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Strategic Interactions in Franchise Relationships

Croonen, Evelien Petronella Maria

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7 The ETOS system

Section 1 introduces the SCTs of ETOS, and sections 2 up to and including 5 discuss the development of the franchise partners' perceptions of the independent variables. The indicators used for establishing these variables are summarized in Appendix 2. Section 6 discusses the mutual responses adopted by the franchise partners during both SCTs. Next, section 7 will take a closer look at individual franchise relationships by analyzing which independent variables actually influenced the responses of the franchise partners. Finally, section 8 presents the three types of conclusions (see section 4.3.5) based on the ETOS system and its SCTs.

The abbreviations used in this Chapter are explained in Appendix 11.

7.1 Historical sketch of ETOS and an introduction to its SCTs

7.1.1 Historical sketch of ETOS

The history of ETOS goes back to 1918 when personnel of the Philips company in Eindhoven started a cooperation with stores to provide them with their day-to-day groceries. These stores (drugstores, groceries, gasoline stations and butcher's shops) gave the Phillips personnel the opportunity to shop cheaper. In 1931, the stores were privatized under the name of ETOS, which is an abbreviation for the Dutch terms 'Eendracht, Toewijding, Overleg, Samenwerking'. Translated into English this roughly means: Union, Dedication, Consultation, Cooperation. At that time, these stores were not only drugstores; the other stores also used the ETOS name.

In 1973, the Dutch chain of Albert Heijn supermarkets took over all ETOS stores. The ETOS grocery stores were changed to Albert Heijn supermarkets and the drugstores continued under the ETOS name. Albert Heijn and ETOS became subsidiaries of the Ahold corporation, also founded in 1973.

For several years, the ETOS drugstore system had solely consisted of company-owned stores. However, in the mid-1980s, a druggist agreed with ETOS upon becoming an ETOS franchisee, and, after several negotiations, the ETOS management and the druggist started experimenting with franchising. In 1988, after two years of experimentation, the druggist actually started as an ETOS franchisee. In later years, the number of ETOS franchisees grew steadily.

As pointed out, ETOS BV is one of the subsidiaries of the Ahold corporation (see Fig 7.1). Other Dutch Ahold subsidiaries are, for example, Albert Heijn BV (supermarkets) and Gall & Gall BV (liquor stores). These companies also have their own franchise systems and operate according to the Albert Heijn and Gall & Gall business format. Additionally, Ahold has various international subsidiaries and is a major shareholder in companies in various countries around the world.

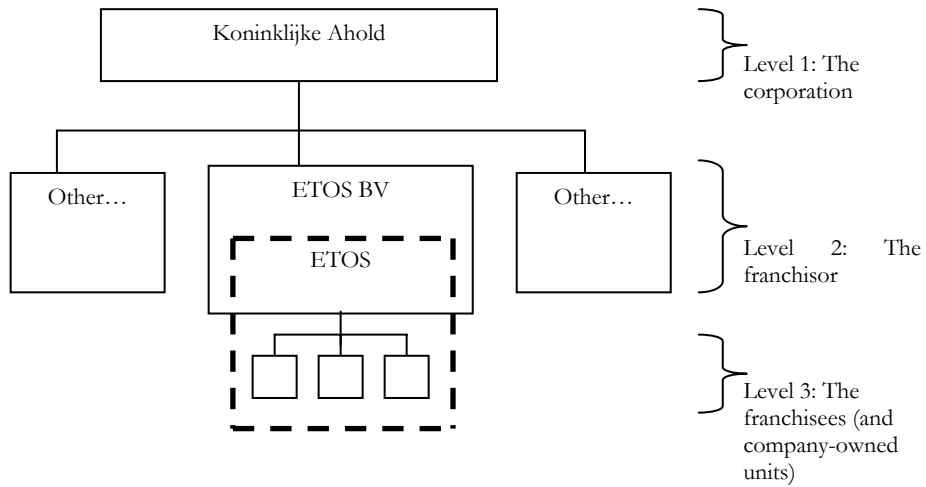


Fig 7.1: Levels of analysis in the ETOS system

This chapter focuses on two strategic change trajectories (SCTs) that occurred at ETOS. SCT5 concerns the stunting with prices of luxury perfumes in the mid-1990s ('Two-front attack' see section 7.1.2), while during SCT6 a completely new business format was introduced, namely the 'Four Worlds format' ('Introduction of Four Worlds format' see section 7.1.3). The management during SCT5 is referred to as management5, and the management during SCT6 as management6.

Fig. 7.2 depicts the developments at ETOS in a general time line. The different formats represent different ways of positioning in the market (see section 7.2.1). It should also be noted that the development of one format into another took place more gradually than presented in Fig 7.2: such changes often took several years.

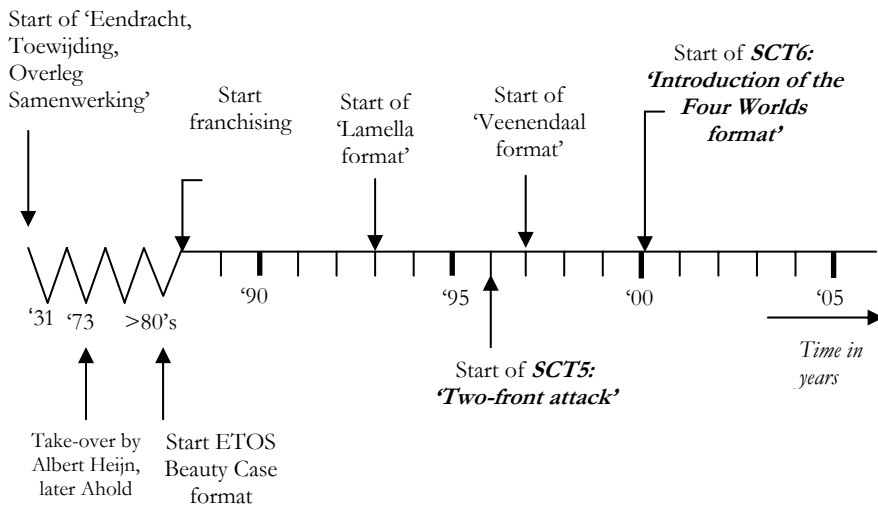


Fig 7.2 A general time line of the ETOS system and its organization

7.1.2 Introduction to SCT5: 'Two-front attack'

Before the acquisition by Ahold, the ETOS drugstores had operated as hard discounters. However, these discounting activities were not in line with the general Ahold strategy, and through the introduction of more product groups and adapting the prices accordingly ETOS gradually evolved into a soft discounter. In the mid-1980s, management decided to start upgrading the ETOS business format by combining the regular drugstore assortment with a more luxury assortment consisting of perfumes and cosmetics, such as Dior and Chanel. Through this new format, management aimed at creating an image of luxury and quality. It was named 'ETOS Beauty Case'. At that time, a combination of this kind was relatively new: perfumes were mostly offered by perfumeries often owned by individual small business owners. By introducing the Beauty Case format, management decided to dispose of certain low margin product groups, such as baby food and diapers, and to replace them with luxury perfumes. However, management soon noticed that the Beauty Case format was difficult to implement for three reasons:

- The ETOS stores needed the low-margin drugstore product groups to build 'traffic': they needed to sell these products in high volumes to attract customers.
- It turned out to be difficult for the ETOS stores to take up the luxury perfumes in their assortments because their suppliers applied a so-called 'selective distribution'. This meant that only some drugstores and perfumeries, often owned by independent business owners, were granted the right to sell these perfumes. The luxury suppliers did not want to supply their products to ETOS, because the ETOS stores did not meet their high requirements.
- The personnel at the ETOS stores was not used to selling luxury cosmetics and perfumes; they were more acquainted with selling mass-products, such as toothpaste and sanitary towels.

For a long time, ETOS had only consisted of company-owned stores, but in 1988 it started with franchising. After the first franchisee had started, management began to attract more franchisees because it saw in franchising a possible solution to the problem of the luxury suppliers, and an opportunity to attract good personnel acquainted with selling luxury perfumes. Management looked for specific kinds of drugstore owners, or as a former CEO put it: *'We searched for drugstore owners with a relatively great deal of luxury perfumes in their stores compared to other drugstore owners. These were mostly the DA druggists... In the period I was CEO I attracted about 30 franchisees. But there were too little of the type I was looking for. And after three years I advised Ahold to give up the upgrading idea and start downgrading ETOS a little bit.'*

The problems with the luxury suppliers and the personnel could not be solved, and the desired upgrading by means of the Beauty Case format did not work out. As a result, management reintroduced the low margin product groups, left out the luxury perfumes, and adapted the store interior. These adaptations gradually resulted in what management internally called the 'Lamella format'. The Lamella format was followed by what ETOS called the 'Veenendaal format'⁵⁹. Both the Lamella and the Veenendaal format were placed

⁵⁹ The Lamella format, the Veenendaal format and the Four Worlds format were all names that were used internally and that were not communicated to the customers. The customers had always known the ETOS as ETOS, and, for a short while, as ETOS Beauty Case. This name was used for a short period of time to indicate a higher positioning. During the gradual change to the Lamella format, the Beauty Case part was removed.

in a middle position of the market, and the main differences between these two formats concerned the store appearance, such as the colors, and a certain way of presenting the assortment. The Veenendaal format was called this way because the first store operating according to this format was introduced in the Dutch town Veenendaal. The Lamella and Veenendaal format represented the traditional drugstore assortment with only few luxury perfumes. Some franchisees offered a broader assortment of luxury perfumes, which was based on their own individual contracts with luxury suppliers, and the availability of luxury perfumes did no longer form part of the format on the national level. From that time, ETOS was more positioned in the middle market, and management experienced a 'squeeze' between the lower end of the market dominated by Kruidvat and the higher end dominated by DA. Management thought of ways to remedy this squeeze. The trajectory introduced at that time is called SCT5 in this study. It consisted of the stunting with prices of luxury perfumes by ETOS. By price stunting management tried to attack ETOS' most important competitors on two fronts: the lower end of the market by means of the price stunting activities and the higher end by stunting with luxury perfumes. The price stunting was not the introduction of a completely new business format, but a specific adaptation of the business format throughout the whole ETOS system.

Management⁵ considered the market as consisting of three product groups: health (non-prescription drugs), care and cosmetics/perfumes. Because of legislation it was difficult to attract attention through the health product group, and the care product group was already confronted with a broad range of actions by competitors. Additionally, around that time, a supply of luxury perfumes became available abroad resulting from a decrease in demand and an increase in stocks, and management saw the opportunity to import these perfumes and sell them at lower prices (parallel import). So, management⁵ tried to attract the customer's attention by means of cheap luxury perfumes, priced at about 20% to 80% of the recommended retail prices.

In 1996, at the outset of the price stunting all went well, since ETOS had a first mover advantage. The stunting gave ETOS a great deal of free publicity, for example in television programs. According to a former manager, it gave ETOS a head start of about two years. However, after some time, competitors copied the idea and also started offering luxury perfumes at lower prices. For ETOS it now became difficult to import the perfumes, because the stocks for parallel import had considerably decreased. Additionally, due to the price stunting the relationships between ETOS and the luxury suppliers had deteriorated and the latter did no longer want to supply to ETOS. These problems led to the termination of the price stunting in 1998.

7.1.3 Introduction to SCT6: 'Introduction of the Four Worlds format'

After the termination of the price stunting, ETOS again found itself in the squeeze between Kruidvat and DA. Therefore, in 1998, the executive board of the Ahold corporation called for a new ETOS management (management⁶) to develop a new business format that would make ETOS more distinctive in the market.

Management⁶ was of the opinion that ETOS had been stuck-in-the-middle in the years before. It was convinced that ETOS could not win the discount-race. Kruidvat had always been an important player, and together with Trekpleister, Dirk and Schlecker the discount part of the market was covered. Therefore, management considered a higher positioning, with a high added value. Moreover, this would be more in line with the strategy of the other franchise systems of the Ahold corporation, such as Albert-Heijn and Gall & Gall.

DA and DA D'Attance largely dominated this higher end of the market. However, according to management⁶, these systems had one weakness, which was a lack of uniformity in the market. Management⁶ wanted to build a new value-adding health and beauty brand that would be uniform in the market. This would be reflected in the ETOS Four Worlds business format. In the words of the CEO: 'By applying this Four Worlds format we want to become the queen of health and beauty'.

The change to the Four Worlds business format is called SCT⁶ in this study. It was a completely new business format containing a new store interior, exterior and assortment. In the Four Worlds format the store was divided into Four Worlds: earth, water, fire and air. Every world had its own color that represented a product group related to health and beauty. In 1998, management⁶ had started to develop the new business format, and in 2000 –after several experiments- it began to diffuse the business format through the entire franchise system. As from January 2000, it decided to renovate the stores according to the Four Worlds format. The format was applied at stores that were relocating or that needed to renovate anyway, and at new stores within the ETOS system. In May 2003, management started to accelerate the introduction of the Four Worlds format, aiming at the whole system to be transformed by the end of 2006.

7.2 Strategic compatibility

This section discusses the strategic compatibility between the franchise partners with respect to the five franchise system characteristics. Each subsection consists of the following parts: '*What the franchisor wanted*', '*What franchisees wanted*', and '*What actually happened*'.

7.2.1 Strategic compatibility regarding positioning during SCT⁵

What the franchisor wanted

As pointed out, the high positioning of the ETOS Beauty Case format did not succeed and gradually it changed to a positioning more in the middle of the market. As a result, management⁵ experienced a squeeze between the higher and lower end of the market, and it searched for ways to distinguish ETOS from its competitors. It tried to do this by the price stunting with luxury perfumes.

The price stunting was a way to attract attention in the market, but it was not a completely new positioning, as was also the case with the Four Worlds format. The price stunting was executed with luxury perfumes only because management saw an opportunity there.

What the franchisees wanted

To the majority of the ETOS franchisees the price stunting only meant the addition of a product group to their assortment which they had not had before: the luxury perfumes. That is why they were very happy with the price stunting. However, for a small group of franchisees the price stunting meant that they drastically had to lower the prices of luxury perfumes that they already had in their assortments. In the late 1980s and early 1990s, a former management had attracted these franchisees in an attempt to meet the requirements of the ETOS Beauty Case format, and, suddenly, ETOS asked of them to offer these luxury perfumes at lower prices and lower margins. Moreover, these franchisees faced a

high risk of damaging their established relationships with their suppliers, which actually happened. In sum, they were not happy with the price stunting. However, management convinced them to participate by explaining why it thought it was a necessary course of action and by laying down the expected costs and benefits. Management argued that the margins would remain favorable and that these lower prices would yield higher turnover levels by attracting more customers. According to a former manager, management⁶ had several fierce discussions with this small group of franchisees before they became convinced.

What actually happened

The price stunting worked out very well in the beginning; it gave ETOS a great deal of free publicity, high turnover levels and a head start with respect to competitors. However, after a while, the competitors also started to stunt with prices, and it became more difficult for ETOS to obtain enough perfumes by means of parallel import. Additionally, ETOS' stunting with prices caused bad relationships between ETOS and the suppliers of luxury perfumes. Even several years after the price stunting, these suppliers still refused to do business with ETOS, and also the individual franchisees who had always sold luxury perfumes had obviously suffered from the price stunting. Some of them still had contracts with the luxury suppliers, but it had cost them a great deal of effort to keep them. For the ETOS system as a whole, the termination of the price stunting meant that it was back at its middle positioning and therefore back into the squeeze between the higher positioned DA and the lower positioned Kruidvat.

