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The moderating role of servant leadership in the relationship between organizational structure and performance in fashion retailing

Journal of Fashion Marketing and Management: An International Journal

Received 10 May 2023
Revised 27 November 2023
18 March 2024
22 May 2024
3 June 2024
Accepted 17 June 2024

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Abstract

Purpose – This study aims to reveal how the organizational structure (vertical integration vs. franchising) of 308 stores in a Spanish fashion retail franchise chain affects their performance measured through two key performance indicators commonly used in this industry, namely, labor productivity and service quality ratings. We also appraise the moderating role played by the servant leadership of franchisees and managers of company-owned outlets to explore its influence on the relationship between organizational structure and store performance.

Design/methodology/approach – We have used multivariate analyses to study the research questions, with a panel dataset of quarterly store-level data for the period January–December 2022.

Findings – Vertically-integrated stores record lower labor productivity than franchised ones. This impact is lower in stores run by individuals high in servant leadership than in those run by individuals low in it. Franchised outlets also record lower ratings in service quality than vertically-integrated stores, and this negative impact is weaker in stores run by individuals high in servant leadership.

Originality/value – Nothing has thus far been published on the moderating effect of servant leadership in the relationship between the organizational structure of different stores and their outcomes in franchise systems.

Keywords Fashion retailing, Franchising, Performance, Servant leadership, Service quality, Vertical integration

Paper type Research paper

1. Introduction

Choices between vertical integration and vertical separation are some of the more crucial decisions made by businesses, so they are unsurprisingly the subject of a substantial amount of theoretical and empirical research (e.g. Ackermann, 2024; Lafontaine and Slade, 2007). However, data limitations and identification issues complicate attempts to estimate the effects of vertical structure on firm performance. Franchising serves as a case study accordingly.

Franchising is an organizational form in which a franchisor creates a product, business plan, and trademarks, and then sells the right to open a branded store to a franchisee. Franchise chains have long been a subject of interest in the management and organizational economics literature (e.g. Bretas and Alon, 2021; Dant *et al.*, 2011). Franchises are neither

The authors acknowledge financial support from the Department of Education of the Government of Castilla y León (Grant SA106P20), from the Spanish Ministry of Science and Innovation and AEI, MCIN/AEI/10.13039/501100011033, and from the European Union (Grants PID2019-107546GA-I00 and PID2022-136496NB-I00).

Journal of Fashion Marketing and Management: An International Journal
© Emerald Publishing Limited
1361-2026
DOI 10.1108/JFMM-05-2023-0138

strictly hierarchical nor purely market-based transactions, so they may constitute the quintessential hybrid form of governance (Ménard, 2004). A franchise agreement is defined as a contractual arrangement between two independent firms whereby the franchisee pays the franchisor for the right to sell the franchisor's product and/or the right to use its trademark at a given place and for a certain period of time (Sadovnikova *et al.*, 2023).

Although some chains franchise 100% of their outlets, most adopt the plural form (Ackermann, 2019; Sánchez-Gómez and Vázquez-Suárez, 2024; Sørensen *et al.*, 2023; Vázquez-Suárez *et al.*, 2022), combining company-owned and franchised stores. Academia has studied the coexistence of both company-owned and franchised stores in the same chains (Ackermann, 2019; Mejía-Vásquez *et al.*, 2022; Sadovnikova *et al.*, 2023; Vázquez-Suárez *et al.*, 2020). One of the objectives in this line of research is to detect whether one of these two organizational structures underperforms the other. This is a crucial matter, as anything that affects a store's performance also impacts upon its long-term survival. The choice of the ownership structure of individual stores in a franchise chain is therefore a critical decision, as franchisees and the managers of company-owned stores are driven by different incentives that may affect their stores' performance (Rubin, 1978). Theoretical studies have proposed that franchising may increase or decrease store outcomes. According to agency theory, the main reason a franchised store should outperform a vertically-integrated one is that a franchisee, whose compensation is entirely determined by store profits, will be more motivated to increase business profits than a store manager, whose compensation is typically less dependent on the outlet's performance (Rubin, 1978). There is also theoretical literature suggesting that franchising has a detrimental effect on store outcomes. For example, a franchisee may be tempted to free ride on the chain's reputation and provide a lower-quality product/service (Kidwell *et al.*, 2007). Agency theory has been widely used to explore the incentive structure of franchising relationships and their relative efficiency compared to vertical integration (e.g. Lawrence and Perrigot, 2015). The empirical literature has used this approach to compare franchised and vertically-integrated stores (e.g. Ackermann, 2019; Lawrence and Perrigot, 2015; Vázquez-Suárez *et al.*, 2022). These studies highlight the capacity franchise contracts have to (a) foster management efforts (i.e. avoid managerial shirking) and (b) promote free riding.

As the organizational structure of the stores in a franchise chain influences their performance, it is essential to discover how this relationship depends on certain conditions or potential moderators. There is no question about the importance that the leadership roles of store leaders have for their outlet's effective operation (Inyang *et al.*, 2018; Jarvis and Williams, 2017). As Arnold *et al.* (2019) state, store leaders "are key to orchestrating the implementation of corporate strategy through direct interactions with both regional managers and frontline employees" (p. 144). Nevertheless, there are few studies that include the store leader perspective, especially in relation to key store outcomes (e.g. Arnold *et al.*, 2019). Although Grewal and Levy (2007) called for research on the critical leadership role of store leaders over a decade ago, relatively few studies have addressed their influence upon an outlet's performance. This study addresses this research gap by exploring the influence on outlet performance of organizational decisions in corporate chains and store leaders' characteristics (e.g. Arnold *et al.*, 2019; Grewal *et al.*, 2009; Lichtenstein *et al.*, 2010). Specifically, we contend here that the servant leadership (SL) of store leaders, which is closely linked to their decision-making (e.g. Eva *et al.*, 2019), may affect the relationship between the organizational structure of individual stores and their performance. SL means prioritizing the needs of teams and even organizations over those of the leaders themselves (Eva *et al.*, 2019). This type of leadership specifically focuses on business performance informed by employees' growth and development (Greenleaf, 1977). SL positively affects an array of outcome variables and satisfies staff expectations over and above transformational, authentic, and ethical leadership (Hoch *et al.*, 2018). It is therefore reasonable to assume that the attitudes and behaviors of store leaders high in SL will transfer to their followers and thus influence store outcomes, possibly more so than other leadership styles

