

Franchising configurations and transitions

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A major business form

During the past four decades, franchising has blossomed into a major business form. Today, over one-third of all retail sales in the USA is through franchised outlets. Additionally, approximately 20 percent of US gross national product results from franchise operations. The importance of franchising is expanding beyond domestic borders with franchising rapidly becoming the fastest growing form of business in the global economic system (Justis and Judd, 1989; Knight, 1984; Sanghavi, 1991; *Success*, 1991).

Franchising organizations differ from most others in three important respects:

- (1) geographic dispersal of organization units;
- (2) replication across units; and
- (3) joint ownership.

First, the essence of franchising lies in the conduct of business activities on-site in various local markets (Klein and Saft, 1985; Krueger, 1991; Martin, 1988). Second, the franchise offering (trade name or business format) is very similar across each unit. Third, ownership rights to the franchise offering are contractually shared between the franchisor and franchisees (Blair and Kaserman, 1982; Inaba, 1980; Klein and Saft, 1985; Lee, 1984; Mathewson and Winter, 1985; Rubin, 1978). Some “non-franchise” organizations may exhibit one or two of these features (e.g. joint ventures, by definition, exhibit joint ownership), but they rarely exhibit all three. Thus, franchising breeds organization forms somewhat different from those of non-franchise organizations (cf. Caves and Murphy, 1976; Child, 1987; Norton, 1988a, 1988b; Rubin, 1978; Stephenson and House, 1971; Williamson, 1991).

Common configurations

The purpose here is to position franchising research within a general theory of organizations. After clarifying the topic by describing the nature of franchise organizations and prior research, Mintzberg’s (e.g. 1979, 1983, 1989) theoretical perspective on organizations is used to identify common configurations of franchise organization. These configurations and the logic linking various features of each are described. Then, adaptive transitions between the configurations are discussed. The contributions, therefore, are extensions of theoretical development in the franchising arena through

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description of franchisor organizing tendencies and positioning of that description within Mintzberg's more general perspective on organization adaptation.

Prior research on franchise organizations

Before beginning a detailed discussion of franchise organizations, some definitions are useful. According to Rubin:

A franchise agreement is a contract between two (legal) firms, the franchisor and the franchisee. The franchisor is a parent company that has developed some product or service for sale; the franchisee is a firm that is set up to market this product or service in a particular location. The franchisee pays a certain sum of money for the right to market this product (cf. Caves and Murphy, 1976; Justis and Judd, 1989; Rubin, 1978, p. 224).

Because franchisors generally seek tight control over their franchisees, Rubin (1978, p. 225) went on to observe that "the definition of the franchisee as a separate firm, rather than as part of the franchisor, is a legal and not an economic distinction." Accordingly, a *franchise organization*, as that term is used here, is the network composed of a franchisor (the parent company, including company-owned units) and its franchisees (cf. Norton, 1988b). *Franchising* is the contractual process used to develop and maintain such a network. As used here, *franchising configuration* (or form) is the pattern among various organizational, situational, and strategic features of a franchise organization.

Two basic franchising strategies differ in terms of *what* is franchised – a trade name associated with certain products or services (referred to as *licensing* henceforth) or a relatively self-contained business operation (referred to as *business-format franchising* henceforth) (Justis and Judd, 1989). Coca-Cola bottling franchises are licensing arrangements, whereas most fast-food chains engage in business-format franchising.

Geographic expansion

Early literature (e.g. Stephenson and House, 1971) viewed franchising primarily as a strategy for extending distribution channels through geographic expansion (cf. Julian and Castrogiovanni, 1995; Justis and Judd, 1986). The conventional wisdom was that access to financial and managerial resources needed for expansion was greater under franchising than company ownership because the franchisee supplies both; thus expansion could take place rapidly (Gilman, 1990). Oxenfeldt and Kelly (1968-69) hypothesized that these advantages diminish as markets become increasingly exploited because expansion slows to a point where the organization can generate sufficient resources internally. Thus, franchisors would tend to buy back franchises as organizations matured, and franchise organizations eventually would become company-owned chains. This led to a series of studies (Caves and Murphy, 1976; Martin, 1988; Nevin *et al.*, 1980; Thomas *et al.*, 1990) generally finding that franchising persists to a large degree, though a limited amount of buy-back sometimes occurs.

Instead of rejecting the Oxenfeldt/Kelly argument that needed resource access diminishes, these researchers (e.g. Caves and Murphy, 1976; Martin, 1988) shifted focus to characteristics of the franchisor-franchisee relationship as an explanation of why mature organizations continue to franchise. Theorists (e.g. Mathewson and Winter, 1985; Rubin, 1978) argued that geographic expansion makes central control of unit operations difficult and costly. If the organization cannot bear those costs, it may experience

Agency concerns

agency problems (Fama and Jensen, 1983; Jensen and Meckling, 1976; Mathewson and Winter, 1985) as unit managers serve self-interests or exert less than maximum effort toward company interests. Because franchisees have considerable financial investment at stake and receive unit profits, they are likely to be more motivated than managers of company-owned units; thus, less monitoring is needed. Norton (1988b) found that franchised units tend to be larger than company-owned units, and he presented arguments that this was due to fewer agency problems. Additionally, Krueger (1991) found that wages are higher in company-owned chains, and he argued that chain-unit managers seem less concerned about maximizing unit profit. Thus, franchising is said to enhance the “entrepreneurial capacity” of the organization (Norton, 1988b; cf. Gilman, 1990), making unit monitoring less costly than in company-owned chains.

However, franchising appears to bring about a different set of agency concerns. Oxenfeldt and Kelly (1968-69) noted various differences in the sales, profit, and other motives of franchisors and franchisees (cf. Kaufmann and Rangan, 1990). In fact, conflicts are inherent because franchisors benefit mainly from systemwide sales while franchisees benefit from unit profit (Blair and Kaserman, 1982; Inaba, 1980; Lee, 1984; Zeller *et al.*, 1980). To increase unit profit, some franchisees may shirk on their responsibilities to maintain quality performance, and system sales may suffer from image problems as a result. Also, as entrepreneurs, franchisees prefer to set their own direction and control their own destinies rather than be controlled by franchisor management (Knight, 1984, 1986; Withane, 1991). Both Knight (1986) and Gultinan *et al.*, (1980) argued that such problems often can be resolved through improved communication. Thus, while monitoring seems less costly under franchising, it still is not cost free. Franchising creates new agency concerns due to franchisee desires for autonomy and unit profit maximization.

