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Strategic Interactions in Franchise Relationships

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2 Theoretical backgrounds

2.1 Introduction

As pointed out in Chapter 1, this study considers the franchise relationship as a specific form of strategic alliance. This chapter will discuss several perspectives that have been used in research on strategic alliances in general and franchise relationships in specific. Osborn and Hagedoorn (1997) indicate that different perspectives have been adopted to gain insight into the formation, evolution, operation and outcomes of different forms of alliances. However, these perspectives have often been used in isolation, which has resulted in an unstructured research field consisting of multiple theories, research designs, and units of analysis. Each perspective has its own contributions and limitations with respect to understanding the formation, evolution, operation and outcomes of alliances and franchise relationships.

There is a need for a comprehensive theory of inter-firm cooperation in which different perspectives are integrated. This chapter discusses how the different perspectives used in alliance research can contribute to understanding what responses franchise partners adopt toward each other in dealing with the exploration/exploitation paradox. Section 2.10 summarizes and discusses how the perspectives have been used in this study.

2.2 Resource perspective

In this section, three perspectives are discussed in which ‘resources’ play an important role. These perspectives are:

- A resource-based perspective.
- A resource dependence perspective.
- A dynamic capabilities perspective.

In general, these perspectives consider the firm as composed of a number of ‘resources’ that are to a greater or lesser extent specific to the firm. In the literature, there are various definitions and categorizations of resources. Some authors (e.g. Grant, 1991) divide resources into financial resources, physical resources, human resources, technological resources, reputation and organizational resources (e.g. organizational climate and internal relationships). Other authors (e.g. Collis and Montgomery, 1995) distinguish between physical or tangible resources (e.g. locations), intangible resources (e.g. technical know-how and reputation) and organizational capabilities (e.g. managerial judgment). Another distinction often made is that between assets and skills (e.g. Hall, 1992). Assets refer to resources that a firm possesses, such as locations, brand names and financial equipment, while skills refer to what a firm is capable of, such as effective marketing or efficient manufacturing.

Regardless of how resources are precisely defined, they play an important role in the three perspectives. However, these perspectives differ in their key ideas and their possible contributions to alliance and franchising research. Therefore, they are discussed separately.

2.2.1 Key ideas

Resource-based perspective

The resource-based perspective has had an important influence in the strategic management literature. Wernerfelt (1984), who developed a 'Resource-based view of the firm', is regarded by a considerable number of authors as the originator of the resource-based perspective, while other authors date back the origins of the resource-based view to Penrose (1959). Teece et al. (1997) argue that Rumelt (1984) may have been the first to self-consciously apply a resource-based perspective to the field of strategic management. Rumelt (1984, p.561) states that the strategic firm is characterized by '*a bundle of linked and idiosyncratic resources and resource conversion activities*'. Teece et al. further state that Wernerfelt was the one who recognized that this approach was at odds with the former product-market approaches and might be a distinct strategy paradigm.

The key idea of the resource-based perspective is that a firm's competitive advantage results from unique, firm-specific resources, and that this competitive advantage may be sustainable over time if 'isolating mechanisms' are present that prevent other firms from imitation. The resource-based perspective states that firms can achieve a competitive advantage if they are able to accumulate resources that are rare, valuable, non-substitutable and difficult to imitate (Barney, 1991). In addition, Barney notes that a firm should be appropriately organized in order to exploit these resources.

The resource-based perspective has made an important contribution to the literature because it emphasizes the differences between firms and shows that the performance of firms is not determined by their industrial structure but by the resources that they possess and the way managers build and exploit them. Apart from its contributions, the resource-based perspective has some flaws.

- Priem and Butler (2001) argue that the resource-based view has originally started as a dynamic perspective that emphasizes changes over time (cf. Penrose, 1959, Wernerfelt, 1984). However, much of the subsequent literature has been static in concept. According to Priem and Butler, these static applications have several limitations with respect to strategic management research. One important limitation they point at is that these static approaches do not take into account the role of 'learning' (or exploration), while the ability to learn to develop effective resources is in itself a resource. Teece et al (1997) acknowledges this fact by developing a 'dynamic capabilities perspective'. This perspective is discussed below.
- According to Priem and Butler (2001) another important flaw of the resource-based perspective is that it considers processes as a black box. In other words, the resource-based view does not provide insight into *how* resources can lead to competitive advantages. According to Priem and Butler, the literature contains many references arguing that resources are useful, but they do not explain when, where and how they lead to competitive advantage. Stoelhorst (1997, p.91) already acknowledged this by stating that '*to better understand the dynamic character of strategy at the level of the firm, we need to more fully acknowledge the central importance of organizational processes*'. In recent years, authors have slowly come to recognize this (cf. Eisenhardt and Martin, 2000).
- The resource-based perspective does not consider the possibility of cooperating with other organizations in order to acquire resources that are required for

sustainable competitive advantage. According to the resource-based perspective it is mostly the firm that is the unit of analysis: in explaining competitive advantage and superior performance researchers mainly focus on a firm's resources. In recent years, authors have increasingly become aware that strategic alliances (such as franchise relationships) are important means to acquire critical resources (cf. Dyer and Singh, 1998).

Resource dependence perspective

The resource dependence perspective has its origins in a social or organizational behavior perspective. The key idea is that organizations are open systems that depend on resources to meet their goals, but their lack of self-sufficiency with respect to these resources creates dependencies vis-à-vis the parties who control these resources. In contrast with the resource-based perspective, the resource dependence approach considers relationships with external parties as important.

Emerson (1962) can be considered as one of the precursors of the resource dependence perspective. He argues that social relations between persons or groups entail ties of mutual dependence between the parties involved. Because parties are mutually dependent, each party is more or less able to control the other party's conduct; in other words, to exert power. According to Emerson, the power to control or influence the other is reflected in control over the things one values, including different types of resources, but also other things depending on the type of relationship. For example, he refers to ego-support or friendship. Emerson argues that the dependence of actor A upon actor B is influenced by the following two factors:

- The 'rewards' that party A consciously or unconsciously receives as a result of the relationship with party B.
- The possibility of receiving these rewards through alternative relationships.

Furthermore, Emerson points at the occurrence of 'switching costs'; *'the costs associated with such alternatives must be included in any assessment of dependency'* (Emerson, 1962, p. 32).

Emerson distinguishes several types of actions ('balancing operations') parties can undertake to influence the power balance in case of changes in the relationship. He acknowledges that changes can occur to which the parties in the relationship can react, and by doing so he offers a more 'dynamic' view on relationships.

Pfeffer and Salancik (1978) are among the authors who have extended this theory and applied it to inter-organizational relationships. Therefore, they are often considered as the originators of the resource dependence perspective. The key to organizational survival is the ability to acquire and maintain resources. However, most organizations themselves depend on other organizations for these resources. Given the assumption that few organizations are internally self-sufficient with respect to their critical resources, two potential problems arise: 1) a lack of self-sufficiency creates a potential dependence on the parties from whom the focal resources are obtained. 2) it generates uncertainty with respect to a firm's decision-making because the resource flows are not under the firms control and may not be predicted accurately.

Additionally, Pfeffer and Salancik recognize the dynamics of the environments that organizations operate in. They argue that environments can change, that new organizations can enter and exit, and that the supply of resources might become more or less scarce. This makes the management of the relations with resource providing parties even more complicated.