(Zarei *et al.*, 2022). SL might also relieve the underlying tension between the goals of employees and shareholders (Lee *et al.*, 2020). This poses the following research question: Can a franchise chain benefit from having servant leaders running their stores or should such behavior be avoided? Our results show that franchised stores record higher labor productivity (LP) than company-owned ones, and this positive impact is stronger in stores run by people higher in SL. Franchised stores also record lower ratings in service quality (SQ) than company-owned ones, and this negative impact is weaker in those run by individuals higher in SL. These findings increase our understanding of SL in managerial positions, making a significant contribution to the research on the professional profile of middle managers and franchise chains. Studying the impact that SL in interaction with organizational variables has on the performance of the stores in a franchise chain will enhance our understanding of franchising itself. Nothing has thus far been published on SL's moderating effect on the relationship between the organizational structure of different stores and their outcomes in franchise chains. Although the literature reports that SL among managers and entrepreneurs may affect business outcomes (Liden *et al.*, 2014; Peterson *et al.*, 2012), no attempt has been made to address its overall impact.

This research uses a panel dataset involving a Spanish fashion retail chain, which must remain anonymous for reasons of confidentiality. The data are comprehensive, with quarterly store-level figures for the key performance indicators (KPIs) in question. The data also reveal whether each fashion store is franchised or vertically-integrated, together with sundry other characteristics (e.g. each outlet's age and size). We also have data on local markets, whereby we may control for several variables that impact on the KPIs analyzed.

2. Literature review and hypotheses

2.1 Franchising in fashion retailing

Franchising is a well tried and tested operating model for business growth, making a significant contribution to the overall economy (Sadovnikova *et al.*, 2023). In 2022, for example, the franchising business in Spain reported a turnover of 26.93 billion euros, accounting for approximately 2.03% of Spanish GDP (Spanish Franchise Association, 2022).

Fashion is one of the world's largest industries. In 2022, the revenue of the global apparel market reached US$ 1.5 trillion (Statista, 2024), and franchising has been used by numerous chains as their main strategy for entering a new market (Märzheuser-Wood and Chatwood, 2015). Fourteen fashion companies are on the list of the world's top 100 franchisors, with PVH Corp., Iconix Brand Group, and Authentic Brands Group ranked third, sixth, and tenth, respectively, with annual turnovers of US$ 18 billion, US$ 7 billion, and US$ 5.3 billion (Chen *et al.*, 2020; License Global, 2017). At the end of 2022, 1,381 franchise chains were operating in Spain, and "Fashion" was the most popular sector, with 206 chains and 7,871 outlets (4,616 franchised and 3,255 company-owned), recording a turnover of 2,089 million euros and a headcount of 23,358 (Spanish Franchise Association, 2022).

The volatility of customer preferences towards fashion products prompts a joint increase in the heterogeneity of production, marketing, and supply management activities. The aggregation of these operations enables the market to respond rapidly to new fashion trends. All the information available throughout the market therefore calls for a specific focus, which will be more successful when there is greater coordination. Additionally, engaging with a combination of diverse channels when shopping for clothes is now common practice for many consumers (e.g. Patten *et al.*, 2020). Within this context of multichannel retailing, the assessment of SQ is becoming increasingly widespread and valued by both scholars and practitioners (e.g. Badrinarayanan *et al.*, 2014). As multichannel consumers are constantly adjusting their purchase choices involving retailers and retail channels, multichannel operators need to introduce coherent and integrated sales and communication strategies across channels (Patten *et al.*, 2020). Retailers should therefore avoid working in silo organizations where one department oversees online activities, and another does the same for offline activities. The departments need to work in tandem, as multichannel consumers expect a seamless shopping experience. In other franchising sectors, such as hospitality, the need for such coordination is not so important. This characteristic of fashion chains is significant because the required degree of coordination impacts upon each outlet's choice of organizational structure (franchising vs. vertical integration). Specifically, the higher the degree of coordination a franchise chain requires, the more probable its stores will be vertically-integrated (Michael, 2002).

2.2 Organizational structure and store performance in fashion retail franchise chains

Most of these kinds of chains manage their stores either through their own staff (vertical integration) or by subcontracting them (franchising). The choice of organizational structure is a major decision, as franchisees and the managers of company-owned outlets are affected by diverse motivations, which may influence business performance (Rubin, 1978; Vázquez-Suárez *et al.*, 2022). These two different organizational structures within the same chain give rise to incentive issues that have been analyzed by agency theory. According to this theory, vertically-integrated stores will be outperformed by franchised ones because franchising circumvents moral hazard issues (Mejía-Vásquez *et al.*, 2022). The theory maintains that franchisees have intense extrinsic motivations to supervise and monitor their staff because they receive the residual profits generated by their stores. In other words, franchisees are likely to supervise their staff more closely than the managers of company-owned outlets, as their own wealth relies heavily on their business outcomes (Rubin, 1978). This extrinsic motivation should therefore encourage franchisees to make more effort than the chain's own managerial staff, thus prompting differing levels of store performance (Ackermann, 2019; Vázquez-Suárez *et al.*, 2022).

A franchisee's capital investment should reduce shirking, whereby they should outperform the managers of company-owned outlets in terms of staff supervision (Mejía-Vásquez *et al.*, 2022). Corporate staff require close monitoring, so franchisors can reduce the associated costs by incentivizing franchisees through the residual profits of their franchised stores (Rubin, 1978), which should therefore outperform vertically-integrated ones in measures such as LP, which is an essential management goal for employees to achieve their objectives and raise output (Vogel *et al.*, 2022). Thus, we formulate the following hypothesis:

H1. Vertically-integrated fashion stores will underperform franchised ones in labor productivity.

As franchisees are part of a retail chain, they might free ride accordingly, compromising SQ (Kidwell *et al.*, 2007; Rubin, 1978). Free riding arises when a franchisee benefits equally without pulling their own weight in costs through a contractual relation designed to lighten their load by failing to undertake activities that would strengthen the overall chain; this involves, for example, overlooking chain procedures in terms of quality or service (Vázquez-Suárez *et al.*, 2022). Customers thus receive a deficient product or service, forming an undesirable opinion of the overall chain. This issue is especially important in the fashion retail industry, where products such as clothing are recognized by their brands, which reflect the qualities and values associated with the chain (Guercini and Runfola, 2016; Kremer and Viot, 2012; Rashid and Barnes, 2021). Fashion chains may therefore decide to operate their stores directly (vertical integration) to exert a high level of control over the entire service process (customer care, fitting rooms, return policy, and store environment) (Aftab *et al.*, 2018; Anselmsson *et al.*, 2017; Rashid and Barnes, 2021).

