Entrepreneurial Autonomy, Incentives and Relational Governance in Franchise Chains

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Franchisee autonomy fosters system-wide adaptability and outlet-owners' motivation but also raises the costs from agency problems present in franchisee-franchisor dyads. Advancing upon the understanding of agency issues involved in franchising, we test the argument that chains counterbalance the loss in control inherent to autonomy with relational governance mechanisms. The empirical results provided strong support for this presumption. In addition and most notably, we found that relational governance becomes more important the weaker agents' incentives are aligned with the interests of the entire network. The moderating effects of five franchisee characteristics influencing goal congruencies were considered: multi-unit ownership, age of the relationship, geographic distance, economic success, and the level of perceived intra-chain competition. Implications for chain management are provided.

Introduction

Franchising is an attractive organizational form to pursue growth strategies (Shane 1996). It does not only permit realizing economies of scale through system-wide standardization in various functional areas such as marketing, purchasing, and product development. Relative to company operations, franchising additionally allows profiting from the expertise of independent entrepreneurs to continuously adapt to local markets (Bradach 1997; Sorenson and Sørensen 2001). For their specific knowledge to be leveraged and local market adaptation to occur, franchisees should be granted autonomy in various operational aspects of the business.

Leeway for independent action is furthermore important to the prospect of the whole chain since it upholds franchisees' satisfaction in the relationship and hence their motivation to deliver performance (Schul, Little, and Pride 1985; Dant and Gundlach 1999). That is, franchisees often choose the franchise option in order to become their own boss and to run a business according to own decisions while profiting from a proven business concept (Peterson and Dant 1990; Elango and Fried 1997). Placing too narrow restraints on outlets' operations increases the risk of disappointing hopes for entrepreneurial behavior.

Notwithstanding the above benefits, increasing levels of autonomy equally raise the potential costs from agency problems present in any franchisee-franchisor dyad (for example, Pizanti and Lerner 2003). In consequence, autonomous decision-making by downstream stores may or may not lead to increased performance *from the franchisor's perspective*. Success eventually hinges on chains' ability to counterbalance the loss in control inherent to autonomy with mechanisms that achieve goal congruence between the exchange partners. Only under conditions of common economic interests between the parties can the full economic potential of decentralized dyadic decision-making be realized.

A growing body of literature analyzes the importance of social interactions in the governance of channel structures. In particular, the functionality of trust and relational norms

– or more generally, the role of relational governance – in coordinating vertical relationships has been subject to scholarly attention (Palay 1984; Kaufmann and Stern 1988; Noordewier, John, and Nevin 1990; Poppo and Zenger 2002). In this paper, we empirically explore the reliance on relational governance as a control mode to attenuate the agency problems resulting from franchisee autonomy. Most notably, we hypothesize that relational governance becomes more important to accompany autonomy the weaker franchisees' structural incentives are aligned with the franchisor. Hence, individual franchisee-franchisor dyads from different networks are the units of analysis. We focus on the moderating role of five franchisee characteristics which have previously been proposed to affect agency issues in the dyad: (1) multi-unit ownership, (2) age of the franchisee-franchisor relationship, (3) geographic distance between the outlet and the company's head office, (4) franchisees' past economic success, and (5) the level of perceived intra-chain competition.

Our study contributes to the literature in the following ways. First, although past work has investigated appropriate functional areas for independent action by franchisees (Kaufmann and Eroglu 1999), little is known about the governance of behavior within these limits. Relative to Kaufmann and Eroglu's conceptual study and earlier empirical literature which has been concerned with the question of 'who makes decisions' in chains (Arruñada, Garicano, and Vázquez 2001; Windsperger 2004), this paper shifts the research focus to the question of 'how to assure that decision rights are not abused'. Our interest therefore is to investigate empirically how companies assure that franchisees use their autonomy in Pareto-improving ways such that it leads to better performance at the outlet while having a non-negative impact on the viability of the system.

Second, by incorporating franchisee characteristics such as single- vs. multi-unit ownership in the analysis, this study extends and corroborates earlier research which found incentive effects of these characteristics to be important for channel management (for example, Dant and Nasr 1998). From a practical point of view, asking how a chain can achieve cooperation

with outlet owners of differing expectations and orientations is crucial (Grünhagen and Mittelstaedt 2005). By focusing on the specific characteristics of each outlet, we advance the theoretical understanding of agency issues in franchising. This knowledge might also provide conceptual guidance to managers in the field when structuring decision rights and control mechanisms.

The paper is organized as follows. First, we define autonomy, elaborate on its various structural sources and discuss the agency issues related to it. Second, the construct of relational governance is introduced and hypotheses about the main and moderated relationships between autonomy and relational governance are derived. Third, an empirical test of our hypotheses is reported. Fourth, we discuss our findings and provide implications for practitioners. We conclude in the last section.

