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„Ownership Strategy in Franchising:
Single- vs. Multi-Unit-Franchising“

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Table of Contents

Table of Figures

1. Introduction

The present thesis is about the ownership strategy in franchising networks. Therefore we want to find out whether it is advantageous for the franchisor to have franchisees who own one outlet or more outlets in the franchise chain. So, the objective of our study is to point out the franchisor's choice between using single- and multi-unit franchising.

As franchising is an important topic in global business world we first give an overview about how franchising works, by presenting definitions, business procedures and the different kinds of franchising in the service sector. Subsequently we present a review about the most important theories to find out in which situations the franchisor should make use of what kind of ownership strategy. For this challenge we do not only present the theory itself but we set up hypotheses for the use of single- or multi-unit franchising.

In the empirical part of our thesis we present two case studies. One is about the Coffeeshop Company and the other is about Testa Rossa Caffèbar, both well established Austrian service franchise systems. This section shows whether the established hypotheses in theory are compatible with business reality or not and, if it is the case, demonstrate the differences between theory and practice and try to explain why the results do not align with those of theory.

Franchising in the service sector is a business format and thus an organizational form. Franchising is a business relationship between the franchisor (headquarter) and the franchisee (local store) that gives the franchisee the right, opportunity and duty to sell a product or service under a common brand name with the help of established business procedures. Those characteristics are owned by the franchisor, assigned to the franchisee and in return, the franchisor receives a lump sum payment as well as a royalty fee. The latter one is based upon sales made by the franchisee for a prespecified period of time (Rubin, 1978).

Due to Kaufmann and Dant (1996) franchising is a growing sector in economies all over the world. In general there exist only a few researches and studies on multi-unit franchising whereas the main focus relies on single-unit franchising. Sorenson and Sorenson (2001) state that franchising is a growing business format for firms that seek for higher wealth creation. Due to Kaufmann and Dant (1996) there exist two reasons why franchising is the preferred organizational form in economical business. They state that franchising helps to overcome the financial scarcity problem. The second point is that franchisees are seen to be better managers of their stores than the managers of company-owned outlets. The authors also argue that multi-unit franchising is a kind of anomaly. Fact is that the previously supplied research studies have focused on single-unit franchising rather than on multi-unit franchising whereas today's business life is confronted a lot with not only single but increasingly with multi-unit ownerships.

2. Types of Franchising

This section is about the term franchising and its different meanings to get a wider overview about what we are discussing. The term franchising can be diversified into several business arrangements (Burton et al., 2000). Therefore it is necessary to state which term of franchising we are using in our thesis.

Due to the discussion of Burton et al. (2000), one has to distinguish between first and second generation franchising. In the first case the franchisee receives a pre-specified set of rights and resources for the production of a product or a service via a contract, for doing business under a special brand name. A more common name for this kind of franchising is licensing. Second generation franchising involves a wider package of rights and resources than the first possibility and involves not only contractible assets but also assets with a tacit and intangible character. Thus, the franchisee is able to replicate business successfully. With the second definition in mind, we go on with further kinds of franchising.

2.1. Single Unit Franchising

In a franchise relationship the owner of a single-unit outlet within the franchise system is just allowed to run this single unit and not more (Garg et al., 2005).

2.2. Multi-Unit Franchising

Kaufmann and Dant (1996) state that multi-unit franchising is the type of franchising that is of most importance. In this case the franchisor allows the franchisee to open up several outlets within the chain. This means that the franchisee has the possibility to establish own mini-chains in the main chain. Kaufmann and Dant (1998) explain that that there exist two ways of doing so. First, there is the sequential acquisition. At the beginning of the franchise relationship, the franchisee may have just one outlet. With the ongoing acquisition of additional stores sequential franchising come into effect. The other possibility of multi-unit franchising is the corporate strategy of the franchisor- also called area development franchising. Thus, the franchisor transfers rights and responsibilities to the franchisee to operate exclusively in a pre-specified area.

2.3. Master Franchising

According to Burton et al. (2000), franchisors often make use of an intermediary in franchising patterns. The one who is called master franchisee recruits other franchisees and offers trainings to them so that they internalize the franchisors concept in order to do businesses efficiently (Shane, 1998). The master franchisee (also known under the term sub-franchisor) has the right to act beyond borders as the franchisor itself, not in the home country but abroad, and can sell the business franchise format to other franchisees (Burton et al., 2000). As Shane (1998) states, the franchisor has to supervise franchisee's activities and has to ensure that franchisee agreements are strictly adhered. The franchisees are recruited, trained and supervised by the sub-franchisors in the pre-specified area (Kaufmann and Kim, 1995) but they do not run businesses themselves (as with single-unit agreements) and they also do not recruit managers (as in the multi-unit case). The master franchise, thus, acts like a franchisor and has additional characteristics of a multi-unit franchisee (Garg et al., 2005).

2.4. Area Development Franchising

This kind of franchising, the area development agreement, is familiar to that of master franchising. In this relationship, the franchisor denominates the master franchisee to compulsory open and conduct business in several stores within a pre-specified time frame (Kaufmann and Dant, 1996). Kaufmann and Dant (1998) characterize area development franchising as a kind of multi-unit franchising.

3. Theoretical Views on Single-unit and Multi-unit Franchising

3.1. Transaction Cost Theory

The transaction cost theory of Williamson (Coase, 1937; Williamson 1973, 1975, 1985) is one of the heavily discussed approaches in recent economic history. It is the first theory which we apply on franchising to understand the decision for choosing multi-unit franchising or single- unit franchising.

The hold-up risk, which occurs through specific investments, is getting higher as the level of the investments increases. Specific investments are these kinds of investments, which the franchisee has to conduct to start an outlet and which cannot be used in any other way. So if the franchisee would decide to exit the franchise contract, he would lose all the money he had spent as a specific investment.

Klein (1995) argues that designing the franchise contract in an appropriate way can overcome the hold-up risk, which occurs through specific investments. He states that a self-enforcement mechanism has to be implemented into the contract to give the franchisee an incentive to run his business with all his effort. To guarantee this, the franchisor should announce a premium payment in the future which is more worth than the extra profit a franchisee could get by doing less in the short term. So the self-enforcement mechanism is a tool, which should offer a premium payment from the franchisor to the franchisee or sufficient rents. Besides the franchisor can make use of his termination rights and threatens the franchisee to perform well. Both things together can create an incentive to the franchisee to meet the agreed requirements and make both better off in the long run as long as the premium is bigger than the short term gains.

Bercovitz (2003) also takes the hold-up risk into account and discusses this issue regarding franchising concepts, namely the effects on multi-unit and single-unit franchising. She argues that multi-unit franchising has an advantage with downstream rents and therefore a multi-unit franchisee has a higher incentive to create contracts with a self-enforcement approach. Multi-unit franchisees are willing to act cooperatively with the franchisor, because they hope to get additional possibilities to open further outlets in the future as their premium. A single-unit operator is not affected by this incentive because he has no plans to open new outlets. In this case the contract would have to be set up with lots of details according the required performance of the franchisee. Threatening on its own will not be a motivation for the franchisee to perform at his maximum.

In the following part, we will discuss the factors, which Williamson (1973) considers to have an effect on the transaction cost theory and we will further discuss these factors, which have a specific influence in the decision making process of franchising systems.

3.1.1. Transaction Cost Factors Influencing Multi-Unit Franchising

The transaction cost theory is applicable on the decision for choosing multi-unit franchising or single-unit franchising. However as not all factors have the same impacts, we will only consider the most important factors regarding governance structure, which are specific investments on the one side and environmental uncertainty on the other side (Williamson 1973, 1975).

Environmental Uncertainty

Environmental uncertainty describes a situation where the location of an outlet suffers from changing market conditions. This makes it difficult to run a shop at this place, because the shop keeper has to adopt his strategy on a regularly base to conquer the changing conditions. Doing this requires a lot resources and experience. Campbell et al. (2009) describe in their paper the effects of this uncertainty according to the choice of franchising. They have chosen the convenience store industry for their testing purpose. Two major observations have been made by the authors. On the one hand they have figured out that different local conditions have led to monitoring issues of the store manager and on the other hand their result has shown that there has been a positive relationship between wide-ranging consumer base, which could have been considered as an environmental uncertainty factor, and the need of an increased amount of local know-how. Know-how, which only the person, who runs the shop on site, has and who can react to environmental changes in a quick and effective way. Hence franchising is preferred to uncertain situations, because the franchisor would not be able to focus only on one specific outlet. Instead of that the franchisee can take all his effort to focus on a successful local market orientation.

The final question is how environmental uncertainty influences the franchisor's decision in choosing multi-unit franchising or single-unit franchising. As Campbell et al. (2009) have stated high levels of uncertainty at a certain location require lots of local knowledge a multi-unit franchisee will not be able to meet these requirements. Being busy with several outlets at once will lead to constraints in paying attention to each location. Therefore we assume that single-unit franchisees will be the ideal partners to cope with locations which are characterized by environmental uncertainty. A single-unit partner can monitor and react to environmental uncertainties better than a multi-unit franchisee.

We derive following hypothesis with these assumptions in mind.

H1: If the level of environmental uncertainty at a location is high, the franchisor will tend to use single-unit franchising.

After discussing environmental uncertainty, we will move further to the second factor related to the transaction cost theory, which is about transaction specific investments.

Transaction Specific Investments

Specific investments are characterized by the fact that they only have a single purpose and cannot be used in any other way. Therefore they lock in the investor and can give the receiver an opportunity to act opportunistically (Williamson, 1985). It has been discussed in the literature if these specific investments influence the relationship between the franchisor and the franchisee. Heide et al. (2003) have tested if there is a connection between the height of the specific investments and the bonding effect between these partners.

In terms of multi-unit franchising we can apply that franchisees, who decide to do multi-unit franchising, have to undertake higher investments, because of the certainty that these investors have to set up multiple outlets and not only a single one. However it has to be pointed out that the one on one costs of each outlet decrease due economies of scale. It is likely that franchisees with high investments and higher risks will claim to get future benefits, like the permission to open further outlets to compensate the costs of the specific investment. This would also be in line with Klein’s (1995) argument that announcing premiums encourage the self-enforcing mechanism of franchise contracts.

So the second hypothesis regarding the transaction cost theory is the following one.

H2: Higher specific investments lead to higher bonding effects between the franchisor and the franchisee and as an effect of that multi-unit franchising is preferred in comparison to single-unit franchising.

3.2. Agency Theory

Ross (1973, p. 134) defines agency theory in the following way:

> *"An agency relationship has arisen between two (or more) parties when one, designated as the agent, acts for, on behalf of, or as representative for the other, designated the principal, in a particular domain of decision problems."*

Pratt and Zeckhauser (1985, p. 2) presents another definition for the principal-agent-theory in a much wider perspective:

> *"Whenever one individual depends on the action of another, an agency relationship arises. The individual taking the action is called the agent. The affected party is the principal."*

Agency theory explains two perceptions that arise in agency relationships. The first problem that can be solved by the agency theory is the in the majority of cases diverge goals of principal and agent. The second problem deals with the difficulty for the principal of verifying the agents' activity. It is hard to measure whether the agent behaves appropriately or not. Another issue is the different attitude toward risk between principal and agent. This disagreement leads to the situation that there is no congruency of steps taken and the principal has to spend resources to align their interests (Eisenhardt, 1989a; Jensen and Meckling, 1976).

3.2.1. Agency Theory in Franchising

A very common agency relationship is the one between franchisor and franchisee. Agency theory includes the delegation of work and the process of decision making (done by the principal) transferring the outcomes to another person (requirements received by the agents). In the case that information asymmetries exist moral hazard appears. This is the case if the agent (franchisee) possesses special knowledge that the principal (franchisor) has not (Garg et al., 2005). In such a situation the goals of the principal and agent may not be congruent and this is the reason why the principal has justified doubt that the agent's behavior does not lead to achieving the principal's goals. Actions taken by the agent are used to achieve their own goals rather than to achieve the principal's ones, used the assumption of self-interested behavior. To avoid this possible outcome, the principal has to monitor the agent with increased advertence or/and he has to align the agent's interests to those of himself by using incentives (Eisenhardt, 1989b). Both parties of the franchise contract have the occasions to put upon the other (Williamson, 1983).

Lafontaine and Slade (1997) state that agency theory explains franchising as inactive device. One reason why firms tend to use franchising for their growth strategy with the background of agency theory is that firms can grow faster than the monitoring costs increase during growth (Norton, 1988a). Following Bradach (1995), franchisors that want to denote fast growth in their franchising chains tend to use multi-unit franchising instead of single-unit franchising.

Many authors argue that the use of multi-unit franchising has several negative outcomes compared to single-unit franchising (Kalnins and Lafontaine, 2004; Garg and Rasheed, 2003). One of them is the increasing bargaining power of the franchisee when he possesses a multi-unit ownership and this can lead to opportunistic behavior of the franchisee against the franchisor. If the franchisee controls many stores in the multi-unit chain he can use his power to weaken the franchisors' one (Kalnins and Lafontaine, 2004).

On the contrary, Kalnins and Lafontaine (2004) also argue that the use of multi-unit franchising leads to less agency problems than compared with single-unit franchising. Although some discussions argue that a franchisee who owns many outlets in the franchise system can use his power against the franchisor there are also arguments that favor the use of multi-unit franchising. One advantage for the franchisor is if the franchisee possesses special knowledge of how to operate stores in specified markets. This knowledge includes inter alia the know-how about the local market conditions and customer taste. To denote a reduction in the case of free riding at the local stores, the franchisor prefers multi-unit franchising instead of single-unit franchising (Bercovitz, 2004). Following Bradach (1997), franchisees of multi units facilitate control patterns of the franchisor because they make use of the franchising standards offered by the franchisor.

To find a franchisee who entails this special know-how is not that easy and of course very costly (Bradach, 1998). With multi-unit franchising, the franchisor can most efficiently use the know-how of the high-quality franchisee (Kalnins et al., 2004). According to Darr et al. (1995), franchisees of multi units do denote more productiveness than franchisees of single units because they can benefit from other outlets due to production experiences. According to Bates (1998) new outlets of already operating franchisees have more chances to survive on the market than outlets from new franchisees. This outcome strengthens the argument that existing franchisees do possess better knowledge about procedures and are of higher quality than new one.

With the help of a well-known franchising brand name franchisors are able to pay the franchisees quasi-rents that are higher than required in order to tie franchisees to their contracts more than with just paying opportunity costs. In the case that the franchisee failures to comply with the rules he sustain damage because he will not receive those quasi-rents. To summarize, those quasi-rents align the interests of the franchisee and franchisor (Klein, 1995).

3.2.2. Monitoring Costs

An important issue in franchising is the matter of monitoring costs. Whenever an institution wants to grow in size monitoring has to be kept in mind. Due to the increased work of the owner supervisor he can hire other supervisors who are responsible to check all day-to-day activities. Fact is that no hired supervisor has exactly the same sentiments and incentives about actions taken in the business than the owner himself. The theory of firms argues that ownership and ‘efficient’ monitoring are implicitly linked. The problem discussed in this paragraph can be defined as entrepreneurial capacity constraints (Norton, 1988b). The term entrepreneur has different meanings and therefore the entrepreneur has to fulfill different task to live up to his name. One of the most common explanations is the one of Alchian and Demsetz (1972), which states that the entrepreneur as a monitor has to observe whether the workforce tries to work as they have promised or not and thus minimize shirking.

If the firm grows the entrepreneur’s function is to monitor activities more than before. This situation cannot be moderated by empower this task to other supervisors or managers because of the divers incentives and motivations of the participators. The problem of shirking, however, can be kept at a lower level with the use of franchising. Therefore the incentives of the franchisee of a local store have to be set in a compatible way with those of the franchisor. This mitigates the problem of entrepreneurial capacity constraints. The franchisor communicates in a franchise contract to the franchisees the status of residual claimants. The result is that the franchisees avoid shirking because otherwise the revenues from their local stores will decline. Due to Weaven and Frazer (2007), multi-unit franchising overcomes the problem of high monitoring costs. The reason therefore is the increased motivation of the franchisees of doing business.

Geographical Distance

Fladmoe-Linquist and Jacque (1995) argue that the monitoring costs decline with an increasing degree of the franchisee's self-enforcement. Those monitoring costs rise the higher the cultural and geographical distance is. Geographical distance appears whenever the outlets are far away from the corporate headquarters. In the case of international business, this distance leaves time and place for incomplete information between the franchisor and franchisee. Although the technology is nowadays well elaborated, the costs of sending and receiving complete information about foreign transactions are still too high and time-consuming. This is the reason why franchisors want to align the goals of the foreign franchisees with those of them. Therefore the costs of moral hazard and self-selection are transferred to the franchisee. If the franchisee shirks he bears the costs of doing so through a reduced net income. This is called to be a financial incentive for the franchisee to behave in the way the franchisor wants to. According to Combs and Ketchen (2003), the higher the geographic distance the more attractive franchising seems to be.

Cultural Distance

The cultural distance, also discussed by Fladmoe-Linquist and Jacque (1995), is another factor that drives up the monitoring costs. They point out the difference of operating outlets beyond national boundaries. These outlets have to be managed different from those of the franchisor's domestic ones. Management systems (for instance trainings) and service concepts both have to be adopted according to the location where businesses are practiced. Both have to be translated not only into the foreign language but also into the cultural standards and norms. Whereas equity ownerships bear all the costs of modifications, in the case of franchising, the franchisor shifts those responsibilities to the franchisees who then have to deal with the risk of adaptations.

3.2.3. Shirking and Free-riding

According to Rubin (1978), franchising allows shirking, free-riding and opportunistic behavior. In franchising relationships, the franchisee is the owner of the assets and receives profits generated by his franchise stores. For this reasons it is in the interest of the franchisee to keep the value of the assets high and to generate sales whereas costs are low. Profits are often maximized at the expense of their franchisee colleagues of other outlets or the whole franchise chain. This is performed through using lower quality and minimized advertising costs - and both methods lead to a weaker brand name value. Another way to strengthen the franchisee's position in a self-interested way is to offer modified products in their markets that would fit better to the local demand. Further, the franchisee can reject the implementation of new processes or services although the new and innovative performance would allow other stores to generate benefits. The explained self-interested behavior of the franchisee has consequences on the extent of standardization in the whole chain and violates the parameter of doing business under a common brand. A significant decision part of becoming a franchise partner in a specific franchise chain is the brand. Profits gathered by franchisees depend on decisions made by the other franchisees in the chain. On the one side, franchisees benefit from the brand name – if it has a good reputation. On the other side, a valuable brand name induces free-riding (Lafontaine and Shaw, 2005).

Klein (1995) argues that doing business under a common brand name is attractive for franchisees to reduce costs via offering inferior quality of products because they do not have to bear the consequences on their own but they are partly passed on all the other outlets in the chain. So, not only the shirking franchisees are affected on the negative future demands due to the inferior quality but also the other franchisees that may try to work in a way the franchisor appreciates. Klein and Saft (1985) mention that a service providing outlet can benefit of the chains brand reputation without meeting the standards themselves.

Consumers who buy products of inferior quality blame the whole franchise chain trading under the same brand name and not only the store where they bought the product of less quality. A consumer buying a product of inferior quality will reduce his demand for other stores operating under the brand name. This is because the consumer now has more information about the franchising policy and is of the opinion that the franchisors monitoring efforts are bad – no matter which outlet (Klein and Saft, 1985).

In order to soften the free-riding problem the franchisor has to supervise the franchisees actions through monitoring efforts. This is done via a franchise contract that includes several arrangements like forfeits in the event of defaults, for instance a pre-specified level of service cannot be reached and therefore the franchisee is motivated to behave appropriately. The franchisor has the possibility to denounce the franchising relationship due to detected shirking on the part of the franchisee and hence, the franchisee is activated to perform according to the arrangements listed in the contract. This is said to eliminate the free-rider problem in theory, but in practice the monitoring aspect plays a much more important role than the use of large penalties (Lal, 1990).

In the service sector the brand name is inter alia a very important intangible asset. This asset has to be protected against hazards. So brand name and aligned with it its reputation as intangible has to be preserved of diverse kinds of hazards (Fladmoe-Linquist and Jacque, 1995).

Bercovitz (2003) argues that the use of multi-unit franchising in franchising networks mitigates the problem of self-interested behavior. The reason therefore is that the franchisee has the opportunity to get an additional store in the future as a result of good work. In the case of single-unit franchising the franchisee will have interests that are not aligned with those of the franchisor and therefore the franchisee's self-enforcement is weaker. According to the findings of Dant and Nasr (1998), franchisees of multi units rather deliver information to the franchisor than franchisees of single units. This is because they do not have that much incentive than their single unit combatants to make use of free-riding and further, they feel more save in the franchise relationship with the franchisor. Also Weaven and Frazer (2007) state that multi-unit franchisees have lower incentives to free-ride on the franchisors belongings because if they do they will denote negative effects in their own mini-chains as their single-unit counterparts.

The previous chapter discusses the agency theory and describes the problems of free-riding and shirking especially in the case of franchising. Therefore we set up a hypothesis to find out in which situations it is advantageous for the franchisor to choose multi-unit franchising instead of single-unit franchising.

> *H3: The higher the behavioral uncertainty due to shirking and free riding is, the higher is the franchisors tendency to choose multi-unit franchising.*

3.3. Resource Scarcity View

Now we will move forward to the resource scarcity view. Teece et al. (1997) describe that getting an advantage over competition can be achieved by having greater resources. The advantage is bigger if the resources, which are the firm specific assets, are difficult to imitate by the rival firms. It is hard to imitate if for example the company has secret know-how or specialized product facilities. Besides, tacit know-how is also an asset, which is hard to transfer and therefore difficult to imitate. Being the only one having a competitive advantage over rivals is a guarantor to get an edge in the market.

Firm's Resources

Barney (1991) states that firms resources include all of their assets, capabilities, information, knowledge etcetera, which are controlled by them. It is crucial that these factors have a positive impact on the firm's efficiency and effectiveness. A company with these advantages will be able to outperform its rivals. The advantages have to be implemented into a value creating strategy, which Barney (1991) summarizes in a framework including four attributes, which will be discussed in the next section of this paper.

Valuable Resources

A resource can only be useful and thus an advantage for a firm, if it creates value. Value is difficult to measure but if the firm gets a performance boost with the help of this resource, it can be defined as value creating. On the other hand it can also create value by defeating competitors by neutralizing threats or opportunistic behaviour of other firms. Protecting the company from other actors in the market is also value creating (Barney, 1991).

Rare Resources

Valuable resources lose their value creating ability if they are available in a large amount to many companies. There might be a first mover advantage for the one, who takes advantage of it at first but rivals will keep an eye on each other, catch up quickly and eliminate the benefit until all players in the market will have the same gain. There might not be many resources, held by only a single firm but if a small number of players have access to it, it will probably be still a value creating asset (Barney, 1991).

Imperfectly Imitable Resources

Due to Barney (1991) imperfectly imitable resources are defined as resources, which guarantee a sustained competitive advantage. This is only possible if rivals can never get the benefit of this advantage. So there is not only a first mover advantage until others start to copy this idea but a gain for the entire lifetime of the firm. Barney (1991) indicates that an imperfectly imitable resource can occur if it is dependent upon unique historical conditions, if there is a causally ambiguity between the possessed and the advantageous sustained resource and if the resource is socially complex.

Non Substitutable Resources

Another factor which is crucial to create value is the substitutability of resources. If a company implements a unique resource to a beneficial strategy, no other firm will be able to use the same strategy because of the lack of this resource. However it might be able to overcome this problem by using a different resource with similar qualities. So with the help of a substitutable resource, a rival will be able to replace a unique or inimitable resource (Barney, 1991).

To sum up, factors or resources of a firm have to fulfil the mentioned conditions to create value to the company in the long term. If one of these attributes cannot be guaranteed, a sustained competitive advantage will not be able to give an edge over competitions. In this case rivals will catch up and sooner or later the initial benefit will fade away.

Franchising and the Resource Based Theory

Franchising has often been a discussed topic in the literature regarding to the resource based view. Kaufmann and Dant (1996) analyse the characteristics of multi-unit franchising towards growth capabilities and management issues. They argue that franchising in general can speed up the growth of the system's network and that multi-unit franchising will even increase the growth rate further. Reasons for this are that multi-unit franchising provides better protecting effects against moral hazard in form of shirking or free-riding. Capital has been considered as mandatory to grow. However financial restrictions can hinder the plans of growing and therefore franchising is an alternate way to overcome this issue and let the system grow without the need of the amount of money when it would have been done without franchise partners. Due the fact that franchisees have to make initial investments at the beginning of the contract, the franchisor is financially discharged.

Multi-unit franchising will probably accelerate the growth rate of a franchise system for several reasons (Bradach, 1995). Multi-unit partners usually have higher capabilities to raise money for investments. Therefore they can build up outlets in a faster way and profit through economies of scale. Contracts only have to be negotiated once between the franchisor and the franchisee to open up new shops. At single-unit franchising, each new location needs a new franchise partner with an own contract. This is slowing down the growth speed and mitigates the growth rate.

As a result, we can formulate the following hypothesis.

H4: Financial restrictions of the franchisor can be better overcome with the use of multi-unit franchising than single-unit franchising.

The next factor that is considered now is know-how, which is needed to conduct franchising. As know-how is a broad and general term, we will specifically talk about the local know-how (Norton, 1988). Local know-how is the knowledge that a franchisee needs to run the business successfully at his specific outlet. Environmental settings are different from location to location and therefore an owner of an outlet has to adopt his business plan to these circumstances and can benefit with the help of this knowledge (Hayek, 1945). If these circumstances are stable, it is easy to determine them but in case that they are changing frequently, the shop manager will be busy adjusting the strategy to the local market. Multi-unit franchisees in unstable environments will struggle to supervise each and every of their outlets. However, to keep up with these environmental changes, they will have to ask their employees or shop managers to conduct this task. The franchisee has not enough resources to do this. The problem is that employees usually lack of motivation. According to Caves and Murphy II (1976) the level of motivation of proprietors is higher than the motivation of employees. The reason for this is that franchisees, who are entrepreneurs, have higher risks than the hired employees. The franchisees want to get back the invested money as soon as possible and therefore they have a higher motivation to run their outlets successfully. Employees on the other hand do not bear the risk of losing money. They get paid their salary at the end of each month independent on the past performance. There can be set some incentives to perform better but they are never in the same risky position as the proprietors. The involvement of high investments leads to risks in the part of the owners of the outlets (Norton, 1988). So single-unit franchisees can acquire local know-how in a more effective way than multi-unit franchisees. They have the advantage of running only one outlet and therefore they can focus on the environmental changes at their site. The single-unit franchisee as a residual claimant is interested to increase profits consistently. Single-unit franchising has an advantage over multi-unit franchising in terms of acquiring local know-how. Environmental uncertainty as a crucial factor gives single-unit franchising the edge.

This assumption leads to following hypothesis.

H5: Acquiring local know-how is more effective by single-unit franchising than by multi-unit franchising. In this case franchisees tend towards single-unit franchising. The smaller the amount of know-how of a certain place for the franchisor is, the higher is the likelihood of choosing single-unit franchising.

