ELSEVIER

CROSSING MOTHER: ENTREPRENEUR-FRANCHISEES' ATTEMPTS TO REDUCE FRANCHISOR INFLUENCE

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EXECUTIVE SUMMARY

Contractual terms guide many entrepreneur-franchisees' actions with the franchisor. However, it is impossible for franchisors to completely specify all future actions. They compensate by continually attempting to influence franchisees, using what franchisees perceive as suasion in their ongoing interactions. We develop a theoretical framework for understanding the informal interaction dynamics between franchisors and franchisees.

Most franchise arrangements include the payment of royalties based on sales. This encourages a growth-oriented strategy, usually appropriate for the franchisees during the initial stages of their operations. Whereas a franchising strategy can reduce entreprenerial risk for franchisees, it does not eliminate it. Thus, as sales of the franchisees increase, profit-oriented strategies will be favored because they represent the payoffs that accrue to continuing entrepreneurial effort and risk-taking. These strategies may be in opposition to franchisors' sales orientation when market conditions do not allow continual growth without margin penalties. A research model is developed, depicting the relationship between franchisees' strategies and performance, and the moderating effect that contractual goals and franchisees' perception of franchisors' attempts at suasion have on this relationship. A set of research hypotheses was then empirically tested using a large sample of franchisees from the commercial truck retailing industry.

The results indicate that sales-growth and profit-growth goals are not always congruent. Balancing

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the goals of the franchisor and franchisee did not appear to be a popular option; either one or the other was emphasized. More importantly, the results indicate that when franchisees perceive attempts by franchisors to use suasion, lower levels of profits result, but there is no corresponding increase in the level of sales.

In the long-term, franchisors are likely to determine that current contractual arrangements are not protecting their longer term interests. Thus, they will be expected to attempt to modify franchise contracts in ways that force franchisees to implement sales-gain strategies. This will require that entrepreneur-franchisees anticipate future events more carefully at the time they are examining the original franchise contract. Because most entrepreneurs are concerned with immediate survival at the start-up stage, this makes examination of the contract less likely to happen; the franchise option is attractive because it reduces such risks.

We recommend that entrepreneurs write ex ante contingent claims contracts that ensure a gradual reduction of franchisor influence. Although this would assume a power or knowledge balance that favors the franchisees, which is unlikely during the start-up phase, it will change over time as franchisees gain a better understanding of the local competitive dynamics. Thus, it may well serve the franchisees to take a defensive posture or push a royalty arrangement that decreases the emphasis on sales over time. This is most likely to be effective where the entrepreneur is considering several competing franchises at the time of the signing of the contract.

Finally, we recommend that entrepreneur-franchisees should not assume that the expert advice offered by their franchisor is always in their best interests. Although technical advice is more likely to be unbiased and should be fully exploited, as this is what makes the franchise valuable, strategic advice, or that which relates to goal setting may well be colored by the financial interests of the franchisor. Franchisors are unlikely to consider the possibility that franchisees would be better served by formulating their own strategies, nor are they likely to consider that the franchise network would be better off, in the longer term, by the collective impact associated with numerous franchisees independently formulating their own strategies. In short, although we do not suggest that franchisees should always assume that "crossing mother" is the best response to all perceived franchisor-suasion efforts, they should carefully examine all strategic advice.

INTRODUCTION

Although there have been over 225 articles published under the auspices of the Society of Franchising,[1] and more than 80 academic articles published in the last 10 years among entrepreneurship researchers, the franchisee has been one of the least studied of entrepreneurial types.[2] This lack of interest reflects the fact that entrepreneurship researchers may view franchising as a programmed mode of entry, which they perceive to be nonentrepreneurial. However, the franchising relationship often goes beyond the formal interactions dictated by the contract. Entrepreneur-franchisees have great latitude in crafting strategies that are congruent with their preferences, because the franchise contract cannot cover all possible contingencies. Franchisees are in fact potentially entrepreneurial because a franchisor's ability to impose a strategic direction on any franchisee is limited, so long as the franchisee conforms to the contractual provisions. Entrepreneur-franchisees are free to pursue their own strategic goals because franchisors have incomplete information about the full capacity of the operation. Anticipating value beyond the contract and altering the strategic orientation of the contractual relationship are areas where franchisees can exert entrepreneurial discretion. Entrepreneurial-franchisees will always have strategic flexibility because ex ante contracts can never specify all contingencies. In addition, it is expensive to enforce provisions

[1] Many thanks to an anonymous reviewer who raised this point.

[2] For example, a search of the 10-year indices of the *Journal of Business Venturing and Entrepreneurship: Theory and Practice* did not reveal a single article directly related to franchising.

that are specified. Thus, whereas the franchise arrangement can reduce operating risk, the strategic risk[3] of the venture increases because franchisees are now exercising discretion in the disposal of scarce resources. They will demand a premium on the rate of return for their efforts proportionate with this added risk. In sum, franchisees exercising strategic discretion and expecting entrepreneurial returns to risk are really entrepreneurs. This expanded context is the intellectual basis for this article.

In addition, our survey of more than 80 articles in the area shows that franchising has been studied from the perspectives of transaction economics, agency and contractual law, developmental economics, political economy, marketing, and international business, but little from the standpoint of its sociological nature. We posit that the interactions between the franchisor and franchisee are opportunities for suasion, which franchisors use to influence the business strategies of their franchisees. We hypothesize that the purpose of these interactions is to either ensure compliance with the terms or goals of the franchising contract, or to encourage the franchisee to emphasize revenue-dependent, as opposed to profit-dependent, performance criteria. We then examined the impact of the outcomes of these interactions by looking at the performance implications of the strategies selected.

THEORY

Franchises come in many forms, but the most popular and fastest growing are those that sell business formats (Walker 1989). The two broad theoretical perspectives we discuss view the franchise as either a contract or a strategic partnership. From an agency perspective, franchise research has focused on how franchisors incorporate provisions that minimize shirking into their contracts (Gal-Or 1991; Krueger 1991; Withane 1991), and on how franchisees use contracts to restrict opportunistic behaviors by franchisors (Dewatripont and Sekkat 1991; Norton 1988). From a strategic perspective, franchise research tends to recommend that both parties to the franchise contract expend considerable resources, ex ante, to ensure that complete contingent claims contracts are written (for example, see Justis and Chan 1991). However, these views do not explicitly model the franchisee as an entrepreneur.

Whether a franchisee is seen as an entrepreneur is governed by the way theorists view his/her role. One view sees franchising as an extension of growth for the franchisor, and therefore there is no additional value added in a franchise relationship beyond that contributed by the franchisor to the franchisee's effort. Here, franchising is seen as a way of delimiting organizational and financial constraints on firm growth (Spinelli and Birley 1996). Franchisors are willing to provide some start-up capital, because franchising allows them to expand with less financial risks than is normally associated with building company-owned outlets. Franchisees are often able to access additional capital by exploiting the financial strengths of the franchisor. Thus, the franchising relationship provides the means for franchisors to penetrate geographically dispersed market segments with smaller commitments of capital and also allows franchisees to obtain capital or technology at lower costs. In this perspective, the franchising relationship is a device for franchisors to vertically integrate without the full capital commitment to do so (Brickley, Dark, and Weisbach 1991). In order for this to be economically viable, the franchisor must elect to share the residual value of the enterprise with the franchisee, which in turn makes this form of business entry economically viable to the prospective franchisee.

[3] Operating risk, defined as the risks associated with day-to-day operational decisions; strategic risk, defined as the risks associated with capital allocation decisions.