Franchisees may increase their profit by reducing their costs/quality, although the ill-feeling of their disgruntled customers may then be passed on to all the other stores in the chain (Rubin, 1978). The major incentives that characterize franchising reduce store leaders' monitoring costs. However, franchising may incite free riding, thereby weakening the chain's coordination (Michael, 2002) and undermining its brand reputation (Vázquez-Suárez *et al.*, 2022). Jin and Leslie (2009) support this claim, reporting lower hygiene ratings in franchised outlets compared to their vertically-integrated counterparts within the same chain. Besides justifying the lower outcomes of company-owned stores, agency theory also suggests that they will outperform franchised ones. As franchisees share their brand with the rest of the network, they might want to reduce costs and free ride accordingly in the knowledge that they will not bear the full brunt of customer dissatisfaction because the ensuing costs are shared by both the franchisor and other franchisees (Mejía-Vásquez *et al.*, 2022). Thus, we formulate the second hypothesis:

H2. Franchised fashion outlets will underperform vertically-integrated ones in service quality ratings.

2.3 The moderating effect of SL of store leaders

The organizational structure of the stores in a franchise system may influence their performance, so it is essential to grasp how this relationship is contingent upon, or restricted to, particular circumstances or potential moderators.

Several studies have dealt with the influence that SL has on the performance of leaders and, therefore, of their business (e.g. Liden *et al.*, 2014). SL is sometimes considered simply one of numerous leadership types underpinned by ethical and moral principles (Hu and Liden, 2011). Its distinctive feature is that servant leaders put their followers or employees first, setting "the following priorities in their leadership focus: followers first, organizations second, and their own last" (Eva *et al.*, 2019, p. 113). The focus then transitions from the leader's own self onto others and forges a concept whereby a leader serves other employees while favoring the practices of listening, building consensus, and providing foresight.

Servant leaders firmly believe in their duty of stewardship, explicitly prioritizing service to their employees, which has significantly shifted the focus of SL from a performance-driven role to a more humanistic perspective based on trust (Eva *et al.*, 2019). Servant leaders believe in their employees and treat them respectfully. SL has a major impact on employees' behaviors as a standard to achieve. Social exchange theory proposes a reciprocal relationship, whereby a person receiving some form of reward will seek to reciprocate accordingly. In the case of servant leaders, followers are expected to correspond accordingly, nurturing reflective behavior (Greenleaf, 1977). Subordinates thus reciprocate to the leader's support, restraint, and modesty. These subordinates are heavily engaged and loyal, which may contribute to higher levels of productivity, as employees' favorable attitudes toward their supervisors are linked to their productivity (Bass, 1990). For example, Chiniara and Bentein (2016) have found that SL increases task performance, and other scholars have also identified this same impact on the performances of teams (Schaubroeck *et al.*, 2011), firms (Peterson *et al.*, 2012), and individuals (Jaramillo *et al.*, 2015).

The research on SL finds that listening, empathy, persuasion, stewardship, commitment to personal growth, and community building are effective, yielding positive individual and organizational results. SL may be particularly effective in organizational settings in which extrinsic motivations are laxer. As explained, the extrinsic motivations of the managers of vertically-integrated stores differ from those of franchisees, who have strong incentives to supervise and monitor their employees because they receive the residual profits of their businesses, whereas the managers of vertically-integrated stores do not. Franchisees are therefore to be expected to work longer hours and make more effort than managers of vertically-integrated stores, whose employees will be less controlled and supervised. It is reasonable to expect that the intrinsic motivations that characterize SL are more effective in organizational settings with laxer extrinsic motivators, such as vertical integration, than in those with stricter ones, as in franchising. The intrinsic rewards for servant leaders (i.e. feelings of satisfaction) attenuate the shirking problems derived from the weaker extrinsic motivators that characterize vertically-integrated stores.

In short, (1) the managers of company-owned outlets have fewer extrinsic motivators than franchisees to maximize the LP of their staff because the former's personal wealth is not as dependent as the latter's on their store's performance (Rubin, 1978), and (2) the intrinsic motivation that characterizes SL is especially effective in organizational settings, such as vertical integration, in which extrinsic motivators are weaker. We may therefore formulate the following hypothesis:

H3. The negative impact that the vertical integration of fashion stores has on labor productivity will be weaker in stores managed by individuals high in SL than in stores run by individuals low in it.

The evidence of differences between those high and those low in SL in terms of honesty, integrity, credibility, and trust (Greenleaf, 1977) –indicators of how far franchisees maintain their system's quality benchmarks– supports the view that there may be divergences between their respective willingness to satisfy these standards. The core principles of servant leaders include honesty and integrity, which foster interpersonal and organizational trust (Greenleaf, 1977). Such leaders inspire credibility because they can be trusted to keep their word.

As explained, free riding is an important problem in franchising (Rubin, 1978). Franchisees do not assume the complete cost of providing a substandard level of quality in their stores and thus have incentives to free ride by skimping on quality. By contrast, managers of vertically-integrated stores have no incentive to free ride because negative externalities decrease the value of their chains.

Servant leaders tend to alleviate the free riding problem in a franchise chain, which prompts franchisees to favor their own self-interests over those of the overall chain. Franchisees high in SL are more likely to consider what would be best for the chain as a whole; they do not therefore act simply in their own interest, while those low in SL are less likely to uphold the chain's quality standards, focusing more on promoting their store's short-term returns. The greater proclivity towards ethical behavior by franchisees high in SL should therefore favor a closer compliance with the quality benchmarks their chain expects. In other words, differences in honesty, integrity, credibility, and trust between the high and low SL of store leaders indicate diverse attitudes in their disposition to maintain appropriate levels of SQ. We may therefore formulate the following hypothesis:

H4. The negative effect franchised fashion stores have on service quality ratings will be weaker in stores run by individuals high in SL than in those managed by individuals low in it.

Figure 1 shows the conceptual framework for testing the moderating effect of SL of store leaders on the relationships between organizational structure and store performance.