7.2.2 Strategic compatibility regarding positioning during SCT⁶

What the franchisor wanted

The Four Worlds format constituted changes in most elements of the business format, such as the assortment, the store exterior and interior, promotion activities and service level. The most important changes were:

- Changes in the assortment. Regarding the assortment several steps were taken. First, several health- and beauty-related product groups were added, such as aromatherapy, food supplements and gifts. Second, according to management⁶ ETOS needed to compete in the areas of innovation and distinctiveness. An important strategy for achieving this was to sell products that were not offered by direct competitors or supermarkets. Examples of such special products were Boots, Mexx Colors cosmetics and hair products of British top hairdressers, such as Charles Worthington and Lee Stafford. In the Netherlands, these brands were only available at ETOS stores. Additionally, ETOS increasingly developed special products under the ETOS brand, such as home tests⁶⁰. In addition to the introduction of these new product groups, management⁶ wanted to dispose of several product groups that did no longer fit into the health and beauty assortment, such as cigarettes, dry cleaner service, hand bags, magazines and fake perfumes.
- The Four Worlds format meant a completely new store appearance that was supposed to give ETOS a more luxurious presentation. Anticipating on the introduction of the Four Worlds format, in the year 2000 management⁶

⁶⁰ These tests worked according to the same principle as pregnancy tests; by ETOS home tests people could test certain health issues at home, for example their cholesterol level.

introduced changes in the ETOS exterior and logo. During what was called ‘Operation Silverstorm’ all ETOS stores were changed to the new store exterior and logo within a few weeks. In line with the Four Worlds format the store interior as a whole was also changed to a more luxurious level with marble on the floor, wooden shelves and new lighting. However, management tried to maintain the low price expectations of customers by keeping a number of bright spots in the stores to highlight specific sales actions.

- A third change was the adaptation of the way of working. In March 2003, management started the ‘customer focus project’ to make sure that ETOS would ‘exceed the customers’ expectations’.
- Another new aspect in the Four Worlds format was the self-service for customers with respect to non-prescription medicines, which became possible thanks to changes in the legislation in this field.

What the franchisees wanted

The majority of franchisees approved of the renewed positioning, because they agreed it would give ETOS a more distinctive market position. However, initially, there were several franchisees who thought that the costs of investing in the new format were too high for them, and that the format would only be profitable above a certain turnover level.

What actually happened

In the year 2000, management⁶ started with the actual introduction of the Four Worlds format by renovating several company-owned stores and requesting new or relocating franchisees to change to this new format. In January 2003, about 117 stores had been changed to the new format, which were for the largest part company-owned stores.

In May 2003, management⁶ aimed at speeding up the diffusion of the new format. However, this process was delayed for several months because management started searching for a new store builder who could carry out the construction more cheaply, so the Four Worlds format could also be profitable in smaller ETOS stores with lower turnover levels. Therefore, several adaptations were made to make the renovation to the Four Worlds format less costly, such as cheaper materials and another store builder. As a result, the format was also expected to be profitable for smaller stores. Finally, the implementation of the format’s cheaper version started in August 2003 and was expected to be finished by the end of 2006.

A final factor mentioned by several franchisees was that although certain non-drugstore-related products, such as fleece jackets or jeans, were no longer desired in the stores, ETOS kept sending them these products. Some franchisees argued that this undermined the ETOS system’s aim of becoming a health and beauty brand.

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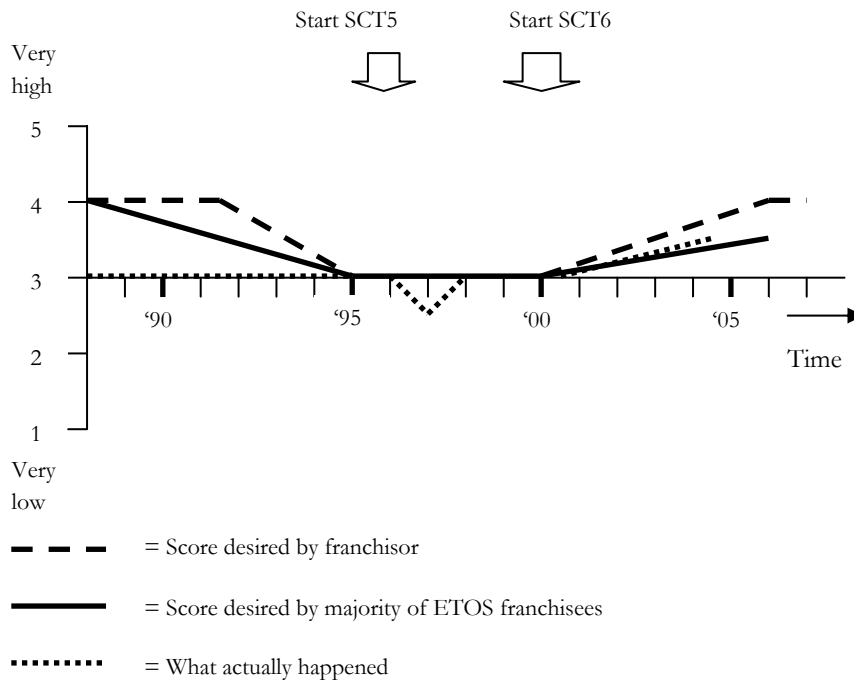


Fig.7.3: Timeline of positioning in the market

7.2.3 Strategic compatibility regarding degree of hardness during SCT5

What the franchisor wanted

When ETOS decided to start franchising it used the franchise contract of Ahold's subsidiary Albert Heijn as point of departure. Except for some details, this contract was a copy of the Albert Heijn franchise contract. As a result, the franchisees' requirements regarding certain elements of the business format, such as store appearance, and assortment, had always been part of the ETOS franchise contract. However, in the early years of franchising, management's enforcement of the rules of the contract had been less strict in order to realize a certain growth of the system. According to a former manager: *'In the beginning we deliberately decided to provide more room for local exploration and initiatives because it gave us the opportunity to attract more franchisees among independent druggists. For these druggists it was a huge step to enter the ETOS system, because by doing so they would start to cooperate with their enemy... In the 1980s, we obviously were the enemy of independent druggists and in those times it was not done to cooperate with the enemy... We had a good product, we made more turnover and profits, but we often had to cross a certain emotional barrier'*. In sum, because its aim was to attract new franchisees, management had been not so strict in enforcing the rules of the contract, at least not with respect to store appearance. Management wanted to introduce price stunting in the system, but first it wanted to consult with the small group of franchisees who already sold luxury perfumes.

What the franchisees wanted

At the time of the price stunting, the franchisees did not really consider ETOS as a hard system because the franchisor did not strictly enforce all the rules. The franchisees felt that

they still had a lot of freedom. Several franchisees had come from DA in the early and mid-1990s, and they had only been asked to make some adaptations to their stores. According to one franchisee who was a member of the Franchise Board: *'When you had a DA store and you put some ETOS stickers on it, you suddenly had an ETOS store. At a given moment, we (the Franchise Board, EC) had made visits to various stores in the Netherlands, and we saw six types of tiled pavements, three types of carpet etcetera. We thought it was a mess. So then we went to the management team, and said that we really needed to be stricter in enforcing the ETOS format. And they said: "Are you serious?"'. They were glad we had told them.'* In sum, a number of franchisees were of the opinion that the system should become harder, while the others mostly agreed with the way things were.

What actually happened

Compared to other franchise or franchise-like systems in the Dutch drugstore industry, ETOS was a relatively hard system in terms of contractual requirements. However, in reality the enforcement of the rules of the contract was not so strict, and the franchised ETOS stores highly differed from each other. This situation would last until a new management started in 1998.

7.2.4 Strategic compatibility regarding degree of hardness during SCT6

What the franchisor wanted

As mentioned earlier, the business format elements had always been laid down in a franchise contract and a handbook, but the enforcement of the rules of the contract had always been relatively loose. The year 1998 was an important turning point in this respect. When the Four Worlds format was developed, uniformity in the ETOS system became important in order to comply with ETOS' image as health and beauty brand. Therefore, management⁶ decided that from that point on the rules of the franchise contract and the format handbook had to be enforced more strictly.

The franchise contract specified the franchisees' requirements regarding selling a basic assortment in their stores and offering all products attached to promotion activities initiated by the franchisor. The displays and store material to support these promotions became obligatory. Additionally, some products connected to promotion activities were automatically sent to the franchisees. However, one important rule was that the franchisees always had the right to return the automatically-sent products that were not sold. As will be pointed out in section 7.3, this positively influenced the franchisees' trust in the franchisor.

Probably the most important change in the degree of hardness at the time of the Four Worlds format was that certain product groups were no longer allowed. For example, some franchisees had dry cleaning services and sold food products in their stores, which was no longer allowed. Management⁶ tried to convince the franchisees not to sell these products in their stores. According to one manager: *'We always aim at consulting with the franchisee. You have to exchange information with them. And finally they will understand. But we never force them to make these decision (these' refers to the disposal of certain product groups, EC)'. In 2004, management⁶ planned to specify more clearly which product groups were allowed in a new franchise contract, and which ones were not.*

What the franchisees wanted

The majority of franchisees did not have too many problems with ETOS' increasing degree of hardness. Several franchisees said that they did not even notice an increasing degree of

hardness. One said: *'You have chosen to become ETOS, so you must not say I will not stick to their rules. But even when we do not stick to them that is still no problem for us. We have certain product groups that ETOS does not have in its assortment, like cuddly toys. We purchase these in our own way, and nobody complains about that.'*

It is important to note that the degree to which the franchisees were prepared to apply the business format highly depended on the operational manager of ETOS involved in this process. For example, one franchisee operating with two stores 'supervised' by one operational manager each, claimed that one operational manager was stricter than the other. Moreover, there were several examples where, on behalf of the management, certain things -mainly products or product groups in the assortment- were not allowed, but about which the franchisee had negotiated with the operational manager. So, in reality the system's uniformity highly depended on the relationship between the franchisee and the operational manager.

Other franchisees pointed out that they did not have a problem with the increasing requirements because they had already been tested out in ETOS company-owned stores before they were introduced to the franchisees. According to one franchisee: *'One is obligated to do everything they do in their company-owned units. By the time they introduce things in their own units, they have already made agreements with their suppliers concerning returning the goods, or they have tested them extensively. Therefore, I do not have a problem with these requirements.'*

What actually happened

To most franchisees the question of whether or not to adopt the Four Worlds format was not really an issue: they knew they would adopt it at some point in time. They were convinced of the need of adopting it, although there were some doubts due to the high investment requirements. This was discussed with the Franchise Board, and management started searching for ways to adapt them. Once these matters were solved, the far majority of franchisees had accepted the adoption of the Four Worlds format.

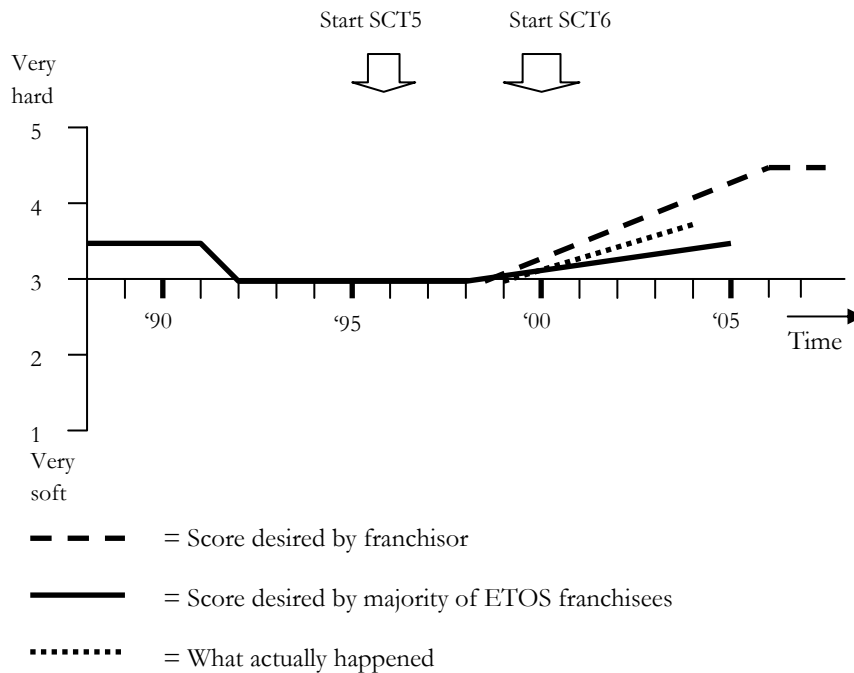


Fig.7.4: Timeline of degree of hardness

7.2.5 Strategic compatibility regarding rate of innovation during SCT5

What the franchisor wanted

According to a former manager of management5, within ETOS the rate of innovation had always been high. ETOS adapted the system by introducing new products, by other business format adaptations and by adjusting the business format as a whole in a relatively quick way. Several of these adaptations were new to the industry. ETOS was the first discount drugstore system in the Netherlands, followed by Kruidvat at the end of the 1970s. The idea of the ETOS Beauty Case format involving the combination of regular drugstore products and luxury perfumes had even been new to the Dutch drugstore industry. This also applies to the price stunting in 1996, which was never done before in the drugstore industry⁶¹.

What the franchisees wanted

As argued before, the majority of franchisees very much approved of the price stunting, because they did not have luxury perfumes in their assortments yet and they expected to increase their profits with these items. However, a small group of about ten franchisees was hesitant, because in their opinion the price stunting could damage their existing relationships with the luxury suppliers, and they were concerned that it would lower their profits. However, they also saw that if they did not participate the competition, such as

⁶¹ Although some people said that Kruidvat had already lowered the prices of luxury perfumes, Kruidvat had not communicated this effectively to the market.

Kruidvat, would anyway. Therefore, they accepted the introduction of the price stunting into all ETOS stores.

What actually happened

The franchisees participated in these actions because the franchisor had succeeded in convincing them of the benefits and necessity of the price stunting. It gave ETOS a great deal of free publicity, higher turnover levels and a head start on its competitors for about two years. However, after a while, these benefits became less because competitors had also started offering luxury perfumes and it became difficult to have enough stock delivered to the stores.

7.2.6 Strategic compatibility regarding rate of innovation during SCT6

What the franchisor wanted

As from 1998, management⁶ stated that it aimed at a more distinctive positioning in the drugstore industry. At the time, it considered the drugstore market as a grey market in which everybody imitated each other. Management decided it should make ETOS a distinctive system solely focused on health and beauty, which would be difficult to imitate by competitors. After experimenting with several formats, such as very large 'super stores', management developed the Four Worlds format, which it considered as a completely new positioning in the market that could last for several years. According to the CEO: *'In earlier years you needed to change your business format within five to seven years, so within that period of time you would have to prepare to convert to the next business format... The Four Worlds format can last for the coming ten to fifteen years, but of course, in ten years time it will be different from the Four Worlds as it is today... When we started with the Four Worlds concept, we did not even know that the new legislation would offer us the opportunity to start with an ETOS chemist. There you see the evolution that took place within three years, and in about ten years there will be other changes.'* In sum, with the new format management aimed at a higher rate of innovation.

