WHO SHOULD OWN IT? AN AGENCY-BASED EXPLANATION FOR MULTI-OUTLET OWNERSHIP AND CO-LOCATION IN PLURAL FORM FRANCHISING

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Plural forms exist when managers use two owners to perform one activity. Franchising is a plural form explained by agency theory, however, the theory is unable to explain two franchisor actions: 1) allowing franchisees to own multiple outlets and 2) co-locating company-owned and franchised outlets. We use research that describes a symbiosis between company-owned and franchised outlets to extend agency theory and explain these actions. Our investigation of ownership patterns among 4,339 outlets of 16 plural form franchisors is consistent with our theory that multi-outlet franchising is cost efficient and that co-location occurs when franchisors fill market gaps left by franchisees. Copyright © 2011 John Wiley & Sons, Ltd.

INTRODUCTION

The way in which ownership of different economic activities is divided among organizations has important implications for the explanations of managers' actions and firm outcomes (Fama and Jensen, 1983). Indeed, an early ownership question that remains relevant today (e.g., Garrette, Castañer, and Dussage, 2009) is: who will own which activities (e.g., Coase, 1937). One challenging aspect of this is that managers sometimes use plural forms—that is, some portion of an activity is performed within organizational boundaries while the rest is performed by others via contract (Bradach and Eccles, 1989).

Plural forms present a challenge because most theories explain which form (e.g., ownership or

contract) is most efficient, but ignore the possibility that it might be efficient to use multiple, or plural, forms simultaneously (Parmigiani, 2007). Common plural forms include concurrent sourcing (or tapered integration, [Harrigan, 1985]), where, as noted above, firms make some portion of an input and contract for the rest, and dual distribution, where employee and outside sales agents both perform sales activities (Dutta *et al*., 1995).

Franchising is a common plural form among retail and service industries (Bradach and Eccles, 1989). Franchising is when the owner of a product, process, or service (the franchisor) sells the right to use its brand name, operating routines, and product specifications to another (the franchisee) in a specific location and time period, typically in exchange for an upfront fee plus ongoing royalties (Combs, Michael, and Castrogiovanni, 2004). Franchising is important to the economy, accounting for over two trillion dollars in economic output and 21 million jobs in the United States; and, with approximately 750,000 franchisees worldwide, it is also an important source of entrepreneurial activity (International Franchise Association, 2010a).

Although not all franchisors use plural forms, many build company-owned outlets alongside, or in 'plural' to, an indistinguishable group of franchised operations (Bradach and Eccles, 1989). The question of why these franchisors relinquish ownership of their branded operations in some locations and not others has long captured researchers' attention (e.g., Oxenfeldt and Kelly, 1968; Rubin, 1978).

Although agency theory is only one among multiple theories used to explain plural forms (e.g., Bradach and Eccles, 1989; Harrigan 1985; Parmigiani, 2007), it is by far the most common explanation for franchising (Combs *et al.*, 2004; Lafontaine and Slade, 1997). Indeed, it is the only organizational economic theory that explains not only why firms franchise, but also which outlets are franchised (e.g., Brickley and Dark, 1987; Carney and Gedajlovi, 1991). Agency theory predicts what kind of contract—output or behavior oriented—agents will receive in different situations (Fama and Jensen, 1983; Eisenhardt, 1989). In franchising, the choice is between a franchise contract with franchisee-owners and an employment contract with employee-managers, and is based on the relative costs of ensuring quality product/service delivery in each outlet (Rubin, 1978).

Franchise contracts require franchisees to pay all input costs, which includes a royalty to the franchisor, and to conform to the franchisor's operational guidelines. In exchange, franchisees receive residual claims on all outlet profits (Barthélemy, 2008). Thus, franchisees possess strong ownership-based incentives to maximize outlet performance (Lafontaine, 1992). Employment contracts with managers, in contrast, offer weaker incentives; employees receive a guaranteed base salary and do not have their personal wealth at stake (Krueger, 1991). Thus, employee-managers must be observed regularly and monitored more closely than franchisees (Bradach, 1997). Agency theory therefore predicts that firms use self-motivated franchisees when it would be costly to directly monitor employee-managers in company-owned outlets—that is, in distant (Brickley and Dark, 1987), rural (Norton, 1988) and foreign (Fladmoe-Lindquist and Jacque, 1995) locations. Meta-analytic results (Combs and Ketchen, 2003) and qualitative reviews (Combs *et al.*, 2004; Lafontaine and Slade, 1997) support agency theory's key predictions.

Despite their empirical success, franchisors engage in two actions that are difficult for agency

theory to explain. The first is multi-outlet franchising wherein franchisees own multiple outlets. These franchisees must hire employee-managers to monitor day-to-day activities in each outlet, which undermines the ownership incentive at the heart of agency theory (Garg, Rasheed, and Priem, 2005). The second inconsistent action is co-location wherein franchisors place company-owned outlets near franchised outlets (Minkler, 1990). Co-location undermines the agency theory assertion that the outlets were franchised because they were too far from headquarters to be cost effectively monitored (e.g., Brickley and Dark, 1987).

Given the economic importance of franchising, and the challenges that multi-outlet franchising and co-location present to current theory, efforts to develop theory that embraces these challenges appears timely and warranted. We draw on a body of research that views company-owned and franchised outlets in a symbiotic relationship[1] (e.g., Bradach, 1997; Sorenson and Sørensen, 2001; Yin and Zajac, 2004) to theorize that multi-outlet franchisees are an efficient and preferred ownership form. Co-location, we submit, occurs when franchisors 'seed' new markets with single-outlet franchisees hoping that one or more will grow into multi-outlet franchisees. When franchisees fail to grow as hoped, the franchisor steps in with company-owned outlets. The result is a system that comprises clusters of company-owned outlets and outlets owned by multi-outlet franchisees interspersed with single-outlet franchisees.

We develop hypotheses about the pattern of ownership among company-owned outlets, multi-outlet franchises, and single-outlet franchises, and test our theory using a sample of 4,339 outlets from the 16 largest plural form food service franchisors in Florida. The ownership patterns we identify are consistent with our expanded agency-based theory; they imply that multi-outlet franchisees are actually preferred and that co-location occurs when franchisors build company outlets to fill market gaps left by franchisees. We reconcile our findings with symbiosis research with the argument that agency theory explains ownership choice but,

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[1] A symbiosis is any interdependent or mutually beneficial relationship between two persons, groups, and so forth. (Webster's Online Dictionary, 2010). The word has been used in the acquisitions literature to describe an integration approach wherein acquirers attempt to preserve a target's autonomy while they exchange strategic capabilities (Haspeslagh and Jemison, 1991). Though the context is different, our use of the word is similar.

once in place, successful franchisors seek symbiotic advantages from their mix of franchised and company-owned outlets.

The research offers three contributions. First, by broadening agency theory's explanation of franchising to encompass multi-outlet franchising and co-location, we make a theoretical contribution. Second, by using each outlet's actual location, we offer a more precise test of the role of geography—as a key driver of monitoring costs, geography has been the most studied agency-based variable in franchising research (Combs and Ketchen, 2003). Third, by distinguishing between single- and multi-outlet franchisees, our theory and empirics not only predict franchisee ownership but also suggest which type of franchisee will own a given outlet.