In a contractual view of franchising, the franchisor, as principal, may differ with its franchisees in what it considers as appropriate economic motives and performance goals. This resulting gap has to be resolved before any transaction can take place, because the franchisee has an incentive to cheat by hiding the real value of his efforts and expropriating the surplus from the franchisor. Most franchise contracts are written to narrow this gap by requiring the franchisee to have a participating interest in the venture (Shane 1996). This forces the franchisee to share part of the residual value of the enterprise with the franchisor. Here, franchising is presented as a method of placing the costs of cheating on the franchisee. In the parlance of agency theory, the franchisee is given the right incentives to maximize economic efficiency because of similar goals arising from the ownership of equity (Carney and Gedajlovic 1991; Krueger 1991; Shane 1996). When the franchisor is viewed as the agent, the franchisee is cast in the role of an active investor in the franchisor's brand-name equity and business technology. Here, the franchisee faces an agency gap when the franchisor acts to hide the true value of its brand-name equity, and overcharge for this asset, (for example, by overselling franchises and underadvertising). Because the value of the knowledge to be transferred cannot be fully assessed in advance and the costs of reversing a franchising transaction are high, the franchisee requires some contractually defined up-front investment by the franchisor. This often takes the form of regular payments into the equity value of the franchise. For example, advertising is a popular form of payment that acts to increase the value of the franchise. In addition, short-term actions that hurt the long-term value of the franchise eventually catch up with the franchisor, eroding the credibility of the franchisor and reducing the value of the franchise as demand for contracts decreases. This mutual hostage situation discourages the franchisor from expropriating the hidden value of the franchise network by overselling contracts (Williamson, 1985).

A strategic perspective sees the franchising relationship more dynamically (Baucus, Baucus, and Human 1996). After the start-up, ongoing network relationships within the franchise system provide opportunities for learning and the transfer of knowledge between franchisees and franchisor (Baron and Schmidt 1991; Birley 1985). The franchisor adds value to a franchisee's human capital by providing brand-name equity, technology, location analyses expertise, and a prepackaged business system. The franchisee learns on the job and accumulates knowledge, which is further diffused and disseminated throughout the franchise system via the franchisor. This process increases the value of the entire network, because the franchisor can now offer more knowledge capital to prospective franchisees (Phan, Butler, and Lee 1994). Thus, the franchisee adds value to the franchise via the creation of new strategies and new solutions to existing problems. In effect, unanticipated contractual contingencies become the focal points for entrepreneurial value creation by the franchisee through the learning process. Strategic flexibility also comes with strategic risk. If the franchisee is expected to exercise strategic discretion, it will also expect risk premiums to be built into its rate of return. For example, we see that when the franchise concept is still new, it is common for franchisors to charge lower sign-up fees, and lower royalties, thereby allowing the franchisee to keep more of the residual as a percentage of sales.

MODEL AND HYPOTHESES

In this study, we take the view that franchisees can add value to the franchise contract, beyond that which is specified in the ex ante value of the contract by the franchisor, through entrepreneurial strategy creation activities. Such activities are often discouraged by the franchisor, because they serve to increase the welfare of the franchisee but not necessarily

the franchisor, which is why we expect to see franchisor influence on the strategic choices of its franchisees. We hypothesize that franchisors engage in informal interactions with their franchisees to either ensure compliance with the terms of the franchising contract or to encourage franchisees to emphasize revenue-dependent, as opposed to profit-dependent, performance criteria. In turn, the presence of noncontractual interactions, if they exist, implies that opportunities for franchisees to act entrepreneurially, that is, to act beyond the context of the formal franchise contract, are present.

Franchisors have an incentive to monitor their franchisees, because fees and royalties are usually tied to the success of the franchisee. Agency theory suggests that the written contract stating the rights and duties of each party serves to close the agency gap between the franchisor and franchisee. The success of both parties is tied to a common performance outcome, and a natural mechanism of mutual control and mutual forbearance is created. Such control mechanisms take away the opportunities for shirking by creating a situation in which the consequences of shirking are shared by both parties. Thus, the franchisor will specify in the contract, ex ante, success criteria over which it will have some level of control (Agrawal and Lal 1995). These formal control policies are often tempered with a certain level of slack, in tolerance of nonperformance. Macroeconomics and local competitive conditions account for part of this. The presence of contractual slack implies that both parties to the contract must have information on the net present value of the individual franchise relationship. This knowledge is necessary so that future cash flows will not be sacrificed due to the enforcement of a contingent claims clause. For example, personal interactions with the franchisee might allow the franchisor to assess the net present cash flow potential of an entrepreneur-franchisee's human capital. The franchisee might have experience, capability, and knowledge that suggests he or she has the potential to operate a successful franchise. Even though such a franchisee's operations is not performing up to its contractual goals, the franchisor will not withdraw the franchise license but instead will choose to be patient.

Franchise contracts also include a cost-sharing arrangement (Agrawal and Lal 1995). This mainly takes the form of sales and advertising expenditures. Such sharing arrangements indemnify both parties from free riding on the brand equity generated by each other's marketing efforts. However, the net effect of these arrangements is to increase revenues, but not necessarily profits for the franchising enterprise. The entrepreneurial efforts of the franchisee, which results in higher profits, are much harder to observe and measure. Thus, we usually observe that franchising contracts tie the award of royalties to the level of sales rather than profits because sales levels are easier to monitor. Given this, franchisors will try to direct the strategies of their franchisees in ways that are likely to maximize sales. Entrepreneur-franchisees benefit only by maximizing the residual cash flows from their enterprises. In addition, entrepreneurs who see themselves as risk-takers will demand a higher premium on their invested human capital. Therefore, they will judge success by their rates of return and will be inclined to concentrate on maximizing profits.

A franchisor's and franchisees' objectives are usually congruent because increasing sales and capturing market share usually leads to increased profits (Julian and Castrogiovanni 1995). A problem arises in markets that are highly competitive or are declining because these markets tend to have many firms, and slack demand is nonexistent because entry acts to fill all available market segments. This means that opportunities for profitably capturing large market shares are rare. In these situations, entrepreneur-franchisees have to sacrifice profit margins in order to increase market share if they are to please the franchisor. Herein lies the conflict that arises in a franchising contractual arrangement (Spinelli and Birley 1996). Franchisors gain from sales maximization and therefore have the incentive to encour-

age sales growth by franchisees. Together with the reason of easy monitoring, we expect that franchisors will write in their franchise contracts formal goals that emphasize sales rather than profits. However, in markets that are not growing, entrepreneur-franchisees gain by being able to preserve margins, by differentiating their services, and by restricting price competition, which might lead to strategies that work against sales maximization.

These issues might not matter if a franchisor negotiates a flat fee. They become serious when a contingency-based fee is used. In areas not covered in the franchise contract, the only recourse for franchisors is to influence franchisees' strategies through what can only be described as suasion, as it is perceived by the entrepreneur-franchisee.[4] For example, the transfer of technology from franchisor to franchisee may be perceived as suasion when such efforts are accompanied by attempts to influence the strategic goals of the franchisee. Such interactions also improve the ability for the franchisor to access private information affecting the accurate calculation of the net present value of the franchise, and they help to encourage franchisee's strategic compliance with contractual goals. The perception of franchisor suasion is further sharpened when such goals become central to the continuance of a relationship that both partners view as beneficial. In this respect, franchisors are acting to change the strategic goals used by entrepreneur-franchisees and to suggest that "crossing mother" is not in their best interests (Dunbar, Dutton, and Torbert 1982).

H1a: Franchisors set formal goals that emphasize sales growth rather than profit growth.

H1b: Perceived franchisor suasion will be directed toward sales not profit growth.