Franchisee autonomy

Definition and Structural Sources of Autonomy

Autonomy can be conceived of as the extent to which a party, here a franchisee, is unconstrained to independently make decisions (Feldstead 1991; Strutton, Pelton, and Lumpkin 1995; Dant and Gundlach 1999). Independence pertains to the practical fulfillment of a task as far as its content is concerned; more precisely, it relates to the search for different solutions, to the choice of one feasible alternative and to subsequent actions. Autonomy entails leeway not only on how but also as to which task is performed – for example, the latitude of franchised outlets to select a new project (Lewin-Salomons 1998). Thus, we refer to autonomy as the scope for 'entrepreneurial freedom' franchisees dispose of to operate affiliated units according to own decisions.

Basically, four structural sources of entrepreneurial autonomy can be identified: (1) the allocation of contractual rights, (2) contractual incompleteness, (3) control costs as well as limited monitoring capacities, and (4) direct acceptance of deviant franchisee behavior by the

franchisor. Since formal, legal documents such as contracts and operating handbooks are most often uncustomized within a network, the first two factors above cannot explain differences in autonomy across individual franchisee-entrepreneurs of a same system – which is the focus of this paper. Yet, since control costs may differ among units (Lafontaine and Slade 1997), differential scopes for decentralized operations within any chain can emerge. Outlets which are more costly to monitor should then experience higher levels of autonomy compared to stores which are less expensive to monitor and therefore controlled intensely. The degree of autonomy across a focal network's franchisees can as well fall apart for the company could accept deviations from contractually regulated business procedures if beneficial outcomes for the whole channel are expected. Conversely, due to power asymmetries between the principal and the agents, chains can enforce certain restrictions at (potentially opportunistic) stores even if these constraints are not formally incorporated in the contract or the handbooks. Lewin-Salomons (1998) argued and provided some anecdotal evidence that this kind of informal allocation of decision rights is a central source of franchisees' operational realm. One representative of a computer retailing franchisor explained to us that the average outlet is visited four times a year. Franchisees which are expected to behave appropriately, by contrast, are visited only once a year and are accorded more operating autonomy. This demonstrates that "in a single franchising chain the level of control and autonomy exercised may differ from one franchisee to the next" (Pizanti and Lerner 2003, p. 138) and that franchisors are aware of the specific level of autonomy which is accorded to each individual outlet.

Agency Issues Related to Autonomy

Agency theory is concerned with the resolution of trading hazards inherent to "a contract under which one or more persons (principals) engage another person (the agent) to perform some service on their behalf" (Jensen and Meckling 1976, p. 308). In distribution, the organizational form of franchising circumvents an important agency problem which would

arise between a system's head office and an employee managing an outlet (Rubin 1978). In particular, franchisees' residual claim on the profits of their unit (net of royalty payments) induces greater effort than is provided by a company employee who receives mainly a fixed salary and who therefore seeks to minimize his costs of effort. Notwithstanding, residual claims create another goal conflict, namely incentives to free-ride on the chain's brand name (Lafontaine and Raynaud 2002). Examples of free-riding include underinvestment in advertising, failure to comply with production standards, and insufficient supervision of staff. Franchisees cheating on investments in the brand name by lowering the quality of output reduce their costs and thereby augment profits since they are unlikely to loose (short-term) sales if other units follow through with obligations. The reason is that consumers credit the goodwill they attach to the trade name even to stores which fail to deliver promised quality. Michael (2000) provided empirical evidence that the horizontal externality problem related to a shared trademark combined with the residual claim status of franchisees have a negative impact on overall system quality. He reported that the quality experienced by consumers was negatively related to the incidence of franchising within any network.

The extent of autonomy allocated to franchised dealers determines the potential costs resulting from the goal conflicts described above (see, generally, Jensen and Meckling 1992). Decentralized decisions involve a control loss for the franchisor since either actions cannot be observed or the franchisor's knowledge is insufficient to evaluate whether decisions are opportunistic or in the interest of the whole channel. Conversely, constraining decision-making authority by imposing procedures regarding the fulfillment of specific tasks reduces monitoring costs for it provides franchisors with a means to quantify the otherwise subjective nature of quality and to better observe behavior (Kaufmann and Eroglu 1999).

In the following, we describe how relational forms of governance curb agency conflicts by aligning the economic interests of the dyadic partners.

Controlling Franchisees: Relational Forms of Governance

Definition of Relational Governance

We define relational forms of governance, also referred to as informal institutions (North 1990), as norms of behavior and unwritten codes of conduct which safeguard exchanges against potential conflicts. Norms, in turn, are defined as expectations of behavior shared by dyadic partners (Heide and John 1992). They emerge from the social embeddedness of a contractual relationship (Macneil 1980; Granovetter 1985; Ring and Van de Ven 1994; Jones, Hesterley, and Borgati 1997) and/or are conditioned by the prospect of realizing a higher transaction value in the future than would be possible without such norms (Baker, Gibbons, and Murphy 2002). While formal governance arrangements such as explicit contract terms are in general discrete (that is, they either exist or are absent), relational forms of governance are continuous since they differ in degree rather than in kind (Zenger, Lazzarini, and Poppo 2001). An intensification of the specific norms considered below conforms to more pronounced relational content in a business liaison (Macneil 1980). The major reason why relational governance is suitable to control the behavior of dispersed franchisees is that control in the day-to-day operations is guaranteed by means of persuasion – not authority (that is contracts). Bradach (1997, p. 288) cited one franchise consultant – franchisor personnel charged with managing the contact to outlets – who described that "relationships are crucial and when they deteriorate it becomes extremely frustrating to try to get the company's goals across".