3. Data and research methodology

3.1 Dataset and sample

To diminish the potential impact of exogenous factors, our study was undertaken in a Spanish franchise chain in the fashion retail industry. Several previous studies have been based on this type of setting (Giolito *et al.*, 2021; Liden *et al.*, 2014), which permits comparing similar businesses (fashion stores in the same chain) to study the impact of leaders (i.e.

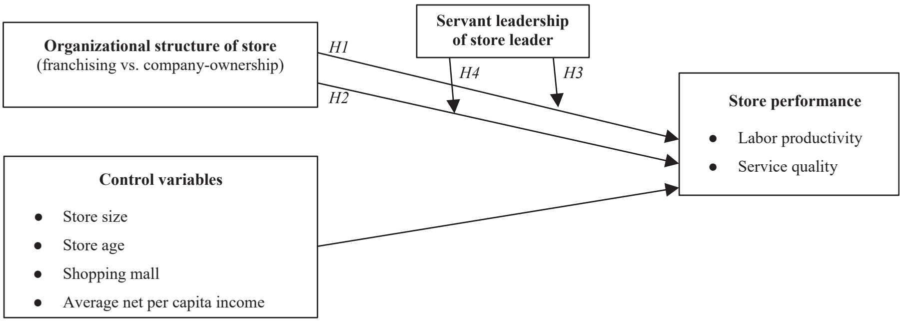

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Figure 1. Conceptual framework of the study

franchisees or managers of vertically-integrated stores) in each case. There is only one echelon of leadership in each store, either a franchisee or the manager of a company-owned store, with all the staff reporting directly to them.

The analyzed chain was launched in the 1980s, and since then it has been refashioning the Spanish clothing industry through the introduction of innovative concepts. The company has rolled out a rapid response strategy that reduces the time between a store's order and its dispatch. This means the firm can streamline its response to both its clients and market trends. It therefore has the necessary flexibility to respond to changes in the fashion industry by adjusting its processes to the orders placed by its retail stores and providing a quick and effective response to new trends. The design of the garments the chain sells in its franchised and company-owned stores is vertically integrated. However, the franchisor does not manufacture the fabrics or accessories, nor does it make the garments, but instead outsources its production to around 150 independent suppliers with whom it maintains long-term relationships. The garments are made in China, Morocco, Turkey, Vietnam, and India. Manufacturing in these low-cost countries enables the chain to sell at relatively low prices. After receiving the garments from its suppliers, the franchisor applies a rigorous quality control system before delivering them to its franchised and company-owned stores.

This company's success has driven its expansion, initially in the domestic market and subsequently abroad. The firm focuses on turning employees into leaders and then helping them to rise through the ranks. Management is interested in developing an employee's talents, abilities, knowledge, and communication. Its corporate values embody the basics of SL, focusing on employees and their performance, as well as on realizing their individual potential. These values ensure that store leaders possess the strength and training needed to manage staff in a way that promotes their development within the company. The company encourages store leaders to view conflicts with staff as an opportunity to teach individuals and redirect them towards a better outcome. For example, when an employee does not follow the company's guidelines on best practices, there are several steps a store leader can take to tackle this issue. Sequential meetings may be held to discuss company policy, but the store leader should also explain this process. The employee then understands the reasoning behind it and can thus instruct others and gain confidence in their work. There are other factors that promote followership, such as quarterly dialogs that help management to "check-in" with employees and discover their strengths and limitations. They are also tools that store leaders can use to reward good work, effort, and accomplishments. This encourages further effort by employees. Dialog also provides employees with constructive feedback on how to reach their full potential and gain promotion within the company. This firm develops and promotes SL by putting the needs of the employees first and building strong connections between staff.

This type of inclusion endorses the employees' abilities to reach their goals, helping them to work as a team and present their best selves.

The analyzed chain has provided store performance data for the four quarters of 2022. The dataset contains quarterly store-level data for the period January–December 2022, with a total of four observations for each one of the stores in our cohort.

We have ensured that neither organizational structure nor store leadership (managers or franchisees) has changed during the timeframe used to measure the performance of the stores (all four quarters of 2022). We have therefore reduced our initial sample as described below. Throughout the whole of 2022, the fashion chain in question here had 346 operating stores in Spain (134 franchised outlets and 212 vertically-integrated ones). The stability of each store's organizational structure has been ensured by discarding five that in 2022 transitioned from franchising to company-ownership or vice versa. In the remaining 341 stores with no change in organizational structure in 2022, 308 (117 franchised stores and 191 company-owned ones) did not change their leader either. Our final sample is therefore made up of these 308 stores.

SL has been measured by administering an anonymous survey on Google Forms (codes instead of names were used to identify respondents) to all the staff that had been employed in their store for one year or more with the same store leader. We outlined our research purpose when introducing the survey, clearly indicating that it was not compulsory to take part and that it had not been commissioned by the chain in question. Each item on the questionnaire (see Table 1) was drafted by first translating it from English into Spanish and then back again to compare the two versions and ensure consistency (Brislin, 1979). A trial test was held in September 2021 to detect and resolve any ambiguities. We used convenience sampling to survey the staff in three franchised stores and three vertically-integrated ones, who were asked to answer the questionnaire. The final survey was administered in October 2021.

The time-lagged data on SL gathered in Time 1 (October 2021) and store performance variables in Time 2 (2022) cater for the possibility of reverse causality, which is common in studies on the link between leadership and performance (Phillips and Lord, 1981).

The survey was held in collaboration with the retail chain in question here, which facilitated a high response rate. Overall, the respondents accounted for 67.3% of the total headcount in the sample, with an average of 6.72 employees per store (SD 4.09; range 3–21). At least three employees have responded to the survey in each store. Among the 2,069 respondents, 80.2% were female, with an average age of 35.71 (SD 9.39 years; range 18–59). The average tenure with store leaders was 5.28 years (SD 5.01; range 1–21), and the average tenure in the job was 6.86 years (SD 7.07; range; 1–29).

3.1.1 Dependent variables. We used sales per employee in each store on a quarterly basis to assess LP, as this variable is a common KPI (e.g. Vidya *et al.*, 2015).

