

Incentives and control in company-owned vs. Franchised outlets: An empirical study at the chain level

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Abstract: In this article, we investigate the relative performances of company-owned outlets vs. franchised outlets using an original database consisting of 150 units of a French chain. At first glance, the financial and quality performances of company-owned units are better than franchised units. However, this result is reversed when the particular characteristics of each unit are taken into account in the analysis. Furthermore, our result suggests that if company-owned units are less efficient than franchised units, all things being equal, they respond more quickly to change imposed by the franchisor leading to higher quality performances. This result highlights the fact that if franchisees have greater incentives to maximize return on sales and quality, they are also more independent of the franchisor and could therefore impede adaptation of the chain. Thus, franchised units may represent a drawback when the franchisor wants to implement a new strategy and may explain why plural forms (i.e. franchise mix) appear to be efficient organizational choices.

JEL Codes: L14, L22

Keywords: franchising, multi-franchises, make or buy, incentives, control, plural forms.

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1. Introduction

The economic importance of franchising partly explains why this contractual relationship has received a significant amount of attention in the literature on contracting (see Blair and Lafontaine, 2006; Lafontaine and Slade, 2007, for surveys). In addition, franchising is one of the few types of contractual relationships for which significant amounts of data are available from public sources (Lafontaine and Slade, 1997). A surprising stylized fact about franchising as an organizational form is that not all units are franchised. Most franchised chains operate some of their units directly and franchise the others. Thus franchised units and company-owned units can coexist within the same chain generating questions about make and buy strategies rather than the classical make or buy one. This coexistence is known as “plural form” or “dual distribution” in literature (see Bradach and Eccles, 1989; Bradach, 1997; Blair and Lafontaine, 2005).

Whatever the proposed explanations, previous articles can be distinguished by their assumptions concerning the relative efficiency of franchises vs. company-owned outlets. Some are based on the assumptions that franchises are more efficient because they are residual claimants. Therefore, a chain may not be completely externalized because it is useful to keep company-owned outlets to signal the quality of the trademark (Gallini and Lutz, 1992) or to limit network externalities due to possible shirking behaviours (Lafontaine and Shaw, 2005). Other explanations are based on the assumption that company-owned outlets are more efficient than franchises. Then, a chain may not be completely internalized because there are financial constraints that require the use of external agents. Finally, several explanations focus on the complementarities between franchises and company-owned outlets (Bradach, 1997, 1998, Sorenson and Sorensen, 2001), emphasizing the correct balance to be obtained between the exploitation of routines by company-owned units and the exploration of new ones by franchised units.

Absent from the franchising literature is a direct test – at the outlet level – of the possible superiority of one governance structure over another. Since many of the previous empirical studies are cross sectional, this issue cannot be investigated at the unit level and instead, proposes an explanation concerning the relationships between performance and dual distribution (Sorenson and Sorensen 2001, Lafontaine and Shaw 2005). Moreover, several scholars have pointed out the fact that the empirical picture is much more complex than a simple coexistence between franchised and company-owned outlets, because multi-unit franchised units also exist and are often excluded from the analysis (Kalnins and Lafontaine, 2004, is an exception). For example, the data from Kalnins and Lafontaine reveals multi-unit owners own 84% of franchised restaurants. This is why the comparative efficiency of these three governance structures that coexist inside the same chain is still largely unexplored.

In this paper, we investigate the nature and the properties of the diverse governance structures/organizational forms at the unit level – franchise, multi-franchise and company-owned outlets. Going inside the “black box” of the chain,

using panel data at the unit level, makes it possible to distinguish if one governance structure is more efficient than another and how the franchisor can construct its performance, and improve it over time through dual distribution.

There are very few studies that address this question at the unit level. The only exceptions we are aware of are Minkler (1990), on the decision to franchise, and Yin and Zajac (2004). This last paper discusses the performance implications of the diverse governance structure (franchised vs. company-owned units), by taking into account the diversity of the strategies to be followed. They use return on sales panel data as we do. Nevertheless, they do not have access to data concerning store characteristics (size in square meters, number of employees, size of repair vs. sales area) and qualitative performance. Our work complements their study by testing the impact of governance structures with multi-franchised units, controlling differences in store characteristics of the financial and qualitative performances. Furthermore, we are able to provide a study that extends the knowledge of the properties of franchised networks by observing unit behaviour in a dynamic context of implementation of a new management routine.

To do so, we use an original panel database consisting of 150 outlets of a French chain (we will call it NET for confidentiality reasons). We investigate the relative performances of company-owned outlets vs. franchised and multi-franchised outlets over two years, before and after the implementation of a new management rule. Our results show that when taking the particular characteristics of each unit into account –i.e. when franchised units and company-owned units are not randomly chosen and distributed over the stores' characteristics, franchised units are the most efficient governance structure. Conversely, we show that, if company-owned units are less efficient than franchised ones, they are more efficient than franchised ones when implementing new routines coming from the franchisor. This result is interesting as it highlights the fact that if franchises have greater incentives to maximize return on sales and quality, they are also more independent from the franchisor. Thus, franchised units may represent a drawback when the franchisor wants to implement a new strategy explaining the efficiency of the franchise mix. Doing so, we are able to complement – and extend – the cross-sectional study led by Sorenson and Sorensen (2001), by emphasizing the implications of the exploration and exploitation trade off when the franchisor wants to implement a new global routine. Also, our study extends the qualitative works of Bradach (1997, 1998), by proposing a global picture of the comparative efficiency of, and complementarities between, franchised, multi-franchised and company-owned units.

This paper is set out as follows. In the first section, we emphasize the efficiency of the diverse governance structures in force in the plural form and derive hypotheses. In the second section, we describe the case study from a statistical and qualitative viewpoint. We expand the analysis using econometric techniques in the third section. A discussion and conclusions follow.

