from.

2C) The franchisee’s thresholds on determining variables

The analysis shows that franchisees had certain thresholds on their determining variables; franchisees accepted a certain level of strategic and/or operational compatibility. Only after strategic and/or operational compatibility had reached below their thresholds franchisees were triggered to adopt another response to deal with this (see point 3 below). In the years after the introduction of SCT1, several franchisees still perceived a medium –instead of low- score on their determining variables even though management had very different objectives. During SCT1, these franchisees just did not implement the proposed changes in their stores, and management1 did not really enforce the obligations and the franchisee still had much freedom. In other words, due to the low enforcement by management1, several franchisees had not reached their thresholds on their determining variables and they just remained passive.

3) 'Triggers' for response switches.

Fig. 4 shows that most interviewed franchisees switched between responses over time during SCT1, except from some franchisees adopting covo (1 to 5). Franchisees 1 to 5 had close relationships with management and therefore almost automatically adopted covo. Over time, several franchisees switched from a passive response to a more active one at a later point in time mostly because they reached their thresholds on their determining variables and felt that they needed to take action. Some of them immediately adopted exit while others adopted covo to try to solve their issues. What responses individual franchisees adopted highly depended on their individual situations, such as their competitive circumstances, personality, or age.

4.1.3 The franchisor's responses during SCT1

The franchisor's responses were more 'stable' than the franchisees' responses; management1 adopted mostly passive responses during SCT1. Only toward franchisees 1 to 5 the franchisor adopted covo because it believed these franchisees could help in creating support among the large group of franchisees for adopting the proposed changes of SCT1.

For the franchisor it was a necessary condition that franchisees could fulfil their financial obligations to the franchisor (OC capa). In other words, OC capa was always a determining variable for the franchisor. Additionally, in deciding how to respond to franchisees, management had to deal with a certain tension, especially toward franchisees who did not want to adopt the obligations. Management1 wanted a certain degree of hardness and therefore it considered SC hard as important. However, some franchisees did not want the increasing degree of hardness and did not want to adopt obligations. This would result in a low SC hard with this franchisee from the franchisor's perspective. However, the franchisees were a very important source of income for the franchisor by means of the payments of royalties and because they were (at least supposed to be) wholesale customers of the franchisor. In other words, individual franchise relationships had a certain degree of profitability for the franchisor (OC profit) and the franchisor rather did not want to loose franchisees with a high profitability. Additionally, with the loss of a franchisee, the franchisor would also loose the store's location, which it took into account in adopting a response. Because of the losses that could occur, management1 often did not dare to enforce obligations on the franchisees and therefore adopted passive responses. The only obligation that was really enforced was the franchisees' participation in promotion activities. Certain goods that were attached to these activities were sent-in automatically and therefore 'enforced'. Over time, management1 increased the frequency and the number of goods that were send in, thereby caused some franchisees to reach their thresholds on OC profit/cost and SC hard and switching to active responses. Other franchisees still perceived a lot of freedom and therefore also did not feel a need to respond actively.

4.2 SCT2: 'Integration and renegotiation'

4.2.1 Introduction to SCT2

Management1 only partly reached its goals for SCT1. After a process of ten years, it had not succeeded in introducing a franchise contract and the DA-system still was not very uniform. In 2003, a new management (management2) started and it introduced SCT2. Management2 introduced several changes of which the signing of a standard franchise contract (the so-called 'FSO') by all DA-druggists was a very important one. It thought DA still had a too expensive image and needed a more uniform and distinctive positioning. Due to the low enforcement by management1 on most obligations, the DA-system still did not have a uniform presentation. Management2 therefore aimed to introduce the following three changes.

First, the DA-system was merged with other drugstore systems of the franchisor[7] into one DA-system with a new commercial policy. Research had shown that DA was well-known among consumers, while consumers were not very familiar with the franchisor's other two systems. To benefit from the well-known DA name, management2 thought these systems should be added together into one new DA-system with an even better-known name and a somewhat lower positioning.

Second, management2 aimed to introduce a standardized contract (the 'FSO') between Dynadro and all its druggists. This had been an issue of discussion between management1 and the DA-druggists for several years. Management2 thought that a standardized contract was necessary for the new DA-system in order to improve its decisiveness and DA's degree of uniformity. In other words, management2 wanted DA's degree of hardness to increase.