Reviewing this literature, Carney and Gedajlovic (1991) concluded that both enhanced access to resources and reduced monitoring costs seem to be the primary advantages of franchising over company ownership – a conclusion supported by their own empirical findings on franchisors in Quebec and in subsequent research on franchisors in the USA (Castrogiovanni *et al.*, 1995; Combs and Castrogiovanni, 1994). These advantages accrue at the franchise organization level where the non-franchise referent is the company-owned chain. At the unit level, franchises (and company-owned chain units) potentially have advantages over independent businesses because of the brand name capital (positive image; reduced customer uncertainty) generated by the network as a whole (e.g. Caves and Murphy, 1976; Norton, 1988b). For example, a traveler having a positive experience at one Days Inn is then more likely to stay at a Days Inn in another city than at a comparable independently owned motel[1]. In some cases, franchisees have buying power and scale/scope economy advantages over independent businesses also; however, royalties that must be paid to the franchisor may offset these cost advantages.

In sum, prior research indicates that franchise organizations differ from others in the accessibility of financial, managerial, and other resources for expansion, relevant monitoring and agency concerns, and the autonomy desired by franchisees. These conclusions give rise to the following premises

on which subsequent arguments concerning additional differences will be based:

- Premise 1.* Franchising enables easier access to resources needed for expansion, particularly managerial and financial resources.
- Premise 2.* Franchising results in lower costs of monitoring geographically dispersed operations. However,
- Premise 3.* Franchising is not cost-free since different sets of agency concerns are encountered.
- Premise 4.* Many of the franchising-specific agency concerns arise from franchisee desires for more autonomy than that usually given to managers of company-owned units.

Franchising configurations

Advocates of “systems” or “configuration” views of organizations (e.g. Galbraith, 1977; Khandwalla, 1970; Mintzberg, 1979; Peters and Waterman, 1982) maintain that strategies, structures, processes, and various other features are interconnected, and thus influences on one will necessarily affect others (cf. Miller and Mintzberg, 1984). Accordingly, the basic differences between franchise and non-franchise organizations (Premises 1-4) give rise to other differences such as those found with respect to unit size (Norton, 1988b) and employee compensation (Krueger, 1991). For example, Krueger’s (1991) argument was that differences in agency relationships (due to differences in the structure of financial rewards) make franchisee-managers more cost conscious – and they pay employees less as a result. Configuration views, therefore, suggest that a focus on franchising as merely a geographic expansion strategy (e.g. Justis and Judd, 1986) or compensation scheme (e.g. Rubin, 1978) is therefore inappropriate since franchising is related to many other organization features.

Five franchisor configurations

In an exploratory study, Carney and Gedajlovic (1991) took this argument one step further, suggesting that the franchisor population itself was heterogeneous. In their study, analysis of 128 Quebec franchisors revealed five franchisor configurations. In a subsequent replication, however, Castrogiovanni *et al.* (1995) were unable to identify similar configurations within a sample of 717 US franchisors. While noting that dissimilarities between the Quebec and US franchisor populations could have accounted for differences in the findings of the two studies, Castrogiovanni *et al.* contended that both studies were limited by their reliance on archival data pertaining to franchisor age, size, and pricing characteristics. Since these data were not intended to be used for such research purposes, they argued that future studies start with more theoretically meaningful strategy and structure variables in efforts to identify alternative franchising configurations.

Traditional distinctions

Indeed, casual observation suggests that the franchisor population is much more heterogeneous than traditional distinctions between business-format franchising and licensing suggest. Among business-format franchisors, for example, McDonald’s seeks franchisees with the financial and administrative capabilities needed to establish new restaurants adhering to the established business format whereas Coldwell Banker seeks franchisees already having large, successful operations within their local markets (International Franchise Association, 1997). Thus, McDonald’s strategy emphasizes the development of new units whereas Coldwell Banker focuses on consolidating existing businesses under the Coldwell Banker umbrella.

A typology of configurations

Configuration perspectives suggest that these strategy differences would likely lead to various structure and process differences because those factors are all interconnected. Whereas McDonald's might exert tight control over its franchisees in order to ensure consistency across its units in nearly all business aspects, for example, Coldwell Banker would likely exert relatively loose control so that franchisees would retain discretion to continue doing many of the things that made their operations successful before they joined the Coldwell Banker network. The question, therefore, is not whether the franchisor population is heterogeneous but how researchers might best proceed in their efforts to identify alternative franchising configurations. Carney and Gedajlovic (1991) chose to use an exploratory analytic approach on available data. An alternative would be to start with existing theoretical perspectives, devise measures consistent with the theory, and then collect new data to test configuration hypotheses drawn from the theory. To stimulate research of the latter type, Mintzberg's (1979) typology of organizations is used in the following sections to generate propositions about alternative franchising configurations.

Mintzberg's framework

Mintzberg (1979) offered a typology of five organization configurations:

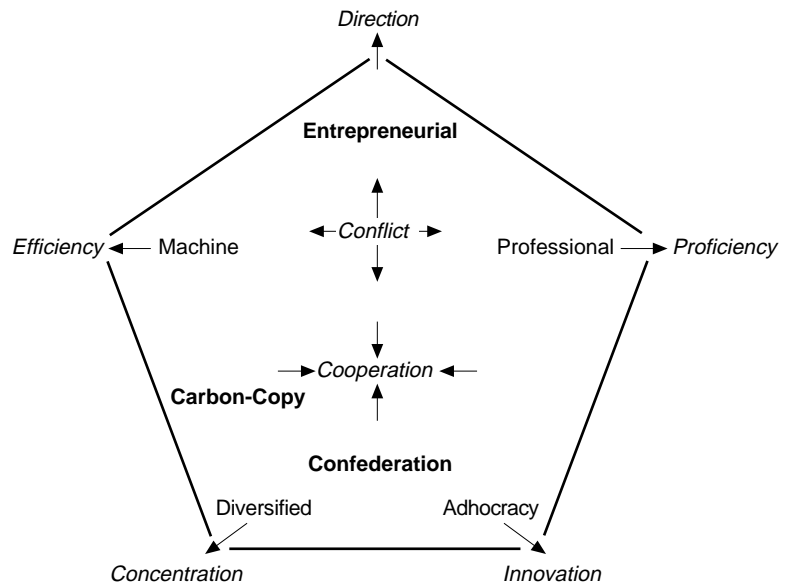
- (1) entrepreneurial;
- (2) machine;
- (3) professional;
- (4) adhocracy, and
- (5) diversified organization forms[2].