Entrepreneur-Franchisee Strategies

Goal compliance and informal interactions take place in a strategic context. One particular set of strategies that lends itself to more study is that allied with growth goals (Kaufmann and Dant 1996). In entrepreneurial research, such strategies are particularly salient because growth motives are at the core of most entrepreneurs' goals (Thompson 1994). Research has shown that growth is necessary for firms to capture economies of scale and scope and to gain institutional legitimacy during the start-up phase (Terpstra and Olson 1993; Hustedde and Pulver 1992). However, it has also been shown that growth can take many forms, depending on the stage of an entrepreneurial firm's life cycle (Thompson 1994). Also, not all forms of growth are congruent with maintaining profitability (Churchill and Lewis 1983).

Drawing from research in the field of diversification, entrepreneur-franchisees' growth strategies can be divided into four categories as shown in Table 1. In these research efforts, growth strategies have been denoted by the perceived future scope of the firm's economic activities and by the degree to which those activities were related to their current businesses (e.g., Hoskisson and Hitt 1990; Rumelt 1986).

Entrepreneur-franchisees can adopt one or more of these four distinct growth strategies. Firms engage in horizontal expansion by moving into new market areas or by buying new franchises, in which they have no previous experience or knowledge. Firms grow using product saturation when they increase the scope of their current product lines or the numbers

[4] As the franchise contract specifies the terms of interaction in the form of professional expertise and operational advice, the presence of suasion can only be ascertained from the perspective of the franchisee. Whether such advice represents legitimate information for which the franchisee paid or whether it suggests manipulation can only be assessed and reported by the entrepreneur-franchisee.

TABLE 1 Types of Entrepreneurial Growth Strategies

Franchisor's revenue potential	Scope of Business Activity	
	Wide	Narrow
High	Product Saturation—New Services (Low Franchisee Profit Potential)	Capital Expansion—New Capacity (Low Franchisee Profit Potential)
Low	Horizontal Expansion—Unrelated Products (Uncertain Franchisee Profit Potential)	Vertical Integration—Vertical Growth (High Franchisee Profit Potential)

of product combination variations offered. Those firms that choose to grow through vertical integration add services or products, which are further up or down the distribution chain. Those that grow by adding more capital equipment, staff, and buildings are said to be growing by capital expansion. A franchisor will attempt to influence franchisees' goals and strategies in ways that are consistent with its own revenue maximizing goals. Formal goals are written into the franchise contract to ensure a minimum performance standard so that franchisors can be guaranteed a cash flow from the operations of the franchisee (Spinelli and Birley 1996). Such goals, as discussed earlier, will stress such observable and measurable performance criteria as sales, which are expected to result in franchisees choosing growth strategies that result in higher sales. Because we set up the study in an industry context that renders the pursuit of both sales and profits incongruent, the strategies selected by franchisees who choose to "listen to mother" will necessarily result in lower profits.

H2a: Formal goals will moderate the relationship between strategy and performance in ways that results in higher sales for franchisees.

H2b: Formal goals will moderate the relationship between strategy and performance, resulting in lower profits for franchisees.

Entrepreneur-franchisees have great latitude in crafting business strategies once a formal contract is signed, because the contract cannot cover all possible contingencies. We hypothesize that suasion which contrains entrepreneurial latitude cannot take the form of contractual obligations but will appear as advice to the entrepreneur-franchisee on matters of operations, marketing, financing, and future growth opportunities. Furthermore, because such perceived franchisor-suasion efforts are directed at sales maximization, rather than at profit maximization, we would expect franchisees who "listen to mother" will choose strategies that result in higher sales and lower profits. Thus,

H2c: Perceived franchisor suasion will moderate the relationship between strategy and performance, resulting in higher levels of franchisee sales.

H2d: Perceived franchisor suasion will moderate the relationship between strategy and performance, resulting in lower profits for franchisees.

As stated earlier, firms can grow by vertical integration, related and unrelated diversification, or simply by expanding the productive capacity of current businesses. Such growth strategies can have varying degrees of revenue potential for the franchisor. For example, entrepreneur-franchisees can increase their overall profits by concentrating on extracting more efficiency from their operations (see Table 1). This requires vertically integrating their value chains and increasing the amount of value they add to their product offerings. The logic then suggests that they concentrate on: (1) streamlining their operational capabilities by identifying ways to add value to intermediate stages of the value chain, (2) packaging

these activities as services and products, and (3) realizing the cash flows by selling them. However, this may not generate higher revenues for the franchisor, because this strategy might not result in franchisees selling more final products. Higher revenues are generated for the franchisor only when the franchisee elects to increase its productive capacity with the aim of selling more.

Growth strategies that move a franchisee into new business areas, which are related to the current franchise agreement, also have positive revenue implications for the franchisor (Shane 1996). These product saturation strategies may increase the flow of products or services that the franchisor provides to the entrepreneur-franchisee. Entrepreneur-franchisees must sacrifice some short-term cash flows, when electing to grow by expanding into new but related products, or when adding capacity to sell more. These new businesses require entrepreneur-franchisees to add line and staff personnel, facilities, production capacity, and inventory. All of these will have a negative impact on short-term cash flows. In addition, learning costs will initially reduce the level of operational efficiency, which will be reflected in higher costs and lower profits. Adding new capacities, in order to be able to sell more, means that entrepreneur-franchisees may have to lower their contribution margin expectations. Thus, they will have to reduce their prices if they want to increase market share. The final short-run impact of this strategy is to reduce discretionary cash flows and the residual value of the enterprise accruing to the entrepreneur.

Growth strategies that move a franchisee into unrelated business areas (i.e., horizontal expansion) will have a negative impact on franchisor revenues, because entrepreneurial human capital and effort are being diverted away from the current enterprise (Hoskisson and Hitt 1990; Hill and Hansen 1991). On the other hand, they may prove to be profitable if these unrelated business areas represent opportunities in emerging or high-growth markets. Thus, diversifying into unrelated products presents a strategy of high uncertainty for the entrepreneur-franchisee. In sum, different growth strategies have different profit implications for the entrepreneur-franchisee. We posit that the growth strategies chosen by franchisees will be congruent with profit maximization. The above arguments are summarized in the following hypotheses:

H3a: Franchisees selecting vertical integration strategies will have higher profits than those selecting horizontal expansion strategies.

H3b: Franchisees selecting vertical integration strategies will have higher profits than those selecting product saturation strategies.

H3c: Franchisees selecting vertical integration strategies will have higher profits than those selecting capital expansion strategies.

METHODS

Sample

The commercial heavy truck industry was selected as the sample because franchising is a common business format in this industry. A previous field study had given the researchers some in-depth knowledge about this industry. Products and services are nonstandardized, and pricing is variable, which permits the testing of the hypotheses related to franchisees' growth strategy options. Franchising contracts tend to be standardized, which made it possible to compare the effects of franchisors suasion efforts on the strategy and subsequent performance of their franchisees. The sample was limited to a single industry to eliminate con-

founds, such as the degree of geographical dispersion, variable definitions of markets, and business practices related to industry-specific accounting reporting standards.

Data Collection

A background investigation of the industry was conducted by interviewing senior executives of a major commercial truck franchisor and seven entrepreneur-franchisees representing four different truck manufacturers. The interviewees told us that this industry has been suffering from poor performance from 1987 to the early 1990s. They attributed this to a continent-wide recession. Franchisors say franchisees' business strategy decisions are critical to their success. In addition, growth strategies were particularly important because they constituted the only ways that both franchisors and franchisees tried to counter the negative economic environment. These strategies often created conflict. Competition between truck retailers increased as a result of the shrinking market demand. This increased the pressure to maintain market share, even at the expense of profit margins.

A questionnaire was developed using the knowledge gained from the field interviews. The instrument was primarily designed to determine the nature of the informal franchisor-franchisee relationship, performance levels of the participating firms, and the nature of franchisor-franchisee contractual arrangements. The instrument was pretested using a sample of entrepreneurs-franchisees in the northwestern United States. Executives were asked to pay special attention to question construction, face validity of the items, difficulties with confidentiality, and jargon. The questionnaire was then refined to address construct definition and editorial problems.

