The Franchisor’s Dilemma -

the identification and application of the key structural and driving elements necessary for the creation of a sustainable franchise network

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INTRODUCTION AND BACKGROUND

“When you start up a company, you go to sleep young and wake up old” – Adizes (2000).

In South Africa, the current company environment is extremely competitive. Shifts in consumer demand, technological innovation, a weaker currency and globalisation have led to harsh trading conditions, where the risk of failure is high. In addition we are experiencing a slowed economy with depressed consumer spending, a weak currency and relatively high interest rates. Restrictive labour laws coupled with the need to provide employment and empowerment opportunities for previously disadvantaged individuals compound this. These are over and above the normal risks associated with start up companies. As a result, starting up a company carries more risk of failure than ever before. One response to the risk of failure and the challenge of creating employment opportunities, is the increasing acceptance of Franchising as a means of creating a start up company.

Franchising is a system whereby two parties enter into a contractual arrangement between each other whereby the franchisor allows the franchisee to market or sell a product or service that the franchisor has developed. In return, the franchisee pays a fixed or variable sum of money to the franchisor for this right (Frazer, 1998; Castrogiovanni and Justis et al, 1998) and agrees to conform to quality standards set by the franchisor (Justis and Judd, 1989). A franchise organisation is described as a network composed of a franchisor (incorporating the parent company and any company owned units) and it’s franchisees (Norton, 1988). Franchising provides the franchisor with the resources necessary to accelerate growth in order to reach minimum efficient scale and brand name capital. Critical resources include capital, managerial talent and local knowledge (Combs and Castrogiovanni and Justis (1994) quoting Brickley and Dark (1987), Carney and Gedajlovic (1991), caves and Murphy (1976), Hunt (1973), Inaba (1980), Martin (1988), Norton (1998 a and b), Oxenfeldt and Kelly (1968-9) and Rubin (1978)).
There are usually two types of *Franchising* strategies in terms of what is franchised

- **licensing** which essentially involves the right to use a trade name associated with certain products or services. Here the *franchisee* is allowed to determine the structure and method of his operations and simply has the right to use the licensed trade name e.g. Coke South Africa who on-licence the use of the name to *franchisees* such as SA Bottling Co and Amalgamated Beverage Industries, both of which have very different methods of operating their companies.

- **business format franchising** whereby a self-contained company operation, sometimes referred to as a “turnkey operation”, is franchised. Essentially, duplicate operational outlets are produced which look the same and operate using identical methods and procedures. “A carbon copy configuration is taken by many organisations engaged in business format franchising, since each outlet becomes a carbon copy of the other”, (Mintzberg (1979) as quoted by Castrogiovanni and Justis (1998)). “Tendencies toward carbon copy are especially common when work tasks are highly repetitive, customers make repeat purchases on a frequent basis and when customers are likely to patronise more than one outlet within the franchise chain. This is often the case among restaurants (Caves and Murphy (1976) as quoted by Castrogiovanni and Justis (1998)). It is thus no surprise to find out that all of the major restaurant and fast food operators in South Africa use this method of Franchising.

Franchising in the restaurant and fast food sector in South Africa

*Franchising* in the restaurant and fast food industry in South Africa has become a popular operating strategy for companies wishing to grow their brands and increase shareholder value. Without exception, all of the major restaurant and food chains currently operating in South Africa have chosen to facilitate expansion and growth in their companies using a system of franchised outlets or alternatively using a combination of company owned and franchised outlets. However it is interesting to
note that, without exception, all of the failed restaurant and fast food companies over the past five years in South Africa had also adopted a strategy of franchising their concepts to increase the value of their brands and increase shareholder value. The failed restaurant and fast food companies were at the time of their failure, the leading or among the leaders in their particular food category. Four of the failed companies formed part of listed entities and were household brand names.

The restaurant and fast food failures were spread across various food categories and included pubs (two brands), fish restaurants, family restaurants (two brands), pizza pasta, flame grilled chicken and grilled rib outlets. They also operated their entities quite differently from one another. However one commonality that existed between the failed entities was that at some stage of their growth, they had embarked on a franchise strategy. Although their may be other factors that helped lead to the ultimate failure of these entities, a discussion and literature review performed on media information (virtually the only source of data available) subsequent to the failure of these companies revealed that the franchise network in each of the entities had broken down or had failed to perform as originally envisaged in certain areas.

RESEARCH QUESTION

Thus although franchising is the preferred strategy for all the major participants in the restaurant and fast food industry in South Africa, the strategy of operating a franchise network could, and has on numerous occasions failed, as a result of key elements of the franchise network not being identified or properly managed. Thus the questions that should be asked by all existing and potential restaurant franchisors are;

- **What are the key causes of the failures in the franchise network?**

- **In order to create a sustainable franchise network, what are the key structural elements and driving forces that need to be put in place to achieve this?**

- **Can a model be developed which can be used to assist with this?**
While there are a number of readings that have appeared in industry media on the subject that have added valuable contributions to the knowledge on the subject, research into the determinants and key performance ingredients of a successful restaurant or fast food franchisor network in South Africa remains rooted in the early stages of development. Other than various articles published in industry media, there is currently no generally accepted franchisor model for use in South Africa that a franchisor could consult for guidance in establishing and operating a successful franchisor operation.

RESEARCH METHODOLOGY

There has been much debate and criticism around the two paradigms that researchers operate in, namely the positivist and phenomenological paradigms. Furthermore some scholars have suggested that it is entirely possible that researchers in many instances switch between paradigms within the same research project (Easterby-Smith et all, 1998). Notwithstanding the debates around this topic, there is general consensus that the researcher operating primarily in the phenomenological paradigm has the basic beliefs that the world is socially constructed and subjective, the researcher is part of what is being observed and that science (in this case the research) is driven by human interests. There is also consensus that when operating within the phenomenological paradigm, the researcher should focus on meanings, try to understand what is happening, look at the totality of the situation and develop ideas through induction from the data. One of the preferred methods of research in the phenomenological paradigm is to use a small sample of data that should be investigated in depth over time (Easterby-Smith et al, 1998).
Grounded Theory

Grounded Theory exists within the phenomenological (qualitative research) paradigm, with a wider base for collecting data. Glaser and Strauss in their 1967 book titled “The Discovery of Grounded Theory”, provide a strong intellectual argument for using grounded theory to develop theoretical models. They developed the model while conducting an observational field study of the way that hospital staff dealt with dying patients. Grounded Theory provides a method of developing theory from data with the intent of providing theory that “will fit and work”. Grounded Theory is a methodology for generating theory and aims to organise many ideas through the analysis of data (Glaser 1978). Grounded theory is theory that has been systematically obtained through social research and is grounded in data (Goulding, 1998). Grounded theory is a methodology that has been used to generate a theory where little is already known, or to provide a fresh slant on existing knowledge (Goulding, 1998). The researcher begins his research within an area of study and allows relevant theoretical constructs to emerge from the research process, as opposed to beginning with a theory that he or she wants to prove or disprove. The theory will usually emerge through the development of key concepts whose relationships are investigated to generate a theoretical framework, which will serve as a basis for future explanation (Strauss, 1987). Thus grounded theory as a methodology was developed for, and is particularly suited to, the study of behaviour (Goulding 1998). The grounded theory researcher does not distance himself from the research as a positivist researcher would do. Instead the researcher will not commit to supporting or proving or disproving any particular theory when undertaking research. This is in order to allow the theory to develop from the data (Parker and Roffey, 1997, Glaser, 1992). However grounded theory does not assume neutrality or lack of bias on the part of the researcher, but the researcher is expected to strenuously avoid superimposing any existing theories on the research.

Since developing the original theory, Glaser and Strauss have subsequently differed on a number of issues relating to grounded theory. The main differences between the two as per Parker and Roffey (1997) are as follows
• The approach to generating the main topic of research. While Glaser advocates that the topic of study should emerge during the course of the onsite research, Strauss allows for the researcher to pre-select the topic before entering the site. In the case of this research document, the researcher chose the topic as much as the topic emerged during the onsite research. The researcher was a part of the early formulation of the case study company and as such he was involved in generating the data in the company way before he “officially” performed the research, thus the topic in effect emerged during this period. However to make sense of the data, the researcher undertook a “formal” research process to enable a theory to emerge which would be useful to him to generate explanations in the future.

• The second main difference is the degree of formal structuring of approaching the data and generating the framework, with Strauss being prescriptive in terms of structured the approach and structuring the ways in gathering of data.

These differences do not discount the underlying principles supporting grounded theory as originally envisaged. In fact, the differences were analysed by Parker and Roffey (1997) and their conclusion was that the expressed differences need not have an effect on the explanatory constructs developed during grounded theory study. They went on to state that Glaser and Strauss’ differentiation might lead to an enrichment of grounded theory.

Grounded Theory is a methodology for generating theory and aims to organise many ideas through the analysis of data (Glaser 1978). The analysis of the data consists of analysing notes, documents and field notes collected, and data generated through interactions, interviews, organisational records, industry data and observations (Strauss, 1967; Parker and Roffey, 1997, Goulding, 1998). The researcher collects his data and decides what data to collect next and where to find them, in order to develop his theory as it emerges (Glaser and Strauss, 1967). Although it is generally accepted that this is the best-suited and often only means of obtaining data using grounded research, one key area of concern is the credibility of the data being gathered.
The main concerns posed here are observer bias, limitation to data access (Glaser 1992; Strauss, 1987; Parker and Roffey, 1997) and the constructs with which the researcher views the world (Kelly’s personal construct theory, Parker and Roffey, 1997, Goulding, 1998). Strategies available to deal with these criticisms include the researcher spending a substantial length of time at the research site, the use of multiple methods of data collection from multiple sources (various senior management and board members) to obtain as many viewpoints as possible and the ethical behaviour of the researcher during the research process. The physical research process (site visit) was conducted over a period of 2 years and data was obtained over a three and a half year period.

Furthermore, as can be seen in the research document, multiple methods of data collection were employed. Yin (1989) as referred to by Parker and Roffey (1997), suggests that rigorous case study research should include comprehensive data collection and examination of alternative interpretations of the data. Over the period, comprehensive data was obtained for the case study, and often the data supported other data over the period of time. Key data was usually obtained from multiple sources, over multiple periods of time, thus confirming the validity thereof. Furthermore the researcher in many cases was part of the data construction, and therefore has accurate recordings of the data. Furthermore often alternative interpretations would have been discussed at length whilst generating the data, and thus by the time the researcher had recorded the data in this document, the data has been through a scrutiny process within the case study company e.g. although a poor performing outlet may be blamed on a poor performing manager, other possibilities such as poor site selection which could also have caused the same result, would by the time that they have been recorded in this research document, already have investigated within the case study company. This case study evaluates data over time and thus the luxury of hindsight and “lessons learnt” in similar situations within the case study company was afforded to the researcher.
Data was collected and generated from the following sources over a two-year site visit period and a three and a half year documentation review period:

- by observing the day-to-day operations from various different perspectives (director, shareholder, employee) of the company over a two-year period (site visit) and an analysis of documentation over a three and a half year period.

- By having prolonged face-to-face contact with the whole range of management, employees, shareholders across the entire spectrum of operations of the organisation, including other stakeholders such as suppliers, bankers, landlords, industry professionals etc.

- from direct participation in senior management meetings and board meetings, which were conducted formally and informally over a two year period, and performing a subsequent review of minutes of formal meetings prior to the two year period

- by conducting formal interviews with board members and senior management. Due to the nature of the study, interviews predominantly took an unstructured format to enable as many creative and unstructured ideas to emerge from the process as possible

- from attending organisation conferences where senior management and board members discussed and set up the strategy of the company

- by holding brain storming sessions with board members of the company

- By conducting interviews with CEO’s of other listed restaurant franchisor groups
• By using *experiential* data gathered from the researchers' own professional, academic, and personal background will be used to develop the emerging theory (Parker and Roffey, 1997). The fact that findings are theory laden rests on the basic proposition that researchers approach the research situation with a theoretical perspective developed from their academic background and personal interests, who will also have their own paradigms or basic belief systems (Goulding, 1998). Knowledge and theory are used as if they were another informant. This is vital, for without this grounding in extant knowledge, pattern recognition would be limited to the obvious and the superficial, depriving the analyst of the conceptual leverage from which to develop theory (Glaser 1978). Leonard and McAdam (2001) also refer to Carson and Coviello (1996) who in fact further this statement by saying that those involved in grounded theory must have considerable knowledge and experience about the topic area. Contrary to popular belief, grounded theory research is not atheoretical, but requires an understanding of related theory and empirical work in order to enhance theoretical sensitivity (Goulding, 1998).

• By conducting a literature search for each series of data collections. Literature can be used as secondary sources of data. Research publications often include quoted materials from interviews and field notes and these quotations can be used as secondary sources of data. The publications may also include descriptive materials concerning events, actions, settings, and actors' perspectives, that can be used as data (Strauss and Corbin, 1990).

The role of the observer can be performed using one or a combination of one of the following four scenarios; researcher as employee (participant observer), research as the explicit role, interrupted involvement and single observation (Easterby-Smith et al, 1988). The method of participant observation has its roots in ethnographic research studies (Easterby-Smith et al, 1998). “Participant observation characterises most ethnographic research and is crucial to effective fieldwork”- (Fetterman, 1989). “This role is appropriate when the researcher needs to become totally immersed and experience the work first hand. Sometimes it is the only way to gain the insights sought” – Easter-Smith et al, 1998. Rigorous grounded theory studies require the
researcher to have a creative imagination informed by significant personal and professional experience, in addition to technical knowledge and awareness of alternative paradigms (Parker and Roffey, 1997). The researcher during the course of research was a director and had initially joined the company at an early part of its formation.

However it should be noted that two problems could arise with this role adopted by the researcher. The first problem is the ethics involved with the role. This problem usually occurs where the researcher is performing his work covertly. This was not the case and the acting CEO of the company and the majority of senior employees were aware that the researcher was carrying out his research. All information obtained was based on actual day-to-day events occurring, which events occurred irrespective of the fact that research was being conducted. Furthermore the natures of many of the events recorded were of an operational nature, which fell outside the area of direct control of the researcher. The second problem that could possibly occur is one of a crisis of identity by the researcher, where the researcher may not want to report certain findings after becoming “one of the gang”. This is also negated somewhat, as at the time of performing the research, the researcher was already an existing board member and shareholder of the company, and it was not a case where the researched joined the organisation to perform the research with the aim of leaving thereafter. Furthermore the research was performed with the specific intention of trying to make sense of what was occurring in the case study company. It would be foolhardy to try and fool oneself in the search for truth.

Grounded theory is a longitudinal theory (Leonard and McAdam, 2001). Leonard and McAdam (2001) also refer to Van de Ven (1992) and Yin (1989) who argue that case studies are especially appropriate within grounded methodology where real life contexts are being investigated over a period of time. In fact as stated earlier in this chapter, Glaser and Strauss developed grounded theory over a longitudinal case study at a hospital. Leonard and McAdam (2001) also refer to Carson and Coviello (1996) who state that longitudinal case studies have much to offer as part of grounded theory.
Applied research is intended to lead to the solution of specific problems and usually involves working with the organisation to identify and understand the problem identified. While performing the research, it is important to explain why things are happening as opposed to simply describing the events. The results are intended for the use of the organisation and in addition potential should exist to discuss their wider implications in industry journals and other publications aimed at industry practitioners (Easterby-Smith et al., 1999; Booth et al., 1998).

**Methodology Conclusion**

The role of the researcher was to provide a rich deep study of data to enable the emergence of a theory, which is practical in its approach and will enable future understanding and utilisation of the theory. Obtaining valid data and a valid sample size played a crucial role in selection of the research methodology to be used. In South Africa there are only a small number of successful restaurant operations using franchise models still remaining in existence today. These companies are extremely competitive with one another and due to the size of the total restaurant population, it is unclear whether new, sufficient, honest and relevant information can be obtained beyond the simple industry statistics that has already been obtained by media reporters, were a positivist approach followed. Furthermore, a number almost equal to the number of franchise restaurant organisations that exist, have already failed, for which failures not enough data exists for research purposes. When trying to trace the individuals involved in some of the failed organisations, they were unavailable for comment or in some instances had emigrated to Australia and America. Thus it is believed that the depth of knowledge required here cannot be simply obtained from a statistical survey or multi-case review, and any meaningful research under these circumstances thus lends itself to utilisation of grounded research.

Based on this and the factors mentioned in each paragraph in this chapter, a grounded theory approach was utilised in the research process and was applied by performing in depth longitudinal research on a case study company over a two-year period.
FINDINGS, DISCUSSION AND ANALYSIS

The “case study” organisation

Having described the methodology of the ethnographical grounded theory approach taken, the findings emerging from the research are now discussed and analysed. Firstly, the history of the case study organisation is discussed. This is done to place the company’s franchise history and experience in context in order to emphasise the level of franchise experience contained within the organisation at the onset of the research program. The “case study” organisation is currently the leader in its food category in South Africa, occupying 80% of its market, with its franchise network achieving turnovers in excess of R160m per annum. The strategy during the period of review changed by the company from one of owning all company owned outlets to a franchise strategy.

The first outlet was created from inception in mid 1996. Due to phenomenal success, a further 26 subsequent company owned outlets and 14 franchised outlets were opened over the next four and a half years. Over this period, and through trial and error, the business idea for the company was articulated and encompassed the following key elements.

1. The founders bringing together a combination of the following initial competencies to create value;

- A product expert who performed a central buying function for the company and its distribution centre. Before joining the company, he had twenty years of experience and contacts built up within the industry supplying the main product line

- A professional restaurateur with thirty years of experience who would go on to be responsible for the operations of the company
• A shop fitter by trade who would be responsible for and later build all company outlets to the same specifications.

The founders were subsequently joined by

• A businessman whose experience included running a listed clothing company

• An accountant who previously headed up the franchise company of another food company

• A second restaurateur and coffee bar owner who would later take over the responsibility of running the Western Cape Region of the company.

The business idea also had a number of weaknesses. These are discussed more fully in the “findings, discussion and analysis” section, and are specifically listed under KE 6A.

2. Creating a unique formula. Although it would appear to be easy to replicate, all other companies attempting to emulate the same concept in a restaurant chain in South Africa have failed. The formula resulted in the company selling in excess of 1.4 million kilograms of raw product through its distribution centre per annum.

3. Developing an operating process encompassing best practice methodology, whereby the same product offering is consistently prepared to a set menu in every outlet. Individual Outlets serve up to 12 000 customers per month with the same standard and quality throughout South Africa as a result of laid down procedures which are now contained in training manuals, recipe books etc.