Subsequently, this typology was extended to include:

- (6) missionary; and
- (7) political organizations;

the latter being a disharmonious configuration associated with deficient organization performance (see Mintzberg, 1989). While suggesting that these "pure" configurations are among the most common ones, Mintzberg also acknowledged that various hybrids exist, many of which can exhibit "fit" within their particular contexts. Bahrami and Evans (1987) argued that one such hybrid, the stratocracy, is particularly common among high-technology firms. Greenwood *et al.* (1990) described the " p^2 -form" as a hybrid common among professional partnerships.

Mintzberg's framework is based on the premise that several major forces combine to greater or lesser degrees, creating a context in which organizing processes occur. When one force dominates the others, one of the "pure" configurations emerges. Hybrids result from reconciliation of alternative forces in situations where two or more forces are great and no force dominates. Figure 1 illustrates Mintzberg's framework. The major forces – direction, proficiency, innovation, concentration, efficiency, cooperation, and conflict are indicated by italics, and arrows represent the directions in which they "pull" the organization. The "pure" configurations are inside the pentagon, near the nodes. (Missionary and political organizations are not shown because Mintzberg argued that they are unlikely within the business sector.) Three common franchising configurations (the entrepreneurial, carbon-copy, and confederation forms; discussed below) are positioned within the pentagon and highlighted in bold face.



Source: adapted from Mintzberg (1989)

Figure 1. Positioning franchising configurations within Mintzberg's organization framework

Mintzberg's entrepreneurial form

Like most others, franchise organizations may resemble Mintzberg's entrepreneurial form when organization members face considerable uncertainty and thus a strong need for direction is the dominant force driving the organizing process. When franchised units are many and geographically dispersed, however, the entrepreneurial form is unmanageable; thus a more complex configuration is needed (cf. Mintzberg, 1989). Nevertheless, Mintzberg's more-complex "pure" forms (machine, professional, diversified, and adhocracy) are unlikely for four reasons. First, business is conducted over geographically dispersed markets; second, products or services need to be generated locally; third, many factors can be well-specified and then standardized across units (i.e. replication is possible); and fourth, there are economies or brand-name capital benefits associated with such specification and standardization.

The first two conditions, in combination, limit the suitability of a pure machine form where operations are centralized to maximize scale economies. Imagine, for example, the ridiculous possibility that hungry patrons throughout the United States would order Big Macs from a central McDonald's facility in, say, Omaha, which would then ship the orders to everyone in time for lunch. The third condition implies that judgment or discretion is limited at the franchised unit level beyond that normally granted to individuals (e.g. doctors in hospitals, lawyers in law firms, etc.) performing the basic work tasks of professional organizations. The third and fourth conditions limit the utility of the fluid adhocracy and decentralized diversified forms.

Since these "pure" forms cannot meet their needs, franchise organizations tend to approximate one of two hybrid forms (i.e. confederation and carbon-copy) when the situation requires an organization more complex than the entrepreneurial configuration. The confederation is a hybrid primarily

Calculated risk taking

combining features of the diversified and adhocracy forms, but placing greater emphasis on inter-unit cooperation (see Figure 1). It is particularly common among large franchising organizations engaged in licensing, and among business-format franchisors engaged in the provision of professional services such as real estate, optometry, and income tax preparation. The carbon-copy form is a hybrid of the machine and diversified configurations, particularly common among large business-format franchisors engaged in the provision of standard products (e.g. fast-food restaurants and convenience stores). Therefore,

Proposition 1. Franchise organizations tend to resemble the entrepreneurial, confederation, or carbon-copy forms more so than organizing alternatives such as the machine, diversified, professional, or adhocracy forms.

Table I contrasts these three configurations in terms of system goals (Perrow, 1970), market opportunities and organization capabilities (Andrews, 1987), and characteristics of organization functioning (Mintzberg, 1979).

Entrepreneurial form

As Table I indicates, entrepreneurial organizations are driven by needs for both survival and direction. Although the level of opportunity may vary, the market is perceived as sufficiently abundant to warrant business activity. Since there is little slack, tight coordination is essential to ensure efficient resource usage. However, since there is vast uncertainty, organization members have difficulty determining how resources should be deployed. Thus, there is a strong need for direction to be provided by a central leader. Ideally, the leader has intimate knowledge of the business and, therefore, is the person most capable of dealing with the situational uncertainty. Nevertheless, to the extent that the leader's knowledge is imperfect, risks must be taken. Thus, decision making is centralized by the leader and characterized as "calculated risk-taking."

For a leader to effectively make all major decisions, power must be concentrated in the leader's hands, the leader must be actively involved in all major activities (i.e. coordination through direct supervision), and the leader must have considerable discretion to assign individuals to various tasks as the need arises (i.e. little structural differentiation). As Figure 1 suggests, the entrepreneurial configuration tends to exist when "direction" (i.e. need for strong leadership) is the dominant force. This situation is most common among franchisors at their inception, prior to opening the initial franchises. The prototype franchise offering (i.e. the business format to be franchised or the product or service to be licensed) is usually developed by an entrepreneurial organization[3]. While the organization is young, there is vast uncertainty – at least until the prototype is refined. Even then, franchising is a new activity, and with its newness come many uncertainties associated with the development of franchise agreements, system management, etc. (Weinrauch, 1986). While the organization is small, its founders are capable of supervising major activities directly. To realize the founders' vision, the organization first acquires the necessary resources and deploys them in a manner that will get the initial franchised unit operating, and then it begins efforts to create additional units. In short, management "gets the ball rolling."

Proposition 2. Like many other organizations, franchise organizations tend to exhibit the entrepreneurial form at their inception, but following inception, they tend to move away from the entrepreneurial form sooner than non-franchise organizations.