FRANCHISE OWNERSHIP PATTERNS: AN AGENCY THEORY EXPLANATION

All firms must connect with markets to purchase inputs and sell goods. The overarching concern, therefore, of several organizational economic theories is to explain why economic activities are organized within firms (Conner, 1991) and, more specifically, which firms will own what activities (Madhok, 2002). Four such theories have been applied to franchising: agency theory, transaction cost economics (TCE), property rights, and the resource-based view (RBV).[2] Table 1 depicts their units of analysis, causal logic, and predictions regarding franchising. Each emphasizes different factors to make predictions about franchising relative to company ownership. TCE, for example, predicts franchising when franchisees and franchisors must both make specific investments that bond them together and align their interests (Klein, 1995; Williamson, 1983), whereas the RBV focuses on how franchising creates value by combining local and centralized value-creating activities (Combs et al., 2004).

Although these theories turn on different factors, as shown in Table 1, they largely offer the same predictions with respect to franchisor inputs. Whether it is because franchisor inputs, such as brand names and operational routines, increase the

cost of free riding (agency theory: e.g., Lafontaine, 1992), expose franchisors to potential opportunism (TCE: e.g., Klein, 1995), make contracts incomplete (property rights: e.g., Windsperger and Dant, 2006), or create the most value when tightly controlled (RBV: e.g., Combs et al., 2004), all four predict company ownership. There is less coherence with respect to key franchisee inputs such as local market knowledge. Agency and property rights theories take the franchisor's perspective and predict franchising based on the costs these inputs add to monitoring (agency theory: e.g., Lafontaine, 1992) or writing efficient contracts (property rights: e.g., Windsperger and Dant, 2006). TCE, in contrast, expects franchisees to avoid exposing specific inputs to potential franchisor opportunism without an off-setting bond by the franchisor (Williamson, 1983), which pushes chains toward company ownership (Dant, 1996).[3]

The theories also address different questions. For example, environmental uncertainty is an important predictor within TCE (Williamson, 1985), but its effects are indirect (through perceptions of risk) in agency theory (e.g., Fladmoe-Lindquist and Jacque, 1995). Another important difference is central to our purpose here. By acknowledging that locations differ in their monitoring costs, only agency theory helps explain which outlets are franchised. Whereas all of the theories help explain conditions under which managers franchise, franchising research is also concerned with understanding why managers franchise some outlets but not others. That is, why is plural form franchising—using both franchised and company-owned outlets—so common (Bradach and Eccles, 1989), and why is one *particular* location given to franchisees while another is company owned (Combs et al., 2004)? Given that it is the only theory that thus far offers answers to these important questions, we ground our study in agency theory.

Agency theory and outlet ownership

An agency relationship exists when one party (the principal) delegates authority to another (the agent) (Eisenhardt, 1989). Agents are assumed to be competent (Hendry, 2002), but self-interested

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[2] Noneconomic theories, such as resource scarcity (Oxenfeldt and Kelly, 1968), institutional theory (Combs, Michael, and Castrogiovanni, 2009), and momentum (Mitsuhashi, Shane, and Sine, 2008) also help explain franchising.

[3] The one study we found that builds franchising predictions from the RBV does not address franchisee inputs (i.e., Combs et al., 2004). However, RBV logic suggests that prospective franchisees will remain independent unless the franchisor can add value to franchisee inputs.

Table 1. Four theories of economic organization and their predictions regarding franchising

	Agency theory	Transaction cost economics (TCE)	Property rights	Resource–based view (RBV)
Unit of analysis	Contracts	Transactions	Decision rights	Resources
Causal driver	Monitoring costs	Potential for opportunism	Contractibility	Value creation
Causal logic	Monitoring costs rise as tasks become less programmable, requiring output-oriented contracts (Eisenhardt, 1989).	Transactions involving specific assets require hierarchical control to guard against opportunism (Williamson, 1985).	Decisions about non-contractible assets are best when made by those with residual income rights (Hart, 1995).	Value creation requiring tight coordination is facilitated by hierarchical control (Conner and Prahalad, 1996).
Applied to franchising	Franchising involves a trade-off between the costs of monitoring outlet managers versus the cost of free riding (Lafontaine, 1992; Rubin, 1978).	Franchising requires that parties are mutually bonded by specific assets and future profit streams (Klein, 1995; Williamson, 1983).	Franchising occurs when franchisees have non-contractible assets that require both decision and residual income rights (Windsperger and Dant, 2006).	Franchising combines local and centralized value creation activities that can be loosely coordinated (Combs et al., 2004).
Predictions when franchisor inputs are valued (e.g., brand name)	More company ownership because these inputs increase the cost of franchisee free riding	More company ownership because these specific assets increase franchisors' exposure to opportunism	More company ownership because decisions about non-contractible assets should be kept with the franchisor who has residual income rights	More company ownership because these resources' value are increased by tight coordination
Predictions when franchisee inputs are valued (e.g., local knowledge)	More franchising because these inputs make it costly to effectively monitor local decisions	More company ownership because franchisees will not expose such assets to potential opportunism	More franchising because franchisees make the best decisions about their non-contractible assets	It depends: franchising if franchisor can add value, local ownership (not chains) if not.[a]
Predictions unique to this theory	Monitoring costs differ among locations, so location-based attributes impact ownership.	Uncertainty increases the risk of opportunism and leads to greater company ownership.	Who owns non-contractible assets affects which decisions are contractually delegated to franchisees.	Franchisors can develop franchisee management capabilities that lead to increased franchising.

[a] This is our extension of RBV logic. We did not find any studies grounded in RBV that address this question.

with goals that diverge from those of the principal (Eisenhardt, 1989). Thus, resources must be expended (i.e., agency costs) to insure that agents act in the principal's interest (Jensen and Meckling, 1976). Applying agency theory to franchising, the challenge for franchisors is to decide which of two potential outlet-level agents—employee-managers or franchisees—will engender the fewest agency costs (Rubin, 1978).

Agency costs come from two problems in franchising: horizontal and vertical agency (Combs *et al.*, 2004). Horizontal agency involves keeping agents in different locations from taking actions that help themselves at the expense of nearby agents. The most pertinent horizontal agency problem in franchising is called free riding, and it occurs when franchisees cut inputs (e.g., staff to clean bathrooms) in an effort to increase outlet profit (Caves and Murphy, 1976). Franchisees also free ride by failing to upgrade facilities, introduce new products, or participate in chainwide promotions (Brickley and Dark, 1987; Bradach, 1997). With respect to horizontal agency, agency theory fails to recognize differences among outlets and thus dovetails with other theories in Table 1 in the prediction of company ownership as horizontal agency risks grow.

Although franchisors use more company ownership when they have valuable inputs (e.g., brands or routines) that might be harmed by free riding (Combs and Ketchen, 1999; Lafontaine, 1992), many franchisors seem to ignore horizontal agency and franchise despite its negative impact on customers' perceptions of quality (Michael, 2000b). For example, although the potential for free riding should peak near highways where there is less dependence on repeat business, such outlets are disproportionately franchised (Brickley and Dark, 1987). A key reason franchisors might ignore horizontal agency is because vertical agency is more costly (Brickley and Dark, 1987; Michael, 2000b).