Outlet performance is also gauged using quarterly SQ ratings, which play a crucial role in fashion retailing. The shopping experience obviously becomes more agreeable for customers and more profitable for fashion retailers when staff are well trained and engaged. Staff

Table 1. Seven-item measure of SL (SL-7)

Q1	My leader can tell if something work-related is going wrong
Q2	My leader makes my career development a priority
Q3	I would seek help from my leader if I had a personal problem
Q4	My leader emphasizes the importance of giving back to the community
Q5	My leader puts my best interests ahead of his/her own
Q6	My leader gives me the freedom to handle difficult situations in the way that I feel is best
Q7	My leader would NOT compromise ethical principles in order to achieve success

Source(s): Table created by authors

interaction with customers and their personal appearance improve the shopping experience and together with store policy create the most favorable impression (Yu-Sum and Leung, 2009). Research has shown that sales staff have a key role to play in the shopping experience. Customers will be encouraged to return to the store by their experience, thereby creating a competitive advantage for the chain (Jackson and Shaw, 2008). Several studies have been used to understand and rate SQ in fashion stores to measure specific in-store services (Leung and Fung, 1996; Leung and To, 2001; Patten *et al.*, 2020). These studies have relied heavily on quality ratings provided by customers. In our case, we have used a dataset on SQ inspection ratings compiled by the chain itself (see Table 2).

3.1.2 Independent variable. The outlet's organizational structure at the start of each quarter takes a value of 1 for franchised stores, and 0 otherwise.

3.1.3 Moderator variable. The impact of the moderator variable –the SL of store leaders– is examined to determine its influence on the relationship between organizational structure and store performance. This SL was measured with the SL-7 scale developed by Liden *et al.* (2015). The scale shown in Table 1 includes the seven dimensions of SL with an item from each one of the seven dimensions with the highest factor loading in the original 28-item scale (Liden *et al.*, 2008). We have used a seven-point Likert-type scale ranging from "strongly disagree" to "strongly agree".

Various studies have employed the 28-item scale designed by Liden *et al.* (2008) (e.g. Schaubroeck *et al.*, 2011), the SL-7 (Liden *et al.*, 2015), or another variant thereof (e.g. Peterson *et al.*, 2012). The SL-7 closely mirrors the SL-28, as the correlations between them in a series of six studies with five different samples (Liden *et al.*, 2015) range from 0.78 to 0.97, and its criterion-related validities reflect those of the SL-28 (Liden *et al.*, 2008). We have performed a confirmatory factor analysis that records values consistent with the results reported by Liden *et al.* (2015), validating its use as a one-dimensional scale. Cronbach's alpha was 0.86.

3.1.4 Control variables. Our study isolates the effect that both the store's organizational structure and SL of store leaders have on our performance indicators. The model uses four quarterly dummy variables and a set of control variables to consider the features of the outlets and their local markets that may influence their performance. Our research specifically contains two demographic variables, namely, size (square meters of retail space at the beginning of each quarter) and age (years in operation at the beginning of each quarter). The study also considers two variables related to each store's local market. As in other investigations in the fashion retailing literature (e.g. Xavier *et al.*, 2015), our study includes the average net per capita income of the sub-city district in which each outlet in our sample operates. In Spain, "sub-city districts have been delimited for all cities with more than 250,000 inhabitants; these districts must have a population of between 5,000 and 40,000 people, a comparable size, and internal homogeneity; they must present spatial coherence, with clearly defined boundaries" (Vázquez-Suárez *et al.*, 2022, p. 4). Our research also uses a dummy variable that takes the value 1 if the establishment is situated in a shopping mall and 0 otherwise. Table 2 lists all the variables, their values, and their descriptive statistics, while Table 3 shows their corresponding correlations.

3.2 The model

The hypotheses have been tested by means of a model including the moderating effect that the SL of store leaders has on the relationship between the organizational structure of such stores and the performance measures studied. Sample selection bias is a significant concern in our model. The notion that organizational decisions are endogenous to the organizational outcomes expected is a recurrent theme (e.g. Vázquez-Suárez *et al.*, 2022). Hence, as organizational structure "is endogenous, such organizational elections are made systematically and not randomly, which means that standard ordinary least squares (OLS) estimates could lead to biased coefficients" (Vázquez-Suárez *et al.*, 2022, p. 4).

Variable	Description	Mean	Standard deviation	Maximum	Minimum
LP	Quarterly sales (in euros) per employee	95,231.92	20,892.08	172,749.74	48,336.44
SQ	Quarterly assessment of operational aspects related to, among others, service convenience (i.e. the suitability of payment methods), staff attitudes and efficiency (i.e. whether they are quick to respond to customers' needs, inquiries, and complaints, informing customers about the services provided; whether they are engaged with their work, polite, courteous, and well informed, and never too busy to attend to customers' requests), reliability (i.e. customers' perceptions of how well the store fulfills its promises and how willingly the establishment deals with returns, exchanges, and complaints), cleanliness of the premises (i.e. internal and external hygiene, such as toilets, enter/exit signage, windows, doors, and shop front), tangibles (i.e. modern equipment, physical facilities, and store materials), the décor, the ease of locating clothes and moving around, the ambient temperature and ventilation, and convenient business hours	91.09	8.87	100.00	72.00
Franchising	Takes value 1 for franchised stores, and 0 otherwise, at the beginning of the quarter	0.38	0.49	1	0
SL	SL of franchisees and managers of vertically integrated stores (SL-7)	5.07	1.18	7	1
Store size	Number of square meters of retail area at the beginning of the quarter	683.21	303.65	2000	330
Store age	Number of years in operation at the beginning of the quarter	13.43	8.66	25.50	3.25
Shopping mall	Takes value 1 if the store is located in a shopping mall, and 0 otherwise	0.46	0.50	1	0
Average net per capita income	Annual average net per capita income in 2020 of the sub-city district where the store operates	14,406.39	3,820.06	48,243	8,598
	Number of observations	1,232			
	Number of fashion stores	308			

Source(s): Table created by authors

Table 2.
Descriptive statistics (by fashion store)

We considered the possibility of selection bias by endogenizing organizational structure and estimating the organizational outcome equations by applying an instrumental variable methodology. Heckman (1990) explains how these equations can be estimated through