One important part of the Four Worlds format was its distinctive assortment. With the introduction of new products, which were only available at ETOS, management⁶ wanted to improve ETOS' distinctiveness in the market. Examples of these products are hair products of famous British hairdressers, ETOS' own home tests or products for jetlag relief.

Next to experimenting with new products, product groups and other adaptations in the existing ETOS stores, management focused more on other activities related to health and beauty. The chemist's activities became an increasingly important issue to ETOS as a health and beauty brand, and ETOS started stores where the chemist and drugstore activities were combined. Although this was new to ETOS, it was not entirely new to the drugstore industry. Other organizations, such as DA, had also started these combination stores. Next to the chemist's possibilities, management saw various possibilities for other activities relating to ETOS as a health and beauty brand name, and it was eager to experiment with them.

What the franchisees wanted

According to the franchisees, ETOS had always pursued a relatively high rate of innovation compared to other organizations within the Dutch drugstore industry. Given their competitive circumstances the majority of franchisees thought the introduction of new products was important. Especially new products of well-known brands, such as L'Oreal,

were very important to have in the stores as soon as possible, because they were advertised on television and people would want to buy them.

With respect to more radical adaptations to the business format (level of other business format adaptations and the business format as a whole), franchisees agreed that these were important, but they required higher investments, and there was a higher level of risk involved. However, most franchisees pointed out that management always first tested these adaptations in some of the company-owned stores before introducing them in the system as a whole. This had two advantages. First, management could use the test results for convincing franchisees to adopt certain innovations. Second, because the franchisor adopted innovations on a large scale in its company-owned units, the franchisees relied on it that these innovations were good for the ETOS stores. Therefore, they were more willing to adopt innovations of this kind in their own stores.

What actually happened

In 2004, management⁶ expected that most franchisees would adopt the new Four Worlds format. According to one manager: *'I do not come forward with anything before I know for sure that my information for the franchisees is correct, and I know for sure that the amount of renovating costs that has to be covered by the franchisees is correct. You always need to give the right information. That is very important. And when you have made a mistake: confess it as soon as possible.'* To the franchisees, it was soon clear how much the renovation of their stores was going to cost. Since ETOS had first experimented with the Four Worlds format in a number of its company-owned stores, it could use this information to convince the franchisees to change to the Four Worlds format.

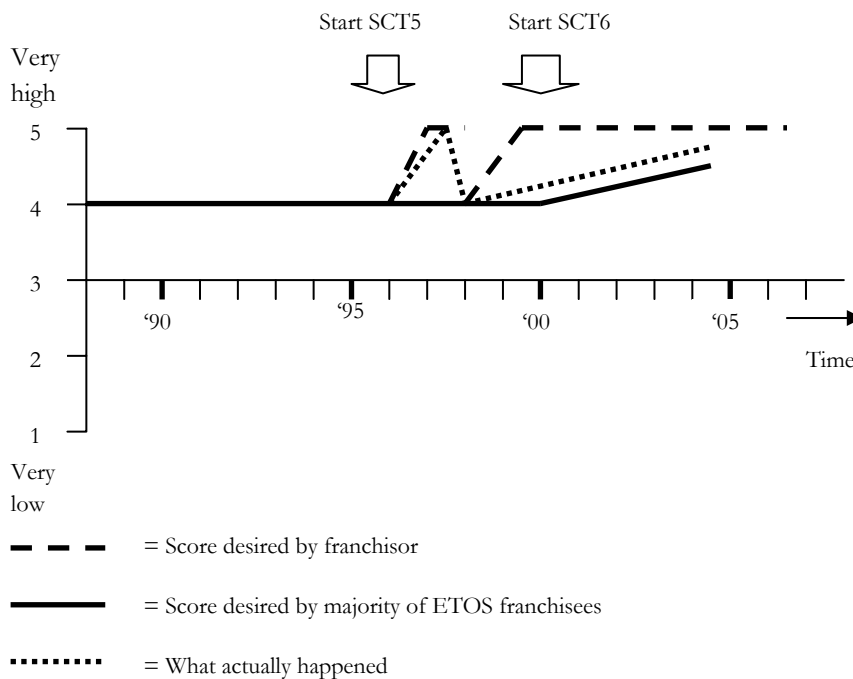


Fig.7.5: Timeline of the rate of innovation

7.2.7 Strategic compatibility regarding the organization of the franchisees' strategic participation during SCT5

What the franchisor wanted

The ETOS Franchise Association and Franchise Board started in 1991, when there were about ten franchisees. It was established on both the franchisor's and franchisees' initiative. The ETOS Franchise Association and the Franchise Board were more or less copies of the franchise organization associated with Ahold's subsidiary Albert Heijn. Albert Heijn had worked with franchisees for a longer period of time, and the organization of the Albert Heijn Franchise Association was already thought out relatively well. The ETOS Franchise Association aimed at serving the ETOS franchisees' interests. The ETOS Franchise Board consisted of a small group of franchisees that were elected by members of the Franchise Association, and it was supposed to serve the interests of the members of the Franchise Association. According to one manager, management largely influenced how the consultation with the Franchise Board took place. The same applied to the Franchise Board: according to a former chairman, the way in which the interactions with the franchisor were arranged depended on the members of the Franchise Board.

At the time of the price stunting, management considered the Franchise Board more as an advisory organ than as a decision-making body. At the time it wanted to start the price stunting, management had first discussed this with the Franchise Board as well as with the ten franchisees who already had these perfumes in their assortment. However, during SCT5 there were no drastic changes in the organization of the franchisees' strategic participation.

What the franchisees wanted

At that time the majority of franchisees agreed with the organization of the franchisees' participation because it was highly structured.

What actually happened

As already pointed out, the 'actual' organization of strategic participation depended on the management and the Franchise Board. At the time of the price stunting, management, the Franchise Board and the franchisees selling luxury perfumes consulted with each other, and management convinced them of the benefits of the price stunting. Moreover, because the price stunting turned out to be a huge success franchisees did not complain.

7.2.8 Strategic compatibility regarding the organization of franchisees' strategic participation during SCT6

What the franchisor wanted

Management⁶ considered the role of the Franchise Board as very important. According to the CEO: *'We have demanded that the Board does actually have a mandate. Therefore one must be really careful who the members of the Board are. The board has been given a mandate, which is only possible if franchisees have trust in it. Otherwise they might think that we, as the management, might try to favor the Board in order to get things done.'*

The mandate meant that the Board made agreements with the ETOS management, which were binding to all ETOS franchisees. According to one manager, the Franchise Board could carry out a mandate for decisions whenever management asked for it. It is interesting that management emphasized the importance of the Franchise Board through

an 'Agreement'⁶². This was a document in which management and the Franchise Board established certain 'rules' in their relationship. This agreement stated that the objective of the cooperation between these partners was to obtain maximum value from the market and that consultation between the Franchise Board and management was central in this. The agreement also stated that honesty, respect and trust were necessary conditions in this consultation.

What the franchisees wanted

The majority of the franchisees agreed with the way in which the franchisees' strategic participation was organized. They argued that they assumed ETOS had thought about the strategy. Some ETOS franchisees felt that they had 'rented' a business format, and that the franchisor was its creator. Again, the company-owned units played a role in this too; because ETOS had company-owned units, the franchisees expected that management knew what was good for the ETOS stores.

However, apart from the way it was organized, the 'practical workability' of the strategic participation was also considered important. According to several franchisees there were various factors that influenced this practical workability. First, some franchisees argued that it mattered who were in the Franchise Board, and whether these people had a large stake in ETOS, or whether these were people to whom ETOS was just a 'side-activity'. Second, according to some franchisees the ETOS system had grown so steadily that it had become impossible to make one's self heard. One franchisee put it like this: *'In earlier years, you could discuss matters with smaller groups, but now when there is a meeting of the Franchise Association, you have to write down your questions on a piece of paper and hand it in before the meeting. It has become a "one-way traffic". You are in a room with 300 people, and then there are problems with the microphones, and when you ask a question they (the members of the Franchise Board, EC) say: "we will come back to the subject some time later".'*

What actually happened

According to one manager the degree of strategic participation depended on the management. Management⁶ considered strategic participation as important. As a guideline management⁶ used the following principles: 'Direction, advice and rules'. This meant that 1) the Franchise Board could assist in thinking about the general direction, 2) management and the Franchise Board together discussed the rules, and 3) they could advise each other.

⁶² In Dutch this is called a 'Convenant'.

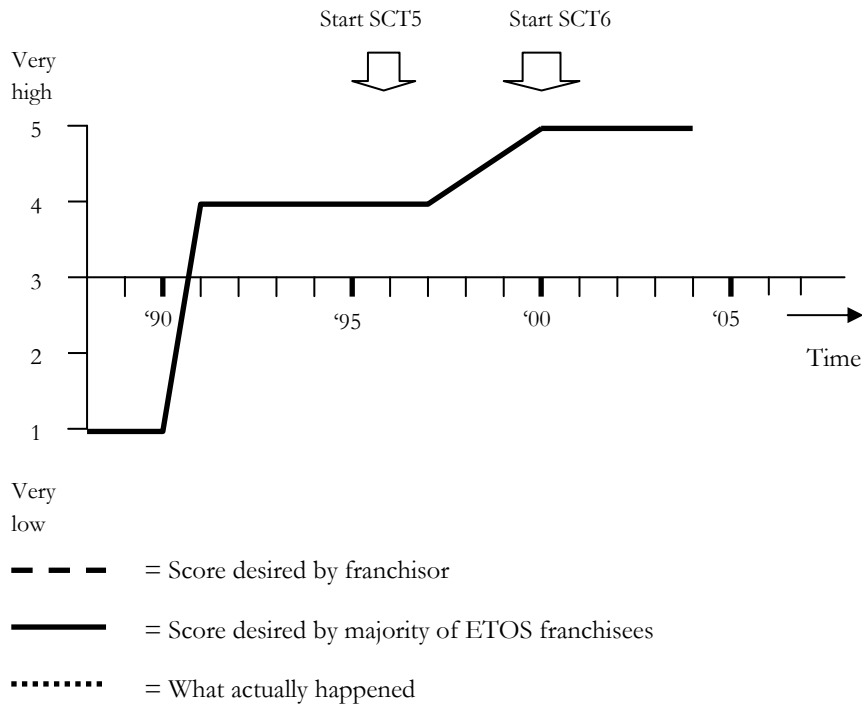


Fig.7.6: Timeline of the organization of the franchisees' strategic participation

7.2.9 Strategic compatibility regarding type of growth objectives during SCT5

What the franchisor wanted:

In the early 1990s, management wanted the number of ETOS stores to increase in order to establish ETOS' reputation at a national level. In other words, the focus was more on growth of the number of units (quantitative growth) than on growth by improving the performance of existing units (qualitative growth). In the 1990s ETOS realized a large degree of quantitative growth by attracting several stores and management was not so critical about which stores to attract and allowed almost every store in the system. Another issue management had to deal with was *how* it wanted to grow: by means of company-owned units or franchised units. It decided to try to grow mainly by franchised units for two reasons. First, this would give management the opportunity to get hold of the locations owned by the prospective franchisees. Second, the franchisees were a source of capital, resulting in less financial requirements for the franchisor.

Additionally, management converted several existing company-owned units into franchised units. This meant that the store managers became the franchisees. These conversions had three reasons. First, it offered the managers of these existing stores opportunities for growth. Second, it could make some stores more profitable because a franchisee would put more effort into it than a store manager would. Third, the management could use the capital resulting from these conversions for investing in other stores.

What the franchisees wanted

For the ETOS franchisees the quick growth of the ETOS system had the advantage that the national reputation of ETOS increased. However, on the other hand, it meant less uniformity. Additionally, several franchisees recalled that the quick growth of the ETOS system had caused some operational problems, thereby affecting the operational compatibility (see section 7.3.1). However, these problems were not severe enough to consider exiting the ETOS system.

For individual franchisees there were few problems because of the rapid growth of the ETOS system in terms of units. The franchisees' exclusive territories were very clear. This was not violated by other ETOS stores entering the system. Moreover, because at that time management did not really have qualitative growth objectives, franchisees were not forced to relocate or renovate. Therefore this did not cause problems as far as the franchisees were concerned.

What actually happened

Management realized its quantitative growth objectives. Because of changes occurring at DA during SCT1, it was in the 1990s relatively easy to attract druggists of the competing DA system (see Chapter 5). ETOS actively approached these DA druggists and asked them to become ETOS franchisees. This approach caused an unexpected 'snow-ball' effect: according to one manager, several leading DA franchisees who went to ETOS were followed by other DA franchisees. However, in these years ETOS had also attracted various small stores that did not fit in ETOS' subsequent strategy (see 7.2.10).

7.2.10 Strategic compatibility regarding type of growth objectives during SCT6

What the franchisor wanted

In 1998, under management⁶, the growth objectives of the ETOS system changed, and management started to focus more on improving the performance of the existing stores. In other words, their focuses shifted from more quantitative growth to more qualitative growth. In some cases, this meant that management tried to convince franchisees to increase their floor area or to move to another location. This also meant that they no longer accepted every drugstore owner as an ETOS franchisee.

These increased requirements were in line with management's intention to change ETOS' positioning, and to build the ETOS health and beauty brand. Rather than national coverage, the main objective of management⁶ became creating a well-known health and beauty brand. Therefore, improving the performance of the existing units became more important than increasing the number of stores.

What the franchisees wanted

The franchisees who needed to increase their floor area or who were asked to move to another location did their best to cooperate, because they expected that this would also be in their own interest. However, due to 'practical' factors, such as plans of real estate developers or financing, these processes occurred only gradually.

What actually happened

From 1998 on, ETOS started to stimulate franchisees to move to locations with larger floor areas in order to realize a better performance. In this respect, management had gradually started to put more emphasis on certain criteria for franchisees. As pointed out, these processes occurred gradually.