Configuration attribute	Entrepreneurial configuration	Confederation configuration	Carbon-copy configuration
System goals	Survival and direction	Learning the business concept and practices most viable under prevailing conditions	Growth and efficiency through standardization and replication
Market opportunities	Varied but often perceived to be abundant (entrepreneurial optimism)	Relatively abundant; unconstraining; dispersed and somewhat heterogeneous	Levels vary constraining or unconstraining; dispersed but relatively homogeneous
Organization capabilities:			
• Resources	Limited and constraining; little slack	Limited but sufficient: some slack	Varies, but little slack is tolerated so that efficiency can be maximized
• Relevant knowledge and experience	Little; thus vast certainty	Little; thus vast certainty	Considerable; thus limited uncertainty
Organization functioning			
• Coordination/control	Direct supervision; direct top-management involvement in all major activities	Mutual adjustment to pursue common interest; loose "clan" control; limited standardization	Standardization; usually of work and facilities but sometimes of skills
• Decision making	Centralized; calculated risk-taking	Decentralized; experimental	Selective centralization and decentralization; analytic
• Structural differentiation	Little; functional if any	Functional; sometimes regional	Functional; sometimes regional
• Power	Concentrated	Shared	Concentrated

Table 1. Common franchising configurations

**A loosely-coupled
franchise network**

Franchise versus non-franchise contrasts. As the preceding discussion suggests, franchise and non-franchise organizations are likely to be very similar prior to the opening of the first franchised unit. Then, resource access, monitoring, and other differences (see Premises 1-4) take effect, creating pressures for franchise organization movement away from the entrepreneurial form much more rapidly than comparable (i.e. relatively new and small, but growing) company-owned chains. Since easier resource access enables rapid expansion, size pressures work toward erosion of the entrepreneurial form. Enhanced system-wide entrepreneurial capacity enables units to be more geographically dispersed, making it difficult for franchisor leadership to personally coordinate unit activities.

At the same time, “entrepreneurial” franchisees view franchisor leadership more as “advisor making suggestions” than as “boss giving orders.” Resistance of franchisor control efforts is especially likely if the prototype franchise offering is unproven or the franchisee’s capital investment approaches (or surpasses) the size of the franchisor’s investment. An unproven prototype leads to limited franchisee perception of franchisor expertise, and this in turn limits the expert power (French and Raven, 1959) that franchisor leadership can exert. Furthermore, a franchisee’s relatively high capital investment may limit recognition of the franchisor’s legitimate power. Thus, franchise organization coordination needs quickly increase (with size and dispersion) while franchisor leadership’s coordination capability quickly diminishes. Additional coordinating mechanisms are needed, but increased reliance on such mechanisms results in movement away from the entrepreneurial form.

Confederation form

The confederation is a loosely-coupled franchise network useful for promoting organization learning (see Table I). In Figure 1, this configuration is positioned between the diversified and adhocracy forms to indicate geographic market diversity and innovative learning, but it is positioned more toward the center of the pentagon to emphasize that cooperation between units and with the franchisor enhances organizational cohesion.

As noted, geographic dispersion limits the use of direct supervision as a coordinating mechanism. If markets are somewhat heterogeneous, specification of unit outputs (characteristics of diversified organizations) provides weak coordination at best, and there is difficulty developing a single franchise offering capable of meeting the diverse customer needs. The latter makes business-format franchising less feasible than licensing because it requires comprehensive specification of considerably more business aspects.

Franchisees are loosely coupled to one another in the sense that each operates independently of others and franchisor control over unit operations is minimal. Since units operate independently, each can engage in trial-and-error learning without placing others at risk. Their financial incentives and autonomous natures make confederation franchisees inclined to initiate experiments to improve performance. Knowledge gained is then communicated to other units. Simultaneous experimentation by multiple units, coupled with interunit communication, thus facilitates learning (Quinn, 1980).

A single product blueprint

The sharing and subsequent use of knowledge implies coordination through mutual adjustment. However, requisite communication among units is difficult since they are geographically dispersed. Cooperative norms are established to facilitate mutual adjustment and learning. Communication often is eased by formation of franchisee councils, the Internet or a company intranet, or other means. Where these do not formally exist, franchisees still tend to interact with one another because of their common business interests and cooperative norms (Knight, 1986).

Thus, the confederation form reconciles three major forces affecting franchise organization:

- (1) need for concentration (i.e. units each concentrating efforts on their individual geographic markets);
- (2) a need for organization learning and innovation; and
- (3) a need for cooperation (see Figure 1).

Such reconciliation occurs through a decentralized structure where each franchisee retains considerable autonomy – i.e. power is shared between the franchisor and franchisees. Since market opportunities are relatively abundant and some organization slack exists, the time needed to engage in trial-and-error learning is available. Furthermore, to the extent that multiple units engage in simultaneous experimentation, the time needed for learning diminishes. Such learning capability is desirable when vast uncertainty faces the organization.

Stephenson and House (1971) argued that loosely-coupled organizations such as these are transitory because franchisors seek considerable control over franchisees. Indeed, confederations are unnecessary for purposes of organization learning when considerable learning has already taken place and the situation is stable, so that knowledge gained in the past is relevant in the present. In such cases, confederations may develop while learning is needed, but then the organization is likely to move toward another configuration after sufficient learning has occurred. This point will be elaborated later when transitions are discussed.

The Stephenson/House argument, however, is less valid for licensing than for business-format franchising. Since, by comparison, the (licensor) franchisor provides little (e.g. a single product blueprint rather than a complete business concept), the franchisees themselves must generate most other relevant knowledge. Each franchisee's quest for knowledge is facilitated if there are mechanisms for sharing knowledge among franchisees, such as those mechanisms characteristic of the confederation form. Furthermore, a franchisor's formal ability to control unit operations often is limited to aspects directly pertaining to the product or service licensed. Thus, informal mechanisms (e.g. mutual adjustment, norms) are needed to maintain cohesion. For these reasons, many licensing franchise organizations take on the confederation form.

Proposition 3. With large-scale licensing come tendencies toward the confederation form.