Third, management2 aimed to introduce a new so-called 'corporate governance structure' to speed up decision making processes and to improve the transparency of these processes both within the organization itself and toward its franchisees. In earlier years, there had been many Boards that had been involved in decision making and management2 was aware of the difficulties with franchisees' strategic participation in earlier years. Therefore, management2 aimed to adapt the organization of franchisees' strategic participation.

4.2.2 Franchisees' responses during SCT2

Fig. 5 presents the development in responses of the franchisees interviewed for SCT2.

[7] These other systems were STIP (drugstores for smaller villages) and DA D'Attance (luxury drugstores in larger city centres).

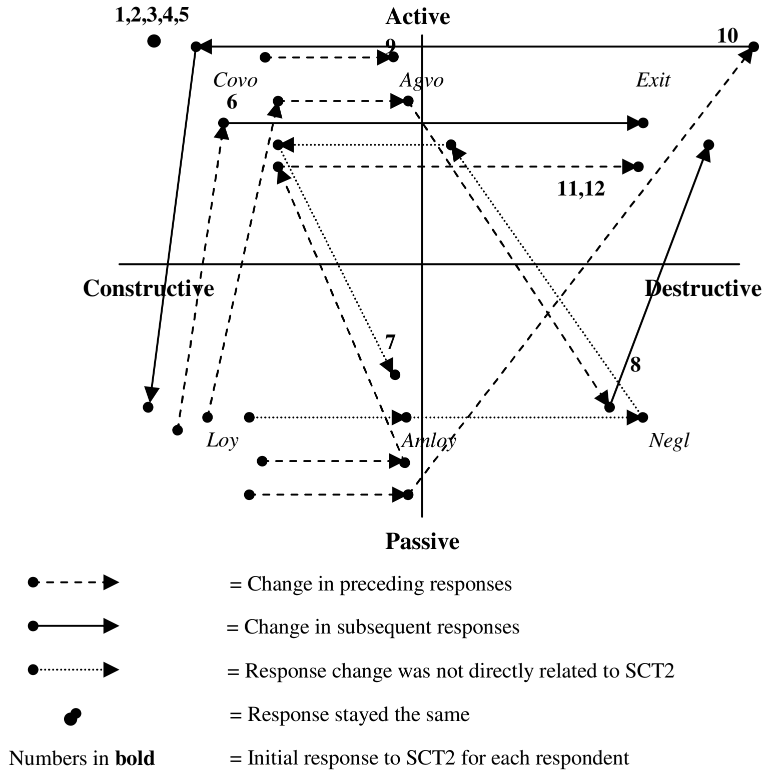

Fig. 5. Development of franchisees' responses for SCT2

The most important results for understanding the franchisees' responses to SCT2 are presented according to the same structure as for SCT1.

1) Adapting the response typology
As was the case for SCT1, Fig. 5 demonstrates the presence of an ambiguous loyalty response (amloy).

2) Understanding franchisees' responses during SCT2
As was the case for SCT1, for understanding why a franchisee adopted a certain response at a certain point in time the following factors turned out important:

A) The franchisee's determining variables.
B) The franchisee's perception on these determining variables and his expectations for the future.
C) The franchisee's thresholds on these determining variables.