According to Pfeffer and Salancik (1978) three elements constitute the dependence of an organization on its partners:

- The importance of specific resources.
- The extent of control over these resources.
- The extent of alternatives for these resources.

The contribution of the resource dependence perspective is that it focuses on the presence of power and dependence in relationships. Furthermore, it takes into account the dynamics of interactions between the actors involved, thereby providing more insight into processes than the resource-based perspective does.

Dynamic capabilities perspective

The 'dynamic capabilities perspective' can be considered as an addition to the resource-based perspective. The originators of the dynamic capabilities perspective, Teece et al. (1997), argue that the resource-based view is a static view and therefore not appropriate for gaining insight into sustainable competitive advantage in rapidly changing environments. According to Teece et al. (1997, p.515) '*the term "dynamic" refers to the capacity to renew competences so as to achieve congruence with the changing business environment; certain innovative responses are required when time-to-market and timing are critical, the rate of technological change is rapid, and the nature of future competition and markets difficult to determine*'. In my opinion, one adjustment should be made to this statement, namely: not only the rate of *technological* change is important, but any kind of change that is relevant to firms, for example a change in customer preferences.

According to Teece et al. (1997, p.515) '*the term "capabilities" emphasizes the key role of strategic management in appropriately adapting, integrating, and reconfiguring internal and external organizational skills, resources and functional competences to match the requirements of a changing environment*'. According to Teece et al. (1997) the competitive advantage of firms is regarded as resting on distinctive processes, shaped by the firm's assets and the evolution paths it has adopted or inherited.

In sum, the resource-based perspective is a relatively static perspective that mostly focuses on the *exploitation* of existing resources, while the dynamic capabilities perspective also pays attention to the *exploration* or development of new resources required in rapidly changing environments.

2.2.2 Possible contributions to alliance and franchising research

In my opinion, these three 'resource perspectives' are complementary, and therefore their possible contributions to alliance and franchising research are discussed together.

Contributions to alliance research

Resources play a central role in alliances because alliance partners exchange complementary resources. However, many theories on strategic alliances tend to emphasize the structural elements of alliances, such as control mechanisms, rather than the resources themselves. In order to understand the interactions between alliance partners, it is useful to gain insight into the value of the relationship to both partners and how that value results in power-dependence relations between them.

The resource dependence perspective also contributes to explaining why firms cooperate in alliances. As was pointed out, organizations are largely dependent on other organizations with respect to their resources, and are therefore compelled to have interfirm relationships to obtain the resources required for their survival. However, the exchange of

critical resources in alliances generates issues of dependency and control. The partner that contributes a resource necessary for the alliance's success, which the other partner cannot easily provide, will gain power over the other partner and will have a relatively larger control over the cooperation. Therefore, an important contribution of the resource dependence perspective is that it takes into account the occurrence of power and dependency in strategic alliances. Furthermore, it includes the dynamics around the interactions between alliance partners, which provides a deeper insight into processes than the resource-based perspective does. However, according to Child and Faulkner (1998) the resource dependence perspective tends to emphasize the conflictual and coercive side of alliances, while researchers should also take into account a certain degree of trust in relationships. A 'social exchange' perspective does take into account issues of trust and is therefore discussed in section 2.5.

Contributions to franchising research

This study builds on the view that franchisors and franchisees cooperate because they possess complementary resources. To the franchisor the franchisee is a source of financial, managerial and entrepreneurial resources; the franchisee pays fees/royalties for the right to use the franchisor's business format and the franchisor can benefit from the franchisee's managerial and entrepreneurial capabilities. As far as the franchisee is concerned the most important resource of the franchisor is the business format, which consists of a certain identity toward customers and a certain degree of back office support. The franchisor has made part of its knowledge explicit by translating it into a 'business format' that can be used by franchisees in return for fees and/or royalties. As pointed out in Chapter 1, the business format consists of certain elements that together reflect a certain identity toward customers, such as the trademark, a certain assortment of products and/or services and certain color schemes. Winter & Szulanski (2001) have discussed this definition from a 'knowledge perspective' by arguing that a 'replicator' (see section 1.3) possesses knowledge consisting of three elements: 1) business format traits that have to be replicated in each unit, 2) actions that can be taken to reproduce those traits, 3) environments in which such traits have satisfactory business value. Winter and Szulanski actually take a dynamic capability perspective by arguing that the replicator's knowledge about these three issues is always evolving, because over time the replicator experiments and learns what works and what does not work and adapts his format accordingly.

In the franchising literature, the so-called 'resource constraints theory' and the 'capital theory' focus on the role of resources in franchise relationships (cf. Carney and Gedajlovic, 1991, Lee, 1999). Lee distinguishes the resource constraints theory and capital theory as two separate perspectives. However, in my opinion, capital theory forms part of the resource constraints theory. Capital theory considers the franchisee as a source of financial capital for the franchisor. The franchisee enables the franchisor to raise capital at lower costs than when dealing with company-owned units. Both the 'resource constraint theory' and 'capital theory' are only used from the franchisor's perspective: franchisors are assumed to work with franchisees because of the latter's resources. However, the franchisees' motivations to enter into franchise relationships have been largely ignored by the literature.

2.3 Transaction-cost perspective

2.3.1 Key ideas

The key idea of the transaction cost perspective, or transaction cost economics (TCE), is that transactions are organized in such a way that the costs of carrying them out are minimized. The originators of TCE are Coase (1937) and Williamson (1975, 1985). The main idea of TCE is that transactions with uncertain outcomes, which recur frequently and require substantial transaction specific investments, are more likely to take place within hierarchical organizations. On the other hand, exchanges that are straightforward, non-repetitive and that require few transaction-specific investments are more likely to take place in a market. In later years, as firms entered more and more into forms of collaboration with other firms, authors have increasingly pointed at the 'blurring' boundaries between the market and the hierarchical form (cf. Powell, 1990, Williamson, 1991). These forms are the so-called 'hybrid forms'.

Williamson (1975) distinguishes five factors that are relevant to the choice between market exchanges and a hierarchical organization structure. These factors are: the occurrence of self-interested and deceptive behavior (opportunism), bounded rationality, the number of partners, the degree of uncertainty and complexity, and information asymmetry. In Williamson's view, bounded rationality is the result of uncertainty about the intentions and competencies of a transaction partner. The occurrence of possible opportunistic behavior and bounded rationality poses a problem to transactions because they form an element of risk. Additionally, in his 1985 article, Williamson pays more attention to the role of asset specificity, which may impose risks upon the co-operating partners. Specific assets are investments made for specific transactions that cannot be readily used for other transactions, which produce 'switching costs'. In these cases contractual or organizational safeguards are made in order to protect the investor in relation-specific assets against the risks of opportunism, bounded rationality and uncertainty.

Various authors have criticized the transaction cost perspective (cf. Ghoshal and Moran, 1996, Nooteboom, 1999). Nooteboom (1999) points out various criticisms and possible extensions of the transaction cost perspective. He refers to two 'main criticisms' (1999, p.23), which are also the ones that are most relevant to this thesis:

- First, the transaction cost perspective puts much emphasis on the role of opportunism in relationships, but ignores the role of trust (see section 2.5). The role of trust in relationships is not taken into account in the transaction cost perspective, while research has shown that trust indeed plays a role in the governance of relationships.
- Second, the transaction cost perspective is a static approach because it does not take into account issues of innovation. In other words, it mainly focuses on 'exploitative' aspects, such as analyzing different governance structures and cost efficiency at a certain point in time, rather than focusing on 'explorative' aspects, such as learning and innovation. As was already stated in Chapter 1, innovation and exploration are becoming more and more important for surviving and prospering in turbulent environments. Therefore, it is important to take these issues into account.