Franchise versus non-franchise contrasts. Mintzberg (1979) mentioned two non-franchise forms similar to confederation. The *socialized divisionalized form* (SDF) arises in situations where unit (division) outputs and processes are necessarily diverse. As a result, coordination cannot be achieved by

Coordination in confederations

specifying outputs and processes. To overcome this limitation, SDF organizations seek control through socialization where unit (division) heads possess strong organization citizenship norms and values, and thus are inclined to act in the organization's interests (cf. Ouchi, 1979). The *entrepreneurial adhocracy* (EA) is a small firm engaged in unit production of a very complex nature. To illustrate, Mintzberg (1979) described small high-technology firms engaged in contract work. In addition to the use of mutual adjustment for coordination, EA organizations rely on the direct supervision of their leader.

Like SDFs, standard norms are important for coordination in confederations. Like EAs, mutual adjustment is important also. However, confederations differ from these organizations in several very important respects (noted below), and therefore confederation may be unique to the franchising arena.

Instead of citizenship norms where self-interests are sometimes sacrificed for the good of the whole organization, confederations develop cooperative norms to pursue common interests. In other words, franchisees pursue self-interests which happen to be aligned with those of other franchisees and (ideally) the franchisor. To shape appropriate norms, franchisor management has to concentrate somewhat less (than the SDF) on selection, indoctrination, and training while concentrating much more on the alignment of interests. Then, franchisor management cannot make decisions that reduce alignment, and it must take steps to ensure that alignment continues to be perceived. Otherwise, the confederation may become politicized with franchisees perceiving their common interests but not alignment with the franchisor's interests.

Cooperative norms, in turn, stimulate formation of the communicative mechanisms necessary for mutual adjustment and learning in the confederation. Unlike EA organizations, however, mutual adjustment is voluntary rather than essential because franchisee interdependence is pooled rather than reciprocal. In confederations, knowledge is created by experiments at the unit level (e.g. by one franchisee), shared at the organization level (e.g. through franchisee councils), and then applied at the unit level (e.g. by other franchisees). In EAs, knowledge is created, shared, and applied at the organization level through the joint actions of all members, under the direction of a central leader.

Carbon-copy bureaucracy

Carbon-copy form

The carbon-copy ("carbon-copy bureaucracy" in Mintzberg, 1979) configuration is taken by many organizations engaged in business-format franchising. Since each unit follows the same (or very similar) format, each becomes a "carbon-copy" of all others to a large degree[4] These organizations employ rigid controls to ensure that specified practices are carried out within each franchised unit. Except over personnel selection, employee discipline, and local marketing, franchisees retain little discretion. To maximize economies of scale and scope, the organization seeks rapid growth through standardization of franchised units and replication of those units in new geographic markets.

Large organization size, combined with standardization and control, requires formality and vertical centralization in the franchise organization's structure. A "formula" facilities strategy (Porter, 1980) for dealing with (geographically)

Institutionalized practices

fragmented markets is often pursued. Standard (“formula”) facilities design has various benefits including reduced construction and related (unit) start-up costs, enhanced purchasing power, and minimized potential deviation across units from standard operating practices. To a large degree, franchised units are identical to one another. Thus, the carbon-copy form combines some features of machine organizations (e.g. standardization of operating practices) with some of diversified organizations (e.g. parallel operating units) (see Mintzberg, 1979).

Tendencies toward carbon-copy are especially common when work tasks are highly repetitive, customers make repeat purchases on a frequent basis, and customers are likely to patronize more than one unit within the franchised chain. This is often the case among retailers and restaurants (cf. Caves and Murphy, 1976). The first condition (repetitive tasks) enables successful practices to be institutionalized. The second and third (repeat purchases, multi-unit patrons) enable franchise organizations to benefit from the “brand name capital” obtained by meeting customer preferences for consistency (Caves and Murphy, 1976). Customers would never develop a “taste” for a Big Mac, for example, if the Big Mac taste differed with every purchase.

Proposition 4. With large-scale business format franchising come tendencies toward the carbon-copy form.

For professional or near-professional service companies, knowledge and skill standards (Mintzberg, 1979) may be needed as supplemental coordinating mechanisms because fewer operating procedures can be standardized and “formula” facilities may yield fewer advantages. To illustrate, consider real estate service franchises such as Century 21 or Re/Max International. Requisite salesperson knowledge is ensured through state licensing requirements, and the organization must defer to the knowledge-based judgments of its salespeople because it is impossible to specify the practices that will be required to complete a transaction in each unique case. Repetitive administrative procedures such as record-keeping, however, typically are specified by the franchisor.

Standardized processes

Although standard knowledge and expert judgment are used where needed, franchisors often attempt to minimize that need by restricting the scope of unit operations to areas where work processes can be standardized to a large degree. H and R Block, for example, generally addresses the relatively simple tax preparation needs of individuals or small businesses, leaving more complex work to non-franchise professional partnerships (see Greenwood *et al.*, 1990) like Arthur Andersen. Apparently, franchisors prefer standard work over standard knowledge (and expert judgment) because less variance in operations (within and between units) is likely to result. Variance can be manifest in inconsistent quality, which impedes development or maintenance of brand name capital and may lead to a higher rate of unit failure, thus diminishing a franchisor’s ability to sell new franchises (Justis *et al.*, 1992).

Franchise versus non-franchise contrasts. Though both may take the carbon-copy form, differences between franchised and company-owned chains exist (see Premises 1-4). Most obvious are differences concerning financial reward structures. Franchisors usually profit from a percentage of unit sales; then the franchisees receive the residual unit profits (Kaufman and Rangan, 1990). Ironically, the exact opposite occurs in many

Franchise organization transition

company-owned chains. Unit managers often receive bonuses based on unit sales; and the company receives residual profits.

More subtle differences emerge in the internal politics and cultures. As a group, franchisees are likely to be more cohesive than company-owned unit managers because of the interrelated influences of financial investment, desire for autonomy, and common interests. This can have positive or negative influences in terms of franchisor profit. Franchisor profit-seeking initiatives perceived as going against franchisee interests (see Lee, 1984; Zeller *et al.*, 1980) may be blocked by a powerful franchisee coalition (see Nevin *et al.*, 1980). When faced with changing environments, however, a franchisee coalition may force a relatively complacent franchisor management to take appropriate action.