Vertical agency is the 'classic' problem described by Alchian and Demsetz (1972) wherein agents withhold effort, or 'shirk,' when their behaviors are not observed. Because employee-managers' wealth and income are not tied strongly to outlet performance, they might focus more, for example, on relationships with other employees (e.g., conversation, horseplay, etc.) than on bottom-line performance (Krueger, 1991; Rubin, 1978). The potential for shirking forces franchisors to monitor employee-managers closely (Carney

and Gedajlovic, 1991; Lafontaine, 1992), and monitoring is expensive. Assistant and shift managers earn about nine percent more in company-owned outlets and their pay grows faster than their peers in franchised outlets (Krueger, 1991). Franchisors also must hire area managers to visit each outlet regularly. Bradach (1997) showed, for example, that restaurant chains' area managers watch over an average of only six company-owned outlets and perform in-depth 'field audits' at least once a month.

The solution to vertical agency described by Alchian and Demsetz (1972) is to make an agent the residual claimant. Franchising does this by making franchisees invest in their outlet(s) and tying all returns to outlet performance, which significantly reduces the need to directly monitor outlet-level effort (Rubin, 1978). Franchisees in Bradach's (1997) study, for example, had only one company manager watching over an average of 65 franchised outlets and doing field audits only once a year. In short, franchisors appear to spend about 10 times more in time and personnel monitoring company-owned outlets than they do monitoring franchised outlets (Bradach, 1997). Thus, a central prediction of agency theory is that franchisees will be used when monitoring costs are highest (Rubin, 1978).

As a starting point for building upon extant theory, we offer a series of hypotheses that test whether franchising is used when monitoring costs are highest. Although we build from extant theory and evidence about the effects of monitoring costs on franchising, our analysis differs from most prior research in that, rather than focus on firm-level attributes to predict the overall proportion of outlets franchised, we focus on outlet-level attributes to predict whether a given outlet will be franchised or company owned.

The most common test of agency theory's monitoring cost prediction investigates the relationship between a chain's geographic dispersion and its proportion of outlets franchised (Combs and Ketchen, 2003). Monitoring outlets in geographic markets that are far from headquarters is more costly due to the number of monitoring personnel required and related travel expenses (Carney and Gedajlovic, 1991). Also, the quality of decision making often depends on local managers' knowledge of local conditions, and geographic dispersion increases the difficulty and costs to the franchisor of evaluating local decision making

(Minkler, 1990). Consequently, dispersed chains use more franchising (Combs and Ketchen, 2003) and company-owned outlets appear to be, on average, closer to headquarters where they can be easily monitored (i.e., Brickely and Dark, 1987). Thus, we anticipate that:

Hypothesis 1a: Distance to the franchisor's headquarters decreases the probability that the focal outlet is company owned.

Another way to reduce the costs of monitoring managers in company-owned outlets is to place such outlets in close proximity to one another. This should facilitate more and less costly visits by area and regional managers (Carney and Gedajlovic, 1991). Accordingly, chains with dense geographic footprints use more company ownership (Combs and Ketchen, 2003), and new company-owned outlets are placed near existing ones (Kalnins and Lafontaine, 2004). Generalizing beyond new outlets to the overall chain, we expect company-owned outlets to be near one another to facilitate low cost and effective monitoring. Therefore, we predict that:

Hypothesis 1b: Distance to the nearest neighbor decreases the probability that the focal outlet is company owned.
Hypothesis 1c: The existence of a company-owned nearest neighbor increases the probability that the focal outlet is company owned.

It follows that if company-owned outlets are near one another, they are more likely to be in larger markets that can support multiple nearby outlets. Consistent with this logic, Norton (1988) used United States Census data and found that establishments in rural areas are more likely to be franchises than their more urban counterparts. Norton's analysis included non-chain independents, but agency theory suggests that because of potential economies of scale in monitoring multiple outlets (Carney and Gedajlovic, 1991), a similar pattern should occur among outlets within chains. Thus, we expect that:

Hypothesis 1d: Market size increases the probability that the focal outlet is company owned.

Finally, agency theory predicts that franchisors with larger outlets will keep more of them because greater sales volume implies greater economies of scale in monitoring (Lafontaine, 1992). At the outlet level, we can extend this logic to suggest that, within a given chain, outlets in locations that support larger facilities have greater economies of scale in monitoring. Accordingly, such outlets should more often be company owned. Thus:

Hypothesis 1e: A focal outlet's size increases the probability that it is company owned.

Challenges to agency theory

Despite its empirical success, there are two aspects of franchising that challenge agency theory. The first is multi-outlet ownership. From the perspective of agency theory, the reason franchisors engage in franchising is because it places a manager in each outlet who, by virtue of ownership, is highly motivated to maximize outlet profits (Rubin, 1978). Allowing franchisees to operate multiple outlets dilutes the incentive advantages at the heart of agency theory by shifting the agency problem from the franchisor to multi-outlet franchisees, who still must hire a manager for each outlet (Garg *et al.*, 2005; Kaufmann and Dant, 1996).

The second challenge to the agency-based explanation of franchising is co-location (Minkler, 1990). If monitoring costs increase with geographic dispersion, company-owned outlets should be clustered near headquarters and in select large markets; franchisees should be relegated primarily to smaller markets and markets further from headquarters (Brickley and Dark, 1987; Norton, 1988). There would be no advantage to placing franchisees in the same market with company-owned outlets. The costly personnel needed to monitor company-owned outlets would already be in place and the marginal cost of monitoring additional company-owned outlets should be small. Nevertheless, the presence of company-owned and franchised outlets in the same market appears quite common (Minkler, 1990; Kalnins and Lafontaine, 2004).

Plural form research and the symbiosis behind multi-outlet ownership and co-location

In trying to understand plural forms, researchers have focused on how the use of multiple ownership forms helps each form balance the weaknesses of the other (Parmigianni, 2007). One advantage

of maintaining some internal production of otherwise outsourced inputs is that it helps managers retain critical knowledge about production processes (Parmigiani and Mitchell, 2009). This enhances managers' bargaining position by giving them information about costs and quality to use in negotiations with supply partners (Harrigan, 1985). It also puts partners on notice that the firm could make more on its own if desired price and quality are not delivered (Dutta *et al*. 1995; Heide, 2003). Indeed, the potential to increase bargaining power over franchisees is one explanation for the presence of company-owned outlets in franchised chains (Michael, 2000a).

Internally generated production knowledge is also used to help suppliers improve and better integrate with the firm's production system (Takeishi, 2002). Sets of inputs often possess complementarities such that knowledge about producing one input improves the production of others (Brusoni, Prencipe, and Pavitt, 2001). Complementarities encourage concurrent sourcing by producing a virtuous cycle of production knowledge that is shared among the firm and its suppliers (Parmigiani and Mitchell, 2009). Sharing also engenders trust and reduces the cost of negotiating and monitoring future contracts (Dyer and Singh, 1998). In this way, plural forms are a stable and efficient arrangement between two or more interdependent firms that coexist symbiotically (Braddach and Eccles, 1989).