4. Setting up a financial and administrative and control structures specifically tailored to restaurant operations
5. A **centralised distribution** division that is responsible for sourcing, buying and distributing the raw product within the company. This is essential as the main product offering is a hunted product, a large portion of which is imported and as a result lends itself to price fluctuations and stock shortages. Furthermore, world currency movements influence the suppliers of the product and as a result, the weak rand against the dollar (product traded mostly in this currency) makes sourcing of the product difficult. The division as a result, buys stock in large quantities to hedge the company against price fluctuations, stock shortages and world currency movements.

*Relationship* building is one of most important functions of the distribution centre. Relationships have been built up with key suppliers over a number of years. As a result we are awarded large portions of industry quotas of certain local suppliers.

6. An **outlet building division** that ensures that each restaurant is built to standard specifications that ensure that all outlets are clearly part of one brand. Relationships have been built with equipment suppliers. The outlet building formula has been refined to the extent that outlets are commissioned at a substantial discount to the capital cost of other branded restaurants. The result is a quicker payback period than is common in many other brands.

7. A recently established **internal marketing division** that performs all marketing related functions and is responsible for assisting with developing of the brand.

8. Meeting the needs of customers by serving a **healthy lifestyle-matching product**. The main product offering is being increasingly being accepted worldwide as forming part of a healthy and correct lifestyle. Doctors and magazines worldwide recommend the eating of the product at least three times a week. Traditional home preparation of this product is viewed as complicated and time consuming, which makes the visiting of outlets a preferred alternative for most consumers.
9. **Barriers to entry (“School fees”).** Physical establishment costs incurred in building infrastructure e.g. a distribution centre with state of the art refrigeration (allowing for the synergies and costs savings associated with bulk buying to be achieved) have been incurred. Training centres, administration head offices, computer systems etc. have been built. Lessons have been learnt in product variations, in what does and does not work, how to conduct and utilise effective customer research, which company models have failed, etc. Competitors will have to incur these costs when starting up a competitive brand. The investment into the company to establish these barriers to entry is estimated to have cost around R40m.

10. **Relationships and reputation with landlords** has ensured that the company is offered key sites in new shopping centres that are being developed.

11. **An established brand.** Although no formal branding exercises have taken place, the creation of a trusted and recognisable food brand in the minds of the customer has been created.

12. **Cost leadership** by being able to provide the customer with a superior quality product and price which cannot be legally emulated

Thus on the face value of the business idea, it would seem that the success of the company would be guaranteed?
Key Events (KE) leading up to the decision to change the strategy of the company to a franchise corporation

During the period under review, certain key events occurred which caused major shifts in the policy of the organisation or the way in which the organisation operated. In the sections that follow, these key events are discussed. A discussion and literature review is performed within each section and where possible, further alternative collaborative evidence has been sought. Finally within each section, an initial proposition emerges which is carried forward to the construction of a management theory section of this document.

KE 1. Management resources

The events

Fig. 1.1 shows the turnovers of the company from inception during the period under review (source management accounts) and Fig. 1.2 shows the average income per outlet over the same period, extracted from the records of the company. Whilst Fig 1.1 shows absolute growth due to the opening of new outlets, Fig 1.2 shows a situation where the average turnover per company owned outlet is decreasing, despite the appearance that turnovers are increasing in absolute terms in Fig 1.1. As a result of this situation, management set out a plan of action, which would ultimately lead to the decision to change the strategic focus of the company to that of a franchise organisation as opposed to an organisation that owns all of its outlets.
Fig 1.1

Fig 1.2
Management discussed this situation at numerous management meetings. For example, the minutes of management meetings over a three week period, which were held on 10 November 1998, 12 November 1998, 17 November 1998 and 1 December 1998, revealed that no less than ten outlets with problems were being discussed, out of a total of 24 company owned outlets (42%), with a number of new outlets set to open in the coming year. Although there are a number of smaller factors that have could have played a part in the decline in performance of company owned outlets, it was initially analyzed by the board of directors after observing and having to deal with problem over some time, that the decrease in the performance of outlets was a result of the outlets having lost the original feel of the founders direct involvement and day to day running of the outlets, which had ceased due to the growth of the company as can be seen in Fig.2.1. It was felt that management were not performing the role that they should be doing in the outlets, which was initially ascribed to a lack of management resources and outlet management not understanding of the company’s goals.

In response, it was decided to establish a regional committee to fill the gap left by the founders to take control of the day-to-day operations in the outlets. This decision was taken in a management meeting held on 18 May 1999 and the following is an extract of the minutes of the meeting,

“2.18 Structured committees and meetings – Control of operations

A sub committee will be formed to deal with the day-to-day operations of the company:

The committee will comprise: XX,XX,XX,XX,XX,XX,XX and XX.

This committee will be responsible for making operational decisions relating to the outlets and will meet weekly on a Wednesday from 4-6pm. XX will be responsible for minutes and will hand these to XX (CEO) weekly.”
The company outlets would be divided up into seven regions and these managers would be responsible for the day-to-day operations of their outlets. They would typically look after two or three outlets and would spend time in each outlet with outlet management trying to re-create the feel and “madness” of the founders’ back into each outlet. The team consisted mostly of managers who had been with the company since start up and also included two of the original founders. As can be seen in Fig. 1.2, this move was not successful. In an attempt to further give support to the creation of the regional manager teams, to attempt to foster a common understanding of the objectives of the company and to incorporate the feel of the founders “madness” into the outlets which had driven the earlier success of the company, it was decided to hold a three day conference at a game lodge from 4 February 2000 to 7 February 2000. It was believed that a communication and sharing of these ideals with management would lead to the initial founding values being re-instilled into the operating of the outlets, and that once that this had happened, that this would lead to the expected recovery in the performance of the outlets.

The company’s founders and other directors spent the first day of the conference, brainstorming the factors that initially made the company successful. The brainstorming session was summarised and graphically presented in a set of slides, which were presented to outlet and regional managers. Regional and outlet managers then spent an afternoon session discussing the slide presentation and thereafter a company session was held to discuss any feedback on the slides and make any adjustments where necessary. As can be seen from Fig. 1.2, no meaningful change occurred in the performance of the outlets subsequent to the conference held, and although the conference had many other benefits for the organisation (discussed further in this paper), the initial goal of enabling outlet recovery did not materialise.

Notwithstanding this, a subsequent review of the turnovers of outlets which were previously owned and included in Fig 1.2, but which were subsequently sold as franchises, was performed. Interestingly, the reverse of the situation in Fig 1.2 was observed! All outlets whether franchised or not are linked by a central computer to the franchisor head office, where daily downloads of turnovers and product sales are recorded on a database. A review of turnovers of all company owned outlets that were sold as franchises during the two-year period under research, revealed that in all
cases without exception, turnovers increased dramatically in the new franchisee set-up. Furthermore, even more baffling, was the situation where two franchisees were selected where the previous manager stayed on to become the franchisee. In the Brooklyn outlet, turnover increased by 54% and in the Glen Outlet, turnover increased by 32% since the conversion of the outlets to franchisees. When asked for a reason for this anomaly, both managers replied, “they were putting more effort into the company as it belonged to them”. Both managers previously had minority shareholdings in the company.

Thus the company faced the realisation that management of franchisee owned outlets performed better that management in company owned outlets.

**Discussion and literature review**

There are a number of reasons that individuals are driven to achieve personal gain. Carl Jung’s analytical theory, and in particular his viewpoints on self-realization set out one viewpoint on this matter. Maslov’s self actualisation theories and the stages of development of individuals, including the need for material possessions and wealth, set out another a similar theory in this regard. Whatever the theories supporting the drivers of individuals to achieve personal gain, the need to acquire more than your neighbour and strive for increased wealth has been active in western civilizations for centuries. The fact that capitalism has succeeded, or rather is the dominant form underlying western civilization today, must be acknowledged as being the will of the people living in these societies. Although the study of these societies and capitalism is way beyond the scope of this research, a large number of people in western civilizations appear to be driven by the need or purpose of creating as much wealth as can possibly be achieved in one lifetime. In fact the majority of people in these societies commit at least two thirds of their active lives in search of financial and material wealth, irrespective of how much they may at any one point already have accumulated. Outlet managers and franchise owners are no different, each operating with his or her own agenda to achieve personal gain.
A study by Eisenhardt (1989) and Jensen and Meckling (1976) noted that agency problems usually arise as a result of a divergence of goals between hired managers (agents) and firm owners (principals). Outlet managers serve self-interests or exert less than maximum effort toward company interests, thus more monitoring is needed. (Fama and Jensen (1983); Jensen and Meckling (1976), (Mathewson and Winter (1985) as quoted by Castrogiovanni and Justis (1998). It thus stands to reason that as franchisees have invested considerable sums of money into the acquiring the franchise and receive outlet profits, they are more likely to be motivated than managers of company owned outlets (Castrogiovanni and Justis, 1998). Hopkinson and Hogarth-Scott (1999) in their research refer to Alchian and Demsetz’s, (1972) theory of a firm, where it was found that outlet managers with no claim over the residual (profits) will sacrifice economic efficiency in order to increase other personal gains. Franchisees invest large amounts of money to purchase a franchise. Therefore, they are highly motivated to maximise the present value of the franchise, and effective management is the only way to recover the investment with an acceptable return (Combs and Castrogiovanni, 1994).

Critical scarce resources necessary for accelerating growth include managerial talent (Combs and Castrogiovanni, 1994). In the events of the case study company above, it can clearly be seen that this was a critical resource needed by the company, and as a result, a lack thereof caused the company to suffer both financial and other losses.

Adizes (2000) discusses the creation of a company as the infancy stage. He states that a company is born when the risk is undertaken. He concludes, based on a study of hundreds of companies and countries, that commitment is commensurate to the risk and that commitment increases as the size of the risk increases. He states that although profitability is important, risk incurred is more important to driving initial success of a company. He adds that a company (in this case outlet) is unlikely to succeed if the manager of the outlet does not have anything to lose. He further states that at this stage of the life cycle of the outlet, the owner should take all major decisions and essentially have the characteristics of an autocrat, reasoning that the outlet is too young for any other type of leadership. Managers of outlets, especially outlets that all operate on similar operating guidelines and procedures, cannot perform this function. Whilst it could be argued that in the case of buying a franchise, systems
are supplied by the *franchisor* and therefore the franchise has in fact passed the stage of infancy, based on the experience of the case study company, this was not so.

Each new outlet opened came with it’s own set of new problems, even after the company had opened in excess of forty outlets. Some problems encountered included site problems, logistical problems, staffing, raising of funding, local community marketing plans etc. The case study company showed that each new outlet opened was indicative of starting up again. Whilst the product was the same, the market that the outlet operated in, staffing, funding, landlord management, local infrastructure and many other factors were different. This is supported by Weinrauch (1986), who when examining common myths about *Franchising*, found that “becoming a *franchisee* within any franchise system entails risk and requires entrepreneurial skills that are encountered in starting any type of company. *Franchisees* must still assume responsibility for making many managerial and operating decisions. They must maintain quality control, implement plans, staff the company and foster creative ideas and practices”.

A review of a franchise application for a South African franchise for the worlds largest fast food burger operation revealed that they only sell franchises to owner operated *franchisees*. To determine whether this was the case with other fast food and restaurant *franchisors* in South Africa, the researcher held separate discussions with the CEO’s of two of the largest listed restaurant and fast food entities in South Africa. The CEO’s of these two companies stated that in their opinion, entrepreneurial qualities could not be instilled in management of company owned outlets and that in their experiences, franchised outlets outperformed company owned outlets directly as a result of the entrepreneurial qualities being present in owner managed *franchisees* as opposed to company manager run outlets. As a result they had taken a conscious management decision within their organisations as a strategy to grow only by means of *Franchising*. A further Discussion and literature review of newspapers, industry journals and financial journals, also revealed that during the period of review, a third listed restaurant and fast food company had taken the decision to change its strategy and was in the process of selling a large portion of it’s company owned outlets to *franchisees* (attempts to contact the CEO of that company was unsuccessful).
On subsequent reflection, the initial assessment of the board was correct that indeed the qualities of the founders were needed to turn the performance of the outlets around. The decision taken that entrepreneurial qualities and ownership culture could be instilled into hired management, including a hired regional management team that shared in company profits, was not. The research showed that the results produced showed no improvement in the performance of the outlets, even though regional management had on the face of it committed themselves to the process. Although one could possibly argue that the failure of the outlet recovery could be ascribed to flaws contained in the operational or personality characteristics of regional management themselves, the fact is that there was no recovery in all of the seven regions, which were run by seven separate regional managers. Furthermore, the performance of the outlets without exception increased in turnovers and operating performance upon becoming franchise outlets, even in the case where the same management team stayed on.

Therefore, as a result the following emergent conclusion has been reached, which will be carried forward to the construction of a management theory.

**Emergent Conclusion KE1 – Independently owned franchise outlets perform better than employee managed company owned outlets**
KE 2. Geographical location

The events

Initially the first sixteen outlets were built around the Guateng and Pretoria areas. Furthermore, after the fourth outlet was built, a distribution centre and head office was established in Midrand, which was ideally placed from a geographical viewpoint. Thus control and monitoring of the outlets was logistically facilitated by the geographical spread of the company in Guateng/Pretoria. The founders, experiencing the great demand for the company's product, and not wanting to lose the concept to any possible “copy cat” outlets arising in other areas in South Africa, decided to expand operations and open outlets in other parts of South Africa. Using the principle of the company owning all outlets as opposed to franchising outlets, the company set up operations in Cape Town. Initially a head office structure was set up and one of the founders relocated to Cape Town in March 1997. During this period he established an infrastructure, located key suppliers and scouted for sites to establish the first outlet. Two outlets were subsequently opened in August 1997 and a further two outlets were opened in December 1997 and August 1998.

From inception, as had been the case in Johannesburg, the outlets exceeded expectations and turnovers matched or exceeded the turnovers being achieved in the Guateng/Pretoria region. As an infrastructure was established in Cape Town, control and monitoring of the outlets was logistically facilitated by the geographical spread of the company in Cape Town.

Based on the success of the Cape Town region, it was decided to further expand to other regions within South Africa. An outlet was opened in Witbank in October 1998 and outlet was opened in George in November 1998, once again, both were company owned outlets, and they represented the first foray into outlying areas by the company where a head office structure had not been created and where one of the founders was not present, as setting up regional structures in these areas which were not feasible or cost effective. Two senior outlet managers were selected from the Guateng and western Cape regions and relocated to Witbank and George. Due to the distance, the founders and other monitoring and compliance teams did not visit the outlet. Instead
the managers were relied upon to travel to the head office regions once every two weeks and give feedback to management. Using daily turnover information downloaded from the computerised till systems, the researcher prepared an analysis of average turnovers per month over the research period for the two outlets. Results of this process are shown in Fig. 2.1. As can be seen, initially the outlets performed well, but soon thereafter average turnovers started dropping quite dramatically. The minutes of meetings held, and observations made in meetings where formal minutes were not taken, revealed that when pressed for reasons for the drop in turnovers (and by implication customer feet), managers in both outlets complained of a lack of support provided to them by the head office, lack of interaction with established suppliers, lack of marketing support and other comments which generally reflected a feeling of isolation from the rest of the company.

They also complained that besides the lack of operational support, there was no maintenance support for computer breakdowns, equipment breakdowns and other maintenance functions. Where outlets in Johannesburg, Pretoria or Cape Town could receive physical support within an hour from the two head office locations, they had to make do with local support who often did not understand how the computer systems worked etc. This severely hampered operating the outlet they claimed. Furthermore, they also complained of lack of support for product sold. Although they received the bulk of raw product from the distribution centre in Midrand, they only received deliveries once a week, compared to three times a week of other outlets. Thus due to fluctuations in demand, they would often run out of product, although this was alleviated to some extent by increasing stock holdings (which in turn added extra pressure to managing the outlet). Subsequently both managers requested that they be transferred back to their homes in Johannesburg and Cape Town. As can be seen in Fig 2.1, except for seasonal fluctuations at the end of the period, the operating performance of these outlets did not improve. The performance of the outlets did not change with the introduction of new outlet management, and for the rest of the period when the outlets were under the control of management, operational problems persisted.
From a head office viewpoint, although the managers had valid arguments, it was held that they had also shown a lack of commitment. When the going got tough, they failed to “go the extra mile”, as in reality they would still get their salaries at the end of the month. Management made numerous attempts at trying different management and implementing localised marketing initiatives, all of which failed. Eventually both outlets were subsequently sold to franchisees living in the towns where the outlets were situated. When comparing the performance of these outlets after they had been sold as franchises to the information contained in Fig 2.1 above, once again a complete turnaround is observed. Both franchisees telephonically confirmed that their average turnovers being reached for the first four months after purchasing the outlet were way above the levels being achieved as company owned outlets. These average turnovers are reflected at the top of the each arrow on figure 2.1 for each store.

Furthermore Gross Profit Percentages are one of the most important indicators of performance of a restaurant outlet. This is widely acknowledged in the industry and has been confirmed as such in numerous articles contained in industry magazines, and was also confirmed to the researcher by the CEO’s of two other major listed fast food and restaurant franchise companies in South Africa (excluding the case study company who also confirmed this to be the case). The reason for its importance is that this ratio measures sales (customer satisfaction), cost of sales (management of
kitchen and stock control) and is comparable quite easily to competitors and to benchmark standards. To support the weakening turnover analysis above, gross profit percentages of these outlets were compared to the average obtained at that time by the remainder of the company outlets. In all cases over the period reviewed as contained in Fig 2.1, the gross profit percentages were at least 6% of turnover below the company average. As an example, gross profits for the month at the end of the period under review were as follows;

<table>
<thead>
<tr>
<th>Outlet</th>
<th>Gross Profit Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Witbank</td>
<td>52.87%</td>
</tr>
<tr>
<td>George</td>
<td>51.31%</td>
</tr>
<tr>
<td>Company outlet average</td>
<td>58.23%</td>
</tr>
</tbody>
</table>

Furthermore, the gross profits subsequently being achieved by the franchisees who purchased the outlets, confirmed that they are achieving gross profit percentages in excess of 60%, way in excess of the previous amounts achieved when held as company owned outlets and even in excess of the current company average gross percentages being achieved.

Therefore management were faced with the facts that outlets in geographically spread regions were not viable as company owned outlets.