Specific Norms and Autonomy

In order to describe how relational governance functions as a protective device against opportunistic abuses of autonomy, concrete exchange norms have to be specified. Most studies on relational governance in distribution channels have drawn from the atmospheric dimensions initially proposed by Macneil (1980), though none considered all of the elements

simultaneously (see, for a review, Ivens and Blois 2004). Concerns about the consequences of incompleteness in the consideration of codes of conduct can be partially accommodated. Noordewier, John, and Nevin (1990) noted that individual norms tend to be highly related to one another and might thus be part of a 'single higher order' relational syndrome. Therefore, we did not attempt to be exhaustive in the enumeration of shared behavioral expectations as they are discussed in the literature. We focused on (1) the harmonization of conflict (2) the intensity of cooperation (3) and the prevalence of trust in any dyad. The construct of relational governance encompasses these three aspects. As explained below, we consider these dimensions to be relevant in the context of franchisee-franchisor dyads.

The *harmonization of conflict norm* defines the extent to which a franchisee and a franchisor find mutually satisfying solutions to conflicts (Macneil 1980; Mohr and Spekman 1994; Gundlach, Achrol, and Mentzer 1995; Brown, Dev, and Lee 2000). A dyad can be classified as being more relational the better it achieves to settle conflicts such that the benefits of the exchange remain *ex post* for both the up- and the downstream firms.[1] Because the long-term character of franchise agreements inevitably imposes needs for flexible change over the life cycle of the relationship, harmonization of conflict also presumes an intensification of the flexibility norm (Ivens and Blois 2004). The flexibility norm refers to the parties' willingness to continuously negotiate and agree on mutual obligations. It is especially needed when franchisees gain in autonomy for decision rights are accorded to them precisely in order to engage in explorative and adaptive activities. Whereas the need for change may be obvious to both parties, there may be intense bargaining over the distribution of outcomes. Dyadic partners who share the harmonization of conflict norm attempt, by definition, "to resolve their disagreements in mutually satisfying ways, including refraining from opportunism" (Brown, Dev, and Lee 2000, p. 54).

[1] Note that every transaction, whether discrete or relational, necessarily needs an *ex ante* minimum level of harmonization within the social matrix for the transaction to take place.

Cooperation is a second element capturing the relational nature in any franchisee-franchisor dyad. It refers to the extent to which exchange parties carry out their respective tasks in a coordinated and cooperative way (Anderson and Narus 1990; Heide and John 1990; Lambe, Spekman, and Hunt 2000). A dyad becomes increasingly relational the more the operations and planning procedures of both parties are intertwined; namely, exceeding the minimum requirements of the contract. Anderson and Narus (1990, p. 45) stated that cooperation is effectuated in order to realize "*mutual outcomes* or singular outcomes with expected *reciprocation* over time" (emphases added). The concept of cooperation is thus related to Macneil's norm of mutuality – which he later referred to as reciprocity (Boyle, Dwyer, Robicheaux, and Simpson 1992). Mutuality, although not requiring equality in the distribution of outcomes, does presume an even distribution of surpluses (Macneil 1980; Kaufmann and Stern 1988; Spinelli and Birley 1996). Cooperation and mutuality establish when franchisors and franchisees learn that outcomes from joint effort exceed those achievable through self-interest seeking and opportunism.

Third, *trust* is a necessary condition for relational governance to emerge (Zaheer and Venkatraman 1995). Drawing from past research on interorganizational linkages, we refer to trust as the expectation of an actor that another actor can be relied on to fulfill promises and to act fairly where the possibility for opportunism is present (Zaheer, McEvily, and Perrone 1998); including situations where his or her own decisions are affected and monitoring of the others' actions is impossible (Gambetta 1988; Adler 2001).[2] Trust between franchisees and the franchisor conditions a multitude of other exchange norms. Most importantly, trusting parties are expected to have a clear understanding of each others' roles and associated promises and a mutual expectation of their respective enactments. This is what Macneil

[2] In the vast literature on trust, there is considerable debate over an appropriate conceptualization. Bigley and Pearce (1998) put forward that a universal conceptualization of trust (and distrust) is unlikely to be successfully devised and should be tailored to the research question at hand. Therefore, we chose to follow a definition employed earlier in the study of interorganizational exchanges. We felt that the definition adopted here, which conceives of trust as a decision to cooperate under asymmetric information, conforms to the circumstances found in principal-agent relationships such as between franchisees and franchisors.

