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## **How Does the Franchisor's Choice of Different Control Mechanisms Affect Franchisees' and Employee-Managers' Satisfaction?**

### **Abstract**

Satisfaction of franchisees and employee-managers affects the overall performance of a franchise system. We argue that different actors in the same franchise system need to be treated in different ways. The franchisor's choice of control mechanisms affects the satisfaction of franchisees and employee-managers differently. To our knowledge this is the first study that gathers primary data from franchisees and employee-managers in the same franchise system at the store level with almost identical questionnaires. We show based on data from the largest German franchise system that outcome control leads to higher satisfaction among franchisees and employee-managers, while behavior control enhances employee-managers' satisfaction. Thereby, outcome control leads to higher satisfaction among more experienced franchisees, while behavior control enhances both highly and lowly experienced employee-managers' satisfaction. Our results suggest that franchisors face a dilemma: On the one hand, behavior control is associated with high costs and has no impact on franchisees' satisfaction at all. On the other hand, it might still be necessary to prevent franchisees from behaving opportunistically.

Keywords: franchising, plural form, control mechanisms, satisfaction

JEL: C21, M10, M13, M31

## Introduction

Franchising has become one of the most influential forms of retailing during the last decades (Beheler, Norton and Sen 2008; Dant 2008; Elango and Fried 1997). Most franchise systems are characterized by the coexistence of varying fractions of franchised and company-owned units under the same brand name (Bradach 1997; Sorenson and Sørensen 2001). Dant (2008) states that there are only few studies from the franchisees' perspective as compared to the amount of research from the franchisors' viewpoint. Single-country studies primarily originating from the US-American context and drawing on data from the fast-food industry dominate the field. We add to Dant's critique the observation that franchisees' and employee-managers' needs and positions are seldom juxtaposed and predominantly investigated from the franchisor's perspective (e.g., Garg, Rasheed and Priem 2005; Yin and Zajac 2004). This gap is puzzling with regard to the prevalence and popularity of the plural form in franchising practice (Bradach 1997).

In this study we ask: *How does the franchisor's choice of different control mechanisms affect franchisees' and employee-managers' satisfaction levels in a franchise system?* Studies from the franchisees' perspective focus on franchisee satisfaction, since it affects overall franchise system performance, the arrangement's future attractiveness and its maintenance in the long run (Dermer 1974; Gassenheimer, Baucus and Baucus 1996; Hing 1995; Morrison 1996). However, franchisees are only one part of a plural form-franchise system. From an agency perspective, ownership and goal achievement are split among the franchisor, the franchisees and the company-owned units (Eisenhardt 1989; Sen 1993). "The franchisor-franchisee relationship is a classic case of an agency relationship, as is the relationship between a chain's headquarters manager and a hired outlet supervisor" (Garg, Rasheed and Priem 2005, 188). Therefore, we need to explain both franchisee and employee-manager satisfaction with reference to goal and incentive alignment with franchisors. Due to their different positions within the franchise system, the impact of the determinants of franchisee

and employee-manager satisfaction may differ and lead to different satisfaction levels. Factors that promote franchisee satisfaction need not nurture satisfaction among employee-managers, since their assessments of the same factors, especially the franchisor's choice of mechanisms for monitoring their efforts and behaviors may differ. As an executive in Bradach's seminal study points out, "The worst thing you can do is treat a franchisee like an employee" (Bradach 1997, 300).

Throughout this study, we aim to contribute to the franchising literature as follows: First, we take Dant's (2008, 93) claim to deepen our understanding of the franchisee's side into account and additionally consider the employee-managers' viewpoint. Whereas prior literature mainly concentrates on issues pertaining to governance form choice, i.e., the optimal proportion of franchised and company-owned entities in a plural form-franchise system, the purpose of this study is to analyze the effectiveness of different control mechanisms for governing existing amounts of franchised and company-owned outlets in a single franchise arrangement in a retail setting (e.g., Brickley and Dark 1987; Lafontaine and Kaufmann 1994; Lafontaine and Slade 2001; Sen 1993). To our knowledge, control mechanisms in post-formation franchise system management are under-researched. Our study thus provides a novel approach. Second, based on agency theory, we identify factors that influence franchisee and employee-manager satisfaction and test our conceptual framework with a unique dataset from the tourism industry, namely with data from the largest German franchise system. To our knowledge this is the first study that gathers primary data from franchisees and employee-managers in the same franchise system at the store level with almost identical questionnaires.

The remainder of this article is organized as follows: We begin with a systematization of the satisfaction concept. Then, we present our theoretical framework and hypotheses, before we describe our dataset, variables and methods for theory-testing. Finally, we discuss our findings and outline implications for further research on plural form-franchise systems.

## **Conceptual Framework and Hypotheses**

### ***Franchisee and Employee-Manager Satisfaction***

Satisfaction relies on individual perceptions of factors that characterize an organization and directly concern its members. Franchisee satisfaction has not been studied in conjunction with employee-manager satisfaction, yet, although franchisees' and employee-managers' satisfaction affects the franchise system's overall performance and its viability in the long run. It is essential for explaining the principal's choice of control mechanisms that govern the franchisor-franchisee and the employer-employee relationships as two different types of agency relationships within the same franchise system.<sup>1</sup> Franchisees' and employee-managers' satisfaction levels are analyzed, since they involve all characteristics of the relationship between a franchisor and his franchisees and employee-managers and determine overall system performance (Ruekert and Churchill 1984).<sup>2</sup>

Franchisees and employee-managers are comparable with regard to their tasks, capabilities, and working context. Irrespective of their status as a franchisee or an employee, travel agents sell products and services based on their knowledge on, e.g., travel destinations and means of transportation. They provide travel booking services to individuals, groups, and companies, and use information and communication technologies in order to coordinate their cooperation with the franchisor (Bradach 1997). Factors that affect franchising and

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<sup>1</sup> We do not analyze the externalities that are the very idea of a plural form-franchise system, i.e., to generate positive externalities in the form of, e.g., product innovations developed in company-owned outlets that are subsequently applied in the entire system. The plural form-franchise system is an organizational form that internalizes these externalities.