Transition paths

As franchise organizations cope with changing conditions, the variety of conceivable transitions is infinite. However, some conceivable transitions may be infeasible or (if feasible) dysfunctional. Arguments presented thus far imply that franchise organization transition between entrepreneurial, confederation, and carbon-copy forms is more feasible and therefore more likely than movement to or from some other conceivable form. Figure 2 illustrates some transition paths between these three forms, and those paths are discussed below. By illustrating movement between the entrepreneurial, confederation, and carbon-copy forms under various conditions (e.g. growth, strategic reorientation, turnaround), the comprehensiveness and utility of this three-configuration framework is demonstrated.

Paths A and B represent transitions of business-format franchisors as they move away from an entrepreneurial form at their inception toward the carbon-copy form suitable for large, more geographically-dispersed organizations, and Path C represents a similar transition as licensors move from the entrepreneurial to the confederation form. Under Path A, a business-format franchisor starts out with an entrepreneurial organization.

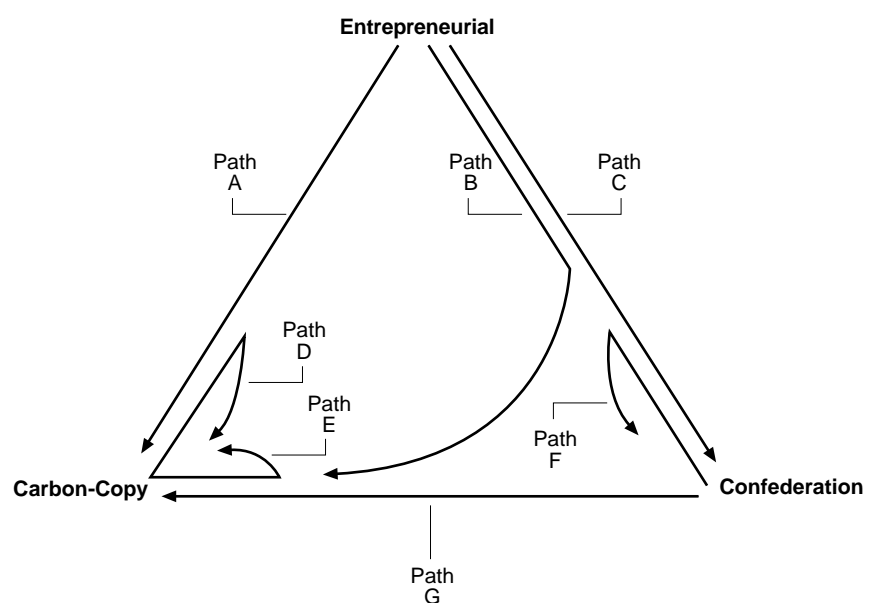


Figure 2. Common franchise organization transition paths

A three-configuration framework

As the organization grows and becomes more dispersed, characteristics of the carbon-copy form are adopted. Similarly, Path C shows a common franchise organization transition by a licensor. During this transition, the entrepreneurial form gives way to the confederation form.

Path B is more complex than A or C, but it may yield the greatest potential long-term success for business format franchisors. For those starting with unproven franchise offering prototypes, Path B may be essential because it enables the learning needed for refinement of the business concept. In a Path B transition, a business-format franchise organization initially takes on the entrepreneurial form, but then organization leadership manages transition toward confederation. While doing so, leadership actively shapes the organization culture, instilling strong norms of communication and cooperation as well as key values. The organization's confederation-like attributes facilitate learning, thus enabling the business concept to be refined. With proven business concept and strong culture in place, the organization then quickly "moves through" confederation toward carbon-copy. The result is a very cohesive carbon-copy organization, with cooperative norms and mutual adjustment mechanisms supplementing the coordination achieved through standard processes, facilities, etc.[5].

This may have been the path followed by McDonald's since that organization seems to have resembled the "very cohesive carbon-copy organization," described above, for many years[6]. The entrepreneurial leadership of Ray Kroc had a continued impact because of the values and norms (e.g. "quality, service, value, and cleanliness") that he infused. Over the years, franchisee-driven innovation resulted in many product successes such as the Big Mac. Yet McDonalds' product, process, facilities, and other standardization is well known (e.g. Deveny, 1986; Robinson, 1989).

Bureaucratic or organic

Mintzberg (1989) distinguished bureaucracies from organic configurations on the basis of whether coordination was achieved primarily by some form of standardization. By definition therefore, carbon-copies (relying on standard work processes, facilities, etc.) are bureaucratic while entrepreneurial organizations (relying on direct supervision) are organic. Although some standardization is used, confederations are somewhat organic because coordination through mutual adjustment takes place as franchisees learn from one another. This distinction is critical to discussion of carbon-copy transitions (Paths D and E) because bureaucratic organizations have difficulty making major changes. Since an "adherence to standard" mentality is essential for bureaucratic control, potential benefits of deviating from present standards are not explored (cf. Starbuck *et al.*, 1978). Thus, bureaucracies often take on an organic form – at least temporarily – when change is needed.

The organic form taken tends to be entrepreneurial in situations of severe crisis, especially if the organization is nearly bankrupt (Mintzberg, 1989). In such cases, there is little time available for learning because inaction or slow action will result in failure. To paraphrase Vroom and Yetton (1973), expediency is more important than decision quality. Thus, strong leadership engaged in calculated risk-taking (i.e. sometimes acting on an "educated guess" of what is appropriate) must specify direction and coordinate all effort in that direction if the organization is to have any chance of survival.

Higher decision quality

Therefore,

Proposition 5. Franchise organizations successfully averting crisis will tend to be those taking on characteristics of the entrepreneurial form during the turnaround effort (cf. Mintzberg, 1989).

When the situation is less severe, however, Vroom and Yetton (1973) logic is that widespread participation in decision making is appropriate because it results in higher decision quality and acceptance, the latter facilitating implementation of the decision. This suggests that the confederation's franchisee communication, mutual adjustment, and learning are desirable. Thus,

Proposition 6. Among all carbon-copy franchise organizations engaged in strategic reorientation, successful ones will tend to be those taking on characteristics of the confederation form during the reorientation effort (cf. Mintzberg, 1989).