We have given an overview about different kinds of resources and have discussed franchising under the prospect of the resource based theory and pointed out the most important factors affecting the choice between single-unit franchising and multi-unit franchising. The next section will be about the organizational capabilities theory based theory and how it affects the ownership strategy.

3.4. Organizational Capabilities

This section discusses the organizational capabilities view that is closely related to the resource-based view. With the help of organizational capabilities, sustainable competitive advantage can be generated. Those organizational capabilities can be valuable or not and are thus not always a source for sustainable competitive advantage. This means that those capabilities are not the sole source for advantage (Collis, 1994).

There exist several definitions on organizational capabilities that can be classified into three overall categories. The first deals with the ability to conduct the most basic operations of a firm. Examples therefore are plant layout and marketing campaigns. The second category is about dynamic improvements of a firm and includes inter alia the learning process of dynamic routines. The last and third category explains that a firm is able to capture new strategies before their competitors do. This means that the organization has the capabilities to design and implement strategies earlier than their competitors. In practice those categories have to be all seen as one big category (Collis, 1994).

3.4.1. Exploration and Exploitation

Due to March (1991), the organization of a firm has to cope with two tasks. On the one hand there is the exploration of new knowledge and on the other hand the exploitation of already existing knowledge. Exploration means the search of dynamic capabilities, risk taking, flexibility, innovation and experimental activities. Exploitation denotes that given knowledge becomes enhanced, thus one is taking about capabilities in monitoring or knowledge transfer as well as efficiency. It is necessary that both factors – exploitation and exploration – are both seen as to be of same importance. This means that there have to be a kind of balance between them.

As described previously, monitoring capabilities belong to exploitation of given knowledge (March, 1991). We have also discussed that franchisors tend to use multi-unit franchising to overcome the problem of too high monitoring costs because of their higher motivation in reducing those costs compared to their single-unit counterparts (Weaven and Frazer, 2007). Another aspect that favors the use of multi-unit franchising instead of single-unit franchising in order to keep monitoring costs low and thus monitoring capabilities high concerns the replication of organizational routines and policies. Franchisees of mini-chains consequently use a similar performance system as the franchisor company-owned outlets what increases the monitoring capabilities (Bradach, 1997).

The reason why multi-unit franchisees decide to run their businesses similar to those of the franchisor is that the franchisor provides an already implemented and pretested system. Therefore the franchisees of mini-chains in the franchise system do not have to experiment with new systems and thus they do not have the need to spend money to design a new one (Bradach, 1997; Rubin, 1978).

3.4.2. Knowledge Transfer

For the creation of a governance structure it is not enough to only consider the terms of exploration and exploitation. Knowledge that exists in one store of the franchise system can be transferred to other establishments and thus, learning results in benefits. In order that such learning benefits can be generated, there has to be a certain degree in standardization (Norton, 1988a). Furthermore, these standards can be sustained if knowledge can be transferred across the units in the whole chain of the franchise system. In addition, the store managers do not only have to change them but they have to conduct business in order to permit a system-wide adaption and thus improvements. In the case that one franchisee has know-how about special issues it is still difficult to transfer it within the stores in the chain because these transactions depend on information similarity of the franchise system as a whole. If a franchisee matches the franchise concept to his local market conditions, standardization decreases and with it the operating routines, unlike to those outlets that have not adjusted their concept to the existing local market conditions (Sorenson and Sorensen, 2001). As Caves and Murphy II (1976) state, outlets within franchise arrangements do business under a special identity that is shared among all stores, no matter if it is single- or multi-unit franchising. So it is necessary that uniformity exists to maintain the brand's value. Due to Darr et al. (1995), knowledge transfer is more effective within multi-unit franchising. The reason therefore is that the mini chain includes outlets that depend on each other. Interactions like telephone calls or meetings take more often place between multi-unit stores because there is one franchisee responsible for all outlets in the mini-chain than between single-unit stores.

As discussed by Kaufmann and Dant (1996) the use of multi-unit franchising allows the whole franchise system to grow faster than with the use of single-unit franchising. As Darr et al. (1995) argue multi-unit franchisees can benefit from experiences of other outlets they have opened before. Bradach (1995) declare that multi-unit ownership is more efficient as the franchise systems starts to grow. This is because multi-units have not that much managers to coordinate than with the use of single-unit franchising, resulting in lower coordination costs. The system-wide adaptation is thus more efficient with multi-unit franchising than with single-unit franchising.

With all information about organizational capabilities in mind we derive the following hypothesis:

> *H6: The higher the degree of system-specific assets, the higher the tendency of the franchisor to choose multi-unit franchising.*

3.5. Screening Theory

One of the franchisor's most difficult tasks is to find the right partner to expand his network. Franchisees are known to act in an opportunistic way to get an advantage out of this relationship. Franchisors are willing to antagonize this behaviour and invest in monitoring their partners. It has already been discussed in the section about the transaction cost theory prior in this paper that specific investments can inhibit the franchisee to exploit the franchisor. This bonding effect is a possibility to sustain a long term relationship between the partners. However it has to be pointed out that the transaction cost theory helps to guarantee a smooth relationship after the contract has been signed. The franchisor would appreciate it if he could evaluate a possible partner before he signs the contract. Rubin (1978) is of the opinion that screening the right partner for a franchise is essential, because the franchisee needs entrepreneurial skills to run this business. This advantage would lead to less monitoring costs and less investments for ex post adoptions of the contract.

Sunk costs are a penalty to franchisees, because all of their initial investments will be lost in case the franchisor decides to terminate the contract (Dnes, 1992, 2000). So the franchisee should be sure to perform well and get the invested money back when he is applying for a franchise. The fact that the franchisee can lose a lot of money shows the franchisor that he is profit-oriented and therefore capable of running an outlet successfully. As a positive effect of that the franchisor will save on monitoring and supervision costs.

According to Dnes (2000) partners with higher investments, in this case multi-unit franchisees should be the one to choose. If the franchisor has to make a decision between a single-unit franchisee and a multi-unit franchisee, he should always sign the multi-unit franchise contract. The screening theory can be further applied on the different kinds of multi-unit franchisees. On the one hand there is the area developed multi-unit franchisees and on the other hand the sequential multi-unit franchisees. Area developers have to undertake higher investments at once and have more pressure to make profit. They should be the preferred partners according to the screening theory.

The screening theory is the driver for the following hypothesis.

> *H7: Specific investments by the franchisee can be used as a screening tool. Franchisors tend to multi-unit franchisees, because the higher the specific investments are, the higher is the possibility of signing a competent partner with high entrepreneurial skills.*

So far we have discussed transactions cost theory, agency theory, screening theory, organizational capabilities view and the resource scarcity theory. The next theory in our diploma thesis is about the property rights theory.

3.6. Property Rights Theory

The property rights theory explains that the ownership structure of firms depends on the contractibility of intangible assets. The owner of the asset, however, has the right to prohibit its use for other persons (Hart and Moore, 1990). In more detail and in the case of franchising, the ownership structure depends on the contractibility of system specific assets of the franchisor and the local market assets of the franchisee. Ownership rights are thus divided according to the importance of intangible assets. If the intangible assets of the franchisor denote more impact on the creation of residual income than those of the franchisee, the franchisor should possess more ownership rights than the franchisee. Correspondingly, more company-owned stores should exist (Windsperger and Dant, 2006).

Within transaction costs the property rights theory helps to allocate resources in the right way (Demsetz, 1966). Therefore complete contracts cannot be drafted because complete contracts include all possible outcomes of future circumstances. This is the reason why only few contracts are complete because it is too time- and cost-consuming to specify all possible outcomes in the contract. As a result, there are some uncertainties of residual rights that are not written down in the contract (Hadfield, 1990).

As the property rights theory is about allocating ownership rights to the economic agents, the important part are the intangible assets because they cannot be codified appropriately. In franchising relationships the franchisee owns assets for generating the profit important for this relationship. The franchisor, on the contrary, offers only the design for both product and relationship, the brand name and of course organizational capital (Brynjolfsson, 1994). As those assets are aligned with the fact that they are tacit, they cannot be transferred easily between the economic agents (Grant, 1996). Thus, intangible assets are hard to codify and measure, therefore they possess low contractibility (Windsperger and Dant, 2006).

Due to Hall (1992) intangible assets contain subjective know-how of resources, skills, competencies and capabilities. According to Sorenson and Sorenson (2001) intangible assets is outlet-specific know-how concerning advertising as well as customer service, quality check, human resource management and product innovation. System specific know-how and brand name are intangible assets of the franchisor (Klein and Leffler, 1981).

Due to Hart and Moore (1990), the property rights theory depends only on intangible assets whereas tangible assets are ignored for the determination of ownership structure in franchising relationships.

Contractibility of Local Market Assets

As described before local know-how is the knowledge that is needed to run an outlet at a certain site at a certain time successfully. Local market information, financial resources and managerial capabilities are summarized under the term local market assets. The aspect of the property rights theory is that the person with the greater amount of knowledge should have greater property rights. With the help of these rights he should be able to generate higher profits by investing in intangible assets and get a high residual income (Windsperger and Dant, 2006). Local know-how can be hard to acquire by persons, who are not on site. In this case it will be difficult to conduct multi-unit franchising, because employees or shop managers of a multi-unit franchisee will usually not be as motivated as the franchisee, who is bearing the risk of investment. However multi-unit franchising could still be the strategy of choice, if local know-how is easy to transfer among the participants. If the assets are easy to transfer, the assets have characteristics of high contractibility and vice versa (Windsperger and Dant, 2006). Henceforward the impact of asset contractibility on the decision between multi-unit franchising and single-unit franchising will be discussed. If local market assets are difficult to transfer, because for instance the contractibility is low, the tendency towards multi-unit franchising is negative. The gathered know-how about the location will not be transferred to a partner. The outlet specific knowledge is necessary to be successful and can only be held at a single site.

As processed in a previous section of this paper the franchisee himself has the best requirements to fulfill this task. A multi-unit franchisee with several outlets at different spots will not be capable to get access to the local information of every outlet. In this case, he might be good at running a small amount of shops but he definitely lacks the resources to be successful at every single outlet.

Bearing this in mind we can derive following hypothesis according to the choice of franchising.

> *H8: The lower the contractibility of local market assets is, the higher is the franchisor's tendency to choose single-unit franchising.*

After we have prepared the hypothesis about the local market know-how we will move further to financial resources and how they impact the ownership strategy in franchising. Once again contractibility, the possibility to transfer assets from one person to another, has an influence on the decision making process. Franchisees can increase the growth of the network by providing money for investments. They give money to the franchisor, which can use it for example to promote the brand name of the franchise. One way to use the funded money can be to increase the speed of expansion through the franchisees' ability to raise money (Kaufmann and Dant, 1996). Using the franchisees' capital has one important advantage for the franchisor. Especially at the beginning of a franchise concept it will be difficult for the franchisor to borrow money from financial institutions like banks, because they will probably not take the high risk to invest in an unknown franchise concept, where no one knows at that point of time, if it will be successful or if it will fail. Furthermore it will be even harder to raise money from banks for intangible assets than for tangible ones. For example a bank will be more willing to lend money to build up factories and plants, which are tangible assets (Caves and Murphy II, 1976). If the customer cannot pay back the credit, the bank can take over the tangible assets and sell them to compensate costs. So investing in intangible assets is bound with risk but in case of failing the bank will not lose the whole value of the loan. On the other side if a bank would invest in intangible assets, like a brand name of a new franchise, risks are much higher for it because if the franchise concept fails to sustain, the bank will lose the full height of its lend money. It might get the rights over the brand name as a mortgage but the value of it will never compensate the invested money. Instead of asking the bank for money, the franchisor can raise capital from franchisees even at the beginning at the life cycle of the franchise. Franchisees might be better to evaluate the risks for funding the franchisor because of their entrepreneurial skills and the great knowledge of local market assets. Financial assets are basically influenced by the contractibility of local market assets on the ownership structure (Windsperger and Dant, 2006). If the contractibility of local market assets is high, the franchisor will not choose multi-unit franchising but prefer single-unit franchising. This yields our following hypothesis.

> *H9: The higher the contractibility of local market assets is, the lower are the effects of financial assets scarcity on the franchisor to choose multi-unit franchising for his expanding strategy.*

Contractibility of System-specific Assets

System specific assets are characterized to be hold by the franchisor. They are called to be intangible assets (Klein and Leffler, 1981) and are thus not easy to transfer between participants due to the problem of contractibility (Windsperger and Dant, 2006). According to Kacker (1988) know-how about the right choice of location for a new store, the appropriate layout of the new stores, new product developments also belong to this category of assets. As the contractibility of system specific assets is quite difficult the franchisor has to train the franchisee in a way that the franchisee can internalize this know-how.

Du to Simonin (1999), face-to-face meetings or telephone calls are essential if the non-contractibility and thus the intangible part of knowledge assets is high so that the franchisees can internalize the factors necessary to constitute residual income.

In the case that the franchisee lowers the quality of goods or services that are components of the franchise contract and thus, the franchise relationship, to achieve higher profits at his own store, the intangible assets of the franchisor experience negative expectations of customers. On the one hand the franchisee can denote higher profits with the decreased quality but on the other hand this attitude lowers the net returns of the whole chain. Further, customers feel disappointed of the low quality of the specific outlet and transfer their negative feelings to the other stores in the chain. Intangible system specific assets are often problematic for the franchisor. This is the case if the maximization of returns depends on investments in local intangible assets undertaken by the franchisee (Caves and Murphy II, 1976). Hall (1993) explains that intangible assets and thus, non-contractible ones, are the major source of competitive advantage. The reason therefore is that they are hard to imitate.

If we keep the property rights theory and especially the contractibility of system-specific know-how of the franchisor in mind, we want to find out whether it is advantageous for the franchisor to choose multi-unit franchising if the contractibility of those assets are high. Therefore we derive the following hypothesis:

> *H10: The higher the contractibility of system-specific assets, the lower is the tendency of the franchisor to choose multi-unit franchising.*

4. Comparative Case Analysis

After the theoretical part of our paper, the second part deals with two case studies, one about the Coffeeshop Company and the other one about the Testa Rossa Caffèbar, which are both Austrian franchise systems.

First of all we will introduce these companies and provide a brief overview about the history of the systems and how they developed over time to well-established franchisors in the gastronomy industry. We will test both systems towards the hypotheses we did previously and evaluate, if theory and real world results are common. Otherwise we will point out the differences between them, analyse them and try to find an explanation why the results don't match.

So we use the case study to provide empirical evidence for the pre-set hypotheses. In the literature this method is common to verify theories and it is also an appropriated way to research themes and topics, which have not been tested by other economists so far (Eisenhardt, 1989b). Many researchers are content with single case studies, because they can provide rich and detailed information to verify results (Yin, 2003). However we will go one step further and discuss not only one but two case studies. In our opinion applying hypothesises on two companies can give more exact results than doing it with only one firm.

It has also been considered to build theory from the information gathered from the case studies as Eisenhardt and Graebner (2007) have suggested it. But the coherent challenges and also the possibility to draw wrong conclusions from the case studies have affirmed us to stay with the traditional way of conducting a case study and not to use the inverted direction.

We use the method of pattern matching for our case study analysis. When pattern matching is applied, an empirical pattern is compared with a predicted one (Tellis, 1997). When the predicted and empirical patterns are equal, the theory is valid.

Even though there is also much resistance in literature against case studies, for example a major reason is that one single case study might struggle to provide scientific generalization (Yin, 2003), we are convinced to get meaningful findings to support our theory about the choice of single-unit franchising or multi-unit franchising.

4.1. Research Design

We have chosen the Coffeeshop Company and Testa Rossa Caffèbar for several reasons for our case study. First of all we wanted to take Austrian based companies, because studies about franchise systems in Austria are rare in recent literature. Furthermore we had to make sure to get as much support as possible from the franchisors' side. Both companies have their headquarters in Austria and their great support helped us a lot to do research and write this paper. Besides, it was in our mind to select two firms, who are doing their business in the same industry sector. There are many franchise systems in gastronomy, which lead us to the decision to focus only on the coffee selling industry in which both are operating.

Both companies have a great market share, operate single-unit and multi-unit franchising strategies and have also expanded successfully outside of Austria. In our opinion Coffeeshop Company and Testa Rossa Caffèbar provide us the best insights for the case studies among a wide range of franchise systems in Austria.

According to Stake (1995) collecting data for the case study is essential. Interviews, documents, archival records and direct observation enhance valuable information for the researcher. Having a high variety of data collecting tools enrich the gathered information and guarantee better results than relying only on a single research method. Considering the Coffeeshop Company we have especially focused on in depth interviews with the director of franchising and the director of marketing. They could both give us detailed insights of the expansion strategy they are pursuing. The interviews were semi structured. In the case of Testa Rossa Caffèbar we conduct interviews with the project and expansion manager. A guideline helped to lead the interview into the right direction but the interviewed persons were explaining the situation from their point of view. The length of the interviews was approximately between 60 and 120 minutes. They were held in English and German. The German part has been translated into English. Both interviews are attached at this paper and can be found at the section of the appendix. The interview with the director of franchising of the Coffeeshop Company and the project and expansion manager of Testa Rossa Caffèbar is to find in the appendix. The director of franchising could deliver much information about the ownership strategy of the Coffeeshop Company. He explained us how the Coffeeshop Company was dealing with multi-unit franchising and single-unit franchising and we were able to apply his answers on our theory. It was very interesting to interview an experienced person as he was because he had already been working for other franchisors like McDonald's, Burger King and Pizza Hut too.

As the project and expansion manager of Testa Rossa Caffèbar is daily involved in decisions in franchising relationships he could give us many insights about their franchise strategy and explained how they choose their franchise strategy.

Except of the interview we collected data from the homepage of the companies. Furthermore we were emailing with each other and we were phoning to clear some unsolved details. This broad range of data collecting gave us a huge opportunity to gather information to conduct the case studies.

4.2. Coffeeshop Company

In the first part of our diploma thesis we have discussed theories relevant to our goal of finding out whether it is advantageous for the franchisor to use single- or multi-unit franchise agreements. All derived hypotheses in theory will now be tested on the basis of case studies. The first case study is about the Coffeeshop Company and the second one deals with Testa Rossa Caffèbar. Both franchise systems are well established in Austria and also have their roots in this country.

History

Coffeeshop Company was founded in 1999 and is part of the Schärf group, a family business, which has almost 60 years of experience in creating large scale coffee machines for gastronomy and being a pioneer in espresso machine technology. It also produced and roasted coffee to sell it to customers. Its headquarters is in the east of Austria, Neusiedl/Burgenland. The first coffeeshop was opened in the heart of Vienna. The basic idea was to develop a new way of selling coffee in Vienna by creating a symbiosis of the idea of American coffeeshops and the tradition and quality of the Viennese coffeehouse culture. The cornerstone of the Coffeeshop Company has always been to create a one-stop shop with ingredients and techniques all provided by the Coffeeshop Company. The overwhelming success of the first Coffeeshop gave the Coffeeshop Company support to continue open further stores. In 1999 the Schärf group realized that selling coffee was far more successful than only producing it.

A year later in 2000 Coffeeshop Company could already gain the American shipping line “Carnival Cruise Line” as a partner for their concept and open Coffeeshop Company corners inside of the ships.

In 2002 the Coffeeshop Company started to roll out to Germany too. At this time six coffeeshops were in Austria and Germany together. Eleven corner shops were in the “Carnival Cruise Line” ships at this moment.

In 2003 the expansion in Austria and Germany further continued and Coffeeshop Company opened another seventeen stores. Coffeeshop Company spread out to Eastern Europe and the Arabian market in 2004. High growth potential in the Eastern

Europe area accelerated the growth of the franchise network. In 2006 Coffeeshop Company already had over one hundred outlets in Austria, Poland, Slovakia, Czech Republic and Hungary. Two years later, in 2008, the franchisor was responsible for more than 180 shops in the previously mentioned countries plus Russia. Nowadays the Coffeeshop Company has outlets in the following countries.

Figure 1: Number of outlets according to countries

country and number of outlets		**country and number of outlets**	
Austria	**34**	Turkey	**3**
Germany	**70**	Egypt	**4**
Hungary	**10**	USA	**38**
Czech Republic	**6**	Russia	**7**
Slovakia	**9**	Croatia	**2**
Poland	**9**	Macedonia	**2**

Source: www.coffeeshopcompany.com, call date: 14.09.2009

Strategy of Expansion

In June 2009, the Coffeeshop Company had 194 outlets in 12 countries. Readers may ask what the concept or strategy was to be able to tell such a successful story about a franchise.

The director of franchising answered:

> *"Because when we started in 1999 nobody had a clue how it would come. So the problem with concepts when they develop is that most of the concept owners telling you that everything was a big plan. In most of the concepts I know is that this is not true. Most of the entrepreneurial businessmen start because they think "wow that's great and they like to play with it before they realize that this is something you can roll out for thousands of units. If you have 30000 units and you look back, for the outside world everybody thinks "what strategic plan must be behind that". But there is not so much of a strategic plan at the very beginning. The very*

beginning is just try & error. Try a new concept, new equipment, new stuff and people and work with that and suddenly the demand of people, the demand of the customers say "hey why don't you have this unit in, Los Angeles or New York." Afterwards you start to roll out. The same with Starbucks. Nobody considered Starbucks as something, which will develop throughout the world because nobody had coffee before. It kind of developed itself over a couple of years because people had the right consideration and how it shows actually it took a while until he came to the point that he can develop Starbucks, because before that he was pretty much a specialist in brewing coffee of a small group of people somewhere in Seattle."

So at the very beginning the Coffeeshop Company didn't have any concept to roll out all over the world. It was more of a coincidence, that the parent company already had the know-how of brewing excellent coffee and that the management decided to open an own store to sell this coffee. However after the launch of the very profitable outlet, the company started to franchise its concept with single-unit franchising at the beginning. The director of franchising stated:

"Coffeeshop Company started its expansion with focusing on single unit franchising. That was pretty easy and no big challenge. The challenge is controlling individuals, which is sometimes not as easy. Individuals have their individual approach to everything. So as we grow rather fast we came to the point to consider multi-unit franchising or Master franchisees or developing franchisees in some areas, because it is faster and something you should never forget is money is always implicated so you get the money now even though the effort you have to bring in comes later."

To increase the speed of network growth, the Coffeeshop Company decided to conduct multi-unit franchising. Especially in faraway markets with a different culture, like Russia and Saudi Arabia, they used area development franchising to guarantee controlled growth with financially strong partners. Markets similar to Austria, for example Germany, were penetrated by sequential multi-unit franchising, because the close location and similar culture was a lower hurdle to expand in such countries.

Franchise Model of Coffeeshop Company

The Coffeeshop Company has a wide variety of ownership structure. First of all it has company owned outlets. It has five of them. Most of their franchised shops are done by single-unit franchising. However multi-unit franchising has become attractive to it too and is a common way to sign partners nowadays.

Entrance Fee

If a franchisee wants to become a partner of the Coffeeshop Company, he has to pass an interrogation about his intention, plans and reasons for applying as a franchisee. This personal interview with the management is crucial, because it finally helps to decide to sign the contract or not.

In the case that the future partner has the capabilities to open an outlet, he has to pay an entrance fee of 25000 Euro. However this is not the sum of the whole investment. Additionally he has to supply 35000 Euro cash at the beginning, which are 30% of the sum of investments. The other 70% can be financed by banks or other institutions. Earlier the franchisor used to support the franchisee with a kind of leasing model, which is not done anymore. But due to the actual financial crisis franchisees suffer to get money from banks. Therefore the Coffeeshop Company recommends the partners to provide 100% of the whole investment at once without taking a loan.

Kinds of Outlet

The franchisee usually needs 200,000 to 300,000 Euro to build up one outlet. This is depending on the size and of the location.

Coffeeshop Company offers three different models of outlets.

The so called “Lounge” concept has a size of about 120 to 200 square meters. Every “Lounge” has employees responsible for the service. The “Lounge” sells all kind of listed products of the Coffeeshop Company.

The “Classic” concept has a size of 40 to 100 square meters and it is based on a self-service principle. The “Classic” offers the full range of products and is often used in town, where rents are tendentially high.

The third model is named “Base” and it is mostly used for shop in shop solutions. The size is between 20 and 30 square meters. The customer can only order to go and there are also just selected products of the Coffeeshop Company.

The Coffeeshop Company is responsible to arrange all the interior and necessary equipment. The rent for the location has to be paid extra to the hirer.

Royalties

Coffeeshop Company charges its franchisees a royalty, which is very common in franchises. The height of the royalty is 5% of the franchisee's net revenue and another 1% of the net revenue for marketing purpose.

Even though it can differ from time to time, the runtime of a contract is between 5 and 15 years. After this period of time there is the possibility to refresh the relationship, which will be decided on the performance and willingness. If a partner becomes a master franchisee, the runtime of the contract can be even longer. This will be negotiated differently from case to case.

Training of Franchisees

First of all every franchisee of the Coffeeshop Company has to come to the headquarters in Neusiedl/Burgenland. There they get a main introduction which takes about 3 to 5 days. For master franchisees it can take even longer to prepare them. Franchisees have to know everything about the used technique, the coffee itself, the service, the marketing tools, the shopping of ingredients, logistics, controlling and much more. Furthermore this is a good possibility to meet the partners face to face and get to know the attachment figures.

The basic training is only done once, but afterwards every franchisee gets a permanent contact, which supervises him and helps whenever needed at the outlet itself.

Quality-Check

Guaranteeing high quality standards is a key factor of the success. Coffeeshop Company uses mystery shoppers, which are professionals, to check every outlet and report to the headquarters. After the test purchase, the franchisor and the franchisee can discuss about possible issues and sort them out.

4.3. Testa Rossa Caffèbar

History

The Handelshaus Wedl is situated in Mils, Tyrol, Austria and was founded in the year 1904. The company finds itself among the top 10 largest restaurant and catering wholesalers that are privately owned and denote about 340 million euros per year (2004). The Handelshaus Wedl established Testa Rossa Caffé as a subsidiary. The company operates as a wholesaler in the hotel and gastronomy domain and focuses also on C+C markets. Furthermore, the Handelshaus Wedl has also its own companies beyond Austrian boundaries – in Germany, Italy and Hungary. The director of the company Handelshaus Wedl is councilor of commerce Mr. Leopold Wedl who has managed the company since 40 years and also helped to develop the franchise concept of Testa Rossa caffèbar.

Coffee always played an important part of the Handelshaus Weld tradition. The company roasts Vienna coffee blends since about 100 years and extended his sortiment with Testa Rossa caffè what was the first espresso in the product range. With the acquisition of the Procaffè roasting plant in Belluno, Italy, the coffee product range has been enlarged with certain Italian coffee brands: Caffè Bristot, Caffè Breda and Caffé Deorsola. The acquired roasting plant Procaffè is one of the most modern and high-powered roasting plant of Northern Italy and exports its products to 40 countries worldwide.