2.3.2 Possible contributions to alliance and franchising research

Contributions to alliance research

According to Child and Faulkner (1998), TCE is used to address a wide range of topics related to strategic alliances, for example modes of entry to markets or the selection of alliance forms. TCE can contribute to alliance research because it provides insight into the efficiency and cost-minimizing objectives of alliances, and it can help firms in choosing a governance structure. It also provides important insights into relational risks that alliance partners can be exposed to. The transaction cost perspective acknowledges that forming an alliance with a partner causes dependence between both partners, which can be managed by designing certain governance structures.

As indicated, TCE is a static approach, since it stresses efficiency and cost minimizing motives. TCE does not incorporate the way in which the relational aspects of cooperation evolve over time, and how issues of trust and bonding can emerge between partners.

Contributions to franchising literature

The relevance of transaction cost aspects differs between different forms of alliances, and therefore research should recognize that in some forms of alliances transaction costs might be more relevant than in other forms (Osborn and Hagedoorn, 1997). Franchise relationships are a specific alliance form, but, as was argued in Chapter 1, they can differ in terms of 'degree of hardness'. From a transaction cost perspective, the softer franchise systems are loose relationships relatively close to the market form while hard franchise systems are relatively close to the hierarchical form (see Fig. 2.1). The degree of hardness is one of the franchise system characteristics that influences strategic compatibility between the partners. It is described in more detail in Chapter 3.

In the franchising literature TCE is not used very often; one example from the Dutch franchising literature is Kneppers-Heijnert (1988).

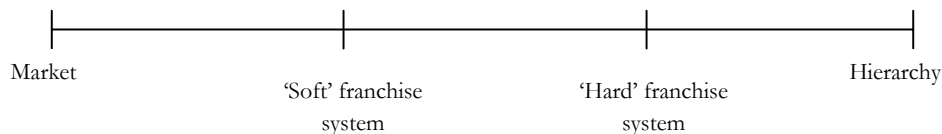


Fig. 2.1: Franchising from a transaction cost perspective

2.4 Agency perspective

2.4.1 Key ideas

Agency theory has been used by researchers in various disciplines, such as accounting, marketing, political science and organizational behavior (Eisenhardt, 1989). From an agency perspective, the relationship or contract between a 'principal' and an 'agent' is the central unit of analysis. In this relationship the principal is the party who delegates work to the other (the agent). The agency perspective focuses on establishing the most efficient contract for governing the relationship between principal and agent (the 'agency relationship'). The aim is to ensure that the agent fulfils the objectives of the principal while at the same time the agent's self-serving behavior is limited.

Agency theory contains several assumptions concerning the nature of human behavior, organizations and information (Eisenhardt, 1989). First, it assumes that human behavior is self-interested, subject to bounded rationality and risk averse. A second assumption is that there is a degree of conflict between the goals of the partners of the contract. Third, there is an information asymmetry between principals and agents (to the advantage of the agent). A fourth assumption is that efficiency is the criterion for the effectiveness of the relationship. Finally, agency theorists assume that information is a purchasable commodity, which means that partners who pay more can acquire more information.

Eisenhardt argues that agency theory is split up into two streams, which leads to different interpretations of the agency perspective. These streams are the 'positivist agency theory' and the 'principal-agent theory'. Both of them share the same unit of analysis (i.e. the contract between the principal and the agent), and the same assumptions about people, organizations and information, but they differ in mathematical issues, the dependent variable and 'style'. The positivist theory is less mathematical and focuses almost exclusively on the relationship between the owners and the managers of large, public organizations. In contrast, the principal-agent theorists make use of a more general theory that can be applied to various principal-agent relationships, such as the employer-employee, lawyer-client, or buyer-supplier relationship. However, although it can be applied in a more general fashion, the principal-agent theory is more abstract and mathematical¹ and thus less accessible to organizational researchers. Therefore, according to Eisenhardt (1989) these two agency theory streams are complementary. She argues that positivist agency theory identifies various contract alternatives, while principal-agent theory indicates which contract is most efficient at various levels of outcome uncertainty, risk aversion, and information.

The agency perspective points at two possible problems in the agency relationship. First, there is the problem of *moral hazard*. This means that the agent might not put as much effort into the work that was agreed upon. Second, there is the problem of *adverse selection*, which refers to the agent's misrepresentation of his abilities. When the relationship starts, the agent might claim to have certain abilities, but the principal might not be able to verify this. The principal has two ways of dealing with these risks. First, he can invest in instruments to collect information about the agent, such as budgeting systems, reporting procedures, or adding extra management layers. With these instruments the principal can monitor the agent's behavior (these are called 'behavior-based contracts'). The second way of dealing with moral hazard and adverse selection is to contract on the outcomes ('outcome-based contracts'). This means that the rewards for the agent are based on the actual outcomes of the task. In this way a great deal of risk is transferred to the agent. This is because outcomes are only partly the result of the agent's behaviors. Also other factors, such as government policies, economic climate or competitor actions can cause variations in outcomes that go beyond the control of the agent. Therefore, a fundamental issue in principal-agent theory is the principal's trade-off between 1) the costs of measuring behavior and 2) the costs of measuring outcomes and transferring risk to the agent.

The agency perspective has some similarities with the transaction cost perspective. The perspectives share the assumptions regarding self-interest and bounded rationality. They

¹ The principal-agent theory is more mathematical than the positivist agency theory because it *'involves a careful specification of assumptions followed by logical deduction and mathematical proof'* (Eisenhardt, 1989, p.60). The positivist agency theory is more focused on describing governance mechanisms that solve the agency problem.

also have identical dependent variables: the market form in the transaction cost perspective is comparable to the outcome-based contracts of the agency perspective, while the hierarchical form is comparable to the behavior-based contract.

Additionally, the agency perspective has several links with mainstream organization perspectives. It is related to the resource dependence perspective because it also assumes conflicts of interests between parties. However, the perspectives differ in their solutions to these conflicts. From a resource dependence perspective conflicting interests are resolved through bargaining, negotiation and coalitions, while from an agency perspective conflicting interests are resolved via (economic) incentives.

An important contribution of agency theory is that it emphasizes the importance of incentives and the occurrence of self-interest in organizations and relationships. However, there are a number of critical points to make.

- Several authors argue that the agency perspective is too one-sided because it only assumes influence of the principal on the agent (Eisenhardt, 1989).
- In the early years after the development of the agency theory, agency researchers treated contracts as a dichotomy: outcome-based versus behavior-based. As pointed out in 2.3, this was also the case with respect to TCE, which in its earlier years made use of the market versus hierarchy dichotomy. In many situations there are 'hybrid relationships' in which mixed (behavior- and outcome-based) rewards play a role.
- As in other economic theories, agency theory stresses 'exploitation-related' issues of alliances rather than 'exploration-oriented' issues.

2.4.2 Possible contributions to alliance and franchising research

Contributions to alliance research

The preceding section has already elaborated on some criticism with respect to the agency perspective in general. In addition, as regards understanding strategic alliances, the agency perspective has some additional limitations, which might explain why it is rarely used in the research on strategic alliances. These limitations are the following.