In Figure 2, Paths D and E illustrate transitions of carbon-copy organizations consistent with Propositions 5 and 6, respectively. Under Path D, the franchise organization temporarily becomes more entrepreneurial; a strong leadership develops or commissions development of new standards. As these are put in place, bureaucracy increases; thus, movement back toward the carbon-copy form takes place. Similarly, Path E shows temporary movement toward the confederation form. This enables the franchise organization to learn which existing standards are appropriate, which are not, and which new ones should be added. Once this is learned, there no longer is a reason to be "confederation-like;" the new set of standards is put into place; and the organization reverts back toward carbon-copy.

Paths F and G are responses of confederations to actual or anticipated performance problems. Since confederations are already somewhat organic, many problems are likely to be addressed without a change in configuration. If business conditions require changes in unit practices, for example, confederation members (franchisees) can use communicative mechanisms in place (e.g. franchisee councils) to learn of the experimental successes and failures of others. Then, each member can utilize the knowledge gained to improve franchise performance.

Changing conditions

When this does not work, however, it is apparent that the confederation is ineffective in its present form. Since franchisees cannot resolve the problems themselves, the franchisor must play a more active role. Path F illustrates one such response, consistent with Proposition 5. Here, the franchisor orchestrates a turnaround, exerting strong leadership to move the confederation in a new direction. Just as "strong leadership" suggests, the confederation takes on some characteristics of the entrepreneurial form. Then, as the various corrective actions take effect, the need for direction dissipates, and the organization moves back toward confederation.

Alternatively, the changing conditions might have resulted in a reduced need for cooperative learning. For example, conditions may have stabilized and become homogeneous across geographic markets. In turn, this may have resulted in the emergence of a common business format used in many of the franchised units. The confederation form would thus be unnecessary and, in fact, may be dysfunctional because remaining inconsistent (unstandardized) practices among franchisees limit development of brand name capital (cf. Caves and Murphy, 1976). Additionally, the franchisor might desire a share

Research directions

of profits accruing from currently unlicensed activities that are part of the common business format.

As a result, the franchisor may follow Path G by moving from licensing to business-format franchising and, consequently, making the corresponding transition from confederation to carbon-copy (see Figure 2). Because of contractual provisions, this process would tend to occur gradually. As licenses expired, they would not be renewed. Instead, some licensees would be offered business-format franchises. Concurrently, other business-format franchises would be sold to new franchisees. This suggests Proposition 7.

Proposition 7. Business format franchising (and the carbon-copy form) will tend to be preferred over licensing (and the confederation form) when geographic markets are stable and homogeneous. Under these conditions, therefore, licensing organizations will tend to expand their franchise offerings to become business-format franchise organizations.

Implications for future research

To help stimulate franchise organization research, several propositions were offered in the preceding discussions. These can be examined using common methods such as in-depth case studies, surveys of (or interviews with) key executives, and content analysis of published information. Additional research can extend this configuration view of franchise organizations in at least three directions. One direction would identify factors mediating the relationships discussed here. Among franchise organizations listed in the annual survey by *Entrepreneur* magazine, for example, most have some company-owned units, but the proportion of units franchised consistently averages above 75 percent. This suggests that dichotomization of franchise versus non-franchise organizations was satisfactory here for purposes of clarity, but it was not completely accurate. Future research can identify whether/how the proportion of units franchised affects the organizing process.

A second research direction would use this configuration framework to compare franchise organizations with their non-franchise organization counterparts. In this spirit, Norton (1988a, 1988b) compared various characteristics of franchised versus company-owned units in several industries, and Brickley and Dark (1987) examined conditions surrounding the choice of whether to franchise a given unit. Where franchise versus non-franchise comparison has been made, however, these and other studies (e.g. Bates, 1995; Caves and Murphy, 1976; Contractor, 1984; Martin, 1988) have tended to focus at the industry, unit, or transaction (e.g. franchising decision) level rather than the organization level discussed here.

Nevertheless, Premises 1-4 and other arguments presented here suggest that organization level differences are likely to be observed. For example, a company-owned retail chain and its business-format franchising counterpart may both be organized as carbon-copies, but differences in the process of strategic reorientation (see Proposition 6) might exist. Since franchisees have considerable investments at stake, they have greater incentive to initiate responses to changing conditions. As a result, franchise organizations might be more likely to respond proactively in a confederation-like reorientation process. If successful reorientation reduces the possibility of crisis, this line of reasoning also suggests that franchise organizations would be less vulnerable.

Restrictions on licensee operations

A third research direction would be to use this framework in a move away from historical or legal distinctions that are sometimes superficial. Propositions 3 and 4, for example, suggest that licensing and business-format franchising are associated with the confederation and carbon-copy forms, respectively. Still, there is heterogeneity within those two major segments of the overall franchisor population that can be understood using the framework presented here.

Among gasoline dealers (which have historically been viewed as licensors), for example, Conoco tends to exhibit the relatively loose standardization and control associated with the confederation form. At many Conoco gas stations, the only significant restriction imposed on licensee operations is that they use Conoco gasoline as long as they use the Conoco name. In fact, many such station owners could change gasoline brands at will if they were also willing to incur the expense of changing their business names and changing the signs, stationery, etc. displaying their names. In contrast, Mobil designs and owns the facilities of many of its stations, while licensing out its name to the station operators. Since facilities design impacts the optimality of particular operating practices, this approach to licensing gives Mobil a degree of standardization and control approaching that associated with the carbon-copy form.

Among business-format franchisors, product-oriented firms such as fast-food restaurant and convenience store franchisors may be more likely to exhibit the cross-unit consistency and tight control of the carbon-copy form than are professional service firms such as real estate brokerage or dental clinic franchisors. As noted previously, complexities in the provision of professional services necessitate reliance on expert judgment over the use of standard operating procedures which, in turn, gives franchisors less control over franchisee operations. Consequently, many professional service franchise organizations may exhibit the relatively loose control and other characteristics of the confederation form. Since much growth in the business-format franchising arena is occurring in professional service areas as traditionally franchised product-oriented businesses face increasingly saturated markets, this research direction can be extremely important in the very near future.

Practical implications

Implications for franchise marketing

The preceding discussions suggest several practical implications for the design, development, and management of franchise organizations, as well as for franchisor efforts to market their franchises. All implications, however, must be considered tentative since they are drawn from a review of the literature and have not yet been subject to direct empirical testing.