Testa Rossa Caffè

Testa Rossa Caffè was created in 1994 and is an Italian espresso brand that has a typical velvety flavor due to the blend of five high-quality Arabica highland coffees. Testa Rossa Caffè is the own brand of the Austrian company Handelshaus Wedl and denotes high international success. The brand rights are thus internationally registered and protected in a several categories of goods and services.

The Franchise Concept

Due to the great success of Testa Rossa caffè and the ongoing trend towards coffee bars, the company decided to create an Italian franchise concept, the Testa Rossa caffèbar. The franchise concept has been tested and improved over several years in the firm's own stores. As the concept was complete developed they offered their first licenses. The franchise concept now provides several types of outlets so that different locations and profile requirements become satisfied. The headquarters of Testa Rossa caffèbar franchise system is situated in Innsbruck. At this place the administration and development of the franchise system is conducted and furthermore, marketing patterns and projects for international expansion are attended. In Innsbruck's shopping centre, the first Testa Rossa caffèbar was established in December 1999.

Until now, Testa Rossa Caffé has several outlets in ten different countries. Figure 1 represents those countries in which Testa Rossa Caffè is already situated, including the number of outlets existing in those countries. Currently, the franchise systems offers locations for the franchise system in Austria (3 stores) and in Germany (5 stores) and is looking for further locations in different countries, especially Germany.

> *"If a potential franchisee or an already existing one has own ideas for a new location for a franchise outlet, then he has to fill out our requirement profile for locations. This checklist gives information about the location itself, the surface of the area, the layout, technical conditions like water-connections and things like that. We offer locations to our franchisees when we think that this is a good one. So, locations are offered by us but there is also the possibility that the franchisee can say that he wants an outlet at a specific place. This means that a franchisee comes to me and proposes a location. When I think that a location for an outlet is good and an already existing franchisee of our franchise system says that he doesn't want it, then he can refuse it. But this situation never happened by now and in general, the franchisee looks for their locations on their own. For us it is important that the franchise partner has a strong identification with our Testa Rossa caffèbar concept. The franchisees must work in teams and they have to work with the headquarter and the*

other franchise partners. This is why we also have a requirement profile for new franchise partners."

In general, Testa Rossa Caffèbar deals with single-unit stores but the concept of having multi-unit outlets plays even more an important part due to their growth strategy. During the in-depth interview it emerged that Testa Rossa Caffèbar sometimes understands the term of master franchising as multi-unit franchising and they do not always make differentiations. Therefore it was not that easy to find out when the interview partner talked about master franchise agreements or definitely about multi-unit franchising. So both terms merge sometimes.

Figure 2: Number of outlets according to countries

country and number of outlets		**country and number of outlets**	
Austria	**38**	UK – England	**1**
Germany	**7**	Italy	**4**
Hungary	**5**	Cyprus	**1**
Middle East	**3**	Turkey	**4**
Rumania	**1**	Egypt	**1**

Source: www.testarossacaffe.com, call date: 20.08.2009

Strategy of Expansion

In the year 1990 the company was present at the exhibition called "GAST" in Salzburg. A German man visited the exhibition stand and communicated that the coffee is so delicious that it would be a good idea to extend the idea of this coffee. Mister Wedl liked this imagination and from this point in time he wanted to create a concept for this coffee. At the very beginnings of Testa Rossa caffèbar, the business people tried to develop a concept for a bistro. In 1998, it was highlighted that this concept was to complex and to cost-intensive in order to multiply it. The reason why this bistro-concept has it negative aspects was the increased need of kitchen equipment. A bistro also offers its customers varieties of food what was not the crucial idea of the coffee-concept. But Testa Rossa still tried to set up such a local in Innsbruck. In the year 1999 the first store was opened, had about 50 square meters and was rented as a delicatessen. This event was the birth of the Testa Rossa caffèbar franchise concept.

To sum up, in 1994 the Italian espresso Testa Rossa caffè was created, in 1999 the franchise concept was developed and the first outlet was opened. Today there exist 65 outlets in Europe and overseas. The Austrian project and expansion manager reports:

> *"At the beginnings we had no idea of any concept that we can use for other countries than Austria. The Handelshaus Wedl made the coffee and we tried to use it for our franchise concept. Our first franchise partner was an employee of me and she runs the first business in Austria. This was I think about 8 years ago. It is very difficult and hard to oversee the outlets and to organize the franchising. This is too complicate for us because we are only 4 people responsible for these tasks. So, what we can do is only one thing. And we wanted to do the franchise concept."*

During the start-up time Testa Rossa caffèbar made use of single-unit franchising contracts. Although there was pretty much organizational work to do at this time, it was the most unproblematic form of franchising. After some time, Testa Rossa caffèbar also wanted to expand their concept to other countries and this is the reason why they made use of multi-unit ownerships as well as master franchising agreements. The Austrian project and expansion manager mentions:

> *"We use only master franchise agreements international. It is too expensive to check everything, this is too absurd and we don't make profits. In Austria or international, we make divisions. Saudi Arabia can be divided into United Arab Emirates and other places, Austria can be divided into Salzburg and Upper Austria. So this is no big deal."*

Entrance Fee

If a franchisee decides to use the franchise concept of Testa Rossa Caffèbar, the financial part is crucial. It depends on the size of the future store and the constructural requirements. The capital investments add up to something between 75.000 Euro and 250.000 Euro. 50.000 Euro to 80.000 Euro has to be the owner's freely availably own funds. This amount has to be free from interest and repayment claims by third parties. The rest can be financed by banks or other institutions. Credits at banks have to be hedged by 100 percent. For each single outlet an individual calculation has to be established because costs for additional constructural activities are not included, like toilets, some broker's charge or the designing of the cladding. The franchisor is unable to provide financing.

Kinds of Outlets

Testa Rossa Caffèbar provides three models of outlets that are described below.

The first store is called "Testa Rossa caffèbar" represents their classic Italian caffèbar and has a size of about 80 to 150 square meters. This store can be found in heavily frequented pedestrian areas, shopping malls and business centres as well. With this store the concept wants to attract the up-market clientele. A facade out of glass is desirable as well as a terrace and this concept offers the full range of products. So speciality coffees, alcohol-free beverage, sparkling and non-sparkling wine, grappa and Italian snacks. The investment costs add up from 100.000 Euro to 175.000 Euro.

The second model is called "Testa Rossa l'Espresso" and is an Italian stand-up coffee bar. The size is about 40 to 80 square meters and can be find at shopping malls, food courts, department stores, office centres and hotels. This kind of store does not provide the full range of foods and beverages. In this case, the investment costs are about 75.000 Euro.

"Testa Rossa 'Piccolo'" is the third concept and is also an Italian stand-up coffee bar with about 8 to 12 square meters. This model is often used in free-standing areas, shop-in-shop arrangements, hotels, department stores and also at exhibitions, events, airports and conference centres and a minimized range of foods and beverages are offered. The investment costs add up from 35.000 Euro to 50.000 Euro.

Royalties

Testa Rossa Caffèbar also charges royalties for the use of their franchise concept. Therefore the franchisee has to pay 4% of the franchisee's net revenue and further

1% of the net revenue for marketing patterns. In sum the royalties add up to 5% of the franchisee's net revenue.

If Testa Rossa Caffèbar and the potential franchisee decide to use multi-unit ownerships there can be a discussion about the royalties but in general, 5% royalties are charged every month.

Training of Franchisees

If a franchisee shows some interest in their franchise concept both, the franchisor and the franchisee conduct an interview that lasts for about two hours on average. The franchisees get introductions in a way that they understand for 100% the system of the concept. It begins with products and ends with the support of the employees. Every single franchisee has to have a good command on the art of coffee and therefore Testa Rossa Caffèbar offers trainings to become an excellent barista. Testa Rossa Caffèbar offers trainings that lasts several weeks for free. Before the franchisee starts with its own outlet he first has to work in an already established one.

Quality Check

Testa Rossa Caffébar also employs mystery shoppers. Those persons range from students to grandmothers. They visit the stores and check them up from the atmosphere to cleanliness. The results are then presented on meetings and possible negative outcomes are discussed in the plenum.

4.4. Empirical Findings

In this part we discover whether out hypotheses established in theory apply with business challenges in practice. Therefore we shortly repeat the different theories. Afterwards we introduce the answers of our interview partners of the Coffeeshop Company and Testa Rossa Caffèbar and so we will find out if theory and practice align with each other.

4.4.1. Transactions Cost Theory

According to Williamson (1975, 1985) transactions are necessary for companies to interact with each other. Therefore transaction costs have an impact on the ownership strategy of a franchise system. Especially environmental uncertainty and specific investments determine the choice between multi-unit and single-unit franchising. We will apply these factors on our case studies and evaluate the findings.

> *H1: If the level of environmental uncertainty at a location is high, the franchisor will tend to use single unit franchising.*

> *H2: Higher specific investments lead to higher bonding effects between the franchisor and the franchisee and as an effect of that multi-unit franchising is preferred in comparison to single unit franchising.*

Transactions Cost Theory – Coffeeshop Company

The hypothesis H1 could not be supported by the Coffeeshop Company. The opinions in the literature and out empirical findings do not match. Single-unit franchising is not the choice when it expands to markets with less know-how about them. Coffeeshop Company recruits multi-unit franchisee, which perform with an area developing strategy. This is exactly the opposite way then predicted in theory.

The director of franchising commented to this topic:

> *"Environmental uncertainty is something which has an influence in the way of what kind of partner do you look like or what kind of partner do you look for. In most of the area with this uncertainty, most of the people coming to you are master franchise interested partners, because I would never do individual franchising in Rumania. I would never ever do individual franchising in China, because I could not control that. So you will have there a multi-unit partner because no one will open there a single-unit in Beijing or Shanghai."*

So it is interesting to see that theory and praxis do not always match like in this case. Even though it is obvious that a single-unit franchisee can be better in using his entrepreneurial capabilities to run one outlet in an uncertain environment, the Coffeeshop Company does operate in another way, because uncertain environment, which is associated with far away locations, face further issues which outweigh the problem of environmental uncertainty. Controlling and monitoring every single franchisee in a distinct market is just too much effort and cannot be done by the Coffeeshop Company, which is a family enterprise with limitations in its resources. The management is convinced that it is more important to have a financially strong local partner, who already has market know-how and can evaluate the current situation better than the franchisor and is able to spread out over the market quickly. Issues, which might occur due the given market forces can be reported to the franchisor faster and more efficient so that both partners are able to find a solution as soon as possible. If there is only one franchisee, monitoring and controlling costs for the franchisor are smaller in comparison to many single-unit franchisees. This effect will be further discussed in this paper.

We wanted to know if specific investments influence the bonding effect and therefore the ownership strategy of the Coffeeshop Company, so that there is a strong commitment to the partner, if a franchisee invests a lot and expects to open up additional outlets in the future to decrease these investment costs. Are there bonding effects due to higher investments as Heide et al (2003) predict? Following statement was given:

> *"…as we talk about multi-unit franchising and you start as a multi-unit franchisee, the initial investment is higher, where you have a development plan, where you plan to open 10 units in the next few years. This has an influence on fees, because if you know that development is coming up, usually you negotiate fees. If you know that there is a guy, who runs 10 units in the near future, you give him a benefit, discount or whatever where you say "if you pay me this 10 units in advance as a security, I decrease the entrance fee for example". This is an element our concept includes. If there is market with a potential of 100, I can calculate 25 times 100 and a discount of 30% is your entrance cost and then you should develop your market and try to open new outlets. So high investments are a bonding, because you cannot go out easily. You have your money there and nobody takes the risk for the money. You will try to be successful, which is a bonding mechanism."*

It has been confirmed, that high financial investments are helpful to have a smooth relationship between the franchisor and the franchisee. Especially multi-unit franchisees with area developing in mind are affected by the bonding mechanism. They are the ones who have to invest high amounts from the very beginning to open many outlets in a given time frame.

Furthermore the director of franchising was of the opinion that marginal costs decline due to lower operational costs too.

> *"…you can split your operational costs, because you work with your staff and you can change your people when there is low business at this season and so on."*

Even Klein's (1995) argument that announcing premiums encourage the self-enforcing mechanism to improve the motivation of the franchisees has been approved by the Coffeeshop Company. As a premium can be seen the promise to get the approval to open further stores in the near future.

> *"If you have higher investments, your motivation to succeed is rather high because it's your money. So this is what you should get back. So it's very often the case that when somebody has an initial high investment, his 2nd approach after opening the first unit is, how can I open a 2nd unit to spread the risk and to get a higher income. If I get 1000 units a month for one outlet and I* get 2000 units for 2 outlets.*"*

To sum up, the results of the hypothesises about transaction theory are split. The Coffeeshop Company is in line with the H2 and support that specific investments are bonding. However it does not agree with H1 at all. The prediction and the observed effects did not match.

Transactions Cost Theory – Testa Rossa Caffèbar

Testa Rossa Caffèbar does not follow the proposition of using single-unit franchising if the level of environmental uncertainty is high. If Testa Rossa Caffèbar wants to expand with its franchise concept beyond Austrian borders, their choice does definitely not include single-unit franchising as theory predicts. In foreign countries Testa Rossa Caffèbar uses only master franchise agreements.

> *"In foreign countries we are quite passive. This means that people come to me and ask if we can open a store together but it is not my task to look for locations abroad. For example let's talk about Orlando. There was a person who asks me "what's about outlets in Orlando? I would like to do this" This is now years ago. We thought that the know-how is in the hands of the franchisee. We asked about the situations in the country, is it the right country, the right moment? All this things are tested but not by us but by the franchisee. Of course environmental uncertainty is very important and we must think about it. All of our franchisees in foreign countries have master franchising arrangements. It is too uncertain to set up a single store with a single franchisee in a not well-known country. It is impossible to control everything so far away!"*

This section shows that theory and practice do not always align as it is the case within transactions cost theory. As Campell et al (2007) argued in uncertain countries one need to have a big pool for special local market know-how. Further discussions of the author lead to the assumption that multi-unit franchisees are not able to meet the necessary requirements. A single unit franchisee can use his market know-how to successfully run one single store, giving all his concentration to it. Although those statements sound logic Testa Rossa Caffèbar operates in the contrary way. The geographical distance (Fladmoe-Linquist and Jacque, 1995) plays an important role for this decision. To monitor every single store beyond Austrian borders is still too time- and cost- consuming because the Austrian franchisor does not have enough know-how about the market characteristics abroad. In this case it is useful for Testa Rossa Caffèbar to send out a master franchise partner who thus acts as a franchisor in the foreign country. The master partner possesses the necessary market know-how and can thus recruit other franchisees more effective than the Austrian partner can do.

> *"If the situation in the foreign country changes the master partner has to report the uncertainties to us. We try to develop some new strategies for the franchise concept in this country together, discuss them. In Egypt for instance we made adaptations concerning the furniture. There we use furniture out of rattan for instance. This is important because the foreign customers appreciate this. For them it is more comfortable. In Austria we*

will not take rattan furniture. We do not like to change our original concept, but sometimes it is better for us and for the franchisees, so that both can make profit. I would never allow a single person to open up a single store in Egypt, this is too insecure and further I cannot control his business every day. So, there is no further discussion, master franchising in foreign countries is a must!"

The second hypothesis deals with specific investments and states that the higher those costs are the more the franchisor tends to use multi-unit franchising. The findings are that the bonding mechanism exists not just in theory but also in practices.

"For instance, we have a business plan that tells that the franchisee has to open up 4 outlets per year over a time period of 5 years. If he runs in 5 years 20 outlets than he has fulfilled the business plan and everything is okay. But the deal is made at the beginning and therefore we offer the franchisee better conditions. If you can open 20 stores in 5 years then the startup fee is just let's say 10.000 € and he can ask for 20.000 € of his sub-franchisees. For instance. There's a framework contract right from the start. We have certain assurance that the franchisee opens up some outlets for us, we have less to do but we also receive less entrance fees. To say the truth, it is a win-win-position, for both of us. You are right, high investments are a bonding effect because you have a lot of money invested that you will not lose. So the franchisee has to do everything to fulfill the business plan and this can be seen as the bonding effect, yes."

Although it is interesting that the bonding effect still exists in practices, it is not definitely the case that the franchisor tends to use multi-unit franchising by high specific investment costs. Heide and Wathne (2003) state that with increasing specific investments the bonding effect strengthens what means that franchisor and franchisee act in a positive way and their actions does not harm the other partner in the franchise relationship.

Moreover the findings of the interview with the contact partner Mr. Potzinger of Testa Rossa Caffèbar result in a bonding effect as soon as a franchise relationship is created. Also the people who run a single unit do have bonding effects and as their investments are also specific ones, because they cannot use them in another business, the bonding effect also occurs with single unit franchising and not only by multi-unit franchisees. Concerning this topic, Mr. Potzinger commented in the following way:

> *"It can be the case that we are the main lessee or the owner of some real estate. If the franchisee decides to invest in furniture and so on, then he has some pressure because it is not his own store. It's just the furniture that belongs to him but not the local. This means that the franchisee is much more motivated to keep the outlet alive. Because if we decide to kick him out and say, ok, take your things because we want another franchisee than he has a very huge damage and loss and that is not good. Exactly these franchisees are very easy to control and so good for us, the franchisor."*

So, the second hypothesis is not definitely confirmed, but to some extent. Due to Mr. Potzinger, it is not that easy to just see whether he deals with a single- or multi-unit franchisee. The personal part – attitudes of the franchisees – is of most importance.

> *"It is a very complicated topic and you can just be successful in gastronomy if you do it because your heart tells you to do it and not because of the money you have or you will earn."*

To sum up the tested hypotheses are not exactly the same in theory than in real franchising life. The first proposition says that high environmental uncertainty at a special location leads to the use of single unit franchising. Testa Rossa Caffèbar does not agree with this statement, because they use at locations where environmental uncertainty is high – beyond Austrian borders – master franchise agreements and do not think about single- or multi-unit franchising. According to the second proposition that tells that higher specific investments lead to higher bonding effects between both franchise partners and therefore the use of multi-unit franchise agreements are preferred. With this statement Testa Rossa Caffèbar does not agree at all but partly. Also with single unit franchise partners bonding effects can occur. This is the case if the franchisor is the main lessee of the location. In this case the franchisee is more motivated to run his business and try to make profit, because when the franchisor wants to kick him out of business, he has the loss with all equipment invested. With a multi-unit franchisee the franchisor receives lower entrance fees but has the assurance that the franchisee opens up a pre-specified number of outlets in a certain area during a pre-specified time period. Of course the franchisee tries to fulfill his business plan because otherwise the franchisor has to take the necessary consequences. Due to Testa Rossa Caffèbar, in both cases the bonding effects arise and occur as soon as there is a franchise relationship.

4.4.2. Agency Theory

Due to Norton (1988a) monitoring is a crucial factor in agency theory and varies with cultural or geographical distance (Fladmoe-Linquist and Jacque, 1995). Also free-riding and shirking are terms included in the agency theory (Rubin, 1978). According to the theoretical explanation of agency theory in the first part of this thesis, the following hypothesis is tested with both Austrian franchise firms.

> *H3: The higher the behavioral uncertainty due to shirking and free riding is, the higher is the franchisors tendency to choose multi-unit franchising.*

Agency Theory – Coffeeshop Company

One of the responds regarding the issue with free-riding and shirking was:

> *"When you have individual partners in the same area you usually have higher sales for the brand than having one partner running more units. I know that very good because as I said I started at McDonald's and came to Burger King where we had a different approach to this topic, because this free riding can be negative of course but also positive. When a partner in the same local area, let's assume one in the 7th district and one in the 8th district and they compete against each other and they always do, they can compete on a positive element as well. Kind of who is doing better. Who is doing better on the service, on the promotion, on the best mystery shops, in doing whatever. If you put that into the franchisees' mind, you get higher sales than with a multi-unit franchisee who has 4 units, which are controlled by the master model of the franchisee. When the franchisee is kind of reluctant then you have 4 reluctant units with 4*

reluctant shop managers. They do whatever is necessary for the system but they will not do what is necessary for the sales."

It is very interesting to know that free riding can have positive externalities too. In literature only the bad case of free riding is highlighted. Free riding by exploiting the brand name does not seem to be a big problem because monitoring the partners scotches this issue.

So we can conclude that monitoring costs definitely influence the decision of going multi-unit or single-unit. The director of franchising highlighted the importance of it with following statement:

"When the partner is far away, it doesn't matter if the partner is in Tyrol or in Russia, then you try to build him up as an organization and you consult an organization. So you do visit the owner or the marketing boss or the operational guy there and you do the meeting with them. You don't have to visit 55 units and then talk. So this reduces the cost a bit and you cannot do a day to day monitoring in Cairo. You have to have certain dates, in our case this is mostly quarterly, so that we go there or have particular training days in periods where we say that we will come over there and train the stuff, shop managers or whatever for this period of time. You are right. The monitoring cost is something which influences the decision on doing single-unit franchising or multi-unit franchising."

According to the Coffeeshop Company multi-unit franchising gives an edge in controlling monitoring costs. It is important to keep the costs low. Consulting single-unit franchisees is time consuming and challenging. It needs much more of resources to meet every single-unit store and talk about the same issues again and again. On the other hand dealing with multi-unit franchisee gives a boost in efficiency. Big partners are seen as companies themselves and are only consulted by the Coffeeshop Company. If monitoring costs would be considered alone for the decision of the ownership strategy, multi-unit franchising would be the choice for expanding the network.

But there has also been pointed out a problem, which can occur with consulting big and powerful multi-unit franchisees. The bigger they get, the more powerful they get.

Negotiating about fundamental changes in a contract can be very difficult, because the franchisees know that they generate a lot of profit for the franchisor and therefore they want to go their own way. When this happens, the advantage of having low monitoring costs can fade away, because negotiating and monitoring someone with great power is more difficult than telling a single-unit franchisee what to do.

A general example of the real world of this problem was provided during one of the interviews:

> *"There was the situation once when Burger King changed from Coca Cola to Pepsi because they saved 7.000.000 Dollars. Headquarters had big troubles with that. They cannot change because Burger King has Coca Cola and at the business meeting the guy said that it was about 7.000.000 Dollars and he will change as long as he doesn't get the money from the headquarters. This is the problem with multi-unit franchising. They can be very powerful. The multi-unit franchisee of this example had 120 units in Turkey. It was his own corporation and he decided to do that. "*

Once again it is crucial for the Coffeeshop Company to have the right mix and balance of multi-unit franchisees and single-unit franchisees. Both have advantages and disadvantages and it is the franchisor's duty to sort out these problems from day to day.

Agency Theory – Testa Rossa Caffèbar

Concerning this issue, the interview partner of Testa Rossa Caffèbar answered in the following way:

> *"Of course it is logic that you cannot control every single franchisee every day on day-to-day activities. The lowest monitoring costs are in western Austria because there we are present all the time anyway. So we can say in Austria we have a negative east-west-slope. In Innsbruck the level is very high because our franchisee knows that I visit him with potential new franchisees and that he has to be on-the-top and his outlet is just five minutes away from our headquarter. Salzburg is another area*

where the franchise agreement is okay. In Vienna or in Styria the monitoring becomes complicated. We must be more present and visit them more often but this leads to much more costs. For us it doesn't matter so much if we have single- or multi-unit franchisees in Austria because of monitoring. The monitoring depends on the geographical distance. We also have a kind of quality management. This means that we meet all franchisors six to seven times per year. We have mystery shopper and they visit the outlets and present the findings on those conferences. In foreign countries we do not have the question about single- or multi-unit franchising, because there we only have master franchising."

For the Austrian project and expansion manager it sounds logic, that multi-unit franchising in theory has positive aspects in this pattern, but they do not have a real strategy for that matter. They interview the potential franchise partner and then they see weather this person is the right one for this job or not or if the person wants to handle one store or more.

"The first interview takes about 2 hours, often longer. In this time I am very honest. I do not want to sell my concept at any costs for 100%. I do confront them with the hard reality. Gastronome is not Gastronome. For example I know a person who ran a hotel for years but this does not mean that he can survive in the franchise system. I was in Orlando and there I met a person who had three hotels with more than 1000 rooms. He was a super manager and we opened a Testa Rossa Caffèbar in Orlando. He never thought in his live that this will be so time consuming to establish and run such a bar efficiently, and so he failed."

As Klein (1995) argues businesses within a common brand name attracts franchisees in a way that they try to reduce costs by offering inferior quality of products. Therefore the author states that not only the free-riding franchisee denotes negative outcomes of this behavior but also the other franchise partners are affected. As theory only predicts negative effects of free-riding and shirking, the interview partner of Testa Rossa Caffèbar gave some statements for this topic with adding some positive results.

> *"No, it's quite the contrary. The people that are good watch out for those that are not so good. They say 'oops, he is not so good, there has to be done something'. So it is more the other way round with free-riding and these things. But we try that the outlets are not so close to each other, this would not be good for the franchise outlets. Free-riding is a good thing in our concept, because the good ones watch out for the bad ones and they say they should do business better because otherwise they damage their good reputation. In general we don't have negative aspects with this. As you want to know the difference between multi and single unit franchising, we do not significantly take care of this problem, because it can arise everywhere."*

To sum up, for Testa Rossa Caffèbar it is not crucial to use a single- or multi-unit strategy due to agency theory. They listen to the potential franchisee and if he is of the opinion he can run more than one business, and the responsible persons of the franchise system agree, than he becomes a multi-unit owner. It is also a possible solution to use sequential franchising as well. There is no reason for the company to decide upon free-riding and shirking problems within agency theory which strategy to use. Moreover, this decision depends on the individual franchisee. Hence, the proposition that higher agency costs encourage the franchisor to make use of multi-unit franchising is not approved in the case of Testa Rossa Caffèbar.

4.4.3. Resource Scarcity View and Organizational Capabilities Theory

Teece et al (1997) describe competitive advantage can be achieved by having firm specific resources that cannot be imitated easily. Those resources include not only tangible resources but also intangible and are for instance secret know-how or specialized product facilities.

Due to Barney (1991), firms' resources include all of available assets in the firm like information, capabilities and know-how. If a firm can denote competitive advantage over its rivals the firm performs effective and can outperform its counterparts. Financial restrictions, local market know-how and system specific assets are crucial factors.

H4: Financial restrictions of the franchisor can be better overcome with the use of multi-unit franchising than single unit franchising.

H5: Acquiring local know-how is more effective by single unit franchising than by multi-unit franchising. In this case franchisees tend towards single unit franchising. The bigger the environmental uncertainty is, the higher is the likelihood of choosing single unit franchising.

H6: The higher the degree of system-specific assets, the higher the tendency of the franchisor to choose multi-unit franchising.

Financial Resources – Coffeeshop Company

The director of franchising made a clear statement regarding H4:

"But as a strategy this is a very risky one. I tell you out of experience that this is really risky. It makes more sense to look on the long run than on the short run, because then the franchisee cannot push you. However multi-unit franchising is very often based on a lack of funds of the franchisor. So this is absolutely true."

