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REWARD STRATEGIES FOR FRANCHISING ORGANIZATIONS

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ABSTRACT

Franchising organizations have peculiar characteristics that distinguish them from other organizations. In view of this, incentive systems that are effective in some organizations may not be appropriate to franchising organizations. In this article, a model is developed for rewarding managers and executives of franchising organizations. This model is based upon the concept of the organization life cycle, and examines reward strategies from the perspective of both the franchisor and the franchisee.

INTRODUCTION

Rapid changes have taken place in the franchising field during the last quarter century. Although franchising is widely known, it is still not well understood (1). Today over a third of all retail sales in the United States are handled through franchising outlets. In addition, approximately twenty percent of our Gross National Product is attributed to franchising operations (12). Franchising is rapidly becoming one of the fastest methods of doing business throughout the world today (6).

A successful franchisor depends upon highly motivated and dedicated employees who think and behave as company representatives (5). In franchising organizations reqard systems need to be established which can motivate employees and help them think and behave as company exemplaries. The reward systems that are often used in well-established or bureaucratic organizations may hamper desired performance levels in a franchising firm (2). For example, seniority-based compensation systems are often used for manufacturing firms, but such systems could easily mislead employees in a franchising firm. In this article a model is developed which will identify appropriate reward strategies for the franchisor and the franchisee at different stages of the organization life cycle. This model is based upon our field experience with numerous successful franchises supported by findings from the compensation literature.

CHARACTERISTICS OF A FRANCHISING ORGANIZATION

There are certain primary characteristics which set a franchising organization apart from other firms or businesses. The major differentiating characteristic is the style of organization and the partnership or relationship which is developed between the franchisor (headquarters corporation) and franchisee (local store) (4). For the franchisor, the greater the rate of growth, including the number of new units being opened, the greater the success of the organization. The franchisor is interested in developing new franchises and company-owned stores on a rapid basis. Franchising allows for replication or duplication of a successful enterprise in a different location or setting (8). One of the primary reasons for franchising in the first place is to utilize the operating capital of franchisees to estalbish a large network of frnachised outlets (11,10).

The franchisee acts as an entrepreneur in estalbishing a new business for the purpose of profit and growth. This entrepreneurship trait is characterized by innovative behavior, use of strategic management practices, and the desire for profit and growth in the near future (15).

Key employees of both the headquarters organization as well as the franchisee organization are concerned with creativity, innovation, cooperation, interactive behavior, and a desire for profit and growth of the franchising firm. Employees assume different economic risks at different stages of organizational growth; and while a pattern of movement through the various stages is illustrative of general tendencies, it is not preordained (16). As such, reqard strategies should be developed that will reinforce employee behaviors that are desirable and necessary at the different organizational stages (2).

There are two groups of individuals in the franchising organization which should have different rewards for their performance: (1) the headquarters organization responsible for the operations and sales of franchising units and (2) the managers and assistant managers of the individual franchisee (or company-owned) stores.

THE ORGANIZATION LIFE CYCLE

An important concept which allows us to relate reward programs to the business strategy of the franchising firm is the organization life cycle. The organization life cycle is divided into different stages which convey different organizing logic resulting in a different configuration of organizational, strategic, and situational factors (13). While the number of stages may differ, a common configuration cycle consists of four stages: (1) start-up, (2) growth, (3) mature, and (4) decline (9,14). The organization life cycle relates the developmental stages of an organization to the sales revenues and size of the organization.

Table 1
Relationship between stages in the life cycle, organization characteristics and compensation strategy for franchising firms.

Organization Characteristics	Start Up	Growth	Mature	Decline
Corporation				
Years	0-3	variable, 2-10	11 plus	variable
Size (no. of units)	1-20	21-100	101 plus	variable
Sales Revenue	very small	small to medium	medium to large	declining
Growth Rate	slow	rapid	moderate	negative
Earnings	low	moderate	strong	weakening
Business Focus	obtaining financing, control costs	increase number of stores open	profitability	survival
Pay and Incentives				
Focus	attract employees, innovation, motivation	recruiting, retention training	consistency, motivation	layoffs cutbacks
Risk Profile	high	moderate	low	high
Headquaters Staff:				
Base Salary	below market level	market level	at or above market level	at or above market level
Benefits	below market level	market level	at or above market level	at or above market level
Long-Term Incentives	stock options (broad participation)	stock options (limited participation)	stock purchase	not offered
Short-Term Incentives	stock or cash bonus	cash bonus	cash bonus	not offered
Franchisee, Company-Owned Staff:				
Base Salary	market level	at or above market level	at or above market level	below market level
Benefits	below market level	market level	market level	below market level
Long-Term Incentives	travel, profit sharing	travel, profit sharing	cash bonus	
Short-Term Incentives	cash bonus	cash bonus	cash bonus	cash bonus