**Discussion and literature review**

The Discussion and literature review performed reveals that the events that occurred in the case study above resemble research findings in the literature. The case study confirmed that running the two outlets in outlying regions was costly and problematic from a operations management point of view. Geographic expansion makes central control of unit operations difficult and costly (Mathewson and Winter (1985) and Rubin (1978); as quoted by Castrogiovanni and Justis (1998)). Geographic dispersion is associated with higher usage of franchising than company owned outlets since the monitoring of units is more difficult and more costly (Norton (1998) as quoted by Hopkinson and Hogarth-Scott, (1999) and (Combs and Castrogiovanni (1994)). Monitoring costs and thus the desirability of franchising, increase with the distance from headquarters to an outlet (Brickley and Dark (1987) and Norton (1988b) as
It is probable that a firm will lose some degree of control over its product, marketing or image because of the physical and social distance between headquarters and the outlet (Quinn, 1999).

Furthermore, hired management in the case study seemed more interested about taking leave and returning to Johannesburg and Cape Town than actually running the outlet and sorting out any problems that existed. This had the effect of management at head office being forced to continuously spend valuable management time in trying to sort out the problems. The research revealed the case where if the organisation cannot bear these costs or deal with the difficulties being incurred, it may experience problems, as outlet managers serve self-interests or exert less than maximum effort toward company interests, thus more monitoring is needed, which in geographically spread organisations, becomes more difficult. (Fama and Jensen (1983); Jensen and Meckling (1976), (Mathewson and Winter (1985) as quoted by Castrogiovanni and Justis (1998). Hopkinson and Hogarth-Scott (1999) in their research refer to Alchian and Demsetz’, (1972) theory of a firm, where it was found that outlet managers with no claim over the residual (profits) will sacrifice economic efficiency in order to increase other personal gains. This occurs increasingly when monitoring by the residual claimant (in this company owning the outlet) can no longer be efficiently executed and becomes particularly more difficult with expansion, particularly geographical expansion. Hopkinson and Hogarth-Scott (1999) go on to conclude that as a result, the firm enters into Franchising in order to overcome the problems inherent in large or geographical dispersed operations.

It also stands to reason that as franchisees have invested considerable sums of money into the acquisition of the franchise and as they are the beneficiaries of outlet profits, they are more likely to be motivated than managers of company owned outlets (Castrogiovanni and Justis, 1998). In reality, in addition to this, all franchisees within the company case study signed leases with landlords, which usually run for a five-year period and contain severe penalty clauses in event of non-performance. Landlords’ also take personal suretyships from franchisees to cover default of the lease. Furthermore, most franchisees have invested life savings, pension funds etc to obtain the franchise. Thus not only do the franchisees carry risk for the set up costs of the franchise, but they also carry the risk of personally being ruined as a result of the
investment. Therefore franchisees are motivated to make the outlet work at all costs, as opposed to hired management who have nothing to lose except a salary (if they run that risk at all).

Adizes, 2000 discusses the creation of a company as the infancy stage. He states that a company is born when the risk is undertaken. He concludes, based on a study of hundreds of companies and countries, that commitment is commensurate to the risk and that commitment increases as the size of the risk increases. He concludes by stating that although profitability is important, risk incurred is more important to driving initial success of a company. This makes sense when looking at the case study company. The managers of the two outlets carried no financial risk and the maximisation of outlet profits was less of a concern.

Kreuger, 1991, found that wages in company owned outlets were on average higher than wages in franchised outlets in a study conducted. His study revealed that managers in company owned outlets earn on average 9% higher than their counterparts in franchisee owned outlets. He stated that in situations where monitoring is difficult, company’s try to “elicit effort” from employees by paying them higher salaries. This was confirmed as being the situation in the case study company, where franchisee owners demanded more from their staff and paid them less than the case study company outlets did. In the case of the two managers in Witbank and George, this was even more so and they were given additional perks such as living allowance, extra leave, car allowances and increased salaries. This fact that the case study company was paying its employees more than restaurant industry averages and guidelines, was also confirmed by the researcher in a meeting with the CEO of a listed restaurant franchise company, who stated that the salaries being paid by the case study company were roughly 15% more than salaries being paid by the franchisees of his company. As can be seen from the results in Fig 2.1 above and from the gross profit analysis, this strategy was not successful.

The initial assessment of the founders that successful geographically dispersed company owned outlets could be operated by hired management was incorrect. The research showed that the two pilot outlets performed poorly, after having been initially successful. Although other factors could have played a role in the poor
performance of the outlets such as site selection etc, this does not explain the continuing deterioration of results, nor the recovery of the outlets under franchisee ownership.

Therefore, as a result the following emergent conclusion has been reached, which will be carried forward to the construction of a management theory.

**Emergent Conclusion KE2. Geographically dispersed outlets perform better when operated as franchises. Therefore, geographical location affects the decision to own company owned outlets or franchised outlets.**
KE 3. Financial Resources

The events

In KE 1 and KE 2 above, management resources and geographical spread were discussed as motivating factors to help decide whether to franchise or own the outlets. It is now considered whether or not financial resources also play a key role in forcing the franchisor to decide whether outlets will be franchised or company owned in the franchise network.

A graphical representation of company owned outlets versus franchised outlets is shown under Fig. 3.1. When the first outlet (which later grew to the become the company) was created in 1996, it was severely undercapitalised. 100% of the initial costs of setting up the outlet and the initial working capital required for stock and deposits were financed on credit. Furthermore, the credit obtained was short term in nature and mostly payable over a six month period. The outlet fortunately was an immediate success, and through trading, the outlet was able to repay its debts. The founders however during the early days did not take salaries to assist the outlet to repay its debts, and thus although this can be viewed as some form of capitalisation by them, the amount was minimal compared to the initial set up costs.

Due to the success of the outlet, demand for similar outlets in other areas grew. The founders, although wanting to open further outlets, did not have the capital to do so, and as they still owed creditors for the set up of the first outlet, were unable to open any outlets. As the concept was relatively new, and as they had no personal funds of their own, the founders were unable to raise funding from financial institutions. As a result and not wanting the momentum of the name (at this stage it did not possess the characteristics of a brand) to die down, the founders were forced to franchise the concept to close friends. As a result the next two outlets that were opened in 1996 were franchised outlets, which both immediately started trading profitably.

The first outlet by now was performing way in excess of expectations and within a six month period had almost paid itself off. Seeing that the concept was working extremely well in three stores, the founders decided to open a further three outlets in
the last months of 1996. Once again, creditors, with a slightly new twist, financed the stores. The new finance twist was that minority-operating partners were found to invest in the outlets, taking a 30% stake in the outlets. The money raised from the minorities for their purchase of 30% of the equity was used as deposits for the initial set up of the outlets, and thereafter profits generated by the outlets were used to repay the stores. Fortunately the outlets opened all performed exceptionally profitably and thus were able to start paying themselves off. Demand was steadily increasing for outlets. The founders, unable to raise further funding, were once again forced to franchise the next outlet as a result of a shortage of capital.

This pattern continued, with the founders funding individual outlets whenever the previous outlets were close to being paid off and when profits from existing stores had accumulated. During 1998, the group restructured and formalised its accounting and control systems (refer to KE 4C). As a result, the company was able to raise finance, and as financial resources were now available, the company opened more owned outlets (as opposed to franchising outlets). As at April 1998, when the group initiated the necessary funding, the group had 19 company owned outlets compared to 10 franchised stores. As at January 2000, company owned outlets had grown to 27 while franchised outlets had remained at 10, showing that during a period where funding was available, the company grew by opening company owned outlets, as opposed to the earlier period where funding was not available and growth was through franchising. It would thus appear that financial resources affect the decision whether to own outlets or whether to franchise outlets.
Discussion and literature review

It is clear that franchises were initially only sold where there was a lack of financial resources available to set up outlets as company owned. The access to financial capital was as a result of the start up company being in an experimentation phase and financiers were unwilling to advance money to the company or invest in the concept at such an early stage. This was compounded by the fact that the founders had no capital to offer as collateral. The most difficult task facing a new franchisor is attracting the necessary money to get the franchise going (Weinrauch, 1986). Critical scarce resources necessary for accelerating growth include capital (Combs and Castrogiovanni, 1994).

Where financial capital is not available, rather than stop growth, it can be deduced that a franchisor will open franchised outlets. As can be seen from the case study, when a franchisor has access to funding, it will revert back to the model of owning company stores. Access to financial and managerial resources needed for expansion is greater under franchising than company owned outlets because the company supplies both, thus expansion can take more rapidly (Castrogiovanni and Justis (1998) referring to Gilman (1990)). Enhanced access to resources by franchisees seems to be one of the primary advantages of franchising over company owned outlets (Carney...
and Gedajilovic, 1991). Franchising allows the franchisor to overcome internal resource constraints by providing access to franchisee resources, facilitating rapid growth (Hopkinson and Hogarth-Scott, 1999)). The most frequently cited resource constraint is financial capital (Oxenfeldt and Kelly (1969), Ozanne and Hunt (1971), caves and Murphy (1976) as quoted by Hopkinson and Hogarth-Scott, 1999).

Had any of the early stores not performed as expected, this would have had severe consequences, as the founders were making a fundamental financing mistake i.e. buying long term assets with short term funding (in this case creditors payable over a six month period). As 100% of the first outlet was financed, it follows that if the outlet did not make enough profits to repay its own running costs and therefore ran at a loss, it would have no ability to repay the creditors, which would in turn result in creditors applying for legal relief, repossessing equipment etc which would ultimately lead to the outlet going insolvent. Likewise by the same token, had the second or third outlet traded unprofitably, then the losses made by these stores would have to have been carried by the profitable outlets, which in turn would have caused pressure on the profitable outlet’s ability to repay the creditors for initial set up costs.

Ideally the long term assets of a start up venture should be funded with long term funding, which long term funding should be a combination of capital injection by the founders and long term funding raised from a financial institution. Long term assets should not be funded by short term cash flows e.g. from profits for the first six months, as the initial annual profits are unlikely to be sufficient to cover the once off costs of the assets. “A well known principle of finance is that funds for long term uses should come from long term sources, which is called the matching principle” (Walsh, 1996; XXX). The controlling of finances is a factor leading to failure of restaurants (English (1996) quoting his own study and a study performed by McQueen (1989)). Franchisors may expand prematurely and experience unanticipated growth related problems or financial failure as a result of a development of a critical cash flow situation (Weinrauch, 1986).
Therefore, as a result the following emergent conclusion has been reached, which will be carried forward to the construction of a management theory.

**Emergent Conclusion KE 3.** Financial resources affect the decision whether to own outlets or whether to franchise outlets. Where financial capital is not available, rather than stop growth, a franchisor will open franchise outlets. However when a franchisor has access to funding, it will revert back to the model of owning company stores.
KE 4. Power relationships in the franchise network

KE 4A. Legal agreements as a source of power

The events

All franchisees within the case study group sign a franchise agreement. A franchise agreement usually stipulates the duties of the franchisee and franchisor, and contains provisions for remedy should the duties by either part to the contract not be met. By reviewing the company’s franchise agreements, it was found that the main focus of the agreement is to set out the responsibilities and duties of both parties in terms of;

- maintaining the standards and procedures set by the franchisor in the operation of the franchise
- maintaining the image and reputation of the brand and protecting the brand (franchisor)
- licensing and usage of the trademarks
- the fees to be paid by the franchisee for use of the franchise
- the exclusive operating area of the franchise
- the appointment of specific suppliers of product and shopfitting equipment
- general rules of conduct and penalty clauses for non-performance of the agreement.

It is commonly accepted by the franchisor and the franchisees within the case study company that legal power in terms of the franchise agreement is heavily weighted in favour of the franchisor.
Within the case study company operating the franchise does not take place in terms of the franchise agreement, and once the agreement has been signed, little reference is made to the agreement again, other than in situations where total breakdown in the relationship has occurred and communications take place through attorneys.

Legal action was only instituted against a franchisee once in the history of the company. This occurred when the franchisee initially fell into arrears with his purchases of stock and refused to pay for the goods he had received from the distribution company. Perusing minutes of meetings and attending some of the meetings with the franchisee, it was clear that the company tried a number of different avenues to assist the franchisee. The debt owing was originally rescheduled on 3 different occasions, penalty interest was waived on the amount outstanding, the franchisee continued to receive stock in spite of previously defaulting on numerous occasions. Furthermore the franchisee first stopped paying his monthly marketing fee and was granted relief from paying marketing fees for a six-month period. He thereafter stopped paying his monthly royalties. Inspection team reports revealed a deteriorating store where recipes, hygiene standards and other operating procedures were not being followed. The franchisor offered to assist the franchisee with these problems and offered to second management to the store to assist the franchisee. After a period of six months where no change was noted and where the franchisee refused to co-operate, the franchisee was legally sent notice that the franchise would be withdrawn. Thereafter all serious communication with the franchisee stopped and the legal process took charge of the matter. Needless to say, the company lost a franchisee and the franchisee lost a franchise product.

The only other instance where a franchise was closed occurred in the Sasolburg franchise. The franchise site chosen was weak in that the town was too small for an outlet to be located. The franchisee ran his operations within the guidelines of the franchisor and was always open to suggestions and receiving help. The fundamentals of the store in terms of hygiene, product standards and level of service required exceeded the requirements of the franchisor. Notwithstanding this, the franchise simply did not work in that location. As a result the franchisee asked to be released from the franchise agreement, and was released without any penalties being levied against him, after paying all outstanding monies owed for stock. This is in stark
contrast to the Meyersdal outlet above, which reinforces the fact that the franchise contract is only used in instances where the franchisor is forced to take action and try and recover any monies outstanding.

**KE 4B. Support activities as a source of power**

*The events*

Support activities in the case study are seen as key in setting up and maintaining the future relationships between the franchisor and the franchisee. The case study company provides support for a number of activities. These are

- Setting up a “turnkey operations” in terms of outlet shopfitting for the new franchisee. This includes the negotiation with landlords and financiers on behalf of the franchisee. This support service has been extremely successful, with the company having created 37 outlets as at January 2000 (48 outlets as at January 2001) that are virtual carbon copies of each other in terms of layout and set up. This has contributed to the building of the brand. Furthermore, when comparing set up costs of case company outlets with the set up costs of outlets in competitors, the cost of setting up an outlet is consistently lower than restaurant competitors. Furthermore it was also revealed that the costs of setting up outlets were even in some cases lower than the cost of setting up a take away outlets of competitors (source: Fast Food magazine survey, 2000).

Set up costs also affect the return on investment to franchisees in that the lower the set up costs, the higher the rate of return. From attendance of franchise meetings and from information obtained in individual meetings with franchisees, all expressed satisfaction with the initial set up costs. It was observed, and franchisees verbally agreed, that whenever maintenance or further shopfitting was required, they would approach the franchisor as first option. Furthermore it was observed that in instances where the franchisor requested maintenance and changes to the shopfitting in three franchised
outlets, that this was performed voluntary by the franchisee at the cost of the franchisees.

- Providing *marketing* activities and marketing advice to franchisees. This is the area of support where franchisees received the least support from the franchisor. On numerous occasions the delivery of support material such as table talkers and posters for promotions etc was late. In one instance, material for a mother’s day promotion arrived on mother’s day only, and in some outlets after mothers day. Furthermore, the researcher saw evidence of marketing material which appeared in magazines or was handed to outlets, which contained basic spelling mistakes, was poorly printed etc. In addition, the head of marketing was consistently involved in disputes with both franchisees and staff of the franchisor on these and other matters. As a result, franchisees often complained about the lack of support, professionalism and quality of work performed. More importantly, they continuously questioned the payment of monthly advertising fees to the franchisor. This is in stark contrast to the situation above where franchisees voluntarily undertook renovations their own cost.

To address this situation the marketing head was eventually dismissed and a new head was hired. Furthermore, a compact disc containing a basic toolkit with standard logos, specials menus, and pamphlet preparation material was put together and given to franchisees. This allowed franchisees to use the toolkit and arrange for the preparation of localised marketing packages from local printers and public relations committees, in an effort to deal with some of the initial complaints and speed up the process of delivery in the stores. Although in the early stages of review, it would appear that complaints relating to the payment of marketing fees have subsided as per the last two franchise meetings attended by the researcher, notwithstanding the fact that annual marketing fees requested by head office have doubled in the past year.

- Providing initial and ongoing *training* for the franchisee and staff members of the franchisee. This is discussed in depth under KE 5 below. In summary,
training of franchisee kitchen staff “back of house” and waiters is of a high standard, and franchisees have expressed their satisfaction with this aspect of support. One franchisee that has a number of other brand franchises of competitors, verbally stated to the researcher that the level of training provided by the case study company is by far the best she has experienced in the industry. As regards the training to “front of house” management, in most instances the franchisee performs the function of managing the outlet (in addition to overseeing back of house operations). As such franchisees interviewed were hesitant to comment on their own performance. Based on discussions with inspections team members, it is clear that some franchisee operators are better operators than others. Notwithstanding this, if the franchisee has the perception that his staff have been well trained, he will view the franchisor as having skill and knowledge. The training school of the franchisor has set up a roster offering retraining to staff and training to new staff. Based on discussions with the head of this department, it is clear that franchisees often make use of the facilities. This was confirmed by franchisees in discussions. To further support this, observations made by the researcher during franchise meetings where new procedures were introduced, it is evident that most franchisees positively accepted the new requirements and voluntarily implemented them. If franchisees had at any stage doubted the franchisors ability, getting them to introduce or make the necessary adjustments would have been extremely difficult.

- Providing a distribution facility whereby franchisees obtain stock at favourable prices as a result of the benefits associated with the buying power of the entire franchised network. However caution should be taken to ensure that the benefits are indeed passed on, and not held for the benefit of the franchisor company. Franchisor institutions have fallen fowl of the law in these circumstances and on two recent occasions, the courts held in favour of the franchisees in this regard, ordering the franchisor to repay all excess profits as a result of bulk purchasing not passed on to franchisees, back to the franchisees.
The access to supply of stock at relatively constant prices is a key support service provided to franchisees. From a review of all data available, it is clear that the majority of franchisees voluntary purchase the main product from the distribution centre of the franchisor. From a pure economical viewpoint, if franchisees were unhappy with the supply support service provided by the franchisor in terms of prices paid or quality of good sold, they would purchase their stock elsewhere. It should also be noted that even though in terms of the franchise agreement franchisees are obligated to purchase supplies from a nominated supplier (in this case a sister company of the franchisor), there have been a number of legal cases in South Africa recently which have found similar supplier clauses in franchise contracts to be unenforceable by the franchisor (e.g. Black Steer Franchise Group and the 7 Eleven Franchise group). It is common knowledge among the franchisees in the case study company that this is the case, yet the majority still purchase their product from the distribution centre, evidencing that franchisees purchase products from the company as a result of the support service offered, and not as a result of being forced to do so by the franchise agreement.