<sup>2</sup> The unit of analysis in agency theory research is the contract that governs the relationship between a principal and his agents. Most studies drawing on agency theory investigate formal and explicit contracts. Any mutual agreement between two parties can be viewed as a contract and outcomes of contractual relationships do not have to be formal (e.g., monetary rewards or sanctions). Hence, agency theory is also applicable to social assessments of (informal) contracts, e.g., satisfaction. In franchise systems, satisfaction of franchisees and employee-managers is essential for explaining the principal's choice of control mechanisms that are the implementation of franchising and employment contracts. They govern franchisor-franchisee and employer-employee relationships. Satisfaction is important as it is an indicator of how efficiently control mechanisms for agency relationships in a single plural form-franchise system are implemented and executed. It is an indicator for how efficiently the costs of information and risk-bearing in both types of agency relationships in that system are organized (Bergen, Dutta and Walker 1992; Eisenhardt 1989; Lafontaine and Slade 2001).

employment contracts might create different levels of satisfaction depending on whether an agent is a franchisee or an employee-manager. Outcome and behavior control are the implementation of franchising and employment contracts (Rubin 1978). Satisfaction is promoted by different combinations of control mechanisms, depending on the type of contract. Being part of the same franchise system, franchisees and employee-managers share a common organizational context. Franchise systems adopt various combinations of control mechanisms in order to achieve appropriate levels of satisfaction among franchisees and employee-managers despite the shared context (Payne 2006).

### ***Control Mechanisms in Plural Form-Franchise Systems***

Control mechanisms are instruments that are used to monitor the activities and behaviors of the members of an organization (Koza and Dant 2007). The franchisor's monitoring efforts aim at preventing franchisees and employee-managers from behaving opportunistically.<sup>3</sup> He seeks to induce them to comply with the clauses and criteria included in their franchising or employment contracts, respectively (Garg, Rasheed and Priem 2005). The franchisor has two options. On the one hand, he can evaluate franchisees' and employee-managers' realized outcomes. The rewards that the agents get depend on their performance outcomes that need to meet the franchisor's expectations and goals, e.g., the sales volume that has to be achieved. On the other hand, the franchisor can use monitoring systems that help determine rewards based upon agreed job behaviors. The agreed job behaviors can be evaluated, e.g., with field observations by a manager from the headquarters of the franchise system (Beheler, Norton and Sen 2008; Bergen, Dutta and Walker 1992).

Plural form-franchise systems in the retailing industry require a mixture of control types (Bradach 1997; Lusch and Jaworski 1991). *Outcome control mechanisms* specify results that

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<sup>3</sup> In line with Ghoshal and Moran (1996), we differentiate between opportunistic *attitude*, i.e., the proclivity to act in a self-interested manner, and opportunistic *behavior*, i.e., the behavioral manifestation of this attitude (Wathne and Heide 2000). We here assume a potentially opportunistic attitude that need not become manifest in harmful actions, e.g., hiding information, shirking or cheating. Opportunism is hence an exogenous variable that justifies the implementation of control mechanisms in plural form-franchise systems.

are to be achieved by the franchise system and its units. They do not specify how a particular task may be fulfilled but what performance objectives need to be realized (Dekker 2004; Koza and Dant 2007). For instance, the franchisor can assess the extent to which goals regarding sales, budgets and other financial ratios are met. Franchisees think entrepreneurially and expect a certain leeway to act within the constraints that a franchise system might impose. Outcome control that involves incentives that drive a franchisee's motivation to pursue the franchisor's goals without constraining his autonomy are thus appropriate to increase his satisfaction (Bergen, Dutta and Walker 1992). Employee-managers tend to be more risk-averse than franchisees (Stewart, Watson, Carland and Carland 1998). Therefore, they may be less willing to accept the exploratory search that is needed to find out how to achieve pre-specified performance outcomes without or with only a few explicit behavioral guidelines on how the franchisor's expectations may be met. They instead prefer incentives that help them maintain established standards (Sorenson and Sørensen 2001).

*H1a: Franchisee satisfaction is positively affected by the extent of perceived outcome control.*

*H1b: Employee-manager satisfaction is negatively affected by the extent of perceived outcome control.*

*Behavior control mechanisms*, e.g., standard operating procedures, rules and regulations, stipulate in what manner members of the franchise system need to fulfill their tasks. They are used to monitor whether actual behaviors correspond to pre-specified behaviors (Dekker 2004). Franchisors tend to use more behavior than outcome control mechanisms to monitor employee-managers' efforts. Employee-managers get incentives to comply with the headquarters' pre-specified behaviors to maintain established practices and routines (Sorenson and Sørensen 2001). Thus, more entrepreneurially thinking individuals may feel restricted. Franchisees that are running a unit within a franchise arrangement on their own and have to make specific investments are likely to have a higher propensity to take risks than employee-managers (Stewart, Watson, Carland and Carland 1998). They are likely to prefer a control

type that does not constrain their behavior. A strong emphasis on behavior control may decrease their satisfaction.

*H2a: Franchisee satisfaction is negatively affected by the extent of perceived behavior control.*

*H2b: Employee-manager satisfaction is positively affected by the extent of perceived behavior control.*

### ***The Interplay between Experience and Control***

The relationships between the franchisor, the franchisees, and the hired outlet managers develop over time. Experience shapes franchisees' and employee-managers' satisfaction levels in different ways. The duration of franchisor-franchisee or employer-employee relationships contributes to the stability of the entire arrangement (Cochet, Dormann and Ehrmann 2008). The formation of routines for intra- and interorganizational coordination may strengthen these relationships, because they facilitate control or even make control mechanisms obsolete (Hoang and Rothaermel 2005). The repeated cooperation in franchise systems between the franchisor and the franchisees as well as the franchisor and the employee-managers can lead to refined interfaces between these actors for communication and decision-making. The introduction of conflict resolution routines and effective channels for knowledge transfer may further contribute to the emergence of stable interaction patterns and franchisees' and employee-managers' wisdom on how to effectively manage outlets according to their franchisor's concept and specifications. Guidelines, operating procedures and standards may be more likely to be accepted and internalized by franchisees and employee-managers (Dyer and Singh 1998). Over time and with growing experience, some control mechanisms may lose their importance to them.