(1980) refers to as the role integrity norm (see also Kaufmann and Stern 1988). Channel members who fulfill their roles do, by definition, not behave opportunistically (Brown, Dev, and Lee 2000). Therefore, in trusting dyads, where the role integrity norm is intense, less opportunistic action is expected compared to dyads in which trust and role integrity are weakly pronounced. The view of trust as a mechanism against the risk of opportunistic action is in line with previous research on the effects of trust on economic organization (Bradach and Eccles 1989; Granovetter 1985; Ring and Van de Ven 1992; Bromiley and Cummings 1995).

As a common feature of norms, they define acceptable limits to behavior, taking the preservation of the relationship as a constraint. Elaborating on their binding character for the behavior of exchange parties, Heide and John (1992) noted that relational norms inherently constitute a safeguard against the exploitive abuse of decision rights. The analysis of the relationship between Avis Europe PLC (AVE) and its franchisees provided by Jacobsen (2004) illustrates this argument: "AVE fully expects the franchisees to operate vehicles that meet Avis quality standards. This 'no lemons' principle refers to the exclusion of cheap, low-quality, high mileage cars. Whilst the maintenance of standards is emphasized in the contract, the particulars are not articulated. Hence, reliance is placed on an informal understanding as a means of preventing shirking or quality-shading on the part of the franchisee" (p. 530). Since franchisees are expected to behave appropriately on the grounds of these informal understanding, they are given autonomy to independently decide on the car fleet. Other empirical results support this logic. In a laboratory experiment, Gundlach, Achrol, and Mentzer (1995), for instance, found that the existence of shared expectations was negatively related to opportunism on both sides of an exchange. The parties use self-control based on internalized values (Heide 1994) and/or the value of future transactions in the relationship (Baker, Gibbons, and Murphy 2002) to prevent opportunism. In light of the reasoning presented above, we formalize the relationship between autonomy and relational governance in the following way:

H1: The extent of franchisee entrepreneurial autonomy is positively related to the intensity of relational governance in any dyad.

The Moderating Role of Franchisee Incentive Characteristics

Thus far, we implicitly assumed that franchise networks accompany autonomous decision-making at the outlets with equal relational governance intensity irrespectively of franchisees' incentives to engage in opportunistic behavior. However, past research revealed idiosyncratic incentive characteristics across stores of a same chain (Gal-Or 1995; Lafontaine and Slade 1997). In addition, we ignored any costs being brought about by relational control. Yet, the setup of dense ties with focal partners consumes time and resources (Larson 1992; Heide 1994; Ring and Van de Ven 1994; Poppo and Zenger 2002). It is a planned activity and may not only include costs of trust building but also those of failing to reach minimal levels of trust (Das and Teng 1998). Thus, investments necessary to shape exchange norms constitute sunk certification costs (Mills and Ungson 2003) to be borne primarily by the systems' headquarters. As a consequence, franchisors should commit resources to the development of intense linkages only in the presence of significant incentives of franchisees to deviate from the company's interests. In sum, franchisees with incentive structures more closely aligned to those of the company should be awarded entrepreneurial autonomy with less counterbalancing through relational forms of governance. Formally:

H2: The degree of structural incentive congruence in a dyad will moderate the relationship between the extent of franchisee autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be less strong the closer franchisees' incentives are aligned with the franchisor.

In the following, five incentive characteristics are considered with regard to their impact on the link between autonomy and relational governance: multi-unit ownership, age of the franchisee-franchisor relationship, geographic distance between a franchisee's outlet and the chain's head office, past franchisee success, and the level of intra-brand competition faced by a unit.

Multi-Unit Ownership. Multi-unit ownership describes a situation where one franchisee owns, operates or controls more than one outlet (Kaufmann and Dant 1996). While some multi-unit franchisees start a single unit in the beginning and acquire the rights to operate additional outlets over time, referred to as sequential expansion, others are entitled to run multiple units from the outset, referred to as master franchising (Kaufmann and Kim 1995).

Empirical evidence suggests that franchise companies must be little concerned about opportunistic abuses of autonomy by multi-unit agents (Dant and Gundlach 1999). This is because the interests of multi-unit owners are closely aligned with those of the entire network. Most notably, incentives to free-ride on the common brand name are weakly pronounced, even in nonrepeat customer industries (Dant and Nasr 1998). By cheating on quality, multi-unit partners would jeopardize their own sales to a greater extent than would their single-unit counterparts. In other words, multi-unit ownership internalizes a large fraction of specific investments in the trade name. Furthermore, due to higher stakes in question, head offices are less likely to terminate or non-renew contracts of multi-unit than those of single-unit franchisees. Therefore, the former should project their channel membership farther into the future than the latter. Consequently, foregoing investments in quality would impair future sales of franchisees owning multiple units to a relatively large degree (Dant and Nasr 1998).