- Providing ongoing communications. Regular franchise meetings between all franchisees within a region and representatives from the franchisor are held on a monthly basis. During these meeting various issues relating to the operating of stores, marketing campaigns and other relevant information is discussed. At these meetings, any new procedures or new requirements by the franchisor are discussed and debated. Franchisee buy-in for any changes or requests for all franchisees are firstly attempted at this level, with the aim of getting the franchisee to buy in to the concept before a formal request or procedure is established. The case study company also employs an operations and inspections team who visit franchisees on a regular basis. From a review of the store visit plan and from a review of the store reports generated, franchisees are visited at least once a month in the Guateng/Pretoria regions, At least once a week in the Cape Town regions, and at least once a month in all other regions. During these visits franchisees are given advice on operating procedures and any other pertinent matters that may come to the attention of the inspections team. Should any non-compliance of any procedure be
detected, then this is discussed with the franchisee and advice is offered to enable the franchisee to correct the situation. Although a report is drawn up, this is used as a discussion document and no further action is taken thereon.

**Discussion and literature review for KE 4A and KE 4B**

The dynamics of power in a franchisor and franchisee relationship

As discussed in the research methodology section above, there is general consensus that the researcher operating primarily in the phenomenological paradigm has the basic beliefs that the world is socially constructed and subjective, the researcher is part of what is being observed and that the research is driven by human interests. There is also consensus that when operating within the phenomenological paradigm, the researcher should focus on meanings, try to understand what is happening, look at the totality of the situation and develop ideas through induction from the data. One of the preferred methods of research in the phenomenological paradigm is to use a small sample of data that should be investigated in depth over time (Easterby-Smith et al, 1998).

The modus operandi of the research methodology used in this research paper (discussed in detail in a section dedicated to this topic in this paper) is to make sense of the facts (events) that were recorded and observed in depth over time in the case study company, and thereafter through observation and induction, to let the findings of the study to emerge. Once this has occurred, a literature review is performed to assist in the understanding and supporting of the emergent findings (conclusions). Therafter where possible, further corroborating evidence is sought to support this process. The resulting conclusions are carried forward to be included in the preparation of a management theory. This differs from some traditional research methodologies that require a literature review to be performed before any research is performed.

The events discussed in the previous section set out the way in which power was practised very successfully in the case study company (sample of data). This will be supported by a review of literature below and will also be supported by other
corroborating evidence gathered. Thereafter emergent conclusions will be developed and utilised to assist with the development of a management theory.

All forms of exercising power have a common goal; that is to communicate with others, with the expectation of changing their behaviour towards established objectives. Similarly power is also defined as the potential ability of an influencing agent to change the cognition, attitudes or behaviour of another person (Stoeberl et al (1998), Fennel quoting Miller (2000) and Gardner (1986), Lam quoting Fennel and quoting French and Raven (1996).) The English word power is derived from the Latin word “posse” which means “to be able”, Fennel (2002). In business format franchising where outlets are carbon copies of each other, as is the case in the case study company (discussed earlier in this document), maintaining power by the franchisor is necessary to protect all stakeholders within the franchise network and to maintain the franchise concept on a long term basis. The dynamics of the power between the franchisor and the franchisee within the franchise network thus becomes critical, as the behaviour of the franchisor and franchisee are dictated by the shift of power between the two parties. Furthermore, through the possession of power, one party can dictate or modify the behaviour of the other party accordingly. Due to the nature of business format franchising, it is advisable that the franchisor has the majority of power in the franchise network. As a result, the franchisee distribution system is typically characterised by the franchisor possessing more power than the franchisee (Quinn (1999) quoting; Ozanne and Hunt (1971), El-Ansary and Stern (1972), Lusch (1976)).

The model developed by French and Raven in their book entitled “The bases of social power” (1959) holds that the sources of power can be identified in five areas;

- **Reward power**: which relates to the target’s (franchisees’) perception that the powerholder (franchisor) can mediate awards e.g. the franchisor will continue to reward the franchisee with something extra or give him “preferred status” for adhering to instructions e.g. royalty breaks, lower prices on purchases of stock, etc. which will ensure that the franchisee makes profits and continues to grow. The franchisee can also be rewarded, by receiving support services (discussed below).
• **Coercive power**: which relates to the target’s perception that the powerholder can mediate punishments e.g. the franchisee is aware that the franchisor could “make life difficult” for the franchisee in the day to day running of his operations and could go as far as cancelling the franchise agreements, or excluding him from certain support services.

• **Legitinate power**: which relates to the target’s perception that the powerholder has the authority or right to prescribe behaviour e.g. the insistence by the franchisor of performance in terms of the franchise agreements.

• **Expert power**: which relates to the target’s perception that the powerholder has some special knowledge or expertise e.g. the provision of support services, where the franchisor provides certain support or advisory services to the franchisee

• **Referent power**: which relates to the target’s identification with the powerholder e.g. the sense of belonging to and being part of the franchise group and the brand will ensure that the franchisee voluntarily complies to rules and regulations.

These five sources of power have been widely used in many power studies and have been empirically tested, supported and found to be valid measures of sources of influence (Stoeberl et al (1998) quoting Hunt and Nevin (1974), Keith et al (1990), Wilkinson (1979)). This is further supported by Lam (1996) who states that “one of the most widely known conceptualisations of social power is the framework proposed by French and Raven”. Quinn (1999) through further research, condensed the five power forms into two areas for a franchising environment, namely coercive and non-coercive power, with coercive power representing legitimate and coercive powers in the French and Raven model, non coercive power including referent, expert and reward power as envisaged by French and Raven. These sources of power and the roles that they play in the dynamics of power in a franchisor–franchisee relationship are discussed in the paragraphs that follow.
Legitimate or Coercive power
The first type of power to be discussed is legitimate or coercive power. Structured (coercive) power emphasises order, control, regulation and avoidance of conflict. This form of power is characterised by rigidity, close adherence to rules and procedures, dominism and legalism (Fennel (2002) quoting Weber and Grabb (1997) and Abbott and Caracheo (1988)). Authority is legalised and legitimate (Fennel (2002), French and Raven (1959)). In a franchise environment, coercive power ensures strict compliance with the franchise agreement and protection of the franchise trademark (Quinn (1999)). Coercive power is usually exercised through the franchise contract, and is the traditional form of power used in the franchise industry. The bias of the franchise contract is usually directed towards the franchisor, which directly influences the location of power in the franchise relationship (Quinn (1999) quoting Forward and Fullop (1993)). All franchisees within the case study group sign a franchise agreement. This was discussed extensively in the previous section under KE 4A above. As can be seen from this section, coercive power is clearly in place in the case study company, although as can be seen from the comments below, the company does not necessarily actively practice this form of power.

Non-coercive power
To exercise power to change the actions of franchisees and still maintain a beneficial relationship with the franchisee, franchise contracts have subsequently proved to be a relatively weak factor in creating commitment (Anderson and Weitz (1992) as quoted by Hopkinson and Hogarth-Scott (1999)), who go on to quote Macauley (1963) as having said “even in cases where a complete contract exists, the exchange may take place with little reference to the contract. Parties will negotiate a solution when the problem arises apparently as if there had never been any original contract”.

This is clearly the modus operandi of the case study company as evidenced above. From the review of the events recorded in the previous section, it emerges that power was practised in the case study company by mostly trying to get the franchisee to voluntary agree to abide by any instructions as a result of the franchisee buying-in to the proposal, and not (unless in extreme cases) by referring the franchisee to the franchise agreement and taking legal action against him in terms of the franchise
agreement. This ties in with research by French and Raven (1959), and Quinn (1999). “Using power to obtain a means need not necessarily be exercised by exerting one’s will on the other party. Instead it can be defined to mean to be able to accomplish something together” (Fennel (2002) quoting Miller (1992) and Surrey (1987)). The poststructuralist view of power is described as being inherently relational in context and should be seen as a means to develop positive, collaborative working relationships (Blasé and Anderson (1995) as quoted by Fennel). Quinn (1999) quotes Etgar (1978) and Sibley and Michie (1982) and Hough (1986) and Manaresi and Uncles (1995), stating that non-coercive sources of power are primarily used to influence franchisee behaviour and thus enhance control.

**Practising “expert power” and providing support services**

Being seen as the expert that possesses knowledge which the other party needs, transfers the source of power to the “expert” (Quinn (1999), French and Raven(1959)). Quinn quotes his own research which concludes that a high level of conflict within the franchise network is not as a result of the power being influenced by the franchisor, but rather by the lack of support being granted by the franchisor to the franchisee i.e. the lack of non-coercive power being exercised by the franchisor. Non coercive power is one of the main forms of power practised by the case study company, and based on discussions with franchisees and based on a review of other data obtained as discussed in the previous section, this form of power has and continues to yield extremely successful results for the case study company. Examples of the “expert advice” provided by the case study company to franchisees are discussed in great length in the events section of KE 4B above and include offering expert advice in areas such as shopfitting, marketing, training and sourcing of raw product (which by its nature, is scarce and hard to obtain, is very expensive if bought in small quantities [traded in USD currency]). Thus the franchisee is dependent on the group in a multiple amount of areas for initial and continuing expert advice. Thus power influence in this area is thus strong and there is great pressure for the franchisee to comply with the requirements of the franchisor, for fear of having these support services withdrawn or reduced (coercive power and reward power - French and Raven). One way to try and obtain an understanding of the magnitutiude of the level of power being applied by the case study company over its franchisees, is to refer to the payment of franchise and other fees due by franchisees to the
franchisor. In all cases, at the time of the research, all due monies were paid up and no historical amounts owing from franchisees were outstanding. In the franchise environment this is seen to be remarkable (based on informal discussions held with the CEO’s of other franchise groups) and evidences the strong from of power being excercised by the franchisor over it’s franchisees (refer to section KE 4B above for a further in depth discussion of the nature of the services provided).

The support services provided has also resulted in greater franchisee satisfaction, as is evidenced by interviews with franchisees and from other data gathered as discussed in section KE 4B. One franchisee of the case study company (who also holds a franchise from two competitor listed food groups that had been in existence for a far longer period than the case study company), noted that the approach to franchisee relationships as a result of the support services provided were far superior in the case study company than its competitors. This is in line with the findings of Quinn (1999), who states that there is general consensus in the literature (some of which has been referenced earlier) that the exercise of non-coercive power by the franchisor on the franchisee will increase satisfaction by the franchisee and vice versa. Hing, (1995) comments that support, and the provision of information, (as forms of non-coercive power), provided to a franchisee, will result in greater franchisee satisfaction, improved franchise performance and decrease franchisor-franchisee conflict. As can be seen above in KE4B, the case study company provide major information support services to its franchisees. The area of providing information as a source of power has been added by some researchers to the five power sources as developed by French and Raven (Lam (1996) quoting Raven and Haley (1982).

However it would be naïve to think that problems and disagreements never arose between the franchisor and franchisees in the case study company. Complete agreement between franchisor and franchisee is not attainable (Weinrauch, 1986). What is important to note is that it is the practice of the group to exert power on franchisees by using passive persuasion, based on the underlying non-coercive power that it posseses (discussed above) rather than use forceful insistence by the coercive power that it also possesse (in the form of franchise agreements) when requesting franchisees to adhere to certain requests and guidelines as laid down by the franchisor. From a business point this makes sense, as when a franchise agreement has to be
legally enforced, the relationship of trust is broken and it is just a matter of time before the relationship is formally ended (Adizes, 2000). As can be seen from a review of the events in the previous section, it has emerged that whenever the case study company exercised any threats or actions in terms of the franchise agreements, no real results were achieved, and in fact the matter was left to the courts to decide. Macauley (1963) as quoted by Hopkinson and Hogarth-Smith (1999), argues that the ultimate act of invoking the contract to the point of pursuing legal action is taken when the creation of hostility poses no threat since relational aspects of the exchange have broken down. Despite the formal contractual side of franchising, franchise networks rely on a level of relational quality to function. Once this is destroyed, there is little incentive to maintain the relationship in the long term, regardless of contractual obligations. The Meyersdal example above supports this research.

Power often shifts back and forth between the parties, depending on the stage of development of the franchise network system. Quinn (1999) quotes Hough (1986) who states that research has shown that franchisors do not hold all the power within the relationship, and that power may shift between the franchisor and franchisee. In some instances it is not unheard of that the franchises may actually hold the balance of power, as to the extent that franchisees posses knowledge and expertise that the franchisor is unable to replicate, the franchisee gains power, and vice versa. Franchisee power is greater still if franchisees generate innovations that are subsequently successful in company-owned outlets (Hopkinson and Hogarth-Scott, 1999). However based on the large levels of support services provided by the case study company to its franchisees and the large reliance that franchisees have on the franchise company, this is not really prevalent in the case study company.

The use of non-coercive control measures by competitors
A 3rd source of data collection (source 1 was the case study company observations, source 2 was the numerous research references listed above which were in themselves triangulated) to further support the use of non-coercive power as a preferred strategy was obtained by the researcher from conducting an interview with the CEO of major listed restaurant company, who confirmed that it was operating policy to use non-coercive control. Having operated for over 30 years, he commented that his group had come to experience that this was the only way to manage relationships. He also
stated that his group had in fact taken this theory a step further and had actually co-opted franchisee representatives (who were franchisees themselves) onto the boards of policy making committees and sub committees within his group. The reason for this was that with franchisee buy in being obtained, adherence or compliance to franchisor requirements was far more successful in their company than when they used coercive power to obtain adherence. He cited as an example the area of marketing, where marketing campaigns were launched using fees obtained from franchisees. Whereas traditionally franchisees did not always agree with the franchisor, these disagreements were almost non-existent as a result of getting franchisees buy in and placing franchisee representatives onto the committee.

Conclusion

Based on the discussion above, and based on the work performed in this entire section, it is evident that the main form of successful power exercised by the franchisor in the franchise network occurred through the use of non-coercive power methods through the provision of support activities to franchisees. This is in spite of the fact that the “face value of the power relationship” was in the form of franchise contracts (coercive or legitimate power). The use of this method of exercising power as opposed to the use of coercive power, has resulted in the franchisor being able to positively influenced the attitudes and behaviour of the franchisees in the franchise network and take control of the relationship. This has led to extremely high levels of franchisee compliance. It also transpired that although the uses of power emerged from the process of data collection, that the methods of power being used largely agree to the underlying theories developed in this regard (as discussed above). Thus, it emerges that the shift of the power balance to the franchisor in the franchise network can be achieved if the franchisor excercises power using non-coercive means with the assistance of strong underlying franchise support systems. Therefore the following emerging conclusions will be carried forward to assist with the construction of a management theory.

Emergent Conclusion KE 4A. Non-coercive power exercised by the franchisor within the franchise network results in higher levels of compliance by franchisees. The exercise of coercive power by the franchisor results in lower levels of
compliance (including non compliance) by the franchisee. Therefore the use of non-coercive power as the main form of compliance seeking is critical to ensuring a sustainable franchise network.

Emergent Conclusion KE 4B. The level of performance of support activities by the franchisor influences the power relationship in the franchise network in that, the higher the level of support activities, the more that control shifts to the franchisor, which results in higher levels of compliance by the franchisee.

KE 4C. Systems as a source of power

The events

A summary of the key management information control systems and management information reports that were used in the case study company are discussed, to facilitate the understand of the financial and information control set up in a restaurant and fast food franchisor, and to highlight key areas that a restaurant and fast food franchisor should consider when setting up these systems. Emergent conclusions formed will be carried forward to the construction of a management theory. As a result of not initially setting up these systems and always playing “catch up” to the growth of outlets, this affected the ability of management to properly control and run the company. Although these systems were subsequently developed to be market leadership standards, the company came dangerously close to ceasing operations, part of which could be attributable to the early non-establishment of these systems. Whilst it is acknowledged that no one control, accounting and management information system is the same, franchisor systems should encompass the majority of the concepts and structures incorporated in the review of the case study systems below.

The management information system, accounting system and reporting system form a key part of control that franchisors can exercise over franchisees. Systems can be used to monitor compliance of laid down procedures and standards set by the franchisor within with the franchise. Systems also provide valuable marketing information to the franchisor in terms of product sales e.g. information can be
obtained as to leading product sales and products that are not selling, whether an advertising campaign has produced increased sales for a particular product, what beverage is sold mostly with a particular product line etc etc. Importantly as long as the information is available, any combination of reports should be able to be produced to give management the information required to assist with the management and control of the brand.

Furthermore based on the number of failures present in the restaurant and fast food industry, financiers and investors are sceptical of investing in this industry. As a result, to attract capital and investment, an excellent accounting, management and reporting systems is necessary. The researcher in discussions confirmed this with senior merchant bankers from four leading merchant banks whilst performing the research. Without exception, all of these bankers expressed concern about the industry and went as far to say that they were hesitant to invest in the industry as restaurants “were not in flavour” on the Johannesburg stock exchange with investors. They also stated that for them to begin considering an investment in a restaurant company, that it was absolutely essential that an excellent control and reporting system be in place, particularly as these were “cash businesses”. Therefore to attract funding for future growth and/or unlock value for the major shareholders, management identified this as a key area of concern. Information systems became more crucial as the company moved to a franchise strategy.

Initially when the company was founded, the first ten outlets were opened as entirely stand alone units. Information systems were virtually non-existent e.g. outlets had different point of sale systems, which offered only basic information e.g. no detailed information relating to product sales was available. Performance of the company was managed by one of the founders on a simple spreadsheet, which essentially recorded turnovers per outlet. Accounting information was outsourced to different accounting officers who prepared simple historical income statements and balances sheets. As per one of the founders, the information was sometimes inaccurately prepared and received by the company long after the information had been generated. Monthly accounting information did not often agree with the annual financial statements produced at the end of the year. Furthermore, information that management needed to assist with the management of operations in the company was non-existent. In short,
the company was managed by recording turnovers on a spreadsheet, by monitoring cash flows through individual bank accounts and by relying on management in the outlets to verbally report on their actions and there view on the progress of the outlet. This had the effect of not detecting the slide in turnovers as shown in Fig 1.2 timeously.

There was however in those early days, huge amounts of interaction and communication on a daily basis between founders and outlet managers. Unfortunately no record of this interaction was kept, but all the founders verbally confirmed this to be the case and often (sometimes quite fondly) refer to the good old days where they knew about everything that happened in the company. In reflection, the company would not have survived had this not at least partially been true, but it is the researchers considered opinion that they only knew what the managers in the outlets wanted them to know.

From a legal structure viewpoint, each outlet was established as a separate close corporation. As a result, and in accordance with South African Law, no consolidated financial accounts were prepared. Furthermore the franchise company and head office structure did not exist legally, and these expenses e.g. costs of the founders, were accounted for through the various outlets owned, which skewed the results of these outlets even further. As a result when the company wanted to raise finance for growth in July 1998 from one of the top four banks in South Africa, a company facility was initially declined as a result of no formal holding or central company being in place, no formalised accounting and management information system for the company being in place and no consolidated set of results for the company being in place. Thus although the brand was highly regarded by the bank, they would not grant finance to a company with no formalised structure and who had no formalised control system and reporting structure in place.