Franchisees tend to benefit more intensely of the franchisor's service assistance and knowledge at the beginning of the franchise agreement than later on. The more experience a franchisee gains in his business, the less he needs the franchisor's support (Peterson and Dant 1990), because, "with increasing experience with franchising, franchisees acquire reasonable

proficiency and self-confidence in operating those systems” (Dant and Gundlach 1999, 43). Experienced franchisees are likely to know their business, can realistically assess what they need to do to be successful in that business, and whether and to what extent the franchise arrangement that they are contractually linked with can meet their expectations. Consequently, they tend to develop their own attitudes toward service quality that may differ from the franchisors’ specifications. The value of prior outlet-specific investments decreases and the franchisor’s expertise and value may even be questioned (Cochet, Dormann and Ehrmann 2008; Grünhagen and Dorsch 2003). The franchisor’s use of more behavior control will lead to lower satisfaction among franchisees with more experience. Among relatively more experienced franchisees, the use of more outcome control mechanisms that emphasize a franchisee’s entrepreneurial autonomy may be preferred to behavior control that tends to guide a franchisee’s way to fulfill tasks. We hence assume that the franchisees’ experience strengthens the impact of outcome control on franchisee satisfaction.

*H3a: The extent of perceived outcome control affects the satisfaction of more experienced franchisees more positively than that of less experienced franchisees.*

*H3b: The extent of perceived behavior control affects the satisfaction of more experienced franchisees more negatively than that of less experienced franchisees.*

There is no evidence on employee-manager satisfaction in franchise systems available. The duration of an employer-employee relationship suggests that there are no reasons for an employee to leave and strive for other career opportunities. Employee-managers also learn and internalize the skills and practices that are associated with a business format over time. At the beginning of their employment contract, their experience with their employer’s routines is low. Similarly to lowly experienced franchisees, they need to learn skills and practices that are specific to the business. Relatively inexperienced employee-managers may appreciate the extensive use of mechanisms for behavior control that help them achieve goals and comply with contractually specified duties. With growing experience, employee-managers may also tend to strive for more autonomy, since they may have internalized the necessary skills and

routines over time. Similarly to the franchisees, they may develop their own beliefs about service quality and products that may even challenge their corporate management's standards and specifications (Cochet, Dormann and Ehrmann 2008). In contrast, outcome control implies an entrepreneurial risk that especially inexperienced employee-managers tend to avoid. Later on and with growing experience, employees that stay in the franchise system have acquired enough proficiency and self-confidence to deal with outcome control. Given that there is a bonus scheme for employees, they are likely to consider outcome control as an additional source of income based on the achieved sales volume. Hence, employee-managers' experience affects the relationship between the franchisor's choice of control mechanisms and employee-manager satisfaction as follows:

*H4a: The extent of perceived outcome control affects the satisfaction of less experienced employee-managers more negatively than that of more experienced employee-managers.*

*H4b: The extent of perceived behavior control affects the satisfaction of less experienced employee-managers more positively than that of more experienced employee-managers.*

## **Methods**

### ***Sample***

Our sample is based on the largest German franchise system, a tourism company that comprises both franchised and company-owned travel agencies under the same brand name. In order to get selected as a franchisee in this system, an entrepreneur needs to accept the franchisor's corporate identity and the minimum space that an outlet is expected to provide. The franchisee bears the lease rental charges, although he cannot decide independently where he leases and how large his outlet should be. The initial investment sum for office equipment and accessories ranges from 10,000 to 50,000 Euros and depends on the size of the outlet. Licensing fees are 0.07 % on sales of products from the franchisor and 0.13 % on overall sales plus a monthly rate of 180 Euros and an advertising fee of 0.2 % on net sales. Thus, a franchisee pays a fixed monthly rate and a variable licensing and advertising fee based on

sales of products to the franchisor. He generates profits based on a gross margin on sales (end customer price minus internal price) minus fees. In addition, the franchisor provides a financial incentive at the end of each year in the form of a bonus based on the growth of the sales volume as compared to the sales volume at the end of the previous year. The bonus is contingent on the growth margins in a franchisee's sales volume.

At the outset of our survey, we discussed and agreed upon the items with franchisees and employee-managers in the franchise system. We conducted semi-structured expert interviews with franchisees and salaried outlet supervisors. All interview partners confirmed that the items that we had selected were relevant. Conversations with managers from the headquarters and our pretest also showed that the items were relevant to both franchisees and employee-managers. The complete list of questionnaire items is reported in the appendix.

The franchisor provided the names and e-mail addresses of the employee-managers of the company-owned outlets and the franchisees in the franchise system. We invited them to complete our self-administered, web-based questionnaire and ensured that they had to respond to our questionnaire themselves. For instance, the web link that was included in our e-mail in order to provide access to the web-based questionnaire could not be forwarded to another person. Overall, we received 334 usable questionnaires, leading to a response rate of 39.2 percent. A total of 187 questionnaires were completed by employee-managers (out of 349 potential respondents, i.e., a response rate of 53.6 percent among employee-managers) and 147 usable questionnaires were sent back by franchisees (out of 504 potential respondents, i.e., a response rate of 29.2 percent). Among the 187 employee-managers, 76 % supervise a single outlet, 24 % two outlets. Referring to the 147 franchisees, 30 % are single-unit franchisees, 54 % operate two units and 16 % more than two units. The high response rates may be attributed to advance notifications and the follow-up procedure of sending reminders and making additional phone calls as well as to the close relationship between the researchers and the corporate managers of that franchise system. Survey sponsorship, especially official or

“respected” sponsorship, is generally expected to enhance response rates (Blumberg, Cooper and Schindler 2008). The questionnaire that the franchisees were asked to complete was announced in advance and strongly promoted by the franchisor. Similarly, the questionnaire that was sent to the employee-managers in the company-owned outlets was accompanied by a benevolent letter from the CEO of the company, explicitly encouraging the managers’ participation in that survey.