The model/matrix in Table 1 relates organizational characteristics to the different reward strategies appropriate for both the headquarters staff and the franchisee staff. The growth rate of most franchising organizations tends to be very slow in the start-up phase (7). In addition, the number of units actually sold and opened tends to be small, and sales revenues tend to be low. The focus of the business in the start-up phase is centered on obtaining financing for the organization as well as controlling costs. The risk involved in these activities is very high, and it is difficult to attract key employees and to provide them with the motivation to develop their creativity and entrepreneurial styles.

As we move from the start-up to the growth stage, the growth rate expands quite rapidly. Sales revenues grow, and the number of units opened increases dramatically. It is difficult now to keep up with the training and opening of stores which is required in a franchising organization. The business focus is centered primarily on the increased number of stores being sold and opened. Reward strategies at the growth stage should be tied in to recruiting, retaining, and training key employees both in the headquarters and in the franchisee stores.

The mature stage in a franchising organization generally finds the growth rate moderating as to the number of units sold and opened. Sales revenues are fairly large, and the number of stores already opened is significant. The focus now turns to the profitability and earnings of the organization. Reward strategies at this stage should place more emphasis on motivation, consistency, and retention of key employees. It is critical that the key employees maintain and further the development and growth of the franchising organization. Otherwise, the declining stage will become a reality, and the business will slowly dissipate.

The stages of the organization life cycle which are most important for formulating reward strategies are the start-up, growth, and mature stages. The growth of the organization is variable during these stages, but it is the lifeblood of the organization. Reward strategies should be based on positive organization growth and the development of an organization structure that will properly sustain and develop that growth. In the declining stage, the growth level is negative, and incentives are generally irrelevant to the survival of the organization.

REWARD STRATEGIES FOR THE HEADQUARTERS STAFF

A start-up franchising organization is generally divided into three different offices: (1) president; (2) sales manager, and (3) operations manager. These constitute the major organizational thrust and operation of a franchising business; therefore, reward strategies should be formulated to allow these individuals to be creative, innovative, cooperative, and committed to developing the franchisor/franchisee relationship.

The base salaries and benefits for these three individuals will generally be below the market level initially, but as the organization expands through the growth stage, both their salaries and benefits should be raised to a competitive market level. When the organization advances into the mature stage, these benefits should be at or above the competitive market level.

The long-term incentives for these offices should generally include initial stock opetions with broad participation by a very limited number of people. As the organization grows, the stock options should become more limited as to the participants, and finally in the mature stage, a stock purchase program may be initiated, often in addition to a limited stock option program. The short-term incentives may take the form of stock or cash bonuses initially. After a period of time, these may include profit sharing and larger cash bonuses.

Stock options for the start-up franchise serve as powerful inducements to key employees. These options provide great incentive for employees to be creative, motivated, and committed to making the company successful. Stock options can also be used in anticipation of retaining the top talents within the organization. The most common stock options include incentive stock options (ISOs), non-qualified stock options (NQSOs), and restricted stock (3). With the ISO the employee receives an option to purchase stock at a specific price at the time the option is granted (book value or market value), usually with up to ten years to exercise such option. Generally, with an ISO no tax is paid when the grant is exercised; however, the gains on selling the stock will receive capital gains treatment. The non-qualified stock option, while similar to the ISO, requires the employee to pay taxes when the option is exercised as well as when the stock is sold. The restricted, stock option generally awards shares to employees who have remained with the company for a fixed period of time, usually from three to seven years. The value of stock options becomes more attractive and more limited as the company continues to grow and increase in size. As the company grows, the eligibility for stock options becomes more restricted, and only key executives and specially targeted employees are permitted to participate during the growth and mature stages of the business.

The sales manager may receive a flat commission of $500 to $2,000 for each franchise sold, as practiced by franchises like Merry-Maids, Fast Track Hamburgers, and Drusilla Seafood Restaurants. This incentive is usually based on three to fifteen percent of the initial franchise fee (e.g. at EconoLodges). Additionally, the cash bonus system, developed for the operations manager and his/her staff, is generally based on the percentage sales increase over the franchised and company-owned stores for which they have responsibility.