The company hired a financial director in June 1998, who set about immediately putting accounting controls and management information systems in place. He also formalised the legal structure of the company to enable a consolidated company to be created. This facilitated an audited set of financial statements to be prepared showing the company results. This entire process took 18 months to complete. The following
A comment from the financial director sums the situation up “When I walked in to the company, there was nothing. There were no controls in place and operating the outlet was based on trust and honesty e.g. founders who were the authorised signatories on the bank accounts, would leave blank signed cheques in the stores for managers to use in some outlets. In other outlets, the outlet managers would be signatories on the cheque account, with full discretion being given to outlet managers to write out cheques as they saw fit. Accurate management information was non-existent. With the growth facing the company, it would have been suicide to let things continue as they were”.

Today the computerised accounting and financial control systems rank alongside those of listed competitors. In a due diligence report issued by a merchant bank, the accounting systems were found to be “excellent in terms of providing accurate reliable and timeous information”.

These systems thus allowed the company to attract capital and investment directly as a result of the controls, procedures, information systems and company structures put in place e.g.

- banking facilities were raised with a bank for 18 times the amount of the original facility that had been declined earlier

- although not taken up, a merchant bank approved funding of R16m in a structured finance arrangement.
From a control perspective, the situation is that the company acts as a central data collection and control point for its outlets – offering a financial reporting system and a management control system. Control monitoring of each outlet included monitoring of; stock control, service provided, hygiene standards, control of cash and financial performance. In addition management information obtained to assist with marketing included numerous types of product sales information.

It is one thing to discuss in principle the systems, management information and controls needed in a system, and another to implement the correct systems and procedures within the given constraints. Within any accounting, management information and controls system, the concern is always that the systems created are insufficient to provide management with the information and tools required to exercise the necessary level of control required, thereby leading to the company not performing to the required standards. A summary of the management reports used in the company has been extracted and is presented in Fig 4.1 below.

The reports are produced from a variety of sources, including;

- Computerised point of sale computers that are linked to a server to the head office. Data is transferred electronically via modem.

- A general ledger package containing the following sources of data entry; a creditors ledger, a debtor’s ledger, a stock control system and a cashbook.
A brief description of the reporting system in Fig 4.1 is follows.

- **Daily reports.** Head office collects financial information from all outlets on a nightly basis, after the managers have cashed up. This information is transmitted electronically and enables daily analysis of a number of amounts, including sales figures per outlet, per product, per stock item and various other combinations of choice. This information is collated and included with the weekly reports sent to outlet managers (see below).
The downloaded figures also includes the “cash to be banked per outlet” total which is produced by the till system as a result of the electronic cash up procedure. This total is then checked against the physical cash bank to a report obtained from the mainframe computer system of the bank. Any differences are immediately followed up with the outlet manager concerned. A monthly outlet cash up report is produced which summarises the cash banked for the entire month and is signed off by the accounting head.

A cash flow prediction model is also prepared on a daily basis, which produces accurate daily cash predictions for the company for a six-month period. The model consists of a complex spreadsheet, which has been developed using a vast amount of information, including the daily estimated turnover per outlet based on daily actual turnovers for each outlet over the previous five years. Thus the spreadsheet is able to accurately calculate the turnover of a outlet for any given day. The spreadsheet also captures expected outflows based on amounts from the creditors system, debtors system, stock system and cash book system (all payments for supplies for the company is centralised including such items as bread, milk, vegetables etc). Outlets have the authority to buy emergency items using a re-imbursive petty cash system. The cash flow prediction model facilitates the accurate managing of the company’s cash flows, ordering of forward stock purchases, capital expenditure and payment of creditors (who effectively fund daily operations).

- **Weekly reports.** More detailed financial reports are prepared on a weekly basis and effectively assist outlet managers to manage a particular outlet. These reports are issued to and discussed with outlet managers individually on a weekly basis. Outlet managers are accountable for the four management areas within their control, namely sales (which incorporates customer service), stock control, outlet hygiene and control over normal expenditure such as telephones etc. Accurate reports are prepared to assist them to perform this function.
Summary reports are prepared for the regional managers and directors of the organisation, which summarise the key information and ratios and show this information for each outlet on the same page. Management are thus able to perform a comparative analysis between outlets to identify areas of concern or areas for improvement.

The first of these reports is the gross profit report, which includes GP% achieved per finished product, per finished product category, per raw material, per plate of food etc. Numerous other variables can be extracted from the database further analysed if a problem is suspected or encountered.

The capacity usage report highlights variables like turnover per customer, turnover per table, turnover per staff member, turnover per square metre, number of customers served versus budgeted target customers etc.

A service report incorporates feedback from customer report cards, providing crucial information on quality and service.

A stock control report is produced after the weekly stock take with the GP report. It lists in detail stock surpluses and shortages, amounts held per stock category, average stock holding of other company outlets and other general stock information.

- Monthly reports. Scientific hygiene tests are conducted monthly at each outlet by the CSIR, an independent company employed to perform these tests. These results are computed and the CSIR reports are forwarded to head office management who review these reports with outlet managers.

An internal quality control division (outlet audit), tasked with measuring quality control and the training of staff, visits each outlet on a regular basis and provides monthly reports on the status at each outlet to head office management and outlet managers.
The company also utilise the services of an external consulting company to run a mystery diner program. This company produces reports for every outlet visit, which is handed to head office management and discussed in detail with outlet managers.

Every six months, each outlet manager prepares a detailed budget for his outlet incorporating all facets of the income statement. A zero based budgeting process is used and a finance official from the head office division assists the manager where necessary. When preparing the budgets, the company’s value-drivers (which include rand value of sales, number of customers, percentage of “specials” sold, average turnover per head and inventory control) are taken into account. The budget is thereafter approved at a head office level and is put into practice.

A monthly financial performance analysis is conducted per outlet, which highlights actual performance against budgets set. Managers are presented with an income statement reflecting actual versus budgeted amounts, which is analysed and discussed with them on a monthly basis in detail.

Monthly outlet income statements are consolidated and put into company management accounts. A ratio analysis is performed on the company on a monthly basis and is included in the management accounts.

- **Annual reports.** Annual financial statements are drawn up and audited. These financial statements include a balance sheet, income statement and cash flow statement. A ratio analysis is performed on the numbers, including a comparative review of previous results.

- **Reward system.** The company financially reward staff that perform to the standards and goals set by the company. The reports listed above form the basis of calculating the bonuses paid via the incentive system and are designed to motivate staff and improve profit and productivity. As an example, during
the 2000 financial year, the company offered a R50 000 all- or- nothing annual bonus for senior managers who achieve a pre-determined level of net-profit. To achieve the targeted net profits they had to ensure that the monthly financial, service and hygiene targets were are achieved, failing which they are unlikely to reach the target levels.

**Discussion and Literature review**

The analysis performed above of the reports issued which form part of the management system, indicate that the systems are adequate to assist management in monitoring and employees achieving the organisations goals. The system provides a exceptionally large amount of information to assist management with the monitoring of outlets. Detailed information such as gross profits per product category, daily cash up reports, daily sales information and other reports seen in Fig. 4.1 above are available on a daily basis in a multitude of different reporting formats, prepared by the system from information generated by point of sales systems electronically. This information assists management to be able to pinpoint problem areas accurately and the outlet manager can thus not hide inefficiencies and operational problems for any long period of time. This puts the company in an extremely powerful position and weakens the position of the outlet manager significantly.

Furthermore external corporations such as the CSIR are contracted to perform hygiene inspections in the stores, which strengthens the power position of the franchisor. In addition, external auditors also review the financial reports and express an opinion on them annually. Therefore it is no longer possible for things to remain hidden or for poor performance to go unnoticed. The power shift has in this situation clearly shifted to the franchisor. [Note. Although the case study system was initially set up for a situation where only company owned outlets were in place, the system can and has been easily adapted to fit a franchise system e.g. the majority of the marketing information reports and other reports can easily be adapted to fit a franchisee system, as the franchisee stores use the same point of sale till system. Instead of company outlets providing the relevant information, franchisee outlets would provide the information via their computerised point of sale equipment and by completing standard feedback reports].
It stands to reason, has been documented in hundred of text books, has formed the basis of numerous university courses, has been written about in countless research papers, forms the basis for many traditional theories and it is generally accepted in commerce, that proper accounting, systems, controls and management information systems are critical to survival and controlling of any enterprise.

It can be seen from Fig 4.1 that the franchisor has more than sufficient systems and information in place to exert control over the franchise network as a result of the system of controls and management information in place. This was supported by the findings of an independent merchant bank when conducting a due diligence review, who remarked that the systems were of an extremely high calibre and were among the best in the industry. However initially when these systems were not in place, the company was unable to raise finance or the necessary capital required for growth. Therefore based on the research performed and the plethora of literature available on the subject, the following emergent conclusion is reached, which will be carried forward to the construction of a management theory.

**Emergent conclusion KE 4C – A proper management information system, accounting system and reporting system facilitates CONTROL by the franchisor in the franchise network and is critical to create a sustainable franchise network.**
KE5. Transfer of knowledge and training

The events

As can be seen in Fig 1.1, the company experienced a tremendous growth phase through its start up years. Initially, the growth was easy to manage, but as the number of outlets grew, performance of existing individual outlets declined as can be seen in Fig 1.2. As discussed in KE1 above, one of the reasons of decline in the performance of individual outlets was that the organisation was unable to transfer “entrepreneurial qualities” of the founders to management and staff. The entrepreneurial qualities referred to in KE1 above essentially relate to the charisma and presence of the owner manager. As can be seen from the introduction to the organisation earlier in this document, no formal knowledge existed within the company as it was created from a start up phase. The only knowledge that did exist was perhaps in the minds of the founders, which was at a very base level. This is consistent with all start up companies at the infancy stage of development (Adizes, 1999; Porter, XXX). Thus for the company to grow and progress further, the organisation had to adopt the role of the learning organisation. To operate an outlet effectively, staff of the outlet needs to have a certain amount of skills over and above entrepreneurial qualities. This is the bare amount of know-how needed to physically operate the outlet e.g. preparing the product offering using standard recipes and systems.

Initially this know how was obtained by working in the first outlet. Managers and kitchen staff of new outlets “served articles” under the guidance of the founders on a day-to-day basis. Whilst obtaining this training, trainee managers observed the actions of the founders rather than receive formal tuition. Furthermore the knowledge did not exist in any medium and was retained in the head of the founder. As the organisation was created from inception, all operating procedures and processes were developed on a trial by error basis. However as the company grew, and as the founders withdrew from running individual outlets and concentrated on running the company, training was performed by managers, who although had trained under the original founders (essentially by observation), did not have the knowledge or skills to pass on knowledge effectively. Furthermore the founders had not transferred any of their knowledge into a medium format that was available to employees.
There were no training manuals available, and what did exist was contained on pieces of paper reflecting various attempts over the years to create an operating manual. The company had reached the situation where all new managers of outlets were being trained by second tier managers, who had themselves not been formally or properly trained, as their training had consisted of taking whatever learning they could by observing the founders. The decreasing average store turnovers shown in Fig. 1.2 and the inability of outlets managers to address or stop this trend is evidence of this. Furthermore it was observed that when discussing problem areas with outlet managers in numerous weekly meetings over the case study period, that outlet management often did not understand the causes of the problems being discussed, had never been trained in problem areas being discussed and often were not following the correct procedures which had led to the causing the problem. To compound this, founders in giving advice were often found to contradict each other when suggesting actions to take to correct the situation. It was clear that the sustainability of the company and future growth would in the future seriously be hampered and even curtailed if the situation was not addressed. As a result management took a conscious decision to collate and rewrite the operating manual. Extracts of the minutes of a management meeting dated 30 March 1999 show that one of the original founders was tasked with this responsibility, which was completed during mid 2000;

“2.16 Training & Operations

Furthermore, XX is to supervise the re-writing of the operations manual.”

It was also decided to employ an official staff trainer and develop a training school, which was established in January 1999. Initially training focussed on training “back of house employees” e.g. kitchen staff and waiters. One strategy used in the training school was to train staff for “multi-skilling” e.g. kitchen staff would be trained to have multi discipline skills such as grilling, filleting, baking, frying, salad and dessert making, soda fountain operating, bar and coffee station operating etc. This would assist the production and service process (which is production line orientated) at peak times or times when log jams occur in the kitchen due to unexpected large orders of
one particular type of food dish. In addition this would assist the process when staff were absent or on leave. In addition this promoted teamwork and enabled the kitchen co-ordinator to structure his kitchen at maximum efficiency levels during each work shift. The cross-sharing experiences in the team enabled all members to learn and grow, thereby ensuring that they participate in a rich learning experience. New and existing staff are continuously enrolled on internal skills training courses where they graduate and are awarded training certificates. This process of development is ongoing.

**Discussion and literature review**

Results have shown that the school has performed a key role in training outlet staff to be able to perform basic operating functions such as preparing dishes served using the processes and recipes of the company consistently over all company outlets. The company is recognised as a leading brand in its category and has essentially caused all of its competition to close. One of the key ingredients in the success of the company is the consistency and quality of its product range in all its outlets, across the country. The company has its customers complete a comments card at the end of the visit to the outlet. Where customers have completed these cards, they are captured onto a database. This base was reviewed by the researcher and customer comments overwhelmingly cited consistency, quality and taste of product as the key reasons that outlets are visited.

To further support this, an analysis of gross profit percentages was performed. Gross profit percentages in the restaurant industry are consistently seen as the key measures of the performance of kitchen operations. Since the opening of the training school, gross profit percentages increased from an outlet average of 3% per annum, consistently over a 2-year period. This evidences the strong level of skills training enforced throughout the company.
However the training school failed in the proper training of management who operate the “front of house” part of the outlet. The training school, due to the needs within the company, initially focussed on teaching skills for kitchen staff to be able to produce the required product. Courses designed for management training touched on general issues and were without depth. Despite setting up a program to re-train all outlet management, this had no effect on the operations of the outlets. Management minutes throughout the period under review contained detailed notes of front of house management problems that existed within the company. Back of house problems within the outlets were seldom mentioned, and no minute can be found where serious problems were discussed relating to the “back of house” for any outlets. On the contrary, almost every minute contained some problem being experienced with outlet management. This in later minutes started including management in the operational and inspection teams as well.

The nature of the problems almost always revealed a common theme in that management were inexperienced and had not received proper training. The researcher reviewed the training received by existing outlet management. Almost all of the managers in existence during the period under review had received no training and had started working immediately after being hired. As an example, the senior operations manager and inspector of outlets at the time was employed to do a task and set standards within the company, yet he received no formal training within the company prior to this. There were also initially no training manuals in place to provide guidance to untrained management to ensure compliance of standards and procedures. This lack of training and lack of transferring knowledge to other forms of medium besides being available in the head of the founders, cost the company dearly.

The Collins dictionary describes knowledge as; “all that a person knows, all that is known, an organised body of information”. The question is thus how does one come to possessing this body of information?
Ikujiro Nonaka, Distinguished professor in Knowledge at the Haas School of Company, has presented a model of knowledge creation that attempts to address this question. Their are two types of knowledge, tacit and explicit. Tacit knowledge is subjective, experienced based knowledge that cannot initially be expressed in formal systematic language e.g. personal know how, insights, intuitions etc. Explicit knowledge can be expressed formally (in written, diagrammatical, systemic models etc) and is easily transmitted between people. Historically it is clear that the organisation tended to concentrate on explicit knowledge.

Tacit knowledge is of limited value to the organisation as long as it remains with the person who possesses that knowledge. Explicit knowledge does not suddenly appear but must be developed and/or improved upon from tacit knowledge. Thus the organisation must convert tacit knowledge into explicit knowledge in order to develop, innovate, create new products etc. As long as tacit knowledge remains within an individual, the organisation cannot leverage and exploit the knowledge to its advantage. Effective knowledge creation is thus a result of interaction between tacit and explicit knowledge. This clearly did not happen, with the tacit knowledge remaining in the heads of the founders, who often disagreed amongst each other, and explicit knowledge being created by “students themselves” as a result of them observing (correctly or otherwise) the actions of the founders.

Knowledge is created through the interaction between individuals and their environments, as opposed to individuals by themselves. Handy in his “Wheel of Learning” describes learning or the obtaining of knowledge as a process comprising four quadrants; questions, ideas, tests (environment) and reflection. Although individuals can create pieces of knowledge, a formal network of interaction enriches the knowledge and allows it to create further opportunities and growth. To succeed in knowledge creation, an organisation must thus be able to provide an environment or place where this can take place and be given the tools to do so. Ikujiro Nonaka refers to this as Ba. Ba is a place where individuals can share experiences, models etc. It is important that the organisation and the systems in use allow for this interaction to take place.
Those companies that create learning organisation, will succeed in the 21st century, because they will harness the imagination, spirit and intelligence of people in ways that no traditional authoritarian organisation ever can (Senge, 1997). Sharing knowledge occurs when people are genuinely interested in helping one another develop new capacities for action in the creation of learning processes (Senge, 1997). The transferring of knowledge from the founders and the creation of training programs in the case study company is the start of creating a learning organisation.

Knowledge is thus created through the following process;

- Acquiring the tacit knowledge through sharing experiences, referred to as socialisation

- Converts the acquired tacit knowledge into explicit concepts by using models, examples etc, referred to as externalisation

- Combining various explicit forms of knowledge with each other to create records of information, new products etc., referred to as combination

- Lastly the knowledge is disseminated to individuals who convert the knowledge back into tacit knowledge, thereby creating as base of knowledge from which to transact with, referred to as internalisation

The company experienced serious difficulties with management and staff during it’s formative years as a result of not having put in place the environment and necessary drivers to enable the organisation to become a learning organisation. These drivers include training, recording knowledge and ideas onto media that can be accessed by the relevant parties and proper recruiting procedures. Had this been done early on in the process of creating the organisation, the problems would not have been experienced to the degree that they were e.g. initially staff were trained by other staff who had served “articles” under the original founders (which mostly comprised of learning by watching as opposed to being taught skills and processes). As a result when the training staff tried to pass these skills on, they were unable to do so and had
no reference guide to assist them with this. The system of training second-generation managers thus did not succeed very well. Although the company has subsequently addresses the problem of training kitchen staff, it is still currently striving to address the training of management.

As a result the following emergent conclusion is reached, which will be carried forward to the construction of a management theory.