Non-response bias was studied by comparing the responses of initial respondents with those that had been received after follow-up procedures. The results did not reveal any significant differences between early and late respondents, indicating the representativeness of the survey data (Armstrong and Overton 1977). Additionally, we compared some characteristics of our respondents with those of non-respondents from the same franchise system. Regarding outlet size and age, we could not find any significant differences between respondents and non-respondents (Homburg, Wieseke and Hoyer 2009). Consequently, non-response bias is not a major issue with our data. To avoid social desirability bias the questionnaire was administered anonymously and all respondents were repeatedly assured that their responses were treated confidentially and used for scientific purposes only (King and Bruner 2000). We verified the information gained from employee-managers and franchisees with a survey of their responsible managers in the corporate headquarters. All in all, 258 questionnaires could be matched with information from the franchisor’s perspective. According to the work council’s and the corporate management’s directives and in compliance with German labor legislation, we did not collect personal data on, e.g., the respondents’ age, gender, education or former professional experience.

### *Variables and Measures*

We use both reflective and formative measurement models.<sup>4</sup> Following the reflective measurement approach, the dependent variable is *satisfaction*. According to Ruekert and Churchill (1984), satisfaction comprises four dimensions: The product dimension reflects the demand for and the quality of the franchisor's product offerings; the financial dimension assesses the franchise system's attractiveness in terms of its prices; the assistance dimension captures the quality of the franchisor's marketing efforts; and the social interaction dimension reflects the cooperation between the franchisor and his franchisees and employee-managers. In awareness of these four dimensions, franchisees and employee-managers were asked to indicate their satisfaction on a seven-point Likert scale with five items. Product and service quality as well as innovation represent the product dimension, prices pertain to the financial dimension, the franchisor's marketing efforts allude to the assistance dimension, and the general cooperative climate reflects the social interaction dimension (Gassenheimer, Baucus and Baucus 1996; Poppo and Zenger 2002). The results of a factor analysis indicate that the five items load on one common factor (Blumberg, Cooper and Schindler 2008). The scores of the items are summed and averaged (using equal weights). The Cronbach's alpha for that composite measure is 0.80.

In order to measure control mechanisms, we use a range of items to construct two formative indices (Diamantopoulos and Winklhofer 2001). The degree of perceived *outcome control* consists of four items addressing standards and guidelines regarding, e.g., sales and budgets, planned/actual comparisons, regular reports to the headquarters and other financial ratios. Three items concerning personal meetings with the franchisor, the elaboration of the franchisor's directives, and the definition of the franchisor's (the headquarters') efforts to alter

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<sup>4</sup> The chosen measurement model explains the relationship between a latent variable and its corresponding indicators. Depending on the causal direction between latent and observable constructs, it is either reflective (from the latent construct to its indicators) or formative (from the indicators to the latent construct). Prior evidence shows that their simultaneous use in a single study does not jeopardize measurement consistency (e.g., Homburg, Hoyer and Fassnacht 2000).

processes allude to perceptions of *behavior control* (Heide, Wathne and Rokkan 2007; Oliver and Anderson 1994; Yin and Zajac 2004). Responses are recorded on seven-point Likert scales with 1 = “not in use” and 7 = “extensively in use”. The scores are used to calculate geometric means for each control type. A geometric mean is appropriate, if the construct is the result of a strategy whose components (i.e., the indicators) all find equal application and do not compensate each other. Put differently, the impact that a change in one dimension has on the change of the entire index depends on the level of the other dimensions, because the perception of the franchisor’s use of control depends on the extent of all underlying dimensions (Homburg, Hoyer and Fassnacht 2002). The constructs of outcome and behavior control represent composites of different indicators that are unique sources of each control type and hence need not correlate significantly. Though each item measures a particular dimension, it contributes to the total value of one of the two control constructs.

Franchisees’ and employee-managers’ *experience* is measured with a single item. Single items are appropriate for measuring basic and unidimensional constructs that are simple and easily understandable to the respondents. Under those conditions predictions obtained with single-item measures are as good as predictions achieved with multi-item measures (Bergkvist and Rossiter 2007). Our single item asks for the number of years that the respondents have been working as franchisee or employee-manager, respectively, in an outlet in that franchise system. Experience is a growth process that is subject to a diminishing effect, since the increment in experience decreases from year to year. Therefore, the logarithm of the duration of the franchisor-franchisee or employer-employee relationship, respectively, is preferred to the untransformed value of the number of years of association with the franchise system (Tikoo 2002).

To strengthen the empirical tests, we control for additional factors in the regressions. Outlet *size* is measured with the number of employees who were working in a unit within the franchise system at the time of the survey. Prior studies used *size* as a proxy for resource

scarcity (e.g., Combs and Ketchen 2003). The amount and quality of available resources in an outlet influence franchisee and employee-manager satisfaction. Travel agencies are relatively small entities. In terms of the number of employees per travel agency, outlets that are run by franchisees are hardly larger than those that are supervised by employee-managers. A relatively higher unit size can increase both the franchisees' and the employee-managers' satisfaction levels, but as supervising employees can mean an additional workload for a leading individual, rather non-entrepreneurially thinking employees might consider a relatively higher size as a burden that decreases their satisfaction, whereas franchisees may be more likely to consider it as an indicator of growth and success.