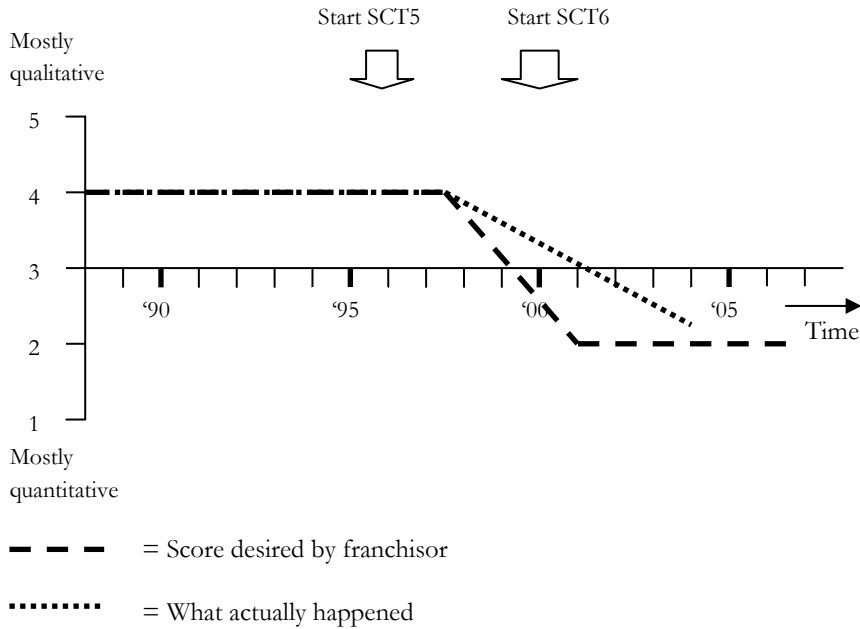


Fig.7.7: Timeline of the type of growth objectives

7.3 Operational compatibility

7.3.1 Operational compatibility during SCT5: 'Two-front attack'

The franchisees' perspective

Over time, due to problems within the ETOS system, several examples can be given of a low degree of OC capa, as perceived by the franchisees. Problems in these areas were mainly caused by automation or logistics. As already indicated, the franchisees saw the rapid growth of the ETOS system as the main cause. However, such operational problems would never be a reason for them to consider exiting the ETOS system. First, they believed that these kinds of problems occurred in every franchise system and that the ETOS system was no exception in this. Second, they believed that management did its best to solve the problems, since this would also be in the interest of the operations at their company-owned units.

Additionally, ETOS benefited from being part of the AHOLD corporation. It was already mentioned that ETOS benefited from the franchise experiences of Ahold's subsidiary Albert Heijn (through the franchise contract and the organization of the Franchise Association and Board). In addition, there were some operational benefits of being part of the Ahold-corporation. First, together with other Ahold subsidiaries (Albert Heijn), ETOS could purchase certain goods, such as diapers. This resulted in huge economies of scale and lower purchasing prices (which were the same for ETOS' company-owned and franchised units).

With respect to OC trust/fd, several factors influenced the franchisees' trust that the franchisor would not act opportunistically and would take the franchisees' interests into account. The following instruments were 'institutionalized' in the ETOS system that positively influenced the franchisees' trust in the franchisor:

- The presence of company-owned units. The company-owned units were used to convince ETOS franchisees that the franchisor also ran a risk. The franchisees trusted that changes/requirements would be beneficial to their stores because they were also beneficial to the company-owned units. Or, as one manager said: *'When it goes bad, or when we have problems with the Franchise Board or when we are really proud, then we sometimes say: we are our largest franchisee because we have two hundred company-owned units'*. Management deliberately aimed for a certain division between company-owned and franchised units. It wanted the turnover of the ETOS company-owned stores to be at least fifty-one percent of the ETOS system's total turnover⁶³. Franchisees were also aware of this goal, and they mentioned it quite often when explaining why they were convinced to adopt certain changes. The chairman of the Franchise Board also pointed at the importance of this division by stating that: *'Imagine that ETOS says it wants to sell twenty company-owned stores. We will then stand up and tell them that we do not accept that, because if that happened ETOS' wholesale activities would become more important, and the stores might become less important'*. Another franchisee formulated it as follows: *'Because ETOS has company-owned stores, the goods we sell need to produce profits; therefore the interests of ETOS and its franchisees run parallel'*.
- The second factor that positively influenced the franchisees' perceptions of trust was the way the strategic participation of the franchisees was organized and how it worked in practice. As section 7.2.7 has shown, there was an ETOS Franchise Association with a Franchise Board that served the interests of the ETOS franchisees. According to most franchisees this body was well-organized, which stimulated the franchisees' belief that the franchisor would take their interests into account.
- Third, there was a role for third parties. For reasons of competition ETOS franchisees did not know the height of the purchasing prices. ETOS guaranteed that franchisees paid the same purchasing prices as ETOS did in their company-owned stores. In this way ETOS would not be tempted to charge higher purchasing prices to franchisees and to sell a great deal of low-margin products. An accountant monitored whether the franchisor kept this promise. The ETOS franchise contract stated that every year an accountant of ETOS or Ahold had to issue a declaration about the correctness of ETOS' purchasing prices as presented toward its franchisees. Additionally, an accountant selected by the Franchise Board was allowed to monitor ETOS' or Ahold's accountant.
- Fourth, franchisees had the right to return goods that were automatically sent-in. According to some franchisees, through this procedure management showed its conviction that a certain product would sell, and if it did not work, ETOS itself would accept the losses (rather than the franchisees).
- The way of calculating the franchise fee. The contract stated that the fee was 7,6% of the value of the purchased goods (without VAT). Franchisees had to pay fee

⁶³ A certain division in turnover between franchised and company-owned units is general practice in the Dutch Ahold subsidiaries Albert Heijn and Gall & Gall.

over 95% of their total value of purchased goods⁶⁴. Some franchisees argued that this way of fee calculation was a guarantee that ETOS would take the franchisees' interests into account. Some franchisees compared ETOS with DA in terms of fee calculation. According to them, DA based a large part of its fees on turnover levels and was therefore tempted to increase turnovers of franchisees without taking into account the costs and the resulting profitability. Because ETOS calculated fee over the purchasing value, it did not have an interest in increasing turnover levels. Moreover, since ETOS had to take the profitability of its company-owned stores into account, the profitability of the franchised stores was automatically included.

The franchisor's perspective

With respect to operational compatibility, to the franchisor it was highly important that the franchisees could fulfill their financial requirements to ETOS (OC capa). During SCT5, due to their relatively small floor area some franchisees made low profits for the franchisor (OC profit). However, as long as these franchisees fulfilled their financial requirements, this was no problem during SCT5.

In the ETOS case, franchisees had to respect certain requirements and the franchisor needed to trust that a franchisee would not act opportunistically by ignoring these requirements or by misrepresenting information about fee calculation (OC trust/fd).

7.3.2 Operational compatibility during SCT6: 'Introduction of the Four Worlds format'

The franchisees' perspective

As regards operational compatibility regarding capabilities (OC capa), it was already pointed out that ETOS benefited from being part of the AHOLD corporation, because it could purchase certain goods on a larger scale. During SCT6, ETOS also started to purchase store materials in collaboration with other Ahold subsidiaries. In this way, they could decrease the costs involved in renovating the stores. Occasionally, there were some operational problems. Due to the relocation of the ETOS head office and distribution centre, one very large problem during SCT6 concerned logistics. This problem lasted for several months but was never a reason for franchisees to exit ETOS, because they believed that ETOS would do all it could to solve it. During the logistics problems, several products were not available, but ETOS nevertheless tried to deliver them to the franchised stores with the result that some products were not available at the company-owned stores.

When the Four Worlds format was introduced, problems initially arose with respect to operational compatibility regarding profitability (OC profit). Several franchisees were afraid that the Four Worlds format would not be profitable for them because the costs of investing would outweigh the benefits. However, in later phases, the franchisor adapted the format, resulting in lower investment requirements for franchisees.

With respect to OC trust/fd, section 7.3.1 already discussed several instruments that were institutionalized within the ETOS system. These instruments were still used by ETOS during SCT6 and they positively influenced the franchisees' perception of OC trust/fd. However, in the year 2000 there had been a change in the ETOS-organization, which had a negative impact on the franchisees' trust in the franchisor. Before 2000, the ETOS head office had always consisted of two separate divisions: one company-owned units division

⁶⁴ It did not matter whether the goods were purchased at or via ETOS or via another supplier.

and one franchise division. However, in order to maintain uniformity in the ETOS brand, management decided to join the franchised and company-owned activities into one back-office. In 2000, management had started to change the organizational structure creating one division for both the franchised and the company-owned units. However, according to several franchisees, these organizational changes were not effected from a customer's perspective, but initiated for reasons of retrenchment. Many franchisees argued that this undermined the promotion of the ETOS franchisees' interests, because now their contact persons from the ETOS head-office had both franchised and company-owned units in their portfolios, and the franchisees were concerned that ETOS would no longer take the specific interests of its franchisees into account. As one franchisee put it: *'I do not feel like meeting with ETOS store managers because they have completely different interests than franchisees have. Store managers say: "How nice, when will this new business format be introduced in my store?". But, as franchisees we have to invest in it ourselves.'*

The franchisor's perspective

From the franchisor's point of view it was always a necessary condition that franchisees could fulfill their financial requirements (OC capa). In the years before SCT5, ETOS had always accepted franchisees who had a relatively low OC profit. However, during SCT6, a tension arose between a franchisee's profitability (OC profit) and the strategic compatibility regarding the degree of hardness (SC hard). Management argued that it wanted all franchisees to adopt the Four Worlds format within a certain time period and that if franchisees did not want to adopt the format they would have to exit ETOS. However, ETOS was less susceptible to this kind of tension than DA, because ETOS franchisees knew from the beginning that ETOS had always exercised a certain degree of hardness and that they were obliged to meet certain requirements.

7.4 Attractiveness of alternatives

7.4.1 Attractiveness of alternatives during SCT5: 'Two-front attack'

The franchisees' perspective

According to the franchisees there were very few attractive alternatives to ETOS. The majority of ETOS franchisees desired a well-known brand with a certain shared identity. DA was the only alternative that could offer a brand of that reputation. However, it was not considered attractive for three reasons. First, often there already was a DA store closeby. Second, DA was not considered as uniform enough; it did not have such a shared identity as ETOS did. Moreover, the franchisees were of the opinion that DA was not organized well because of several rumours they had heard. Third, other franchisees had just switched from DA to ETOS because of their dissatisfaction with the DA system. Softer franchise systems, such as DIO, UED or De Vakdrogist were not considered as alternatives because they were not well-known brands in the market. This also explains why the franchisees did not wish to proceed as completely independent druggists (CID).

Apart from that, during SCT5 most franchisees did not even evaluate their alternatives because they highly approved of the price stunting, and they were generally satisfied with ETOS.

The franchisor's perspective

Also to the franchisor applies that during SCT5 possible alternatives for the franchisees were not really an issue, simply because there were few problems. Moreover, the franchisor had the advantage that it could (temporarily) turn a franchised unit into a company-owned one in case a franchisee would exit.

7.4.2 Alternatives during SCT6: 'Introduction of the Four Worlds format'

The franchisees' perspective

To SCT6 the same applies as to SCT5; franchisees considered only few alternatives as attractive. Although DA was regarded as a possible alternative by some franchisees; it was generally considered as a bad one for several reasons. First, many franchisees already had a DA store closeby. Second, franchisees argued that DA's organization was not working well. Moreover, DA had a bad reputation among ETOS franchisees because they believed that it did not take the franchisees' interests into account.

The softer systems were not considered as alternatives because in the eyes of the franchisees they were not powerful enough, and they argued that they needed a well-known brand name to operate successfully at their locations. Again, the same applied to becoming a CID; this was considered as impossible by the majority of ETOS franchisees.

As was the case during SCT5, franchisees did not seriously consider alternatives, simply because they were satisfied with their current relationship.

The franchisor's perspective

Also to the franchisor applies that possible alternatives for franchisees were not really an issue during SCT6, because there were practically no problems.

7.5 Switching costs

7.5.1 Switching costs during SCT5: 'Two-front attack'

The franchisees' perspective

First of all, several ETOS franchisees did not even consider switching costs because they were satisfied with the price stunting and the franchise relationship in general. They generally perceived switching costs as low. The following considerations played a role in this.

First, the duration of the franchise contract was five years. At the end of the term the franchisee could either exit the relationship⁶⁵ or extend it for another five years. The contract stated that when the franchisee would end it before its term had expired, the franchisee had to pay a compensation for the fees that the franchisor would not receive in the remaining time. However, the franchisees who objected to this expected that they would be given the opportunity to work this out with the management.

Second, for several franchisees during SCT5 the financial switching costs were low because they had already recouped their investments in the 'Lamella format'. Moreover, the contract stated that ETOS would take back specific goods from the franchisee, such as products from ETOS' own brand. In return, the franchisor would pay a certain compensation, thereby decreasing the franchisee's financial switching costs.

⁶⁵ Of course, they had to take a certain term of notice into account.

Third, another element playing a role in the franchisees' perception of switching costs was the ownership of the location. If the franchisee was the owner of the store's location, he would not have to lose it; if he had rented the location via ETOS/AHOLD he would no longer be able to use it.

The franchisor's perspective

For the franchisor switching costs with respect to individual franchisees were generally low.

7.5.2 Switching costs during SCT6: 'Introduction of the Four Worlds format'

The franchisees' perspective

To SCT6, the same applied as to SCT5. Most franchisees did not seriously consider switching costs because they were satisfied with the relationship. The duration of the franchise contract had not changed, and so the franchisees' views on this issue were the same as during SCT5. As regards financial switching costs, some franchisees had not yet completely recouped their investments in the Veenendaal format, but they claimed this would not stop them from exiting if they wanted to. However, they explicitly stated that they did not want to exit. The issue of ownership of the location started to increasingly play a role because over time more franchisees had rented a location via ETOS/AHOLD, and they would lose this location if the franchise relationship ended.

The franchisor's perspective

For the franchisor switching costs were still generally low because he had not made specific investments in particular franchisees.

7.6 Responses of the partners

7.6.1 Responses during SCT5: 'Two-front attack'

Responses of the franchisees

After such a long time it was difficult for former members of management5 to estimate percentages of how ETOS franchisees were divided between the different types of responses. Therefore, only the researcher's estimations are presented in Fig. 7.8. This estimation is based on the interviews and is as follows: covo=5%, loy=90%, amloy=5%, negl=0%, agvo=0% and exit=0%.

According to a former manager the general picture of the responses was as follows. No franchisee had left the franchise system because of discontent with the price stunting initiative. There were about ten franchisees who had not been so happy with the price stunting because they already had luxury perfumes in their assortments. With these ten franchisees management had had some discussions to try to convince them of the necessity of the price stunting.

As pointed out, the ten franchisees had two main reasons to disapprove of the price stunting. First, they expected that their margins would decrease of the perfumes that they already had in their assortments. Second, they were afraid that their existing relationships with the luxury suppliers would be damaged. However, the franchisees felt that the price stunting was inevitable: if ETOS would not do it, then ETOS' competitors would.

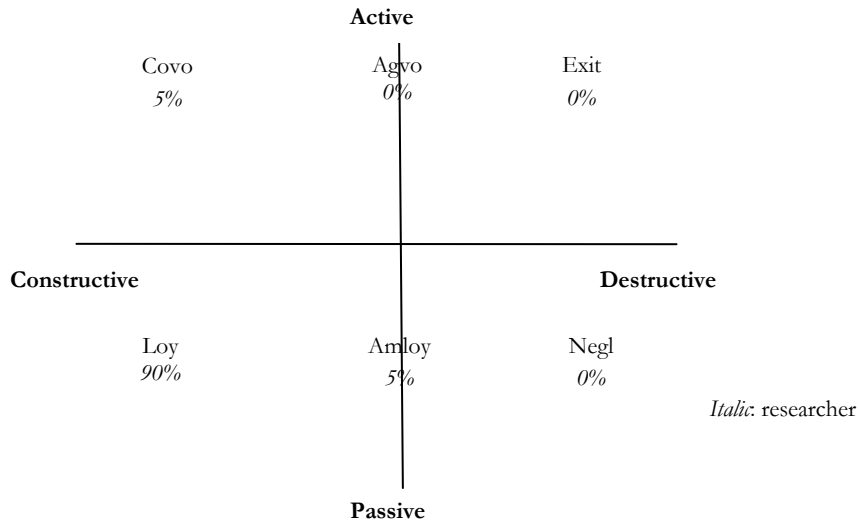


Fig. 7.8 Estimations of responses of the ETOS franchisees for SCT5

Responses of the franchisor

Management5 discussed the price stunting extensively with both the Franchise Board and the ten franchisees who sold the luxury perfumes. It mainly used a covo response; management5 tried to explain to the franchisees why the price stunting would be useful, while also pointing out the risks.