	1	2	3	4	5	6	7	8
1. LP	1.00							
2. SQ	0.14**	1.00						
3. Franchising	0.16***	−0.14***	1.00					
4. SL	0.19***	0.27***	−0.01	1.00				
5. Store size	0.29***	−0.07	−0.18**	0.08	1.00			
6. Store age	−0.08	−0.06	−0.03	0.09	−0.21***	1.00		
7. Shopping mall	−0.05	0.03	0.09	0.05	0.07	−0.08	1.00	
8. Average net per capita income	0.20***	0.17***	−0.28***	−0.03	−0.18***	0.04	−0.16***	1.00

Note(s): Significance levels: *10%, **5%, ***1%
Source(s): Table created by authors

Table 3. Correlations among variables

standard two-stage least squares by applying a linear probability model for the first stage. Following Vázquez-Suárez *et al.* (2022), we began by "estimating a treatment model to describe the self-selection decision (Equation (1)); the equation of interest (Equation (2)) was then estimated following its adjustment for self-selection from the first equation, so the treatment equation is a probit model that predicts the probability of selecting a franchised outlet or a company-owned one" (p. 7).

$$Franchising_i^* = \alpha_0 + \alpha_1 Distance_i + \alpha_2 Size_i + \alpha_3 Age_i + \alpha_4 Shopping\,mall_i + \alpha_5 Income_i + v_i \tag{1}$$

where v_i is a random error term, and $Franchising_i^*$ is an underlying index of a store's organizational choice. If $Franchising_i^* \leq 0$, then $Franchising_i^* = 0$ and denotes vertical integration; if $Franchising_i^* > 0$, then $Franchising_i^* = 1$ and indicates a franchised store.

The econometric identification of Equation (1) calls for at least one instrument not contemplated in the outcome regression equation to be added to the treatment regression. We employ the distance between each store and the chain's headquarters as the instrument for organizational choice. In theory, this variable should affect the choice of organizational structure, as it alters supervisory costs. Agency theory predicts that those stores nearest the chain's headquarters will be vertically-integrated (Rubin, 1978). In statistical terms, this premise is supported in our outcomes because this distance has a positive effect on franchising (Table 4) and does not appear to have a direct impact on the KPIs in question. Our data also provide empirical evidence accordingly, as this measure has no effect when it is incorporated into the outcome equations (see the Appendix).

	Franchising
Distance	0.004*** (3.967)
Size	−0.002*** (−5.106)
Age	−0.003 (−0.415)
Shopping mall	0.000 (0.144)
Income	−0.001*** (−3.542)
Constant	1.763*** (6.981)
N	308

Note(s): *t* statistics in parentheses. Significance levels: *10%, **5%, ***1%
Source(s): Table created by authors

Table 4. Probit model that predicts the probability of choosing a franchised fashion store or a vertically integrated one

The main equation has been defined as follows:

$$Y_{it} = f\left(F_i, SL_i, F_i \times SL_i, X_{it}, Z_i, \varepsilon_{it}\right) \tag{2}$$

where i and t indicate fashion store and quarter (1–4), respectively; Y_{it} is the log of the outcome measures analyzed; F_i indicates the organizational choice of each store (franchising ($F_i = 1$) or vertical integration ($F_i = 0$)), considered as endogenous; SL_i represents the SL of the franchisee or manager of each individual store; X_{it} represents the store and time-variant local market factors, and Z_i those that do not change. Following Vázquez-Suárez *et al.* (2022), we also consider $\varepsilon_{it} = \mu_i + \mu_{it}$ "to be a composite error term, where μ_i stands for outlet-level unobserved heterogeneity, which is not correlated with observed features, and μ_{it} stands for an idiosyncratic error term" (p. 6). The variance-covariance matrix White/Huber estimator is applied to correct the standard errors involving potential heteroscedasticity. The continuous variables are in logarithmic form in all the regressions.

4. Results

Table 5 shows that vertically-integrated stores record lower LP than franchised ones. The effect of vertical integration on this performance indicator is negative, as confirmed by Model 1b in Table 5 ($\beta = -0.0317, p < 0.01$). These findings support H1, whereby franchisees work harder than managers of company-owned stores (Rubin, 1978). Our results confirm that franchisees have more extrinsic incentives to keep a close eye on their staff, as their wealth is closely linked to the outlet's performance. This argument is supported in the literature on franchising (Ackermann, 2019; Mejía-Vásquez *et al.*, 2022; Vázquez-Suárez *et al.*, 2022).

The SL of managers of vertically-integrated stores alleviates the negative impact vertical integration has on LP. The positive coefficient of the interaction term *Vertical integration* $\times$ *SL* ($\beta = 0.0124, p < 0.01$), as indicated in Model 1c (Table 5), shows that the negative effect that vertical integration has on LP decreases in step with the SL of managers of vertically-integrated stores. These findings support H3, whereby individuals high in SL perform better than those low in this type of leadership when they operate in organizational settings where extrinsic motivators are laxer, such as vertical integration. As noted, the intrinsic rewards of servant leaders (i.e. feelings of satisfaction) weaken the shirking issues resulting from laxer extrinsic motivators that typify vertically-integrated outlets.

Our results also confirm that franchised stores have lower SQ ratings than vertically-integrated ones. The franchising dummy variable has a negative effect on this performance

Table 5. Moderating role of SL in the relationship between organizational structure (treated as endogenous) and log (LP)

	Model 1a	Model 1b (basic model)	Model 1c (interactive effects)
Vertical integration		−0.0317*** (0.0056)	−0.0440*** (0.0061)
SL		0.0829*** (0.0126)	0.0788*** (0.0095)
Vertical integration × SL			0.0124*** (0.0017)
Size	0.2252*** (0.0319)	0.2743*** (0.0312)	0.2413*** (0.0308)
Age	0.0357 (0.0360)	0.0483 (0.0409)	0.0298 (0.0227)
Shopping mall	−0.0196 (0.0363)	0.0275 (0.0471)	0.0318 (0.0553)
Income	0.5810*** (0.0665)	0.5288*** (0.0623)	0.4557*** (0.0560)
Constant	1.6031*** (0.2109)	1.2174*** (0.1623)	1.1748*** (0.1569)
Quarterly dummy variables	Yes	Yes	Yes
Observations	1,232	1,232	1,232
Number of fashion stores	308	308	308
R^2	0.41	0.69	0.70

Note(s): Standard errors in parentheses. Significance levels: *10%, **5%, ***1%
Source(s): Table created by authors

measure ($\beta = -0.0247$, $p < 0.01$), as seen in Model 2b (Table 6), thus supporting H2, which argues that franchisees could free ride and provide less SQ than company-owned stores (Rubin, 1978). Mejía-Vásquez *et al.* (2022) support this argument in their study on the fashion retail industry.