**Emergent Conclusion KE 5 – Transferring all processes and know how from the founders (tacit knowledge) to generic media formats (explicit knowledge), and putting in place proper training procedures is critical to creating a sustainable franchise organisation. This will also assist in creating a learning organisation.**
KE 6A. Determining structural strategy

KE 6B. The effect of constraints on structural strategy

KE 6C. The re-adoption of the correct structural strategy

The events

In June 1999 (the third year of operation), the company found itself in a situation where a number of events forced the company to consider its business idea (model) and its strategy. A summary of the key events and management responses thereto are discussed to understand strategy planning in a start up restaurant and fast food franchisor and to highlight key areas that a restaurant and fast food franchisor should consider when determining structural strategy. Findings are carried forward to the construction of a management theory. As a result of not initially clearly defining the business idea and developing a strategy, particularly as regards financial and human resources, the company came dangerously close to ceasing operations, notwithstanding the fact that the product and the brand was well established in the marketplace.

The main events that forced the company to consider its business idea are;

- As discussed in KE 3 above, the company was severely undercapitalised from inception and to an extent relied on income earned in the outlets. However, when looking at Fig. 1.2 also evident that turnover in the outlets had dropped significantly. As a result the company had fallen into a liquidity trap.

- The company was unable to continuously attract and keep quality staff.

- The company had fallen down in certain areas of operational management and had implemented a regional manager structure which had not succeeded. This was discussed in KE 1 above.
• Senior management had spent a large portion of their time fighting fires as opposed to strategic planning, often fighting the same fire in different directions.

• Newly opened outlets were not performing as they should have

• Customer feet through outlet doors had dropped, in some cases by up to 50% (reflected in Fig. 1.2).

Although these problems were in some instances hidden by the rise in turnover due to the opening of new outlets (refer figure 1.1), it was clear that if the company continued growing at the rate it was currently achieving, and if the above problems persisted or even spiralled which was highly likely given the nature of these problems, the company would collapse further down the road. The board of directors (which included the founders) decided to firstly identify the business idea. It may sound strange that the directors had to formally identify the business idea, but management found themselves in a position where no formal strategy or business idea had ever been formulated. Based on a scrutiny of the minutes of board and attending all by attending all major management meetings over the entire research period, it is clear that meetings were very much operationally orientated. One reason obtained for this from discussions with management and from observations performed, is that the company had originally grown by replicating outlets and management spent the majority of time managing the day-to-day growth and operating issues facing the company. As a result, administration and support infrastructure had followed the growth of the outlets on a need to have basis and was always in a sense, always playing catch up. Formal strategy setting meetings were not held and strategy was developed as an “after thought”.

Furthermore, although management may have tried to address certain individual problems facing the company, no systemic understanding of the problems were undertaken at that stage. Thus any interrelationships between the problems or any drivers that may have existed between the problems was not addressed. As evidenced in minutes of meetings, solutions for problems were specifically directed at the problem and were thus usually short term solution orientated.

To identify the business idea management enlisted the help of a consultant. Tony Manning, a well-known company consultant and strategist in South Africa, was hired to assist with the task. The board of directors went away for the weekend in June 1999, to create the environment that would allow them to concentrate on the task at hand and to avoid the mounting operational problems and disturbances that the directors would be forced to deal with if they decided hold the discussions at the head office. The weekend resulted in the board of directors preparing a detailed SWOT analysis, which resulted in the identification of the business idea (as discussed in “the case study organisation” at the beginning of this research document). This conference was the prelude to the general conference held with all senior staff (KE 1).

Thereafter management reviewed the business idea and tested it for robustness. A review of the documentation where the exercise was performed revealed that management concluded that the idea was particularly strong. However a number of weaknesses were also noted with the business idea. Notwithstanding the fact that the strengths of the business idea spoke for themselves, it was clear that management were concerned that one or a combination of the following weaknesses could seriously affect the viability and immediate survival of the company.

- *Initial under capitalisation and high levels of debt.* This was discussed in KE 3 above.

- *High Growth.* The company had experienced monthly turnover growth since inception over a three and a half year period of 13 800%. The company did not fully understand and therefore failed to provide for the effect of this tremendous growth e.g. capital required, management and support structures
needed, administration systems required etc. As a result all systems were being severely strained

- **Shortage of senior and middle management.** This was discussed in KE 1 and KE 2 above. What the company failed to take into account is the human resource infrastructure required to run a large company e.g. strategic management level, middle management level, administrative departments, marketing departments, shopfitting departments, distribution departments etc.

- **Large working capital requirements.** Due to the large number of company owned outlets in place and the ownership of the distribution centre, a working capital of R6,5m was required at any one point in time to maintain a strategic advantage in stock holding in the outlets and distribution centre. Furthermore this amount was set to increase given the growth rate of the company.

- **Increasing cost structure for the training school and increasing administrative infrastructure whilst achieving decreasing average turnovers per outlet.** This added to the liquidity pressure created from poor initial capitalisation and large working capital requirements.

- **Forays into avenues of non-expertise.** The company entered into property and other concept investments outside of the core business. Examples are where the company bought a building and a commercial property which it let out to tenants. The company was poorly set up to manage these “investments” as landlords, and this foray caused the management team to lose focus and spend valuable time managing these properties. As a result, both properties were subsequently put onto the market for sale.

Based on the weaknesses identified, the CEO and financial director of the company prepared a scenario analysis for the company, using proper scenario planning techniques. Four likely scenarios were developed extracts of which are below to give the reader a richer understanding of the critical events that occurred which lead up to the emergent conclusions at the end of the section.
CEALOCANTH SCENARIO

In this scenario the company is unable to raise or adequately renew funding with its bankers.

Outlets continue to under perform in the short term. Non-performing assets such as the properties are not sold in the short term.

The continuing losses and decrease in banking facilities cause the company to default on payment to suppliers, it’s lifeblood. Suppliers resort to dealing with the company on a cash basis only. The company resorts to using alternate suppliers, which results in increased prices being paid and a loss of quality being experienced. The company runs short of key supplies and the menu becomes “bastardised”. Poor performing stores close eventually close down and landlords of these stores act against the company and claim performance of their leases. The brand suffers serious loss of credibility. Skilled staff leave the company.

As a result all talks with equity partners and bankers cease. The company is put into liquidation causing losses to all stakeholders (shareholders, banks, staff, suppliers, sureties for leases, government etc.).

What once was the brand now becomes virtually extinct, with maybe one or two independent franchise stores surviving, as has happened with other brands.
WHALE SCENARIO

In this scenario the company restructures debt with its bankers to enable it to trade through the current liquidity crisis. However the continuing under performing outlets force the company to slide into an illiquid position again. Bankers start putting pressure on the company and refuse to grant the company further facilities. Management make knee jerk decisions to correct the situation and in the process compound the position. Key staff start leaving the company which puts more pressure on management. Management realising the Coelacanth Scenario is approaching, sell or liquidate the company to salvage some of its value.

The company wallows in shallow waters with loss making stores and other non-performing assets forcing the company to slide into a situation where it is forced to sell or liquidate (the company swims onto a beach).
SHARK SCENARIO

In this scenario the company is unable to raise funding with its bankers. It trades on a day-to-day basis but at the same time loss making outlets and non-performing assets are turned around or sold. The company concentrates on cutting expenses and losses. Profits are used to repay debt over the next three years and growth slows down or ceases. As a result the liquidity position slowly increases until over a period over the medium term all debts are repaid.

Attempts are made to increase the franchise operations but as a result of cost and inability to hire the correct driver and put into place the proper structures, the division is undercapitalised and does not feature significantly. Initial school fees to be paid from opening a franchise division takes its toll and costs the company money. No funding is available for marketing, which is performed on a very downscaled manner, and the brand loses national impact. Competition who perceive the company’s market leader position to be waning, gain market share and as the company is not growing, the value of the company in terms of wealth goes backwards and diminishes.

The company, now leaner and operating alone, continues to trade in this static position, making profits which it uses to repay its debt and to sustain its shareholders. Growth into a bigger wealth format into the future is limited.
SARDINE SCENARIO

In this scenario the company restructures debt with its bankers to enable it to trade through the current liquidity crisis. Loss making stores and non-performing assets are turned around or sold. As a result management time is freed up.

An equity partner is found and the company grows into different markets and leverages the brand [Subsequent note from researcher. The strategy of finding an equity partner was subsequently replaced with the selling of company owned outlets as franchises to raise capital]. Stronger relationships are formed with suppliers. The company attracts skilled staff. Research and development is continuously performed on product and concept and the company remains the premium restaurant brand in its category in the country. The company continues to maintain good relationships with its landlords and are able to attract premium sites in new developments.

Middle management are trained to run the company and directors concentrate on the strategic focus of the company. The franchise division grows with the leveraging of the brand into a formidable market force. International franchise opportunities arise and the company diversifies offshore.

The company prospers and multiplies and becomes an entrenched brand in South Africa, annually growing from strength to strength.
As a result of the weaknesses identified in the review of the business idea and as a result of the possible scenarios facing the company, management developed a number of strategic options that could be taken in response to the threats facing them. These strategic options have been extracted from data obtained as represented as follows:

1. **Funding should be found** immediately to restructure the company’s liquidity position.

2. Urgent steps should be taken to address the under performing outlets of the company. **Operations should be restructured** to put strong managers into outlets that are not performing.

3. **Sell or scrap non-performing assets** such as the properties held.

4. **Expenses should be reduced** including reducing staff levels

5. **Refocus and train management.**

6. **Develop Franchising** as opposed to owning outlets.

7. **Sell offshore franchise master licences**

8. **Start building relationships** with alternative (back up) suppliers

9. **Sell Company owned Outlets.** One option considered by management was to sell outlets to current outlet management in an empowerment deal.

10. **Sell selected outlets and assets to third parties** to decrease loans outstanding.

11. **Sell the company.** Shareholders escape personal liquidation.

12. **Merge with the Competition**

13. Voluntary put the company into **liquidation.**
However once management had identified the possible **options** to take in response to the earlier problems identified, which were at that stage affecting the survival of the company, the problem lay with sorting out and determining **which of the options should be exercised and in what order?** To assist management with this, four key business areas were identified and the options were then ranked against these to try and determine which options would be best to follow;

- long term financial survival/gain
- scenario fit
- strategic fit
- organisational fit.

The following graph extracted from company records shows the evaluation process summary.

![Evaluating Strategic Options](image-url)
Upon review of the graph, management had decided that options 1, 7, 6 and 2 were the best course of action to consider. Interestingly, converting the company to a franchise organisation appeared as two out of the four options.

**Discussion and literature review**

Management subsequently put options 7, 6, 2 and 4 into place. Option 1 was also exercised by selling company owned outlets as franchises (options 9 and 10). From a review of the data gathered from various sources such as minutes of meetings, discussions with directors, discussions with the company’s bankers, discussions with the company’s suppliers, discussions with employees and from general observations made, it was clear that had this process not been followed and acted upon, the company would not have survived the liquidity and management crisis facing it. Although there were a number of valid reasons that had caused the company to experience the problems that it faced, it is clear that had a strategy been put in place from the inception of the company taking into account the resource constraints that had caused most of the initial problems in the first instance, then the company would not have faced the severe risk of failure that it did.

An example to illustrate this follows. The company after following the option process above, has now successfully converted itself to a franchise company, and the liquidity crisis that it faced has all but disappeared. However when the company started out, all outlets were owned by the company. From a review of other sections of this document (KE 1, KE 2, KE 3), it is apparent that based on the financial and management resources in place at the time, had the company taken a franchise strategy from inception, that they would not have faced a liquidity and operational crisis and not have come close to shutting the company down. This was confirmed in discussions with management, who added that the company would have had far more retained profits had this been the case. It must be remembered that the demand for franchises was extremely strong, and management purposefully chose not to grow by franchising. Therefore growth rates would have been the same and outlets would have opened in there current locations. This is not to say that having a company with company owned outlets cannot be successful. It is simply stated that due to the initial constraints the company had faced when starting up, that the correct way to grow
would have been to franchise outlets from the start. It is suggested that this position worsened, because as the company grew, the financial and management resources constraints were magnified. Thus the switch to a franchise strategy was unavoidable and should have been instituted from the beginning.

The same can be said for developing a learning organisation. As can be seen from KE 1 and KE 2 above, the company experienced serious difficulties with management and staff during the formative years as a result of not having put in place the necessary drivers of knowledge sharing and training, to enable the organisation to become a learning organisation. Had this been done early on in the process of creating the organisation, the problems would not have been experienced to the degree that they were e.g. initially staff were trained by other staff who had served “articles” under the original founders (which mostly comprised of learning by watching as opposed to being taught skills and processes). As a result when the training staff tried to pass these skills on, they were unable to do so and had no reference guide to assist them with this. The system of training second-generation managers thus did not succeed very well.

The decision to own or franchise outlets depends on a number of factors, specifically including financial resource and management resource availability (Quinn, 1999). Franchising allows the franchisor to overcome internal resource constraints by providing access to franchisees resources, facilitating rapid growth (Hopkinson and Hogarth-Scott, 1999)). The most frequently cited resource constraint is financial capital (Oxenfeldt and Kelly (1969), Ozanne and Hunt (1971), caves and Murphy (1976) as quoted by Hopkinson and Hogarth-Scott, 1999)). Human capital constraints may also operate within smaller or younger companies (Thompson (1994) as quoted by Hopkinson and Hogarth-Scott, 1999)). It stands to reason that the financial and management constraints facing the company will hinder its ability to function or grow properly. This is clearly visible from the case study above. The characteristics associated by the size of the company restrict its ability to support a franchise network (Quinn, 1999). Access to financial and managerial resources needed for expansion is greater under franchising than company owned outlets because the company supplies both, thus expansion can take more rapidly (Castrogiovanni and Justis (1998) referring to Gilman (1990)). Enhanced access to
resources by franchisees seems to be one of the primary advantages of franchising over company owned outlets (Carney and Gedajilovic, 1991).

The long-term viability of a company is determined by its ability to create wealth within its operating environment. As the company is relatively young and still in a growing phase, it’s wealth lies in it’s future ability to grow. Thus the corporate strategy of the company must map plausible options for creating value in the future and releasing it’s profit potential to feed the expectations of stakeholders for future gain (Van Der Heijden 1997). The development of strategic plans in differentiating product and services is extremely critical to survival (English, 1996). This is more so in the restaurant industry where competitors who are franchisees of other brands, are difficult to compete against as a result of marketing and other support provided by their franchisors. When initial start up capital is high and when there is intense competition, the likelihood of success is proportionally diminished, which leads to the importance of developing a differentiation strategy (Porter, 1990). It is a generally accepted in business and trade circles that the restaurant and food industry is overtraded in South Africa. Evidence of this is the fact that all the listed restaurant and fast food groups in South Africa have publicly stated and are actively pursuing new markets in Africa and in other continents, as a result of local growth of outlets slowing down due to market saturation. A further plethora of information exists in hundreds of textbooks and journals relating to the necessity and benefits of preparing a strategy for a company to ensure sustainability. It also widely accepted in government and business circles that strategies are key to survival and sustainability.

Although management eventually did consider the business idea and attempt to create a strategy, this happened as a result of events forcing them to do so. All of the data obtained show that the company came extremely close to closing its doors. These events forced the company to consider its business idea and develop a strategy. After the strategy had been developed, performance of the outlets stabilised. Looking at Fig. 1.2, it can be seen that the average turnovers per outlet reach their lowest point at just before the strategy was developed, whereafter it stabilised and started slightly increasing.
It would appear that had the strategy been identified and put into practice earlier, the problems experienced may have been avoided, or alternatively may have been precipitated and dealt with better. A systemic understanding of the problems as evidenced by the production of a proper strategy would also have ensured longer-term solutions being implemented, which in turn would produce sustainable results.

**Structural strategy** as defined in this research document is the process of determining the correct strategy for deciding on the structure of the franchise network, based on the constraints facing the franchisor. As a result, the emergent conclusions will guide the franchisor in setting up this network. They are listed below and are carried forward to assist with the construction of a management theory.

**Emergent conclusion KE 6A.** The company should initially determine its business idea and thereafter determine its strategy (strategic fit between the business idea and the external market that the franchisor operates in), prior to opening the first franchise. This will lead to a sustainable franchise network and will decrease the risk of failure.

**Emergent conclusion KE 6B.** The financial and management resource constraints that initially face a franchisor upon formulation of the franchisor company, will determine the way that the franchisor company should be set up in terms of company or franchised outlets.

**Emergent conclusion KE 6C.** If financial and management constraints exist, the company should grow by means of franchised outlets. Should the company chooses to grow by opening company owned outlets in spite of the fact that it has financial and management constraints, then the company will be forced later to readopt the strategy that it initially should have taken (as a franchise format), as the resource constraints are likely to increase as the company expands.
CONSTRUCTION OF A MANAGEMENT THEORY

As stated in the introduction to this document, the situation in South Africa is that an inordinate number of restaurant franchisors, despite the fact that the concepts and products that they offered were widely accepted and the brands that they represented were household names, failed to develop sustainable franchise networks and ended up shutting down operations. The concern that a prospective or existing franchisor thus faces when setting up a franchise network is that the venture may fail, despite the fact that the concept or the product being franchised is sound. The question that a prospective or existing franchisor should thus consider in order to create a sustainable franchise network, is what are the key structural elements and driving forces that need to be put in place to achieve this. The answer lies in the development of a model that will assist existing and prospective franchisors to address and adopt the key events that may influence the long-term sustainability of a franchise network. The rationale to provide a logical basis for the development of the model is contained in the “findings, discussion and analysis” section above, where the gathering of data as evidence is discussed. In that section, through the use of a longitudinal case study analysis, events and data were observed and reviewed to make sense of what transpired. This resulted in logical conclusions (claims) emerging from the data, for which evidence, warrants and qualifications were provided based on the data obtained and from the performance of a literature review. These emergent conclusions, having been analysed and discussed in depth previously, are now brought forward and used to create a model that will assist existing and potential franchisors to address the key events that may influence the long-term sustainability of a franchise network. Thus the creation of the model and the rationale underlying the model all took place in “findings, discussion and analysis” section above, where emergent conclusions were also reached. This section thus concerns itself with the exploration of the relationships between the emergent conclusions and develops a model based on these interrelationships. The use of the model is thereafter explained to the reader.