7.6.2 Responses during SCT6: ‘Introduction of the Four Worlds format’

Responses of the franchisees

Fig. 7.9 shows the estimations of a manager, the CEO and the researcher. The CEO based his estimations on the responses by the members of the Franchise Board, while the manager was more closely involved in the relationships with the franchisees.

In general, management perceived few destructive responses. This was because it was able to convince the franchisees of why certain changes would be good for them. According to the manager most franchisees wanted to change to the Four Worlds format, but some were restricted because of financial reasons. The responses of neglect, aggressive voice, and exit were not adopted often. According to management, franchisees did not exit the ETOS system out of discontent with the ETOS system. According to the manager, the exits were related to personal problematic situations, but did not concern discontent with ETOS or the Four Worlds format. Examples of problematic circumstances were financial or personal problems.

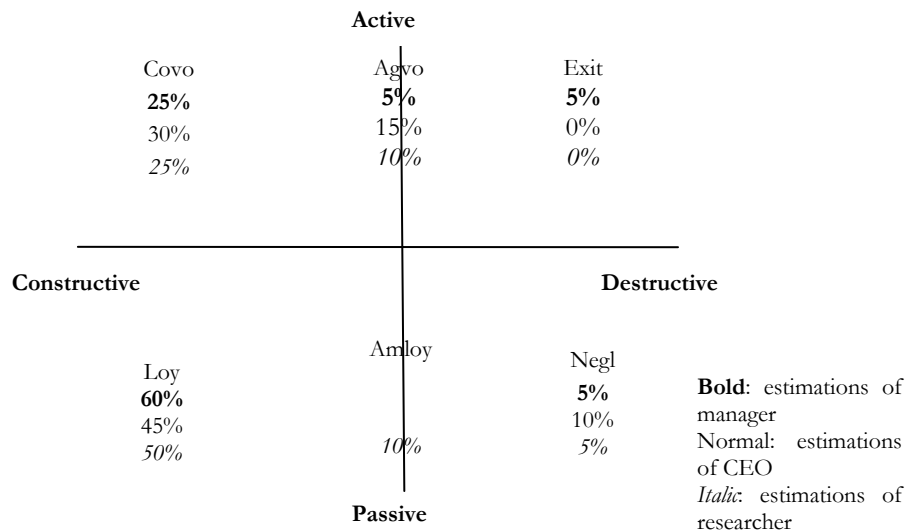


Fig. 7.9 Estimations of responses of the ETOS franchisees for SCT6

Responses by the franchisor

Management6 decided to make fewer concessions compared to earlier years, and if franchisees would not agree with the new strategy, they simply had to go. Management6 argued that it did not want to bind the franchisees because that would not be effective; the franchisee would not be motivated then, which might damage the system.

7.7 Analysis of relationships between variables

Sections 7.2 to 7.6 have described the developments during SCT5 and SCT6 as well as the franchise partners' perceptions of the independent variables in general (leading to conclusions of type 1). The following section will take a closer look at the individual franchise relationships by analyzing the relations among the independent variables and the responses (leading to conclusions of type 2). For SCT5 as well as SCT6, the development pattern of the franchisees' responses is presented in a figure (Figs. 7.10 and 7.11). In these figures each number represents an individual franchisee. Each response type ('X-response' as example) is discussed according to the following structure:

- Preceding responses to the X-response (broken lines in Figs. 7.10 and 7.11).
- The X-response as initial response (bold numbers in Figs. 7.10 and 7.11). This will be the focal point in the analysis, in which the determining variables (see section 4.3.5) and the franchisees' perceptions of these variables are discussed to explain why the X-response was adopted.
- Subsequent responses to the X-response (unbroken lines in Figs. 7.10 and 7.11).

Additionally, the franchisor's responses to those of the franchisees and to the determining variables are discussed.

A limitation of Figs. 7.10 and 7.11 is that they do not indicate the time lapses between the switches of one response to another, while in fact these varied from a few weeks or months to several years. For a better understanding of the development of the responses, these time lapses have been pointed out in the text.

This section discusses the franchise relationships on a very detailed level. To readers who are interested on a more general level, I recommend to skip this section and to continue with section 7.8 in which the general conclusions for the ETOS system are discussed.

7.7.1 Analysis of SCT5: 'Two-front attack'

Table 7.1 presents a summary of the data of SCT5. Of each response type, it presents the number of respondents (franchisees), the modus of the respondents' perceptions of the independent variables and the modus of the franchisor's responses. The sample consists of three covo franchisees, five loy franchisees and two amloy franchisees. The table shows that directly after the introduction of SCT5 none of the respondents adopted a negl-, agvo- or exit response. During SCT5, there were only few franchisees who adopted these responses. This can be explained by the fact that the price stunting with the luxury perfumes was introduced unexpectedly for the majority of franchisees who did not yet have these perfumes in their assortments. And, as already mentioned, it was almost immediately a success.

		Strategic compatibility (SC)						Operational compatibility (OC)					
Res- ponse FRE	SC Pos	SC Hard	SC Innov	SC Org	SC Growth	OC Capa.	OC Profit	OC Trust/ fd	Attalt	Swico	Res- ponse FRO		
Covo N= 3	High (+)	Very high	Very high	Very high	NP	High	Med	Very high	Low	Low	Covo		
Loy N=5	Very high	High (+)	High (+)	Very high	NP	High	High	High	Very low/ low	Low	Loy		
Amloy N=2	High/ very high (+)	High/ very high (+)	Very high	Very high	NP	High	Med.	High/ very high	Low	Low/ med	Loy		
Negl N=0	-	-	-	-	-	-	-	-	-	-	-		
Agvo N=0	-	-	-	-	-	-	-	-	-	-	-		
Exit N= 0	-	-	-	-	-	-	-	-	-	-	-		

Table 7.1 Summary of data for SCT5

Fig. 7.10 depicts the developments of the franchisees' responses during SCT5.

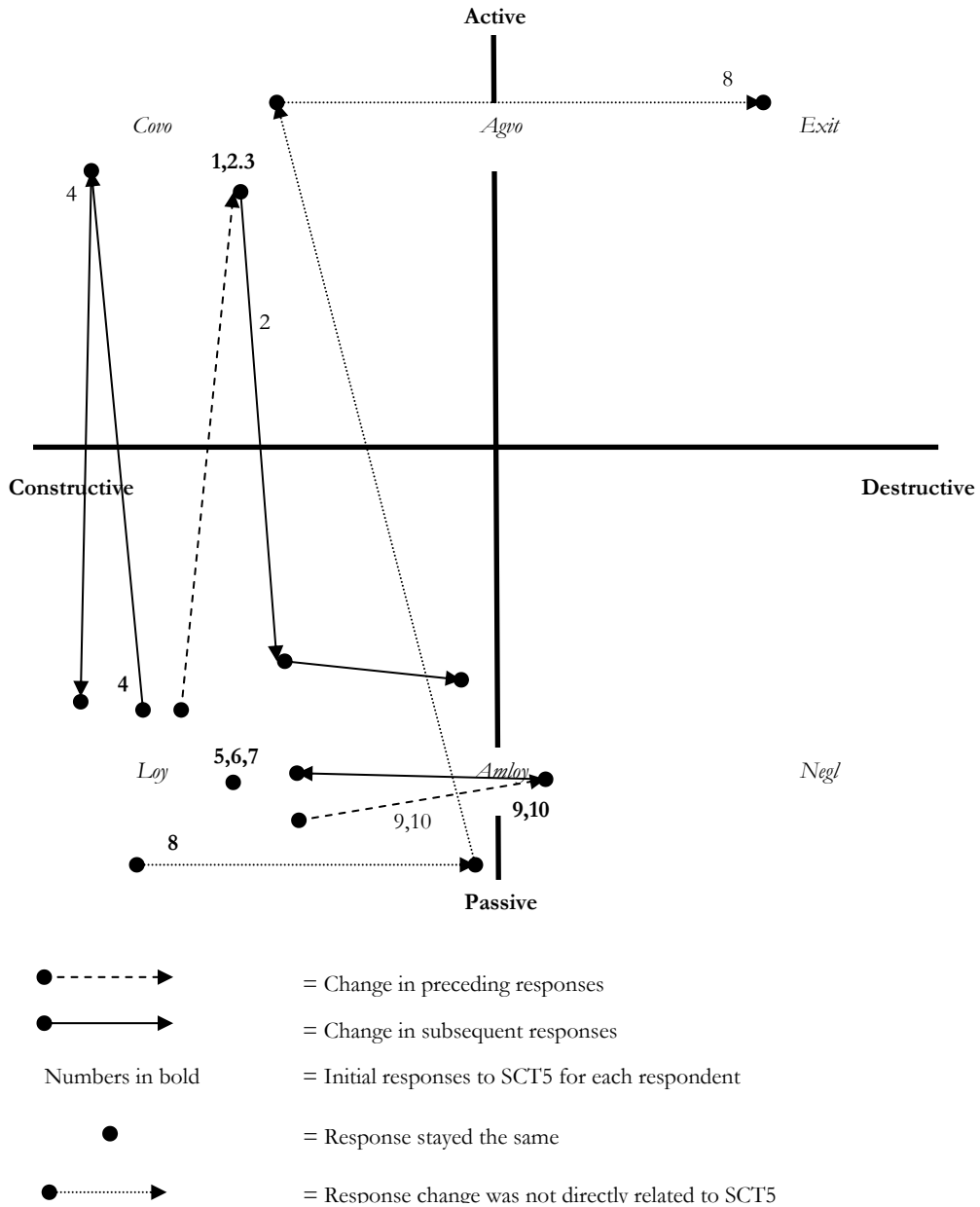


Fig. 7.10: Development of franchisees' responses to SCT5

Responses preceding covo

Fig. 7.10 shows that franchisees 1, 2 and 3 initially adopted covo to the introduction of SCT5 (see bold numbers). Before that time, they had all adopted loy. These franchisees

sold the more luxury perfumes and were approached by management⁵ before the introduction of the price stunting to explain why it was initiated.

Covo as initial response

In reaction to the franchisor's covo the franchisees also adopted this response. The covo responses of franchisee 1, 2 and 3 can be explained by their determining variables and their perceptions of these variables. Their determining variables were in order of importance:

- OC profit. The franchisees were concerned that their profitability would decrease because they had always sold luxury perfumes at relatively high margins. Due to the price stunting these margins would decrease. Therefore, at the introduction of the price stunting OC profit was perceived as medium.
- SC hard. The degree of hardness was regarded as important because the franchisees considered a well-known brand name as a necessity. They perceived the level of SC hard as very high because they had the same objectives as the management on this issue.
- SC pos. This was a determining variable because several requirements were related to positioning. The covo franchisees did not approve of the price stunting because they wanted to maintain their higher positioning, and they were afraid of losing their contracts with the luxury suppliers, which meant that they would not be able to offer luxury perfumes in the future. However, management had convinced them that the price stunting was inevitable.
- OC trust/fd. Since there were several requirements trust was considered an important variable, and the franchisees perceived OC trust/fd as very high.
- SC innov. Due to the fierce competition in the areas where they were located, the franchisees believed that innovation was crucial to survive. That is why this variable was perceived as important. The franchisees considered SC innov as very high during SCT⁵ because ETOS was the first system that introduced the price stunting on such a large scale and with so much media attention.
- OC capa. Although this variable was important in the light of the requirements regarding these factors, it was less important than the other variables because the franchisees expected operational problems, such as problems of automation, logistics or purchasing prices, to be solved at relatively short notice. ETOS' company-owned units played a role in this: because operational problems would also have repercussions on these units, it was in ETOS' own interest to solve them quickly.
- SC org was the least determining variable during SCT⁵ because the price stunting was a huge success. Therefore, the franchisees felt that strategic participation was not necessary.

During SCT⁵ SC growth was not a determining factor because management did not force franchisees to renovate or relocate their stores, and there were no problems with exclusive territories.

The covo-franchisees did not consider the attractiveness of alternatives and switching costs because they still perceived the relationship as highly attractive.

As pointed out, the franchisor had already adopted a covo response toward these franchisees before the actual introduction of the price stunting. The reason for this was that the franchisor wanted to prevent the franchisees from adopting a destructive response (negl, agvo or exit). Management⁵ tried to convince them that the price stunting was

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inevitable: if ETOS would not pursue this course of action another competitor would. Moreover, the problem of the lower margins would be solved by the higher turnover levels.

Responses subsequent to covo

The price stunting turned out to be a success almost immediately after its introduction, and the covo franchisees quickly went back to loy because their turnover level had indeed increased dramatically, which compensated for the lower margins. The result was a high OC profit.

Responses preceding loy

Fig. 7.10 shows that franchisees 4 up to and including 8 adopted loy as initial reaction. All of them had adopted loy as preceding response because they had been satisfied with the relationship before the price stunting and had not felt the need to respond actively.

Loy as initial response

Franchisees 4 up to and including 8 maintained loy during the introduction of the price stunting. According to these franchisees, the determining variables were in order of importance:

- OC profit. These franchisees did not yet have the luxury perfumes in their assortments and therefore they were not afraid that their margins would decrease. Moreover, the price stunting resulted in higher turnover levels almost immediately after its introduction, so these franchisees were quite content and did not feel the need to adopt an active response.
- SC hard. This was an important variable to these franchisees because they felt they needed a well-known brand name on their stores. They perceived SC hard from high to very high.
- OC trust/fd. This was a determining variable because the franchisees were faced with several requirements with respect to which they needed to trust the franchisor. These franchisees perceived OC trust/fd as high.
- SC pos. As far as the loy-franchisees were concerned this was a determining variable because of the requirements attached to it. The loy franchisees perceived SC pos as very high.
- SC innov. This was also an important variable, again because of the requirements related to it. The loy franchisees aimed at a high rate of innovation and perceived SC innov as very high because the price stunting was new to the industry at the time.
- OC capa. This variable was considered important, but less so than the other variables, because the franchisees expected that possible problems regarding this variable would be solved on a relatively short notice thanks to the ETOS' company-owned units. Moreover, with respect to the issue of the franchisor's capabilities, in their view there was no better alternative to ETOS.
- SC org. This was considered important but less so than the other variables, thanks to ETOS' large number of company-owned units, which would guarantee favorable policies on the part of the franchisor.

SC growth was not determining for the same reasons as franchisees 1, 2 and 3.