First, it has already been pointed out that some researchers consider the agency perspective as too one-sided because it implies a one-sided influence and direction by one partner. According to Nooteboom (1999), in strategic alliances this one-sided influence is generally inappropriate and counter-productive, and therefore he does not adopt this perspective in his strategic alliance model. Child and Faulkner (1998) suggest that researchers should view strategic alliances as relationships in which the partners become each other's agents.

Second, as is the case with the transaction cost perspective, agency theory does not focus on possible bonding and trust in the relationship.

In my opinion, the agency perspective can contribute to alliance research because it considers both alliance partners as principals and agents who both have to deal with the abovementioned agency problems. However, it should be complemented with other perspectives in order to gain a more complete insight into relevant factors regarding interacting alliance partners.

Contributions to franchising research

The franchise relationship is quite often viewed from the agency perspective, according to which the franchisor is considered the principal and the franchisee is considered the agent

(e.g. Carney & Gedajlovic, 1991, Lafontaine, 1992, Shane, 1996, Pizanti and Lerner, 2003). In the franchising literature, franchising is mostly regarded as a way to solve the agency problems of moral hazard and adverse selection. This particular stream in the literature focuses on the benefits of operating franchised units versus operating company-owned units from the franchisor's perspective. In other words, it focuses on explaining the distribution of franchised and company-owned units in a system. It is often argued that the monitoring of company-owned managers is more difficult than the monitoring of franchisees. This is because franchisees retain the rights to the unit's earnings and are therefore automatically inclined to make more efforts (outcome-based contracts), while company-owned managers receive fixed salaries (behavior-based contracts) (cf. Carney and Gedajlovic, 1991).

However, because franchisees have their own interests and objectives agency problems will also exist in franchise relationships. Carney and Gedajlovic (1991) point at the following agency problems in franchise relationships: inefficient investment, free-riding and quasi-rent appropriation. *Inefficient investment* results from the fact that franchisees have a large proportion of their wealth tied up in one or a few units, and therefore have to consider the full risks of each marginal investment they make. So, franchisees are tempted to under-invest. Additionally, units of the system are subject to spill-over effects; for example, local advertising campaigns and promotions also influence other units of the system. Therefore, franchisees may attempt to under-invest because they can benefit from the investment efforts of other franchisees. According to Carney and Gedajlovic the problem of *free-riding* refers to the situation where the franchisee tries to cut costs by offering a lower quality than specified by the franchisor. In these cases, the franchisee benefits from the system's well-known brand name, but at lower costs than the other franchisees. As a result, the franchisee's lower quality offerings might damage the reputation of the franchise system. The third agency problem concerns the issue of *quasi-rent appropriation*. A quasi-rent exists if the value of an asset is higher in its current use than it is in alternative uses. Quasi-rents arise when partners make relation-specific investments. Franchisors as well as franchisees can try to appropriate this rent by means of 'post-contractual opportunistic behavior' (Brickley and Dark, 1987 and Garg and Rasheed, 2003). For example, the franchisor can behave opportunistically if the franchisee has invested in system-specific assets. Because the value of these assets is at its highest during the relationship with this franchisor, the franchisee will find it in his interest to maintain this relationship. The franchisor may then take advantage of this situation by means of demanding higher fees of the franchisee, which the latter will be willing to pay. The franchisee can also engage in such behavior by refusing to pay the fees agreed upon or by demanding lower fees once the franchise relationship has been settled.

2.5 Social exchange perspective

2.5.1 Key ideas

According to Das and Teng (2002) social exchange theory was initially developed to examine interpersonal exchanges that are not purely economic. Theorists (cf. Homans, 1958 Thibaut and Kelley, 1959 and Blau, 1964), who adopted such an approach, viewed people's social behavior in terms of the exchange of resources, which was the result of resource scarcity. They viewed social exchange as an ongoing reciprocal process in which actions are the result of reactions of others. Blau (1964, p. 4) gives the following description: *'The concept of social exchange directs attention to the emergent properties in interpersonal*

relations and social interaction. A person for whom another has done a service is expected to express his gratitude and to return a service when the occasion arises. Failure to express his appreciation and to reciprocate tends to stamp him as an ungrateful man who does not deserve to be helped. If he properly reciprocates, the social rewards the other receives serve as inducements to extend further assistance, and the resulting mutual exchange of services creates a social bond between the two.'

Social exchange is different from economic exchange because as regards the latter there is always some economic value that is exchanged, while in social exchange this either may or may not be the case. In economic exchange the benefits of the exchange are often contracted explicitly, while social exchange is more about implicit obligations, or as Ring and van de Ven (1994) define it, 'indebtedness'. Because of this implicitness and the risk of 'free riding', trust plays an important role in the social exchange perspective. According to Das and Teng (2002) a degree of trust among the exchange parties reduces anxiety and enables reciprocity to develop over time. However, trust also involves a certain degree of risk: when an actor decides to trust another actor, he will have expectations regarding the latter's future behavior, and he may be disappointed in this respect.

2.5.2 Possible contributions to alliance and franchising research

Contributions to alliance research

The originators of the social exchange perspective mainly focused on social exchanges between individuals. In later phases this perspective was extended to organizational and inter-organizational levels, and trust became an increasingly important issue in the study of inter-organizational relationships.

Ring and Van de Ven (1994) have adopted a model of inter-organizational relationships in which the abovementioned social-psychological processes play an important role. They argue that such processes are central to managing alliances, and that the way in which individuals negotiate, execute and modify the terms of the alliance strongly influences the degree to which parties judge the alliance to be equitable and efficient. A social exchange perspective takes into account the partners' motives for, and their expectations and perceptions of the relationship. It includes socio-psychological processes of sense-making that influence the partners' interactions in relationships.

According to Ring and Van de Ven (1994, p.93), in the management and sociology literature two views on trust can be found. The first is a '*business risk view based on confidence in the predictability of one's expectations*'. In this view, parties use formal instruments, such as guarantees, insurance mechanisms, laws and organizational hierarchy, to deal with uncertainty. The second view on trust is based on confidence in the other party's goodwill, in which faith in the moral integrity or goodwill of others is emphasized. This integrity or goodwill is supposed to be created through interpersonal interactions that, in turn, lead to mutual norms, sentiments and friendships. This second view of trust is related to the social exchange perspective and has been adopted by Ring and Van de Ven. One important issue Ring and Van de Ven point at in this respect is the issue of 'fair dealing', which goes beyond rational and economical calculations. It includes the sociological meaning of 'indebtedness', which means that among parties in organizations or among alliance partners there can be social norms or obligations. This concept is further illustrated in Chapter 3.

Another author who discusses the role of trust on an inter-organizational level is Bachmann (2001). He also argues that the views of basic sociological theory can serve as a supplement to the more conventional economic theories. Bachmann focuses on the role of trust and power in inter-organizational relations. Both trust and power are social control

mechanisms that help improve the coordinating interactions between actors. He states that several classifications of trust have been made in the literature.