Plural form research focused specifically on franchising has described a similar symbiosis. However, the nature of the symbiosis between company-owned and franchised outlets is more defined; research ascribes a specific role to each ownership form. That is, franchisees are good at adapting to local conditions and experimenting with new products and processes, whereas company-owned outlets are good at standardization (Bradach, 1997; Kaufmann and Eroglu, 1998; Sorenson and Sørensen, 2001; Yin and Zajac, 2004). Adaptation is important because it allows for increased product/market fit and it prevents brands from becoming outdated (Kaufmann and Eroglu, 1998). Yin and Zajac (2004), for example, showed how pizza franchisees helped a chain adapt to local conditions by combining dine-in and delivery services in some locations. Standardization, in contrast, furnishes image continuity and product/service homogeneity across time and geography, which is important because it gives customers clear expectations and predictable experiences that encourage return patronage (Nayyar, 1993).

Perhaps the search for symbiotic advantage explains why researchers have been able to identify several ways that multi-outlet franchising and co-location enhance the symbiotic processes of, and thereby foster, standardization and adaptation. First, multi-outlet franchisees model how franchisors compensate, monitor, and support managers, which results in outlets that largely mirror company-owned outlets (Bradach, 1997). Second, the prospect of additional outlets furnishes a powerful incentive for current and aspiring multi-outlet franchisees to keep existing outlets at company standards (Gillis *et al*., 2011). Third, multi-outlet franchising reduces the number of franchisees with whom the franchisor must build relationships and persuade to adopt new promotions, introduce new products, change operational routines, or invest in new infrastructure (Kaufmann and Eroglu, 1998). Co-location also helps in this regard by persuading franchisees to take such actions based on evidence gathered in nearby company-owned outlets (Bradach, 1997). Finally, co-location aids adaptation because franchisees have the flexibility and incentive to innovate and respond to changes in customer preferences, and co-located company-owned outlets help franchisors learn about such innovations more quickly (Darr, Argote, and Epple, 1995).

Although symbiosis research explains the benefits of multi-outlet franchising and co-location (Bradach, 1997; Kaufman and Eroglu, 1998), it implies a very different ownership pattern from agency theory. Specifically, it implies a wide distribution of company-owned outlets so that the symbiotic advantages of co-location can be maximized. Although co-location is common (Minkler, 1990), the empirical evidence is more consistent with agency theory and our first set of hypotheses; company-owned outlets are kept near headquarters and clustered together in large markets in order to minimize monitoring costs (Combs and Ketchen, 2003). In short, agency theory explains overall ownership patterns among franchised and company-owned outlets, but not multi-outlet franchising or co-location; symbiosis explains the latter, but not the former. Theory is therefore needed to bridge the gap between what these two approaches explain.

Extending agency-theory to explain multi-outlet ownership and co-location

We believe that with a slight change in the basic assumptions behind agency theory, it can be stretched to incorporate insights from the symbiosis perspective and thereby explain why co-location occurs and why multi-outlet franchising is an efficient choice. First, we adopt the assumption that market penetration and economies of scale are key strategic objectives for most franchisors (Oxenfeldt and Kelly, 1968). Agency theory highlights efficiency as managers' primary objective (Eisenhardt, 1989), but, as is the case for other growth-oriented entrepreneurs (Gundry and Welsch, 2001), the desire to reach strategic growth goals might require less than optimal organizational efficiency, at least in the short term (Grunhagen and Mittelstaedt, 2002).

Second, we maintain the agency-based assertion that incentives embedded in the franchise contract make franchising an efficient solution both in the short and long term (Rubin, 1978), but from the symbiosis perspective we also recognize that the prospect of additional outlets gives multi-outlet franchisees a strong incentive to maintain standards and that there are costs to manage many small franchisees (Bradach, 1997; Gillis *et al.*, 2011). Thus, despite the reduced outlet-level incentives and extra layer of management that multi-outlet ownership entails (Kaufmann and Dant, 1996), its benefits outweigh its potential costs—especially for franchisors seeking standardization (Bradach, 1997).

Third, according to agency theory, one reason that franchising is attractive is that it solves the adverse selection problem of trying to identify which potential managers are truly qualified; only competent local entrepreneurs would self-select to put their money at risk by investing in a franchise (Shane, 1996). Entrepreneurs are diverse, however, in terms of their overall motivation and desire to pursue growth (Fauchart and Gruber, 2011). Self-determination theory, for example, suggests that franchisees might seek a first outlet in an effort to feel less coerced and pressured than they did when working in large organizations, but that external motivators, such as money, might not always provide motivation to invest in and manage additional outlets (Deci and Ryan, 1985; 2008). Consistent with self-determination theory, studies of franchisees have found considerable variance in their stated motivations (Kaufmann, 1999; Morrison, 1997). Further, many entrepreneurs who do seek growth, overestimate their ability to achieve it (Busenitz and Barney, 1997). Consequently, we assume that not all franchisees have the desire or ability to expand their business into multiple-outlets—what Hendry (2002: 100) calls 'honest incompetence.' Honest incompetence might also lead some franchisees to select poor (or 'unlucky' [Barney, 1986]) locations or make poor operational decisions that lead to weak performance, which further decreases the desire or ability to expand into multiple outlets.

From this set of assumptions, we submit that multi-outlet franchising is the preferred method of growth, but that finding prospective franchisees with the managerial capabilities, local knowledge, and financial capital needed to penetrate a market is difficult. Once selected, many franchisees do not grow as hoped (cf. Hendry, 2002). Consequently, a pattern of co-location emerges where franchisors penetrate new markets by first 'seeding' them with single-outlet franchisees who have the potential to grow (Garg *et al.*, 2005; Minkler, 1990). If these franchisees fail to penetrate the target market in a timely fashion, the franchisor achieves growth objectives by entering the market with company-owned outlets.

To test our theory, we examine the potential for multi-outlet ownership to be an efficient form of monitoring vis-à-vis franchisor- and single-outlet ownership. By separating single- and multi-outlet franchisees, traditional agency-based hypotheses can be reexamined to see whether the ownership patterns are consistent with our expanded theoretical explanation. Our theory suggests that franchisors prefer that one or more of the initial franchisees in a new territory grow into multiple-outlets. When franchisees are unable to fully penetrate important markets, however, the franchisor steps in using company-owned outlets. Consequently, markets that can sustain multiple outlets should either be populated by 1) a mix of single-outlet franchisees who did not grow surrounded by multi-outlet franchisees who did or 2) by a mix of single-outlet franchisees who did not grow surrounded by company-owned outlets.

Our theory departs from prior research with respect to the expected location patterns between single- and multi-outlet franchisees. Prior research focused on outlet location vis-à-vis franchisors'

headquarters and found that company-owned outlets tend to be closer as we predicted in Hypothesis 1a. If multi-outlet franchising is relatively efficient, however, the reverse should be true regarding the *outlet owner's* headquarters. Single-outlet franchisees can monitor closely by using their outlet or a nearby home as headquarters, so their headquarters should be closest to their outlets as agency theory predicts (Kaufmann and Dant, 1996; Rubin, 1978).