Our results also suggest that the SL of franchisees weakens the negative relationship between franchising and SQ ratings. The positive coefficient of the interaction term $Franchising \times SL$ ($\beta = 0.0146, p < 0.01$), as indicated in Model 2c (Table 6), shows that franchising's negative effect on SQ decreases in step with SL. These findings provide support for H4. Differences in honesty, integrity, credibility, and trust between those high and those low in SL reflect varying attitudes in their readiness to uphold their chain's quality benchmarks and the appropriate level of SQ. In other words, the greater predisposition towards ethical behavior by franchisees high in SL promotes suitable compliance with their chain's quality benchmarks.

Our findings also indicate that greater outlet size increases LP (Table 5). Finally, as the average per capita net income of the local market rises, each outlet's LP (Table 5) and SQ ratings (Table 6) also rise.

5. Conclusions

We examine how the SL of franchisees and managers of vertically-integrated outlets belonging to a Spanish retail fashion franchise chain interacts with their different organizational structures, and how this interaction ultimately affects each store's performance. We use data covering the interval January–December 2022. Our study addresses the impact that two organizational structures, namely, vertical integration and franchising, have on store-level performance measured using two KPIs commonly applied in the fashion retail literature (LP and SQ ratings). Our findings reveal that the SL of store leaders influences the links between the organizational structure adopted by each outlet and the performance measures studied.

5.1 Research contributions

This study adds to both franchising and leadership literature in the fashion retail industry. Vertically-integrated fashion stores record lower LP than franchised ones, although the former record higher SQ ratings. Our results explain the diverse findings in the research on this topic according to the KPIs used (Lawrence and Perrigot, 2015; Vázquez-Suárez *et al.*, 2022).

	Model 2a	Model 2b (basic model)	Model 2c (interactive effects)
Franchising		−0.0247*** (0.0041)	−0.0391*** (0.0047)
SL		0.1209*** (0.0183)	0.1065*** (0.0157)
Franchising × SL			0.0146*** (0.0017)
Size	−0.0349 (0.0412)	−0.0310 (0.0389)	−0.0281 (0.0365)
Age	−0.0915 (0.0878)	−0.1102 (0.0917)	−0.0796 (0.0807)
Shopping mall	0.0277 (0.0163)	0.0353 (0.0195)	0.0246 (0.0140)
Income	0.3429*** (0.0402)	0.3128*** (0.0373)	0.3082*** (0.0416)
Constant	−2.024*** (0.2509)	−1.6755*** (0.2206)	−1.8045*** (0.2303)
Quarterly dummy variables	Yes	Yes	Yes
Observations	1,232	1,232	1,232
Number of fashion stores	308	308	308
R^2	0.27	0.64	0.66

Note(s): Standard errors in parentheses. Significance levels: *10%, **5%, ***1%
Source(s): Table created by authors

Table 6. Moderating role of SL in the relationship between organizational structure (treated as endogenous) and log (SQ)

It is vital to gain an enhanced understanding of how the SL style of a manager or franchisee may affect performance by interacting with the organizational structure of outlets in a franchise chain, although, this has yet to be studied in detail in the franchising literature. To the best of our knowledge, this study is the first to examine the moderating role that SL plays in the organizational structure and performance relationship, not only in the fashion retail industry, but also in a general franchising context.

Our research sheds further light on the implications of SL. First, by empirically countering some of the theoretical claims propounded by detractors of ethical views on leadership (e.g. Liu, 2019). Some researchers argue that these views "simply do not work in the real world" (Mumford and Fried, 2014, p. 630), as leaders are required to fulfill the needs not only of their employees but also of other stakeholders. They contend that prioritizing followers ignores the tensions affecting managers: "positive, prosocial interactions with followers may occur only by sacrificing the concerns of other stakeholders" (Mumford and Fried, 2014, p. 626). Shareholders are the prime stakeholders. Managers are therefore judged according to their capacity to generate profit, which implies controlling costs and raising LP. Critics contend that a leader may boost their followers' satisfaction because they are liked (Brown and Keeping, 2005), using managerial discretion to support them and thereby reducing LP and consequently earnings. Prior research has not resolved this matter. SL has been linked with higher subjective outcome evaluations and consumer satisfaction ratings, but very little research has been conducted on its financial ramifications (e.g. Giolito *et al.*, 2021). By prioritizing employees' needs in fashion stores, SL increases LP and SQ, which are two important metrics for shareholders. Our findings therefore close the circle between the connection of SL and different KPIs, directly benefitting stakeholders with varied and often disparate goals, ranging from employees with career ambitions to shareholders expecting efficient management. Our research addresses these effects within a homogenous sample of fashion stores. This discards a series of exogenous aspects that may compromise the analysis. The closely uniform nature of the fashion stores studied here, belonging to the same chain and country and sharing a simple hierarchical structure, renders it less likely that exogenous factors will influence the relationships among variables.

A further strength is our time-lagged gathering of data on SL in Time 1, and the store performance variables gathered in Time 2. This scheme responds to a frequent concern related to research associating leadership and performance: the problem of reverse causality (Phillips and Lord, 1981). In our research, lagged data-gathering generates a temporal window for assuming causality, with staff assessments of SL predicting store performance.

A further strength here stems from the nature of our dataset. The fashion chain in question applies a control mechanism for regularly assessing store performance. As this mechanism is used for in-house purposes, the data are mostly considered confidential and rarely disclosed. Most of the assessment measures applied to the fashion retail industry have relied on customers' own assessments of SQ (Leung and Fung, 1996; Leung and To, 2001; Patten *et al.*, 2020), which poses a number of issues because of self-selection bias.

Lastly, this study has used a panel dataset with outlet-level data on different fashion stores gathered between January 2022 and December 2022. Most of the studies on performance differences between vertically-integrated and franchised stores (e.g. Lawrence and Perrigot, 2015) have taken a cross-sectional approach, which has major limitations.