According to Bachmann, an important distinction can be made between so-called 'system trust' or 'institutional-based trust' and the so-called 'personal trust' or 'process-based trust' (cf. Luhmann (1979), Giddens (1990) and Zucker (1986)). *System trust* is mostly based on institutional arrangements. One classical example is the trust that economic actors put in the universal usability of money, which enables the efficient functioning of economic systems. In contrast, *personal trust* is likely to develop when individual actors frequently have face-to-face contact and become familiar with each others' personal preferences and interests without the extensive use of institutional arrangements. This form of trust takes an extreme amount of time and effort and is therefore not a very efficient way of coordinating complex socio-economic systems.

Nooteboom (1999) relates to this distinction by discussing the difference between 'trust' and 'confidence'. Confidence refers to trust in the institutional environment, and '*this is at the same time confidence in the robustness and "tightness" of the social system*' (Nooteboom, 1999, p. 27). With respect to trust on the personal level, he refers to 'behavioral trust', which is trust in people. An interesting question posed by Nooteboom is how trust can be understood on an intermediate level, namely the organizational level. He argues that '*organizational trust is a constellation of behavioural trust, with organizational structure and culture acting as institutions that limit and guide behaviour of staff*'. Later on, Nooteboom refers to this organizational trust as 'system trust', while other authors use this term when referring to the higher level. This might be confusing, and therefore I propose to use the term 'personal trust' on the individual level, 'organizational trust' on the organizational level and 'system trust' on the level of the 'socio-economic system'.

The research model used in this study (see Chapter 3) focuses on the personal and organizational levels when dealing with franchise relationships as inter-organizational relationships in which individuals interact with each other. The case study results show that the different levels of trust have indeed played a role in the franchise partners' responses toward each other. Therefore, they are discussed in the concluding Chapter (Chapter 9).

Contributions to franchising research

As already indicated, franchise relationships are mostly considered from economic perspectives that rather focus on efficiency and governance structures than on the social-psychological processes and the role of trust in these relationships, while these factors may play an important role in the interactions between the franchise partners. Especially when partners engage in exploration activities of which outcomes are uncertain a certain degree of trust between them is needed because one cannot foresee the returns to be shared.

It has been argued that different perspectives might have different degrees of relevance in different forms of alliances. Franchise relationships are mostly governed through tight formal instruments, such as an extensive franchise contract, which explains the fact that only few researchers have studied the role of social processes in franchise relationships. However, since contracts can never be entirely complete and monitoring the compliance of the agreement can be difficult, there will always be some room for opportunism for both partners. Therefore, a relevant question is how social-psychological issues, such as trust, play a role in the interactions between franchise partners.

2.6 Cognitive/interpretive perspective

2.6.1 Key ideas

In recent years, the cognitions of strategic decision makers have received increasing attention from researchers (cf. Schwenk, 1988, Koza and Thoenig, 2003, Baron, 2004). It is now recognized that subjective factors influence actors' perceptions of the environment and the organization, and, as a consequence, their strategy formulation and implementation. Therefore, many strategy researchers have started to adopt a 'cognitive perspective', which acknowledges that strategic choices are determined by the way strategists make sense of their environment, industry and their organization. Koza and Thoenig (2003) argue that by means of cognition parties define causal relationships, choice indicators, and time and space horizons. As a consequence, this process may provide implicit decision criteria and instigate actions and behaviors.

In an article about the cognitive perspective on strategic decision-making, Schwenk (1988) discusses four topics that are the most useful in gaining insight into the ways in which decision makers understand and tackle strategic issues. These topics are: cognitive heuristics and biases, strategic assumptions, cognitive frames ("schemata"), and analogy and metaphor. Schwenk argues that in understanding cognitive processes the concept of cognitive simplification is a useful starting point. He therefore refers to Simon's bounded rationality, which indicates that decision makers have to construct simplified mental models when dealing with complex problems. Decision makers start from strategic assumptions ('schemata'²) that form the basis for the way in which they represent these problems. These schemata serve as interpretive lenses that help the decision-maker analyze a situation and make decisions accordingly. However, cognitive limitations cause biases in the development of such schemata, which have an impact on the decision-making process. Over time, researchers have identified several biases and cognitive heuristics. For example, 'selective perception' means that expectations bias observations of variables that are relevant to strategy. Schwenk also points at the role of analogies and metaphors; decision makers create meaning by drawing on earlier experiences or by comparing a strategic issue in their organization with situations in other organizations. Analogies and metaphors, which are of course also biased, influence strategic decisions. Moreover, as will be indicated below, parties also use them in a 'political manner': by means of using certain analogies or metaphors parties construct meaning on behalf of others and thereby exert influence (Bradshaw and Murray, 1991).

There is also the danger of myopia (Nooteboom, 2000). Nooteboom (p. 71) sees the firm as a focusing device; *'in order to achieve anything at all, a firm must direct and align perception, understanding, and evaluation by the people connected with it'*. However, focusing in one direction involves the risk of missing out on opportunities and threats coming from other directions. This is also argued by Schwenk; the use of certain 'schemata' always leads to some degree of myopia. Therefore, Nooteboom states that one needs complementary, outside sources of cognition, which are relevant but different. Such sources require a certain 'cognitive

² Schwenk also uses the term 'cognitive maps'. However, he argues that in the literature the difference between 'cognitive maps' and 'schemata' is not entirely clear. He considers a cognitive map as a particular type of schemata in particular situations, while schemata are in fact broader and more abstract conceptions of people with respect to the social world, which can be used in different problem situations.

distance'. This distance should not be too large because a certain common understanding is required, but it has to be sufficiently large to yield novel insights. As will be pointed out below, such a view is very interesting in the context of strategic alliance and franchising research, in which different strategic partners are involved.

A view closely related to the cognitive perspective is the so-called 'interpretive perspective', which assumes that reality is socially constructed (cf. Bradshaw and Murray, 1991, Koza and Thoenig, 2003). I consider the cognitive and interpretive perspective to be very closely related, because both refer to the construction of meaning by actors, which forms the basis of their actions and behaviors. Regarding the process of constructing meaning Bradshaw and Murray (1991) explicitly focus on the influence of other parties. They argue that an interpretive perspective can contribute to the understanding of 'organizational politics'. In this respect, there are two or more parties³, some form of interdependence between them, and the perception that divergent interests and potential conflicts exist. According to these authors (p.379), the interpretive perspective '*assumes that parties exert influence by constructing the meaning of what others experience*'. An interpretive perspective can be used to show how parties define their own identities and those of other parties, and how they interpret certain situations, such as developments in the environment and industry, or certain strategic issues. Bradshaw and Murray point out that parties influence each others' understanding by means of their language, myths, symbols, ideologies, normative systems, information control, metaphors, stories and humor.

2.6.2 Possible contributions to alliance and franchising research

Contributions to alliance and franchising research

A cognitive/interpretive perspective may contribute to alliance and franchising research because it helps understand how partners construct meaning for themselves and others in the relationship. The schemata that alliance partners adopt influence their strategic decisions and are therefore likely to influence their 'responses' toward their partners. Moreover, as pointed out by Bradshaw and Murray (1991), parties can construct meaning for others in order to exert influence. So, it is very likely that alliance partners also use such 'instruments' to influence the development of the alliance. One example from the case studies in this thesis is the use of the word 'franchising' itself. To many independent drugstore owners, this term still has a negative connotation. Therefore, the administrators of 'franchise systems' purposefully use other terms in their contacts with these drugstore owners in order to give them the impression that they are still independent⁴.