2A) The franchisee's determining variables

- Section 4.1.2 already discussed a certain hierarchy in determining variables in the eyes of franchisees. During SCT2, OC profit (or OC profit/cost, see SCT1) still was the most important variable, except for the negl- and agvo-franchisees. They considered their status as a small business owner as very important and therefore they rather wanted to be part of a soft system rather than a hard system. Therefore, SC hard was most important to them. During SCT2 there were still several franchisees who emphasized their cost level as part of profitability (OC profit/cost) because they perceived their turnover levels as stable. During SCT1 several of these franchisees had stayed because of the low enforcement by the franchisor, but during SCT2 they felt management2 would actually enforce the obligations and cost levels would actually increase.
- Franchisees during SCT2 have almost the same determining variables as for SCT1, but the difference with SCT1 is that SCT2 involved more obligations on these variables. After signing the FSO there would be more obligations with respect to positioning, and franchisees would have less freedom left to establish their own positioning. Therefore, SC pos had become an even more important variable for the franchisees than during SCT1. The same applied to rate of innovation: once the FSO was signed, there would be more obligations with respect to the adoption of certain innovations, and SC innov became more important.
- OC trust/fd and SC org also became even more important during SCT2 because of the increased obligations. Due to this increase franchisees would become even more dependent on the franchisor and therefore they wanted to trust that the franchisor would not behave opportunistically. In the past, the degree of OC trust/fd had been low in the perception of several franchisees, but they believed that management2 would improve this situation in the future. The same applies for SC org. Because several obligations were established in the new franchise contract, these franchisees considered it important that they could influence these obligations by means of strategic participation. The majority of franchisees had mostly considered SC org as low in the past, but expected that with the new 'corporate governance structure' SC org would increase in the future.
- During SCT2, OC capa also became more important because the new franchise contract stated several obligations with respect to services that had to be taken from or via the franchisor, such as automation and purchasing. So, OC capa became determining during SCT2, because franchisees would become more dependent on the franchisor's capabilities. However, OC capa was still considered less determining than the other variables because franchisees expected that problems with franchisor capabilities could be solved on relatively short term and these services would not be better when offered by another party or when the franchisee arranged these by himself.

- Regarding alternatives and switching costs the same applies as to SCT1: these only became important when franchisees perceived strategic and/or operational compatibility below their thresholds.

2B) The franchisee's perception on these determining variables and expectations for the future

- For SCT2 it became also very clear that there were certain relations between independent variables. For SCT1, section 4.1.2 already pointed at the relation between degree of hardness (and SC hard) and cost level (and OC profit or OC profit/cost): a higher degree of hardness resulted in a higher cost level for franchisees because they needed to adopt certain investments. Some franchisees wanted a higher degree of hardness because they expected that with a more uniform system they could increase their profitability while others mainly wanted to keep their cost level stable because of their stable turnover levels.
- As was the case for SCT1, the covo-franchisees were the only franchisees who perceived a high degree of OC trust/fd and SC org. It turned out that franchisees also took into account their future expectations on determining variables because several franchisees believed that OC trust/fd and SC org would become better under management2 and therefore they adopted loy.

2C) Franchisee's thresholds on determining variables

As was the case for SCT1, SCT2 shows that franchisees had certain thresholds on their determining variables. Franchisees were triggered to adopt another response when their perception of strategic and/or operational compatibility reached below a certain threshold.

3) Triggers for response switches

Based on SCT2, it became apparent that another trigger for franchisee response switches was in the responses of the franchisor. For example, franchisee 10 was a very large and powerful franchisee who decided to exit immediately after the introduction of SCT2. However, for the franchisor he was an important wholesale customer and franchisee who was very profitable (high OC profit). Moreover, the franchisor would loose several locations when this franchisee would exit. Therefore, the franchisor tried to keep this large franchisee by means of threatening with a lawsuit (agvo). Because the franchisee did not want a lawsuit, he adopted covo, and, eventually, the franchise partners came to an agreement and the franchisee stayed in the DA-system. Another example was franchisee 9 who perceived the franchisor's response to the franchisees as indecent and therefore switched from covo to agvo.

4.2.3 The franchisor's responses during SCT2

Also for SCT2, whether the franchisee could fulfil his financial obligations (OC capa) was considered as a necessary condition, and was therefore always a determining variable for the franchisor. The additional determining variables for the franchisor mostly were the same as during SCT1; SC hard and OC profit. For management2 the tension between imposing and enforcing obligations and the risk of loosing profitable franchisees became even bigger, because it now *really* wanted to enforce obligations. The higher the desired degree of hardness and profitability of the franchisee for the franchisor, the larger the tension; especially when a very profitable franchisee (such as franchisee 10) did not want to adopt certain obligations.