Financial restrictions are a common reason for the franchisor to choose multi-unit franchising for expanding his network. It is an attractive way to get money in a fast and comfort way. Coffeeshop Company tries to get financially healthy corporations as multi-unit partners to raise capital for future investments. However it is definitely not the most important factor to sign a partner with money. Entrepreneurial capabilities are as important or even more important for the franchisee. It has already been argued that entrepreneurial capabilities are necessary to run outlets in the long run. So finding partners with the right balance of financial resources and know-how to run the business is what Coffeeshop Company is aiming for. Even though this hypothesis is supported, it is not used with high priority. The reason for this might be that Coffeeshop Company is in a financial situation where it is not heavily dependent on the money of the franchisees. Financially strong partners are welcomed to guarantee growth of the network but they are not everything. Relying only on other partners would be too risky.

Financial Resources – Testa Rossa Caffèbar

As the interview partner has seen him confronted with the issue of the Resource Scarcity View Theory he totally agreed with the proposition that multi-unit franchise agreements help the franchisor to ease his financial restrictions. Therefore his statement was as follows.

> *"Yes, I would say so. It depends again if it is an own establishment or if he forward the store to sub-franchisees. The son of Mr. Schilcher is also Managing Director. Both of them have this position, but Mr. Schilcher has established his own small empire. Two outlets of the son hasn't worked that well and therefore the senior has taken the two outlets of the junior and has incorporated the two stores. They made now good profits and so loss and profit and so this cancels each other out. For outstanding persons, the name Testa Rossa Caffèbar continues. Yes, this is true."*

Although the contact person of Testa Rossa Caffèbar totally agreed with the proposition made in theory he also indicates that this is not the sole reason to agree upon a multi-unit franchise agreement. For him the most important thing is not the available money of the franchisee but rather the entrepreneurial capabilities. As he often says the money does not help to successfully run a business but instead the personal attitudes do. Of course the franchisee has to have funds but this is not a guarantee for success of the franchise concept for both partners in the long run.

Local Market Know-how – Coffeeshop Company

Even though we spend several hours of interviewing the managers of the Coffeeshop Company we could not find any supporting data for this hypothesis. Local market know-how does not influence the ownership strategy of the Coffeeshop Company in an appropriate way. This does not mean that it does not affect the management decisions for opening new outlets at all but that there is no clear line between multi-unit franchising and single-unit franchising decisions regarding to local market know-how.

It cannot be said that one or the other method is more favorable. The management had success and failure with both methods. Therefore they do not only rely on local market know-how as a crucial factor. It turned out during the interview that other factors are more important to decide between single-unit franchising and multi-unit franchising, for example monitoring costs and system specific assets.

Local Market Know-how – Testa Rossa Caffèbar

The next proposition is about the local market know-how. Therefore the interview partner was asked what kind of franchise agreement helps to effectively acquire local market know-how. As stated above theory predicts that in this case single unit franchising is preferred. Testa Rossa Caffèbar answered in the following way.

> *"No, we do not do this. We won't do this. This would be sheer madness. If we have to monitor each single outlet from our headquarter, we would fail to do so. We stay away of this in general. This means, for instance, we are not present in Switzerland and if a guy of Switzerland asks us if he is allowed to open up a store in St. Moritz then we definitely say 'no, thank you.'. At first we have to find a master partner who monitor the ongoing activities. Otherwise we would travel around the world for just single outlets. No, thank you, that's nonsense."*

Following this statement, for Testa Rossa Caffèbar it is unimaginable to open up single stores with single unit franchise agreements in foreign countries with different local market know-how. Rather they use master franchise contracts to break into a new market because in general they possess the necessary market know-how and have the guarantee that they open up several stores in a pre-specified time period based upon the franchise contract.

> *"If an, let's say, Austrian partner wants to open up a store in Switzerland, pay attention. You should not give a franchisee more rights than necessary, because otherwise you are blocking yourself. For the case if there is already a master partner in Switzerland he could say 'stop, this is all mine.' Except you make a new business plan for the Austrian partner and you say 'okay, open up 20 stores in 5 years, than it's okay, but then he has to deal with whole Switzerland and he has to fulfill the business plan. If someone wants to do this, okay, he can, but he has to fulfill the criteria of the contract. We have to wait until we find the right person."*

With just a single store beyond Austrian borders the monitoring costs would burst and Testa Rossa Caffèbar definitely wants to eliminate this situation.

System Specific Assets – Coffeeshop Company

Coffeeshop Company does support the proposition H5.

> *"This is what you do with MUF. You go there and test some new product in a few locations. From a development and innovation point of view there is the advantage of the multi-unit franchise."*

The management is eager to develop its concept on a continually basis to stay competitive in a market with many players, because coffee is sold by thousands of people. To accelerate the speed of innovation, they use multi-unit franchising to try new concepts and products. Coffeeshop Company is taking advantage of the size-development capabilities of the multi-unit franchisees because of the experience they already have in opening and running outlets.

The following statement of the director of franchising underlines the increase in exploitation capabilities compared to single-unit franchising:

> *"You need a bigger head count for single-unit franchising, because the single-unit franchisees need stronger consultancies on the field. They have to make sure that the operational business is working well and the rest can be done by the headquarters. Multi-unit franchisees are usually very capable in operations, finance and controlling so you need lesser people but higher capable."*

To sum up specific knowledge is very important for the growth and success of Coffeeshop Company. It does not only transfer the know-how and tools for brewing coffee but also the USP of it.

The Coffeeshop Company always tries to sell its USP, which is described as follow:

> *"But Vienna on the opposite with his history and everything which is behind Vienna, you know it's romantic, it's music, it's theatre, it's something you can sell to people in every part of the world and its coffeehouse tradition when in 1684, after the 2nd Turkish invasion is also a major*

selling factor out in the world, because people like that and people believe that. So we took that part stronger into our concept to sell to other countries and if you now go to Saudi Arabia, where we open this year or to Bahrain or to Kuwait or to Egypt or even to the Americans with the Carnival Cruise Line ships."

Coffeeshop Company supported the propositions about financial resources scarcity and the importance of system specific know-how but it did not support the hypothesis about local market know-how.

System Specific Assets – Testa Rossa Caffèbar

The proposition that the degree of system specific assets lead to the tendency to make use of multi-unit franchising seems to be logic for Testa Rossa Caffèbar, but in business life it is not the crucial factor to decide whether to use single- or multi-unit franchising.

„If we have to make some adjustments because we live in a world where innovations are necessary then we test this in our own stores or in single stores of some our franchisees, most of the time in Innsbruck because it is just 5 minutes away from our office. It happens that a franchisee has some new ideas, and then we talk about it in a committee that takes place about one to two times a year. But improvements or innovations are changed in new stores and not in already existing ones. I think about for instance new ground floors or things like that. Corporate Identity and Corporate Design change, but the basic attributes are okay. You have to keep up with the time, like McDonalds does."

As Testa Rossa Caffèbar is not that widespread than McDonalds or the Coffeeshop Company, the asset specificity is not such an important factor for the question of which franchise agreement to use. In the interview, indeed, Mr. Potzinger agreed with the statement made out of theory, but they do not use it active in their franchise strategy.

"The great success of Testa Rossa caffè was an indicator for us to make an Italian coffee-concept around the coffee bean. So we try to make our

customers feel to be in Italy, with great coffee, we make our concepts for those people who enjoy drinking a coffee, the great taste, the aroma and so on. And our baristas make a good job."

Although Testa Rossa Caffèbar of course has a high degree of system specific assets that constitute their franchise concept, it is not essential for the decision whether to use single- or multi-unit franchising. Maybe the reason therefore is that it is a quite young franchise concept in comparison to the other coffee-related combatants like for instance Segafredo or the Coffeeshop Company. Fact is, that since January 2009 Testa Rossa Caffèbar has become an own enterprise, the Testa Rossa Caffèbar GmbH. Before, it was integrated in the Handelshaus Wedl.

4.4.4. Screening Theory

Due to Rubin (1978) the screening theory is essential in every business. According to Dnes (1992), those persons who accept higher investments at the beginning, as it is the case with multi-unit franchising, should be preferred by the franchisor.

H7: Specific investments by the franchisee can be used as a screening tool. Franchisors tend to multi-unit franchisees, because the higher the specific investments are, the higher is the possibility of signing a competent partner with high entrepreneurial skills.

Screening Theory – Coffeeshop Company

The answer we got from the management of the Coffeeshop Company was surprising:

"…I thought like that as well when I started the business but it not always turned out to be right. There are more people with money incapable to run units than people with lesser money being capable, because whether you find investors, which is a big trouble. When you find an investor as a partner, the investor focuses on questions like "when do I get my money back? What's my return on equity? What's my return on investment? How much money can I make? How can I sell it?" These are the guys with the money. The entrepreneurial business man who comes up and has a 100000 Euros but can develop the market has been often

the right persons to choose as a partner. Because before you become big you have to become good. And becoming good has nothing to do with money. Becoming good is a personal readiness to go in there, being entrepreneurial, let the people know that I'm the greatest and then you can invest in growth. In a lot of concepts word wide, this thought of having a guy with more money means having better capabilities turned out wrong. Whether they have so much money that they force you to do things you don't want…… Lots of concepts made this mistake. They get partners in with money and not partners with passion, with the right approach to this business and with operational skills. They are good about talking about 100 units but they are lousy about talking the first 5. So making step 5 before they do step 1. Sometimes this leads to troubles. So we have not stopped but try to see that as a very crucial point for our development and do not only go for the money."

Even though the screening theory makes perfectly sense in theory the Coffeeshop Company can't recommend relying on this theory. It has proven to be wrong to expect investors with only high financial capabilities to be successful in building up franchise networks. The problem here is that the persons owning the money often do not run the outlets. They just provide the money and use shop managers to face the operational challenges. However as we already know employed persons are never as good in running shops as the owner of the money.

Coffeeshop Company definitely prefers partners with higher entrepreneurial capabilities than only having money to invest. It might feel safe for the franchisor to contract a financially healthy franchisee but it is the most important thing for the Coffeeshop Company is to be successful in the long run. It does not help to receive all the initial fees to set up at the start of a collaboration but getting low royalties for the next 5 to 15 years, which is the average time-frame of a contract between the franchisor and the franchisee. It is better to have a franchisee, who might not have all the required money at the beginning but who invests all his resources and managerial and entrepreneurial capabilities to build up a franchise network and generate lots of revenue in the long term. Coffeeshop Company has a revenue based royalty model and only high revenues of the franchisee will increase the profit of the franchisor. So having the necessary money on day one is helpful to have a smooth relationship at the start of the franchise contract but finding partners with passion to run business units, learn to use new opportunities and develop themselves. Continuity is what really counts, if the top goal is to grow a network over a long period of time. Screening theory and therefore H7 is not supported.

Screening Theory – Testa Rossa Caffèbar

As Mr. Potzinger has seen him confronted with the topic of screening theory he narrated the situation within their franchise concept as follows.

> „*Generally spoken, skills and effort has nothing to do with money. I like it more if someone has less money but instead he has a better feeling and more experience for gastronomy. It is such a delicate topic and you can just be successful in gastronomy if you do it because you want to do it, you want to satisfy your dreams and you do it not just for money. I made some experiences with persons who had lots of money, but they didn't succeed because they had no ideas of doing business in franchising and so they are not so successful. Those people are just investors. I think about McDonalds. There the situation would be another one because this franchise concept is more systematic and not that much related on individuals. For us it makes no sense to just say 'ok, you have lots of money, you can operate at multi units, you are better than the other potential franchisee who just wants to have one store.' This is nonsense."*

The responsible of Testa Rossa Caffèbar agree to those statements made in theory, because it sounds a kind of logical, but only in theory and not in practices and therefore he cannot approve it. Due to Mr. Potzinger, those persons with lots of money are often just the investors. Such persons do not run the business but they hire other persons who may have more feelings and experiences than himself. For Testa Rossa Caffèbar it is much more important to have franchisees who understand the concept and who have an emotional connection to the concept. The reason therefore is that the customers will recognize the attitudes of the franchisee in the outlet. Those attitudes result in friendliness and a comfortable atmosphere store. This is much more important than just having a franchisee with lots of money but no idea of how to serve the customers. In a franchise relationship where the franchise concept is based upon individuals it is necessary to look for persons with money indeed, but it is much more necessary to have a person with entrepreneurial capabilities. At more systematic franchise concepts the preferences may be listed in another way.

> *"For us it is quite good to receive lots of money at the beginning of our franchise relationship, but just in the short run. What is good if the rich person has to close his stores after a short time period because he cannot handle the store and the customers are dissatisfied? This is not good for the name Testa Rossa Caffèbar. You have to think about the long run, this is much much more important."*

To sum up, the proposition that specific investments made by the franchisee can be used as a screening tool is not confirmed by Testa Rossa Caffèbar. The hypothesis that franchisors prefer multi-unit franchisees due to higher investments at the beginning of the franchise relationship because the higher investments are a grant for having a competent partner with well-educated and entrepreneurial skills is definitely not supported by Testa Rossa Caffèbar.

4.4.5. Property Rights Theory

According to the property rights theory discussed in the first part of the thesis we derive the following hypotheses that have been tested with the Coffeeshop Company and Testa Rossa Caffèbar to see whether theory matches with reality or not.

> *H8: The lower the contractibility of local market assets, the higher is the franchisor's tendency to choose single unit franchising.*

> *H9: The higher the contractibility of local market assets is, the lower are the effects of financial assets scarcity on the franchisor to choose multi-unit franchising for his expanding strategy.*

> *H10: The positive effect of system specific know-how on franchisors tendency towards multi-unit franchising decreases with contractibility of assets.*

Property Rights Theory – Coffeeshop Company

As Coffeeshop Company denied the effects of local market know-how on their ownership strategy, data according the pre-set hypothesis H8 could not be gathered.

Building up a franchise is a costly project and it is difficult to fund it, especially at the beginning of it. However Coffeeshop Company is part of the Schärf group, a financially strong company, which came up with the idea of selling coffee directly to the customers via the stores by the Coffeeshop Company. Therefore it did not have as much issues with financing the network.

All the information we have filtered through the interviews do not give us enough knowledge to evaluate H9. Instead of misinterpreting and falsify the results of the Coffeeshop Company, we decided to skip this hypothesis as there is no clear answer to this issue.

Transferring system specific know-how is a very difficult task. The director of franchising described this with following answer according to H10:

> *"Every partner from all parts of the world has to come to us to understand what we stand for. How we see coffee, what's the culture of coffee houses in Vienna, how did coffee develop, how did coffee grow, where does it grow and so on. You need to develop the USP with the partner so he can sell it to the partners locally. We help him to do this at the beginning and my people are there to support him and make sure that he knows what he is selling. … So this is part of the transfer which is in the handbook of course but most of it is done personally."*

System specific assets have characteristics of low contractibility. Even though Coffeeshop Company is using a handbook as a guide to transfer system specific know-how, this is not enough at all. Training the franchisees personally is the only way to let them understand the concept and strengths of the Coffeeshop Company. The impact of low contractibility on the decision to do multi-unit franchising is obvious. The franchisor only has to teach the multi-unit franchisee to run the outlets once. The franchisee himself can transfer this new acquired knowledge to all the stores he owns and trains his shop managers and employees. The significant advantage for the franchisor is having fewer costs in transferring know-how to franchisees, especially to those which are operating in a faraway market with different culture and language. On the down side it has to be mentioned that it can happen more easily that misinterpreted system specific know-how will spread out rapidly over the outlets of a multi-unit franchisee. In this case the Coffeeshop Company has to retrain the multi-unit franchisee again.

So due to the fact that it is hard to write down the system specific know-how and transfer it that way to the partners, Coffeeshop Company takes full advantages of the multi-unit franchisees to explain their Viennese coffee concept.

Property Rights Theory – Testa Rossa Caffèbar

Concerning the results of the interview there exist several domains where contractibility is high. First of all the choice of the right location was mentioned. There exists an explicit profile for the site selection. It is important that an outlet is near to infrastructure or at easily accessible places like in shopping malls, airports or pedestrian areas.

> *"The right location for a store is not that hard to find. We have a so called location study where the most important characteristics are listed. You just have to check if everything is available, for instance, do we have waste containers, or how long are the opening hours, is there some air ventilation, storeroom and so on. If one criterion cannot be fulfilled, this is a knock-out criterion. Also the preparation of the food or drinks can be exactly written down. You can find this all in the handbook. It's an addition to the contract. We have standards concerning service, in which glass, how many, which ingredients. If the franchisee cancels the relationship he has to give me the handbook back, otherwise he incurs a penalty. He is not allowed to copy anything."*

During the whole interview it was not possible to gather any information about the first two hypotheses. As this is the empirical part of the diploma thesis we do not want to misinterpret anything of this interview in order to definitely find an answer. Therefore these two hypotheses have been canceled out. On the other side, the interview partner had a lot to say about system specific assets. As system specific assets also refer to the brand name the franchisees have to know how to deal with it. Due to

Testa Rossa Caffèbar the potential franchisee has to understand the atmosphere and the whole concept itself to represent it to the customers.

> *"Our franchisees have trainings to understand our concept. At the beginning all of them have trainings in Austria, no matter if they work later abroad or here, so that they understand to 100% what we do. The franchisee has to live our concept. This starts with products, support of employees, how to organize everything. The franchisee is obligated to learn the art of coffee, so he has to go to some barista seminar. Barista means you become an excellent coffee maker. We also organize those trainings, national and international. Later, the franchisee can train his employees on his own. So this means that this favors multi units."*

Although there exist some profiles for site selection and product preparation, what means that there exist contractibility, it is not that easy. As Testa Rossa Caffèbar is not as systematical as it is McDonalds for instance, the personal support of the franchisor plays a major part. As discussed before, the transfer of knowledge to persons abroad is very difficult and not easy to handle. As this topic is not the most important part for deciding to use a multi-unit franchise agreement it of course favors this strategy. So by part of it Testa Rossa Caffèbar aligns the contractibility of system specific assets to the choice of using multi-unit franchising.

5. Summary of Empirical Results

The case studies about the Coffeeshop Company and Testa Rossa Caffèbar has provided rich information about their ownership strategies. It was not possible to find satisfying results to all of the preset hypotheses but the positive findings definitely outweighed the negative ones. We have preset ten hypotheses in the theoretical part to test them in real life environment.

The findings of the Coffeeshop Company show that four hypothesis are compatible with those in theory. The hypotheses 8 and 9 could not be tested because the gathered data were insufficient to support or rebut them.

The evaluation of the interview with Testa Rossa Caffèbar was quite positive and gives us thus insights in their decision strategy of when they use single- or multi-unit ownership. The table below shows that one of the propositions is the same in theory and business life. Four of them do not align with those of theory. With another three hypotheses the interview partner agrees but cannot give a definitive answer. Hypothesis number 8 and 9 could not be supported because the information gathered was not sufficient so therefore we cannot provide an explicit evaluation. The following table summarizes the results of the Coffeeshop Company and Testa Rossa Caffèbar and so we found an approach of their choice of network expansion.

It is interesting to take a closer look at the results and notice that the answers regarding the hypotheses of the Coffeeshop Company and the Testa Rossa Caffèbar are very similar even though we can confirm that the major interviews with the representatives of both companies have been held separately. This clear finding strengthens the value of our outcome and encourages us in our decision to conduct two case studies to verify the results.

It is also unexpected to have just four hypotheses of the Coffeeshop Company and four hypotheses of the Testa Rossa Caffèbar affirmed, at least partly. As an effect of that surprising result we can state that there is quite a big gap between the theory, which we have gathered in multiple publications, and business life. In some cases the predictions and the findings were completely contrary.

Hypothesis 1 about the transaction cost theory could not be supported by both Austrian franchise systems. Although theory predicts that it would be better to make use of multi-unit ownership, real business life does not agree with it. If the firms see them confronted with environmental uncertainties, both firms do not agree with the statement that multi-unit franchising should be the preferred choice.

Hypothesis 2 about the specific investments is totally supported by the Coffeeshop Company and partially supported by Testa Rossa Caffèbar. On the one hand the Coffeeshop Company is of the opinion that the higher the specific investments at the beginning of the franchise relationship are, the higher is the so called bonding effect from the franchisee to the franchisor. Testa Rossa Caffèbar also states that there exist a kind of bonding effect, but cannot totally agree that this situation is stronger in cases of multi-unit ownership. They declare that such bonding effects occur as soon as a franchise relationship starts.

Hypothesis 3 is about free riding and shirking and states that multi-units should be preferred to lower the problems of agency theory. It was interesting to find out that both companies, the Coffeeshop Company as well as Testa Rossa Caffèbar gave a very similar answer to the questions asked. In their cases, free-riding is not a negative aspect of the agency theory but instead a positive one. Those franchisees that do their work best have a look on those who maybe do not care too much to the franchise system.

Hypothesis 4 analyzes the financial restrictions of the franchisor. Again, both companies agreed upon the choice that multi-unit ownership can best help the franchisor to overcome financial restrictions. Therefore also some examples of their own business life were stated.

Hypothesis 5 discussed the local market know-how and says that multi-unit ownership is better than single-unit franchising. Whereas there were no results concerning the Coffeeshop Company, Testa Rossa Caffèbar stated that multi-unit franchising is not the best choice.

Hypothesis 6 is about the system specific know-how and implicates that firms in the franchise sector should prefer multi-unit franchising over single-unit franchising. Within our interviews we could find out that this statement is true when talking about the Coffeeshop Company but is just partially supported by the Testa Rossa Caffèbar and declare they that this is not the most important factor to decide upon using single- or multi-unit franchising.

Hypothesis 7 discusses the screening effect. Literature states that those franchisees who are willed to conduct multi-unit franchising are the one that should be preferred over those who just want to run a single store. Both companies rejected this statement because good work and effort has nothing to do with money. The most important thing for them is that the franchisee understands to 100 % what they have to do and they have to transfer their business know-how in a way to the consumers that they are satisfied.

Hypothesis 8 and 9 were about the contractibility of local market assets regarding first to financial assets and second to local market know-how. During our interviews with Testa Rossa Caffèbar and the Coffeeshop Company we could not find clear statements to this topic. In order to not tamper our empirical findings we decided to leave this statement without any answer.

Hypothesis 10 states that the positive effect of system specific know-how on franchisors tendency towards multi-unit franchising decreases with the contractibility of assets. This assumption is fully supported by the Coffeeshop Company and partially supported by Testa Rossa Caffèbar.

We have given the reader an insight to two successful franchise systems in Austria and used five crucial theories to test our propositions. These were transaction cost theory, agency theory, resource based view and scarcity view, organizational capabilities view, screening theory and the property rights theory.

This paper has managerial implications and might affect managers' decisions of other franchise systems to expand their network by using multi-unit or single-unit franchising.

We are aware of the fact that, even though we had almost the same findings at both franchise systems, testing two out of over 290 possible franchises in Austria is not as significant as doing a large scale survey. Therefore we expect further research according this topic to be directed to analysis with a greater number of participants to achieve even more meaningful results and get further insights to define the use of single-unit franchising and multi-unit franchising.

Table 1: Results of Hypotheses

Hypotheses	Assumption	Theory	Practice	Support of Hypotheses	
				Coffeeshop Company	**Testa Rossa Caffèbar**
1	Environmental uncertainty	MUF will be preferred to SUF	MUF will be preferred to SUF	No	No
2	Specific Investments of franchisees	MUF will be preferred to SUF	MUF will be preferred to SUF	Yes	partly supported
3	Free riding and shirking	MUF will be preferred to SUF	MUF will not be preferred to SUF	No	No
4	Financial restrictions of franchisor	MUF will be preferred to SUF	MUF will be preferred to SUF	Yes	Yes
5	Local market know-how	MUF will not be preferred to SUF	No coherence at all	No	No
6	System specific know-how	MUF will be preferred to SUF	MUF will be preferred to SUF	Yes	No
7	Screening tool	MUF will be preferred to SUF	MUF will not be preferred to SUF	No	No
8	Non contractibility of local market assets regarding to financial assets	MUF will be preferred to SUF	No data	N/A	N/A
9	Non contractibility of local market assets regarding to local market know-how	MUF will not be preferred to SUF	No data	N/A	N/A
10	Non contractibility of specific know-how	MUF will be preferred to SUF	MUF will be preferred to SUF	Yes	partly supported

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Websites:

http://www.testarossacaffe.com/

http://www.coffeeshopcompany.com/

Appendix

Interview: Testa Rossa Caffèbar

In-depth interview with Mr. Potzinger, project and expansion manager of Testa Rossa Caffébar on the 08th of July 2009:

Project and expansion manager: The great success of Testa Rossa caffè was an indicator for us to make an Italian coffee-concept around the coffee bean. So we try to make our customers feel to be in Italy, with great coffee, we make our concepts for those people who enjoy drinking a coffee, the great taste, the aroma and so on. And our baristas make a good job.

Once we had looked for a partner via an agency. This partner has to have certain requirements. He should have know-how about gastronomy, but also from system gastronomy. He should have contacts in the countries, and equity. He should have possibilities for the import, this means, he should have experience with this in the past. So, this know-how should exist.

This master partner get some education in Austria, he should get to know the system to 100%. It starts with products and goes further to the support of the employees. He learns how to organize employees and the whole store. The master partner must have his own bureau in the host country for operation, management, planning and he should have a secretary or an assistant. It depends on how fast you will expand. And there you go with expanding.

For instance, if we have found a store in the particular country, we go there and have a look on it. The whole situation is important and the location is proofed on the suitability. If all the criteria are ok, the analysis of the location for instance, then we move further to build it up. The franchisee is told how the accommodation has to look like, which music he can play, which clothes they are allowed to wear, the whole product range. In general the whole product range is defined. That's not always so easy. In Russia for example there are problems. In Cafés there exist in principle warm food. Cafébars as you know them in Austria don't exist there. In Russia you have to offer food, otherwise the customers don't come and sit down.

We receive the layout of the floor plan. The whole store is planned and equipped in Austria. This is my task, I do all things in a container and then on the ship and then it goes to overseas. Some Austrian guy oversees all things, so we have the assurance that everything is okay. Normally, about 120% of a store are computed. This is important because when he wants to expand then he can do so because of the additional 20%. The controlling is important especially at the beginning, because we don’t want to multiply errors that occur at the beginning in the future.

Similar to this this happens also national. Master partner don’t exist in Austria, this makes the subsidiary “Jochen”.

Of course I made mistakes at the beginnings, but they have been corrected. The whole Testa Rossa Story happens in Austria. As soon as everything, the whole system, was overall okay, the franchisees could come. At the beginnings we had no idea of any concept that we can use for other countries than Austria. The Handelshaus Wedl made the coffee and we tried to use it for our franchise concept.

Our first franchise partner was an employee of me and she runs the first business in Austria. This was I think about 8 years ago. It is very difficult and hard to oversee the outlets and to organize the franchising. This is too complicate for us because we are only 4 people responsible for these tasks. So, what we can do is only one thing. And we wanted to do the franchise concept

Some time ago somebody said „wow, this idea is great in Austria“. Mr. Schilcher is master partner in Austria for Salzburg and Upper Austria. With this agreement he is responsible to open up a certain number of outlet, because ‘master” means “duty”.