Moreover, in order to prevent myopia, parties need complementary, outside sources of cognition that are relevant but to some extent different (Nooteboom 2000). As indicated, they need a certain degree of 'cognitive distance' in order to learn from each other. In many types of alliances the following question is relevant; how much cognitive distance do the partners need? This is also interesting in the light of franchising research because the larger part of this literature considers the franchisor as the sole partner who makes the strategic decisions that have to be adopted by the franchisees. In other words, the current literature implicitly assumes that there is a small cognitive distance between franchisors and

³ These can be individuals, groups or other entities.

⁴ These administrators mostly used the Dutch term 'ondernemer', which has a positive connotation and gave the participants in the system the idea that they still were independent business owners, even though they were confronted with several obligations.

franchisees. The most important contribution of a cognitive/interpretive perspective to franchising research is therefore that it can help in understanding both the franchise partners' cognitions and perceptions and the way in which these influence the partners' responses in the relationship.

2.7 Game theoretical perspective

2.7.1 Key ideas

The origins of game theory can be traced back to the nineteenth century with the works of Cournot and Bertrand (Van Witteloostuijn, 2003). In 1944, Neumann and Morgenstern introduced the application of game theory as a way to model social and economic interaction. However, game theory in its pure form mostly consists of mathematical modeling which, according to Van Witteloostuijn, results in '*an incomprehensible mush of formulas*' (p.55). Nevertheless, he argues that game theory can provide a useful contribution to management literature, and he therefore considers its conceptual ideas as valuable focus points.

Game theory applies to situations involving two or more actors ('players') with interconnected interests. A typical example is an oligopolistic situation. The players have competing interests in terms of market shares, but a common interest in maintaining a high price. In such situations it is important for the player to consider how the other player is likely to respond. Game theory helps analyzing the 'strategies' that players can adopt in the game and the effects these strategies have on the game's outcomes. The term 'strategy' refers to how the player chooses to act when he has to make a decision. The types of games can vary in complexity depending upon the number of players, their interests (they may conflict, coincide or both), the information to which they have access, the number of games played and whether the players are allowed to communicate and to make promises, commitments or threats.

In a game, each partner may choose to cooperate or to defect, resulting in different outcomes of the game. The problem is that no partner has any knowledge of what the other partner will do. In that sense, an important contribution of game theory is the fact that it reveals reputation effects: the strategy of defecting could harm the defecting actor's reputation, which means that this player will be known as a partner who cannot be trusted in later games.

Game theory provides insights into situations in which (several) parties with interconnected interests interact. It forces researchers to think about the players involved, their motives, the strategies they can pursue and the possible benefits that may emerge from them. However, game theory is often criticized for its assumptions, which are considered too simplistic. Bachmann (2001) argues that game theory assumes that actors' behaviors are exclusively motivated by calculation, which is a simplistic view. According to Child & Faulkner (1998) several factors have not been incorporated in applying a game perspective which, next to the expected outcomes, should be taken into account in the understanding of strategies that players adopt in certain situations. These are factors such as the personalities of the players, their social ties, the communication between the players, the norm-building consequences of such communication, and the institutional rules in which the players and their interactions are embedded. As was pointed out in section 2.5, the social exchange perspective focuses on several of these factors, especially the presence of

trust in relationships between actors. With respect to the personality of the players, Van Witteloostuijn (2003) argues that in addition a 'humanized' game perspective is possible in which the individual characteristics of the players influence the strategies they adopt. These characteristics include for example, education, gender, personality and cultural background. Moreover, he pays explicit attention to the role of trust in game-theoretic frameworks. Because players always have conflicting interests and, therefore, may behave opportunistically, the role of trust automatically becomes an important issue that should be taken into account.

2.7.2 Possible contributions to alliance and franchising research

Contributions to alliance and franchising research

The contributions of game theory are also relevant to strategic alliances and franchise relationships, which can be regarded as a series of games played by partners. As already mentioned, a game perspective forces researchers to think carefully about the players involved, their motives, the possible strategies and the pay-offs resulting from them. Specifically, because strategic alliances actually involve a series of games, reputation effects become important (cf. Dixit and Nalebuff, 1991). Dixit and Nalebuff refer to an example where one player who tries a strategic move and then backs off might lose its credibility. They argue that in a once-in-a-lifetime situation reputation may be unimportant, but since in general there are several (potential) players at the same time, or the same players at different times, reputation effects do matter.

This study's research model distinguishes several types of responses that the franchise partners may adopt. This distinction is inspired by the 'strategies' in the game theoretic perspective.

2.8 Evolutionary perspective

2.8.1 Key ideas

According to Aldrich (1999), an evolutionary perspective can help explain how particular forms of organizations come to exist in specific kinds of environments. Central to this understanding are the processes of variation, selection, retention and diffusion, and finally, the struggle over scarce resources. These processes can occur at several levels, such as the level of routines, the level of resources and/or competencies (depending on the definition), the organizational level, the inter-organizational level or the level of organizational populations. These processes can be described as follows:

- Variation. Variation refers to the change of current routines or competencies. Variations can be either 'intentional' or 'blind'. Intentional variations are variations that people or organizations make deliberately in an attempt to generate alternatives or to seek solutions to problems. These variations often result from formal programs of experimentation or incentives offered to employees. In other words, the possibilities of variation may be institutionalized in the organization. In contrast, rather than deliberately designed, blind variation is the result of accidental events, such as accidents, misunderstandings, chance, conflict, luck or idle curiosity.
- Selection. Selection concerns the '*differential elimination of certain types of variation*' (Aldrich, 1999, p.22). Through the process of selection some variations are selected while others are not. A distinction can be made between external selection and

internal selection. External selection refers to forces outside the organization that have an influence on which variations are selected and which are not. Examples are market forces, conformity to institutional norms or competitive pressures. Internal selection takes place by forces inside the organization, for example pressures within the internal organization that encourage internal stability and cohesion.

- Retention and diffusion. This is the process of retaining and replicating or diffusing the variations that are selected. According to Aldrich (p.30), '*retention occurs when selected variations are preserved, duplicated or otherwise reproduced so that the selected activities are repeated on future occasions or the selected structures appear again in future generations*'.
- Struggle for resources. This refers to the contest of obtaining scarce resources. According to Aldrich, the struggle for resources puts extra pressure on the processes of variation and selection because not all variations can be selected.

Analytically, the abovementioned processes could be separated into discrete phases, but in practice they are linked together in continuous feedback loops and cycles.

The evolutionary perspective contributes in gaining insight into strategy because of its more 'dynamic' perspective on organizations in which both exploration (variation) and exploitation (selection, retention, diffusion) are incorporated. The possible contributions of the evolutionary perspective are the following:

- It can encompass several levels. According to Aldrich (1999), the evolutionary perspective is an overarching perspective, flexible enough to serve as a framework in which other approaches can be combined. Therefore, the evolutionary perspective is highly suitable for an interdisciplinary approach.
- Stoelhorst (1997) argues that it is surprising that there have not been more attempts to ground theories of strategy in evolutionary reasoning. He states that after all competition is at the core of evolution theory, and adaptation, which is similar to achieving environmental fit, is one of its central concepts. Moreover, an evolutionary approach enables one to understand dynamic organizational change processes by distinguishing the four evolutionary processes.