2. The Efficiency of the Plural Form: Theoretical Background and Hypothesis

The puzzle of plural forms comes from their combination of governance mechanisms that conform to different logics: company-owned units, franchised units, and multi-unit franchises. Why would a chain combine these different governance mechanisms? For a long time, studies essentially focused on the advantage of the franchise over the company-owned solution, emphasizing that a franchise reduces agency problems in a growth strategy (Shane, 1996). The literature has radically changed over these last years, based on a view that focuses on “make or buy” to the evidence of “make and buy” (Bradach and Eccles, 1989, Bradach, 1997, 1998, Sorenson and Sorenson 2001, Lafontaine and Shaw, 2005). In many cases, chains simultaneously and significantly use numerous governance mechanisms, leading Bradach and Eccles (1989) to coin the term “plural form”. The co-existence of several organizational forms may come from the fact that none of these forms dominates the others according to the diverse dimensions of performance. However, it can also be argued that synergetic effects take place between the diverse governance mechanisms (Bradach, 1997, 1998) leading to the co-existence of efficient and inefficient forms. Specifically, one can wonder if it is necessary to combine owned units and franchised units in order to obtain efficiency in the diverse contexts.

2.1. Franchises, Company-Owned Units and Other Strange Forms

Franchise chains are usually comprised of several different forms of organization, namely franchise, company-owned and multi-unit franchise. Each has its own characteristics making it efficient in a specific context.

2.1.1- Franchised Units

Since the franchisee is the residual claimant of his store, it is frequently assumed that he will have more incentives than managers in company-owned units. Even if the franchisee agrees with the franchisor to respect the rules and norms of the franchising agreement (a framework contract), he is still the owner of his store, which results in his ability to maintain some autonomy vis-à-vis the franchisor. Thus, franchisee discretion enables him to better adapt to local circumstances and to use his knowledge of local markets (Minkler, 1990). Also, one can consider that the franchisee’s autonomy enables him to experiment with new practices or rules, in order to adapt his business to local customers. Hence, the franchisee can adapt more efficiently to a changing environment or his customers' needs. In this sense, one can consider that it would be possible for the franchised unit to explore, i.e. develop new routines (Sorenson & Sorensen 2001). Finally, from the franchisor’s point of view, the increase in franchises enables him to limit the resources needed – and especially his capital investment – due to the creation of new stores. In this sense, franchises (or multi-unit franchises) lead to a more rapid growth of the chain by preventing capital shortage, financial constraints (Caves & Murphy,

1976, Lafontaine 1992), and by providing access to entrepreneurial abilities (Norton, 1988).

However, the franchisee's autonomy may lead to problems of control (Klein, 1980, Brickley & Dark, 1987). In some situations, it may be difficult for the franchisor to control the behaviour of the franchisees. If scholars generally stress the franchisees' interest in shirking on quality or more generally, on unobserved dimensions (Pénard and al 2009), there is also the possible difficulty for the franchisor to change a franchisee's behaviour. The franchisor, being in an uncertain environment, can be led to modify certain characteristics relating to organization, behaviour or rules. Since the franchising agreement is an incomplete contract, it is possible for the franchisee to maintain autonomy with regard to compliance with the franchisors' changes in rules or behaviours. In this sense, paradoxically, the franchisor can suffer a loss of control over his organization.

2.1.2. Company-owned Units

Company-owned stores operate in a classical hierarchical mode. A manager is employed for each store and must comply with the franchisor's orders. Generally, as the chain becomes larger, there will be one or more levels of supervisors (area managers) between the headquarters and the store managers. Since store managers are not residual claimants, it is generally assumed that company-owned units are less efficient than franchised units (Lewin Solomons, 1998, Rubin 1978). Nevertheless, this is a matter to be discussed. For instance, in their analysis of the connection between organizational learning and the performance of chains, Sorenson and Sorensen (2001) assume that the owned stores are more efficient in exploitation – i.e. in the incremental improvement of existing routines – than franchised ones. In their study, they consider that because the store manager is strictly monitored by the franchisor (See Bradach, 1997, 1998), he will have a stronger incentive for efficiency in routine operations, as well as a greater tendency to sacrifice exploration activities that are not imposed on him or that are difficult to observe by the franchisor.² Also, using data from the shops, Yin and Zajac (2004) convincingly discuss the strategy-governance structure ideal for a pizza chain whose shops use either a pure dine-in vs. delivery strategy or a mixed strategy that enables restaurants to offer both dine-in and delivery services. They show that company-owned units are more efficient than franchises in the context of pure strategy but less efficient in the mixed context.

Therefore, one can consider that the comparative efficiency of company-owned versus franchised units is an empirical question. Moreover, in a dynamic dimension, one can consider that company-owned units have the advantage of possess-

² Notice that in the viewpoint of Holmström and Milgrom (1991) company-owned units are the locus of multitasking problems. If some dimensions are not controlled by the franchisor, they will probably be sacrificed. Store managers will have a strong tendency to substitute observable tasks with those difficult to observe.

ing better adaptation properties than franchised units. Having to comply with orders (or having less autonomy than franchised units), store managers obey orders and adapt to changes in strategic, organizational or operational decisions. In this sense, they enable the franchisor to obtain a better uniformity of practices than franchisees (See Bradach, 1997, 1998), and they enable the franchisor to better adapt to changing circumstances. We would thus obtain the classical result of better efficiency of hierarchies in cases of strong uncertainty or radical changes (Aoki, 1988, 2001), with the company-owned outlets more able than franchised units to implement new routines, and to exploit them (Sorenson and Sorensen, 2001).

2.1.2- The Strange Form: Multi-Unit Franchises

Multi-unit franchised outlets (MUF) are "chains within chains", as they consist of two or more outlets owned by the same franchisee. In this case, several units (with store managers) comply with the orders of a multi-unit franchise. Therefore, this form is positioned between owned units and franchises. Since the multi-unit franchisee is a residual claimant over his stores' performance, the stores are then managed according to the rules of the (employed) store managers. Hence, multi-unit franchising introduces hierarchies in franchised units, which probably leads to a loss of efficiency for each store.

Nevertheless, one can consider that the hierarchy in multi-unit franchises is reduced as compared to company-owned units because the multi-unit franchisee has fewer units to control, therefore experiencing less "loss of control" than within the hierarchy of owned units. Also it can be noted that the MUF simplifies the task of deploying the franchisor policy, as there are less franchisees who need to be convinced to change their behavior, in order to obtain a change in the franchised store policy. Lastly, the MUF limits the problem of shirking by franchisees: as the Multi-Unit Franchisee has an important stake in the chain, he will have an incentive to maintain his reputation.

Therefore, the picture seems complex with no form performing better than the other in every situation.