For example: in the year 2009, so to say in the first year, only one to two outlets are opened. In the following year already 6-8 stores. In Istanbul are hundreds of locations. There arise about 150 shopping malls, you have to be there present.

Mister Schilcher is responsible to open in Austria four stores per year. He has established an organization himself. He can transfer this from his hotel. Mister Schilcher has taken his son to familiarize him with the topic of Testa Rossa. His son around 20 years and he is responsible for the expansion strategy. This is a huge responsibility because he has to open 4 stores per year. But this father works with him very good.

They have some further staff out of the hotel and they use them for organizing the things.

We have two possibilities. Either I go to the franchisees and offer them some locations or the other way round. This means the franchisee comes to me and presents a location. If I think that a location is good and for example Mr. Schilcher says, that he don't want it, because he already has his 4 stores, then he can decline it theoretically. But this never happens and in general the franchisees look on their own for new locations.

Of course it is better to work with already existing franchisees. If there is a location in Innsbruck, then we ask the franchisee in Innsbruck if he wants this store. So about in 20 kilometers surroundings – this is sequential franchising, right? This makes sense because here I have some assurance and I know the existing franchisee better than a new one, right? Also from the complexity its better, because an existing franchisee don't need some trainings anymore and he can transfer his know-how independently to employees.

Top quality of coffee is very very very important. The single franchisee is responsible to know everything about the art of coffee. So we offer some trainings to become an excellent coffee maker, we say barista, you know. We offer some trainings, national and international. We organize those trainings. But the franchisee trains his employees on his own. I also offer some trainings that lasts several weeks for free. The franchisee also has to work at the beginning in one of the existing stores and he gets an excellent barista training, so if he leaves to his own outlet, he can manage everything in a perfect way.

If a potential franchisee or an already existing one has own ideas for a new location for a franchise outlet, then he has to fill out our requirement profile for locations. This checklist gives information about the location itself, the surface of the area, the layout, technical conditions like water-connections and things like that. We offer locations to our franchisees when we think that this is a good one. So, locations are offered by us but there is also the possibility that the franchisee can say that he wants an outlet at a specific place. This means that a franchisee comes to me and proposes a location. When I think that a location for an outlet is good and an already existing franchisee of our franchise system says that he doesn't want it, then he can refuse it.

But this situation never happened by now and in general, the franchisee looks for their locations on their own. For us it is important that the franchise partner has a strong identification with our Testa Rossa caffèbar concept. The franchisees must work in teams and they have to work with the headquarter and the other franchise partners. This is why we also have a requirement profile for new franchise partners.

> *Interviewer: So you have no problems to find the right location for a new store?*

Project and expansion manager: The right location for a store is not that hard to find. We have a so called location study where the most important characteristics are listed. You just have to check if everything is available, for instance, do we have waste containers, or how long are the opening hours, is there some air ventilation, storeroom and so on. If one criterion cannot be fulfilled, this is a knock-out criterion. Also the preparation of the food or drinks can be exactly written down. You can find this all in the handbook. It's an addition to the contract. We have standards concerning service, in which glass, how many, which ingredients. If the franchisee cancels the relationship he has to give me the handbook back, otherwise he incurs a penalty. He is not allowed to copy anything."

> *Interviewer: Okay, wow, thanks a lot for this great introduction. It sounds to be very interesting to hear more about your franchise concept. Maybe you can move further with some history of Testa Rossa Caffébar?*

Project and expansion manager: Of course I can. So, Testarossa was an own brand of the Handelshaus Wedl. The Handelshaus Wedl sells about 15 different kinds of coffee. We blend them by our own and roast them also on our own and we sell them afterwards to gastronomy. This all begins from cheap breakfast coffee and goes further to high-quality espresso. Testa Rossa is one of the youngest brands and is also a premium brand. It costs 21,50 Euro per Kilo and this is in the upper segment. It was created in the 90er and was sold to gastronomy in western Austria. Some when in the mid 90 we were in Salzburg at the exhibition GAST and Herr Gerlicher, a guy of Germany, came to us and said "Wow, you have a great coffee, you should make more out of it". Mr. Wedl became great ears and wanted to make some concept out of the coffee. Primarily the idea had something of a bistro concept. And exactly this idea was realized in 1998, but this concept was too expensive to multiply it. It was too expensive to multiply it because you need more of kitchen equipment, you need a full equipped kitchen. We have tried this in the near of Innsbruck. In 1999 the first store in the shopping mall in Innsbruck was opened and the outlet was relatively small, about 50 square meters, at that time it was loaned as a delicatessen shop. But this was the birth of the Testa Rossa Franchise.

For example we have the Piccolo concept in bookstores or car dealerships. There are many people and we can present the brand very good. You see the name of Testa Rossa, you drink your coffee and so you have already heard the name and you will tell your friends or you will remember it again in the future.

We have another model, L'espresso. This concept means that there are up to 80 square meters, you find them in shopping malls, undergrounds, airports. You find this concept there because you just want to drink a quick coffee and then you leave. Because everything is very small, this concept lives from the quick rotations and from quantity. The lease is relatively small because of the small square meters. L'espresso offers fewer foods, more coffee and in the end more benefit. I personally like this concept, the concept "smaller than 100 square meters", because it is very important. If the outlet is bigger, you pay more for the loan and you have to cook to be able to pay the rent. But cooking is not our business.

The „Caffébar" means that there are more than 80 square meters. Here you find some place to sit down and there is also a lounge area. The product range is wider, so there is antipasti, prosciutto, in summer we offer salads. In some single stores we cook pasta, this is not the preliminary idea of our concept, but at midday we offer some small menus and if the requirements are okay and the franchisee agrees, than it is also okay for us.

So sorry, to go back to theory the first bar we have established was too modern and I was the boss. But the ice was broken soon and from that time on the whole story ran very good. In the course of my career there existed some outlets that have to be closed. If you just can show two to three cafés to potential franchisees, we had to make discussions about the equity. At the beginnings, the quantity was more important than the quality, almost every location was accepted and it lasted very long, to remove all the errors. But at least the brand and the name Testa Rossa was on the market.

Interviewer: But nowadays, Testa Rossa Caffèbar is an independent business, right?

Project and expansion manager: Yes, Mr. Petzold is responsible for international expansion, and the same is with Mr. Wedl. Since the beginning of the last year, so, since January 2009, Testa Rossa Caffèbar switched to an independent business, the so called Testa Rossa Caffèbar GmbH. Before, it was integrated in the Handelshaus Wedl.

Interviewer: Why have you chosen franchising and why have you not offered licenses for your coffee? Why have you decided to create a Caffèbar of the initial idea of Italian Coffee?

Project and expansion manager: We chose franchising due to the history of origins. We have everything what a gastronome needs and we obligate them to buy from us. Products of coffee, cups, sugar, polo-shirts, skirts, shirts, and things like that. You also have to have hot chocolate, you get them exclusively from Testa Rossa, and also other products of other marketing activities. There is the flyer, called offerta special, it's for the summer, when it is hot, then I prefer drinking cold coffee products. Viscous chocolate is to buy from the Handelshaus Wedl. I buy in bulks from the Handelshaus Wedl and I achieve them cheaper and can sell them cheaper to our franchisees. Due to the motto "together, we are strong".

We also sell our coffee to gastronomy, this means, that also the Cafè XY can buy our Testa Rossa coffee. Mr. Wedl wanted to have the white and red logo everywhere. I am of the opinion that the white and black logo is even better. So we had to discuss about it. There are guys that are of the opinion that a franchise concept is not the right thing for them because they have to pay the fees, and royalties and initial investments. So there are guys who are super gastronomes but they just want to sell our coffee in their cafés. So I can say that some persons want to copy our concept. They want to imitate us. They use dark wood for the furniture and they get the logo because they buy our coffee from the Handelshaus Wedl. Outstanding persons the think that this café is a store of Testa Rossa. So why should a franchisee pay fees and royalties if it also works without it? This was a quite bad experience for us. This was the reason why we wanted to eliminate the quality customers and we had to differ from those stores. This was the birth of our new logo, the black-white one. You can see it in the Europark in Salzburg. I like the Europark, it's a good location. If you have five times the same square logo next to another, this doesn't look good. A friend of mine is designer and he helped us to develop the new logo. We met us 4 hours and created 8 or 9 designs and we decided to take the black and white one. Some general information for you. Mr. Wedl has a house next to the Lake Garda and so he has some affinity to Italy. He loves good wine, good coffee, good prosciutto and antipasti.

Interviewer: Okay. How many outlets do you have in Austria and also all over the world? How many guys do you employ?

Project and expansion manager: In Austria we have about 30 outlets and all over the world I think something around 70. Mr. Wedl wanted to open in 5 years 1000 outlets. Last year in September we have opened the seventieth bar in Ischgl and 2 month later the hundredth. Mr. Wedl pushes this. He also counts the quality customers for example those in the Kärnterstraße here in Vienna. Mr. Wedl offers some marketing things to the customers, like sticker or tags. Mr. Wedl is now 70 years and he is going to work every time because this concept is his baby. We can say that we have about seven employees per outlet inclusive the franchisee.

Interviewer: How do you look for franchisees? With the job applicant profile which I found on your homepage only the first step is induced, right? How is the further procedure?

Project and expansion manager: Yes, you are right. At first there is the job applicant checklist. It is the first step because it involves all the relevant questions. When a person calls us then he should first check this profile to have some basis for our talk. Some persons honestly cross "no" at some questions. The second step is the interview. Often the franchisee thinks that witch 20.000 Euros everything is fine, but this is definitely not true. Some guys I do definitely ask very soon how much money they had available. We talk about the regions he is interested in. Some guys are interested in Austria as a whole, no matter where exactly. Others talk about some specific regions or present a specific location.

Also the family relationship is discussed. For me it is important to know if the franchisee works with his wife or husband, if his is responsible himself or not. I want to get to know all the persons involved in my concept.

The first interview takes about 2 hours, often longer. In this time I am very honest. I do not want to sell my concept at any costs for 100%. I do confront them with the hard reality. Gastronome is not Gastronome. For example I know a person who ran a hotel for years but this does not mean that he can survive in the franchise system. I was in Orlando and there I met a person who had three hotels with more than 1000 rooms. He was a super manager and we opened a Testa Rossa Caffèbar in Orlando. He never thought in his live that this will be so time consuming to establish and run such a bar efficiently, and so he failed.

We also have mystery shopper, from student to granny. This function is done by something else. The results are presented at one of our meetings. You present the good results and also the bad ones to show the franchisee what's good or what's wrong. Where are his strengths? Where are his weaknesses? Where is need for action? This is called quality management and there are about 6 to 7 visits per year.

After a positive talk the franchisee receives some information folder at home to think about the whole thing again. Why does he wants to choose Testa Rossa Caffè or why in general a coffee-concept? Afterwards, we arrange another meeting and diverse kinds of stores are visited. The history is illustrated, why the concept has been created, so to say we talk about things throughout the vegetable garden, don't know the word in English. The potential franchisees talk to already existing franchisees to interchange experiences. As soon as the franchisee has decided to use our concept, we go and have a look on potential locations. I check the location, if we have an external storage, is there enough place for the delivery, is it in general ok for a gastronomy shop and so on.

Another possibility is that the franchisee comes to me and says that he wants to have a special location. It is very good if the franchisee is quite flexible, because then I can put him elsewhere. The question that arise is if he can wait or if he wants to wait until a special location is available. This can be tomorrow, or just in 3 months, or in half a year. If it lasts longer than six month, the franchisee is away, in general.

Normally the location is away within a few days or weeks. The franchisee is within three to six month also away. It is important how much know how we transfer to the franchisee. It can happen that we give him lots of information and the potential franchisee run away with our information, but with not being a franchisee of us. If we give him the plan of the location and its ground floor before we both sign the contract, this can be very tricky. A long time ago, a potential franchisee took this information and has built up a store autonomous without belonging to us.

When we find a location, we invite the coffee builder. This is a general firm, that buys let's say each single store. If this company build let's say ten bars, then I can achieve some reductions in price and I don't have to tell him again and again what and how he has to do his business because he already knows what's going on. The profile for the layout of the store is an underlay for all of us. The firm that builds up the store, the franchise bureau and the customer, I mean the potential franchisee, we all discuss about the procedures. On this basis, the cost calculation is done and out of this, including the seats, we generate a turnover prediction and further more a business plan. Not later than now, the reality appears again. The store construction is very expensive. Everything has to be prepared. The lessor or the franchisor has to allocate some location. The location does not have to have holes, the walls have to be okay. I try as well as I can to transfer the costs to the lessor, because he generates profits for years because of us. If it is an old building, you have to pay attention. These are all points of experiences. You have to put everything into the contract. For example, in the so called "Edelrohbau" there is no bottom, no floor, the whole glasses are missing. Electricity and air supply has to be okay. The rest is our task. The general firm has to search a painter, a carpenter, and the one who has the right price-benefit proportion wins or the firm already knows a good supplier. It is also an option that the brother of the franchisee plays the painter or the carpenter. This is no problem. He receives the architecture handbook and a franchise handbook. We also need a plasterer or an electrician. We establish a time frame to see when who for what and why comes and we create to-do lists. We look for employees for the firm, we register them, the storage has to be organized and things like that.

Interviewer: How hard is it for you to find the right franchisee for your concept?

Project and expansion manager: Our franchisees have trainings to understand our concept. At the beginning all of them have trainings in Austria, no matter if they work later abroad or here, so that they understand to 100% what we do. The franchisee has to live our concept. This starts with products, support of employees, how to organize everything. The franchisee is obligated to learn the art of coffee, so he has to go to some barista seminar. Barista means you become an excellent coffee maker. We also organize those trainings, national and international. Later, the franchisee can train his employees on his own. So this means that this favors multi units.

Interviewer: What about foreign franchisees or new locations abroad? How do you manage this situation?

Project and expansion manager: "In foreign countries we are quite passive. This means that people come to me and ask if we can open a store together but it is not my task to look for locations abroad. For example let's talk about Orlando. There was a person who asks me "what's about outlets in Orlando? I would like to do this" This is now years ago. We thought that the know-how is in the hands of the franchisee. We asked about the situations in the country, is it the right country, the right moment? All this things are tested but not by us but by the franchisee. Of course environmental uncertainty is very important and we must think about it. All of our franchisees in foreign countries have master franchising arrangements. It is too uncertain to set up a single store with a single franchisee in a not well-known country. It is impossible to control everything so far away!"

Interviewer: Why have you chosen exactly those countries listed on your homepage like Austria, Germany, Italy, Hungary, Turkey and so on and not for example Greek?

Project and expansion manager: That is a good question. I have to say, that we are very passive when we talk about the international area. This means that they come to us and not otherwise. Here we have again the example from Orlando. We trust a lot that the know how is with the franchisee. Of course we had a look if the situation of the country is ok or if it is the right country, the right moment. This has all been considered, but more from the other side. So, the franchisees knocked at our door and we, the franchisor, have reacted.

Interviewer: The literature about franchising discusses a lot whether it is better to use single- or multi-unit franchise agreements in business life. Which kind of franchise agreement do you prefer, single or multi-unit franchising?

Project and expansion manager: In national areas we only use master franchising. The reason therefore is that it would be nonsense to care for everything, we would make loss if we do so. There has to be a contact person in the special country, this is the basic requirement.

In Austria or in the international area there we can split it up. Saudi Arabia can for example be split up into the Emirates and other districts. In Austria it's for example Salzburg and Upper Austria and both are for Mr. Schilcher. And this is good so. To answer your question, in practices we use single-unit franchising.

Interviewer: Where are the advantages and disadvantages of the diverse kinds of franchise agreements?

Project and expansion manager: At the various countries, we only use master franchising, as I told you before. I have to look if the business is like the business should be. How the franchisee makes his profits is his thing. He has a master plan and he has to deliver afterwards to me. That's it. An advantage of multi-unit is that we know each other, there is some trust between us, fewer costs. A further disadvantage is that he is not present at the store himself. The Caffèbar is very personally related and he cannot care about everything and personality disappears. If the franchisee works also in the store, this is much better for the firm because he talks with the guys in the coffee, with the guests. The customer likes it and they recognize who is the franchisee and who is an employee. Mr. Schilcher works quite autonomously, he doesn't ask everytime, he just does as he wants. This can be a problem because of the energy he gets.

Interviewer: Which kind of arrangement represents the fewest effort concerning costs or something like this, for instance trainings and so on?

Project and expansion manager: Here I can definitely say, that multi-unit franchising represents the fewest effort over the time. A disadvantage for us is that the franchise has to pay fewer royalties to Testa Rossa. Concerning monitoring costs, we have about the same efforts, no matter if we have single or multi-unit arrangements. We have mystery shopper, so he has to be good in his job. I think it doesn't matter if he has one store or more.

> *Interviewer: If you don't have very good know-how about some area, let's say in Egypt, what kind of franchise strategy do you prefer? Do you choose your strategy due to culture, tax settlements, and legal issues?*

Project and expansion manager: Areas where we do not have specialized know how are areas beyond Austrian borders. And there we only use master franchises. We do not have a kind of strategy. We visit this country and you know the cultures a little bit. We conduct interviews with franchisees, more of them, as we do in Austria, and we are present on that Market a time, like in Croatia. If one talks about a partnership, then there are several talks in the past. Mr. Wedl has a 20 meters long yacht and so he knows a lot of cultures. What can I say to political issues? Some kind of market observation is permanently existent.

We visit a country more than one time. We look together if the location is good, we analyze the competitors, the customer attitudes, other countries, other manners. For example Russia. This market in general is nothing for us, because we should adopt our business completely to achieve an authorization.

Importing issues differ from country to country, it is a very complex procedure and we find our barriers, it is very troublesome. The Handelshaus Wedl helps us with those regulations and they communicate the results to us.

> *Interviewer: Which type of franchising do you prefer due to the lowest agency-problems? I mean, where do you have the lowest monitoring costs?*

Project and expansion manager: Well, where do we have the lowest agency problems… Of course it is logic that you cannot control every single franchisee every day on day-to-day activities. The lowest monitoring costs are in western Austria because there we are present all the time anyway. So we can say in Austria we have a negative east-west-slope. In Innsbruck the level is very high because our franchisee knows that I visit him with potential new franchisees and that he has to be on-the-top and his outlet is just five minutes away from our headquarter. Salzburg is another area where the franchise agreement is okay. In Vienna or in Styria the monitoring becomes complicated. We must be more present and visit them more often but this leads to much more costs. For us it doesn't matter so much if we have single- or multi-unit franchisees in Austria because of monitoring. The monitoring depends on the geographical distance. We also have a kind of quality management. This means that we meet all franchisors six to seven times per year. We have mystery shopper and they visit the outlets and present the findings on those conferences. In foreign countries we do not have the question about single- or multi-unit franchising, because there we only have master franchising. "We use only master franchise agreements international. It is too expensive to check everything, this is too absurd and we don't make profits. In Austria or international, we make divisions. Saudi Arabia can be divided into United Arab Emirates and other places, Austria can be divided into Salzburg and Upper Austria. So this is no big deal."

If you have a look on the whole story, what do you think how many people stand behind it? There is Mr. Petzold, me, Mrs. Mitterrutzner, and another one who is responsible for the operative business. That's not perfect because we are just four persons, there should be more guys. We use the resources of the Handelshaus Wedl for bookkeeping, personal, lawyer and so on.

In Mils in Tyrol we have a location where the potential franchisee can train to work in a café. It looks like a real school, if you want to say so. A complete store has been rebuilt to make it as real as possible. Before, the guys have been trained in Munich with the help of the shop manager. A whole daily routine was practiced and in the evening there was the account. Also the coffee trainings have been there, before. This was all before there was the competence center in Mils.

A bad reputation of one store can be bad for the whole system. Bad reputation of one store means bad coffee in every store. The Europark in Salzburg is Europe's best shopping mall, because of the infrastructure.

Interviewer: Where do you think are the differences to Testa Rossa Caffèbar and Segafredo or the Coffeeshop Company? What makes you unique?

Project and expansion manager: The most important factor is the quality of the coffee and I think also the trainings. Segafredo is more lifestyle and attracts younger guys. It's something like hitparade, if you understand. Guys sometimes mix Segafredo and Testa Rossa because of the same colors and so on. Test Rossa is more with system than Segafredo. We have a certain music style. Latino, Italian, on afternoons more lounge music, southern. We work with semi-automatic machines, here we can control or adopt the end product. We celebrate coffee. If you do not have well educated guys the coffee would be at about 70% out of 100%. That's in sum quite okay. With semi-automatic machines it could be that you reach just 40%. With fully automatic machines you do not get perfect coffee but also not non-perfect coffee. With semi-automatic machines it is possible to get the 100%. This is why barista trainings are very important for us. There is also a refiner, it switches all the time. If the local is full, the weather changes, coffee is very sensible, react directly. The cycle time of the espresso changes and the coffee becomes herb. The barista has to know how the machine works. Either I chose less amount or the refining should be smoother. You have about 20 to 25 seconds for one espresso. With a full automatic machine you cannot influence this. And you need about 20% more of the coffee. We also offer coffee-to-go, because it is required nowadays.

Interviewer: What is your target group? Does this depend on the different kinds of store layouts?

Project and expansion manager: Our target group reaches from 20 years to the mid fifty. Business people, employees of commerce and draper's shops. It depends on the location. But most of all the up-market cliental. It really depends on the accommodation. In Innsbruck at the railway station it is quite curious. There is a certain inhibition for the public Testa Rossa doesn't want. And this is good for us. The atmosphere and ambience select the guys. You make your own customers. Which kind of music, the ambience. The customer knows what he can expect and he know, if he orders this and that than it would be okay. In Vienna I get the same product than in Innsbruck. Maybe you compare this with Mc Donald's.

Interviewer: Are three store models enough for Testa Rossa Caffèbar?

Project and expansion manager: Due to the international expansion we see us confronted with huge challenges and we are not averse to further adaptations. For example there is the take-away coffee. We have a better cost of sales because we have a reduced product range. Food increases this. We have about 23% of it, but restaurants much more. The more food you offer the more garbage you have and the more difficult and expensive. There is a lot of handling you have to consider.

Interviewer: Do you adopt your concept to different countries? Do you have the same standards/furniture/menus in Egypt and in Cyprus?

Project and expansion manager: Yes, as you say we adopt the concept to the different countries. For example we use rattan for our furniture in Egypt. I do not have that much fun with those adaptations. It is possible that a franchisee pays all the fees and so on, but the store doesn't look in any way as a Testa Rossa Caffèbar. And this is negative for us and the whole franchise concept.

We try to keep the standards alive, especially at the bar or the counter. Corporate Identity, Corporate Design, especially at the bar is very important for us. The rooms where the customers can take a seat are maybe really adopted, but according to Testa Rossa, but there you can see differences, yes.

Testa Rossa is very system-oriented and wants to sell it as a whole. There are different kinds of shirts or this or that, there are some crucial questions, but it is very important to keep the uniform alive, with less variance.

Interviewer: If you have to make adoptions in your concept due to changes of the market, is it easier for you to have some multi units or lots of single units?

Project and expansion manager: If we have to make some adjustments because we live in a world where innovations are necessary then we test this in our own stores or in single stores of some our franchisees, most of the time in Innsbruck because it is just 5 minutes away from our office. It happens that a franchisee has some new ideas, and then we talk about it in a committee that takes place about one to two times a year. But improvements or innovations are changed in new stores and not in already existing ones. I think about for instance new ground floors or things like that. Corporate Identity and Corporate Design change, but the basic attributes are okay. You have to keep up with the time, like McDonalds does. If the situation in the foreign country changes the master partner has to report the uncertainties to us. We try to develop some new strategies for the franchise concept in this country together, discuss them. In Egypt for instance we made adaptations concerning the furniture. There we use furniture out of rattan for instance. This is important because the foreign customers appreciate this. For them it is more comfortable. In Austria we will not take rattan furniture. We do not like to change our original concept, but sometimes it is better for us and for the franchisees, so that both can make profit. I would never allow a single person to open up a single store in Egypt, this is too insecure and further I cannot control his business every day. So, there is no further discussion, master franchising in foreign countries is a must!"

> *Interviewer: Are you of the opinion that a franchisee that agrees to conduct multi-unit franchising is the better franchisee as a person that just wants to have a single store?*

Project and expansion manager: The interview with Mr. Schilcher, you know, the guy who is responsible for Upper Austria and Salzburg, were very interesting. He decided to use our concept because he thought a lot about this topic. He had visions and goals, he wanted to open twenty stores in five years. Such a person thinks more about the concept, yes. Generally spoken, skills and effort has nothing to do with money. I like it more if someone has less money but instead he has a better feeling and more experience for gastronomy. It is such a delicate topic and you can just be successful in gastronomy if you do it because you want to do it, you want to satisfy your dreams and you do it not just for money. I made some experiences with persons who had lots of money, but they didn't succeed because they had no ideas of doing business in franchising and so they are not so successful. Those people are just investors. I think about McDonalds. There the situation would be another one because this franchise concept is more systematic and not that much related on individuals. For us it makes no sense just say 'ok, you have lots of money, you can operate at multi units, you are better than the other potential franchisee who just wants to have one store.' This is nonsense. But multi-unit franchisees guarantee to open up a specified number of stores, but he also has to pay fewer royalties and so on and he blocks the area, but Testa Rossa can intervene. The franchisees have to pay 4% of their net revenue and another 1 % for marketing. So in sum there are 5 % what the franchisee has to pay.

Interviewer: You are present in Turkey and you can split up Turkey in separate areas as you do it in Austria. Here you can split the country into the diverse provinces. Am I right?

Project and expansion manager: No, we don't do this in general. There we have a master partner and he cares about the whole Turkey. We don't have the structures there as we have them here, they are just at the beginnings and we cannot split it up into separate areas, they are not that huge so far.

Interviewer: For instance, China is quite big. What would be the case there? For a master partner this country would be too big.

Project and expansion manager: I think that this would be different there, of course. But China is not that developed so far and therefore no topic for us. This would be done individually, but we are not that far. But somewhere you have to start and if you start you have to start in a special area, you try to start your concept there and you have to develop this and will be improved and expand it internally later.

Interviewer :If you would diversify one country into different areas, would you adopt your product range or equipment to the different areas? For instance, would you offer Soup in South China but not in North China?

Project and expansion manager: Now, we could not judge this. Until now it wasn't the case so far. But I think we would do this. China is so big, of course I can imagine that we would make modifications there, but until now we don't do so, that we offer different products and things like that in different areas of one country. But in China, there are definitely lots of cultures and there we have to change our concept. But this is not tested so far.

Interviewer: In which countries do you use multi-unit franchising? In Austria you just have Mr. Schilcher in Upper Austria, right?

Project and expansion manager: No, since three weeks we have a new location in Kufstein and this is already the second of Mr. Schilcher and I give already existing franchisees new locations. This is of course usual, that franchisees have more stores. They open several stores, but not from the very beginning. If they have enough resources, then we talk about more locations with the potential franchisees, but at first we test what's going on with the first store, what's its development, and if this all is positive that we can talk about more outlets, this is of course possible. That's for both of us ideal. The only requirement is that the first store runs very good.