Aldrich (1999) points out that some (social) scientists still consider the term 'evolutionary' in a negative way. He argues that this has mainly been caused by '*authors who confused old-fashioned social Darwinist ideas with modern evolutionary ideas*' (p.21). Some authors have remained too close to the biological idea of evolution, which has led to misunderstandings. Nooteboom (2000) also states that the biological metaphor of evolution can be quite misleading, and he presents a list of differences between socio-economic evolution and biological evolution (Nooteboom, p. 83). For example, it is not clear what exactly the 'genes' or 'species' are in a socio-economic model of evolution: are they firms, products, organizational routines, values, norms etc.? As pointed out, the evolutionary perspective can be applied to several levels, and researchers themselves can specify the 'genes and species' in their studies. A second difference is that socio-economic evolution has certain characteristics, such as culturally-embedded, shared, tacit categories of perception and thought as well as norms of conduct that influence variation, selection and retention processes. These do not occur in biological evolution. Aldrich (1999) argues that the evolutionary perspective can and should be complemented with other perspectives on organizations, such as an interpretive perspective or the organizational learning approach. For example, from a cognitive/interpretive perspective (see section 2.6); variation occurs

when people create meaning through interaction, selection may be the result of obtained insights and compromises, while retention depends on learning and sharing.

In recent years, several authors have adopted a so-called 'co-evolutionary' perspective (cf. Lewin and Volberda, 1999, Koza and Lewin, 1998 and 2000, Das and Teng, 2002). According to Lewin and Volberda (1999), most research on the evolution of organizations involves studies of short-term adaptations and retrospective case studies or panel studies. Moreover, when studying processes of variation, selection and retention, strategy and organization researchers take environmental change as an exogenous variable, while there are only few scholars who actually examine how organizations systematically influence their environments and how environments (consisting of other organizations and populations) influence those organizations in return. Lewin and Volberda argue that a 'co-evolutionary perspective' is required and they define co-evolution as '*the joint outcome of managerial intentionality, environment and institutional effects*' (1999, p. 526).

They argue that co-evolutionary research can be conducted by starting from several theoretical perspectives, such as the resource-based or transaction cost perspective. However, they point at several essential requirements for adopting a co-evolutionary perspective. Co-evolutionary studies should study organizational adaptations over a long period of time and within a historical context. They should consider 'multidirectional causalities' between variables, 'non-linear effects' (as a result of feedback flows) and path dependence (because this both enables and restricts adaptation). Finally, co-evolutionary studies should take into account changes occurring at the level of different institutional systems and economic, social and political macro-variables.

This study adopts a co-evolutionary perspective in the sense that franchise partners interact by means of 'responses' toward each other. The partners adopt these responses when changes are proposed (by one of the partners). Next, the responses will influence whether, how and what changes actually take place. This study does not take into account the influence of environmental variables, but it incorporates the partners' perceptions of the environment (see cognitive/interpretive perspective), because these influence the partners' responses in the relationship.

2.8.2 Possible contributions to alliance and franchising research

Contributions to alliance research

Aldrich (1999) points out that in a large number of domains major tasks are performed by interdependent organizations rather than by single organizations, and that in understanding the development of interfirm relationships an evolutionary perspective can be adopted.

In recent years, several authors have advocated a 'co-evolutionary' approach in studying alliances (cf. Koza and Lewin, 1998, Das and Teng, 2002). Das and Teng (2002, p.726) argue that '*co-evolution refers to the simultaneous development of organizations and their environment, independently as well as interactively.*' Moreover, alliances differ a great deal from formal organizations or hierarchies in terms of their evolutionary processes. The interactions between an organization and its environment are much more complicated when an alliance consists of two or more partners than when single organizations are involved. Therefore, they argue that understanding the developmental processes of alliances requires more than just envisioning several stages; it requires an understanding of how both partners co-evolve with each other.

Contributions to franchising research

As far as I know, in the research on franchise systems and franchise relationships an evolutionary perspective has never been explicitly used. As indicated, an evolutionary perspective can be applied to several levels on which variation, selection and retention take place. In this section, I will elaborate on how the evolutionary perspective has inspired this study. It has done so with respect to the following two issues:

- Variation, selection and retention of business format elements.
- Variation, selection and retention of franchisees within a franchise system.

These two issues are discussed below.

Variation, selection and retention of business format elements

As explained in section 1.2, the ‘business format’ of a franchise system reflects a certain identity in the market, and consists of four main elements: product/service deliverables, benefit communicators, system identifiers and format facilitators. At a more detailed level, these main elements again comprise several elements; for example, the product/service deliverables consist of various product groups or services offered to customers. When applying an evolutionary perspective there can be variations in these elements, and the question is why and how certain elements are either being selected or not and why and how they are replicated through the franchise system.

Winter and Szulanski (2001) implicitly discuss these processes in their article ‘Replication as Strategy’. They state that ‘replicators’ search for and experiment with variations in their ‘business model’ (exploration) to learn which variations actually work and which do not work. On the basis of this knowledge they select certain variations. After that these are replicated on a large scale (exploitation). A difficulty here is that the business model and its elements have to be replicated at locations often subject to (slightly) different environmental circumstances. Therefore, what may ‘fit’ at one location may not fit at another. One additional complicating factor, not pointed out by Winter and Szulanski, is that former retentions might influence the selection of new variations. In other words, Winter and Szulanski assume that the replicator starts from scratch, while in reality locations have a ‘history’ that has an influence on which variations may be adopted by these locations. In a franchising context, often locations (franchisees) have already used a particular business format for a considerable number of years, which might make the introduction of a completely new business format more difficult.

As was already argued, franchise systems serve as a good example of a replication strategy, but replication through franchising is even more difficult than replication in a hierarchical situation, because franchisees have their own ideas, objectives, and personalities. This also shows that replication in a socio-economic system is different from replication in a biological system (as was explained in section 2.8.1).

Variations in franchise systems are sometimes deliberately suppressed by the franchisor because it wants to preserve a uniform presentation toward the customers. This is in line with one of the five franchise system characteristics discussed in Chapter 3, namely the system’s ‘*degree of hardness*’. Franchisees in a hard franchise system have little room for local variation or exploration, because the franchisor wants to maintain uniformity and exploit its own business format. As pointed out, there is always tension resulting from different environmental circumstances.

Another tension on the part of the franchisor is the tension between maintaining the business format constant over time (exploitation) and making adaptations to it for the benefit of the system as a whole (exploration) (Bradach, 1998, see also section 3.2). In some cases variations may occur, for example through a discovery by a local franchisee

(‘blind variation’) or by a special working group (‘intentional variation’). The franchisor faces the challenge of deciding which variations should be selected and replicated (exploited) by the whole franchise system⁵. In this thesis, this tension is reflected by one of the five franchise system characteristics, namely the system’s ‘*rate of innovation*’ (see section 3.2.3).

It has already been mentioned that variations can either be blind or intentional, and that organizations may make use of formal experimentation programs or incentives for experimenting employees. Because in franchise systems franchisees generally have little room for local variation (exploration), the franchisor might want to benefit from their ideas with regard to variation by means of a Franchise Board or working groups. This is also reflected by one of the franchise system characteristics that will be discussed later on, namely ‘*the organization of franchisees’ strategic participation*’ (see section 3.2.4).

Variation, selection and retention of franchisees within a franchise system

Another way of looking at evolution within franchise systems is by paying attention to changes in the group of franchisees within a certain franchise system. A relevant question in this context is: why and how does the composition of franchisees within a franchise system change over time? Why are some franchisees ‘selected in’, and why do certain franchisees stay in the system and others not?