Responses subsequent to loy

Franchisees 5, 6 and 7 maintained loy because they ascribed high scores to their determining variables, and therefore they never felt a need to actively respond toward the franchisor. However, franchisees 4 and 8 switched to other responses over time.

Franchisee 4 switched to covo because he wanted to acquire more perfumes in order to continue the price stunting and to benefit even more from its success. Eventually, there was not enough stock available to continue the stunting activities, and franchisee 4 returned to loy.

Franchisee 8 had slowly switched from loy to amloy, and via covo to exit. The reasons for this development were not directly related to SCT5. Therefore, in Fig. 7.10 this line is dotted. I discuss the development pattern of this franchisee's responses because he was one of the few ETOS franchisees who exited due to dissatisfaction with ETOS. His determining variables and the scores of these variables were the following:

- OC profit. Because of the automatically sent-in goods franchisee 8 perceived OC profit as low. Although the franchisee had the right to return these goods, this was considered to take too much time and effort. Moreover, the costs of returning the goods were not refunded, which he considered as unacceptable. This resulted in a low score of OC profit.
- SC hard. When using a well-known brand name, franchisee 8 believed that a high degree of hardness was necessary. However, he did not agree with the contents of the requirements, and therefore opposed to the positioning and rate of innovation of ETOS.
- OC trust/fd. This variable was considered as important in the light of this franchisee's requirements. Franchisee 8 rated it as high. Therefore, this did not cause any problems.
- SC pos. Franchisee 8 rated SC pos as low and because the positioning was to a large extent obligatory; this was considered problematic.
- SC innov. Franchisees 8 rated SC innov as low and because the rate of innovation was to a large extent obligatory; this was also considered problematic.
- OC capa was one of the least relevant variables because franchisee 8 expected problems to be solved in a relatively short term, and believed that the capabilities of other franchisors would not be better.
- SC org was considered the least relevant variable because according to this franchisee the ETOS' company-owned units were a guarantee that management would pursue a favorable store policy.

During SCT5 SC growth was not a determining variable because management did not enforce franchisees to renovate or relocate their stores, and there were no problems with exclusive territories.

In sum, franchisee 8 had reached his thresholds regarding OC profit, SC pos, and SC innov, and therefore he adopted covo. At this time, management6 was already operative, and it adopted a passive response toward this franchisee because it expected that he would not be willing to fulfil the increased requirements, resulting in a low SC hard. In reaction to this, franchisee 8 adopted exit in favour of an attractive alternative. Franchisee 8 also perceived the switching costs as low, which made the exit even easier.

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Responses preceding amloy

Franchisees 9 and 10 adopted amloy for a very short period of time. However, before the price stunting they had adopted loy because at that point in time they had been satisfied with the relationship as it was.

Amloy as initial response

The amloy franchisees showed the same determining variables as the loy franchisees, and for the same reasons. However, they differed in their perceptions of these variables, which explains the difference in their responses. The determining variables and the amloy franchisees' perceptions of these variables were the following:

- OC profit. The amloy-franchisees already had the luxury perfumes in their assortments and were concerned that their profits would drop. Therefore, they expected that their OC profit would decrease in the future.
- SC hard. The franchisees rated SC hard as high to very high, so this did not pose problems.
- OC trust/fd. The franchisees rated this variable as high to very high.
- SC pos. The amloy franchisees feared that their positioning would be damaged if the suppliers of the luxury perfumes would no longer supply them, with the result that they could not maintain their higher positioning. However, they perceived the price stunting as inevitable.
- SC innov. The franchisees rated SC innov as very high.
- OC capa. The franchisees rated this variable as high.
- SC org. The franchisees rated this variable as very high.

The franchisor adopted loy simply by introducing the perfumes. The franchisor did so because he believed the franchisees would agree with this course of action, resulting in a high SC hard.

Responses subsequent to amloy

As already indicated, almost immediately after its introduction the price stunting was a success in terms of turnover levels and profits. Therefore, franchisees 9 and 10 switched back to loy relatively shortly afterwards.

Determining variables of the franchisees' responses in order of importance					
Covo	Loy	Amloy	Negl	Agvo	Exit
OC profit SC hard OC trust/fd SC pos SC innov OC capa SC org	OC profit SC hard OC trust/fd SC pos SC innov OC capa SC org	OC profit SC hard OC trust/fd SC pos SC innov OC capa SC org	-	-	Not directly related to SCT5: OC profit SC hard OC trust/fd SC pos SC innov OC capa SC org
Determining variables of the franchisor's responses (to the franchisees' responses) in order of importance					
Franchisor's response to covo= covo 'Preventing destructive responses'	Franchisor's response to loy=loy OC capa SC hard OC profit	Franchisor's response to amloy=loy OC capa SC hard OC profit	-	-	Franchisor's response to exit=negl OC profit OC capa SC hard

Table 7.2 Summary of determining variables per response type in order of importance during SCT5

7.7.2 Analysis of SCT6: 'Introduction of the Four Worlds format'

Table 7.3 presents a summary of the data of SCT6. For each response type, it presents the number of respondents (franchisees), the modus of these franchisees' perceptions of the independent variables and the modus of the franchisor's responses. The sample consists of five covo responses, eight loy responses, two amloy responses and one agvo response.

Res- ponse of FRE	Strategic compatibility (SC)					Operational compatibility (OC)					Res- ponse FRO
	SC Pos	SC Hard	SC Innov	SC Org	SC Growth	OC Capa.	OC Profit	OC Trust/ fd	Attalt.	Swico	
Covo N= 5	Med/ very high (-/+)	High/ very high (+)	Med/ very high (+)	High/ very high (+)	NP	Med	Med	High	Very low	Low	Covo
Loy N=8	High/ very high (+/-)	Very high	Very high	Very high	NP	High	High	Very high	Low/ med	Low	Loy
Amloy N=2	Med (+/-)	Low/ very high (+)	Med/ very high (+)	High/ very high (+)	NP	Med	Med	Med/ high	Very low/ low	Low	Loy
Negl N=0	-	-	-	-	-	-	-	-	-	-	-
Agvo N=1	Med (+)	Low (-)	Med (+)	Low (+)	NP	Low	Med	Low	Very low	High	Covo
Exit N= 0	-	-	-	-	-	-	-	-	-	-	-

Table 7.3 Summary of data for SCT6

Fig. 7.11 presents the development patterns of the franchisees' responses during SCT6.

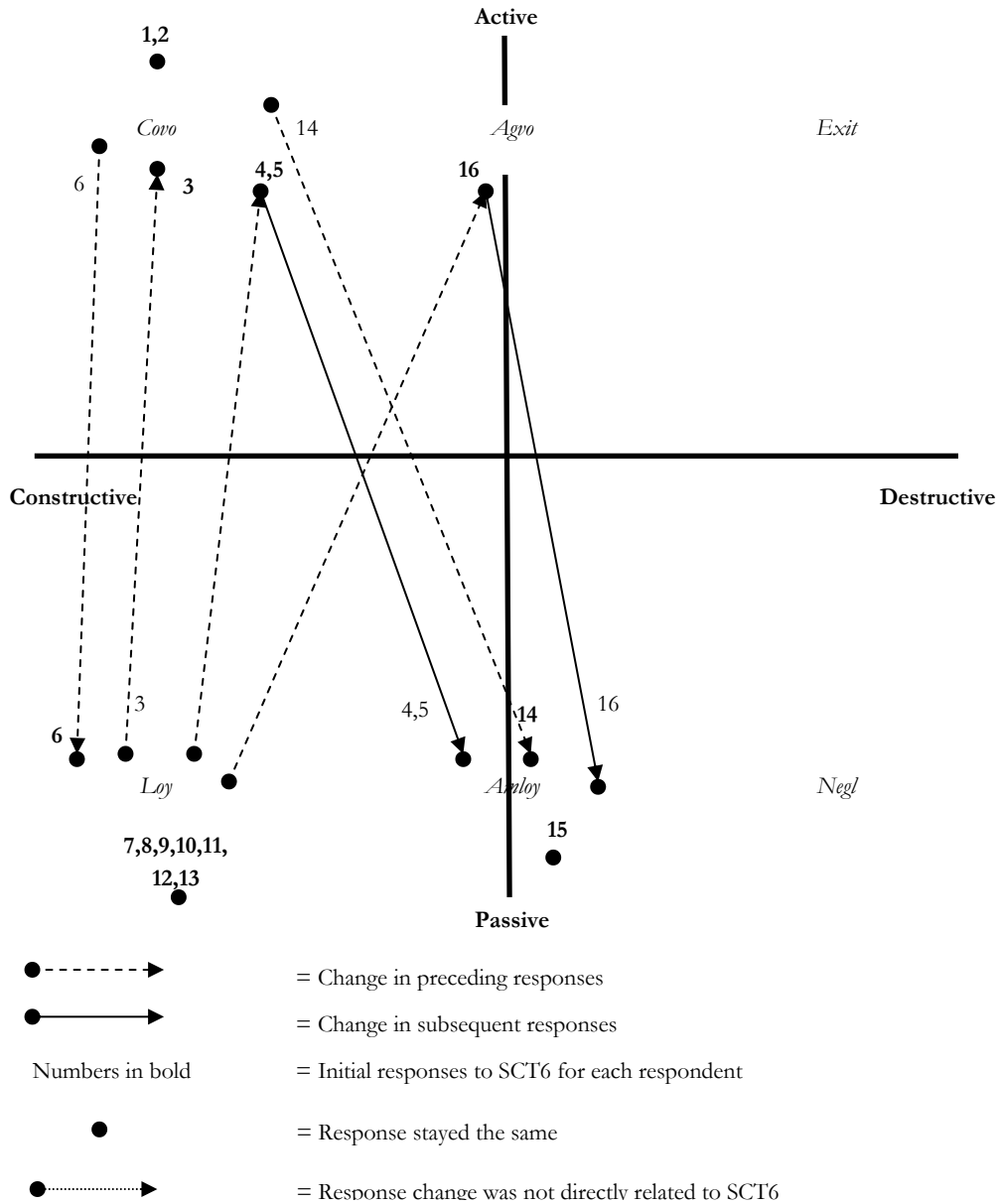


Fig. 7.11: Development of franchisees' responses to SCT6

Responses preceding covo

As pointed out in Fig. 7.11, franchisees 1 up to and including 5 adopted covo as an initial reaction to the introduction of SCT6 (see bold numbers). Of these franchisees, franchisee 1 and 2 had formerly adopted covo because they were members of the Franchise Board.

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Franchisee 3 became a member around the introduction of SCT6. Franchisees 1, 2 and 3 had been involved in the development of the Four Worlds format from an early stage. Franchisees 4 and 5 had precedingly adopted loy.

Covo as initial response

At the introduction of SCT6 franchisees 1, 2 and 3 were members of the Franchise Board. Their covo responses can be explained by their determining variables and their perceptions of these variables. Their determining variables during SCT6 were in order of importance:

- OC profit. This variable was considered as the most important one because the franchisees wanted to know the costs of the Four Worlds format investments and how these would influence the stores' turnover levels. In other words, how the adoption of the format would influence OC profit. Because these franchisees were members of the Franchise Board they were not only interested in what the consequences would be for their own stores, but also for those of other franchisees. At the introduction of SCT6, the franchisees rated OC profit as medium because they believed that the Four Worlds format would be too expensive for their own stores and those of several other ETOS franchisees. In other words, they expected a low to medium OC profit in the near future.
- SC hard. This variable was considered as important because the franchisees wanted the Four Worlds format to be realized in order to increase the reputation of their brand name as well as to establish a consistent positioning. Franchisees 1, 2 and 3 already perceived SC hard as high, but in their view the ETOS system could be even harder, which was in line with management's objectives.
- OC trust/fd. This variable was considered as important due to the increasing requirements after the introduction of the Four Worlds format. Franchisees 1, 2 and 3 perceived a high degree of trust.
- SC pos. This was an important variable because the adoption of the Four Worlds format resulted in a certain positioning. Franchisees 2 and 3 approved of this positioning, but franchisee 1 was afraid that it would still be too high and preferred it to be slightly lower. However, he still perceived SC pos as high.
- SC innov. This was a determining variable for the same reasons as SC pos; because of the requirements related to it. Franchisees 1, 2 and 3 had different perceptions of SC innov, which can be explained by their different types of locations (see 'Background variables'). But all of them considered SC innov at least as medium, which was above their threshold.
- OC capa. This variable was important because of the requirements attached to it. However, the franchisees expected that problems regarding the franchisor's capabilities would be solved in a relatively short term because ETOS had company-owned units that would suffer just as much from operational problems. Therefore, the franchisees trusted that management would do all it could in this respect.
- SC org. Franchisees 1, 2 and 3 considered this variable as slightly important, but they made clear that they wished to be 'conversation partners', giving a certain amount of information and advice. However, in the end management had to make the decisions because it knew what the consequences would be for the whole system. This is why SC org was the weakest determining variable.

Franchisees 1, 2 and 3 considered neither alternatives nor switching costs because they were generally satisfied with the relationship.

In turn, management6 adopted covo by developing a 'cheaper' version of the Four Worlds format in terms of required investments (for example by adapting store materials and hiring a less expensive interior builder). This would not only be more profitable for the franchised stores but also for their company-owned units.

Franchisees 4 and 5 had different motives for adopting covo. They shared the same determining variables in the same order of importance but they differed in their perception of these variables from the other three covo franchisees. In contrast to franchisees 1 to 3, franchisees 4 and 5 felt more or less 'forced' to adopt covo because they expected the relationship to deteriorate otherwise.

- OC profit. The franchisees wanted to know how the switch to the four world format would influence their stores' profitability; they were afraid that the costs of investing in the new format would not lead to higher turnover levels, thereby resulting in lower OC profit.
- SC hard. The franchisees believed that a well-known brand name was important but in their view they had too little room for local exploration. With respect to degree of hardness they applied lower thresholds than the other covo-franchisees did. They sometimes did not fulfil their requirements, and because their operational manager was not so strict they still rated SC hard as medium to high.
- OC trust/fd was important because of the requirements. Franchisees 4 and 5 rated this variable as medium to high.
- SC pos. Franchisees 4 and 5 were of the opinion that the Four Worlds format was too luxury. Therefore they rated SC pos as medium, and they expected it to be lower in the future.
- SC innov. The franchisees assigned a medium to a very high score to this variable. This difference between them can be explained by variances in location (see background variables, see section 7.8.3).
- OC capa was less a determining variable than the other ones because the franchisees expected that problems in this field would be solved in short periods of time, and that circumstances would not be better in other systems.
- SC org. This became a determining variable for the sole reason that franchisees 4 and 5 did not agree with the proposed requirements. Earlier on they had not had problems with these requirements because they approved of their contents. However, the franchisees felt that the Franchise Board had too little power to influence them, which is why they directly contacted management to discuss this issue.

The attractiveness of alternatives was rated very low, and also switching costs were perceived as low. The switching costs were not considered because the franchisees did not know of an attractive alternative to switch to, and therefore their height did not matter.

Management6 adopted covo by trying to explain why they made certain decisions and why it was in the stores' interest to invest in the Four Worlds format.

Responses subsequent to covo

Franchisees 1, 2 and 3 maintained their covo responses. Because they were members of the Franchise Board, they had contact with management6 on a regular basis.