Dant and Gundlach (1999, p. 45) summarized the argument as follows: when allocated decision-making authority, multi-unit franchisees "are not likely to exploit such opportunities to deviate from the prescribed procedures because they can directly appreciate the rationale

for discipline and standardization within a franchising context from the franchisor's perspective". Anticipating this incentive structure, the marginal benefits from investments in relational quality with multi-unit owners should be smaller for every given level of autonomy compared to the benefits derived from investments in good dealings with single-unit operators.

> *H2a: The number of outlets owned by a franchisee will moderate the relationship between the extent of autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be less strong among multi-unit than among single-unit franchisees.*

Age of the franchisee-franchisor relationship. Age of the relationship defines the time period since a franchisee started operating an outlet. Relationship length has been argued to positively influence the expectations on both sides of the dyad about the continuity of the exchange in the future (Dant and Nasr 1998). Franchisees' incentives to invest in system-specific assets, thereby refraining from free-riding, increase as the future time horizon over which such investments can be amortized extends. Also, potential pecuniary advantages from opportunistic deviation that would accrue in the short-run are more likely to be evened out by the gains from cooperation the longer the discounting period.

From the perspective of the chain, the age of a relationship can also be interpreted as an indicator for past agent behavior, namely whether autonomy has been utilized constructively (see, generally, Eisenhardt 1989). Franchisors' unilateral discretion about periodical contractual renewal provides a bond to punish opportunism. Thus, the track record of franchised partners which have been part of the system over two or more contractual periods should certify their quality (Dant and Nasr 1998).

Besides the risk of opportunism, downstream decision-making independence can also damage a system's reputation due to a lack of knowledge about routines and procedures on behalf of inexperienced franchisee-entrepreneurs. In this sense, relational governance can be understood as a communication and cooperation mechanism amenable to assist the outlets as they gain in control over decisions. With the passage of time, the dispersed units acquire proficiency and specific knowledge about operations and assistance should become less important.

The preceding arguments support a negative relationship between relationship length and the need for shared behavioral norms. From the knowledge-based rationale above, however, one can also derive a positive relationship between age of the relationship and the severity of agency issues. Since, over time, franchisees gain in experience regarding specificities of local demand and efficient operating processes, they develop own beliefs about quality and behavioral standards and increasingly challenge the franchisor's authority (Knight 1986; Baucus, Baucus, and Human 1996). Their willingness to comply with imposed standards may decrease as a result, augmenting agency conflicts.

In sum, however, we feel that the motivation for franchisors investing less in relational governance at every level of autonomy when relationship length increases are more compelling and we therefore expect the following hypothesis to hold.

> *H2b: Age of the franchisee-franchisor relationship will moderate the relationship between the extent of autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be less strong among older than among younger dyads.*

Geographic Distance. Geographic distance denotes how far an outlet is physically remote from the franchisor's monitoring head office. Distance raises the level of behavioral uncertainty about the agent and widens the information gap in the dyad (Fladmoe-Lindquist 1996). This is because monitoring is costly. More precisely, the costs of sending a company representative to inspect a unit's operations (for example, cleanliness, product quality) increase in the number of kilometers between the system's head office and the outlet.

Monitoring costs are central to agency theory's prediction about the choice of vertical integration versus franchising. The argument assumes that managers of owned units have weak incentives to perform efficiently since a large fraction of their salary is fixed. Although financial performance of a store can be gauged by the company in each period, performance may not be attributable to either the outlet's manager or to other factors beyond his control, for example the general economic environment. Where behavior-based monitoring is difficult, the franchisor may, in consequence, franchise an outlet. Franchisees have higher incentives to perform since they claim the unit's residual profits. Brickley and Dark (1987) as well as Fladmoe-Lindquist and Jacque (1995) provided empirical evidence in line with the agency theoretic argument that physically removed outlets tend to be franchised whereas those in proximity to headquarters are company-owned. Monitoring costs thus have an important bearing on the organization of distribution channels.

The behavioral uncertainty associated with increased distance should amplify agency problems associated with a shift of decision rights from the franchisor to the outlets. Agrawal and Lal (1995) showed that monitoring costs negatively affect the frequency of inspections by the franchisor and the level of service provided by franchisees. Since behavior-based monitoring is costly, outcome-based controls may be a valuable substitute. However, electronic data transmission is often inadequate to communicate information that accurately reflects the outlet's operations (Fladmoe-Lindquist and Jacque 1995). In addition, franchisees seldom integrate their information systems with the head office (Bradach 1997). If relational

governance is a mechanism to reduce information asymmetries and behavioral uncertainties, we would expect the relationship between autonomy and relational governance to be stronger for distant franchisees than for those partners located close to the network's head office.