2.2. The Efficiency of Plural Forms: Hypothesis

It is important to observe the way "chains benefit by sharing routines in response to feedback from past experiences and environment" (Cyert and March, 1963), and the way company-owned and franchised units interact in the learning process. Specifically, the units exploit routines in force in the chain, but there is also an interest in adapting the routines – even to create new ones – in order to improve the performance over time. Sorenson and Sorensen (2001) emphasize the right balance between company-owned (that exploit routines more efficiently) and franchised units (that explore more efficiently), "but it fails to consider how governance structures might influence the learning process" (Sorenson and Sorensen, 2001, p. 714). Using their distinction between exploration and exploitation, we will distinguish what happens when the chain is in a stable context – i.e. each unit exploits the actual routines of the organization or explores locally, and in the con-

text of an organizational change – i.e. the franchisor designs changes in the routines or concepts of the main chain, and implements them in the entire chain. This will lead us to making a hypothesis on the efficiency of each form in the chain according to the context.

2.2.1. Stability of Routines and Efficiency.

In the context of the stability of the routines, one can contend that we observe the classical make or buy issue. Following a transaction cost analysis or agency analysis, we expect franchise units to be characterized by higher incentives because franchisees are residual claimants, whereas managers in company-owned units have fewer incentives to perform efficiently. Multi-unit franchises appear to be in between, providing a better level of control than company-owned units, but fewer incentives than franchised units. This leads us to our first hypothesis:

Hypothesis 1: In a stable environment, due to the incentive level that characterizes each form, we can expect that franchised units should perform better than multi-unit franchises, which should perform better than company-owned units regarding financial performances.

The loss of control that characterizes franchised units and multi-unit franchises is potentially important because the franchisee might behave opportunistically by reducing efforts concerning quality. This could then have an impact on the value of the brand name of the chain and on every unit (i.e. negative externality). This could explain why chains with a high quality level strategy might target a lower franchise mix (Lafontaine and Shaw 2005). Nevertheless, the franchisee cannot behave opportunistically if this has an impact on his financial results. This is connected to the kind of clients we are taking into consideration: episodic or regular. Since we consider a franchise chain dealing with clients to be a durable good (car owners), we expect the issue of opportunistic behaviour to be reduced: the franchisee knows that he will lose a (recurrent) client if the quality provided is too low. Also, one can consider that multi-unit franchises provide an important stake for the franchisee, reducing his potential opportunism and incentives to shirk and as a result would be better than the classical franchised units. This leads us to our second hypothesis:

Hypothesis 2: In a stable environment with recurrent customers, due to the incentive level that characterizes each form, we can expect that franchised units should perform better, regarding quality indicators, than multi-unit franchises, which should perform better than company-owned units regarding quality performances.

2.2.2. Change of Routines and Efficiency

In a competitive context – with evolving needs and technology – one can observe that the chains' concept, its offer, or even its management principles can evolve, leading to the discovery and the implementation of new routines in the en-

tire chain. In such a context, one can wonder what organizational form would be suitable to (1) identify the main changes in routines, and (2) implement the new routines and improve efficiency.

Following Sorenson and Sorensen (2001), we believe that company-owned units tend to engage in exploitation while franchised units engage more frequently in exploration. This is due to the franchisee's relative independence of the franchisor, and their incentive to improve their specific routines in order to better adapt to their local context. Then we can expect franchised units to innovate and find new ways to improve quality at a local level developing local solutions.

However, taking stock of local experiences, the franchisor may want to implement global routines to capitalize on local experience defining new uniform routines and implementing them in the entire chain. We expect reluctance from franchised units and multi-unit franchises for implementing such new global routines as they have already developed local ones that may differ. Furthermore, they are able to resist, since they are more independent than company-owned units. This leads us to our third hypotheses:

Hypothesis 3: The implementation of new routines at the chain level will be easier in company-owned units compared to franchised units. This should reflect in efficiency indicators, especially qualitative ones.

Such an analysis sheds light on the efficiency of the plural form, suggesting that at time t one form is more efficient than the others (namely franchised units) but also that the plural forms make it possible to achieve efficiency through the ease of implementation and adaptation of routines in the chain, leading to better efficiency in changing contexts. In order to test such a hypothesis, information concerning the efficiency of each unit of a chain is needed, in a stable and evolving context. We collect such data on Net.

3. The NET Case Study

The investigation reported here consists of data collected on NET, a leading French franchise chain.³ We have collected qualitative and quantitative data thanks to the active participation of one co-author in the organizational projects of the chain over a two-year period. This co-author was an advisor at the chain's headquarters and was therefore able to interact both with the headquarters and with several units, within a project of quality improvement. Qualitative data resulted from interviews with executives, middle managers, franchisees and multi-unit franchisees of the chain. This active participation also enabled us to construct an original database on 150 outlets of the chain, providing us with extensive information regarding the characteristics and performance of the stores. Using this material, we were able to take a complementary approach to the main studies real-

³ Due to confidentiality of the data we must keep the chain anonymous.

ized in the literature: Instead of using the cross-sectional data on a population of chains, we carried out an in-depth case study covering the 2003-2004 periods. Moreover, we believe this data is interesting because of the appropriateness of the case of NET for shedding light on franchise debates: In addition to being an experienced leading actor in franchising, NET also experienced a change in its strategic choices in 2003, which led to a new quality policy in 2004. Thus, light was shed on both the organizational impact of the diverse governance mechanisms and the ability of a plural form to cope with changes in organizational strategy.

After providing general details on the case – and its specificities – we will use qualitative material and descriptive statistics to complete the picture of the case study. We will use the data to show the diversity of the characteristics and the performance of the three governance mechanisms – the franchised unit, the company-owned unit and the multi-unit franchise – before giving insight into the strategic and organizational changes that took place in 2003-2004, and their preliminary results.