Franchisees 4 and 5 had switched from covo to amloy as a subsequent response. Franchisee 4 was still hesitant to invest in the Four Worlds format because he was not sure what it would mean for his store's profitability.

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Franchisee 5 had made the investments in an early stage of the Four Worlds format because management had convinced him that his turnover level, and thus his profitability, would rise. However, franchisee 5 felt that his turnover levels had not increased, resulting in a decreased OC profit. Therefore, the franchisee switched to amloy. Next to changes in OC profit, there were also changes in this franchisee's perceptions of SC hard, SC pos, and SC org. Franchisee 5 believed that in the future the degree of hardness would increase and SC hard would decrease below his threshold. At the time when franchisee 5 invested in the Four Worlds format, he had expected a clearer positioning in the market. However, franchisee 5 was of the opinion that management's attitude was not consequent as regards positioning, because it reacted too strongly on different competitors. SC org had become more important because franchisee 5 did not agree with certain requirements. Via the Franchise Board he tried to make himself heard, but he felt that this did not work.

Responses preceding loy

Franchisees 6 up to and including 13 initially adopted loy. The preceding response of franchisee 7 up to and including 13 had mostly been loy because in general they were satisfied with ETOS and the relationship. The preceding response of franchisee 6 was covo. Franchisee 6 had been involved in the Franchise Board for several years but had withdrawn because of personal reasons, which made him wanting to spend fewer days at the business location.

Loy as initial response

As pointed out, franchisees 6 up to and including 13 adopted loy as initial response. Their perceptions of the determining variables were slightly different from those of the 'forced-covo' franchisees. Their perceptions and thresholds were higher than those of franchisees 4 and 5, which is why they did not feel the need to adopt an active response.

- OC profit was considered as high and expected to be high in the near future.
- SC hard was perceived as very high.
- OC trust/fd was perceived as very high.
- SC pos was perceived as high/very high.
- SC innov was perceived as very high.
- OC capa was perceived as high.
- SC org was perceived as very high.

SC growth was not a determining variable because management did not enforce the franchisees to renovate or relocate their stores and there were no problems with exclusive territories.

In sum, these franchisees perceived the relationship as highly attractive. Therefore, alternatives and switching costs were not really considered.

Management adopted loy toward these franchisees because it expected that they would adopt the Four Worlds format at some point in the future. The franchisor had communicated toward all the franchisees that it was developing a cheaper version and expected that they would be willing to adopt this one.

Responses subsequent to loy

At the time of the interviews, these franchisees had maintained loy.

Responses preceding amloy

As Fig. 7.11 points out, franchisees 14 and 15 adopted amloy as initial response. Franchisee 14 had always been an active member of the Franchise Board, but at some point he had become dissatisfied. This was also the reason he left the Franchise Board. He was hesitant to invest in the Four Worlds format, and was waiting to see how it would develop. Franchisee 15 was in another situation. He ran a relatively small ETOS store in a village where the cost level was considered as highly important because of the relatively low and stable turnover level. Franchisee 15 did not wish to be confronted with all of the requirements. Therefore, he did not react arguing that when it would not work out he would switch to an alternative. Because there was another drugstore in the village, this franchisee experienced the tension between benefiting from a well-known brand name and costs issues.

Amloy as initial response

Franchisees 14 and 15 adopted amloy, but for different reasons. The reasons of franchisee 14 to adopt amloy were:

- OC profit. He was not convinced that the extra investments would result in a higher turnover level, and he was afraid that his store's profitability would be damaged.
- OC trust/fd. This was a very important variable in the eyes of this franchisee, and he continued to give this a very high rating because of the presence of the ETOS company-owned units. He argued that he would have left ETOS if there had not been company-owned units.
- SC hard. The franchisee considered the uniformity of the ETOS system as very important and was of the opinion that management had not sufficiently enforced the requirements regarding this issue. Franchisee 14 did not want to invest in a format that was not actually enforced across the whole system, and that did not involve a consistent presentation toward customers.
- SC pos. He rated this variable as low because he felt that ETOS was still stuck in the middle and due to low enforcement levels did not have a clear positioning.
- SC innov. He considered this as important, but believed that because management did not enforce the requirements it was not capable of making proper arrangements with the suppliers of new products and product groups, which resulted in a low rate of innovation.
- SC org was important because franchisee 14 did not agree with certain requirements and believed that the Franchise Board did not work the way it should. Therefore, he assigned a low score to SC org.
- OC capa. This variable was considered as important, but less so than the other variables because franchisee 14 expected that problems would be solved in a relatively short term.

This franchisee rated the attractiveness of alternatives as low, although he had figured out one alternative in case he would really want to exit. He considered the possibility of renting his locations to some large company-owned retail chain. Apparently he had not yet reached his thresholds with respect to his determining variables, otherwise he would already have switched to this alternative. He considered switching costs as low.

Toward franchisee 14 management adopted loy for the same reasons as it had done toward the loy franchisees: the expectation that this franchisee would eventually switch to the Four Worlds format.

Franchisee 15's determining variables were in order of importance:

- OC profit/cost. To this franchisee the cost level of participation was particularly important because he considered his turnover level as constant, and did not expect to attract more customers by investing in the Four Worlds format. As pointed out in the DA Chapter, OC profit/cost is a variation of OC profit.
- SC hard. Franchisee 15 considered this variable as very important because he considered the degree of hardness as related to the cost level. Because of the stable turnover level, the cost level was also regarded as very important. The franchisee rated SC hard as medium since he still experienced a great deal of freedom; he was in the position to make certain arrangements with management about particular requirements. In this way the cost level was kept relatively low.
- SC pos. This variable was considered important because positioning was for the greater part obligatory. Franchisee 15 rated SC pos as medium because he believed that in his village a lower positioning with a less expensive image was required.
- SC innov. This was a determining variable because the rate of innovation was obligatory for the larger part. The franchisee assigned a very high score to this variable, so this was not a problem. This high score can be explained by the fact that the franchisor allowed this franchisee some freedom with respect to the adoption of certain adaptations, which resulted in an acceptable cost level.
- OC trust/fd. This variable was important in view of the requirements, but because franchisee 15 was subjected to fewer requirements than the other ETOS franchisees he considered it less important.
- SC org was not considered important for two reasons. First, because the franchisee experienced a relatively great deal of freedom, he did not consider strategic participation as important. Second, he trusted that management would make the right decisions about the ETOS system in general, because the franchisor had company-owned units and was acquainted with their activities.
- OC capa. This variable was considered important, but, like many other franchisees, franchisee 15 expected that problems would be solved in a short term.

Franchisee 15 felt that alternatives were scarce because in his village there was another drugstore. Therefore, to compete with this store the ETOS name was required. However, the franchisee argued that if this drugstore would ever disappear he would seriously consider an alternative drugstore system with a less well-known name and operating by means of a lower cost level.

The franchisor adopted *covo* toward this franchisee by accepting a lower degree of hardness regarding certain elements, so costs would stay at an acceptable level. The franchisee needed to invest in the new Four Worlds format, but management accepted some creative solutions to keep the cost level low. The reason for this is unclear, but there were several indications that it had to do with personal bonds with management. Another explanation is that the store's location was in a small village and for ETOS this location was less important than a location in a well-known place in the Netherlands.

Responses subsequent to amloy

Both franchisees 14 and 15 expected that in the future they would eventually have to adopt the Four Worlds format. For franchisee 14 the most important reason for this was a lack of alternatives. As pointed out, franchisee 15 expected that also in the future the franchisor would allow him to keep the costs at an acceptable level. A few months after the interview, the franchise contract had to be extended and the franchisee had decided to continue with

ETOS. This decision would increase his switching costs because if he terminated the contract before it had ended, he would have to pay the remaining fees for its original duration. Although franchisee 15 was aware of this, he accepted it because in his view there was a lack of attractive alternatives.

Responses preceding agvo

Franchisee 16 adopted agvo in reaction to the introduction of SCT6. His preceding response was loy, because in general he had always been satisfied with the ETOS system and the franchise relationship.

Agvo as initial response

Franchisee 16's agvo can be explained by the following determining variables and his perceptions of them:

- OC profit. He felt that the costs of the Four Worlds format were not in balance with the turnover level, which would result in a low OC profit in the near future.
- SC hard. He felt that the ETOS system had become harder over time, and he expected that after the introduction of the Four Worlds format this hard line would be continued, causing a low SC hard. Additionally, in his opinion the style of management had become more authoritarian in the sense of more small rules which had to be followed strictly. Franchisee 16 did not approve of this development.
- OC trust/fd. He considered this variable as important in the light of the requirements, especially because in his eyes these requirements increased. He rated the degree of trust and fair dealing as low. He had the impression that ETOS earned money on certain products that he was forced to sell and that his margins were very low. This concern made him extra susceptible to the low degree of trust.
- SC pos. According to franchisee 16 management was not consistent in its positioning policies in that it aimed at a higher positioning but continued to introduce the non-drugstore-related goods resulting in lower margins. The franchisee did not approve of non-drugstore-related goods because these often costed more than they yielded; or in other words, resulted in lower OC profits.
- SC innov. He considered this variable as important to his location, but he was of the opinion that ETOS did not realize a high rate of innovation. In franchisee 16's view it merely followed the competitors.
- SC org. To this franchisee this variable was important because he did not agree with the changes. Therefore, he contacted the Franchise Board hoping that it could negotiate with management. However, he believed that the Franchise Board did not work well. In his view it consisted of people who could not relate to his situation because they operated different types of stores.
- OC capa. Franchisee 16 rated this variable as low, mainly because of problems in the field of automation, communication and general support.

Responses subsequent to agvo

Franchisee 16 had shifted from agvo to amloy. Because of the efforts of management, the cost level of investing in the Four Worlds format had slightly improved, and therefore franchisee 16 expected OC profit to become more favorable in the future. He accepted the low scores of the other determining variables for three reasons:

- The low degree of attractiveness of alternatives.

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- The high switching costs, which were mainly caused by the fact that the store’s building was rented from Ahold. If he decided to exit, he would no longer be able to use the store’s location.
- Age: franchisee 16 expected to retire in a few years time, and was willing to deal with the incompatibilities during this last phase. Age is a background variable that indirectly influenced this franchisee’s responses (see section 7.8.3).

Exit as initial response and preceding responses

There were no respondents who initially adopted exit. Therefore, it could not be analyzed as initial response, and so preceding responses do not apply here.

Determining variables of franchisees’ responses in order of importance					
Covo	Loy	Amloy	Negl	Agvo	Exit
Franchisees 1 to 3: OC profit SC hard OC trust/fd SC pos OC innov SC innov OC capa SC org	OC profit SC hard OC trust/fd SC pos SC innov OC capa SC org	Franchisee 14: OC profit OC trust/fd SC hard SC pos SC innov SC org OC capa	-	OC profit SC hard OC trust/fd SC pos SC innov SC org OC capa Attract alt Switch costs	-
Franchisees 4 and 5: OC profit SC hard OC trust/fd SC pos SC innov OC capa SC org		Franchisee 15: OC profit/cost SC hard SC pos SC innov OC trust/fd SC org OC capa			
Determining variables of franchisor’s responses (to franchisees’ responses) in order of importance					
Franchisor’s response to franchisees 1 to 3= covo OC capa SC hard OC profit	Franchisor’s response to loy= loy OC capa SC hard OC profit	Franchisor’s response to franchisee 14= loy OC capa SC hard OC profit	-	Franchisor’s response to Agvo= negl OC capa SC hard OC profit	-
Franchisor’s response to franchisees 4 and 5		Franchisor’s response to franchisee 15= covo Reason is unclear			

Table 7.4 Summary of determining variables per response type in order of importance during SCT6

7.8 Summary and conclusions for ETOS and its SCTs

This section discusses the three types of conclusions that can be drawn from the ETOS case and its SCTs. The structure is as follows:

- 5.8.1 Conclusions about the independent variables.
- 5.8.2 Conclusions concerning relationships between independent variables and responses
- 5.8.3 Conclusions about background variables.

The conclusions about the two SCTs are discussed together.

7.8.1 Conclusions about the independent variables

This subsection is divided into:

- 1) Independent variables from the franchisees' perspective
- 2) Independent variables from the franchisor's perspective
- 3) Relations between independent variables

1) Independent variables from the franchisees' perspective

This section will first discuss the conclusions about the independent variables as such. After that various relations between the independent variables and their indicators will be dealt with.

Strategic compatibility

With respect to strategic compatibility from the franchisees' perspective the following conclusions can be drawn:

- The ETOS franchisees were more easily prepared to accept a certain degree of hardness, because the ETOS system had company-owned units. Since in adopting certain changes ETOS itself would also run a risk, the franchisees could be more easily convinced to accept certain requirements. Next to this, there was an important difference with DA and STIP with respect to the automatically sent-in goods. Because ETOS franchisees had the right to send back these goods they had less problems with them. In sum, because the franchisees trusted that the franchisor would not act opportunistically and would take the franchisees' interests into account (high OC trust/fd), they were more willing to adopt certain requirements.
- Also with respect to the ETOS case the extent of enforcement by the franchisor turned out to be a very important aspect of the degree of hardness variable. 'On paper', the ETOS system had been relatively hard from the beginning (compared to the DA system). However, in practice, ETOS' management allowed a lower degree of hardness to realize certain quantitative growth objectives. Additionally, the ETOS case showed that the operational managers partly influenced the 'actual' degree of hardness: some operational managers were stricter than others in enforcing certain requirements.
- There were indications that due to the relatively high degree of hardness franchisees checked on each other whether they fulfilled their requirements (peer

monitoring'). This can be explained by the fact that they all had to make certain investments and did not want other franchisees to 'free ride' on them.

- With respect to rate of innovation the different levels became apparent again. On the level of new products the ETOS franchisees generally considered a high rate of innovation as important. On the more 'radical' levels (product groups and other business format adaptations and the business format as a whole), due to their competitive circumstances franchisees also considered innovation as important. However, on these levels they were more careful and they wanted to know how the adoption of certain innovations would affect their profitability. Most ETOS franchisees expected that they could increase their turnovers as well as their profitability by means of investing in particular innovations. In this respect the company-owned units played two roles. First, they were used to experiment with certain innovations, and the test results and information were used to convince franchisees to adopt them. Second, the company-owned units increased the franchisees' trust that their interests were taken into account, because ETOS would not introduce innovations to franchisees that did not work in their company-owned stores.
- With respect to SC org it appeared that apart from the organization of the franchisees' strategic participation also its practical workability was important. At least, this was the case at DA and STIP. From the ETOS case it became clear that the way in which strategic participation is used in practice depends on the management team. It also became clear that it mattered to the franchisees who were in the Franchise Board: the Franchise Board members had to be representatives of the large group of franchisees. This was especially important because the Franchise Board had to represent all ETOS franchisees' interests.