> *H2c: Geographic distance between a franchised outlet and the franchisor's monitoring head office will moderate the relationship between the extent of autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be stronger among distant franchisees than among those located closer to the monitoring head office.*

Franchisee Success. Success pertains to franchisees' satisfaction with past economic performance relative to comparison levels (Anderson and Narus 1990). Drawing from power-dependence theory, Dwyer and Oh (1987) noted that because of their criticality for systems' access to growing markets, franchisee-entrepreneurs operating in munificent environments (that is, those who are generally successful) have power over the extent of control exercised by the principal. Conversely, poor performing outlets are more likely to actively seek centralized franchisor support (Peterson and Dant 1990). Indeed, empirical evidence indicates that munificence in local markets decreases bureaucratization (that is., formalization and centralization) thereby favoring downstream independent decision-making (Dwyer and Oh 1987). In a similar vein, it could be argued that networks' dependence on successful franchised stores also increases these agents' bargaining power in case of conflict; bargaining power which franchisees can exploit to their advantage and at the expense of the chain. This line of reasoning would suggest relatively strong requirements for relational exchange norms to accompany autonomy of successful franchisees.

Based on self-enforcement theory (Klein 1995), we alternatively submit that high levels of satisfaction with past performance reduce the risk of opportunism. Self-enforcement operates by leaving sufficient rents downstream such that the threat of termination of the relationship ensures franchisee compliance. Chains must observe performance at stores through monitoring and subjectively decide whether it conforms to the desired level. Specifically, in order for the implicit contract to be self-enforcing, franchisees' discounted extra gain from opportunistic behavior (before being terminated) must be smaller than the discounted rent stream that accrues from cooperation in the long run.[3] The higher a franchised outlet's economic potential the more important the returns foregone upon termination. At every given level of autonomy, opportunism should then be better controlled the higher a franchisee's performance. Therefore, we expect:

> *H2d: Franchisee success will moderate the relationship between the extent of autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be less strong among franchisees which are more successful than among those which are less successful.*

Competition. Intra-chain competitive intensity soars with the number and geographic proximity of affiliated outlets. The extent of rivalry a franchisee confronts with peers (and company-outlets) of the same chain determines his incentives to free-ride. Arruñada, Garicano, and Vázquez (2001) pointed out that the larger the network size, as given by the number of dealers, the more important the extent of horizontal externalities. Horizontal externalities emerge as a result of an individual franchisee's inability to realize the full benefits accruing to his investments in improving the quality of products and the reputation of

[3] Note that a franchisor can credibly promise the payment of rents to franchisees only if the franchising option is more attractive than using company-owned outlets.

the chain. While the whole chain capitalizes on enhanced reputation in terms of rising sales volumes, the individual outlet will only extract a small fraction of these increases. Franchisee-entrepreneurs have an incentive to wait for other stores to commit the necessary resources, thereby keeping costs down and profits up. Now, competition has the effect of reducing a franchisee's market size and thereby the fraction of returns from investments in reputation which can be internalized. Furthermore, market size affects the functioning of the self-enforcement mechanism. This mechanism, as outlined above, relies on the provision of an ongoing rent to franchisees. Market size positively determines the level of these rents and thereby the amount foregone by franchisees when the contract is terminated (Klein and Murphy 1988). The lower the level of rents lost upon termination the higher the attractiveness of realizing short-term gains from moral hazard. Therefore, competition amplifies the need for relational safeguards. As a result, for every given level of autonomy, franchisors should invest more heavily in the quality of relationships to franchisees facing intense competition than to those facing low competition.

> *H2e: The level of intra-chain competition perceived by a franchisee will moderate the relationship between the extent of autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be stronger among franchisees which perceive higher levels of competition than among those which perceive lower levels of competition.*

Empirical test

Sample

To test the hypotheses, we used cross-sectional data collected from a sample of franchisees operating in Germany. The data was gathered through mail surveys and for purposes of a

broader research project on franchisee satisfaction during the years 1999 to 2003. A self-administered questionnaire was sent to the whole population of franchised outlets within each of 11 different business-format franchise chains participating in the study. Franchisors provided the postal addresses of their partners to the researchers. Each mailing included the questionnaire, a cover letter describing the purposes of the study and guaranteeing anonymity to participants, as well as a postage-paid reply envelope.

The specific formulation of the Likert-type questionnaire items emerged from a qualitative-explorative pre-study involving franchisors, consultants, and franchisee focus groups. A total of four moderated focus groups gathered 15 franchisees from eight different chains. In the framework of these meetings, probands were given the opportunity to express important facets of the relationship to their franchisors. Balance and trust in the partnership were named central criteria regarding relationship quality.

In collaboration with the participating chains' management teams, channel members had been informed about the study in advance of the mailings to assure that, following the key informant approach, the owners of the outlets personally answered the questionnaire. Despite collaboration with the systems' head offices in conducting the survey, participation in the study remained voluntary. In order to enhance response rates, subjects were offered a copy of the survey results; no other incentives to participate in the study were provided.