Tolerance of ambiguity is a trait that differentiates an entrepreneur from a non-entrepreneur (e.g., Budner 1962). It is "the ability to deal effectively, i.e., without experiencing psychological discomfort or threat, with situations or information that are vague, incomplete, unstructured, uncertain or unclear" (Schere 1982, 404). We assume that franchisees are more likely to tolerate ambiguity than salaried managers and that high ambiguity more negatively affects the satisfaction levels of employee-managers than that of franchisees. Franchisees and employee-managers were asked to indicate their perceptions of *ambiguity* on a seven-point Likert scale with four items alluding to the frequency of changes in underlying skills, the frequency of changes in operating procedures and practices, the amount of components that a particular practice includes, and the number and variety of solutions for problems that result from practices (Poppo and Zenger 2002). A factor analysis indicates that the five items load on one common factor. Using equal weights, we sum and average the scores of the items. The Cronbach's alpha for our composite measure is 0.72.

From a franchisee's perspective, in the presence of *uncertainty*, the franchisor's service assistance and knowledge provide protection and helpful means to achieve the contractually specified objectives. Service assistance, a valuable brand name and standard operating procedures are likely to be more appreciated in the presence than in the absence of uncertainty,

because “the more complex and uncertain the environment, the greater the risk attached to an agents’ (*sic!*) achievement of specified outcomes” (Hendry 2002, 105). The same may be true for employee-managers, but they enjoy some protection from uncertainty through their employment contract and bear a lower entrepreneurial risk than franchisees. Uncertainty is hence not likely to strongly enhance the perceived value of the franchisor’s support. More precisely, we expect differential effects of this control variable on franchisees’ and employee-managers’ satisfaction. Our respondents were asked to assess on a seven-point Likert scale the difficulty in interpreting the impact of external factors on operating procedures, the difficulty in planning sales and the number of customers in a travel agency, the variability of the competitors’ products and services, and the stability of the travel market (Artz and Brush 2000; Carson, Madhok and Wu 2006). The Cronbach’s alpha for our composite measure is 0.68, which is a still acceptable value for a newly developed scale (Hair, Tatham, Anderson and Black 1998).

*Specificity* is included as a control variable in the analyses concerning the franchisees. Specific assets are only those assets that are devoted to the franchisor-franchisee relationship. They have little value outside the respective franchise system (Williamson 1985). The knowledge that franchisees and employee-managers need to perform their tasks is not specific to a particular franchise, because German travel agents complete a state-approved apprenticeship of up to three years in a travel agency, the hospitality industry, or a tourism company. In contrast, tangible assets such as furnishings or equipment can hardly be used in other franchise systems, because their design (e.g., color, shape) and functionalities need to conform to the requirements of the corporate design and meet the standards of a franchise system. Most franchisors define guidelines on how and where to position furniture and equipment and what wall paints are acceptable. Franchisees need to invest in system-specific assets that bond them to the franchising contract (Bradach 1997; Garg, Rasheed and Priem 2005; Windsperger 2004). The assets that include, e.g., a unique store design, can no longer

be exploited by a franchisee after the franchising contract has been terminated, as they are specific to a particular outlet concept (Combs and Ketchen 1999). A single item asked for the extent of financial investments in furniture and equipment that were custom-tailored to that particular travel agency concept and not redeployable to alternative concepts (Artz and Brush 2000). The franchisees' responses were recorded on a seven-point Likert scale with 1 = "fully disagree" and 7 = "fully agree".<sup>5</sup>

### ***Data Analysis***

Table 1a and b present means, standard deviations and correlations for the study variables. They show that multicollinearity between the study variables is not a problem.

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 Insert Tables 1a and 1b about here  
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In order to test our hypotheses we calculate a series of linear regressions for each of our two samples from the same franchise system (Blumberg, Cooper and Schindler 2008). Within the constraints set by our data, we have done everything to ensure that our models do not suffer from endogeneity bias.<sup>6</sup> We expect to find differential effects of the pre-specified factors on the franchisees' and the employee-managers' satisfaction levels.<sup>7</sup> Further, we divide these samples into groups according to their levels of experience. The two samples are

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<sup>5</sup> Most franchisees lack the experience with switching from one franchise system to another. They might hence have difficulties in estimating exact proportions of investments that they would be able to reclaim, if they were allowed to use these assets in other franchise systems, or the rate of depreciation of the assets at the end of the franchisor-franchisee relationship.

<sup>6</sup> We intensely thought about potential endogeneity problems. Within the constraints set by our data, we have done everything to control for the most important factors (omitted variables bias). In addition, the dependent variable does not influence the independent variables (simultaneity in results) nor do we have a self-selection problem due to truncated or censored samples (Hamilton and Nickerson 2003; Sampson 2004; Winship and Mare 1992).

<sup>7</sup> Garg, Rasheed, and Priem (2005) describe the franchisor-franchisee and employer-employee relationships as two different agency relationships in the same franchise system. Therefore, our research design is not a subgroup analysis and does hence not include a test of differences between parameter estimates between franchisees and employee-managers. We follow Haleblan and Finkelstein (1993) who expect significant effects in one industry but not in the other, which is similar to our idea that one type of control mechanisms leads to significant effects in one agency relationship but not in the other.

split at the median values for franchisee and employee-manager experience, respectively. Regression models are then calculated for each group.

### **Results**

Table 2 reports the results of the regression analyses for the effects of control and experience on franchisee and employee-manager satisfaction. Hypotheses 1 and 2 assume that franchisees and employee-managers perceive the control mechanisms that the franchisor uses to monitor their behaviors in different ways. In fact, there are differences between franchisees and employee-managers regarding their perceptions of outcome and behavior control.