Operational compatibility

- With respect to operational compatibility, OC profit and OC trust/fd were the most important factors. OC capa was the weakest determining variable, since the franchisees expected that, given the fact that ETOS had company-owned units, it would do everything in its power to properly perform the operational activities.
- As already indicated, OC profit was important because the franchisees were always eager to know how certain requirements/investments would affect their profitability. In the ETOS case the franchisees expected that they could increase their profitability by making particular investments. This attitude was mainly the result of their competitive circumstances (background variable, see 7.8.3).
- OC trust/fd was considered very important because of the requirements that had to be met within the ETOS system. The franchisees had a high degree of trust in the franchisor. This could be explained by the fact that the franchise system had institutionalized certain 'instruments' for this purpose. These were the following (see section 7.3.2): the number of company-owned units, the organization of the franchisees' strategic participation, the right to send back automatically sent-in goods, the role of third parties and the way of calculating fees. As will be pointed out in Chapter 9, these factors influenced the franchisees' trust in the functioning of the ETOS system. I will call this concept 'franchise system trust'. Because several instruments were institutionalized in the system, the franchisees were highly confident that the franchisor would take their interests into account and would not act opportunistically.

Attractiveness of alternatives

- In general, the ETOS franchisees saw few alternatives to ETOS because for a long time it was considered as the only hard franchise system in the Dutch drugstore industry. It is interesting to observe that in later years some ETOS franchisees started to consider DA as a more attractive alternative. The main reason for this was that the DA system had become slightly harder over time. When considering alternatives, most ETOS franchisees looked at whether or not the system had a well-known brand name. They did not regard the softer systems, such as STIP or UED as attractive alternatives since, these did not carry well-known brand names, which in their opinion was necessary in view of their competitive circumstances.
- Another possible alternative was that ETOS franchisees rented their building to a large company-owned chain, such as Kruidvat or any other retail chain that would be interested. This indicates that some ETOS franchisees did not attach much value to operating as druggists. They rather considered themselves as small business owners who could run any type of business as long as it was profitable (see background variables section 7.8.3).

Switching costs

- Switching costs could vary over time, involving certain ‘cycles’. When a franchisee had made specific investments the financial switching costs were high. After some years these investments would be fully recouped, resulting in lower financial switching costs. In addition, apart from the financial switching costs there were contractual switching costs. The franchise contract had a duration of five years, with possible extensions of five years each time. If the franchisee wanted to end the relationship in an earlier stage, the franchise contract stated that the franchisor would be paid a compensation during the remaining period. The cycles of ‘financial’ and contractual switching costs were often not completely synchronous, and this meant that situations could differ with respect to the total switching costs. However, it was important that the (remaining) contract period was long enough for the franchisee to recoup his investments.
- Moreover, the height of the switching costs depended on to what extent management was inclined to observe the rules of paying remaining fees. The franchisees indicated that according to their knowledge management had never actually applied these rules.

2) Conclusions from the franchisor’s perspective

- The franchisor had to deal with a tension between the type of growth objectives and the degree of hardness. A franchise system requires a certain scale and dispersion of units in order to operate under a nationally known brand name. To realize this, management had mainly adopted a quantitative growth strategy in the 1990s. In order to attract a large number of stores, management initially accepted a lower degree of hardness. However, when it wanted to increase the degree of hardness its growth objectives became more qualitative.
- As the timelines in section 7.2 show, from the franchisor’s perspective there were relatively small differences between the desired score on certain franchise system characteristics and ‘what actually happened’ (compared to DA). These differences were not so large since ETOS had company-owned stores in which it could

introduce changes relatively quickly and due to the relatively high degree of hardness. Moreover, as already explained, the company-owned units also helped in convincing franchisees to adopt certain changes.

- Also within ETOS, as far as the franchisor was concerned, the organization of strategic participation actually played a different role than the other franchise system characteristics did. From the franchisor's perspective, strategic compatibility with individual franchisees regarding this characteristic was not really important; the organization of strategic participation was merely an instrument for creating support for certain requirements within the large group of franchisees.

3) Relationships between independent variables

In the ETOS case there were also indications of relationships between independent variables and/or indicators:

- Relationships between franchise system characteristics. Similar to DA and STIP, the ETOS case indicates that there were certain relations between franchise system characteristics. It is not possible to discuss all relations here in detail, and Chapter 9 will provide a more systematic analysis of this issue.
 - Relation between rate of innovation and degree of hardness. Because ETOS had company-owned units and was a relatively hard system in which innovations could be introduced rapidly, it was possible to realize a high rate of innovation.
 - As in the other cases, a higher degree of hardness led to a higher degree of organization of franchisees' strategic participation. This became especially clear during SCT6 when management wanted to further increase the degree of hardness. Although the franchisees' strategic participation was already highly organized, management expressed the importance it attached to it to the Franchise Board by making an extra 'Agreement'. Although this agreement did not specify any extra procedures, management considered it necessary to make this agreement in the light of the increasing degree of hardness. With the Agreement management emphasized the importance it attached to trust within the franchise system.
 - As for the DA-case, there were clues that a higher degree of hardness would result in more qualitative growth objectives by management.
- It is interesting that most ETOS franchisees did not emphasize the relations among degree of hardness, positioning, rate of innovation and the cost level. Most ETOS franchisees looked at OC profit rather than at OC profit/cost. Most franchisees expected they would be able to improve their turnover levels and profitability by means of particular investments.

7.8.2 Conclusions concerning relationships between independent variables and responses

This section consists of two subsections:

- 1) Conclusions from the franchisees' perspective
- 2) Conclusions from the franchisor's perspective

1) Conclusions from the franchisees' perspective

Conclusions about the responses

- As was the case with DA and STIP, the franchisees' responses were more heterogeneous than expected. Also within the ETOS case an 'ambiguous loyalty' response prevailed.
- Moreover, franchisees adopting covo differed in their motives for doing so. Some franchisees responded this way because they felt 'forced' to; they felt that if they would act otherwise the relationship with the franchisor might deteriorate, which was undesirable ('forced-covo'). In contrast, other franchisees adopted covo because they agreed with management's plans but wanted to be actively involved in discussing future possibilities ('voluntary-covo'). As in the other case studies, these franchisees often had close personal contacts with management and in turn were 'used' to create support within the large group of franchisees.

Conclusions about relations among the variables of the research model

- As was the case within DA and STIP, the following aspects turned out to be important in understanding a particular franchisee's response at a certain point in time:
 - The franchisee's determining variables at that point in time.
 - The franchisee's perceptions of these variables at that point in time.
 - The franchisee's thresholds with respect to these determining variables.
 - The franchisee's expectations regarding future developments of these determining variables.
- Tables 7.2 and 7.4 illustrate that the determining variables and their order of importance are identical with respect to the different responses as well as in both SCTs. The differences in responses can be explained by differences in the franchisees' perceptions of the determining variables, their thresholds with respect to these variables and their future expectations.
- The fact that the determining variables are the same can be explained by the fact that ETOS has been a relatively hard system from the beginning. Therefore, it has attracted certain 'types' of franchisees that have more or less the same background variables (see 7.8.3). At DA the heterogeneity among franchisees was much bigger, which also explains their larger heterogeneity as regards their determining variables and responses.
- The tables show that many variables from the research model were considered important ('determining') by the franchisees. An explanation for this is that ETOS has always been a relatively hard franchise system in which many elements were obligatory, such as positioning, rate of innovation and services by the franchisor (regarding which the franchisor's capabilities were important). With respect to the aspects that were obligatory compatibility was considered important. In addition, due to the degree of hardness, franchisees felt they were dependent upon the franchisor and believed that a certain degree of trust in the franchisor was crucial. In other words, they had to be certain that the franchisor would not act opportunistically and would take the franchisees' interests into account (OC trust/fd). For that same reason, SC org was also a determining variable; franchisees considered a high organization of strategic participation as important because this was a guarantee that the franchisor would take into account the franchisees'

interests as regards the requirements imposed upon them. However, as pointed out, the ETOS company-owned units also helped a great deal in convincing franchisees that their interests were taken into account.

- The tables show that OC profit was the most important determining variable: franchisees accepted certain requirements as long as they believed them to be profitable. The DA-case differed slightly. Here certain franchisees did not accept any requirements because they considered their status as independent small business owner as highly important. To ETOS franchisees SC hard was also a significant determining variable, because they preferred a well-known brand that expressed a certain identity (positioning and rate of innovation). Because positioning and rate of innovation were largely obligatory, in this respect strategic compatibility was also important. As pointed out, to the ETOS franchisees OC trust/fd was important because of the requirements they were faced with, and the institutionalization of different instruments positively influenced this trust. These instruments ensured that the franchisor took their interests into account, making SC org less important. However, SC org would again gain importance whenever a franchisee absolutely did not approve of certain changes and tried to stop them via the Franchise Board.
- Also to the ETOS case it applies that franchisees first evaluated their strategic and operational compatibility with the franchisor before seriously considering alternatives and switching costs. In the adoption of agvo by one particular franchisee (during SCT6) these variables clearly played a role. Due to a low level of attractiveness of alternatives and high switching costs he felt forced to stay with ETOS.

2) Conclusions from the franchisor's perspective

- Over time, the tension between the determining variables as perceived by the franchisor showed a pattern of change. Because the management's desired degree of hardness increased, the tension between SC hard and OC profit became stronger. This also applied to the tension between type of growth and degree of hardness. In the early 1990s, management accepted a lower degree of hardness because of its quantitative growth objectives, and it also accepted franchisees who were not that profitable to the franchisor (OC profit). As long as they could fulfil their financial requirements (OC capa), there had been few problems. However, during SCT6, management aimed at an increasing degree of hardness and it was not willing to accept large deviations from the Four Worlds format, not even in case the franchisee made high profits for the franchisor. In sum, during SCT6 also the tension between SC hard and OC profit as perceived by the franchisor became more visible.
- The franchisor's responses could not always be explained by the research model. Even though the franchisor argued that the system's uniformity, to which the degree of hardness was obviously related, was the most important issue, there were some franchisees of whom the franchisor accepted a lower degree of hardness. This could be explained by personal connections of the franchisor with these franchisees as well as the locations of these stores. Some ETOS stores were located in a village. For these stores it was less crucial to fully get the shared identity across and fulfil certain requirements.

7.8.3 Conclusions about background variables

This section consists of two parts:

- 1) Background variables from the franchisees' perspective
- 2) Background variables from the franchisor's perspective

1) Background variables from the franchisees' perspective

The background variables from the franchisees' perspective can be categorized into four groups:

- Store characteristics.
- Franchisee characteristics.
- Franchisor characteristics.
- Characteristics of the franchise system.

Store characteristics

- Location characteristics. This type of background variable has already been discussed as important background variable for the DA and STIP cases. It refers to the store's location and its competitive circumstances as perceived by the franchisees. This variable influenced the scores desired by the franchisees regarding certain franchise system characteristics, and thereby indirectly influenced the franchisees' perception of their strategic compatibility with the franchisor. The location characteristics determined whether franchisees regarded their turnover as stable or whether they felt that they could attract more customers and increase their profitability by making more investments. Most ETOS franchisees were located in town and larger city centers and they expected to attract more customers through particular investments. There were only a few ETOS franchisees located in villages, and they had relatively small floor areas and stable turnover levels, which influenced their attitude toward the adoption of certain requirements.
- History of the store. During SCT5 it became clear that the store's history played a role. A distinction can be made between 'drugstore-perfumeries' with a focus on regular drugstore products and some perfumes versus the 'perfumeries-drugstores' with a focus on luxury perfumes and some drugstore articles. This resulted in indirect as well as moderating effects. An example of an indirect effect is that the type of store influenced the positioning desired by the franchisee (as part of SC pos) and the franchisee's perception of the attractiveness of alternatives. An example of a moderating effect is that the type of store influenced the degree to which SC positioning was regarded as an important variable compared to the other independent variables of the research model. The 'perfumery-drugstores' considered SC pos as a more important determining variable than the 'drugstore-perfumeries' did.

Franchisee characteristics.

- The history of the ETOS franchisees. Over time, several ETOS company-owned units had been transformed to a franchised unit operated by a former ETOS-store manager in the role of franchisee. Franchisees of this kind differed from franchisees who had always had their own drugstores. First, they ran stores of a different type: former ETOS-managers used to run the drugstore-perfumeries,

while, in general, franchisees used to manage the perfumery-drugstores⁶⁶. An indirect effect of the history of the ETOS franchisees during SCT5 was the difference occurring between the desired degree of hardness and the desired positioning. The former managers were more used to working in a hierarchical environment and were therefore more inclined to accept a higher degree of hardness than the former independent druggists. Additionally, since the former store managers did not have the luxury perfumes in their assortments the price stunting did not really influence their perception of SC pos.

- Scope of the franchisees' activities. Next to their ETOS stores, several ETOS franchisees had more activities, mostly in the form of other (franchised) businesses. This had an indirect effect in the sense that these franchisees mostly preferred a very high degree of hardness because this enabled them to manage their stores from a 'distance'. Moreover, they often saw broader alternatives for their ETOS stores. They did not consider themselves solely as 'druggists' but as small business owners who could conduct several activities.
- Multi-unit franchising. Owning multiple ETOS stores had a similar effect on franchisees. They aimed at a high degree of hardness because this stimulated the standardization of the management of their stores, which was necessary because they were not always present in the stores themselves.
- Personal/psychological characteristics. The DA-case has already shown that for some franchisees their independence as small business owners was crucial, which was the reason why they did not approve of a certain degree of hardness, while other franchisees preferred a higher degree of hardness and considered their independence as relatively less important. The ETOS franchisees generally considered their independence as small business owners as less important, which indirectly influenced their perception of SC hard.

Franchisor characteristics.

- The 'style' of management. This was an important background variable to franchisees. 'Style' can be characterized by 'authoritarian style' on the one hand, and a 'participative style' on the other hand. The management style had indirect effects on the franchisees' responses. An indirect effect was that the style of management influenced the franchisees' perception of the 'actual' degree of hardness. The participative style of the management encouraged the view that the ETOS system was not really hard. Another example relates to the organization of strategic participation. As a result of management's participative style the franchisees perceived their strategic participation as well-organized.

Characteristics of the franchise system.

- The number of company-owned units. With respect to this characteristic an important variable was already introduced earlier, namely the significance of company-owned units within the ETOS system. The large number of company-owned units could be explained by the fact that ETOS had originally started off as an entirely company-owned system. As already explained, ETOS' relatively large stake in company-owned units had an indirect effect on OC trust as perceived by

⁶⁶ In later years, ETOS also attracted franchisees among independent druggists who did not have that many perfumes in their assortments.

the franchisees. In addition, it had moderating effects on the relative importance of variables in the model: because of the large number of company-owned units SC org was considered as a less significant variable because the franchisees knew that management would not introduce requirements if it did not believe they would work. The same applies to OC capa: because of its large number of company-owned units ETOS would just as much suffer from operational problems as the franchisees would and therefore the latter expected that management would do everything it could to prevent operational problems.

2) Background variables from the franchisor's perspective

As already mentioned in the DA and STIP cases, from the franchisor's perspective one type of background variable could be distinguished, namely managerial characteristics. Within this category two types of background variables can be distinguished:

- Management's experiences with former strategies. This variable had an indirect and moderating effect because it influenced management's view on viable strategies for the ETOS system, and how these strategies should be implemented.
- Personal characteristics of the managers. The managers from the management team had certain personal characteristics that indirectly influenced their management style and the way in which they responded to franchisees.