The instrument was mailed to 700 truck retailing entrepreneur-franchisees in the United States. Two major United States heavy truck manufacturers were surveyed, and 160 surveys were returned ($n = 47$; $n_2 = 113$). This represented a 23% response rate. A chi-squared test, comparing the respondents with nonrespondents, found no statistically significant differences in terms of geographic location, manufacturer representation or firm size. The responses of the franchisees, from the two manufacturers, were compared.[5] No biases were discovered, and thus data from both manufacturers were combined and treated as a single sample.

Scale Construction

The contents of communication are often context specific. In order to operationalize our constructs, including perceived franchisor suasion, we needed to understand the different types of conversation topics and the context in which such interchanges took place. At a minimum, this entailed an understanding of the industry and also the business operation, common jargon, and cultural norms in which such communications took place daily. Thus, in constructing our scales, we could not rely on scales used in past studies or even assume, a priori, to know the items that they may contain. Instead, we had to create a validated item pool from scratch, using clinical research methodology.

To do this, we followed Cacioppo and Petty's (1982) procedure for scale construction. First, we created an item pool, taken from interviews with a major Pacific Northwest manu-

[5] We used the Kolmogorow-Smirnov two-sample (unequal sized) test to determine if the sample distributions of the respondents from Manufacturer 1 and those of Manufacturer 2 differed in terms of size, geographic location, and time of reply. See Phan and Hill (1995) for a detailed explanation on the use of the $D_{m,n}$ statistic.

TABLE 2 Equations of the Model

$Perf_i = B_0 + B_{1i}Strat_j + B_{2k}Suas_k + \sum B_{xijk}Strat_jSuas_k + \epsilon$ Eq.1

$Perf_i = B_0 + B_{1i}Strat_j + B_{2k}Goal_l + \sum B_{xijl}Strat_jGoal_l + \epsilon$ Eq.2

$Perf_i$ refers to sales when i = 1 and profits when i = 2

$Strat_j$ refers to capital expansion strategy when j = 1
vertical expansion when j = 2
horizontal expansion when j = 3 and
product saturation when j = 4

$Suas_k$ refers to operational related topics when k = 1
financial managment topics when k = 2
marketing related topics when k = 3

$Goal_l$ refers to franchisor's emphasis on profits if 1 = 1
franchisor's emphasis on sales if 1 = 2

$Strat_jSuas_k$ is the interactin between $Strat_j$ and $Suas_k$

$Strat_jGoal_l$ is the interactin between $Strat_j$ and $Goal_l$

B_x refers to the standardized regression coefficients of the interaction terms where $x = j^*k$

facturer of two class-8 truck nameplates, and four of its franchisees. Over a three-month period, these interviews familiarized us with the operational and industry practices that were common to all manufacturers of trucks. They also afforded the opportunity to obtain contacts with manufacturer association representatives. Their participation conferred upon the project a degree of legitimacy, which helped increase the response rate in the large sample study. The item pool was then refined by showing it to three other franchisees representing other nationally known truck manufacturers. This allowed us to both validate the findings from the first set of interviews and also ensured that the items were generalizable across manufacturers. Later, tests to determine if there were statistically significant differences between the respondents from the two manufacturers represented in our large-scale survey revealed no significant differences (see footnote 5), which confirmed the generalizability of the items. Finally, we performed confirmatory factor analysis to ensure that the items measured the constructs we developed them to measure.

Empirical Tests

A series of hierarchical moderator regression analyses were conducted. These tested for the hypothesized interaction effects between franchisor goals and growth strategies, and between perceived franchisor suasion and growth strategies. These equations are summarized in Table 2. The equations suggest that in a moderator regression, to find interpretable results for the moderator variable, the interaction term must be statistically significant. Taking the example of equation 3 in Table 3, to determine a moderation effect, the coefficients B_{1i} and

TABLE 3 Example of Moderated Equation of the Model

$Perf_i = B_0 + B_{1i}Strat_j + \epsilon$ Eq.3

$Perf_i = B_0 + B_{1i}Strat_j + B_{2k}Suas_k + \epsilon$ Eq.4

$Perf_i = B_0 + B_{1i}Strat_j + B_{2k}Suas_k + \sum B_{xijk}Strat_jSuas_k + \epsilon$ Eq.5

Where the terms of the variables are the same as in Table 1

B_{2k} should be significant in equation 4, and the coefficient B_{xijk} in equation 5 must also be statistically significant. We report standardized regression coefficients in order to compare the relative strengths of the influence of each of the independent and interaction term variables on the dependent variable.

Dependent Variables

Because the sampling population we used is mostly privately held firms, it was crucial that we obtained performance variables that were unbiased. Common variance in survey studies tends to arise because of percept-percept bias. That is, a respondent is asked to evaluate qualitatively how he or she feels about an outcome while at the same time, he or she is providing information on the independent variables. One way to alleviate this problem is to ask respondents to report objective measures that do not depend solely on perception (see the technique used in Phan and Hill 1995). For this study, such objective measures of performance had to have face validity and be context sensitive, that is, they had to reflect the formal objectives of the franchise contract.

Given the above strictures, we chose to use ranges for growth rate in return on sales (ROS), and the sales growth rate for the 1989 calendar year over the previous three years to measure a franchisee's profit and sales performances, respectively. Critics may take issue with our use of accounting measures, pointing out that, in a small firm, accounting measures may be unreliable, because they are subject to manipulation by management. We decided that accounting, rather than the alternative, which is market measures, provided the highest level of face validity for this study, because our interviews revealed that formal goals in franchise agreements are focused on accounting, rather than market measures of performance. In addition, we are reasonably sure that in this study, manipulation is controlled and probably random, if it occurred, because this sample used two nationally known truck manufacturers that relied on franchise agreements that included standards of reporting and standard reporting formats. This assured comparability in the data between the respondents. We checked this with our truck manufacturer informant, who also told us that franchisee records are frequently audited, because the royalty payments are based on accounting measures of performance. In addition, using standard reporting formats and standard financial statement line items are common practices in this industry. This was confirmed when our preliminary analyses did not reveal statistically significant differences in performance between the respondents from the two truck manufacturers.

Independent Variables

Independent variables measured respondents' responses to items related to the importance of various types of perceived franchisor suasion, performance goals, and strategic decisions. A 5-point Likert scale was used. Higher scores indicated that franchisees placed a greater emphasis or importance on a particular item. The items were specifically selected to allow for the development of multiple-item factor variables, which could be used in subsequent statistical analyses. Confirmatory factor analysis was performed to validate the factor variables and measure the reliability of each factor variable. Items that did not contribute to factor reliability were deleted from the final factor solution. Following Nunnally (1978), factor variables with reliability alphas of 0.70 or greater were retained. Factors were orthogonally rotated so that they could be used in regression analyses. This ensured that the factor variables for each scale were not collinear. Appendix 1 reports the scales used in this study.

TABLE 4 Factor Analysis of Formal Goals

Formal Goals	Profitability	Size
Rel. market share	0.90213	0.03203
Pretax profits	0.89125	0.12776
Sales	0.16219	0.73187
Contribution margin	−0.83305	−0.39941
Alpha	0.8515	0.7125
Variance expained	51.7	20.3
Eigenvalue	2.00	1.16

Franchise Contract Formal Goals

Franchise contracts are predicated on the establishment of formal goals. These goals are the bases for setting franchisee fees, royalty payments, and so forth. In our interviews with the truck manufacturer—franchisor—we were able to determine that such goals, expressed in franchise contract agreements, in the truck retailing industry, could be classified into two categories. Interviews with franchisees representing other truck franchisors confirmed this finding.