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 Insert Table 2 about here  
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As the results in Table 2 show and consistent with Hypothesis 1a, franchisees are likely to be more satisfied when they perceive relatively high outcome control. Opposed to Hypothesis 1b, employee-managers' satisfaction is higher, when the franchisor uses more outcome control. We gain support for Hypothesis 2b, since employee-managers' satisfaction increases, when more behavior control mechanisms are applied to monitor their efforts. With regard to the franchisees, Hypothesis 2a is not supported. Franchisees are not less satisfied, when the franchisor uses more behavior control mechanisms. These results remain stable, when we further include experience as an additional explanatory variable that neither exerts any significant effect on franchisees' nor on employee-managers' satisfaction levels. Referring to the control variables, the results show that uncertainty increases the actors' risk (Hendry 2002). It mainly exerts a negative and significant effect on franchisees' satisfaction. We have suggested that this effect would be observable in the franchisee sample only. In contrast to hired managers, franchisees need to invest specifically and bear a greater risk of unemployment. A negative and significant effect is additionally revealed in the control model for the employee-manager sample (Model 4 in Table 2). In addition, employee-managers are

more satisfied, when they have fewer employees and perceive relatively high ambiguity, whereas size and ambiguity do not exert any significant effect on franchisee satisfaction.

Regarding the differentiation between franchisees and employee-managers with either high or low experience in their business (Models 7-10 in Table 3)<sup>8</sup>, highly experienced franchisees appreciate outcome control mechanisms. A t-test shows that the differences between franchisees with different experience levels are significant for outcome control ( $\alpha = 0.10$ ), hence supporting Hypothesis 3a. Behavior control does not decrease their satisfaction under conditions of high experience, lending no support to Hypothesis 3b. Referring to employee-managers, different levels of experience have no differential effect on the relationship between behavior control and satisfaction, as both highly and lowly experienced employee-managers are likely to be more satisfied in the presence of behavior control. Under conditions of relatively lower experience, outcome control enhances employee-manager satisfaction. Thus, Hypotheses 4a and 4b are not supported.

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 Insert Table 3 about here  
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Uncertainty exerts a negative influence on franchisees' and employee-managers' satisfaction under conditions of high but not low experience. This finding indicates that, the longer the duration of the franchisor-franchisee or employer-employee relationship, respectively, the more franchisees and employee-managers learn about the negative impact of uncertainty in the presence of intensified competition. Comparatively lowly experienced

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<sup>8</sup> On average, franchised and company-owned units have existed for approximately eight years. In awareness that the risk of entrepreneurial failure is highest during the first four years after foundation (German Franchise Association 2009) and that in most German franchise systems the first franchised unit was established less than ten years ago (Franchise-Monitor 2009), this average duration of system affiliation indicates a meaningful value of experience. We could only measure the experience that our respondents gained during the time that they had been spending in this system. Prior literature from psychology (e.g., Bradley 2010), upper echelons research (e.g., Bigley and Wiersema 2002), and franchising (e.g., Grünhagen and Mittelstaedt 2005; Tikoo 2002) provided examples for similar measures. Therefore, the length of time that a franchisee or an employee-manager have been spending in a franchise system in that position is an adequate indicator for reflecting an individual's experience in a selected franchise system and in a particular function.

employee-managers are more satisfied when their outlets are smaller. Contrary to the models drawing on employee-managers, the coefficients for size are not significant in the models that pertain to franchisee satisfaction. Ambiguity exerts a positive effect on employee-manager satisfaction, indicating that it is perceived as a chance to benefit from a given leeway to act. Finally, specificity increases the experience of lowly but not highly experienced franchisees. Without the differentiation between experience levels, specificity does not show any significant effect on franchisee satisfaction.

### **Discussion**

Prior research has collected much knowledge on the franchisor's benefits of using and governing plural form-franchise systems, but studies from the franchisees' perspective are rare and those that additionally consider the employee-managers' viewpoint are actually missing (Cochet, Dormann and Ehrmann 2008; Peterson and Dant 1990; Grünhagen and Dorsch 2003; Sorensen and Sørensen 2001). Franchisees and hired outlet managers differ in terms of need for achievement, preference for innovation and learning, and the propensity to take risks (Sorenson and Sørensen 2001; Stewart, Watson, Carland and Carland 1998). Therefore, the franchisor's choice of control mechanisms for monitoring those actors' efforts within a franchise system may affect satisfaction differently.

### ***Contributions***

This study contributes to management research in three ways: First, although most franchise systems are plural forms and the satisfaction of franchisees and employee-managers affects the attractiveness and maintenance of the whole franchise system, the impact of different types of control for governing the plural form has not been investigated by prior research. Outcome control leads to higher satisfaction among franchisees and employee-managers, while behavior control only enhances employee-managers' satisfaction. In addition, to our knowledge, this is the first study that examines the consequences of the franchisor's choice of control mechanisms depending on franchisees' and employee-managers' experience.

While outcome control leads to higher satisfaction among more experienced franchisees, behavior control enhances both highly and lowly experienced employee-managers' satisfaction. Our findings provide managerial implications for effective monitoring efforts concerning lowly experienced employee-managers and franchisees and employee-managers with relatively high experience. However, neither outcome nor behavior control add to rather inexperienced franchisees' satisfaction in this system.