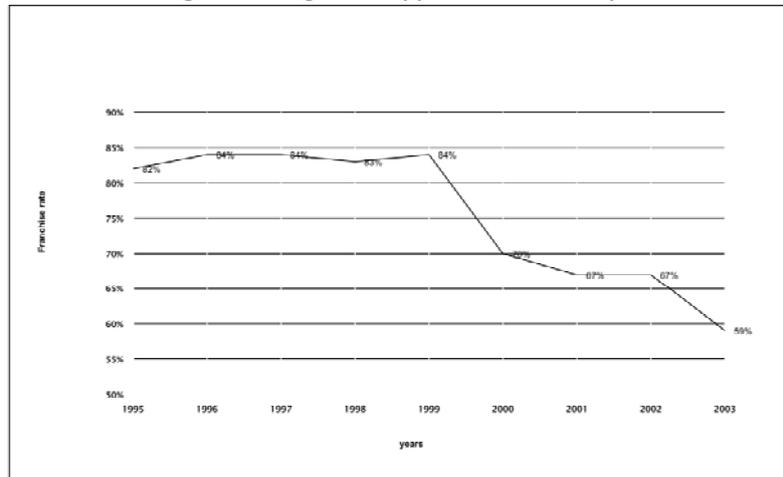
3.1- NET: A Plural Form in a Reform Context

Created in 1972, NET is one of the leading French chains in its activity. In 2003, it realized M€735 returns on sales with 6,000 employees and 301 stores. Although the chain was initially founded with company-owned stores, it began creating franchised stores in 1979. Also, its executive managers insisted on the strategic necessity of growth by combining the creation of company-owned stores with franchised stores. For instance, in 1994 the executive manager asserted “the necessity of combining 1/3 of company-owned units with 2/3 of franchised units”⁴. Beyond this discourse, we nevertheless would have to wait for an M&A operation to take place in 1998 to observe this global distribution of the governance structures in the chain (See figure 1). In 1998, NET acquired CAD, a competitive chain comprised of company-owned units, which resulted in NET being comprised of franchised (70%) and company-owned units (30%).⁵

⁴ Such an explicit strategy reinforces the view of the plural form as a strategic target (Lafontaine and Shaw 2005)

⁵ Notice that a second M&A operation took place in 2003, leading to an increase in the proportion of company-owned units (41%). Nevertheless, since the integration of this network is very recent – the operating rules are not entirely deployed – we have excluded these units from our data, restraining our study to 150 units owned before the M&A.

Figure 1- Proportion of franchised units of NET



In addition to the global distribution between franchised and company-owned units, we must further distinguish between the franchised units and multi-unit franchises in which the franchisee possesses two or more stores. These three governance structures are present in the NET case, with the multi-unit franchise having a slight predominance over the two other forms (multi-franchised units represent 44% of the entire chain while franchised units represent 23%). We can thus consider that the NET case is particularly interesting to study: with its long history of management of a plural form, NET founded its strategy on this organizational strategy and has proven to be successful when considering its leading position on the French market.

Moreover, although these characteristics emphasize the interest in the NET case, there is also another point of interest: its recent change in strategic choices regarding the quality policy. In 2002, NET's executive managers decided "to become the French reference in 2006". To do this, they decided to posit quality as a priority project, in order to enhance the quality of services and the internal operating processes. Following an audit, the top management created a task force for quality and, in 2003, initiated a consultative process to define an "action plan". This action plan defined the operating processes as well as the criteria that needed to be respected in order to improve customer satisfaction.

As a result of the NET case, we are able to discuss (1) the properties of the diverse governance structures, especially regarding their financial and qualitative performance, as well as (2) the diversity of reactions of the governance mechanisms when facing a change in operating rules and observable management tools of the chain. To better illustrate these dimensions, we must complete the picture for these two topics.

3.2- NET: A Contrasted Plural Form

NET is composed of a mix of the three governance structures, franchised units, multi-unit franchises and company-owned outlets. We can complete the picture by statistically specifying the characteristics of each governance structure and their performance.

At first glance, we can identify several differences between the governance structures (See table 1). If we look at the criterion relating to size and the number of employees, we observe that company-owned units are statistically larger than multi-unit franchises and the latter are also statistically larger than simple franchised units. Nevertheless, this global comparison can be shaded by a more precise analysis. Each unit is composed of two distinct activities: a repair area (workshop, which is organized by boxes or work area), and a self-service (or help yourself) area for the sale of products and furniture. In this sense, the NET case is interesting as it illustrates a “simple” or pure strategy (Yin & Zajac, 2004): even if the units sell a large range of products, they all offer the same kind of products and services. Therefore, the only differentiation factor is the choice of size of the repair and self-service areas. We observe that the size difference among the shops essentially comes from the difference in the self-service areas, the gap between the numbers of boxes being statistically insignificant. So, it seems that the franchisor retains the control of the greatest amount of units, with a specialization of the company-owned units in the sales activity, whereas franchises and multi-franchised units are both smaller and specialize in the repair activity.

Table 1. Units' characteristics (whole chain)

Types of centers	Square meters for the shop	Square meters for the help yourself area	Square meters for repairs	Number of boxes	Employees
Franchised Units	742.27	366.98	216.81	6.15	11.16
Multi-Unit franchises	763.71	375.08	218.65	6.40	12.45
Company-owned Units	856.86	434.73	219.62	6.17	15.04
Total	789.03	392.62	218.53	6.27	12.99

This differentiation of units is confirmed by a return on sales comparison (See table 2). Once again, company-owned units are significantly greater than multi-unit and simple franchises. Notice that this turnover indicator is especially important in our context. As Royalties are determined in proportion to the return on sales, and since sales are an important management indicator for company-owned

stores, it is generally assumed that turnover is a good indicator of the units' efficiency or performance (See Yin & Zajac, 2004: 374 for a discussion).⁶

Table 2 – Return on Sales⁷

	Return on sales 2003 – whole chain (234 units) (in euros)	Return on sales 2003 – reduced sample (150 units) (in euros)	Return on sales 2004 – reduced sample (150 units) (in euros)
Franchises	1 664 432	1 555 233	1 620 848
Multi-unit Franchises	1 844 676	1 920 701	1 967 181
Company- owned Units	2 192 918	2 197 308	2 228 451

We can complete the analysis by comparing the data on representative clients, i.e. on the average expenditure by customer and by observing that the average expenditure of the customers of franchises and multi-unit franchises (56 €) is significantly greater than the customers' expenditures in company-owned units (49 €). If this difference can be viewed as reflecting a gap in commercial efficiency, we must emphasize that this difference is essentially the result of the specialization difference between company-owned vs. franchised units. The company-owned units are more oriented toward the self-service sales activity than franchises and multi-unit franchises and the repair and maintenance costs of a product are generally greater than an average sale. Finally, it can be interesting to connect units' specialization choice with their commercial location (See table 3).