In total, questionnaires were sent to 1050 franchisees. After reminder notices, the survey yielded an overall average (weighted) response rate of 21 percent (system specific response rates lay between 13.68 and 42.85 percent). Our final sample consisted of 208 observations. Table 1 provides a breakdown of the number of sampled units across chains. Based on the detailed classification scheme used by Lafontaine and Shaw (2001), each of the networks operated in a different industry sector. The population our sample draws from is defined as the entirety of franchisees from these sectors in Germany.

[Insert Table 1 about here]

We tested for nonresponse biases by comparing the average sampled observation in each system with the average outlet-owner computed from the population of each chain along the dimensions age, gender, number of years in business, and multi-unit ownership. To obtain information on the characteristics of the populations, we contacted officials in the chains. For System 4 (10 percent of cases in our sample, see Table 1), we could not discuss our data with the chain's management because the network has dissolved since the survey was conducted. No evidence of obvious nonresponse biases emerged for the remaining systems.

Variables

Dependent Variable. Relational governance was operationalized using items alluding to the exchange dimensions identified in the theoretical section: harmonization of conflict, intensity of cooperation, and prevalence of trust (see Table A1 in the appendix for the exact wording). The questions relating to the harmonization of conflict norm (5a-5c) evaluated to which degree dyadic partners engaged in problem solving as opposed to cultivating disputes (see Dant and Schul 1992). Items 5d to 5f assessed the most important element of cooperative behavior, namely, the extent to which mutual interdependence was appreciated by the channel members in their respective business processes (see Anderson and Narus 1990). The trust specific items (5g-5i) tapped whether vulnerabilities on both sides were mutually exploited by the other, a central theme of trust research (see Bigley and Pearce 1998).

The 'syndrome' of relational governance was expected to encompass these partially overlapping norms. Results of a principal component factor analysis (see Table 2) revealed that the three dimensions were indeed part of a higher order construct. All of the items loaded highly on one factor (all factor loadings $\geq$ 0.577), suggesting that they were strongly associated with each other. We built a composite measure by summing and averaging – using equal weights – the scores of the individual items.

[Insert Table 2 about here]

Reliability of the summated scale was assessed by Cronbach's alpha. The alpha value of 0.87 was well above the lower limit of acceptability, set at 0.60 for newly developed scales (Hair, Anderson, Tatham, and Black 1998). We also investigated item-to-total as well as inter-item correlations. The results confirmed sufficient reliability of the relational governance construct. Furthermore, we assessed (convergent) scale validity by inspecting the correlation between the summated scale and a single item capturing franchisees' overall satisfaction with the quality of the relationship to the provider of the business-format (exact wording: How satisfied are you overall with your relationship to the franchisor? 1-7; very unsatisfied-very satisfied). The strength of the bivariate correlation was substantial ($r = 0.773$, $p < 0.001$). Concerning validity, we caution that we relied on a single source key informant approach. John and Reve (1982) noted that sentiments variables, such as exchange norms, may fail to converge across respondents from the opposite sides of a dyadic relationship. However, we claim that we measured relational governance on the 'right' side of the dyad (with franchisees), for relational governance only safeguards against conflict when the party which has room for opportunism (brought about by franchisee autonomy) perceives the above norms to be relevant for his behavior.

Independent Variables. Respondents assessed their perceived level of *autonomy* on four separate questionnaire items (see Table A1). These intended to capture two notions of autonomy frequently reappearing in the literature: 1) the leeway to make independent decisions and 2) quasi as a result, the extent to which a franchisee feels to be his own boss (for example, Schul, Little, and Pride 1985; Feldstead 1991). Questions 6a and 6b grasped to what extent franchisees perceived to be unconstrained when making decisions, referring to the first notion above. Items 6c and 6d measured, corresponding to the second notion, whether the franchised partners considered themselves as primarily executing directives, being employees, or rather managing their outlet according to own decisions, being entrepreneurs. Results of a principal component factor analysis (see Table 3) indicated the four items to load highly on

one common factor (all factor loadings ≥ 0.645). The scores on the four items were summed and averaged – using equal weights.

[Insert Table 3 about here]

Cronbach's alpha of reliability for the composite autonomy measure was 0.64. We further assured reliability through item-to-total and inter-item correlations. With all inter-item correlations except one (being $r = 0.29$) exceeding the threshold of 0.30 and all item-to-total correlations above 0.50 (the smallest correlation being 0.55), we felt confident about reliability of the scale.

We assume that franchisors are aware of the level of autonomy each franchisee disposes of. It could be argued that measuring *franchisors*' perceived levels of autonomy with regard to each individual outlet would have been more accurate. However, John and Reve's (1982) results accommodate this concern. They showed that perceptions on structural variables such as the degree of centralization of channel dyad decision-making converge across key informants from the different sides of a dyad.

Consistent with earlier literature (for example, Dant and Gundlach 1999), a nominal no/yes question, coded as a dummy variable (no = 0; yes = 1), was used to ascertain *multi-unit ownership*, that is, whether a franchisee operated one or more outlets (see Table A1).