Second, our results give us hints that the costly control mechanisms seem to work on employee-managers whilst franchisees mostly seem to be immune to these. Especially behavior control is associated with very high costs and has no impact on franchisees' satisfaction at all. Nevertheless these control mechanisms might be necessary to prevent opportunistic behavior from franchisees. Consequently, franchisors might face a dilemma: they know that behavior control is costly and does not increase franchisee satisfaction and performance, but at the same time might be necessary to prevent opportunism. Therefore, control mechanisms serve different functions: increasing satisfaction and performance and preventing opportunism. Our research has focused on the former.<sup>9</sup>

Third, our theoretical framework is tested with primary data from the largest German franchise system. Only few studies have departed from the US-American context before (e.g., Barthélemy 2008; Cochet, Dormann and Ehrmann 2008; Windsperger 2004). Many studies draw on data from the restaurant sector (e.g., Beheler, Norton and Sen 2008; Grünhagen and Dorsch 2003; Hing 1996). Only few authors report results that rely on data from other industries (e.g., Knott 2003). Although restaurant chains are especially suitable for explaining governance in plural form-franchise systems, the results obtained in that sector cannot easily be generalized to other industries (Dant 2008; Grünhagen and Mittelstaedt 2005; Yin and Zajac 2004). For instance, restaurant chains are likely to employ a rather low-educated

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<sup>9</sup> We thank two of the three anonymous reviewers for pointing us into this direction.

workforce, whereas travel agents need an occupation-specific and strongly regulated vocational training in the German tourism industry. Attitudes towards, e.g., control or leeway to act may differ between actors from various industrial and institutional settings. Franchising research will not be able to embrace the management of franchise systems realistically, if our insights are mainly based on a single industry and a single institutional context, although franchising can be found in a great variety of sectors, e.g., gyms, undertakers, pet retail, and diet/nutrition counseling, and many different countries outside the North American continent.

### ***Limitations and Implications for Future Research***

Looking at employee-managers, our findings reveal that outcome control especially enhances the satisfaction of relatively lowly experienced employee-managers. It does not exert a significant influence on the satisfaction of highly experienced employee-managers. This result can be due to the increasingly uncertain tourism industry. For instance, the Internet has dramatically changed the competitive position of tourism companies, hotels, airlines, customers, tour operators, and travel agencies. The bargaining power of consumers and tourism suppliers has been strengthened, because they can communicate directly at the expense of the position of intermediaries such as travel agencies (Buhalis and Zoge 2007). While employee-managers enjoy a certain protection from environmental threats, franchisees fear that their existence as entrepreneurs is put at risk. Thereby, lowly experienced employee-managers seem to view outcome control as an opportunity to generate additional income in terms of bonuses based on the achieved sales volume, while their more experienced colleagues may have learned over time that, under deteriorating conditions for travel agencies, the franchisor's requirements associated with behavior control can more easily be satisfied than those pertaining to outcome control. Put differently, an employee's constant monthly salary may be perceived as more beneficial than entrepreneurial freedom. Future studies may compare our findings on control and satisfaction with those from other industries.

The  $R^2$ -values for the franchisees in our models are relatively low. This is not unusual for studies that explore new ideas and test them for the first time and provide opportunities for future studies to include additional variables that could be important. In addition to control mechanisms that were center stage in our study we expect that personal variables of the franchisees and employee-managers, like age, gender, marital status and educational background influence also satisfaction. Furthermore, we could only measure the experience that our respondents gained during the time that they had been spending in this franchise system in their function as a franchisee or a salaried outlet supervisor, respectively. It would have been interesting to learn more on their functions and positions prior to their entry into the franchise system. Future studies should control for these issues and their differential effects on franchisee and employee-manager satisfaction.

Overall, we hope that our study will be seen as an innovation in the franchising literature, since it is one of the rare exceptions that juxtaposes both franchisees' and employee-managers' perspectives, thereby illustrating differences between franchisees and employee-managers that may justify the franchisor's reliance on different treatments. It examines an under-researched issue that alludes to the post-formation franchise system management and provides new knowledge on the interplay between control, experience and satisfaction in plural form-franchise systems.

**Table 1.**  
**Means, Standard Deviations and Correlations**

**(a) Franchisees:**

Variables	Mean	SD	1	2	3	4	5	6	7	8
1 satisfaction	4.902	0.909	1.000							
2 size	5.860	8.414	-0.078	1.000						
3 ambiguity	5.371	0.966	-0.008	-0.145	1.000					
4 uncertainty	4.549	1.104	-0.171*	-0.115	0.395**	1.000				
5 specificity	5.300	1.734	0.073	0.111	0.145	-0.014	1.000			
6 experience	0.862	0.268	-0.030	0.221**	0.064	0.077	0.096	1.000		
7 outcome control	4.170	1.392	0.214**	-0.226**	0.120	-0.026	0.143	0.008	1.000	
8 behavior control	4.141	1.430	0.140	-0.160	0.099	-0.151	0.085	-0.051	0.161	1.000

N = 147.

Significance levels: \*\*  $p < 0.01$ , \*  $p < 0.05$ .**(b) Employee-Managers:**

Variables	Mean	SD	1	2	3	4	5	6	7
1 satisfaction	5.032	0.982	1.000						
2 size	4.780	2.331	-0.146*	1.000					
3 ambiguity	5.342	1.005	0.272**	0.022	1.000				
4 uncertainty	4.572	1.212	-0.093	-0.051	0.220**	1.000			
5 experience	0.808	0.358	0.017	-0.089	0.199**	-0.048	1.000		
6 outcome control	5.779	1.012	0.257**	-0.027	0.199**	0.000	-0.051	1.000	
7 behavior control	3.061	1.180	0.301**	0.106	0.097	0.196**	0.002	0.137	1.000

N = 187.

Significance levels: \*\*  $p < 0.01$ , \*  $p < 0.05$ .

Table 2.