Table 4 reports the items constituting the two categories of formal, contractual goals in the truck retailing industry. Goals related to growth in profitability consisted of an emphasis on relative market share and pretax profits. Those related to growth in size focused on increasing sales and decreasing contribution margins. This was congruent with our theoretical discussion, which argued that to increase sales in a stagnant market, firms have to sacrifice margins by lowering prices in order to generate volume. Thus, an emphasis on growing sales will necessarily lead to a deemphasis on margins in this environment. The factors had high reliabilities, with alphas of 0.85 and 0.71. Face validities for the factors were also high, because an emphasis on relative market share and profits would lead franchisees to manage with efficiency. Thus, an emphasis on sales, combined with a deemphasis on margin, would lead franchisees to focus more on size. A further examination of the scale on formal goals revealed that there was an overall emphasis on sales growth rather than profitability, confirming our notion and that of previous empirical studies (for example, Julian and Castrogiovanni 1995; Manolis, Dahlstrom, and Nygaard 1995) that growth is in the center of a franchisor's strategy and that it will push such a strategy in its contractual arrangements with its franchisees.

Perceived Franchisor Suasion

In field interviews during the initial stages of our study, we determined through a content analysis that franchisors often related to franchisees at the operational level. That is, it was common for franchisors to call upon franchisees regularly to discuss matters of accounting control, staffing, capital requirements for expansion, sales performance, and the like. These topics of discussions (often held over the phone) could be classified, a priori, into three categories.

Table 5 reports the three categories of discussion between franchisees and franchisors in this industry. These are formulated as franchisor-suasion tactics as perceived by franchisees. The first relates to internal operational issues, such as general management, human resources, and operations. The second category focuses on marketing issues, such as pricing, industry trends, and sales. The final category deals with finance and cash-flow issues, such

TABLE 5 Factor Analysis of Perceived Franchisor-Suasion Tactics

Tactics	Operations	Marketing	Finance
General mgt. issues	0.85659	0.14358	0.06024
Staffing and HRM issues	0.76364	0.08585	0.15267
Operational issues	0.72776	0.12075	0.26265
Pricing issues	−0.16732	0.75286	0.30830
Industry trends	0.19801	0.73696	0.06336
Sales and marketing	0.38007	0.71592	0.00953
Financing	0.09264	0.17748	0.88401
Credit policies	0.35043	0.09217	0.82575
Alpha	0.7466	0.7301	0.7734
Variance explained	39.4	16.4	13.7
Eigenvalue	3.15	1.31	1.09

as financing for growth and customer credit policies. The confirmatory factor analyses showed that the items used in the questionnaire conformed to prespecified factor variables. Items meant to measure perceived franchisor suasion, in the form of advice on operational matters, financial management, and marketing issues were correctly grouped. The reliabilities of the factors were high, with alphas of 0.75, 0.73, and 0.77, respectively.

Entrepreneur-Franchisee Strategies

Our theoretical model dictated the development of our growth-strategies scale. Using the categories of growth strategies we developed in Table 1, we approached our first set of field respondents for suggestions as to the kinds of items that might measure these strategies. Then, we refined the scales by asking the second set of field interviewees the same question, but showed them the items in each scale and asked for comments. Finally, the data from the large sample survey was factor analyzed to confirm the scale items. Whereas the conceptual categories are derived from extant theory, the items are specific to the industry we studied; thus these items may well differ in another industry context. In order to ensure that the survey instrument had overall face validity, we needed to include items that franchisees told us were relevant to their businesses. The confirmatory factor analysis validated the growth strategies.

Table 6 reports the factor analyses of franchisee growth strategies. There were four types of strategies reported by the scale. The "growth by capital expansion" strategy describes franchisees who grow their firms through the addition of new sales and administrative personnel, buildings, and truck servicing facilities. We included the increase in the size of the firm, as measured by the increase in employees, as a correlate to an increase in the physical plant of the firm. Our interviews revealed that firms never increased physical plant size without also increasing staff size to run that plant. This was deemed conceptually important enough for us to include the items even though the we named the scale "capital" expansion. Essentially, we are arguing that the resources required to increase physical plant size must also include the attendant resources required to run that plant because in trying to capture resource allocation decisions we had to fully account for the financial impact of these decisions as well. The reliability alpha of 0.73 allowed us to keep this factor for further analyses.

The second factor, "growth through vertical integration," described how franchisees can grow by integrating backwards into wholesale and retail parts sales and by integrating forward into the after-market of used-truck sales. An alpha of 0.74 indicated high reliability. The third factor measures "growth by product saturation," which describes how franchisees

TABLE 6 Factor Analysis of Growth Strategies

Strategies	Capital Expansion	Vertical Integration	Product Saturation	Horizontal Expansion
New sales personnel	0.83864	0.09017	0.08955	0.04867
New admin. personnel	0.75395	0.01508	−0.08398	0.09870
New buildings	0.71291	0.07755	0.21111	0.14197
New service facilities	0.54778	0.19317	0.31341	−0.07272
Wholesale parts sales	0.11371	0.83114	0.13391	0.12449
Retail parts sales	0.00669	0.82137	0.02622	0.04574
Used truck sales	0.17687	0.72546	0.09675	−0.15728
Maintenance contracts	0.08865	0.24894	0.88401	0.05116
Full service leasing	0.21451	−0.02408	0.84078	0.24220
New truck brands	0.00834	0.01763	0.09980	0.90233
New truck classes	0.16960	0.01574	0.12972	0.87735
Alpha	0.7309	0.7357	0.8237	0.8069
Variance explained	26.9	13.3	10.9	9.1
Eigenvalue	3.76	1.87	1.53	1.28

grow by adding truck service maintenance contracts to more fully exploit their service facilities and by moving into the growing full-service truck leasing business. A reliability alpha of 0.82 and the factor item loadings further confirmed our initial notions about this growth strategy. Finally, the last factor, "growth through horizontal expansion," shows how franchisees grow by adding new truck brands and makes, new truck classes (sizes), and other truck-related businesses that are not connected to the original franchise contract. They do this to extract the surplus value of the knowledge learned from the original contract and by applying this knowledge to the sales of other products without having to pay for its use. A high alpha of 0.81 confirmed our assessment of the reliability of this factor.

A Pearson correlation of the variables is shown in Table 7. It indicates that the sales performance of franchisees is significantly impacted by perceived franchisor suasion. In addition, it also appears that perceived franchisor suasion is significantly correlated to the strategies adopted by franchisees. The next step was to perform moderator regression analyses based on the model we developed. We followed the procedure outlined in our previous discussion with respect to Tables 2 and 3.

RESULTS

Summary statistics revealed that the average performance of franchisees is not very high. This reflects the time frame of this study. The North American economy was in a slump, and manufacturing activities were reduced. This negatively impacted heavy truck sales and truck leasing activities. There was more variance in sales performance than in profit performance, with profits recording a decline. This indicates that franchisees were taking steps to protect their bottom lines, even though revenues were severely hit. It appears that vertical integration strategies were one way that franchisees used to stave off the erosion of profits, which was caused by intensive competition. It is also interesting that the variance on the importance of this strategy is the lowest of the four examined. This indicates that franchisees uniformly recognized the utility of increasing product value in protecting their margins.