Emergent conclusions
The emergent conclusions generated from the previous sections are as follows;

<table>
<thead>
<tr>
<th>Emergent Conclusion KE1.</th>
<th>Independently owned franchise outlets perform better than employee managed company owned outlets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emergent Conclusion KE2.</td>
<td>Geographically dispersed outlets perform better when operated as franchises. Therefore, geographical location affects the decision to own company owned outlets or franchised outlets.</td>
</tr>
<tr>
<td>Emergent Conclusion KE 3.</td>
<td>Financial resources affect the decision whether to own outlets or whether to franchise outlets. Where financial capital is not available, rather than stop growth, a franchisor will open franchise outlets. However when a franchisor has access to funding, it will revert back to the model of owning company stores.</td>
</tr>
<tr>
<td>Emergent Conclusion KE 4A –</td>
<td>Non-coercive power exercised by the franchisor within the franchise network results in higher levels of compliance by franchisees. The exercise of coercive power by the franchisor results in lower levels of compliance (including non compliance) by the franchisee. Therefore the use of non-coercive power as the main form of compliance seeking is critical to ensuring a sustainable franchise network.</td>
</tr>
<tr>
<td>Emergent Conclusion KE 4B.</td>
<td>The level of performance of support activities by the franchisor influences the power relationship in the franchise network in that, the higher the level of support activities, the more that control shifts to the franchisor, which results in higher levels of compliance by the franchisee.</td>
</tr>
<tr>
<td>Emergent conclusion KE 4C –</td>
<td>A proper management information system, accounting system and reporting system facilitates CONTROL by the franchisor in the franchise network and is critical to create a sustainable franchise network.</td>
</tr>
</tbody>
</table>
Emergent Conclusion KE 5 – Transferring all processes and know how from the founders (tacit knowledge) to generic media formats (explicit knowledge), and putting in place proper training procedures is critical to creating a sustainable franchise organisation. This will also assist in creating a learning organisation.

Emergent conclusion KE 6A. The company should initially determine its business idea and thereafter determine its strategy (strategic fit between the business idea and the external market that the franchisor operates in), prior to opening the first franchise. This will lead to a sustainable franchise network and will decrease the risk of failure.

Emergent conclusion KE 6B. The financial and management resource constraints that initially face a franchisor upon formulation of the franchisor company, will determine the way that the franchisor company should be set up in terms of company or franchised outlets.

Emergent conclusion KE 6C. If financial and management constraints exist, the company should grow by means of franchised outlets. Should the company chooses to grow by opening company owned outlets in spite of the fact that it has financial and management constraints, then the company will be forced later to readopt the strategy that it initially should have taken (as a franchise format), as the resource constraints are likely to increase as the company expands.

Interrelationship analysis

Before the model could be developed, a proper understanding of the relationships between the emergent conclusions needed to be gained. This was obtained by performing an interrelationship diagram between the emergent conclusions and is shown under Fig. 3.1 below. “An interrelationship diagram provides a method for thinking in multiple directions to find relationships between and among ideas and identifying issues that drive each other. It helps to systematically identify and analyse
and classify the cause and effect relationships that exist among critical issues so that key drivers or outcomes can become the heart of an effective solution” (Ryan, 2000).

**Interrelationship Diagram**

TRIGGER QUESTION: what drives a sustainable franchise network

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Fig. 7.1
Cause or influence relationships between the emergent conclusions are shown with arrows. The amount of in or out arrows per emergent conclusion are shown at the bottom of each emergent conclusion. A high number of outgoing arrows indicates that an item is a root cause or driver. In Fig 3.1, KE 1, KE 2, KE 3 and KE 6B are key drivers. This is consistent with the rationale discussed in the development of the emergent conclusions earlier in the document, where geographical locations, financial resources and management resources were seen as key factors to consider before determining a strategy. It was also stated that they in fact dictated the way that a franchise strategy should be developed (drivers). A common factor in all of the items is that they are all represent some form of constraint.

A high number of incoming arrows indicate that the item is a key outcome. Emergent conclusions KE 4A, KE 4B, KE 4C and KE 5 as per Fig 3.1 indicate that these are outcomes. Considering the rationale in the development of these emergent conclusions earlier, this would seem to make sense, as they lend themselves to physically operating and maintaining a sustainable franchise network. Thus where the drivers were concerned with creating the framework for a sustainable franchise network, the outcomes are a reflection of this and concentrate on the operating and sustaining of the network. The outcomes due to their nature, can be categorised into two main areas, namely KE 5 which discusses the creation of a learning organisation and KE 4A, KE 4B and KE 4C which relate to control and power relationships within the franchise network.

Items with a high number of both incoming and outgoing arrows could be viewed as “bottlenecks” or events that should be addressed between addressing the drivers to achieve the outcomes. In Fig 3.1 above, one “bottleneck” that is clearly visible is KE 6A, relating to the establishment of a business idea and strategy. This in effect links the major drivers being KE 1, KE 2, KE 3 and KE 6B to the major outcomes being KE 4A, KE 4B, KE 4C and KE 5. In effect the interrelationship diagram suggest that the constraints will drive the way that the development of the business idea and strategy is determined, which in turn will thereafter drive the critical factors for success and sustainability in the franchise network, which are control and power relationships and the creation of a learning organisation.
The careful review and analysis of the interrelationship diagram and a review of the rationale (including claims, evidence, warrants and qualifications) contained earlier sections, led to the creation of what was initially a specific model to assist existing and potential restaurant franchisors in setting up and maintaining a sustainable franchise network, but as will be demonstrated later, can be used to create a generic model containing a number of critical factors that entrepreneurs could use to minimise the risks encountered when creating any franchise network.

The model

While there are a number of readings that have appeared in industry media on the subject that have added valuable contributions to the knowledge on the subject, research into the determinants and key performance ingredients of a successful restaurant or fast food franchisor network in South Africa remains rooted in the early stages of development. Other than various articles published in industry media, some of which contain “checklists” for the franchisor to consider and do, there is currently no generally accepted model for use in South Africa that a franchisor could consult for guidance in establishing and operating a successful franchise network. Some literature has suggested “checklists” that a franchisor should do to ensure parts of succeeds, but there is no model that contains a holistic systemic understanding of the franchise network available. The development of the model is thus appropriate and will add to the existing literature and understanding on the subject.

Before the model is discussed below, it should be noted that it is not the aim of this section to re-discuss the rationale and data that led to the emergent conclusions arising in the “findings, discussion and analysis” section. This has been discussed in depth in that section. The aim of this section is to explain the process used to understand the relationships between the emergent conclusions (Interrelationship diagram) leading up to the development of the model. Thereafter the workings of the model will be discussed to enable the reader to understand the workings of the model and enable the reader to adapt and use the model to suit his particular circumstances.
It should also be noted that the model does not attempt to instruct the franchisor to perform specific acts e.g. insist that a franchise organisation of 20 outlets be created to ensure success. Rather the model forces the franchisor to put in place the correct drivers to create a sustainable franchise network.

It should also be noted however that putting the necessary drivers in place alone will not ensure a sustainable successful franchise network, and the model does not make this claim. Obviously, all normal criteria pertaining to the running of a successful corporation based on traditional disciplines e.g. economics, finance, human resource management etc still all apply to the successful running of a corporation. These disciplines have been written about in numerous textbooks and management journals and this model in no way seeks to negate these studies and research findings. What the model does claim, is that if any of the items contained in the model are not addressed by the franchisor, taking into account the findings of the research and the key emergent conclusions reached, then the franchise network will not be sustainable.

When considering the structure of an existing franchise network, or when considering the set up of a new franchise network, the franchisor should first assess the restraints that face him. Thus the entry point of the model for the franchisor is to consider the availability of financial, management and geographical constraints (KE1-KE3). As shown in previous sections, geographical constraints and financial constraints lead the franchisor toward choosing a franchise outlet network as opposed to setting up company owned outlets. Thus working through the model in Fig 8.1, a new franchisor would start at the bottom of the model in the constraints triangle. Wanting to set up operations, the franchisor would need to consider where it intends to situate outlets. If they are geographically dispersed, then the franchisor should set up franchise outlets as opposed to company owned outlets. The same applies to financial and management constraints. If the franchisor has financial or management constraints, it should set up franchised outlets, as franchise management perform better than company outlet managers, and franchises bring their own financial resources to enable the set up of the outlet. If however, the franchisor does not suffer from any of the three constraints, and in fact shows that it could actively manage the geographical spread of the network, then it is possible that a franchise network with company owned outlets could be set up.
As can be seen from the research work performed on the case study company in previous sections, all three constraints do not have to be present to cause a franchise store to fail. If any one constraint is not present, then this could result in the franchise failing. Furthermore, by the same token, it is possible that constraints may overlap or apply to other constraints or may be stronger than other constraints, depending on the particular circumstances that may apply at the time e.g. KE1 could override KE2 or KE3 etc. This can be seen from the research work performed on failed stores above e.g. Meyersdal store. This store was independently owned (KE1), was located geographically close (KE2) but yet still failed as a result of a lack of funding (KE3). Therefore although it appeared as if KE1 would override the other constraints, in this instance it did not. Thus the risk of failure as a result of choosing the wrong strategy as a result of a missing or dominant constraint is the same. The research points us to propose that if the franchisor has only one or two constraints addressed, or one dominant constraint with a deficiency in other constraints, then it should adopt a franchised outlet strategy as opposed to a company owned strategy, notwithstanding the fact that only one or two constraints have not been addressed. In summary, taking into account the dynamic and continuously changing business environment that franchisors operate in, the model does not propose to identify a set of rigid hierarchical rules relating to constraints that must followed. The model is interactive and it is expected that one or more constraints may influence the other constraints depending on circumstances. What the model does try and do is reduce the risk to the franchisor of failure by ensuring and insisting that all three constraint areas are addressed systemically, as these drive the rest of the model i.e. KE1 along with the other constraints (KE2 and KE3) drive KE 4 and other KE’s upwards. This is graphically captured in the model (see 8.1 or 8.2 or 8.3), where the constraints are graphically depicted in a triangle at the base of the model, balancing on the point of the triangle, suggesting that if any of the parts of the triangle are not present, then the whole franchise structure will collapse.

Thus as an entry point, the franchisor should consider the constraints facing it and plan the best strategy as per the guidelines provided by the research in the case study. It should be noted that as per emergent conclusion KE 6C, if the franchisor chooses the wrong strategy, it will be forced to adopt the correct strategy later, as the resource
constraints, and notably the management and financial constraints, are likely to increase as time goes by. However in doing so the franchisor could run the risk of shutting down, as was nearly the case of the case study company, who were forced to change their strategy back to the initial one that they should have taken, and in so doing came extremely close to shutting down, and even though they survived, the financial and management costs incurred were substantial.

Furthermore, in the same way as discussed above, existing franchisors should reconsider their strategy in light of the existing constraints faced by them. It is accepted that there may be other constraints facing particular franchisors. As stated earlier, this model does not try and capture every possible conceivable restraint that may face the franchisor at any one point in time. Franchisors are encouraged to perform a review of all constraints that they feel are valid to assist them with the creating of a strategy to determine the structure of the company. What the model does state, is that if the constraints contained in the model are not addressed by the franchisor taking into account the findings of the research and the key emergent conclusions reached, then the franchise network will not be sustainable.
Having considered the financial, geographical and management constraints facing the franchise company, the franchisor should fully develop the business idea and structural strategy pertaining to the franchise concept. Thereafter, as per the research performed, there are two critical areas which affect the sustainability of a franchise network, namely creating a learning organisation and creating proper power and control relationships within the franchise network.

The franchisor, having strategically determined how to create the structure of the franchise network, must now concentrate on putting drivers in place to ensure that the franchise network is structured to ensure sustainability. What follows is not a checklist to ensure that “ten-points” is completed. Rather the model steps back from this level to consider a wider systemic viewpoint, and encourages the franchisor to put in place key driving elements that will lay the foundations for constructing a sustainable franchise network. Looking at the right hand side of the top part of the model contained in Fig. 3.1, the first key driving element to be discussed is the creation of the proper power and control relationships within the franchise network. As can be seen in KE 4, there are three driving areas to be considered.

The research performed concluded that the exercising of non coercive power leads to greater compliance within the franchise network (KE 4A) than does the exercising of coercive power, with exercising being the key word. For the franchisor it is logical and desirable to put in place a franchise agreement and as many other legal support structures as possible (coercive controls). However what the case study company and literature review concludes, is that coercive power should not be exercised unless in extreme cases where relief sought cannot be obtained by any other means. The research concludes that exercising of non-coercive power leads to greater compliance and sustainability in the franchise network. The franchisor should thus set up his structures in such a way that communication flows and other interactions with the franchisee should be structured in a non-coercive way. Thus a key driver for the franchisor to address, after having determined his strategy for setting up structures, is to put in place a policy and structures to ensure that power will be exercised by non-coercive means at all times.
Another factor that franchisor should consider when setting up power and control relationships, is the creation of support services (KE 4B). From the research conducted in the sections above, it is clear that the level of support activities provided by the franchisor is directly related to the level of control that the franchisor possesses in the franchise network. The greater the amount of reliable and functioning support services that are provided to franchisees, the greater authority and power the franchisor possesses over the franchise network. Support structures as discussed in the sections above included; providing turnkey operations to franchisees (including shopfitting requirements), providing marketing support for localised marketing activities for franchisees, providing initial and ongoing training to franchisees and their staff, and setting up a distribution facility. Thus when setting up a sustainable franchise network, the franchisor should pay careful attention to creating support services, and existing franchisors should concentrate on upgrading or increasing support services where necessary. Creating a support system also facilitates the creation of non-coercive power structures (as discussed in the previous paragraph). Thus another key area that the franchisor must address, after having determined its strategy for setting up structures, is to put in place proper support structures that function efficiently.

A proper management reporting, accounting and information system facilitates and increases control by the franchisor over the franchise network (KE 4C). e.g. if the franchisor possesses information relating to the operation and performance of franchisee operations, this information can be utilised to assist or communicate via non-coercive means to the franchisee, changes or actions that the franchisor requires the franchisee to undertake. KE 4C highlights several key control areas, systems and reports that a franchisor should put into place within the franchisor company and the franchise network to assist with this. Thus a further key area that the franchisor must address, after having determined it’s strategy for setting up structures, is to put in place, proper reporting, accounting and information systems.
Thus the franchisor should put in place systems and procedures necessary to enable the power and control structures to be created in a way that will create a sustainable franchise network. According to the research conducted, this should consist of adopting a policy of no-coercive management, creating proper support systems and implementing proper systems controls and management information systems.

Once the franchisor has developed a strategy for its operating structure, and set up systems for controlling the power and control relationships within the franchise networks, he should concentrate on putting in place an ethos that ensures the creation of a learning organisation (KE 5). As per section 2, this includes transferring knowledge from the founders to an easily accessible medium, providing training and creating a culture of learning and experimenting (research and development) within the franchisor company and franchise network. Thus a further key area that the franchisor must address, after having determined its strategy for setting up structures, is to put in place and encourage the creation of a learning organisation as discussed in section 2.

Thus after running a franchise concept through the model, and taking the research results and emergent conclusions generated into account, the franchisor should have;

- developed a correct strategy for setting up the company structure,
- put in place necessary drivers for creating a learning organisation, and
- put in place necessary drivers to create the proper structure for maintaining power and control relationships within a franchise network

to assist with the creation of a sustainable franchise network.

A further adaptation of the model follows below.
Fig 8.1

DEVELOP A BUSINESS STRATEGY

LEARNING ORGANISATION

POWER AND CONTROL RELATIONSHIPS

NON COERCIVE POWER KE 4A

CONTROL AND INFORMATION SYSTEM KE 4C

SUPPORT ACTIVITIES KE 4B

TRAINING AND TRANSFERING OF KNOWLEDGE KE 5

RESTRAINTS

KE 1

KE 2

KE 3
When performing research on the case study company, it was noted that the company did not undertake significant advertising or branding campaigns to assist with building of their brand. To the contrary, what little branding and advertising did take place, was not successful due to problems incurred with management of that division (discussed in KE 4B). However notwithstanding the fact that the case study company did not actively have a strategy for developing its brand, and did not physically perform any “accepted” brand building exercises, it is acknowledged (both within and outside the company) to be the leading brand in its food category. The brand was recently awarded the restaurant brand of the year in its food category by respondents to a competition in the Hello Johannesburg magazine. In a survey performed by SA Fast Food magazine, it was also found to be the leading brand in its category, despite not having a focussed brand building advertising or marketing strategy. When discussing the lack of formal branding advertising with the contradictory success of the brand, the research revealed that the founders ascribe this to the fact that they believed that building a brand is performed by getting the basics in the outlets right e.g. “looking after customers, serving good food prepared the correct way and offering good service, either through happy franchisees or through good management in company owned outlets”. Thus it would almost appear that the brand was formed on the foundations laid in fitting the business idea to the external environment of the company, and then meeting these needs through performing sound operations in the outlets. The researcher discussed this almost “informal” way of building a brand with the CEO of a listed food brand (who is also the leading food brand in it’s category). He concurred that the best way to build a brand is to get into the stores on the ground, serve customers good food coupled with an efficient service, which will result in the spread of the concept and thus result in the building of the brand.

As a result of this, the model (which is developed from research of the case study company) was updated to give effect to the fact that the brand in the case study company was created through determining the correct strategy (business idea fit with the external environment) and performing operations in outlets (which should be achieved by setting up the correct drivers as contained in the model). The updated model is shown in Fig 8.2 below. The updated model reflects the brand as having arisen from “outcomes” of the strategy developed and the creation of critical drivers (power relationships and creating a learning organisation), which create a sustainable
franchise network. The brand effect is graphically displayed at the corner points of the model, indicating that they are reliant upon the correct strategy being developed, and the critical drivers being put in place, almost like the foundation pillars of an oil rig e.g. should any of the critical drivers or correct strategy not be in place, the brand will as a result, be compromised and the oil rig will started “tilting or collapsing” in that area. Strong corrective action against the movement of the ocean will be necessary to rescue the situation and put place in the correct basics to rescue the structure and prevent it from sinking. As can be seen from the case study, this happened as a result of the company choosing the incorrect strategy in terms of financial and management constraints, which cost the company valuable financial and management resources, and facilitated the almost collapsing of the group. This also was the case with the creation of the learning organisation driver, where proper training and transferring of information from; the founders to training manuals, operating manuals, research and development practices and manuals, shopfitting and maintenance procedures etc. did not originally happen, which also facilitated the downward spiral of the group. In both cases, strong corrective action was put in place, but in doing so, this cost the company an immense amount of financial and management resources. These experiences have been captured in the emergent conclusions discussed above and subsequently developed into the model, which if followed, will prevent the pillars of the rig collapsing and sinking.