Interviewer: If you have a strong multi-unit franchisee and he doesn't want to realize new procedures or actions, what are you doing then? If he has lots of stores he can put pressure on you, right? So if you want to realize some changes that are not due to the law but because you want to change something because of the pressure of innovation would it be better to conduct single or multi units?

Project and expansion manager: Yes, okay, this exists everywhere, also at McDonalds. Of course there is some danger, that he puts pressure on the headquarter, but this is everywhere the case. You have to estimate this but also the benefit from this situation. We engage a lot with such franchise partners, especially because of the several locations, we meet us permanently, and the partner is a confident person and we would recognize if he goes into another direction. We work in a common sense, in principle, and we would recognize this, so we have to see that we walk the same way again.

Interviewer: Can we say that a franchisee with higher initial investments is more motivated to operate business in a good way?

Project and expansion manager: We help the franchisees with the accommodation, we take over the accommodation or the contingent liability for the accommodation. If an outlet costs all inclusive 150.000 Euro, I have never had a person – except Mr. Schilcher – who had this amount liable with single units and who said "okay, let's do it". He always has to borrow money from the bank. It can be the case that we are the main lessee or the owner of some real estate. If the franchisee decides to invest in furniture and so on, then he has some pressure because it is not his own store. It's just the furniture that belongs to him but not the local. This means that the franchisee is much more motivated to keep the outlet alive. Because if we decide to kick him out and say, ok, take your things because we want another franchisee than he has a very huge damage and loss and that is not good. Exactly these franchisees are very easy to control and so good for us, the franchisor.

> *Interviewer: In theory you find the term bonding-effect. If the franchisee invests more at the beginning, the bonding effect is higher the more he invests and the more stores he wants to open in future.*

Project and expansion manager: Yes, I would say so.

> *Interviewer: Can we say that the franchisee is bounded more to you if he operates more units, because he pays fewer fees?*

Project and expansion manager: No, this is defined at the beginning. For instance, we have a business plan that tells that the franchisee has to open up 4 outlets per year over a time period of 5 years. If he runs in 5 years 20 outlets than he has fulfilled the business plan and everything is okay. But the deal is made at the beginning and therefore we offer the franchisee better conditions. If you can open 20 stores in 5 years then the startup fee is just let's say 10.000 € and he can ask for 20.000 € of his sub-franchisees. For instance. There's a framework contract right from the start. We have certain assurance that the franchisee opens up some outlets for us, we have less to do but we also receive less entrance fees. To say the truth, it is a win-win-position, for both of us. You are right, high investments are a bonding effect because you have a lot of money invested that you will not lose. So the franchisee has to do everything to fulfill the business plan and this can be seen as the bonding effect, yes.

> *Interviewer: Literature says that higher investments can be seen as screening effects. Is it right that persons with more resources are the better franchisees? Is it true that multi-unit franchisees are the better investors?*

Project and expansion manager: It is a very complicated topic and you can just be successful in gastronomy if you do it because your heart tells you to do it and not because of the money you have or you will earn.

Interviewer: And what is about the assumption that multi-unit franchisees are the better investors?

Project and expansion manager: No, not necessarily.

Interviewer: Theory also says that environmental uncertainties change the market situation, for instance changes concerning competitors. Would it be better in this case to start with single or with multi units?

Project and expansion manager: This is an interesting question, but I cannot answer it, because I have no experience in this topic, but I think that it would be better to use single units.

Interviewer: Do you react so fast to your competitors? Earlier in the interview you said you do not have that great look on others because you are inimitable. So if persons do like Starbucks they go to Starbucks.

Project and expansion manager: Starbucks has nothing to do with our topic, this is something quite different. We are other like the others. It is hard to answer, I cannot say, I have no experience.

Interviewer: Now let's talk about monitoring costs. If you have 100 single units and 10 multi units, are the monitoring costs with multi units lower?

Project and expansion manager: Yes, definitely. It's logic. You mean for the headquarter? Yes, of course. In this case I just have to talk to 10 persons and not to 100. If ten times Mr. Schilcher has 10 outlets than I has to talk only to him and not to 100 others.

Interviewer: But the monitoring costs are not critical for you to use multi units? Has this choice nothing to do with our monitoring costs?

Project and expansion manager: So to say, no. But this question is not as important in such a small country as Austria is, because it is a manageable market. Mr. Schilcher can open in his area just a specified number of outlets. If there would be another 2-3 Mr. Schilchers, the market would be more than covered. In this case you example before, the one of China, would be more interesting. But more interesting would be big markets, there would be multi units better I think.

> *Interviewer: How easy or complicated is it to transfer system specific know-how to foreign franchisees?*

Project and expansion manager: Extremely difficult and quite troublesome, because the quality standards in the different countries are definitely not that high as here and we have made some experiences that we have defined everything but the end product was awful. We have invited architects, visited the locations together, have analyzed the locations, talked about the system, the handbook, the concept, catalogue, color definition and so on and they have built the store in a complete different way. The reason therefore? I don’t know. It would have been perfect if there would have been a permanent monitoring. There has to be a project leader who look for the first one to two locations over some weeks, in the hot phase, at the beginning and at the closure, who sees when something goes wrong. Otherwise we have a big problem, it doesn’t work. Our problem was that we didn’t have a project leader and this was the reason why the whole thing failed. The system worked after the third or fourth store, but so far there can happen so much what should not happen. We have observed it, but we weren’t present there.

> *Interviewer: If you can transfer the value of your concept to the foreign franchisee, would it be better to have multi units abroad? The expansion would be faster with multi units, right?*

Project and expansion manager: Of course, we do so. The master partner has a business plan and he has to open a specified number of outlets and the first three stores has to be own establishments that he has to handle by his own. Afterwards he can offer licenses for other franchisees. His own stores are so called demonstration stores.

> *Interviewer: Multi unit partners use a similar organization structure than the headquarter and so it is more easy to transfer know how instead within single units?*

Project and expansion manager: This should be the case, yes, exactly. This is based upon experience that we made at home. This is the goal, it doesn't work every time, but of course it is the goal.

Interviewer: Is it more easy to transfer know how to multi units than to single units?

Project and expansion manager: Sure, because it is more labor intensive. I just have to go one time to Mr. Schilcher and tell him what to do and he realized it afterwards. I support him maybe at the first one to two stores, but the rest he need no help anymore, because he already has the experience. If he then makes sub franchisee stores, I help him with it but the training takes place in his own store. So, he has the experience and he knows not just theory.

Interviewer: In order to acquire foreign know how it is more effective to use single units. The less the know how in a certain area is the more likely one uses single units. What do you say about this?

Project and expansion manager: No, we do not do this. We won't do this. This would be sheer madness. If we have to monitor each single outlet from our headquarter, we would fail to do so. We stay away of this in general. This means, for instance, we are not present in Switzerland and if a guy of Switzerland asks us if he is allowed to open up a store in St. Moritz then we definitely say 'no, thank you.'. At first we have to find a master partner who monitor the ongoing activities. Otherwise we would travel around the world for just single outlets. No, thank you, that's nonsense

Interviewer: If Mr. Schilcher has some connections to Switzerland, can he initiate this?

Project and expansion manager: If an, let's say, Austrian partner wants to open up a store in Switzerland, pay attention. You should not give a franchisee more rights than necessary, because otherwise you are blocking yourself. For the case if there is already a master partner in Switzerland he could say 'stop, this is all mine.' Except you make a new business plan for the Austrian partner and you say 'okay, open up 20 stores in 5 years, than it's okay, but then he has to deal with whole Switzerland and he has to fulfill the business plan. If someone wants to do this, okay, he can, but he has to fulfill the criteria of the contract. We have to wait until we find the right person.

> *Interviewer: Financial restrictions on the part of the franchisor are coped better with multi units instead of using single units. What is your opinion?*

Project and expansion manager: Yes, I would say so. It depends again if it is an own establishment or if he forward the store to sub-franchisees. The son of Mr. Schilcher is also Managing Director. Both of them have this position, but Mr. Schilcher has established his own small empire. Two outlets of the son hasn't worked that well and therefore the senior has taken the two outlets of the junior and has incorporated the two stores. They made now good profits and so loss and profit and so this cancels each other out. For outstanding persons, the name Testa Rossa Caffèbar continues. Yes, this is true. For us it is quite good to receive lots of money at the beginning of our franchise relationship, but just in the short run. What is good if the rich person has to close his stores after a short time period because he cannot handle the store and the customers are dissatisfied? This is not good for the name Testa Rossa Caffèbar. You have to think about the long run, this is much much more important.

> *Interviewer: Free-riding is another interesting topic. Does the existence of free-riding limits you in your expansion strategy because franchisees who free ride maybe damage the good reputation of your franchise system?*

Project and expansion manager: No, it's quite the contrary. The people that are good watch out for those that are not so good. They say 'oops, he is not so good, there has to be done something'. So it is more the other way round with free-riding and these things. But we try that the outlets are not so close to each other, this would not be good for the franchise outlets. Free-riding is a good thing in our concept, because the good ones watch out for the bad ones and they say they should do business better because otherwise they damage their good reputation. In general we don't have negative aspects with this. As you want to know the difference between multi and single unit franchising, we do not significantly take care of this problem, because it can arise everywhere.

Interview: The Coffeeshop Company I

In-depth Interview with the director of franchising on the 15th of July 2009

Director of franchising: Actually the history of my life is basically multi-unit development. I started at McDonald's, went to Pizza Hut, spend some time with Burger King and then I found coincidentally Mr. Schärf, who was at the beginning of rolling out the Coffeeshop Company over Europe. So let's say the experience in developing multi-unit concept is rather huge. I saw it from several perspectives and tried to take the best things from other companies and try to implement them into the Coffeeshop Company. I'm 40, I'm married, and I have a 14 year old daughter. She is one of my heavy users in any concepts I have ever worked with. She gave me the best possible feedback to say this is good – this is not good. This should be done better.

Thanks to you that you considered Coffeeshop Company as an example for your empirical study.

Coffeeshop Company is part of company Schärf. Schärf is family business, a family cooperation for almost 60 years. Founder of the company recently died 2 weeks ago. The main idea or main focus of the company's business was manufacturing coffee machines on a very high standard, producing coffee, roasting coffee and selling that to the customers. Over the years it turned out that conceptual selling coffee is far more successful than just selling coffee machines. So out of this and giving the development out in the world regarding chains selling coffee, the idea came up to do something similar to Starbucks, actually. So Starbucks was there already and with all the experience Schärf had, we considered to do our own coffeeshop concept and call it Coffeeshop Company.

> *Interviewer: One aspect I want to mention is when I saw your coffeeshop, they tried to imitate some of the brand.*

Director of franchising: You are pretty close. I mean 75% of all logos in the world are round; some of them are green – so most of the company say it's coincidental but I very doubt that. I honestly think that the key player in this particular type of business was Starbucks. A lot of companies came to the point and said that they want to do a business like this. The problem of being a copy is that you come to this "me too" section. If you do everything the same as everybody else does, the question to the customer is, “why should I take you” besides you are much cheaper probably. So we came up in 1999 with our first coffeeshop in Vienna. Starbucks was not there. They came 2 years later. So we actually built the first coffeeshop in Krugerstrasse in 1999, which was a very small shop in a narrow place. It’s not the best location but at this very time people flooded the shop because it was so new and everybody wanted to see how a “to go” concept works. The start of the Coffeeshop Company was on “to go” business. At that time nobody really considered a role out in high numbers. It was just the “let’s do a concept – make some money and everything is fine” idea, which we wanted to sell to some people and everything is good. So it was pretty much a “try & error” thing. We try because we have the coffee machines and the coffee and all the other knowledge to build this up and then we will see how it works. So from this very point on, actually it was under development, more or less, or under construction. We tried everything and found out that this works well and this doesn’t work well. I joined the company 5 years ago, so 2004, when I met Mr. Schärf coincidentally. A head-hunter called me and said “you have to meet Mr. Schärf, they need somebody”. I said that I have a job because I was at Burger King at the moment. So I met Mr. Schärf and I thought, “this guy is a lunatic – one lunatic meets another one – that makes 2 lunatic – this just can be good. If you have weird people together, something good should come out. And I decided to join him and from 2004 and fine-tuned the Coffeeshop Company franchise concept. Before that it was developing by coincidence. We made a little here and we made a little there and there was something and here was something but it wasn’t streamlined or focused to a particular direction. When I came we hat about 20 units or 22 and currently we are over 190 units in 14 countries. We spread out in lots of areas but I think we will come to that later. What makes us different or what’s out USP when you like to say that is besides the fact that we have a very special coffee – nobody knows, because we never put flyers in the shops, which was a very big mistake we ever did, because we never told anybody that we have something so good is that we offered service in a coffeeshop. We started to change the system besides Alserstrasse, Krugerstrasse and Millennium City. We changed the system from a typical coffeeshop concept, which is self-service to a full service concept to get a much wider range of customers. Not just the trend seekers or the trend setters but to get the people in our age which we convinced with the service, the idea to sit down and have a business talk where somebody will come and give me something to increase top line sales. That was pretty much the change in the system that actually makes it possible to develop the system in other countries, because you know America before Obama was not the best of a name in the world in most of the countries you work with. There is lots of good invention people like but the general culture is not liked everywhere. But Vienna on the opposite with his history and everything which is behind Vienna, you know it's romantic, it's music, it's theatre, it's something you can sell to people in every part of the world and its coffeehouse tradition when in 1684, after the 2nd Turkish invasion is also a major selling factor out in the world, because people like that and people believe that. So we took that part stronger into our concept to sell to other countries and if you now go to Saudi Arabia, where we open this year or to Bahrain or to Kuwait or to Egypt or even to the Americans with the Carnival Cruise Line ships, where we have 30 units or something – when we go to them the reason why we are there is, because we are able to put this two cultures together and create a symbiotic approach to the customer. So that everybody believes everything. So the young guys believe that "Oreo shake" is a good product for them and that's why they come to this place. But other aged groups like the service, the coffee, and the style, whatever. So we get a wider range of target group. So that actually evolved out of this, first started in 1999. Because when we started in 1999 nobody had a clue how it would come. So the problem with concepts when they develop is that most of the concept owners telling you that everything was a big plan. In most of the concepts I know is that this is not true. Most of the entrepreneurial businessmen start because they think "wow that's great and they like to play with it before they realize that this is something you can roll out for thousands of units. If you have 30000 units and you look back, for the outside world everybody thinks "what strategic plan must be behind that". But there is not so much of a strategic plan at the very beginning. The very beginning is just try & error. Try a new concept, new equipment, new stuff and people and work with that and suddenly the demand of people, the demand of the customers say "hey why don't you have this unit in, I don't know, Los Angeles or New York. Afterwards you start to roll out. The same with Starbucks. Nobody considered Starbucks as something, which will develop throughout the world because nobody had coffee before. It kind of developed itself over a couple of years because people had the right consideration and how it shows actually it took a while until he came to the point that he can develop Starbucks, because before that he was pretty much a specialist in brewing coffee of a small group of people somewhere in Seattle. So it's something most of the chains have. Only a few numbers of chains say "we will come to this place and we will roll out." Vapiano is such a thing. This is a different story because they came to the place and said "we take the money, we roll out, we are going to make as much money as possible and we will probably sell it to somebody." But most of the traditional multi franchise units concepts came out of trying to this point where they started to roll out. This is for start-up.

> *Interviewer: A general question in the literature is: what are the reasons for a franchising company like the Coffeeshop Company to multi-unit franchising or single-unit franchising. What are the decision criteria for choosing the strategy? Afterwards I would like to ask you some more detailed questions about that.*

Director of franchising: Most of the chains will have this problem some time because to accelerate growth, you need either money yourself, because you have the money and accelerate growth or you need partners with money to accelerate growth. Most of the chains do not have the money themselves, so they need partners to do it. Besides McDonald's they started differently. They started in the 1960ies to buy the land, to rent the land long-time and give it away to another guy. Coffeeshop Company started its expansion with focusing on single-unit franchising. That was pretty easy and no big challenge. The challenge is controlling individuals, which is sometimes not as easy. Individuals have their individual approach to everything. So as we grow rather fast we came to the point to consider multi-unit franchising or master franchisees or developing franchisees in some areas, because it is faster and something you should never forget is money is always implicated so you get the money now even though the effort you have to bring in comes later. This is sometimes a very tricky situation because getting the money now is good for you balance sheet now but it will cost you money in the future. So the decision to do this is good for foreign countries where you will never have the power to rule or control the concept there as long as you don't invest in your own organisation and Pakistan, China, India or in Australia if you invest into local organisation then you can do individual franchising there. If you are not willing to invest there or you are not able to do that, you will come to the point that multi-unit franchising or master franchising will be your solution.

Interviewer: Are you doing this only in foreign countries or also in Austria?

Director of franchising: Master franchising in only for other countries.

Interviewer: and multi-unit franchising?

Director of franchising: Multi unit is something, if the franchisee is good and he in good enough to take a 2nd unit we come to a point where multi-unit franchising is ahead of us. So we start multi-unit franchising when we see that we have a good franchisee – let's grow with him. In Germany, in Austria it's not that big, we have a rather huge one with 26 units, who has a development contract with us for the Eastern part of Germany, because he was very well experienced in this area and made the decision to grow with him. We did not start with him as multi-unit franchisee but as a single operator and because of his operational skills we came to unit 2, 3, 4, 5, and when you reach unit 7 or 8, we come to the point to say "let's do a development contract together to develop the country quicker.

Interviewer: Do you have some strategy to suppose sequential multi-unit strategy? So if you have one good partner you develop this partner further. You don't have area development in the first place?

Director of franchising: No we don't have this. We are considering area development for Turkey at the moment. I meet these guys in the afternoon. Turkey is just too big for a Master franchisee, because it has 80.000.000 people and no one can cover the whole country. Nobody will pay for this country. There we consider area development like around Istanbul, or the area at Antalya or the tourist section from Antalya to Alanya. This is something which makes sense in huge countries like China or even the US is the same story. Nobody will take the market of the US as an exclusive market, because nobody will be able to develop. So as you say this is a sequential plan. In these countries we are going to start with area development. If he is doing well in one area, he will get the right or the option to do this in another area too. But if you stretch a partner to much in too many areas, then you will ruin it.

Interviewer: Is this the same problem with company owned chains?

Director of franchising: Yes exactly. It's the same story we have in Eastern Germany. The partner, who started there very good and has now 26 units has now this operational stretch that it is not possible to control the shops in equally quality. He is good in 65% or 70% of his shops, but at 30% of his shops he wasn't able to control them, which makes the decision not right. In Russia we have a master franchisee, it sounds silly because the country is so huge but the areas where we can develop are overlookable. We have St. Petersburg, we have Moscow and we have a couple of other cities where we can develop but it is not as versatile as Turkey for example. We have 50 different areas where we can develop in Turkey but we have 10 in Russia. It makes no sense to develop in the forest. In our case we have our own equipment and our own know-how and we have our coffee machines and our coffee, our equipment and our technology and whatever so our strategic approach to the world is different than in other companies, because as a matter of fact that it is my equipment, it doesn't really matter where I deliver it to. I can deliver it to Guatemala or Australia, it doesn't matter because it's mine and the only thing we have to do due the technology we work is, to train and educate the technician locally to fix the machinery, because I won't send a technician from Vienna to Sydney to fix a machine. The technology we use is pretty traditional so every well-educated technician can work with it, which makes it easy to maintain even in the farthest countries in the world.

Interviewer: How do you train the franchisees? Is there only one training in the beginning and do you have strict rules in the design and operations?

Director of franchising: We have a handbook which describes almost everything. What we did or doing actually is that after 10 years in the market every chain comes to the point to say, "Am I still on the right track or do I have to regroup?", because when other chains started, McDonald's started in 1955, Burger King started in 1954, they had a total different concept as they have now and we have the same story. We started in 1999, we had this change from green to red, we had a couple of other things and now we are in a situation given the international crisis and adopt ourselves to the demand of the customer. It's not about what we are thinking, it's about what the guest or customer is looking for. And if we cannot demand his wish, then the problem will be that we serve something nobody wants.

Interviewer: So do you localize your units?

Director of franchising: Absolutely yes. When we started in Cairo, we had 8 units. Now we are opening in Alexandria and Bulgado recently. When we started in Egypt, the first approach was this is our product range, this is what we have and this is what we have to do there. There is a big mall in the better part of Cairo and the franchise partner there kind of came up with the idea to say "no we cannot do that, because the Egypt customer doesn't like that. If you provide a cake in this size (director of franchising is showing a pretty small sized one) he will smile at you and leave it, because this is not the size of a cake it should have. It should be big and it should be fruity and real fruits and not this artificial something out of a machine fruit, because they have fruits like hell. So please bring cakes like that." We couldn't deliver this. We started to say "let's adopt our product range to local needs. That makes us different from Starbucks and others, because we don't just aim for the tourist guest, we aim for the locals and suddenly we have all the customers. And even if have only 8 units there, we really own the market. From a direct competition way of view and sales turnover view, we own the market. This is a far better system than everything else which is in the market, because the local say "this is great. I know the market. This is where I go." But the core concept is the same like everywhere. We have the same coffee, we have the same menu boards, it looks the same, the colour is the same, the furniture looks the same, so the identification things are the same but the product range, especially when it comes to food and drinks, we are pretty local, besides of a couple of products, because we think that the customer do not get it anywhere else. So we brought up a good mix, which we are also trying for the Eastern Europe countries like Poland, Czech Republic, Slovakia and Russia we already did it, because they have also a different demand how cakes should look like. The same with sour products, if you go for a bagel or whatever you have to keep this in mind. So we are changing the system now to allow more individual elements to the franchisee to make it more profitable.

Interviewer: So do the franchisees have decision rights?

Director of franchising: Well he has to talk to us and agree with us or has to argue with us when we are against it but at the end of the day he has more rights in the future than he had in the past.

Interviewer: In a certain country do you also adopt your product range within the country or do you have the same products in a country?

If we are in a market we try to have the same product range in the whole market. Of course if Rumania has cost line and forests and mountains and like other chains are doing that – McDonald's is offering soup in China – you can add products according to the location of the cost line and take that in consideration. It will not always happen but it is important to think about it, because not to think about it means that you force your franchisee to lose money and if we are frankly honest to each other, franchise concepts have mainly the idea to give a partner the chance to get money quicker that if he does it individually, because we have a concept. If he gets no money or loses money or gets lesser money than he does it by himself, the question mark is "why have I chosen the system. This question is always on the table, he is not always asking it but this is mainly the reason. Just go to franchising, multi-unit franchising or single-unit franchising, for making money will turn out soon or later as a major mistake, because this always fires back and there are enough concepts that showed dramatically what happens when a franchisee starts to say "no. I won't do this anymore. I will be against you with a couple of other partner to make sure that this concept will not continue the way it does."

Interviewer: Is this a risk in the concept of multi-unit franchising that for example the German partner is very powerful and you might have issues in cooperation?

Director of franchising: Yes, absolutely. This is a problem. In a crisis as we are, we have faced the non-smoking ban last year in Germany which cost us 40% in sales. If you have a strong partner the strong partner is very demanding and he is coming up and says "hey look, what are you doing against that? What can we do together against that?" If you have a single, the single in such of situation is bonded to you in a completely different way because he needs us to survive. A bigger partner has his own strategies to survive. So you have to balance this proper to make sure that he survives and you survive, because of his size he brings you into a situation which you might not like in the end, moneywise. There was the same situation with Burger King in the US a couple of years ago when a franchise partner with 150 units had a bigger chat than the owner. This is a very tough thing as everything in life runs smoothly and everybody is doing fine, no problem until there is a moment where there are problems and then suddenly the bigger franchise partners are more demanding. On the other hands side to be very frank, this is what you need. If you want to develop your franchise concept, you don't need sissies. You don't need people, who always agree with you. You need somebody who is against you in some things and gives you better ideas. Somebody who argues is difficult to handle and you don't like that because you want to see yourself as the keeper of keys and secrets and everything because you are the owner of the big franchising concept. But suddenly there is a partner who comes up and says "no". I meant the Big Mac is an invention of a franchisee. It wasn't invented by the headquarters. So anyway this is something you have to keep in mind.

Interviewer: If you have one franchisee in the first instance and this one in a multi-unit franchisee with several units, does he pay less, because he increases the network?

Director of franchising: You know fees are one of the most discussed topics in any franchise concept. The entrance fee in our concept is 25000 units. We have a 5% royalty and a 1% marketing fee, which covers promotion and basic things like that. So finding a partner in the very beginning, fees are always under discussion. Can we negotiate this – This is too much… The question is what is right. If he makes a ton of money from the very beginning fees are not really important. If the business is not doing so well, of course the fees are too high, if the business is doing lousy, I should not pay any fees.

Interviewer: Is it very costly to start franchising for your partners? Are the investment costs high?

Honestly yes. We have changed this for the last 3 years. It was not so easy because the project development goes directly into the balance sheet of Schärf cooperation. Schärf makes the money on the project, Coffeeshop Company makes the money on the running unit. So Schärf was interested in selling the project on a very high price to have a high turnover and if the price was too high, the resulting problems belonged to Coffeeshop Company. So we changed the process of this over the last 3 years and made sure that the partner has a better opportunity to get the shop cheaper. He can choose whether he buys the whole thing with us or he founds he is own company and build the whole thing himself. The gap between this is between 20% and 25%. He can get this thing cheaper, if he has access to companies. So this makes it a fairer deal to the partner. As the contract runs 10 years and I want to earn money for 10 years it is not so important to think about the amount of money we can get now. The important question is how much money do I get over 10 years. If I can make sure that the partner grows over 10 years, my income will be much bigger than making 30000 Euros right now. This is why we changed the system now with new partners to make sure that their income history is in their favour and in our favour.

Interviewer: Are the outlets rented or owned by the partner or you?

Director of franchising: 99,9% of the outlets are rented or leased by either the partner or by us. In foreign countries we don't lease for several reasons. For example no legal entity. In Austria or Germany 90% of all premises are leased by us. So we are the lessee. In other countries it's by the partner. So the partner in other countries has bigger influence on the business than here, because here we have the contract only out of one reason to make sure that we have at least the rental right if something is going wrong to make sure, that we get the site at the end. That is something under renegotiation to consider if this really makes sense. The current rental law, even if you have the right, you won't get him out. He will stay even if he doesn't pay you his rent. So honestly it doesn't really make sense and it harms our balance sheet with people who are not paying on time.

Interviewer: Is the franchisee paying the whole equipment?