When we compare multi-outlet franchises to company-owned outlets, however, multi-outlet franchisees should still be much closer to their outlets than the franchisor is to company-owned outlets. Even though multi-outlet franchisees must hire an employee-manager in each outlet, their proximity should allow them to monitor their employee-managers more closely than the franchisor could be if the outlets were company owned. Further, our theory suggests that franchisors place some outlets far from headquarters in order to penetrate desired markets where franchisee 'seeds' fail. This should lead to a pattern wherein multi-outlet franchisees keep their outlets closer to a centralized headquarters than the franchisor is able to with respect to company-owned outlets, but not quite as close as a single-owner franchisee might. Consequently:

Hypothesis 2a: Among company-owned and multi-outlet franchised outlets, distance to the owner's headquarters increases the probability that the focal outlet is company owned. Among franchisees, distance to the owner's headquarters decreases the probability that the focal outlet is a single-outlet franchise.

Not only should outlets owned by multi-outlet franchisees be close to their owner's headquarters but they also should be close to each other for efficient monitoring, at least relative to their single-owner counterparts. That is, just like company-owned outlets are clustered together to facilitate the monitoring efforts of an area manager, multi-outlet franchises will be clustered together to facilitate the monitoring efforts of multi-outlet franchisees (Kalnins and Lafontaine, 2004). Single-outlet franchisees have less need to be near other outlets and, thus, should be relatively more dispersed. Therefore, we anticipate that:

Hypothesis 2b: Among franchisees, distance to the focal outlet's nearest neighbor decreases the probability that the focal outlet is a multi-outlet franchise.
Hypothesis 2c: Among franchisees, having a multi-outlet-franchise nearest neighbor increases the probability that the focal outlet is a multi-outlet franchise.

When we contrast the market size of franchised and company-owned outlets, we anticipate that franchisors focus on markets that are large enough to support multiple outlets under a single area manager. Such markets will also be those where efforts to 'seed' the area with single-outlet franchisees failed, forcing the franchisor to accomplish market penetration via company ownership. Consequently, if our theory is correct, many large markets will contain single-outlet franchisees who have not grown into multi-outlet owners.

Additionally, because less populous markets are less important to the franchisor, they are unlikely to be targeted as places to seed outlets. Instead, multi-outlet franchisees who are looking for expansion opportunities are more likely to identify suburban and smaller cities as areas that can be profitably reached. Thus, whereas we expect that franchised outlets will be in less populated areas compared to company-owned outlets, when we look only at franchisees, we expect that it will be multi-outlet franchisees who expand into less populated areas, leaving single-outlet franchisees in urban areas where they were initially placed as seeds. Thus:

Hypothesis 2d: Among franchisees, market size decreases the probability that the focal outlet is a multi-outlet franchise.

Regarding outlet size, franchisees themselves typically find locations, which are then approved by the franchisor (Bradach, 1997). This suggests that at least some large outlets will be allocated to franchisees who, because of their local market knowledge, are more likely to identify locations where large outlets can survive. Further, the strength of company ownership is in standardization, including optimal outlet configuration (Sorenson and Sørensen, 2001). Franchisees, in contrast, have the autonomy to develop the adaptations necessitated by larger outlets (Kaufmann and Eroglu, 1998). Yin and Zajac's (2004) finding that

franchisees often handle more complex strategies among pizza restaurants suggests that the autonomy granted to franchisees might also give them more flexibility to manage nonstandard operations. Thus, we submit that large outlets are more likely to be built by multi-outlet franchisees who have the local knowledge and chain-specific experience necessary to know when a large outlet will be successful, as well as access to the financial capital needed to construct a large outlet. Stated formally:

> *Hypothesis 2e: Among franchisees, a focal outlet's size increases the probability that it is a multi-outlet franchise.*

METHODS

Our sample comes from the fast-food/quick-service industry because of its well-known association with franchising. This sector provides more jobs and generates more output than any other franchise sector (International Franchise Association, 2010b). Additionally, a single-industry design aids in controlling for potential industry effects (Roquebert, Phillips, and Westfall, 1996). The state of Florida was used as the geographic context. Florida is one of the top five states in the United States (along with California, Texas, Illinois, and Ohio) where franchised businesses provide the greatest economic impact (International Franchise Association, 2010b).

Our archival data source was collected in 2005 from the State of Florida Division of Hotels and Restaurants. All active public food service establishments are required to carry a license, and information about each establishment is reported at the county level. In order to capture the pattern of ownership, we had to identify plural form franchisors with sufficiently established geographic ownership patterns. Thus, we initially attempted to include all plural form franchisors with more than 100 outlets in Florida. We retained one chain with 94 outlets and another with 97 because these were close to our arbitrary cutoff of 100 and the next largest was considerably smaller at 58 outlets. This resulted in 16 firms with 4,339 outlets; approximately 70 percent were franchised, of which 88 percent were part of a multi-outlet franchise. To confirm the accuracy of reported locations, we double checked a random 10 percent

from each chain using franchisors' Web site directories, which were correct with few exceptions.

Dependent variables

The dependent variables are indicator variables that refer to whether or not the focal outlet is company owned, owned by a single-outlet franchisee, or part of a multi-outlet franchise. The data were kept together to test Hypothesis 2a, which contrasts the distance to the owner's headquarters among all three possible owners, but were divided into two sets for the other hypotheses (i.e., one set for Hypotheses 1a–1e and another for Hypotheses 2b-2e). In the first set, *company owned* are contrasted with *franchised* outlets, with company owned set to 1.00. Only franchises are considered in the second set wherein *multi-outlet franchises* are contrasted with *single-outlet franchises*, with multi-outlet franchises set to 1.00. Whether an outlet was owned by the franchisor or a franchisee was determined by the address of its headquarters. In addition to typically being numbered (e.g., Store #123), company-owned outlets share a common headquarters' address. Multi-outlet franchisees were also paired with their outlets based on common mailing addresses for the owner's headquarters and common company names. The remaining outlets were coded as single-outlet franchisees.

Independent variables

The location address for every outlet was converted to latitude and longitude coordinates. Geographic mapping software (i.e., ArcView) was then used to calculate the *distance to the franchisor's headquarters* and *distance to the owner's headquarters*. For company-owned outlets, distance to the franchisor's headquarters and distance to the owner's headquarters are the same (because the owner is the franchisor). Next, *distance to the nearest neighbor* was calculated in miles between each outlet and its nearest neighbor in the same chain within a maximum 60-mile radius. The frequency of nearest outlets greater than 60 miles is very small and does not materially impact results, but some practical cutoff was necessary given Florida's landscape (e.g., the Florida Keys). We also coded the nearest neighbor as to whether it was a *company-owned nearest neighbor* or a *multi-outlet-franchise nearest neighbor*. *Market size* was measured based on the population of the one of

67 counties where the outlet was located based on the 2005 Census update. Lastly, *outlet size* was measured by the number of seats in each outlet as reported by the Division of Hotels and Restaurants.

Control variables

We included a series of indicator variables to capture fixed effects for each *chain*. This is important because it statistically holds constant variance in ownership decisions that are due to idiosyncratic characteristics of each chain, such as resource scarcities, managerial preferences, first-mover advantages, market segments served, financial performance, or size. We also controlled for the *per capita income* of the county where the outlet was located to account for the market's relative attractiveness. These data also were based on the 2005 Census update.