The units' distribution across the diverse commercial areas leads to further apparent differences between the governance structures. Company-owned units are overrepresented in the areas with high commercial potential, typically the hypermarket or commercial centre areas.⁸ Conversely, franchised and multi-franchised units are much more present in the urban areas (main streets and downtown areas).

⁶ Notice, also, that we were not able to obtain the profit data.

⁷ We were not able to collect data for the whole chain in 2004, leading us in our econometric part to focus on a 150 units subsample

⁸ Notice that the quasi lack of franchised units in the CAD hypermarkets is due to the 1998 M&A: NET acquired the CAD units, which were located in the CAD hypermarkets.

Table 3. Locations of Units

Location	Kinds of unit	Number	Distribution (%)	Average shop size (square meters)	Employees (average)
Location 1_Main streets	Simple franchise	7	30%	686,86	10,71
	Multi unit franchise	12	52%	794,5	11,83
	Company-owned	4	17%	845	11,75
	Total	23		770,52	11,48
Location 2_downtown	Simple franchise	7	64%	903	11
	Multi unit franchise	4	36%	848,75	13,25
	Total	11		883,27	11,82
Location 3_CAD Hypermarket	Simple franchise	2	4%	552	9
	Multi unit franchise	11	22%	773,82	13,64
	Company-owned	38	75%	842,49	16,26
	Total	51		816,28	15,41
Location 4_Hypermarket w/park	Simple franchise	15	28%	753,71	11,2
	Multi unit franchise	22	42%	758,63	12,95
	Company-owned	16	30%	900,5	14
	Total	53		800,07	12,77
Location 5_commercial area	Simple franchise	10	36%	687,1	9,9
	Multi unit franchise	13	46%	727,71	12,5
	Company-owned	5	18%	1 019,20	15,6
	Total	28		765,26	12,14
Location 6_commercial area near hyper	Simple franchise	13	21%	755,08	12,77
	Multi unit franchise	36	59%	756,07	12,17
	Company-owned	12	20%	789,42	13,75
	Total	61		762,42	12,61
Location 7_Hypermarket area	Simple franchise	1	17%	599	11
	Multi unit franchise	4	67%	772,06	9,75
	Company-owned	1	17%	749,83	11
	Total	6		739,51	10,17

The observation confirms a relative specialization of the franchised vs. company-owned outlets. NET tends to retain the control of the large units located in high potential commercial areas, whereas it delegates to franchisees the responsibility of urban areas, more oriented toward the repair and maintenance activity.⁹

3.3- NET and Quality: How Can we Dynamically Implement Quality?

Launching a “Quality Project” is a strategic issue for a leading retail chain. While trying to improve the quality of its services, the top management of NET hoped to enhance customer satisfaction to better control the homogeneity of its services and, consequently, to improve its leading position by increasing the chain’s reputation, its market share and its internal efficiency. We must note that this quality project is at a turning point in NET’s quality policy. In 1994, NET

⁹ One can wonder if the nature of each activity (repairs vs. sales) better corresponds to each kind of governance structure. One idea could be that (1) the franchisee would prefer activities like repairs that are less dependent on the warehouse; and (2) the franchisor would prefer to franchise complex activities (repairs) rather than the simpler ones (sales) because the sales activity is more difficult to monitor than the repairs. We do not address this issue.

had initiated a quality policy, but there was no quality department or manager to supervise the processes. Instead, the quality analysis was divided between several interlocutors (marketing services vs. communication services). In 2002, top management radically changed its view, with the quality becoming the direct responsibility of top management, in order to emphasize NET's strategic aspect. While we might reflect on the initial situation of the quality practices in governance structures, emphasizing the possible performances, it may also seem necessary to present the reform process and discuss its results.

3.3.1- Contrasting Quality Perceptions

The first global quality policy appeared only in 2002 in the NET chain. Nevertheless, since 1994, one initiative – called the “BEST” device – has been launched in order to measure quality levels in force in the NET stores. Through surprise visits, the “BEST” device consists of auditing several aspects, such as reception quality, neatness of outlets, employee availability, service quality, and so on. Several control points are identified on these aspects and are verified by the auditor. Nevertheless, several problems are apparent in this device. First of all, the control points are essentially focused on the sales activity and not the repairs, since it seems more difficult and costly to verify the quality of the repair and maintenance operations. Also, the subjectivity of the auditor is frequently discussed. Last but not least, the results of the audit are neither really exploited by the top management of NET nor are they really publicized within the chain. In this sense, one can consider that quality is a non-observed aspect for the stores – or a non-monitored activity, leading each unit to be autonomous in its exploitation of the results and in the definition of its actions. This has implied a strong demarcation between franchised vs. company-owned units.

In company-owned units, quality is viewed as a facultative activity, as there is no monitoring by NET's top management. Interviews with employees, store managers as well as operators, emphasize that they are not concerned with the quality aspect. Their main argument was “the Top Management never asks us to deliver quality”. The main preoccupation of store managers (and other employees) is with turnover objectives, since they have quantitative objectives to reach in order to obtain bonuses (articulated with several commercial campaigns). The repairs and sales turnovers of the store are, symptomatically, displayed within the store, whereas nothing is mentioned about quality. Conversely, several store managers asserted “If one (top management) asks me to deliver quality, I will do it with pleasure and I know how to implement it”.

Even if they consider that the “BEST” device is biased, franchisees seem to pay more attention to quality. The franchisees interviewed seemed more disposed to use the “BEST” device results in order to improve the quality of their service. Also, several franchisees led a local quality policy, because they believed that “quality makes money” or “goodwill will prosper with quality”. In some cases, franchisees have created financial incentives connected to the level of the “BEST” device results. Also, some franchisees created activities or services to improve

customer satisfaction: for example the free lending of products in cases of a repair activity has been reported. Or, more important in day-to-day activities, some franchisees have introduced specific actions to improve the repair reception, which is generally considered important for the units, in order to improve customer care and waiting time. Also, quality meetings are organized. Therefore, although the initiatives of franchisees are difficult to measure specifically, they reveal a commitment to quality. So, there seems to be strong adequacy with the exploration of routines emphasized by Sorenson and Sorensen (2001): Franchisees try to drastically improve (or change) routines, in order to adapt to their local context.