5.2 Implications for management

Our research has suggestions for practitioners in the fashion retail industry in the franchising field. Although some chains franchise all their stores, most of them exhibit the plural form (e.g. Bradach, 1997; Sørensen *et al.*, 2023), combining franchised and vertically-integrated outlets. Managers of company-owned stores have lower extrinsic incentives than franchisees to maximize their employees' LP because the former's personal wealth is not so dependent as the latter's on store performance (Rubin, 1978), which is consistent with the negative impact that vertical integration has on LP. However, this negative impact is weaker in vertically-integrated stores run by leaders high in SL than in those run by leaders low in it because the intrinsic motivators of servant leaders mitigate the shirking problems derived from the laxer extrinsic rewards that characterize vertically-integrated stores.

The negative effect franchising has on SQ decreases in stores run by individuals high in SL, which is consistent with research reporting differences between those high and those low in SL in terms of honesty, integrity, credibility, and trust (Liden *et al.*, 2008), favoring a closer compliance with the system's quality benchmarks by franchisees high in SL. Franchisees high in SL consider their businesses to be interrelated structures of relationships instead of separate compartments; the problems of free riding are therefore mitigated in their stores. This means that those chains more exposed to free riding may prefer franchisees high in SL. This may be the case when a standardized brand image and a high level of SQ are required. Free riding can seriously undermine brand reputation, so its preservation is essential for the chain's strength and durability (Kidwell *et al.*, 2007).

When SQ is crucial, a franchise chain should choose applicants high in SL to run their franchised stores or resort to vertical integration. In turn, when LP is a crucial factor for a chain, it should select applicants high in SL to run their vertically-integrated stores or resort to franchising. Hence, those chains seeking to attract consumers that appreciate SQ should know that this will be delivered if their stores are company-owned or run by franchisees high in SL. Our results support this premise. Table 4 shows that the likelihood of a store being franchised (rather than company-owned) diminishes as the average per capita net income of the local market rises. High-earning consumers are more likely to value service and product quality, and a pleasant shopping experience (Baltas *et al.*, 2010).

Our findings, together with those in the prior literature reporting that SL is associated with a series of KPIs, reveal that the more store leaders are involved in SL, the better they develop their businesses compared to their counterparts rated lower in this type of leadership. As SL is highly pertinent and critical in management, it is important to promote employees with the requisite skills to implement it successfully. This is also true in the case of external recruitment. To achieve this, fashion retail chains should uphold stringent selection and hiring policies. Hence, firms should make effort to train store leaders to develop SL attributes. Specifically, through providing training programs, firms could improve the store leaders' awareness on the importance of SL and help them hone their skills to develop SL in daily practice. Firms may provide periodic training for franchisees and managers of company-owned stores aimed at developing SL. This can be accomplished using experiential exercises and the company's own track record of problems or challenges. Furthermore, firms could also search for several personal traits from subordinates and store leaders, which were found to be predictors of SL such as openness and agreeableness (e.g. Hunter *et al.*, 2013; Sun and Shang, 2019), during the recruitment and selection processes. For firms wanting to develop SL, they can assess these personal traits in their employees and store leaders. This can be the basis of future training and advancement. Based on these personal traits, one can actively observe those whose behaviors signal potential for advancement within the servant-led organization. It can also be the basis for recruitment new employees and store leaders into the firm.

5.3 Study limitations and future research

Our research has its shortcomings, as our empirical setting focuses on a large Spanish fashion retail franchise chain. Although this allows controlling for external effects, it has a negative impact on the validity of the results. The small number of KPIs and timeframes studied are additional limitations, whereby our results cannot be generalized.

More research is needed to verify whether the findings are applicable for other KPIs and other fashion retail chains, as well as for other industries and markets. Future research should therefore study whether varying levels of SL among franchisees and the managers of company-owned outlets have a positive or negative impact on other KPIs in these chains, and when or why store leaders high in SL perform better or worse. Further research into these topics would extend our present understanding of SL, providing more accurate implications for management and valuable advice for businesses.

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Further reading

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Appendix

Table A1. Moderating role of SL in the relationship between organizational structure (treated as endogenous) and log (LP)

	Model 1a	Model 1b (basic model)	Model 1c (interactive effects)
Vertical integration		−0.0307*** (0.0055)	−0.0429*** (0.0058)
SL		0.0790*** (0.0123)	0.0731*** (0.0092)
Vertical integration × SL			0.0120*** (0.0016)
Distance	0.0084 (0.0103)	0.0112 (0.0136)	0.0099 (0.0121)
Size	0.2301*** (0.0322)	0.2812*** (0.0317)	0.2378*** (0.0315)
Age	0.0368 (0.0373)	0.0464 (0.0385)	0.0330 (0.0237)
Shopping mall	−0.0205 (0.0367)	0.0281 (0.0473)	0.0327 (0.0549)
Income	0.6047*** (0.0670)	0.5152*** (0.0618)	0.4606*** (0.0572)
Constant	1.5365*** (0.2011)	1.2093*** (0.1587)	1.1802*** (0.1610)
Quarterly dummy variables	Yes	Yes	Yes
Observations	1,232	1,232	1,232
Number of fashion stores	308	308	308
R^2	0.41	0.69	0.70

Note(s): Standard errors in parentheses. Significance levels: *10%, **5%, ***1%
Source(s): Table created by authors

Table A2. Moderating role of SL in the relationship between organizational structure (treated as endogenous) and log (SQ)

	Model 2a	Model 2b (basic model)	Model 2c (interactive effects)
Franchising		−0.0251*** (0.0042)	−0.0385*** (0.0046)
SL		0.1213*** (0.0184)	0.1067*** (0.0157)
Franchising × SL			0.0143*** (0.0016)
Distance	0.0026 (0.0037)	0.0034 (0.0044)	0.0031 (0.0040)
Size	−0.0579 (0.0453)	−0.0486 (0.0425)	−0.0429 (0.0420)
Age	−0.1008 (0.0917)	−0.1195 (0.1033)	−0.1266 (0.1109)
Shopping mall	0.0282 (0.0165)	0.0361 (0.0198)	0.0255 (0.0136)
Income	0.3397*** (0.0384)	0.3109*** (0.0369)	0.3053*** (0.0414)
Constant	−1.9603*** (0.2377)	−1.6108*** (0.2175)	−1.7890*** (0.2244)
Quarterly dummy variables	Yes	Yes	Yes
Observations	1,232	1,232	1,232
Number of fashion stores	308	308	308
R^2	0.27	0.64	0.66

Note(s): Standard errors in parentheses. Significance levels: *10%, **5%, ***1%
Source(s): Table created by authors

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