Data analysis

Most hypotheses were tested using binomial logistic regression because the dependent variables are categorical and the hypotheses specify two-way comparisons. The exception is Hypothesis 2a, which required a three-way comparison and thus was tested with multinominal logistic regression. Logistic regression is highly sensitive to scale differences (e.g., miles vs. people [Bowen and Wiersma, 2004]), so all continuous variables were standardized. Individual effects from logistic regression can be interpreted through the odds ratio (OR), which is the increase or decrease in the odds of an outlet being in a given category when the value of the predictor variable increases by one standardized unit; an odds ratio of 1.00 indicates no effect. When odds ratios are less than 1.00, we report the inverse to ease interpretation.

RESULTS

Means, standard deviations, and correlations are presented in Table 2. Although logistic regression does not provide a test for multicolinearity, the largest bivariate correlation between independent variables in the same regression is 0.35 in magnitude,[4] well below the 0.90 cutoff for multicolinearity suggested by Tabachnick and Fidell (2001).

Nevertheless, we ran the models using ordinary least squares regression for the sole purpose of calculating variance inflation factors; all were below 2 for all regressions, suggesting that multicolinearity is not a problem (Tabachnick and Fidell, 2001).

Table 3 shows the results of the logistic regressions. The model comparing company-owned to franchised outlets is significant with $\chi^2 = 2,287.97$ ($p < 0.001$), Cox and Snell $R^2 = 0.41$, and Nagelkerke $R^2 = 0.58$. The model comparing single-outlet franchises to multi-outlet franchises also is significant with $\chi^2 = 552.40$ ($p < 0.001$), Cox and Snell $R^2 = 0.17$, and Nagelkerke $R^2 = 0.33$. For Hypothesis 2a, the overall model is significant with $\chi^2 = 2903.63$ ($p < 0.001$), Cox and Snell $R^2 = 0.49$, and Nagelkerke $R^2 = 0.59$. The McFadden R^2, which is only pertinent to multinomial logistic regression, is 0.39.

Hypotheses 1a–1e predict differences between company-owned and franchised outlets. Hypothesis 1a predicts that the distance to the franchisor's headquarters decreases the probability that an outlet is company owned. This hypothesis was supported ($\beta = -1.34$; $p < 0.001$). A one standard deviation increase in distance from the franchisor's headquarters (about 314 miles) reduces the odds that an outlet is company owned by 3.8 times (the odds for a randomly selected outlet). Hypothesis 1b anticipates that distance to the nearest neighbor decreases the probability that an outlet is company owned. This hypothesis also received support ($\beta = -0.31$; $p < 0.001$). A one standard deviation increase in distance to the nearest neighbor (about six miles) reduces the odds that an outlet is company owned by 1.4 times. We found strong support for Hypothesis 1c ($\beta = 2.56$; $p < 0.001$); having a company-owned nearest neighbor increases the odds that the focal outlet is company owned by almost 13 times. Hypothesis 1d was also supported ($\beta = 0.39$; $p < 0.001$); it predicts that market size increases the probability that an outlet is company owned. A one standard deviation increase in number of people in the county (about 687,000 people) increases the odds that an outlet is company owned by 1.5 times. Finally, Hypothesis 1e anticipates that outlet size increases the probability that an outlet is company owned. The hypothesis was not supported ($\beta = -0.06$; *ns*).

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[4] Having a company-owned nearest neighbor is negatively correlated with having a multi-outlet-franchise nearest neighbor

($r = -0.82$), but these are only in the same equation as part of a three-way categorical factor (that includes single-outlet nearest neighbors) in the multinomial regression for Hypothesis 2a.

Table 2. Means, standard deviations, and correlations[a]

	Variable name	Mean	SD	1	2	3	4	5	6	7	8	9
1	Company owned	0.30	0.46									
2	Multi-outlet franchise	0.88	0.32	[b]*								
3	Distance to the franchisor's headquarters[c]	6.40	0.31	−0.16	−0.04							
4	Distance to the owner's headquarters[c]	3.34	0.42	0.36	0.17	0.27						
5	Distance to the nearest neighbor	4.81	6.36	−0.13	−0.10	−0.07	−0.06					
6	Company-owned nearest neighbor	0.30	0.46	0.63	−0.10	−0.18	0.27	−0.09				
7	Multi-outlet franchise nearest neighbor	0.62	0.49	−0.55	0.30	0.13	−0.20	0.08	−0.83			
8	Market size[d]	8.78	6.87	0.20	−0.10	0.18	0.19	−0.35	0.18	−0.20		
9	Outlet size	63.10	45.41	−0.04	0.02	−0.28	−0.08	0.01	−0.05	0.03	−0.04	
10	Per capita income[e]	3.12	0.59	0.02	0.03	0.09	0.02	−0.17	0.01	0.01	0.22	−0.04

[a] $N = 4,339$; All correlations $(+/-)$ 0.04 are significant at $p < 0.01$
[b] Cannot be computed because the variable is binary
[c] Mean and standard deviation reported in 100s
[d] Mean and standard deviation reported in 100,000s
[e] Mean and standard deviation reported in 10,000s

Hypothesis 2a predicts that among company-owned outlets and multi-outlet franchises, distance to the owner's headquarters increases the probability of company ownership, and that among franchisees, distance to the owner's headquarters decreases the probability of single-outlet-franchisee ownership. This hypothesis was supported in that company-owned outlets are farther from their headquarters than multi-outlet franchises ($\beta = 1.05$; $p < 0.001$), and single-outlet franchises are closer than multi-outlet franchises ($\beta = -1.52$; $p < 0.001$). Specifically, a one standard deviation increase in distance from headquarters (about 420 miles) increases the odds that an outlet is owned by a multi-outlet franchisee by 2.9 times. Among franchisees, such a distance reduces the odds of an outlet being a single-outlet franchise by 4.5 times.

Hypotheses 2b-e predicts differences between single-outlet and multi-outlet franchises. Hypothesis 2b expects that the distance to the nearest neighbor decreases the probability that the focal outlet is a multi-outlet franchise. As shown in Table 3, we found support for this hypothesis ($\beta = -0.37$; $p < 0.001$). A one standard deviation increase in distance to the nearest neighbor (about six miles) reduces the odds that an outlet is a multi-outlet franchise by 1.5 times (the odds for a randomly selected franchised outlet). Hypothesis 2c also

expects that having a multi-outlet franchise as the nearest neighbor increases the probability that the focal outlet is a multi-outlet franchise. This too was supported ($\beta = 1.66$; $p < 0.001$). Having a multi-outlet franchise nearby increases the odds of the outlet being a multi-outlet franchise by 5.3 times. Hypothesis 2d also received support ($\beta = -0.40$; $p < 0.001$); it predicted that market size decreases the probability that an outlet is a multi-outlet franchise. A one standard deviation increase in the number of people in the county (about 687,000 people) decreases the odds that an outlet is a multi-outlet franchise by 1.5 times. Finally, Hypothesis 2e predicts that outlet size increases the probability that the focal outlet is a multi-outlet franchise. The hypothesis is not supported ($\beta = 0.03$; *ns*).