Even if the quality seems to be an aspect that should be managed locally, it seems that the franchisees and store managers do not give it the same attention. While franchisees have elaborated local answers to the quality issue, store managers seem to have eluded it in their management preoccupations, since quality is not perceived as being controlled by NET's top management. This attitudinal difference can probably explain the difference in the measures of customer satisfaction realized at the end of 2003: the customer satisfaction rate of franchisees (59.97) largely dominates the performance of multi-unit franchises (48.40), the latter is also much higher than the rate of customer satisfaction of company-owned units (39.57).

3.3.2- The Change Process and its Ambiguous Results

Hoping to change its quality policy, the top management of NET decided to implement a change process in 2003, in order to obtain a complete deployment of the new policy in 2004.

The first step consists in the conception of the quality process. To do so, the top management created a pilot committee and organized three "composite committees" that brought together 150 participants coming from franchised and company-owned units and having different jobs in NET, from area managers to franchisees to operators. These composite committees had to discuss and define the pertinent aspects of the quality of services and the criteria and actions to put in place in order to obtain a perfect quality process.¹⁰ This led to defining a "Quality Mix" (with "4Ps", like the Marketing Mix) that identifies the main courses of action, the NET commitment on quality and the specific actions (and criterion) to be respected (See table 4). So defined, the Quality Mix was progressively deployed within the entire chain (step 2), from September 2003 to January 2004, in which (step 3) every NET outlet began applying the new quality policy. Thus, the year 2004 was the first year of operation for the new quality policy. Nevertheless, it is interesting to notice that the results obtained are both contrasted and ambiguous. The customer satisfaction rate for the franchised units has decreased (54.51), whe-

¹⁰ Notice that 1400 proposals arise from the three committees. They have been collected and treated by a team of consultants to inform NET's top management team, and to lead to decisions.

reas the MUF customer satisfaction rate has remained stable (47.11) and the satisfaction rate observed in the company-owned units increased sharply (46.94). Although the satisfaction rate for franchised units remained significantly greater than the satisfaction rate for the other stores, the gap between the other units is much smaller, with an insignificant difference in the satisfaction rate between company-owned and multi-unit franchises. Moreover, the satisfaction rate of franchised units decreased significantly between 2003 and 2004 (to 97%), leading to further question the impact of the new policy.¹¹

Table 4. The Quality Mix

4 courses and 15 shared commitmentsdecline in specific actions for each profession in the units
Neatness & Reception	<ol style="list-style-type: none"> 1. Having a neat and arranged unit 2. Having an inside and outside reception unit 3. Warm welcome of the customer 	1.1 Specific actions for the centre manager, the cashier...
Efficiency taken into account	<ol style="list-style-type: none"> 4. Announcing and keeping delivery dates 5. Being available to the customer 6. Explaining delay 7. Having good waiting conditions 	4.1 Specific actions for the centre manager, the cashier...
Service provision without worry	<ol style="list-style-type: none"> 8. Doing well the first time 9. Warm welcome of the customer, even without appointment 10. Giving efficient information and advice, and accurate explanations to the customer 11. Promoting quality of components, products and services to the customer 	8.1 Specific actions for the centre manager, the cashier...
Clear Prices	<ol style="list-style-type: none"> 12. Giving prices suited to the customer's needs 13. Offering easy terms 14. Being transparent 15. Being honest 	12.1 Specific actions for the centre manager, the cashier...

¹¹ Specifically, one can wonder if the homogenization resulting from the new quality policy has not limited the autonomy of franchisees with regard to quality, also leading them to limit their local adaptation to customer needs.

Therefore, the NET case seems quite interesting, leading us to a better understanding of the plural form of governance, the difference in the performance of their diverse governance structures, as well as their adaptation capacity when faced with radical changes in the franchisor policy. The description of the characteristics and the outlets' performances has, essentially, stressed an interest in distinguishing between these three populations of stores, which differ in size, commercial specialization and location. Also, an analysis of the change in the quality policy emphasizes the differences in the behavior of the diverse governance structures and their adaptation ability. Whereas company-owned units neglected quality before the 2003 Quality Project, and therefore obtained poor results with respect to customer satisfaction, the franchises (and, at a lesser degree, the multi-unit franchises) were concerned with the quality aspect and hence obtained better quality results. In this sense, we show that status matters, as each agent reacts according to his own characteristics and incentives: therefore, the same aspect, when not centrally managed, leads to diverse behaviours. Also, this Quality Project sheds light on the dynamic of change. On this point, company-owned units have a better capacity for adaptation than the franchises.

Nevertheless, if the stylized facts that we emphasize seem stimulating and give sense to the analysis of the plural form, it seems also necessary to complete the picture by using econometrical techniques of analysis, taking the heterogeneity of each store into account.

4. Econometric Analysis

Our main goal is to assess the relative efficiency of franchises, multi-unit franchises and company-owned units. To do so, we cannot only compare the average levels of our efficiency variables (as we did in the previous section). Such statistics could lead us to inaccurate conclusions because each store differs not only in its governance structures but also by other characteristics (e.g. square meters per unit, a higher number of employees, better location and so on) that might explain their performances.

In order to go a step further in our analysis, we collected data about each unit of the Net chain. More precisely, we obtained information for two years, in 2003 and in 2004 for 150 of the 234 units of the NET chain. The period thus corresponds to a stable environment (2003) and a period of change during which the franchisor implemented a new global routine to be applied by each unit of the chain (2004) and will permit us to test our propositions.

4.1. Explained Variables

In order to assess the efficiency of the units that comprise the franchise chain, we use two variables. The first one is the turnover of each unit (TURNOVER). The second one is the satisfaction rate for each unit, resulting from interviews with customers (SATISFACTION RATE). The satisfaction rate is measured through a composite indicator (see table 4.) derived from a direct customer survey. We

monitored several criteria comprising the global satisfaction rate, and obtained the same results in our estimates for the diverse criteria.