Therefore, if management set the correct strategy, and put in place the necessary key drivers as per the model, this will have a positive impact on the brand. Thus a sustainable franchise organisation which has been developed based on the experiences (some often extremely costly) of the research on the case study company, will increase customer satisfaction, which in turn leads to profitability and promote sustainable franchise network. This is shown in Fig. 8.2. Likewise, if the reverse occurs and the brand declines as a result, customer satisfaction will be poor resulting in a loss of customers, which will lead to lower profits (or even losses), which will lead to the brand losing value. Thus the feedback loop between the brand “cornerstones” on the model as in Fig 8.2 is positive, meaning more leads to more and less leads to less in terms of brand value i.e. the more customer satisfaction, the more the profitability, the more the chances of creating a sustainable franchise network, and vice versa.
Fig. 8.2

Creating a Sustainable Franchise Network

- Develop a Business Strategy
- Key Elements (KE)
  - KE 1
  - KE 2
  - KE 3
  - KE 4A: Non-Coercive Power
  - KE 4B: Support Activities
  - KE 4C: Control and Information System
  - KE 5: Training and Transferring of Knowledge

Profitability and Shareholder Value

Customer Satisfaction

- Learning Organisation
- Power and Control Relationships
To illustrate the workings of the model in another context, we can apply the model, as an example, say to the South African rugby franchise. This is shown in fig 8.3 below. Please note that a complete analysis of the South African Rugby franchise system is not performed here, nor is it the intention to do so. The sole intention of this illustration is to assist the reader with the description and understanding of the workings of the model. Thus the model is not being tested or critiqued at this point of the document.

As stated earlier, the point of entry to the model starts with the assessment of management, geographical and financial restraints. From a geographical constraint, rugby is played nationally, thus although the geographical spread is desirable for the SA Rugby brand, as was seen in the case study company, it is potentially problematical due to physically managing the outlying regions from a central point.

Furthermore, as the game is played nationally, the development and infrastructure requirements are huge, if one takes into account the huge amount of players that form part of the game, including schools, clubs, provincial teams and super 12 teams. Furthermore there is a huge backlog in terms of development with regards to previously disadvantaged players, and the lack of infrastructure that these players have in terms of fields, equipment and other playing structures required. From a management perspective there is a huge shortage of adequately skilled coaches, referees and administrators.

Lastly, as was the case where the research revealed that franchisee management outperformed company outlet management, super 12 coaches have by and large outperformed the national coaches (who as a result of their achievements, have constantly being changed with eleven coaches having being used in the last ten years).

As a result the model, which has emerged from the research performed, indicates that SA Rugby should grow through the franchising of outlets. However, in the case of SA Rugby, the existing structures have been “inherited” from past administrations. In this case the model holds that the organisation should restructure itself, or it will be forced to eventually restructure (KE 6). Evidence of this process starting is the
continuous restructuring of provincial and creation of the super 12 formats (SA rugby requested a super 14 structure recently) in the recent history of the game.

Once the strategy for growth has been determined, the drivers can be put in place to create a learning organisation. As examples to achieve this, SA Rugby can put the following in place;

- teaching skills with coaching, playing and refereeing clinics
- development of disadvantaged and other young players
- incorporate all levels of players e.g. from school to provincial level into the learning circle
- create formal examinations and qualifications for refereeing, rugby administration etc

Once the strategy for growth has been determined, the drivers can be put in place to create the necessary control and power relationship structures. As examples to achieve this, SA Rugby can put the following in place;

- create non coercive power relationships between itself, provincial rugby unions, super 12 structures, club structures and school structures
- create systems to measure the effectiveness of key drivers and monitor the results. Thereafter implement controls to ensure compliance thereof is achieved.
- provide support activities e.g. clinics, regional tournaments, support coaching, refereeing, infrastructure building, resource allocations etc

By putting these structures in place, the foundations will be laid for the development of the SA Rugby franchise.
Creating a Sustainable National Rugby Franchise

Growth through the franchising of Rugby brand to "Super Teams" (Super 12) or to provinces

Regional couches outperform national coaches
Rugby is geographically dispersed nationwide
Development and infrastructure require large amounts of capital. Shortage of good coaches, administrators and referees

Restraints

Produce support activities e.g. clinics, regional tournaments, support coaching, refereeing, infrastructure building, resource allocations etc.

Create systems to measure the effectiveness of key drivers, resulting performance, and thereafter implement controls to ensure compliance thereof

Provide support activities e.g. clinics, regional tournaments, support coaching, refereeing, infrastructure building, resource allocations etc.

Create formal examinations and qualifications for refereeing, rugby administration etc.

Incorporate all levels of players e.g. from school to provincial level into the learning circle

Teaching skills in coaching, playing and refereeing clinics

Development and disadvantaged and other young players

Create non coercive power relationships between provincial rugby unions

Create non coercive power relationships between key drivers, resulting performance and thereafter implement controls to ensure compliance thereof

Good performance by the team

Profits through gates and merchandise

SA Rugby Brand

Learning organisation

Power and control relationships

SA Rugby Brand
CONCLUSION AND IMPLICATIONS FOR FUTURE RESEARCH

This research document has attempted to develop a model from data collected as it occurred in a “case study” organisation over a two-year site visit period (rich in-depth longitudinal case study) and a three and a half year data collection period. In so doing, the research identified the key critical performance points that are essential for prosperity and long term survival in the restaurant franchise network, which can be used to assist existing and potential franchisors with developing a strategy for structuring a franchise organisation and putting in place key driving elements to ensure a sustainable franchise network.

The study contributed to existing knowledge of the subject by performing an in depth exploration of franchisor activity of the case study company over an extended period of time. This period of time included performing research during the start up and growth phases of the company, and more importantly the research covered a period when fundamental strategic changes in terms of franchising were made in the case study company. The study also added to existing knowledge by providing a portrayal of what actually happens in practice on a day to basis (“from the horses mouth”) by employing various differing data collection techniques. The findings are relevant for franchise companies who are contemplating setting up franchise networks and those who are at various stages of operating a franchise network. It also provide rich insight to the reader and tries to give an appreciation of how the nature of a franchisor organisation develops over time.

The research focussed on developing theories which emerged from making sense of events that had transpired in the case study company over a period of time. Whilst performing the research, key events in the growth of the company were considered and reviewed in an attempt to understand what had transpired as these events occurred. As a result of this analysis, conclusions emerged from the study, which provided an emergent reason (theory) for each particular event that occurred. These theories were labelled emergent conclusions in the research document. These theories were supported by further corroborating evidence obtained by conducting interviews with CEO’s of other listed franchisor , supported by the experiential knowledge of the researcher and supported by a literature review performed. The emergent conclusions
are thus grounded in theory based on the research work performed. As theories they are thus able to be acknowledged individually and are not dependent on the model, which was developed as discussed below. However when considered individually, and not in relation to each other, they loose their systemic properties, which is essential for planning longer term sustainable solutions.

A summary of the emergent conclusions are;

1. Independently owned franchise outlets perform better than employee managed company owned outlets.

2. Geographically dispersed outlets perform better when operated as franchises. Therefore, geographical location affects the decision to own company owned outlets or franchised outlets.

3. Financial resources affect the decision whether to own outlets or whether to franchise outlets. Where financial capital is not available, rather than stop growth, a franchisor will open franchise outlets. However when a franchisor has access to funding, it will revert back to the model of owning company stores.

4. Non-coercive power exercised by the franchisor within the franchise network results in higher levels of compliance by franchisees. The exercise of coercive power by the franchisor results in lower levels of compliance (including non compliance) by the franchisee. Therefore the use of non-coercive power as the main form of compliance seeking is critical to ensuring a sustainable franchise network.

5. The level of performance of support activities by the franchisor influences the power relationship the franchise network in that, the higher the level support activities provided, the more that control shifts to the franchisor, which results in higher levels of compliance by the franchisee.
6. A proper management information system, accounting system and reporting system facilitates CONTROL by the franchisor in the franchise network and is critical to create a sustainable franchise network.

7. Transferring all processes and know how from the founders (tacit knowledge) to generic media formats (explicit knowledge), and putting in place proper training procedures is critical to creating a sustainable franchise organisation. This will also assist in creating a learning organisation.

8. The company should initially determine its business idea and thereafter determine its strategy (strategic fit between the business idea and the external market that the franchisor operates in), prior to opening the first franchise. This will lead to a sustainable franchise network and will decrease the risk of failure.

9. The financial and management resource constraints that initially face a franchisor upon formulation of the franchisor company, will determine the way that the franchisor company should be set up in terms of company or franchised outlets.

10. If financial and management constraints exist, the company should grow by means of franchised outlets. Should the company chooses to grow by opening company owned outlets in spite of the fact that it has financial and management constraints, then the company will be forced later to readopt the strategy that it initially should have taken (as a franchise format), as the resource constraints are likely to increase as the company expands.

In an attempt to understand the relationships between these theories, an interrelationship exercise was performed to determine the driving forces and resulting outcomes between the emergent conclusions. Once this was performed and an understanding of the interrelationships between the emergent conclusions was obtained, a model was developed. Using the understanding of the interrelationships between the individual theories, the model attempts to create an application tool that holistically encompasses the individual theories and gives effect to the causality
between the theories developed. This makes sense, as from a systemic viewpoint, individual theories are part of a wider system that interrelate to each other.

It is important to note that the model represents one theory, and not all theories pertaining to the creation of a sustainable franchise network. Furthermore, it should be noted that the model has been created from a number of grounded theories based on research performed. Although the model was briefly reviewed against an example of a franchise organisation, this review was performed for explanatory purposes only, and was not intended to be an in depth study or evaluation of the model. Thus the model as a single entity has not been tested and properly evaluated as a whole. Thus for future research purposes, the model should be further analysed and examined using common methods such as other case study examples, large surveys, interviews with other organisations and performing literature reviews.

Any future analysis should also consider Mitroff’s (1998) stakeholder analysis shown in Fig 9.1 below.

![Fig 9.1](attachment:image.png)

Mitroff’s recommends that all problems or significant events should be analysed using his stakeholder analysis contained in Fig. 9.1. Mitroff holds that all problems have significant aspects from each of the four perspectives contained in the analysis. He further contends that to ignore any of these aspects when solving a problem, almost guarantees that the incorrect problem will be solved. The model developed as part of this research (shown in Fig 8.2 above) assists the franchisor to avoid committing fundamental errors when creating a sustainable franchise network. Thus
it makes sense when performing an analysis of the model in future research, and when applying the model to future research data, to compare the model created to Mitroff’s stakeholder analysis, to ensure completeness in the existing model and ensure that the problem is not half solved or that the incorrect problem is solved. To assist the reader in this task, a brief analysis of each perspective as it might pertain to the model developed follows.

The **scientific and technical** perspective in Mitroff’s analysis, concerns the technical nature and methods of the problems being solved. The model developed in the research shown at Fig 8.2 is derived as a result of events that occurred in the case study company, and the theories generated in the emergent conclusions offer technical advice to avoid failure.

The **existential perspective** concerns the issues of meaning and purpose and searches for the reasons for the existence and the occurrence of events. Common questions centre around what is the meaning of what has or is occurring. As can be seen from the methodology in the forming of the model, development of the model was based on a number of theories that had been emerged from the meanings of events that had occurred in the case study company. The model guides the user in putting in drivers to prevent events occurring which might jeopardize the franchise network. These drivers were developed from theories which emerged from the meaning of certain events having taken place. The model also has a clear purpose to assist existing and future franchisors practitioners with the understanding and implementing of a structure strategy and assist them to put in place key drivers in the development and application of franchise networks. Thus the model developed takes the existential perspective into account.

The **interpersonal/social perspective** concerns the interpersonal and social effects that the model has on the stakeholders of the franchise network. Interpersonal knowledge according to Mitroff (1998), refers to how we get along and relate to society, institutions, networks and humankind. This aspect was dealt with in depth in terms of creating power and control relationships within the franchise network. It was also addressed when discussing management and franchisees in the franchise network. However the model does not deal with certain aspects of this perspective e.g. what
effects does the franchise network have on the families of the franchisees or founders of the franchisor? The future researcher should therefore consider a wider net of stakeholders that could be affected by the interpersonal and social perspectives, and then perhaps adapt the model to take into account drivers that could deal with issues that have arisen (if any).

The **systemic** perspective holds that events occur as a result of a larger pattern or series of events, and hold that each system is part of a larger system. In this context, therefore the model should take multiple perspectives from different systems into account. As it stands, although there are traces and evidences of the other paradigms in operation, the model appears to operate mainly within the functionalist paradigm. “The functionalist paradigm uses the laws that govern relationships between the parts or sub parts of a system to gain knowledge of the system. If knowledge about the behaviour of a system can be gained in this way, the knowledge can be used by experts to improve the technical efficiency or efficacy of the system and/or it’s long-term ability to adapt and survive. The root metaphors of mechanism, organism and formism hold sway within functionalism.” (Jackson, 2000). Functionalism operates on a structured way of thinking that is focused on improving the real world situation. Other paradigms to be considered when reviewing or analysing the model as per Jackson (2000) are the interpretive paradigm, the emancipatory paradigm and the post modern paradigm. The discussion of each of these paradigms is beyond the scope of this research document, and any meaningful discussion relating to these paradigms, at the conclusion of a research paper, would be an injustice to the topics concerned. As a result, the reader is directed to the numerous research papers, journals and text books that have been written on systems thinking and specifically on the paradigms themselves e.g. Jackson’s “Systems Approaches to Management” (2000) describes each paradigm, including a history of the systems thinking and the development of each paradigm over the past years.
The concept of marketing and branding is widely acknowledged in numerous textbooks, research papers and journals to be a key determinant in creating franchising networks. Although branding was incorporated into the model developed in Fig 8.2, this research did not deal with this issue in depth. This was a result of;

- the fact that, although the case study company is the brand leader in its category, during the period under review no specific major branding exercises were undertaken by the case study organisation. The brand in the case study company was generally developed as a result of its outlets operating properly and successfully i.e. by “staff doing the right thing” and by customers marketing the outlets “by word of mouth”.

- The scope of the research of this document

It is acknowledged that further research into branding needs to be conducted to determine its role in the creation of a franchise network, and that this research document does not, nor does it intend to, give it the full prominence to this area that it deserves. The outcomes of this future research should be assessed with a view to determining it’s impact on the model and should be incorporated into the model where necessary.

In conclusion, long term problems with systemic roots cannot be solved by short-term “quick fixes”, but require carefully planned, long terms solutions, incrementally implemented. The model attempts to create a platform for putting the necessary drivers in place to form the foundations of a successful franchise network to create long term sustainability.
PERSONAL REFLECTION AND INSIGHTS GAINED FROM THE LEARNING EXPERIENCE

In my workplace

The research process was extremely relevant at this point in time to my performance in my workplace. Being part of senior management, I urgently needed to understand the reasons that were causing upheaval in the company. The results of the process followed when conducting the research forced me to perform a thorough and accurate assessment of the current position. Not only did the research result in a number of theories and a model being generated, it also resulted in me recommending strategic options to the company, which were identified during the course of the research process. Some of these options were implemented. The deliverables from the research and the lessons learnt during the process were found to be practical and able to be implemented, unlike many other strategy techniques available on the market today. I found that the research and rigour required during the research process forced me to scrutinise issues at a level beyond just being superficial. Other methods used by me previously did not force me to dig into my understanding of the issues at hand. It is clear to me that concrete theories and a usable model (deliverables) have been generated by the research, which can be used by me in my workplace (as opposed to a cleverly worded report). As a manager I have through the research been taught and given various techniques and tools to assist me with the day to day management skills required by me e.g. methods and practices to perform analysis or conduct research, preparation of interrelationship diagrams and the preparation of causal loop diagrams to assist in my systemic understanding of events and occurrences in my workplace, and a number of other practical tools and concepts e.g. brainwriting, critical incident logs, ladders of inference, personal construct theory, affinity diagrams to name but a few.
The research process

The research process forced me into a learning experience like non other. I have two other degrees and the learning techniques and processes used in the research were extremely different to what I had previously experienced and expected. The rigorous requirements of the research process coupled with the immense amount of data gathered forced me to embrace the subject more than ever before. The format and structure of having to critically select, argue and apply a methodology of research, identify the problem, perform literature reviews and gather data from multiple sources, develop a model and conclude on the research, and thereafter ensure that the process was rigorously applied benefited me greatly. Initially I struggled with the structure and methodology of doing research which seemed foreign to me, “particularly as I thought that I already had the solutions”. As a result, when starting off the research, I was led up many blind alleys and areas which appeared not to be relevant. The format and structure of research forced me back on track, and although I initially thought that these “wild goose chases” were a waste of valuable time, I now realise that they were part of my learning process and increased my knowledge used in the research process.

The results of the research surprised me. Whereas I previously had a long list of predetermined answers to the problems identified, I realise that this was always how I had solved problems, which were solved mostly in isolation of one another. The research delivered a set of theories which emerged from the data, and not by my design. Furthermore they were captured into a model which incorporated only three key areas, namely constraints, learning organisations and power relationships. On reflection, it seemed almost impossible to accept that from the amount of time spent in performing the research, gathering the data etc, that the model that emerged listed only three main areas of focus that need to be addressed. Furthermore, the problem that I posed in the early stages of the research process and the problem that ended up on the title page of this research document are vastly different from each other. It almost seemed as if the real problem had emerged after the research process had almost been completed. After my initial panic of the two year research process being two flimsy subsided, I suddenly realised that I had moved away from devising quick solutions in isolation, to developing a more long term sustainable solution, which was
Systemic in nature. I had been through a process of intense analysing and the research process had forced me to drill down into the root causes of events in an attempt to understand and critically review reasons for the occurrence of events. The result was that I was far more equipped to understand the real problem as opposed to the surface problem that had initially appeared, and as a result was in a far better position to propose a model that offered long term solutions to the problem, which was devised based on grounded theory.

Furthermore, I now understand that a large part of the learning occurred whilst performing the research and is a key deliverable of the research, in addition to the physical deliverables produced by the research (model and theories).

**A personal front**

From a personal perspective, I have grown immensely during the research process. I see every event as an opportunity to learn, and relished the learning opportunity that the research process guided me through. One of the main learning’s that the research process taught me, was to think about things and events more critically. As a result I now as a force of habit, consciously slow my thoughts and actions down and to enable me to reflect before, during and after an experience. The research has also taught me the valuable lesson of time management. As a result of the time constraints that plague life in general, I have placed my seeking of knowledge (part of which started with this research process, and which has become clear to me will be a life long experience), my work and my family/social life in context with everything else. I am consciously trying to find a balance between the three areas, and as a result I am more aware of the value of the sacrifices in each of the three areas as a result of not managing priorities and time correctly. As a result of the learning experienced during the research, including knowledge obtained from IMS sessions during the period under review, I have also grown spiritually.
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