During SCT2 the franchisor thought imposing and enforcing obligations had become more important. Therefore, management2 expected to adopt exit-responses by itself to break up with franchisees who did not want to adopt the FSO and the resulting obligations. However, it still often adopted passive responses. This can be explained by the fact that management2 again had to deal with the tension of enforcing obligations versus keeping (profitable) franchisees. It also was afraid it would loose too many franchisees if it would introduce the changes the way it was initially planned. As was the case for SCT1, management2 only adopted covo by itself toward franchisees of which it thought these could help it in creating support at the large group of franchisees.

5 Conclusions and practical implications

First of all, this paper illustrates that responses in relationships are more heterogeneous than so far suggested in the literature. An important contribution of this paper is the addition of the 'ambiguous loyalty response' (amloy) to the existing response typologies. Amloy is a form of passive response which is more destructive than loy, but less destructive than negl (see Fig. 6). Franchisees adopting these responses were in doubt of how to react to certain changes and therefore waited to see what would happen and how this would affect their relationship with the franchisor.

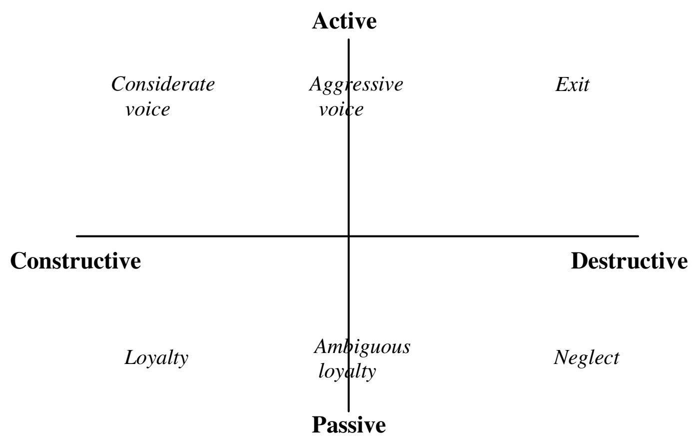

Fig. 6. Adapted typology of responses

It is highly likely that amloy also occurs in other forms of human interaction, such as other forms of strategic alliances or employer-employee relationships. One partner's amloy is quite 'dangerous' for the other partner because it is not so easy to detect, and it might lead to unexpected exits by valuable partners. One example from this case study is when a valuable franchisee switched from amloy to exit and the franchisor had to take desperate measures (a lawsuit) in order to keep this franchisee (franchisee 10 during SCT2).

Another response that might be 'dangerous' for the franchisor and its franchise system is a passive response by the franchisor itself. In the DA-case the franchisor mostly responded passively, and this resulted in a low degree of enforcement of obligations and franchisees could do what they wanted. Because the franchisor did not really enforce obligations it allowed that some franchisees adopted negl, which resulted in damaging the uniformity of the system. Moreover, because the franchisees were not enforced to make specific investments they kept their switching costs relatively low, which sometimes also resulted in sudden exit responses.

A second important conclusion from this paper is that franchisees switched between responses over time, which falsifies the assumption of many authors that franchise relationships are static. Such response switches were always caused by one or more 'triggers'. The most important triggers for both SCTs were the increasing degree of hardness of the franchise system. The case study has shown that when the franchisor tried to increase the degree of hardness the franchise relationships became more complex because a higher degree of hardness resulted in more determining variables from the franchisee's perspective. The case study shows that when obligations were introduced which were *actually* enforced by the management, compatibility with respect to these obligations became important for the franchisees; franchisees did not want obligations on aspects they do not agree with or that do not work. This resulted in an increase in importance of the determining variables. This mainly applies to the variables to which obligations applied during the SCTs: positioning, rate of innovation, and franchisor's capabilities. Additionally, issues of trust and fair dealing and the organization of franchisees' strategic participation became more important in the eyes of franchisees when the franchise system actually got harder. Franchisors have to be aware that when they aim to change the system's degree of hardness, the franchise relationships become more complex and franchisees might adopt certain responses.

For franchisees this paper provides insights in how they can evaluate and manage their relationships with the franchisor. It helps franchisees to understand the challenges the franchisor has to deal with and the franchisor's motivations for adopting certain responses. It therefore also helps franchisees in managing their relationships with the franchisor because franchisees can better estimate how their responses will influence the franchisor's responses.

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