Perceived franchisor suasion seemed to be an important aspect of the franchising relationship, as indicated by the above average scores for all three suasion tactic categories. It appears that the tactics related to financing for growth issues were particularly important

TABLE 7 Pearson Correlation Table

	P1	P2	S1	S2	S3	S4	C1	C2	C3	FG1
Sales performance P1	1.0000									
Profit performance P2	0.0942	1.0000								
Capital growth S1	0.0948	0.0000	1.000							
Vertical growth S2	−0.0149	1.0000	0.0000	1.000						
Horizontal growth S3	−0.1808[a]	0.0783	0.0000	0.0000	1.0000					
Product saturation S4	0.0910	−0.0833	0.0000	0.0000	0.0000	1.000				
Suasion-operations C1	0.1568[a]	0.1776[a]	0.2326[b]	0.1098	0.0345	−0.2321	1.000			
Suasion-finance C2	0.2834[b]	0.0622	0.0749	0.2326[b]	−0.1788[a]	0.2146[b]	0.0000	1.0000		
Suasion-marketing C3	0.0954	−0.1599[a]	0.0794	−0.0658	0.0613	0.0447	0.0000	0.0000	1.000	
Formal profit goals FG1	0.1948[a]	0.0336	0.1094	0.1919[a]	0.0303	0.0003	0.2356[b]	0.1265	0.2702[c]	1.0000
Formal sales goals FG2	0.1236	0.1089	0.0316	0.1195	0.0056	−0.0347	0.1300	0.0831	0.1510	0.0000

[a] $p < .05$.
[b] $p < .01$.
[c] $p < .001$.
$n = 160$.

to franchisees. The variance on this variable was the lowest of the three, demonstrating that it was uniformly considered by franchisees to be the most important growth suasion tactic. This seems congruent with the argument that franchisors will push growth, because it protects their income streams. The easiest way of doing so is to push growth by financing expansion, rather than pulling growth through long-term investments in brand-name capital.

Finally, franchisors demanded a high level of emphasis on sales goals by their franchisees. This is in stark contrast to the deemphasis on the importance of formal profitability goals in the franchise contract, and this condition appears to be uniformly applied, regardless of franchisor. In a *t*-test of the means, the emphasis on sales goal (4.4—"very important") was statistically significantly ($p < .001$) and different than the deemphasis on profits goal factor (2.8—"not very important"). This result supports the contention that franchisors will emphasis sales more heavily that profits, and in this case, even deemphasize profits in order to increase sales. This strongly supports hypothesis 1a.

Moderator regression results are presented in Table 8. Four models, representing the separate moderating impact of perceived franchisor suasion and formal goals on profits and goals, are reported. The analysis was laid out in this manner so that individual effects of formal goals and perceived franchisor suasion on franchisee strategies and performance could be tested. The impact and interactions of formal goals on strategy and perceived franchisor suasion on strategy were analyzed separately. This was done to be consistent with our model, which does not imply any relationship between formal goals and perceived franchisor suasion. It also made the interpretation of the coefficients more manageable.

Variance explained by the equations was between 14% to 41%. This indicates a wide

TABLE 8 Moderator Regression Results

	Equation 1 Profits	Equation 2 Sales	Equation 3 Profits	Equation 4 Sales
$Strat_1$	−0.09	0.21[c]	−0.15[b]	0.25[c]
$Strat_2$	0.15[a]	0.23[c]	0.06	0.31[d]
$Strat_3$	−0.35[d]	0.09	−0.32[d]	0.07
$Strat_4$	0.14[a]	0.26	0.05	−0.09
$Goal_1$	0.06	0.06		
$Goal_2$	0.06	0.01		
$Suas_1$			−0.23[c]	0.19[b]
$Suas_2$			−0.23[c]	0.16[a]
$Suas_3$			−0.15[b]	0.17[b]
$Strat_1/Goal_1$	−0.10	−0.13		
$Strat_1/Goal_2$	0.08	−0.12		
$Strat_2/Goal_1$	−0.24[c]	0.09		
$Strat_2/Goal_2$	−0.05	0.20[b]		
$Strat_3/Goal_1$	−0.27[c]	0.03		
$Strat_3/Goal_2$	−0.21[c]	0.04		
$Strat_4/Goal_1$	−0.12	−0.01		
$Strat_4/Goal_1$	0.02	−0.03		
$Strat_1/Suas_1$			−0.29[c]	−0.08
$Strat_1/Suas_2$			0.07	0.19[b]
$Strat_1/Suas_3$			−0.18[b]	0.32[d]
$Strat_2/Suas_1$			−0.17[a]	0.03
$Strat_2/Suas_2$			0.03	0.05
$Strat_2/Suas_3$			0.05	0.05
$Strat_3/Suas_1$			0.11	0.08
$Strat_3/Suas_2$			−0.02	−0.10
$Strat_3/Suas_3$			0.11	0.16[b]
$Strat_4/Suas_1$			−0.04	0.12
$Strat_4/Suas_2$			0.00	0.14[a]
$Strat_4/Suas_3$			−0.06	0.12
Adjusted R^2	0.412	0.146	0.343	0.321
F	7.0[d]	2.7[b]	4.6[d]	4.2[d]

[a] $p < .10$.
[b] $p < .05$.
[c] $p < .01$.
[d] $p < .001$.

$Strat_j$ refers to capital expansion strategy when j = 1; vertical expansion when j = 2; horizontal expansion when j = 3; and product saturation when j = 4.

$Suas_k$ refers to operations related suasion topics when k = 1; financial management topics when k = 2; marketing related topics when k = 3.

$Goal_l$ refers to franchisor's emphasis on profits when l = 1; franchisor's emphasis on sales when l = 2.

$Strat_j$ $Suas_k$ is the interaction between $Strat_j$ and $Suas_k$.

$Strat_j$ $Goal_l$ is the interaction between $Strat_j$ and $Goal_l$.

variation in the power and relative importance of the variables used. It also permits a comparison of the efficacy of formal goals and perceived franchisor suasion on influencing franchisee strategies and performance outcomes. Three of the four equations used explained at least 30% of the variance in the model. This indicated that the variables were well specified.

As our results show, there is some evidence that attempts at suasion affected franchisee's performance in favor of sales growth. The interaction of formal profit goals with vertical integration strategy (equation 1: $p < .001$) and the horizontal expansion strategy (equation 1: $p < .001$) resulted in lowered profitability. The interaction of an emphasis on sales goals

with a horizon expansion strategy also suggests that perceived franchisor-suasion was used to lower profitability (equation 1: $p < .001$). The significance of the interaction of an emphasis on sales goals and a vertical integration strategy suggests that perceived franchisor suasion is directed toward high sales (equation 2: $p < .05$).

Taken together, these results appear to provide weak support for hypothesis 2a but stronger support for hypothesis 2b. The effects are not strong enough to conclude that formal goals were instrumental in influencing the strategies of franchisees to the extent that this influence always resulted in higher sales, but we found that this influence does result in lower profits. It appears that formal goals emphasizing sales did not necessarily guide franchisees to succeed in that dimension but instead hurt their abilities to maintain profits.

An examination of the results, related to equations 3 and 4, suggests that perceived franchisor-suasion tactics led to lower profits and higher sales. In particular, we found that franchisees who reported that franchisors used suasion in the form of advice on operational issues had lower profits (equation 3: $p < .01$) and higher sales growth (equation 4: $p < .19$). Those reporting franchisors favoring suasion in the form of advice on financial management for growth had reduced profitability (equation 3: $p < .01$) and increased sales (equation 4: $p < .10$). Finally perceived franchisor suasion in the form of advice on marketing-related topics reduced franchisee profitability (equation 3: $p < .05$) and increased franchisee sales growth (equation 4: $p < .05$). Taken together, these findings appear to provide strong support for hypothesis 1b.

The results show that the interactions of perceived franchisor suasion on operational issues and franchisee capital expansion (equation 3: $p < .001$) and vertical expansion strategies (equation 3: $p < .10$) resulted in lower profits. The interactions of perceived franchisor suasion in the form of advice on financial management for growth, with franchisee capital expansion (equation 4: $p < .05$) and product expansion strategies (equation 4: $p < .10$), led to higher franchisee sales growth. The interaction of perceived franchisor suasion in the form of advice on marketing, and franchisee capital expansion strategies resulted in lower profitability (equation 3: $p < .05$) and higher sales growth (equation 4: $p < .0001$). Similarly, the interaction of perceived franchisor suasion in the form of advice on marketing and franchisee horizontal expansion strategies resulted in higher franchisee sales growth ($p < .05$). Taken together, these results support hypothesis 2c and hypothesis 2d. Again, we find that franchisors were effective in influencing franchisees' strategies to increase sales but not profits.