4.2. Explanatory Variables

4.2.1. Organizational Choices

All our hypotheses are based on the relative efficiency of units in the chain depending on their organizational form. We thus created variables **FRANCHISE**, **MULTI-UNIT FRANCHISE** and **COMPANY-OWNED UNITS** that are dichotomic variables reflecting the actual form of the studied unit.

4.2.2. Unit's Characteristics

As we already pointed out in the previous section, units may differ because of their characteristics. These characteristics as well as the way units are governed reflected by their organizational form, might have an impact on observed performances. Thus, we created variable **SQUARE METERS**, **SQUARE METERS FOR "HELP YOURSELF"**, and **SQUARE METERS FOR REPARATION** measuring the size of the unit in square meters of the unit and for each of its activities as well as **NUMBER OF BOXES**. All these variables reflect the physical investments made by each unit and should have a positive impact on their efficiency.

In addition, we also created **NUMBER OF EMPLOYEES**, measuring the number of employees in the unit. We took into account the **LOCATION** of the unit (i.e. the fact that it is located in a supermarket or another type of location). Finally, we created **EXPERIENCE** measuring the number of years the unit has been operating within the **NET** chain.

All variables used are presented and summarized in table 5. A correlation matrix is provided in annex 1.

Table 5. Variables Used

Variable	Obs	Mean	Std. Dev.	Min	Max	Definition
ROS 2003	150	1981564,0	898834,8	691944,0	7192345,0	Return on sales of the unit in 2003 in €
ROS 2004	150	2024444,0	915744,3	790019,0	7288009,0	Return on sales of the unit in 2004 in €
SATISFACTION RATE 2003	150	46,1	21,4	6,7	93,3	Clients satisfaction rate concerning the unit in 2003
SATISFACTION RATE 2004	150	48,5	18,7	10,0	91,7	Clients satisfaction rate concerning the unit in 2004
NUMBER OF EMPLOYEES	150	13,3	5,2	6	42	Number of employees of the unit
EXPERIENCE	150	9,9	4,9	2	23	Number of years the unit exists
SQUARE METERS	150	799,6	231,0	300	1760	Square meters for sales in the unit
SQUARE METERS FOR REPARATION	150	217,5	83,2	90	635	Square meters for reparations in the unit
SQUARE METERS "HELP YOURSELF"	150	397,2	111,4	142	715	Square meters "help yourself" for the client in the unit
NUMBER OF BOXES	150	6,1	1,9	1	13	Number of boxes in the unit
FRANCHISE	150	0,19	0,4	0	1	Takes value 1 if the unit is a franchisee one.
MULTI-UNIT FRANCHISE	150	0,35	0,5	0	1	Takes value 1 if the unit is a multi-franchisee one.
COMPANY-OWNED	150	0,47	0,5	0	1	Takes value 1 if the unit is a company-owned one.
LOCATION 1	150	0,09	0,28	0	1	Takes value one if the unit is a location type 1.
LOCATION 2	150	0,01	0,12	0	1	Takes value one if the unit is a location type 2.
LOCATION 3	150	0,28	0,45	0	1	Takes value one if the unit is a location type 3.
LOCATION 4						Takes value one if the unit is a location type 4.
LOCATION 5	150	0,25	0,43	0	1	Takes value one if the unit is a location type 5.
LOCATION 6	150	0,09	0,29	0	1	Takes value one if the unit is a location type 6.
LOCATION 7	150	0,25	0,43	0	1	Takes value one if the unit is a location type 7.
LOCATION 8	150	0,03	0,16	0	1	Takes value one if the unit is a location type 8.

4.3.3. Organizational Choices and Performances: Econometric Results

In order to test our proposition, we estimate the following equation:

$$PERFORMANCE_{it} = \alpha MULTI-UNIT_i + \beta COMPANY-OWNED_i + \gamma SQUARE METERS_i + \delta SQUARE METERS HELP YOURSELF_i + \zeta SQUARE METERS FOR REPARATION_i + \eta NUMBER OF BOXES_i + \theta NUMBER OF EMPLOYEES_i + \varphi (NUMBER OF EMPLOYEES)_2i + \psi EXPERIENCE_i + \sum_j \square_j LOCATION_{ji} + \varepsilon_i$$

With i the considered unit, t representing time and j the kind of location characterizing unit i . When considering the financial performances of units, we performed simple OLS estimates. However, when considering the quality performances of units, we used Tobit regression to explore the impact of governance structures. Tobit regression is more suitable than OLS regression when the dependent variable is truncated at a given level. Since our explained variable varies from 0 to 100, OLS regression can lead to biased estimates of the coefficients (Greene, 2003).

The following table presents our results, the distinguishing units' performances depending on the kind of indicator used (financial vs. quality performances) and the period considered (stable vs. unstable period).

Table 6. Estimated Results

	OLS ROS 2003	OLS ROS 2004	TOBIT SATISFACTION RATE 2003	TOBIT SATISFACTION RATE 2004
NUMBER OF EMPLOYEES	116418,448***	110235,599***	-0,28	0,16
	-18321,03	-20531,94	-1,14	-1,09
SQ(NUMBER OF EMPLOYEES)	1147,114**	1391,712***	0,00	-0,02
	-454,25	-509,07	-0,03	-0,03
EXPERIENCE	9779,51	14135,612*	0,61	0,20
	-6530,28	-7318,33	-0,41	-0,39
SQUARE METERS	346,19	521,119*	0,043**	0,01
	-280,27	-314,09	-0,02	-0,02
SQUARE METERS FOR REPARATION	-1054,616*	-1143,521*	-0,105***	-0,02
	-566,67	-635,05	-0,04	-0,03
SQUARE METERS "HELP YOURSELF"	355,32	318,60	-0,02	0,01
	-415,10	-465,19	-0,03	-0,03
NUMBER OF BOXES	3907,35	-14980,61	-1,75	-0,40
	-20962,94	-23492,66	-1,30	-1,25
MULTI-UNIT FRANCHISE	-6140,72	-34596,65	-15,976***	-5,93
	-76111,39	-85296,20	-4,72	-4,54
COMPANYOWNED	-175648,341**	-207149,991**	-24,213***	-8,945*
	-80986,01	-90759,06	-5,02	-4,83
LOCATION	yes	Yes	Yes	Yes
INTERCEPT	117589,57	189836,02	81,981***	50,146**
	-319064,19	-357567,52	-19,78	-19,02
Log Likelihood			-648,98	-642,16
R2	0,905	0,885		
Number of Obs.	150	150	150	150