REWARD STRATEGIES FOR THE FRANCHISEE (OR COMPANY-OWNED) UNIT

With the franchisee (or company-owned) store, there are two major classifications as to who should receive salary and pay incentives. These include the store manager and the assistant manager(s). While the reward structure for most managers and assistant managers of franchising organizations is very competitive at the local market level, it is important that a new franchise store have a manager hired at a strong competitive base salary and not below the local level. The franchisee or manager is going to be primarily responsible for the success and profitability of the franchising unit. Ideally, because of his/her important role the manager should be paid at or above competitive market level salaries throughout the start-up, growth, and mature stages of the franchise unit's development. Because of the growth possibilities of franchising units, it is not as important that the benefits package be as competitive as the base salary. Often the initial benefits package may be below the market level at the growth or mature stage of the organization's development.

Many first time managers of a franchising unit have been promoted from assistant managers in other franchise businesses. Examples can be seen at Hardee's and Burger King. Most managers and assistant managers in franchise units are young and generally do not have a lot of experience in management. The primary long term incentives for these managers and assistant managers may be developed through travel and profit sharing programs. Travel programs may vary from year to year while profit sharing can be anywhere up to 3% of the sales of the organization.

The short-term incentive program for managers and assistant managers should be based on a cash bonus system, such as that developed by Kentucky Fried Chicken and Burger King.

As Table 2 shows, the cash bonus or incentive systems for store managers and assistant managers may be easily developed based on the sales or percent of sales increase over a previous time period. Because of the seasonality of most franchising operations, cash incentive programs are usually developed around a quarterly sales statement with an increase in the percentage of sales for

Table 2
Incentives For Company-Owned Stores

Increase in quarterly sales over previous years' quarterly sales

	First Alternative				Second Alternative		
Percent Increase	Total Store Bonus	Mgr.	Asst. Mgr.	Total Asst. Mgr.	Store Bonus	Mgr.	Asst Mgr.
0- 2.0%	No bonus	0	0	0	0	0	0
2.01- 4.0%	400	200	100	100	340	240	100
4.01- 6.0%	800	400	200	200	680	480	200
6.01- 9.0%	1200	600	300	300	1020	720	300
9.01- 12.0%	1600	800	400	400	1360	960	400
12.01- 15.0%	2000	1000	500	500	1700	1200	500
15.01- 18.0%	2400	1200	600	600	2040	1440	600
18.01- 21.0%	2800	1400	700	700	2380	1680	700
21.0- up	3200	1600	8700	800	3200	2400	800

STORE MANAGERS:

Any company-owned store manager with annual sales of $500.000 or more for any continuous twelve month period between now and June 30, 1991 will receive a seven day, six night expense paid trip to Hawaii for two.

ASSISTANT STORE MANAGER:

Any company-owned assistant manager with annual sales of $500,000 or more for any continuous twelve month period between now and June 30, 1991 will receive a 5 day, 4 night expense paid trip to Orlando, Florida for two.

a particular quarter over the previous year's quarterly sales. For example, a manager who is responsible for a 13% sales increase over the previous year's quarter, should receive a $1,000 bonus (see Table 2). During the year this bonus could easily total $4,000 to $6,000 if sales are good.

A cash bonus system (short-term incentive) coupled with an employee profit sharing and travel plan (long-term incentives) along with a generous base salary and benefits package provides the franchisee (or company-owned store) with a salary and incentive structure that should enable him/her to reach the organization's objectives. This generally coincides with previous findings from the compensation literature (2).

CONCLUSION

Reward strategies provide an effective tool to reinforce desired attitudes and behavior of employees in any organization. In this article we have identified those effectively used by successful franchising organizations such as McDonald's, Burger King, Fast Track, Merry-Maids, Kentucky Fried Chicken, Hardee's, EconoLodge, and Drusilla Seafood Restaurants. Based on our experience with these and other franchising companies in diverse industries, we have developed a model that integrates reward strategies with the stage of development within an organization's life cycle. In our opinion this model should be generally applicable to all franchise organizations.

This paper underscores the need for both the franchisor and franchisee organizations to have different incentive systems for their employees at different stages of the organization life cycle. It is important to have good base salary structures and to provide both short- and long-term incentives valuable to employees at each of these stages. These incentives, when properly implemented, should motivate and retain a strong operating staff for both the headquarters organization as well as the franchisee store. Because franchising is such a unique method of doing business, reward strategies should be carefully designed and developed before they are implemented.

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