Finally, the results indicate that both capital expansion strategies (equation 4: $p < .01$) and vertical integration strategies (equation 4: $p < .001$) led to higher levels of sales growth but had no positive impact on profitability. Those adopting capital expansion strategies reported lower profitability (equation 3: $p < .05$). Franchisees adopting horizontal expansion strategies reported lower profits (equation 3: $p < .001$), but not higher sales. There is some evidence that, at least for this industry, sales growth and profitability maximization were incongruent objectives. However, these results refuted hypotheses 3a to 3c. No strategy reported by the survey participants increased profitability, whereas two of the growth strategies used resulted in higher sales.

The results provide partial support for the research model, when taken as a whole. In particular, they show that franchisors using suasion were more able to influence franchisee strategies than those simply relying only on the contractual goals in the franchise agreement. The results do not hold much hope for franchisees, because they uniformly reported lower profits because of franchisor intervention. In some instances, these sacrifices were not even matched with the higher sales franchisors anticipated.

DISCUSSION

Findings

The most intriguing finding is the refutation of hypotheses 3a to 3c, which stated that franchisees following a vertical integration strategy would have higher profits than those following the other growth strategies. There is always the possibility that the variables were inadequately operationalized or measured, but care was taken in constructing these variables. The interviews were comprehensive and provided us a representation of practices and norms across firms. Thus, items that were finally selected for the study were deemed to be valid for executives answering the questionnaire. Confirmatory factor analyses of the scale revealed a high degree of reliability. Analyses of the individual components reported no anomalies. Thus, we are confident about the construction and measurement of the strategy variables.

If methodological inadequacy can be ruled out, is there a theoretical alternative explanation for the refutation of hypotheses 3a to 3c? It may be that, in the economic environment of the late 1980s and early 1990s, intense competition for shrinking markets did not lend itself to any type of growth strategies. Harrigan (1986) suggests that engaging in vertical integration strategies under adverse industry conditions will lead to poor performance, and that the best conditions in which vertical integration works tend to be in growth or low uncertainty industries. Thus, retrenchment or restructuring strategies would have been more appropriate in this industrial context. Respondents never forwarded these as options in the interviews or on the survey responses, even though space was provided for open-ended comments.

The fact that franchise agreements are framed to emphasize sales growth, that opportunities are discussed in the context of growth, and that perceived franchisor suasion emphasized sales growth may be responsible for the entrepreneur-franchisees' almost uniform response in spite of declining market opportunities. Franchisees may consider buying market share through lower margins as the only option, because they have not been sensitized to other strategy options. This uniform response may have produced the statistical artifact that resulted in the refutation of hypotheses 3a to 3c. The set of franchisee strategies (Table 1) was bounded by our observations of what actually took place in this industry. However, in doing so we fell short by not including other possibilities that would have been, a priori, more congruent with industry conditions.

In sum, the evidence seems to suggest that franchisors' attempts at directed strategy may contribute to lower franchisee profitability but generally increases the level of sales. It appears that a win-lose situation for franchisor-franchisee characterizes these franchising relationships when franchisors get involved in franchisee strategies.

Limitations of the Study

There are several caveats about this study that should be raised. First, this study was deliberately aimed at a troubled industry, and all findings may not be generalizable to other industry contexts. Industries in their growth stage may find that the profit/market share tradeoff is less relevant. In addition, the commercial truck retailing industry for franchisees has been on a decline since 1987. Part of the reason for this has been the move by commercial transportation companies to emphasize fleet sales, which are made directly with the manufacturers. In addition, private carriers, manufacturers, and agricultural companies, which transport their own goods, have been on the decline. This has resulted in a transfer of business to

contract commercial carriers. Many of these carriers have turned to leasing or fleet sales as an alternative. Thus, applications from this study cannot be applied to all industries, but most industries involved in franchising can expect to eventually experience some of these conditions because geographic expansion, often a strategy favored by franchisors, will decrease environmental slack as all available niches are filled (Bates 1995; Julian and Castrogiovanni 1995).

Truck retailing is an industry in decline. This is evidenced by the narrow margins and enormous efforts that manufacturers use to increase market share at the retail level. This implies that franchisees, in declining industries, probably know more about their competitive conditions than the parent franchisor. Thus, if franchisees are unwilling to "cross mother" and instead allow franchisors to direct their strategies, franchisees will reap lower profits because franchisors lack complete information about the local marketplace. In start-up industries, where the expertise of the franchise parent is critical to the survival of new ventures, this will not occur. The transfer of knowledge from franchisor to franchisee will take the form of formal as well as informal communication. Further, the goals of franchisor and franchisees, in growing industries, are more likely to be congruent. In such industries, greater market share often does translate to higher profit rates. These franchisees will not see suasion as an attempt to accomplish a hidden agenda.

Although we chose the two largest class-8 truck manufacturers in North America, it is by no means guaranteed, ex post, that our findings can represent the entire truck retailing industry. However, we tried to ensure representativeness, ex ante, by talking to industry association representatives and other industry participants when we first conducted our initial field studies to get a sense of industry practices, norms, and values. Our initial foray into the field was largely driven by the knowledge we gained from talking to these association representatives and manufacturers other than those we chose for our survey sample. Thus, although we are not able to present a formal test of the external generalizability of our sample, we are confident that our survey questionnaire was able to capture standard industry practices and norms and therefore ensure that the results from this questionnaire are generalizable to the rest of the truck retailing industry.

Our study is vulnerable to all of the standard criticisms leveled at studies that use survey data (e.g., social desirability effects, common method variance, the inherent ambiguity of survey questions, nonresponse bias). We also recognize that using only a single respondent per firm can be problematic and could be justly criticized as potentially biased. We have three replies to these potential criticisms. First, in order to test the hypotheses generated in this study for a large sample of firms there was no other alternative but survey data. Our model requires information that is not available in the public domain. Consequently, we were forced to be sensitive to the needs of our sample firms for privacy and therefore could only ask for a limited amount of hard financial data. Second, we tried to be as careful as possible in the construction of the survey, extensively consulting with those involved in franchising and pilot testing the survey on a limited sample before settling on a final design. Moreover, as reported earlier, we conducted all of the standard tests for geographic and nonresponse bias. Third, given that we were surveying entrepreneurial firms, and as such the organizational memory and knowledge of these firms resided with the entrepreneur, we had little choice but to rely on the entrepreneurs' responses. In such a situation, multiple responses from others within the same firm would not have ensured reliability because many of our items are indeed perceptual and it is the entrepreneurs' perceptions that are most salient. We ensured, as much as we were able, that it was the entrepreneur who responded,

by requesting his/her exclusive participation in our letters, reminder postcards, and survey instructions. As a consequence, although we are as confident as one can be about these matters—that our survey measured what it was intended to measure—we also recognize that social desirability effects may bias our sample toward the better performing firms, that is, those firms who perceived their performance as being superior would have been more willing to participate.

Finally, it is worth emphasizing that our strongest results focused primarily upon the short-run impact of noncontractual interactions on franchisee on performance. Given that our survey focused on a period of time when overall economic conditions were depressed, the overall declining sales trend we found may have also been strongly influenced by this. Further, the types of interactions reported were confined by our items, developed in consultation with Northwest Pacific area franchisees and franchisor, in the survey. Methodologically, our priority was to obtain complete and statistically representative responses. Thus, we felt that we could only request the type of information that franchisees could conveniently and willingly reveal. This meant that we could only obtain relatively short-run and not-too-recent performance data, simplifying the item pool to shorten the questionnaire, and promising response anonymity, which precluded us from doing telephone follow-ups.