Significance levels: * 0.10 ** 0.05 *** 0.01

The first striking results that we obtained concerned the relative efficiency of franchises, multi-unit franchises and company-owned units regarding return on sales. Looking at estimate (1), and contrary to what a simple approach would re-

veal, we observed that results comparing simple means are not confirmed when controlling for the characteristics of the units. The company-owned unit is no longer the most efficient governance structure. This result does not come as a surprise and confirms our hypothesis 1: we observe that franchised units generate significantly better returns on sales than company-owned units, all things being equal. And this result is true whatever the period considered (see estimate (2)) and whether it is stable or unstable. It suggests that in any situation, because of greater incentives to maximize benefit, franchised units are doing better as compared to company-owned.¹²

Another interesting result is the fact that franchises and multi-unit franchises seem to be at the same level of efficiency. This result is surprising since multi-unit franchises are often considered as having fewer incentives than managers of franchised units. Our observations suggest that multi-unit franchises are able to control store managers more efficiently than company-owned stores. This observation suggests that the old argument of the span of control, i.e. the number of employees per supervisor, matters. In the case of the multi-unit franchise, we observe that store managers are closer to franchisees (who are residual claimants) than store managers are to their area supervisors (who are employees). This would be one explanation of such a performance. Experience or location does not seem to be a crucial variable in explaining turnovers in units. This is probably because in the franchise chain, all locations are very good.

If we now look at the satisfaction rates as an efficiency indicator for our units, results are slightly different (estimates 3 & 4). In a stable environment (Estimate (3)) franchised units are clearly the most efficient ones since the choice of the company-owned unit has a 24point negative impact on the satisfaction rate compared to franchised units, while the multi-unit franchise has a 16-point negative impact. This again does not come as a surprise because, prior to 2004, company-owned units did not have any objectives concerning quality. This clearly confirms our hypothesis 2. Nevertheless, what is surprising is that the inferiority of multi-franchised units (compared to franchised units) does not have an impact on their financial results (return on sales) compared to franchised units (Estimates (1) and (2)).

An interesting feature of our data is the fact that we can observe satisfaction rates before and after the franchisor decided to measure and give incentives to increase the quality of his service. Taking advantage of this, we re-estimate using the same tobit model for the 2004 period (Estimate 4). We observe that after the quality reform, company-owned units are still less efficient than other organizational forms with regard to quality. Nevertheless, the satisfaction rate gap is re-

¹² Such a result nevertheless contradicts Yin & Zajac (2004) who found that company-owned units performed better in a case of pure strategy (i.e. a simple strategy, with little differentiation between shops). Following their definition, we can consider our units follow pure strategies. However, company-owned units do not perform any better.

duced (9 points instead of 24) and multi-franchised units are now as efficient as franchised units. These results partly confirm our hypothesis 3 and suggest that (1) the franchisor succeeded in reforming the behaviors of the managers of the company-owned units and (2) the reform was concerning franchised and multi-franchised units was unsuccessful.

5. Conclusion

In this paper, we studied the efficiency of several co-existing governance structures in a franchise chain. Our results confirm that, when controlling for size, location and other aspects of units, franchising is the most efficient organizational choice with regard to returns on sales or satisfaction rate compared to the company-owned or multi-unit franchise choice.

More interestingly, we found that this result is no longer valid once the franchisor decides to implement a quality policy. If franchised units are still the most efficient devices to maximize turnover it appears that such an organizational form does not outperform others when quality and customer satisfaction are the main concern.

These results suggest that, in a static environment, where quality is not the main issue for the chain (i.e. no clear objectives with observable and verifiable indicators), franchised units perform better. However, as soon as the franchisor wants to implement radical changes in the way the chain evolves, things become more complicated. Therefore, franchised and multi-franchised units seem to limit the franchisor's ability to implement change. It may be helpful for the chain to implement changes through company-owned units that are more reactive and controllable. In this way, it would be ideal for the franchisor to have franchised, multi-franchised and company-owned units coexisting within his chain.

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ANNEX 1. Correlation matrix

	ROS 2003	ROS 2004	Satisfaction Rate 2003	Satisfaction Rate 2004	Number of Employees	SQ(Number of Employees)	Experience	Square Meters	Square Meters for Reparation	Square Meters "Help Yourself"	Number of Boxes	Franchise	Multi Unit Franchise	Company Owned
ROS 2003	1.0000													
ROS 2004	0.9885	1.0000												
Satisfaction Rate 2003	-0.2274	-0.2242	1.0000											
Satisfaction Rate 2004	-0.2849	-0.2794	0.4419	1.0000										
Number of Employees	0.9411	0.9280	-0.2492	-0.2324	1.0000									
SQ(Number of Employees)	0.9236	0.9152	-0.2268	-0.2373	0.9594	1.0000								
Experience	-0.0614	-0.0364	0.0895	0.0007	-0.0711	-0.0813	1.0000							
Square Meters	0.5462	0.5447	-0.1975	-0.1287	0.5491	0.5343	-0.0559	1.0000						
Square Meters for Reparation	0.3543	0.3606	-0.2418	-0.1396	0.3869	0.4033	0.2372	0.7399	1.0000					
Square Meters "Help Yourself"	0.4542	0.4473	-0.1911	-0.0704	0.4424	0.3990	-0.0370	0.8012	0.4530	1.0000				
Number of Boxes	0.4424	0.4361	-0.1771	-0.1355	0.4521	0.4511	0.1772	0.6677	0.6599	0.5542	1.0000			
Franchise	-0.2280	-0.2118	0.3619	0.1849	-0.2873	-0.2321	0.2324	-0.1698	-0.0324	-0.1891	-0.0476	1.0000		
Multi Unit Franchise	-0.0495	-0.0457	0.0265	-0.0144	-0.0812	-0.0567	-0.0458	-0.0910	0.0192	-0.1808	0.0637	-0.3490	1.0000	
Company Owned	0.2253	0.2091	-0.3080	-0.1307	0.3018	0.2354	-0.1378	0.2194	0.0070	0.3202	-0.0236	-0.4481	-0.6814	1.0000