This study’s research model proposes that both franchise partners, who adopt certain responses toward each other, influence the selection and retaining processes. Ending the franchise relationship is one possible response that can be adopted by both franchise partners, which influences the composition of the franchise system in terms of franchisees.

The franchise partners’ responses are influenced by several motives and processes that are pointed out in the other theoretical perspectives, such as the resource perspective, the transaction costs perspective, the agency perspective and the social exchange perspective.

2.9 Other perspectives

So far, the perspectives most often used in alliance research have been discussed. However, some additional comments should be made based on the franchising literature in specific.

First, a recurring topic in this literature concerns the legal aspects of franchising, such as specific contractual clauses or a case law discussion about franchising (cf. Van der Heiden, 1999). Such literature often addresses the ‘wider institutional environment’ in which franchise systems and franchise relationships operate. This study has not explicitly adopted a ‘legal perspective’, but acknowledges that this environment can influence interactions between the franchise partners.

Second, in the small business and entrepreneurship literature franchising is often approached from an ‘entrepreneurial perspective’. In recent years, the field of entrepreneurship has grown dramatically, both in terms of courses taught and research conducted. The term ‘entrepreneurship’ has been in use for several centuries, but as a discipline it is still underdeveloped. Researchers are still debating about important issues, such as the definition of entrepreneurship, relevant levels of analysis, and the nature of the entrepreneur (Morris et al, 2001). According to Shane and Venkataraman (2000),

⁵ I would like to emphasize that the franchisor may decide to replicate a certain business format element, but this does not mean that this will actually happen because the franchisees might not be willing to adopt it. In these instances, ‘social aspects’, such as power, negotiation and trust, play an important role.

‘entrepreneurship has become a broad label under which a hodgepodge of research is housed. What appears to constitute entrepreneurship today is some aspect of the setting (e.g. small businesses or new firms) rather than a unique conceptual domain. As a result many people have had trouble identifying any distinctive contribution of the field to the broader domain of business studies.’

Entrepreneurship researchers have studied a wide range of topics. For example, Bull and Willard (1993) distinguish the following five fields in which entrepreneurship research takes place: the definition of entrepreneurship and the function of entrepreneurs, characteristics of entrepreneurs, success strategies of entrepreneurs, the start of new ventures and the effects of external factors on entrepreneurship. Additionally, Kaufmann and Dant (1998) indicate that entrepreneurship entails a set of overlapping constructs, such as change management, innovation, technological and environmental turbulence, and new product development. They argue that the most common themes in the conceptualizations of entrepreneurship are acts of innovation and risk-taking behaviors. Because of this wide array of topics it is not surprising that in the research on entrepreneurship several disciplines have been used of which the most important ones are psychology, economics and sociology. Less significant disciplines are, for example, history, finance and social anthropology (Van Dijk and Thurik, 1998).

With respect to franchising and entrepreneurship research, Kaufmann and Dant (1998, p.5) pose the following question: *‘What is it about franchising that uniquely qualifies it as an entrepreneurial activity?’* They argue that some authors take the connection between franchising and entrepreneurship for granted, while to others *‘franchising is the antithesis of innovation, which represents the lamented homogenisation of our commercial culture, and which is singularly responsible for the lack of variety in a number of retail sectors’* (p.6).

Kaufmann and Dant consider the franchise relationship as an entrepreneurial partnership in which both franchisor and franchisees play ‘entrepreneurial roles’. They indicate that both franchisors and franchisees have to deal with constantly changing environments that pose new challenges and opportunities but are also risky. This thesis adopts the same view by acknowledging that both franchisors and franchisees run risks by investing resources in something new. The franchisor does so by investing resources in the development of a business format and an operating system in a manner that permits an efficient and turnkey transfer to the franchisees. The franchisee is a small business owner who runs a financial risk by adopting the franchisor’s business format in a location subject to specific environmental circumstances.

2.10 Conclusions with respect to perspectives

In the preceding sections several theoretical perspectives have been discussed that help in understanding different aspects of relationships between alliance partners in general and franchise partners in specific. It has become clear that each perspective has its own contributions and limitations in strategic alliance and franchising research. This has increasingly been acknowledged in the literature on strategic alliances but less in the franchising literature. This section summarizes and discusses how these perspectives can contribute to gaining insight into the interactions between franchise partners when dealing with the exploration/exploitation paradox.

As was discussed in section 2.8 (evolutionary perspective), ‘replicators’ have to deal with two types of tension that relate to the exploration/exploitation paradox. The first type refers to maintaining a uniform presentation of the business format across all units (exploitation) versus allowing local adaptation by individual units (exploration). Second, there is the tension of keeping the business format constant over time (exploitation) versus

making system wide adaptations (exploration). As was pointed out, dealing with these tensions is even more complicated for replicators operating in collaboration with franchisees. Franchisors and franchisees are engaged in a strategic alliance in which they have to deal with the 'issue of governance'; they aim at creating mutual advantage through the cooperation, but at the same time they have to deal with dependency risks.

From a resource perspective, this study builds on the idea that franchisors and franchisees can create mutual advantages because they have complementary resources. From the franchisor's point of view, the franchisee is a provider of financial, managerial and entrepreneurial resources. As far as the franchisee is concerned, the franchisor's most important resource is the business format, which consists of a certain identity toward customers and a certain degree of back office support. As already indicated, the resource-based perspective has mainly been used as a relatively static perspective focusing on the exploitation of existing resources, while a dynamic capabilities perspective also pays attention to the exploration or development of new resources. In this study it is recognized that the partners may want to engage in explorative activities (such as adapting the business format), which could result in changes in the relationship leading to specific responses of the partners toward each other.

The resource dependence perspective pays attention to the issue of dependence in a relationship. In contrast with the resource-based perspective, the resource dependence perspective acknowledges that when it comes to their resources organizations are largely dependent on other organizations. It recognizes that partners offer a certain 'value' to each other depending on their resources. The higher this value is, the higher the degree of dependence between the partners. Additionally, according to the resource dependence perspective, in assessing a partner's dependence the role of alternatives and the height of switching costs should be taken into account. This degree of dependence influences the 'actions' or responses that partners undertake in the relationship. As Chapter 3 will point out, this study's research model takes into account the 'value' that the partners have to offer each other, the attractiveness of alternatives and the costs of switching to these alternatives. It is proposed that the franchise partners' perceptions regarding these elements influence their responses toward each other.

The partners' dependence forms a risk because partners may behave opportunistically in the relationship. This possibility of opportunistic behavior is incorporated in the agency- and TCE perspective, which focuses on the instruments to deal with this issue, such as economic incentives and contractual safeguards. Additionally, issues of trust and social interactions have been incorporated in this study because research has shown that, apart from the more formal instruments, trust is a relevant element in the governance of relations. The social exchange perspective does take into account issues of trust and has therefore been adopted in this study. Moreover, this perspective integrates socio-psychological processes of sensemaking, which are also important from a cognitive/interpretive perspective. This study proposes that the cognitions and perceptions of partners in a relationship influence the way in which they respond to each other.

Finally, this chapter has discussed the game theoretical perspective because it has often been used in alliance research. However, this study has not actually adopted this perspective, but it has been inspired by the idea that partners adopt certain 'strategies' in the relationship and that one partner's strategy (response) influences the other partner's response.