Future Research

Future research directions clearly indicate a follow-up study using longer term data. Also, it would make sense to lag the dependent variables so that the full impact of perceived franchisor-suasion activities may be registered, which would increase the variance explained and perhaps give us cleaner results. Conceptually, lagging would have been a superior technique for treating the dependent variables. However, we were constrained by the need to keep the questionnaire user-friendly, nonthreatening, and relatively short. On reflection, it may have been better to deal with a lower response rate ex post, than sacrifice data richness ex ante.

We speculated that a decline of an industry, accompanied by environmental parsimony, may be a causal factor in the kinds of franchisee behaviors we measured. It would also be useful to determine the generalizability of this study by applying the model to different task environments, such as the insurance, real estate, fast food, and retail merchandising industries (Bates 1995). The aim here, would be to find out what dimensions of an industrial context are important in determining franchisee-franchisor interactions and their impact on franchisee performance. However, beyond the methodological concerns, the best way to treat the current study is to view it as an exploratory attempt to determine if a phenomenon exists. Given that we were able to support some of our hypotheses, but lacked stronger findings, future research would be more fruitful if we took a step back and conducted more in-depth clinical studies with an aim to build grounded theory before continuing with large sample studies.

Finally, it is necessary to connect this research with the broader literature on franchising perspectives. Specifically, one needs to ask the question, if franchisees act entrepreneurially, does this also imply that they necessarily create value for the franchise system (Baucus, Baucus, and Human 1996)? We argued in an earlier section that franchisees, because they have the capacity to learn from local competitive environments, can add value to a franchise system because such learning effectively expands the range of strategic responses available to other franchisees facing the same issues. If so, then franchisors may find it in their interests

to allow entrepreneurial, i.e., strategic decision-making, activities to take place and even allow franchisees to take short-run actions that may conflict with a franchisor's performance objective, in the hope that long-run value maximization of the franchise system can be achieved.

CONCLUSION

Notwithstanding the caveats regarding methodology and the interpretation of the findings we raised earlier, we believe that there are a number of important lessons we can learn from this study. This research suggests that entrepreneur-franchisees, in declining industries, should be leery of franchisors' attempts at directed strategy. This is because the goals of franchisors and franchisees will most likely conflict. More importantly, such conflict can lead to undesirable performance outcomes. We found that franchisors' strategy advice tend to depress franchisees' profits. Successful suasion by franchisors did not lead to improved performance for franchisees. This has an important practical implication. It is often easier for a franchisee to "obey mother," because to do otherwise may violate the spirit of the franchise contract. However, doing so means a loss of entrepreneurial autonomy. Franchisors are unlikely to consider the possibility that franchisees would be better served by formulating their own strategies or that they would be better off, in the longer term, by learning from the collective impact of numerous franchisees independently formulating their own strategies. To the extent that entrepreneurial capital is often the crucial ingredient in determining the success of an enterprise, "crossing mother" appears to be a preferred course for entrepreneur-franchisees, when revenue expansion strategies are suggested by franchisors in declining industries.

In this study, we have tried to make the distinction between what is entrepreneurial, i.e., self-directed strategy-making, and what is not entrepreneurial activity for a franchisee. More importantly, this distinction allows us to conclude that if franchisees are engaging in entrepreneurial activity, we would expect to see a divergence of interests and thus vigorous suasion activity. To the extent that franchisees perceive suasion activity in the franchise relationship, we can surmise that some franchisees are probably acting entrepreneurially and therefore should be creating value, whether for themselves or the franchise system as a whole. A more interesting question, one our research does not answer, is whether such a normative statement—that franchisees are creating value because they act entrepreneurially—is borne out by empirical data. We can ask related questions, such as, "what course of action should entrepreneurs take in the period before the industry reaches maturity and eventual decline?" Franchisors are likely to eventually determine that current contractual arrangements are not protecting their longer term interests. They will then attempt to modify, ex post, franchise contracts in ways that force franchisees to implement market-share or sales-growth strategies. This requires that entrepreneurs anticipate future events more carefully at the time they are examining the original franchise contract. Most entrepreneurs are concerned with immediate survival at the start-up stage, which makes it less likely that this will happen.

A second recommendation is to encourage entrepreneurs to write ex ante contingency contracts that ensure a gradual reduction of franchisor influence. However, this would assume a power or knowledge balance that favors the franchisee. This is very unlikely. Franchisors are usually in the position to dictate the contractual terms. It may well be that franchisees

would be better off taking a defensive posture or trying to push a royalty arrangement that decreases the focus on sales over time or that stresses both sales and profits. This is most likely to be effective where the entrepreneur is considering several competing franchises.

In conclusion, entrepreneur-franchisees should not assume that the professional advice offered by their franchisors is always in their best interests. Although this may seem, on the surface, obvious, it is not entirely clear that academic research has uncovered this implication. Most of the studies that we reviewed for this research modeled the franchise relationship as a one-way transfer of information from franchisor to franchisee (see, for example, Agrawal and Lal 1995; Gal-Or 1995; Brill 1994). Part of the reason for this is an entrenched theoretical perspective that views the franchise relationship as a contractual exchange of information and expertise for entrepreneurial effort—implying that entrepreneurial effort does not include learning (Phan, Butler, and Lee 1994). However, our research has shown that entrepreneurial effort includes a strategy setting component that implies some learning over time. Thus, although franchisees should not assume that "crossing mother" is best against all perceived franchisor-suasion efforts, when it comes to dealing with strategic advice or goal setting, franchisees should be circumspect.

APPENDIX I

Franchisor's Goals for Franchisee Scale:

Specify how important each of the below factors is to your truck manufacturer when they evaluate your truck dealership:

	Extremely Important	Very Important	Somewhat Important	Not Very Important	Not Important
Market share	5	4	3	2	1
Pretax Profits	5	4	3	2	1
Sales	5	4	3	2	1
Contri. Margin	5	4	3	2	1
Sales Growth	5	4	3	2	1

Franchisor Suasion Tactics Scale:

Listed below are some items that are normal topics of conversations between franchisors and dealers. Indicate the importance of the information you have received during such interchanges:

	Extremely Important	Very Important	Somewhat Important	Not Very Important	Not Important
Financing					
Pricing issues	5	4	3	2	1
Industry trends	5	4	3	2	1
National trends	5	4	3	2	1
National accounts	5	4	3	2	1
Credit policies	5	4	3	2	1
Operational issues	5	4	3	2	1
Management issues	5	4	3	2	1
Financial planning	5	4	3	2	1
Staffing and HRM issues	5	4	3	2	1
Sales and marketing	5	4	3	2	1

Franchisee Articulated Growth Strategy Scale:

Indicate how important adding each of the below has been toward fulfilling your strategy:

(*continued*)

APPENDIX I Continued

	Extremely Important	Very Important	Somewhat Important	Not Very Important	Not Important
New truck brands	5	4	3	2	1
New truck classes	5	4	3	2	1
New equipment types	5	4	3	2	1
New services	5	4	3	2	1
Full service leasing	5	4	3	2	1
Maintenance contracts	5	4	3	2	1
Retail parts sales	5	4	3	2	1
non-truck business	5	4	3	2	1
Used truck sales	5	4	3	2	1
Parts sales	5	4	3	2	1
New service fafcilities	5	4	3	2	1
New sales personnel	5	4	3	2	1
New admin personnel	5	4	3	2	1
New buildings	5	4	3	2	1
New dealerships	5	4	3	2	1

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