DISCUSSION

Franchising is an important plural form (Bradach and Eccles, 1989), and research continues to advance understanding of why franchisors often cede control of their branded outlets to franchisees (e.g., Mitsuhasi *et al.*, 2008). Agency theory is the dominant explanation with its focus on the (vertical) agency costs of monitoring local managers (Combs *et al.*, 2004). Studies support the theory's prediction that company-owned outlets are kept near headquarters and in large markets where

Table 3. Regressions for ownership type[a]

Hypothesis	Variable	Logistic regression				Multinomial logistic regression			
		Company owned (1) Vs. franchised (0)		Multi-outlet (1) vs. single outlet (0)		Company owned (0) vs. multi-outlet (1)		Multi-outlet (1) vs. single outlet (2)	
		β (SE)	OR	β (SE)	OR	β (SE)	OR	β (SE)	OR
	Intercept	−1.22*** (0.18)	3.38	1.44*** (0.25)	4.22	−0.19 (0.24)		−1.20*** (0.27)	
	Chain indicators[b]	Yes		Yes		Yes		Yes	
	Per capita income	−0.01*** (0.51)	1.01	0.07 (0.68)	1.07	0.01 (0.05)	1.00	−0.72 (0.67)	1.07
H1a	Distance to the franchisor's headquarters	−1.34 (0.16)	3.83	−0.08 (0.21)	1.08	−1.37*** (0.17)	3.92	0.10 (0.21)	1.01
H2a	Distance to the owner's headquarters	—	—	—	—	1.05*** (0.06)	2.86	−1.52*** (0.19)	4.54
H1b & H2b	Distance to the nearest neighbor	−0.31*** (0.07)	1.36	−0.37*** (0.06)	1.45	−0.26*** (0.07)	1.30	0.36*** (0.06)	1.44
H1c	Company-owned nearest neighbor	2.56*** (0.10)	12.87	—	—	1.41*** (0.18)	4.10	−0.35† (0.21)	1.42
H2c	Multi-outlet franchisee nearest neighbor	—	—	1.66*** (0.14)	5.27	−1.30*** (0.18)	3.65	−1.95*** (0.17)	7.04
H1d & H2d	Market size	0.39*** (0.06)	1.48	−0.40*** (0.08)	1.49	0.47*** (0.07)	1.60	0.47*** (0.08)	1.57
H1e & H2e	Outlet size	−0.06 (0.08)	3.37	0.03 (0.12)	1.03	−0.00 (0.00)	1.00	−0.02 (0.12)	1.02
	n	4,339		3,108		3,982		3,018	
	Cox and Snell R^2	41.00%		16.70%		48.80%			
	Nagelkerke R^2	57.90%		32.70%		59.30%			
	Overall correct classifications	85.80%		90.30%		38.60%			

[a] Standardized values were used for all continuous variables. Standard errors are in parentheses. Inverse ORs reported for negative variables.
[b] These categorical control variables were included in the analysis, but the results are omitted for clarity. $†p < 0.10$; $* p < 0.05$; $** p < 0.01$; $*** p < 0.001$ (two-tailed)

monitoring costs are lower (Lafontaine and Slade, 1997). The theory struggles, however, to explain multi-outlet franchising and co-location.

Thus, our first contribution is to broaden agency theory's explanation of franchising to embrace multi-outlet franchising and co-location. Specifically, by adopting the assumptions that: 1) market penetration is a central franchisor goal, 2) the advantages of multi-outlet franchisees outweigh their costs, and 3) many single-outlet franchisees choose not to, or are not able to, become multi-outlet owners, we can explain the choice between franchisee and franchisor ownership, the use of multi-outlet franchising, and the presence of co-location. Specifically, our theory is that franchisors 'seed' target areas with single-outlet franchisees hoping that they will grow. Where this does not occur, the franchisor enters with company-owned outlets.

Our second contribution is empirical in that using each outlet's actual location offers a more precise test of the role of geography. The results of our first set of tests largely mirror the ownership pattern between franchised and company-owned outlets found in prior agency-based research. Franchised outlets are farther from the chain's headquarters (Brickley and Dark, 1987), more isolated (Norton, 1988), and near other franchised outlets (Kalnins and Lafontaine, 2004); company-owned outlets are in densely populated areas where multiple outlets can be efficiently monitored (Lafontaine, 1992). Thus, results using actual outlet locations are consistent with prior research showing that geography-based monitoring costs impact firms' use of franchising.

Our third contribution is that our theory and empirics go beyond predicting franchisee ownership by predicting which type of franchisee will own a given outlet. Results from our second set of tests are consistent with our theory that 1) multi-outlet franchising is efficient, and 2) co-location occurs because of franchisor entry after single-outlet franchisees fail to grow. With respect to multi-outlet franchisees, they keep their outlets near one another and near headquarters for efficient monitoring. Indeed, multi-outlet franchisees keep their outlets much closer together than franchisors do, and this clustering implies monitoring efficiencies that suggest multi-outlet franchisees are a preferred ownership choice. With respect to co-location, prior contrasts between franchised and company ownership showed mostly franchised outlets in rural areas (Norton, 1988). When we look only at franchisees, however, single-outlet franchisees are mostly in populous areas. The reason, we believe, is that these are remnants of the franchisor's effort to seed populous areas with franchisees. Because the franchisor is less interested in suburban and small city markets, it is their multi-outlet franchisees who, by virtue of their proximity, spot these opportunities. Thus, although we lack temporal data showing that franchisees arrived first, the pattern of co-located single-outlet franchisees in populous areas suggests that these outlets are seed remnants. We believe that our theory has important implications for franchising research and practice, and for research on other plural forms.

Implications for franchising research and practice

For franchising research, our study points to a tension between seeking symbiotic advantages and making ownership decisions based on agency costs. If franchisors were seeking symbiotic advantages in ownership decisions, we would expect company-owned outlets near franchisees—especially multi-outlet franchisees—throughout the chain (cf. Bradach, 1997; Darr *et al.*, 1995). Ownership patterns, instead, reflect a desire to achieve growth in a way that limits vertical agency costs—that is, multi-outlet franchisees are used except in some urban areas where company ownership appears necessary.

Given that symbiotic advantages appear important, it seems reasonable to ask why they are not a key factor in ownership decisions. One possibility is that the symbiotic advantages observed by Bradach (1997) and others (e.g., Kaufmann and Eroglu, 1998; Sorenson and Sørensen, 2001) are largely byproducts of efficient growth. That is, franchisors might seek cost-efficient market penetration as our theory describes, but once they have clusters of company-owned outlets in key markets interspersed with (mostly single-outlet) franchisees, successful franchisors seek out and realize the symbiotic benefits of this arrangement. Thus, future inquiry focused on how ownership coevolves with symbiotic advantages might further understanding of the apparent tension between monitoring efficiency and symbiotic advantage.