Director of franchising: This is what we have had in the past is that we offered a leasing contract. It wasn't via us but a company which offered leasing but given our very good contact to this company we helped the partner to finance, which was helpful but the problem of that is that you always take the responsibility on that even if you don't have it. We don't want to do this anymore. We are coming to this growing factor of the concept. You want to grow fast. So the first thing you need is a model which shows how the franchisee can get the money he needs quickly. Financing is the most crucial part we have, because franchisees do not have a lot of money. Most of them have 40000 to 50000 Euros, if they ask their family and also get something from their bank. But they need at least 150000 to 200000 Euros so they need finance. They go to the bank now and there isn't even a Penny to get because there is no financing gastronomy at the moment. They don't even finance themselves so why should they finance gastronomy. So the leasing concept was an easy concept to get the money quick without big troubles but the issue with leasing is the duration of leasing contracts because you have a right on equipment, which can be up to 6 years. So you have a 60 months payback period and on furniture and other stuff it's 7 years, which is 48 months. So when it comes to liquidity it's a big problem. Short duration means lack of liquidity, if there is any crisis or summer or hot you run out of cash and you are in trouble. So we don't do that anymore.

Interviewer: Is it possible to argue that a franchisee with higher initial investments is more motivated to run a successful outlet?

Director of franchising: Sometimes it turns out right. When the franchisee doesn't invest anything, his motivation is very limited. This is something I can tell you out of experience over 17 years. If the investment is too high, it belongs to the bank. If it belongs to the bank, his motivation sucks in the very moment there is trouble because the first call he gets is from the bank "here is your bank. There is not enough money on your account. What are we going to do?" and this has a big influence on your motivation. So the ideal is that the investments are on a mid-sized level. It should be enough to say that the franchisee has to do a lot as it is his money but you should have a cushion on your bank account to overcome crisis. That's pure theory. In real life as soon as there is a cushion the partners will spend it on something else. And when we get the balance sheet on a monthly base and we do benchmarking and evaluate how their business is you can see this immediately. The same with opening a unit and starting with high sales. Partners will start to think that this is the sales level. They have a high turnover in the first 2 months and the whole calculation on their life style is based on this two months. Wherever I interview a franchise partner at the beginning of a start, the first thing I tell him is that I wish him a very slow opening. They always think that I am a bad person. Actually I'm not but when there is a slow opening, you stay concentrated and focused and we should build up the business over the years and we shouldn't win it within the first 2 seconds. There is a 10 year marathon and we need your power for the next constant period. So we try to get them down which is not very easy. When you expect 20000 Euros on sale on a coffeeshop and they do 40000 Euros then of course the guy is running around considering that he is the best. Have you ever been to Casino? On a roulette table? You know when somebody won on the roulette table, look at his face. In this very moment he really thinks that he has the unbeatable system to make money. And then look at the same face when he won a 2nd time in a row. It's unbelievable. This guy would give all his money on this particular money because he is very convinced that he will not lose. The mathematical calculation on how big the chance is to win or lose is always the same story but they don't believe that because in this very moment he thinks he is the greatest. And in franchising it is the same story again. Big start - Wow I'm the greatest. When the sales go down, depression. What have I done wrong? What have I made to my customers? The concept doesn't work and so on. The motivation when it goes up is bigger than the increase but when it goes down, the demotivation is bigger than the real decrease. We have this development in our business that you usually have a strong start, maybe 3 to 6 months. After this period you start to decrease, because this is pure curiosity.

Interviewer: Could this be affected with the newness of a specific outlet?

Director of franchising: Exactly. When you open a new outlet you always have a monopoly because of this newness at the beginning. People will come to you just to see how it is. This is a monopoly at the moment. Even if you do your job right, after 3 to 6 months, it starts to decrease and when it starts to decrease it's about how good you have been in the first 3 to 6 months operation-wise, customer-wise, marketing-wise and so on, because then you can stop the decrease after a period of 3 to 6 or sometimes 8 to 12 months – it depends on what kind of shop it is – and then you start your real business, where you start to have a flat line and you start to go up 3% and another 5% to develop your business. We tell that every single partner but in the end it is always different. This is true for every kind of franchising.

Interviewer: If you don't mind we would like to discuss the model in the literature and ask you about this and you can agree or disagree with it. Based on the literature, we have a model based on these hypothesizes. The first was that the higher the specific investments, particularly at the start of the franchise contract may cause a higher motivation of the franchise partner, because as we have discussed parts of this question earlier, does the higher involvement if his investment lead to higher motivation? Additional to that if you have a partner who is willing to have high investments might also want to get some incentives like additional units in the future.

Director of franchising: Exactly. It is right. If you have higher investments, your motivation to succeed is rather high because it's your money. So this is what you should get back. So it's very often the case that when somebody has an initial high investment, his 2nd approach after opening the first unit is, how can I open a 2nd unit to spread the risk and to get a higher income. If I get 1000 units a month for one outlet and I get 2000 units for 2 outlets.

Interviewer: So there are decreasing costs compared to the initial set up costs.

Director of franchising: Exactly, because you can split your operational costs, because you work with your staff and you can change your people when there is low business at this season and so on. At the end you are right. So the investment should not be too high, because if the investment is too high in proportion to the business, then the motivations sacks, because he cannot stand against this pressure for a long time. It's possible at the beginning but not in the long run. This is the case.

Interviewer: In the literature there it is called a bonding-effect. There is a strong commitment to the partner if he invests a lot and expects to open up additional outlets in the future to decrease this investment costs.

Director of franchising: Exactly as we talk about multi-unit franchising and you start as a multi-unit franchisee, the initial investment is higher, where you have a development plan, where you plan to open 10 units in the next few years. This has an influence on fees, because if you know that development is coming up, usually you negotiate fees. If you know that there is a guy, who runs 10 units in the near future, you give him a benefit, discount or whatever where you say “if you pay me this 10 units in advance as a security, I decrease the entrance fee for example”. This is an element our concept includes. If there is market with a potential of 100, I can calculate 25 times 100 and a discount of 30% is your entrance cost and then you should develop your market and try to open new outlets. So high investments are a bonding because you cannot go out easily. You have your money there and nobody takes the risk for the money. You will try to be successful, which is a bonding mechanism. You are absolutely right.

> *Interviewer: There is an additional aspect which is directly related to the last topic, which is the screening effect. The literature says that these high investments are a screening effect. You screen better partners because you have potential partners, if you have relatively higher specific investments; you get more entrepreneurial and financial capable partners in the system. If they are low, everybody could enter as a partner.*

Director of franchising: Honestly I thought like that as well when I started the business but it not always turned out to be right. There are more people with money incapable to run units than people with lesser money being capable, because whether you find investors, which is a big trouble. When you find an investor as partner, the investor focuses on questions like “when do I get my money back? What’s my return on equity? What’s my return on investment? How much money can I make? How can I sell it and so on”. These are the guys with the money. The entrepreneurial business man who comes up and has a 100000 Euros but can develop the market have been often the right persons to choose as a partner. Because before you become big you have to become good. And becoming good has nothing to do with money. Becoming good is a personal readiness to go in there, being entrepreneurial, let the people know that I’m the greatest and then you can invest in growth. In a lot of concepts word wide, this thought of having a guy with more money means having better capabilities turned out wrong. Whether they have so much money that they force you to do things you don’t want. In Saudi Arabia for example, everyone there has more money than our entire company. They can buy us easily. Our franchise partner in Saudi Arabia is one of the biggest groups in the Middle East. So money is not an issue. How good they are operational, I don't know yet. They say that they are very good but I cannot confirm that now. Money wise they are very healthy. Lots of concepts made this mistake. They get partners in with money and not partners with passion, with the right approach to this business and with operational skills. They are good about talking about 100 units but they are lousy about talking the first 5. So making step 5 before they do step 1. Sometimes this leads to troubles. So we have not stopped but try to see that as a very crucial point for our development and do not only go for the money.

> *Interviewer: The theory says that if the environment is quite uncertain, due to economic issues or the forecast is not so good and you cannot predict the market, particularly the number of competitors is frequently changing or they are coming with new ideas all the time so that you cannot predict the situation on the market, locally. This might lead to a situation where the franchisor is going to have a smaller partner, because he is not going to use the larger multi-unit partners. Can you agree with that? So if you are in a locally unknown market where you need such a strong entrepreneurial behavior and therefore you don't give multi-unit franchising in the first step.*

Director of franchising: Exactly. I mean first step multi-unit franchising decisions are very rare in a concept development. It is an option you give to somebody who is good enough to say that he can do that. What you say is to 100% right. When you don't know the environment and in most cases partners don't know. They talk to you about the environment but they don't know and the reason why I say that is when I go with them and be there and have no clue of the market and go around there with a guy, you see things because you do this for such a long time which are crucial and critical. The guy lives there and he doesn't know. So actually this is something important but this is something you can do in the pre negotiation before you start the business and work on that. If there is a multi-unit franchisee and we know that there is the need of an entrepreneurial partner we tell him that he needs someone to run the business. If you don't have them, we don't make the deal.

> *Interviewer: The idea is compared to such a situation where you would be in a well-known and stable environment, like Austria, in the first step*

and then you go to some German market in some regions. In this case you could also use multi-unit franchising.

Director of franchising: Absolutely, because it is fully developed and you know exactly what to do but as you say you are right. Environmental uncertainty is something which has an influence in the way of what kind of partner do you look like or what kind of partner do you look for. In most of the area with this uncertainty, most of the people coming to you are master franchise interested partners, because I would never do individual franchising in Rumania. I would never ever do individual franchising in China, because I could not control that. So you will have there a multi-unit partner because no one will open there a single unit in Beijing or Shanghai.

Interviewer: If you go from Vienna to Tyrol and you don't know the market there, you will look for one partner and in comparison to that if you go to Wr. Neustadt or Eisenstadt you could start with more partners.

Director of franchising: This is exactly what we do. Tyrol is such an example. There is a guy in Tyrol, who runs 2 units there and we would do whole Tyrol with him, if he likes to, because he is good, he has a corporation behind him, he has enough money, he has the right approach and he has a partner, girlfriend, who does all the operational business. So this is exactly what you say.

Interviewer: We also predict that monitoring costs, particularly when you are operating in a far distance market, which are different in terms of culture and so far difficult to monitor. Then probably the franchisor could use higher multi-unit arrangements, because it would be difficult to him to monitor, as for example mentioned in Russia, it would be difficult for you to manage the franchisees over there.

Director of franchising: Exactly. When the partner is far away, it doesn't matter if the partner is in Tyrol or in Russia, then you try to build him up as an organization and you consult an organization. So you do visit with owner the owner or the marketing boss or the operational guy there and you do the meeting with them. You don't have to visit 55 units and then talk. So this reduces the cost a bit and you cannot do a day to day monitoring in Cairo. You have to have certain dates, in our case this is mostly quarterly, so that we go there or have particular training days in periods where we say that we will come over there and train the stuff, shop managers or whatever for this period of time. You are right. The monitoring cost is something which influences the decision on doing single-unit franchising or multi-unit franchising.

Interviewer: And do you think that the expectations of the franchisors and the behavior of the franchisee and particularly if suppose I'm confident about the behavior of the franchisee that he is not going to do something wrong.

Director of franchising: That's a very good question. At the beginning of a partnership, most of the partners, franchisors and franchisees, have this big trust sign above them. At the beginning everything is good. Over the time there is that lack of being really particular in what you do and particular in the standards and whatever. This is a matter of how good is the relation to your partner, how much pressure I'm able to put on him. Multi-unit franchising and far away - pressure situation very complicated. That's why McDonald's never did master franchising very much. They had joint ventures in Japan because they feared the lack of control on a partner locally.

Interviewer: This is also related to the situation where unstable environment increases the monitoring problem for the headquarters.

Director of franchising: Absolutely. Even when you are there regularly. You fly to Cairo and you fly back home and three days later nothing will change, because as long as you are not there with your own people you will always have the risk that something is not working to your favour. This will stay as long as you run franchise units, it doesn't matter which concept you chose. The franchisee, which is far away and knows that you are not there, can do something which is not right.

Interviewer: And is particularly to his own benefit.

Director of franchising: Not always. Sometimes they do things not to their own benefit. Sometimes if you talk to them and say that you shouldn't do that because you lose money, they suddenly understand their mistake. There was the situation once when Burger King changed from Coca Cola to Pepsi because they saved 7.000.000 Dollars. Headquarters had big troubles with that. They cannot change because we have Coca Cola and at the business meeting the guy said that it was about 7.000.000

Dollars and he will not change as long as he doesn't get the money form the headquarters. This is the problem with multi-unit franchisees. They can be very powerful. The multi-unit franchisee of this example had 120 units in Turkey. It was his own corporation and he decided to do that.

> *Interviewer: If the brand name is quite strong of the franchisor, he is going to tend towards multi-unit franchising, because he is able to get better and larger partners and individual small partners cause damage to the network by free-riding on the quality to gain money in the short term. If there is for example only a market of single partners, they can free ride on the brand name. One is offering more service and the other is offering less and has lower costs. If you concentrate an area with multi-unit franchising, you wouldn't have free riding between the partners. If I'm here in 8th district and in 9th district is a single-unit partner, they could compete on service. So it would be better to use multi-unit franchising from this point of view for both districts because bad competition for the brand name is reduced. One reason in literature is that they say if you have a very high brand name, the franchisor wants to protect his brand name against this free rider risk and therefore he reduces the risk by a bundle of partners in an area.*

Director of franchising: Out of experience - when you have individual partners in the same area you usually have higher sales for the brand than having one partner running more units. I know that very good because as I said I started at McDonald's and came to Burger King where we had a different approach to this topic, because this free riding can be negative of course but also positive. When a partner in the same local area, let's assume one in the 7th district and one in the 8th district and they compete against each other and they always do, they can compete on a positive element as well. Kind of who is doing better. Who is doing better on the service, on the promotion, on the best mystery shops, in doing whatever. If you put that into the franchisees mind, you get higher sales than with a multi-unit franchisee that has 4 units, which are controlled by the master model of the franchisee. When the franchisee is kind of reluctant then you have 4 reluctant units with 4 reluctant shop managers. They do whatever is necessary for the system but they will not do what is necessary for the sales. The concept of franchising works on turnover and therefore this is not the best solution for me as a franchisor. Free-riding happens in both areas. It happens in the multi-unit franchising and in the single-unit franchising, because when you have 4 units together and you have a shop manager who believes that he is the best in the world, and then you have a different location from the same operator than you have 500 meters away. If you want to have a proof of empirical stuffy, go to the US where McDonald's was at the corner here, which was really good and there was a McDonald's 5 meters away which wasn't very good. I personally do not believe that multi-unit franchising solves this problem.

> *Interviewer: There is some literature regarding the car dealership industry in the US. If you are a car dealer the customer will go to the dealer with low costs and therefore low prices but the customer gets the information from the other outlet where the partner has very high service costs but then he switches to the other partner who is offering a lower price.*

Director of franchising: But for multi-unit franchising in gastronomy it is not and if you refer to the time which was called "burger wars" a couple of years ago, when Burger King and McDonald's competed against each other with the lowest price on their key product. So you were able to buy a Big Mac and a Whopper for 99 cents and suddenly you got a meal for 99 cents. The whole idea was to gain traffic, which worked very well. The problem is when they did that they ruined everything they have ever built up on the high quality stuff. Suddenly the Big Mac, the best product you have, costs 99 cents and the Whopper the same story. Then the 2 chairmen had a secret meeting together to stop this immediately, because it ruined them. So then they started how they can come back to a level, where we can make money. They quit the 99 cent burgers and started to ask for 2,50 Dollar per Big Mac. The customer reacted to this by going to Wendy's or to In-n-Out Burger. That almost ruined both companies because their approach was how can we win everything by the price and the concept of Coffeeshop Company is different because we say that the only way to make better business is that the combination of service and value works together because if you don't offer service, you can give the coffee for free and no one will come to you. So this free riding is a problem which you have in a market where you have a partner never considered himself as a franchisee. When you pick the wrong guy, who actually is an entrepreneurial businessman but never wanted to become a franchisee, there you have the problem. With free riding, the guy considers himself as the developer of the system and he will change then everything to his own benefit or to his own wishes. This is a risk when you puck a partner with a lot of money but never considered himself to work within the system. The biggest challenge for somebody to join a franchise system is that he gives up his own individualism a bit. There will be things he likes but also things he dislikes but he has to take it anyway to his favour or to his miss success. This is part of the system and therefore doesn't matter. This is something people consider at the beginning as no problem but over the time they find out that this is a problem and there is somebody who calls you and tells you what to do because it is important for the system. Why haven't you done this? And if the guy is far away, free riding in on the stake.

Interviewer: In Coffeeshop Company case, I think that the local adoption is quite important as you have already said about Cairo, where you have adopted your products to the local needs. Does it also somehow effect the selection of larger partners and smaller partners?

Director of franchising: If it comes to multi-unit operator, usually the guy who invests the money is not the guy who runs the business. So we try to pick a guy who runs the operation and in foreign markets, this works very well. The adoption of the system to the local market works well, because it is a benefit to the franchise partner, where he pays all this money, is a benefit to him – that there is a company like us, because usually he has interviewed a couple of companies before he came to us and then he suddenly finds a company which says that local adoption is very important. Most of the other say that there is no adoption at all. But at Coffeeshop Company the franchisee has to bring in his input, because we want to deliver any goods, we won't deliver deep frozen goods to Cairo from here and we cannot deliver frozen goods to Saudi Arabia because we are not Halal certified. So for all the Moslems, we cannot provide the food. This is something positive for the partner and therefore we never have problems with that. The coffee itself is never under discussion.

> *Interviewer: The local adoption refers to the entrepreneurial capabilities of a local partner. If they are very important, the literature would say*

“we don’t use very strong multi-unit franchising strategy, because then you reduce these entrepreneurial capabilities at the local outlets.

Director of franchising: Very often you can see this from several perspectives. The entrepreneurial businessman is important for any kind of development and it doesn’t matter where it is – even if you open something in Graz, Tyrol or Vienna. You need this guy who works there and tells people about the Coffeeshop Company and its culture. Same important is this for any other market. The problem is that the entrepreneurial business guy usually does not have the money. He needs someone with money. So in most of the cases, when there is just a guy with the money, we don’t do this business, because then we have this missing link. If there is a guy with money, who brings in a person with operational capabilities, then we do the business. Sometimes the guy with the money can run the shop too but this is very rare. The guy with the money has a good network; he has connection to supply, to the government, to manufactures of goods, to bakeries and whatever. The entrepreneurial guy has the advantage of being able to talk to the people so we need both to do the adoption.

Interviewer: One additional question I didn’t ask in the beginning is do you also have company owned outlets?

Director of franchising: Yes we do.

Interviewer: Only here?

Director of franchising: We have 2 in Germany, we have 6 in Austria.

Interviewer: Because some of the literature is arguing, if the company owned outlets have the same entrepreneurial capabilities compared to a partner, you wouldn’t choose a partner because you can do this on your own anyway.

Director of franchising: This is unfortunately wrong. In all the companies I have ever worked with and in all the companies we ever had stores even with good shop managers, the delta is about 25%. The partner is in average 20 -25% better in everything than we are, because even if you have a really good shop manager, it is still not their money. It is still the money of the company. Even when you train them and educate them and do bonus systems and you link their salary to the sales – for them it's still the money of the company.

Interviewer: And they don't feel that they are doing all that for themselves.

Director of franchising: Exactly. There is a good system which I like very much but we cannot do this often which is called "management contract". If you have a strong shop manager and you give him the opportunity to say "look, you are so good that I give you a chance to get an own shop, so you don't have to invest anything yet. You just make sure that the costs are covered and it belongs to you and you pay back the shop over a long period of time."

Interviewer: This is also done in the hotel industry.

Director of franchising: We do this with shops too but not very often. We did this with fast food sometimes. That can work really good, because the guy gets a chance to have his own shop and this is something, which boosts the motivation and you still have the link to him. So he will never run away. But the company owned concept is something for franchisors who are really big with a lot of turnover, then you will try to get the high turnover location to get some additional money for the company. McDonald's has 25 to 30 owned outlets in Austria, because they bought back a couple of shops to make cash money.

Interviewer: We have already spoken about the importance of the franchisee for the financing the network. Do you think that multi-unit franchising gives a financial advantage to the franchisor?

Director of franchising: Yes I do. A strong multi-unit franchising partner, who has strong financial capabilities, is very good to our financial situation.

Interviewer: And particularly if the franchisor has not enough funds then he will choose a larger partner, who can finance the growth.

Director of franchising: That's what I said at the beginning. The franchisor often decides to do multi-unit franchising or master franchising because he needs the money. That's not always right to do it but it's very often the reason to do it. You have to make sure that the whole thing works in the long run and usually when you have strong partners you negotiate with, they know exactly in which situation you are. When I do a negotiation with a partner somewhere in the world, I know more about him before he tells me, because otherwise I would not go there. So I do my research and every partner, who invests up to 2.000.000 into a business know which company you are. So he knows what your financial capabilities are, what's your turnover, how is your company structured and when the money thing in on the table, he starts to play with it.

> *Interviewer: Some of the financial literature argues that financial restrictions of the franchisor motivate the franchisor to find multi-unit partners to get this financial fund.*

Director of franchising: But as a strategy this is a very risky one. I tell you out of experience that this is really risky. It makes more sense to look on the long run than on the short run, because then the franchisee cannot push you. However very often multi-unit franchising is based on a lack of funds of the franchisor. So this is absolutely true.

> *Interviewer: What are the specific features of your system that you transport to your franchisee, like the coffee making equipment?*

Director of franchising: We transfer the equipment; everything which goes with coffee comes through us. Training in several elements like marketing, operation, controlling and purchasing. How to pick the goods, how to store them, how to work with them, how to prepare how the recipe is and so on. We do this here in Neusiedl am See in our facility. It's called the "art of coffee" and it's something remarkable. Every partner from all parts of the world has to come to us to understand what we stand for. How we see coffee, what's the culture of coffee houses in Vienna, how did coffee develop, how did coffee grow, where does it grow and so on. You need to develop the USP with the partner so he can sell it to the partner locally. We help him to do this at the beginning and my people are there to support him and make sure that he knows what he is selling. Language is no barrier as long as you are friendly and smile and he will think that this is a nice place. Of course you need a translator but the expression and mimic is very convincing. So this is part of the transfer which is in the handbook of course but most of it is done personally.

Interviewer: One major argument in the literature is that regarding to system specific know-how, multi-unit franchising increase the organizational capabilities of the system referring to the monitoring capabilities of the whole system, if you have more multi-unit, because if you have only single-unit, the monitoring capabilities for the whole system is smaller than compared to a system, where you have multi-unit partners, because they are stronger and they control their outlets. In addition it is argued that the specific assets or specific know-how is very important for knowledge transfer. So if you have multi-unit partners they can better transfer the know-how to their outlets, because if you transfer everything from the top to all single-unit partners, that is very difficult. Furthermore it is said that multi-unit franchising increases innovation capabilities of the system, because the multi-unit partner can develop some new ideas and you can transfer this new ideas to the system better compared to the situation, if you only have single partners, because they have their own information and don't transfer all their knowledge to you. So if you want to increase the innovation capabilities, multi-unit franchising has a higher organizational capabilities transfer, new product innovations for the system to spread the new ideas. And if you want to test new ideas, you could do this in one mini chain.

Director of franchising: This is what you do with multi-unit franchising. You go there and test some new product in a few locations. From a development and innovation point of view there is the advantage of the multi-unit franchisee. Absolutely.

Interviewer: And also concerning monitoring capabilities? The idea is that you don't increase the monitoring capabilities not only for one outlet but if you compare a system with 100 single units to a system with 10 multi units, the theory would say that under this situation, the monitoring capabilities are higher for the system when you use multi-unit franchising.

Director of franchising: You need a bigger head count for single-unit franchising, because the single-unit franchisees need stronger consultancies on the field. They have to make sure that the operational business is working well and the rest can be done by the headquarters. Multi-unit franchisees are usually very capable in operations, finance and controlling so you need lesser people but higher capable. So from multi-unit franchising point of view, you need better people to control high number of multi-unit franchisees.

Interviewer: An additional argument is that you have some economies of scale effect on monitoring, if you have this on a multi-unit franchisee because he can better organize his own network to reduce the coordination.

Director of franchising: We have this situation in several markets from an effort point of view the multi-unit franchising has a lot of advantages, because you need lesser people but you can be much more flexible and effective. You can do much better than having lots of singles. The effort you have to put in to get all the singles aligned is much bigger than getting the multi-unit operator to a certain point. It's easier from a management point of view but travelling is not always easy but expensive. However it makes more sense it the end.

Interviewer: How easy is it to transfer this system specific know-how to the franchise partner? Is it quite complicated for you?

Director of franchising: You are from Pakistan, aren't you? How difficult is it to learn a foreign language?

Interviewer: That's quite difficult.

Director of franchising: So you got the point. It is really difficult. Why? Because transferring culture is something which didn't work for the last 2000 years. So transferring culture to understand why a Moslem is a Moslem needs the readiness in your mind to say "I'm open, I'll try to do it". But it takes time to get the routine to live with that. It's the same with you have to try things for at least 8 weeks so that you get it into your common habit. When you transfer culture, history, coffee and so on, the people are listening to you but they cannot feel this as long as they don't try it. So what you have to do is that you constantly work on trying bit. When they open a unit, you will be there and say “tell the customer that this is coffee from Vienna”.

Interviewer: In case of Coffeeshop Company it’s a concept and culture but not only a product.

Director of franchising: Yes because you don’t sell coffee. You sell culture. The USP around the world is always the same. It is important to sell the story and people will sit there and say “wow. I didn’t know that you balance the acids so it’s good for my stomach. If I drink a cup of your coffee, it has not more caffeine than one Coca – Cola.” If you don’t tell him, they don’t know it. So this is the real challenge. Training the franchisees that this is a selling concept and getting them understand the story. There are thousands of other places where you can buy coffee. This is a very complicated thing. But you know, taking the results from most of the markets, it works.

Interviewer: Does this situation let the franchisor prefer multi-unit franchising over single-unit franchising, because they can help to transfer this?

Director of franchising: Yes, this speaks for multi-unit franchising. He can translate this to his language.

Interviewer: If you can make him understand the whole concept, then it is quite easy to spread it out locally.

Director of franchising: That’s right. We train a lot of managers here in Austria to tell them what this is all about so that they can train their people. It’s more difficult to train the managers of a concept than the crew, because they already think that they are perfect. Managers are a specific kind of people. They have this idea of knowing everything.

Interviewer: If you use multi-unit partners, they use more a similar organizational system like the headquarters and this is an advantage to transfer the know-how because if you only have single-unit partners, each one is different and he is not imitating the whole management approach of the headquarter. Multi-unit franchising refers to economies of coordination and management because this transfer of management system is eas-

ier from the headquarters to the multi-unit partners and the single-unit partners do not use this management system.

Director of franchising: The thing you say is right. But most of the multi-unit operators invest too much into structure instead of understanding. So very often you find yourself with a partner who has a management structure after a couple of weeks but they don't understand the concept. They have the management skills from other companies and they come suddenly to something where the keyword is passion, dedication and coffee with its history but they have learned things about numbers and expansion. There is no strategy behind passion. This is something you have to get over to your people. This sometimes a disadvantage, because they have structure similar to the franchisor but they cannot deal with it. They only watch out for the facts but telling the story isn't enough – you have to live it.

Interviewer: In the literature it's always mentioned as something very positive.