Nevertheless, since franchisors cannot wait to take action until future research evidence is generated, tentative implications must be drawn from the existing literature in order to provide franchisors with the best possible guidance available to date.

The major organization implications are summarized as follows:

- At their inception, franchise organizations should take on characteristics of the entrepreneurial form, with top management actively overseeing and directing all organization activities.
- Once franchising gets underway, franchisor management should make a conscious choice to direct the organization's development toward either the confederation or carbon-copy forms. (Ideally, the decision would

have been made earlier, and only its implementation would begin at this point.)

- To the extent that local markets are heterogeneous and unstable, the franchise organization should resemble the confederation form; and to the extent that local markets are homogenous and stable, the franchise organization should resemble the carbon-copy form.
- When relatively-minor strategic reorientations are needed, franchise organizations should become more confederation-like, at least temporarily, in order to learn what kinds of changes would be optimal.
- When major turnaround is needed, franchise organizations should become more entrepreneurial, at least temporarily, with top management exerting strong leadership to quickly redirect the organization before the crisis escalates into franchisor bankruptcy.

These organization implications, in turn, give rise to three important implications for franchise marketing. First, the particular nature (or organization form) of the franchise organization should be accurately described to prospective franchisees so that their expectations will be realistic. Accurate information prior to a franchise sale will result in greater franchisee satisfaction, improved franchise performance, and less franchisor-franchisee conflict following the sale (Hing, 1995; Morrison, 1996).

Turnkey operations

Consider, for example, the frequent depiction of franchises as “turnkey” operations, with systems and procedures so well-specified that the business essentially runs itself (Gerber, 1995). The implication is that, to be successful, franchisees need to do very little other than turn the key to unlock the door and open for business. Although few, if any, franchises can be described as perfect turnkeys, the label is reasonable when the franchise organization exhibits the carbon-copy form. Under the confederation form, however, the turnkey label is inappropriate because systems and procedures are not well-specified. That is, to a large extent confederation franchisees need to figure out what works best in their local markets and then develop their own systems and procedures accordingly.

Thus, prospective franchisees should not be led to believe that they would be getting turnkey operations if the franchise organization exhibits the confederation form. In fact, confederation franchisors probably should go out of their way to tell prospective franchisees that they will not get turnkey operations if they purchase franchises since the stereotypic view of franchising is consistent with the carbon-copy model. Otherwise, the prospective franchisees would likely make inappropriate assumptions about what they would be getting.

In their franchise marketing efforts, it therefore follows that confederation franchisors should emphasize the discretion given to their franchisees. This is the second marketing implication of the previous discussions. Some prospective franchisees opt for independent business ownership because they do not want to be subject to the many rules and procedures characteristic of the carbon-copy model. Confederation franchisors would do a better job tapping this part of the franchisee market if they made it clear that they are different, and that they do not fit the stereotypic (i.e. carbon-copy) view of franchising.

Relatively high need for autonomy

The third marketing implication pertains to the targeting and subsequent selection of franchisees. Carbon-copy franchisors should seek franchisees with a relatively low need for autonomy and low tolerance for ambiguity. Since systems and procedures are well-specified in carbon-copy organizations, franchisees face very little ambiguity. Also, since franchisee adherence to rules and procedures thus specified is essential for ensuring consistency across franchises, carbon-copy franchisees cannot engage in a great deal of autonomous behavior. In contrast, confederation franchisors should seek the opposite types of individuals. Confederation franchisees should have a relatively high need for autonomy and high tolerance for ambiguity since they will have to figure out for themselves the optimal ways to operate within their particular local markets.

Conclusion

As promised in the introductory section, Mintzberg's theoretical framework was expanded through detailed discussion of franchise organizations. Common franchising configurations were positioned within that framework, and franchise organization transitions were described. Since the intent was to stimulate organization-level research in the franchising arena, key arguments were summarized in a set of testable propositions. Also, indications were given as to how research might proceed beyond the propositions offered here. Finally, organizing implications were summarized, and related marketing implications were elaborated.

Notes

1. This example illustrates why replication (e.g. similar Days Inns) is a common feature among franchise organizations – i.e. replication helps generate brand name capital. The example also illustrates why franchisee shirking is such an important concern. After all, a negative experience at the first Days Inn would reduce the traveler's likelihood of staying at the second.
2. Since this typology was first offered, Mintzberg modified the labels somewhat. For example, the diversified organization was previously called the divisionalized form.
3. For purposes of clarity, it is assumed that only proven business formats are franchised (and only proven products or services are licensed) because the franchisor of an unproven business would have great difficulty convincing prospective franchisees to invest. This assumption is relaxed later when "Path B" transitions are discussed. It is further assumed that the organization is, primarily, a franchisor. In cases where long-established company chains begin franchising, their franchising effort itself tends to be organized as an entrepreneurial configuration whereas existing chain operations most likely resemble some other form. Later, that entrepreneurial franchising effort is likely to make a transition toward the form taken on by the existing chain operations.
4. Obviously "carbon-copy" refers to the many similarities across units. Following Mintzberg (e.g. 1989), "bureaucracy" refers to the organization's reliance on some form of standardization for coordination. In carbon-copies, the specified business format is the mechanism by which standards are conveyed to franchisees and the referent to which each unit is compared for coordination and control purposes.
5. Path B closely resembles Quinn and Cameron's (1983) synthesis of organization life cycle research. Using their terms, the franchise organization begins in an "entrepreneurial stage," becomes confederation-like in a "collectivity stage," and then moves toward carbon-copy in a "formalization and control stage." The final Quinn/Cameron stage involves elaboration of structure. Here, a franchise organization retains the carbon-copy form, but structural complexity is increased to deal with continued organization growth. For example, regional divisions might be created by adding a hierarchical level to facilitate coordination among the many units. The carbon-copy phenomenon would then exist at two levels: regional divisions would closely resemble one another; and units within regions would resemble one another also. Ultimately, international divisions might be added, but then "carbon-copying" is likely to diminish slightly at the division level to cope with differences between domestic and foreign markets.

6. Recently, however, McDonald's has begun to experience a significant increase in franchisee discontent and related internal disputes.

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