It also might be fruitful to investigate contingencies that could affect managers' ability to garner

▲ Company-owned outlet
● Single-owner franchisee outlet
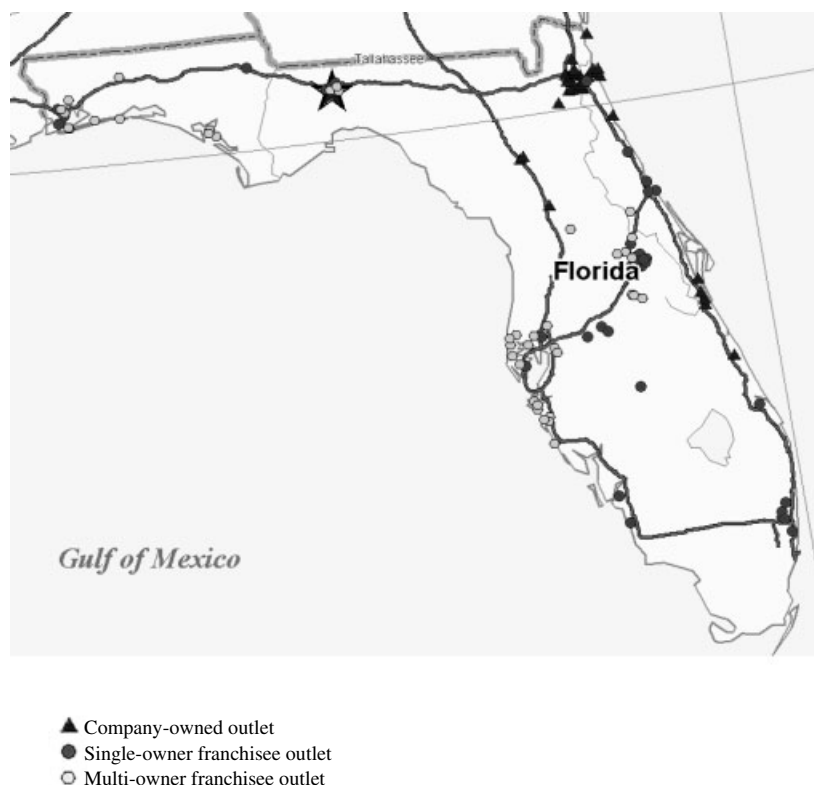○ Multi-owner franchisee outlet

Figure 1.   Locations and ownership patterns of a young franchise chain in Florida

symbiotic advantages: franchisor size and maturity, for example. Younger chains might begin operations with company-owned outlets clustered near headquarters and geographically dispersed single-outlet franchisees. Indeed, Figure 1 shows a map of the outlets in the youngest (and fourth smallest) firm in our sample. As agency theory predicts, company-owned outlets are clustered near the Jacksonville headquarters whereas single outlets are dispersed throughout the state's major population centers. In time, our theory predicts multi-outlet franchisees will arise, which appears to be happening for this firm in Tampa, Orlando, Pensacola, and Tallahassee.[5]

For franchising practitioners, our study has implications for both franchisors and franchisees. For franchisors, our theory suggests that it is important to select entrepreneurially oriented franchisees who possess both the financial and managerial resources to build 'mini-chains.' Potential

franchisees with prior management experience, for example, should be better equipped to manage multiple outlets (Gillis *et al.*, 2011). Regarding franchisees, at least among the large chains we studied, multi-outlet franchisees' growth opportunities appear to be in small and mid-sized markets, suggesting that these franchisees can benefit from leveraging their local knowledge in the search for profitable locations.

Implications for plural form research

The tension between agency-based efficiency and symbiotic advantage might have wider implications. Some plural form studies show that firms use internal operations to gain knowledge that is used to improve bargaining (Harrigan, 1985) and monitoring (Dutta *et al.*, 1995), whereas others focus on joint problem solving and cost improvements (Parmigiani and Mitchell, 2009). In the franchising context, ownership decisions appear based on efficiency motivations with symbiotic advantages identified later. Thus, future investigations of other plural forms might gain from looking separately

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[5] Maps of small firms are revealing, but maps of larger firms are difficult to read and interpret because of the number of overlapping data points.

at the decision to start using a plural form and the advantages that occur later. Managers might initiate internal production, for example, to gain bargaining leverage and improve monitoring, but may later find symbiotic advantages when internal units work closely with external suppliers (Dyer and Singh, 1998; Parmigiani and Mitchell, 2009).

A second implication is that franchising research might inform the specific nature of symbiotic advantage within other plural forms. In franchising research, franchisors enhance standardization while franchisees foster adaptation (Sorenson and Sørensen, 2001). Future inquiry might ask whether there is a similar parallel regarding concurrent sourcing or dual distribution. Taking concurrent sourcing as an example, it seems reasonable that sourcing firms might focus on process innovation around component integration while suppliers yield product and cost-focused process innovations (cf. Takeishi, 2002).

A third area where our theory might have implications involves international plural forms. Researchers are only beginning to deal with the complex web of ownership around foreign operations (Benito, Peterson, and Welch, 2009). In plural forms such as concurrent sourcing, it might not matter who supplies a *particular* standardized input, but it can matter a great deal in settings where location creates important differences among otherwise standardized operations. Although transaction costs (e.g., Hennart and Reddy, 1997) and learning (e.g., Tong, Reuer, and Ping, 2008) explain many international ownership choices, perhaps (as in our theory) some firms invest only after a local partner fails to perform. Future research might, therefore, benefit from investigating parallels between franchising and international plural forms.

Limitations and future research

One limitation that seems particularly relevant is that we proposed a dynamic theory in which 'seeds' are enlisted at one point in time and company ownership occurs only after those seeds fail to grow. Whereas the pattern of ownership we identified is consistent with our theory, we unfortunately do not have access to the outlet age data needed to test this aspect of our theory. Minkler (1990) studied Taco Bell restaurants and found one important piece of evidence in that franchised outlets were older than nearby company-owned

outlets, but it would also be helpful to know whether single-outlet franchises are older, on average, than other outlets.

We contacted every firm in our sample, but due to corporate confidentiality rules, we were only able to obtain outlet age data from one chain. This chain has over 100 outlets in Florida.[6] As expected, single-outlet franchises are older than either company-owned outlets or multi-outlet franchises ($p < 0.05$). Thus, when combined with Minkler's (1990) results, the evidence is consistent with single-owner outlets as seeds that failed to grow. Still, an important goal for future research will be to investigate new outlet timing. How long, for example, will franchisors wait for franchisees to expand before entering with their own outlets?

A second potentially important limitation is that the study is restricted to Florida. Florida is one of the largest states for this industry, but the important role that tourism plays in the state suggests higher free-riding (i.e., horizontal agency) risks because capturing repeat business is difficult (Caves and Murphy, 1976). Although agency theory might anticipate more company ownership in Florida, prior findings suggest that franchising is common at other non-repeat locations (i.e., freeways [Brickley and Dark, 1987]), and that franchisors seem to ignore the negative effects of free riding (Michael, 2000b). Perhaps comparing company-ownership rates among U.S. states can shed additional light on the impact of tourism and free-riding risks.

CONCLUSION

Franchising is an enduring aspect of the business landscape and a key competitive growth tactic. Past inquiries into why some firms choose franchising instead of company ownership has left unanswered questions regarding multi-outlet franchising and co-location. We built upon an emerging symbiotic view of franchising to suggest that multi-outlet ownership is an efficient way to organize and that co-location occurs as a result of using company ownership to complete market penetration in areas where single-outlet franchisees fail to grow. Our study suggests that agency theory can be extended to explain ownership patterns among

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[6] To get these additional data, we signed a nondisclosure agreement stating that we would not reveal company identifying information.

plural form franchisors. Once these decisions are made, however, it seems that some franchisors move beyond selecting the most efficient owner by building symbiotic advantages between company-owned and franchised outlets. Our hope is that understanding how ownership interacts with symbiotic advantages will help future franchise practitioners build stronger relationships that yield ever more prosperous franchise partnerships.

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