Director of franchising: This depends on the product you work with. If it's industry, it is no problem. If it is something where emotions are included, you need a different approach, because otherwise you find yourself in a comparable situation of this "me too" situation. Franchisees often are more concerned about the competition. They know what Starbucks is doing all the time but they don't know what to do by themselves.

Interviewer: Starbucks have the problem with standardizing too much their outlets and they are having more an approach of an fast food restaurant. I was in New York City and all 200 meters there is a Starbucks. I don't like this.

Director of franchising: Yes they let go 12000 people. They closed 600 units and will close another 200. So the biggest problem and that's what the founder said in an interview with "Die Zeit" is that he felt very sorry that the whole idea has turned into a marketing instrument. They were not able to transfer the story of Starbucks to the customer. They became an industrial plant for coffee. You could place there a vending machine and let it do the job. They really lost this huge potential at the customer front. I'm very sorry for this, because we are only a small tiny competitor and it was important to us to have a strong market leader. If there is no market leader, the whole market sacks, because everyone will think that this is no business. So fortunately McDonald's came with McCafe and they spend billions to tell the people to drink coffee. That's the best thing which could happen to us. Starbucks just lost it. They were mentioned in the press only negatively for quite a long time. And Howard Schultz came to this big conference of Starbucks with his brand new jet. When they lost billions, he came in and asked how things were running. So he lost it too. People said that the picture didn't fit.

Interviewer: Maybe just another question about competitions. Is Segafre-do a major competitor?

Director of franchising: Actually the answer with competition is very easy. Everyone who sells coffee in a proper manner is a competitor, because I'm not too much in thinking about other chains. If there is somebody around the corner, who does a good job on coffee and has a nice service is a competitor. Starbucks is not a competitor. It's a huge company. When I was in Zurich at the airport I was as that Starbucks unit, where a guy from Ghana made an incredible show selling products to the customer. He sold them coffee, cakes and mineral water and I asked him why he was so motivated. Well he told me that it was the same time. He could have some fun or be bored. So I think if this guy was in one of the shops next to ours, he would take us away all the customers because he made such a good service. Segafredo is more a espresso bar. They had their time but it's now declining for some years, because the espresso bar in its general usage of having an espresso and smoking a cigarette went away with the smoking ban. And McDonald's is something we have to keep an eye on because they do good product, probably not on the coffee but as a general approach with good looking shops and so on. We look what they do and see if we can copy some ideas. There is a phrase in franchising which says "Franchising is shameless stealing" because there is no need of permanently invention. Sometimes you only have to see it and take it.

Interviewer: It was very nice and very informative. Thank you very much for your time.

Director of franchising: You are welcome. I hope I could help you.

Interview: The Coffeeshop Company II

In-depth interview with the head of marketing and communication of the Coffeeshop Company on the 27th of June 2009

Interviewer: How many company owned outlets do you have?

Head of marketing and communication: In sum we have 5 company owned outlets. 3 in Austria. Furthermore there are 2 outlets for certain events and also 2 mobile Coffeeshop Company stations, which are going around Austria. There were at the “Donauinselfest” or at the soccer games of SK Rapid and the theatre in Mörbisch.

Interviewer: Is it right that there are 34 outlets within Austria?

Head of marketing and communication: There are 34 partnerships with different contracts. Most of them are franchisee but there are still few from the old days, when the Coffeeshop Company was also licensing its products.

Interviewer: Do you have more outlets than franchisees and therefore the model of multi-unit franchising?

Head of marketing and communication: Yes we have more outlets than partners. However most of them only have one location in Austria. Eres has 2 locations. One at the Salzburg and one at the Viennese airport. Another one has one outlet in the Milleniumcity and another one in the UCI cinema. Besides there is one with a shop and a lounge solution in Innsbruck, Tyrol. Someone else has 3 outlets: 2 in WIFI in Vienna and 1 in the golf club in Hüttelsdörfel. The last one is a licensee.

Interviewer: What’s the difference between a brand-user and a franchisee?

Head of marketing and communication: A brand user and a franchisee is almost the same. The difference is based on the older contracts, which have a longer runtime. But brand user and licensee are always shop in shop solutions. So there is an already a gastronome at a certain place, like a gas station in Gmünd for example, which also contains a restaurant, that has coffee from the Schärf group and also a Coffeeshop Company corner in the same building. The owner wanted to have in both locations the same service. Therefore he could save some money by synergy effects. So a brand user pays a fee for know-how once and has the right to use the brand names like Moccachino, which is a company owned brand name. Furthermore he has to purchase some products from the Coffeeshop Company. He has to pay a different price than a franchisee. On the other hand the franchisee also has to pay a monthly fee, which the brand user doesn't have to.

Interviewer: When and where was the Coffeeshop Company founded?

Head of marketing and communication: The company was founded in Austria in 1999. The Dr. Alexander Schärf & Söhne GmbH is more than 50 years old.

Interviewer: Was your first franchise partner the Carnival Cruise Line in the USA?

Head of marketing and communication: Yes it was one of the first ones in 2000. There was also an outlet in Oldenburg Germany, a classical franchisee and also a shop in shop solution in Duisburg. This was also around the year 2000.

Interviewer: When did you start franchising in Austria?

Head of marketing and communication: The first two outlets were built up in Linz and in Vienna in 2001. The outlets in the Milleniumcity and the UCI cinema were also at this time. The same with the one in Oldenburg.

Interviewer: How many employees do you have working in the headquarters here in Neusiedl?

Head of marketing and communication: Well we have 14 – 15 people working in the management. However this can change over time. But something around 15.

Interviewer: How high is the entrance fee for a franchise partner?

Head of marketing and communication: It's 25k EUR.

Interviewer: And how high are the investments, which have to be made at the beginning of a shop opening?

Head of marketing and communication: The franchisee needs at least 60k EUR, which is approximately 30% of the whole sum of investment. The 60k is the height of money he has to provide from his capital resources. But nowadays, the financial crisis has a huge impact on this sum because there is hardly anybody, who gives credits to the franchisees. Banks don't face risk these days. As an effect of this situation, we hardly recommend to provide 100% of the investment at once without taking any credit. Even though the credit rates are low, it is difficult to get any credit at all. You have to consider that banks want guarantees from the investors too and it may not pay off to borrow money from financial institutions.

Interviewer: Does the Coffeeshop Company also help the franchisee to raise capital or does the franchisee has to pay for the whole investment?

Head of marketing and communication: Earlier we had an opportunity to help our partners to get credit capital. It was a leasing model but nowadays this option is not available anymore. From our point of view this is incomprehensible because the creditor could monitor the franchisee easily.

Interviewer: How high are the average costs to open a new outlet without the entrance fee?

Head of marketing and communication: These costs are between 200k and 300k EUR. This depends on the size of the location. The Coffeeshop Company is responsible to arrange all the interior and necessary equipment.

Interviewer: How high is your share of the revenue?

Head of marketing and communication: We charge a 5% fee of the net revenue and another 1% fee for marketing purpose.

Interviewer: How long is the runtime of a contract?

Head of marketing and communication: It is between 5 and 15 years. But Master Franchises are handled in a different way, because they can be responsible for 100 to 150 shops.

Interviewer: Are there any regular meetings of a committee for consulting?

Head of marketing and communication: As the size of the company is pretty small, there are continuous meetings. These are not scheduled.

Interviewer: Do you have meeting with the advisor board?

Head of marketing and communication: Not directly. The Schärf enterprise group contains two business groups. On the one hand the Dr. Alexander Schärf & Söhne GmbH and on the other hand the Coffeeshop Company. The general owner and the director of the company is Reinhold Schärf. But there are investors, who want to be informed about the progress we make. This is done at the board meeting.

Interviewer: Is there are an official meeting between the franchisees?

Head of marketing and communication: We will have a 10 year anniversary this year. But this is a very difficult situation. We know that franchisees might act together to get better conditions from us. So these meetings can become a problem for us. But it is also crucial to set up these meetings because the knowledge of the franchise partners is incredibly important. It is our duty to filter and get an access to this information and provide it to the other franchisees. That is the most difficult part of franchising.

Head of marketing and communication: There has not been any official meeting yet. The franchisees know each other and I'm sure that they have already met each other and interchanged information without letting us know. This is the most important task of the franchisor.

Interviewer: What about meetings between you and the franchisees? Are there any?

Head of marketing and communication: Yes of course. We meet on a regularly basis. We also stay in contact by phone and email and meet at least every three months. Partners, who are operating in faraway countries like in Russia, cannot be visited that often but we try to visit them every six months. As I told you we have permanent contact.

Interviewer: How often do you have trainings?

Head of marketing and communication: All the franchisees have to come to Neusiedl at the beginning. The core team is trained in Neusiedl. If we have a new Master franchisor, the management will be trained here. So the introduction takes 3 to 5 days. It can take a bit longer for Master franchisors. They learn everything about the used technique, the coffee itself, the service, the marketing tools, the shopping of ingredients, logistics, controlling and much more. Furthermore this is a good possibility to meet the partners face to face and get to know the attachment figures.

The basic training is only done once. But the permanent contact guarantees further trainings. We give them one month to get to know the operative side of running a shop and continue the training sessions by sending out key accounters to help them with specific tasks. These key accounters or also called "operatives", who know everything to run a shop and are good in training people. They also do vacation replacement for franchisors. A unique service that we offer. To sum up, we do have regular trainings but not at certain appointments. For example a MU franchisee with 24 outlets sends approximately 20 employees to us every two years.

> *Interviewer: As I told you previously on the phone my topic of my thesis is about Single Unit & Multi Unit Franchising. I'd like to proceed with questions about the difference of these methods, if you don't mind.*

Head of marketing and communication: I don't mind. Please ask me everything you want to know.

> *Interviewer: To start with a general question, what are important factors of franchising to be successful? From the franchisor's perspective.*

Head of marketing and communication: The most important fact is to have a really great concept and even better product, which sells well. The rest isn't that important. These are the basics you need. As long as the franchisee doesn't make any money, you have problems. Therefore the concept and the product are everything you need.

> *Interviewer: How important is to have a strong brand name and do you take any actions to protect it or make even stronger? Are you facing problems with opportunistic behavior of franchisees, e.g. someone who*

profits from a strong brand name and do less effort to run his shop? Is there any threat regarding this?

Head of marketing and communication: The most difficult thing of franchising is that it is a partnership. And it is hard to find the right one. Franchisor and franchisee do not always fit together. The franchisor needs the right mix of people. There are 2 kinds of franchisees. The ones who do exactly what you tell them to do and aggregate know-how and those who are some kind of queer fellows and thinker. The last mentioned kind would probably be better for an individual-concept. But these franchisees, which are “troublemakers”, are the one who take you further and challenge us every day. They are the ones who invent new products and have good ideas. They are very important but also very time consuming. So having the right mix of people is difficult. Multi-unit franchising and single-unit franchising are both important too. Both models have advantages and disadvantages. It doesn’t make sense to have 3 or 4 big MU franchisees, which run all the outlets. If someone of them have financial problems and have to end the contract, you have a problem. But if you still have another 20 small SU franchisees, you can still continue with the franchise. Having a strong brand is important but not everything. We don’t have a strong brand. McDonanld’s, Merkur, OBI and Spar are well known brands but the Coffeeshop Company is a very small player. No famous brand.

Interviewer: But you are a major player in comparison to other coffee shops, aren’t you?

Head of marketing and communication: Yes, we are. I would say that we are the market leader in Austria regarding coffeeshop concepts. Segafredo, Cappucino, Caffee&Co are strong competitors. They do something else than we do. Segafredo for example is similar to a classic café but not that nice. But that’s Segafreds’s concept and it’s good to differentiate.

Interviewer: So there is no misuse of the brand name, is there?

Head of marketing and communication: We take care of our partners and also monitor them. Taking care of the franchisees and doing continuous trainings prevent misuse. The Coffeeshop Company has an established system to prevent misuse. We do know that sometimes a franchisee buys muffins at a different supplier. In the end the most important thing is that he makes money!

> *Interviewer: Is there a special method to find the ideal franchise partner? I know that you can get in contact with you via your homepage and that you need the start-up capital but is there something else which helps you to find the right person? Are there any other criteria?*

Head of marketing and communication: Experience is the most important factor. The human factor is crucial. Mr. Schärf and Mr. Odwaka have this experience. Mr. Odwaka has 15 years experience in different franchise systems. He worked at McDonald's, Burger king, Pizza hut and even more companies. They interview possible partners and look for the human factor, if they understand the topic „coffee" and have the right emotions.

> *Interviewer: Is it possible that a well-established franchisee has advantages in opening new outlets? If there is the situation where 2 possible franchisees want to open the same outlet and one of them is a SU franchisee and the second one is a MU franchisee, does the MU franchisee has an advantage?*

Head of marketing and communication: If the MU franchisee has good running shops and he is capable of being a good manager, he will get the outlet. That's for sure. But you can't generalize this as this is different from case to case.

> *Interviewer: Investments have to be made by franchisors and franchisees at the beginning of a partnership. Do you think that MU franchisees, who have much higher investment costs, might be the persons with the higher entrepreneurial capabilities?*

Head of marketing and communication: This cannot be generalized. Some MU franchisees overstrain themselves by having too many outlets. There has been one MU franchisee, who was running 2 outlets successfully but when he opened a third shop, he wasn't able to manage them and all outlets lost on performance. We had to find a new partner for the third location. So higher investments do not directly lead to better partners but the management prefers them. However we have to discuss the risks of a MU franchisee and find a common solution together.

Interviewer: How does the Coffeeshop Company consider markets, which are affected by fluctuation and uncertainty? Is this an important factor?

Head of marketing and communication: It is definitely no problem in Austria, Germany and Switzerland. These markets are very similar and well known. We don't have issues here. The culture and language is similar and Germany is also a member of the European Union. No problems with local know-how there. But Russia, Saudi Arabia, CEE countries and Bahrain for example are different. There it only makes sense to have a big financial strong partner with the capabilities to open many outlets at once. If there is one in Bratislava and he is managing Slovakia, Czech Republic, Hungary and Poland, he will need people in Hungary and Poland to get the market know-how for these countries. We are always seeking for huge partners. The partner in Russia is a company with more than 5000 employees and being the franchise partner of the Coffeeshop Company is just another branch of business for him. Our partner for the CEE countries has 4 or 5 factories and is running the coffee shops as a further business. This is the only thing that makes sense. Everything else is not successful.

Interviewer: Which franchising model are you using for these markets where you do not have the local market know-how?

Head of marketing and communication: Well these are all Master franchise solutions. However these franchisees use a kind of MU model to get to know their own market. This means that they start to open a few outlets owned by the franchisees and if they know the market well enough, they start to contract other new franchisees. We are only consulting them and doing some services. For example in Cairo we have a franchisee, who started with 3 outlets and afterwards he signed new partners for the market in Cairo. The franchisee of the CEE countries had 36 owned outlets before he started to establish a franchise system there. The partner in Russia has 5 shops and is starting to look for possible franchisees now.

Interviewer: What about Austria? Are there any environmental uncertainties? Is there a difference between cities and the countryside or do you have exactly the same concept?

Head of marketing and communication: There are minor differences and we are also considering these differences. McDonald's for example doesn't do that. But McDonald's has many resources. It took them decades to establish themselves in Austria. However the Coffeeshop Company customizes its shops as long as people can recognize the shop as an outlet of the Coffeeshop Company. The design of the outlets and also the core products are the same. Well the differences are very small in Austria. The franchisee has often the opinion that some products won't sell at his location but most of the time they are not true. Even though we think that it doesn't make sense to differentiate markets in Austria, we respect the opinion of the franchisee.

Interviewer: How important is the local market know-how?

Head of marketing and communication: It is extremely important! The franchisee has this kind of know-how, which we are trying to get from them. We visit exhibitions in foreign markets before we enter a new market with a partner and discuss the general situation in this market, e.g. culture there. We develop a concept for this market together and learn from each other.

Interviewer: If you think about multi-unit franchising and single-unit franchising, which model do you prefer in markets with environmental uncertainty? Do you agree that a SU franchisee could focus on a single location and gain more know-how there and run the outlet more successfully than a MU franchisee?

Head of marketing and communication: This is a difficult question. We have done both successfully and also not successfully. It is bad if a MU franchisee wants to enter completely different markets. If you consider entering a new country it's definitely better to have a partner, who is able to open many outlets there. It doesn't make sense to open one shop and open another shop when the first one has generated enough money to invest in the second one. This would be far too slow and it wouldn't be possible to establish a new brand. It's better to open for example 5 shops in the beginning and 10 shops after a year. That's the only way to do this!

Interviewer: Do you agree that multi-unit franchising is a possibility to grow faster?

Head of marketing and communication: Yes I do. This is much more efficient. But penetrating a foreign market slowly is also an option. In Cairo we only had 2 shops at the beginning and our franchise partner opened another store a year later and now he has 7 outlets there. But I have to point out that Cairo is a special case because we are operating there only close to the airport. You couldn't do that in the whole country.

Interviewer: Would you confirm that multi-unit franchising has financial advantages for you as the franchisor?

Head of marketing and communication: Yes of course! It's a big advantage that we don't have to negotiate every single contract again and again. This wouldn't make sense in a foreign country where the culture is much different from ours. This doesn't work at all.

Interviewer: If we consider franchisees with more than one outlet, is this an advantage from the franchisor's point of view? For example can you gain advantages through economies of scale?

Head of marketing and communication: Yes this is what we prefer. If the contractor is a MU franchisee, we don't have to train him every time he opens a new outlet. We appreciate that franchisees open 2 or 3 shops but having more might be difficult to manage. This would only work if the franchisee has the role of a manger and has shop managers in his outlets. These partners open 3 or 4 shops at once and open another 4 outlets soon after the first ones. There is a MU franchisee with 24 shops in Eastern Germany.

Interviewer: If you think about the specific know-how you need to run a shop in Germany for example, is this easy to transfer? Can you write that down or would you say that this kind of know-how is tacit and it is difficult to transfer from one person to another. Can you exchange a franchisee with another one for the same location easily?

Head of marketing and communication: Single partner can be exchanged quite easily. He doesn't have to be from the same region either. But this is not possible for

MU franchisees with many stores. It might work for a new partner with high capital resources and an excellent long time plan. The problem would be that the employees of the former franchisee will stay with him and most of them leave the company together. So SU franchisees can be exchanged. It's also better if the new partner is familiar with the market there, but both ways work. For example we have a partner who moved to Passau and had an issue with his social life. He complained about a bad work life balance. But this was a private issue. There was no problem from our point of view. However private problems always affect the business. The Coffeeshop Company as a family enterprise considers this.

> *Interviewer: How important is it to have system specific know-how and how does it affect the franchise model? Is the recipe or the controlling tool for example all provided by the franchisor and is this a global concept?*

Head of marketing and communication: Yes we provide all the necessary things to run the coffeeshop but these tools have to be adapted to each country. Austria and Germany are well structured and only minor changes have to be made. But we give the franchisees everything they need: customized business plan, promotion plan, inventory list and even more. But if the franchisee decides that he doesn't need all the tools he can use his own ones. At the end of the month they have to provide us the right data. We don't really care how they get to the data.

> *Interviewer: The system specific know-how is educated in the headquarters in Neusiedl, isn't it?*

Head of marketing and communication: Yes we give them an introduction here and continue training them at their outlets too. The franchisees get an overview about the tools we provide. We always differ between three kinds of franchisees. The first kind is interested in marketing, the second kind in operative and the third kind in controlling. If there is for example a marketing interested franchisee, we give him a longer training session for marketing and a shorter one for controlling. We know that he will get issues with controlling but at the beginning we cannot force him to do controlling related things all day long. So time after time we send employees to him to help to get the controlling done. We are always trying to train the partners about controlling tools, inventory lists, rosters, tools to calculate the cost of sales, tools to calculate the amount of coverage even more system specific know-how on a regularly basis. It's our job to provide powerful tools.

Interviewer: Do you think that there are advantages, when system specific know-how can be transferred to many outlets by a MU franchisee?

Head of marketing and communication: At master franchising we have to show him everything very detailed. He has to transfer this know-how to 30 shops, which he will probably run too. But these huge MU franchisees often have their own tools.

Interviewer: Does the franchisee have any decision rights? Is he involved in the invention of new products?

Head of marketing and communication: Yes partners are important in this case. The Big Mac was also invented by a partner. And the flatbread was also invented by one of our franchisees. This system will adapt to other outlets by us. Every partner has an opinion about new products but the final decision is done by the franchisor.

Interviewer: Where do you test new inventions? Is there a flagship store or even the possibility to do this in the mini chain of a multi-unit franchising?

Head of marketing and communication: We usually test them in the company owned outlets and in a few outlets of franchisees. Afterwards we introduce the new product to our master franchisors and they decide if it will work in their market. If it works in Austria we can sell it in Germany too. Sometimes there is the need to change minor things for a different market. The prices are often different but the product itself is almost the same everywhere. The café latte sells in every market.

Interviewer: Wouldn't it be a possibility to test new products in MU franchisee's mini chains?

Head of marketing and communication: Yes this is done in 2 or 3 shops of a MU franchisee. He tells us his results and we evaluate that. Sometimes the partners invent new products and don't tell us anything about it. We don't like this but we usually tolerate this as long as he doesn't change anything with the coffee itself. This is strictly prohibited. The coffee has to be the same around the world. We try to guarantee to have the same quality standard of water too but that's difficult. Milk is different from place to place.

Interviewer: Is there a high level of trust between you and the franchisees or do you negotiate every detail within contracts?

Head of marketing and communication: Trust is absolutely necessary to be successful in franchising. There is a high level of trust between our partners and us. It wouldn't work without it.

Interviewer: Do you agree that the level of trust is higher with partners you know for a longer period of time?

Head of marketing and communication: Yes for sure.

Interviewer: Do franchisees influence the decision about the location? Is this done by either the franchisor or franchisee or together?

Head of marketing and communication: This decision is always done in cooperation, because the franchisee has to work and live there. We cannot force anybody to open an outlet at a specific location. However if we tell him that a specific location is not a good idea, we hope that the franchisee won't do this. He should trust us in these cases. I think that's the reason why he comes to us as a franchisor. We have all the experience and knowledge to find successful locations.

Interviewer: Does the franchisee have any influence on pricing?

Head of marketing and communication: This is another topic which will be discussed together.

Interviewer: Are there any differences at certain locations?

Head of marketing and communication: The entrance fee is always the same and it is 25k Euro. But then the costs depend on the kind of coffeeshop the franchisee wants.

Interviewer: But are the prices of the products the same in every store?

Head of marketing and communication: Well the franchisor can recommend a price. But the franchisee has the right to set higher or lower prices. The difference between us and other franchisors is that the others rely on fix prices and we don't. I have even noticed that McDonald's has different prices too. We do have 3 to 4 different prices in Austria. It is dependent on the location. You can charge higher prices at an airport for example but students might not be willing to pay such high prices at university. Therefore the franchisee adjusts prices related to the market he is operating in. However the prices of the coffees are almost the same. There can be a 10 cent difference among franchisees. It wouldn't work if one store is selling the coffee for a certain price and another one next to it is selling it for less. A price war will hurt both of them. The prices for mineral water for example are varying quite much, because our partners sell different brands of mineral water. The pricing of food is also different sometimes. This is related to the different food concepts we have. And then there are some exceptions which differ from case to case.

Interviewer: Do SU franchisees and MU franchisees have the same decision rights?

Head of marketing and communication: No. The MU franchisee with 24 outlets doesn't need our know-how to open the 25th store. We still evaluate the location together but this is a shorter process than for a SU franchisee. The MU franchisee can make decisions based on his long time experience. But this is only the case for MU franchisees with more than 10 outlets. A MU franchisee with 3 or 4 shops has not enough experience yet to make such important decisions. Master franchisors run their countries on their own anyway. But there is no other way, because the master franchisor has the knowledge for the foreign market. We don't know anything about the locations of the sub franchisees.

Interviewer: How do you conduct the quality conformance test?

Head of marketing and communication: This is done by so called mystery shoppers, which are professionals. We haven't used them for a while now and as far as I can remember there was only a single case where we asked for their help. Airports or shopping centres have their own mystery shoppers. They give us the feedback of the test purchase. We also control our outlets by our employees. Everyone in the Schärf group goes to stores, test them and give us a feedback. This is how we guarantee high quality standards.

Abstract (English)

The main focus of this thesis is to analyze which factors determine the decision about whether to choose single- or multi-unit franchising. Due to the fact that scientific studies predominantly consider single-unit franchising this work wants to highlight both, single- and multi-unit franchising. Therefore prevailing science-based theories (that is Transaction Cost Theory, Principal-Agent-Theory, Resource-based Theory in conjunction with the Organizational Capability View, Screening Theory and The Property Rights Theory) are scrutinized to identify under which circumstances single-unit franchising is preferred over multi-unit franchising and vice versa. The empirical part of the thesis then investigates by means of two well-established Austrian franchise firms (Coffeeshop Company and Testa Rossa Caffèbar) if the theoretical statements coincide with real world business.

Abstact (German)

Das Ziel dieser Arbeit ist eine Aussage darüber treffen zu können welche Faktoren die Entscheidung über die Wahl der Franchisingform festlegen. Aufgrund dessen, dass in der wissenschaftlichen Literatur bezüglich Franchising vorwiegend Single-Unit-Franchising diskutiert wird, soll in dieser Arbeit im Gegensatz dazu auch Multi-Unit Franchising Gegenstand der Untersuchung sein. Anhand der vorherrschenden neuen Institutionenökonomie (Transaktionskostentheorie, Prinzipal–Agent–Theorie, Ressourcentheorie in Verbindung mit der Organisationstheorie, die Screening Theorie und die Theorie der Verfügungsrechte) soll untersucht werden in welchen Situationen Single-Unit Franchising Multi-Unit Franchising vorgezogen wird, und umgekehrt. Im empirischen Teil der Arbeit sollen mit Hilfe von Tiefeninterviews mit zwei etablierten österreichischen Franchiseunternehmen (Coffeeshop Company und Testa Rossa Caffèbar) die theoretischen Aussagen auf ihren Wahrheitsgehalt geprüft werden.

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Aufteilung der Diplomarbeit

Kapitel 1: „Introduction“
Julia FRAUSCHER

Kapitel 2: „Transaction Cost Theory“
Christian SCHROMM

Kapitel 3: „Agency Theory“
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Kapitel 4: „Resource Scarcity View“
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Kapitel 5: “Organizational Capabilities”
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Kapitel 6: “Screening Theory”
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Kapitel 7: “Property Rights Theory”
Julia FRAUSCHER, Christian SCHROMM

Kapitel 8: “Research Design”
Julia FRAUSCHER, Christian SCHROMM

Kapitel 9: “Coffeeshop Company”
Christian SCHROMM

Kapitel 10: “Testa Rossa Caffèbar”
Julia FRAUSCHER

Kapitel 11: “Empirical Findings due to Hypotheses”
Julia FRAUSCHER, Christian SCHROMM

Kapitel 12: “Summary of Empirical Results”
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