## Results of the Regression Analyses for the Impact of Control on Satisfaction

Model Variables	Hypotheses	1	2 Franchisees	3	Hypotheses	4	5 Employee-Managers	6
Constant		5.279*** (0.494)	4.680*** (0.546)	4.682*** (0.576)		4.359*** (0.434)	2.937*** (0.536)	3.039*** (0.557)
Size		-0.011 (0.009)	-0.008 (0.009)	-0.008 (0.010)		-0.068* (0.029)	-0.076** (0.028)	-0.078** (0.028)
ambiguity		0.043 (0.086)	0.009 (0.086)	0.009 (0.087)		0.305*** (0.069)	0.235** (0.068)	0.246** (0.070)
uncertainty		-0.165* (0.074)	-0.135† (0.074)	-0.135† (0.075)		-0.138* (0.058)	-0.086 (0.056)	-0.090 (0.056)
specificity		0.039 (0.044)	0.024 (0.044)	0.024 (0.044)		-	-	-
outcome control	H1a (+)		0.111† (0.056)	0.111† (0.056)	H1b (-)		0.164* (0.066)	0.160* (0.066)
behavior control	H2b (-)		0.061 (0.054)	0.061 (0.055)	H2b (+)		0.210*** (0.057)	0.209*** (0.057)
experience				-0.003 (0.288)				-0.130 (0.188)
R <sup>2</sup>		0.05	0.09	0.09		0.12	0.22	0.22
adj. R <sup>2</sup>		0.02	0.05	0.04		0.11	0.20	0.20
F		1.77	2.23*	1.90†		8.67***	10.26***	8.61***
N		147	147	147		187	187	187

Standard errors in parentheses. Dependent variable: satisfaction.

† p &lt; 0.100

\* p &lt; 0.050

\*\* p &lt; 0.010

\*\*\* p &lt; 0.001

Table 3.

## Results of the Regression Analyses for the Combined Effect of Experience and Control on Satisfaction

Model		7				8				9				10			
		Franchisees Experience				Employee-Managers Experience											
Variables	Hypotheses	High	Low	High	Low	Hypotheses	High	Low	High	Low	Hypotheses	High	Low	High	Low	Hypotheses	High
Constant		5.716*** (0.700)	4.357*** (0.739)	4.886*** (0.737)	4.298*** (0.894)		5.107*** (0.640)	3.772*** (0.618)	3.772*** (0.784)	2.248** (0.785)							
Size		-0.011 (0.010)	0.028 (0.047)	-0.007 (0.010)	0.029 (0.050)		-0.056 (0.041)	-0.097* (0.045)	-0.058 (0.039)	-0.103* (0.043)							
ambiguity		0.032 (0.115)	-0.005 (0.136)	-0.022 (0.114)	-0.008 (0.141)		0.204* (0.093)	0.391** (0.109)	0.175† (0.090)	0.287** (0.109)							
uncertainty		-0.193* (0.092)	-0.030 (0.126)	-0.155† (0.091)	-0.028 (0.131)		-0.192** (0.071)	-0.078 (0.096)	-0.127† (0.071)	-0.044 (0.093)							
specificity		-0.012 (0.057)	0.123† (0.070)	-0.041 (0.056)	0.122† (0.072)		-	-	-	-							
outcome control	H3a (+)			0.177* (0.068)	0.000 (0.106)	H4a (-)			0.092 (0.082)	0.234* (0.108)							
behavior control	H3b (-)			0.081 (0.065)	0.017 (0.105)	H4b (+)			0.214** (0.071)	0.196* (0.095)							
R <sup>2</sup>		0.06	0.07	0.15	0.08		0.12	0.16	0.22	0.25							
adj. R <sup>2</sup>		0.02	0.00	0.09	0.04		0.09	0.13	0.17	0.21							
F		1.40	1.00	2.47*	0.65		4.16**	5.23**	5.00***	5.50***							
N		90	57	90	57		97	90	97	90							

Standard errors in parentheses. Dependent variable: satisfaction.

† p &lt; 0.100

\* p &lt; 0.050

\*\* p &lt; 0.010

\*\*\* p &lt; 0.001

### Appendix: Questionnaire Items

Variable	Items	Scale	References
satisfaction	We are satisfied with the quality of the products and services ( <i>product dimension</i> ).	1 = fully disagree, ..., 7 = fully agree $\alpha = 0.80$	Gassenheimer, Baucus, and Baucus (1996); Ruekert and Churchill (1984)
	We are satisfied with the prices for the products and services ( <i>financial dimension</i> ).		
	We are satisfied with the product innovations of the franchise system ( <i>product dimension</i> ).		
	We are satisfied with the franchisor's (the headquarters') marketing efforts ( <i>assistance dimension</i> ).		
	We are satisfied with the cooperation with the franchisor (the headquarters) ( <i>general cooperative climate</i> ).		
independent variables:			
outcome control	standards and guidelines regarding, e.g., sales and budgets	1 = not at all in use, ..., 7 = extensively in use	Heide, Wathne, and Rokkan (2007); Oliver and Anderson (1994); Yin and Zajac (2004)
	planned/actual comparisons miscellaneous financial ratios regular reports to the franchisor (the headquarters)		
behavior control	personal meetings with the franchisor (the headquarters) The franchisor (the headquarters) makes sure everyone knows what to do and how to do it. precise definition of the franchisor's (the headquarters') efforts to alter processes	formative indices	
experience	number of years that the respondents have been working as franchisees or employee-managers in an outlet in the franchise system	count measure (logarithm)	Tikoo (2002)
control variables:			
outlet size	number of employees in an outlet	count measure	
ambiguity	The skills and capabilities that we need to perform our tasks are rapidly changing.	1 = fully disagree, ..., 7 = fully agree $\alpha = 0.72$	Poppo and Zenger (2002)
	The operating procedures and practices are rapidly changing.		
	Our current operating procedures and practices are an outcome of a great variety of ways to perform tasks. Difficulties pertaining to the operating procedures can be overcome with many different solutions.		
uncertainty	It is difficult to interpret the impact of external factors on our operating procedures.	1 = fully disagree, ..., 7 = fully agree $\alpha = 0.68$	Artz and Brush (2000); Carson, Madhok, and Wu (2006)
	It is difficult to plan sales and the number of customers in this travel agency.		
	The competitors' products and services are highly variable.		
	The travel market is not stable at all.		
specificity	We have made high financial investments in furniture and equipment that are custom-tailored to this franchise system.	1 = fully disagree, ..., 7 = fully agree	Artz and Brush (2000)

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