Franchisees were asked to indicate the year in which they opened their outlet, from which we calculated the age of the franchisee-franchisor relationship. This measure is consistent with Dant and Nasr (1998).

Following Brickley and Dark (1987) as well as Minkler (1990), *geographic distance* was calculated as the number of kilometers (instead of miles) that lie in between a franchised outlet and the chain's head office. In the questionnaire, respondents specified the first two digits of their postal code. Although information about the full postal code, comprising five digits, would have added precision to our calculations, only two digits were requested in order to guarantee anonymity. To calculate distance, we used a standard route planning software;

introducing franchisees' two-digit postal code as the destination and the five-digit postal code of chains' headquarters as the starting point.[4]

Franchisee *success*, or the extent of satisfaction with past performance, was measured by four separate questionnaire items (see Table A1). The questions asked respondents to evaluate their recent performance relative to different comparison levels. Comparison levels included 1) alternative activities 2) average industry sales growth 3) own income expectations and 4) own sales objectives. Anchoring success by reference to comparison levels is in line with Anderson and Narus (1990). The results of a principal component factor analysis (see Table 3) revealed the four items to load highly on one factor (all factor loadings $\geq$ 0.633). We built a scale which averaged – using equal weights – the sum of the scores on the four items. Cronbach's alpha of reliability was 0.83. Inspection of item-to-total correlations and inter-item correlations provided further support for the reliability of the scale. We verified convergent scale validity via the correlation between the summated scale and a single item assessing franchisees' overall satisfaction with performance (exact wording: How satisfied are you overall with your performance? 1-7; very unsatisfied-very satisfied). The correlation can be classified as substantial ($r = 0.713$, $p < 0.001$).

Our measure evaluated the intensity of *competition* between franchisees of the same chain, that is, intra-chain competition (see Table A1). Outlet owners were called upon to report whether the number of franchised outlets in the chain exceeded a reasonable size. In our context, a perceptual measure seemed more appropriate than an objective count of the number of outlets in the chain – as previously used by other researchers (for example, Arruñada, Garicano, and Vázquez 2001). First, a simple count does not capture the geographic dispersion of outlets and thus the level of intra-brand competition faced by each individual unit. Although our measure did not ask respondents to state whether the number of franchised outlets in *their geographic area* had exceeded a reasonable size, it is sensible to assume that

[4] A two-digit postal code covers a surface of approximately 6000 square kilometres. There are 99 different two-digit postal codes in Germany.

answers were provided with this fact in mind. Second, actual free-riding behavior generally needs to be preceded by the perception of the potential to improve one's own performance at the expense of peer franchisees and/or company-outlets. We checked validity of this measure by correlating it with the number of sampled franchised outlets within each geographic area, as defined by the two-digit postal codes. This is a measure similar to Minkler's (1990) outlet density, calculated as the number of stores within a five mile radius. The correlation between our two measures amounted to only 0.19, but was significant at the 0.01 percent level. Given that we could only count franchisees which were included in the sample, we felt that the correlation with the perceptual measure indicated sufficient convergent validity.

Control Variables. In our empirical models, we did not need to control for contractual variables (for example, royalty rates) usually considered by agency theorists in the study of franchising (for example, Lafontaine 1992). This is because we focused on variance in autonomy across outlets of a same chain. As an empirical fact, franchisees within any system face homogenous contractual conditions. Variance in contractual terms across the 11 different chains in our sample was captured by 10 system dummy variables. We also included the variables which describe franchisees' incentive characteristics as controls since these are expected to affect the need for relational governance.

Methods and results

Descriptive Statistics. Table 4 shows descriptive statistics on the variables used in this study (only arithmetic means and standard deviations are reported).

[Insert Table 4 about here]

Inspection of descriptive statistics on the dependent variable revealed that the average franchisee perceived high relational governance intensity in the past (mean = 5.35). Positive responses to questions tapping relational elements in franchising are not unusual. In part, they may reflect structural characteristics of franchise chains, that is, franchising by definition

implies an ongoing relationship and cooperative effort between dyadic partners (Dant and Schul 1992). However, with a minimum of 2.56 and a maximum of seven (s.d. = 1.06) the data also showed a high range of scores. The observed variance across franchisees assured us that our measure captured 'true' relational facets. This observation is not trivial since, for instance, Dant and Schul (1992) found – reflecting structural conditions – virtually no variance on other atmospheric variables such as the degree of solidarity within any dyad.

Table 4 shows bivariate Pearson correlations between the variables. We found a positive and highly significant correlation ($r = 0.55$, $p < 0.001$) between autonomy and relational governance, providing preliminary evidence for *H1*. But, significant correlations among the independent variables suggested using multivariate regression techniques to examine the variance in the endogenous variable uniquely explained by the theoretical constructs of interest to the hypotheses.

Regression Results. As a multivariate dependence technique, we relied on hierarchical ordinary least squares regressions (OLS). For testing the implications of franchisee incentive characteristics on the relationship postulated in the first hypothesis (*H2a* through *H2e*), moderated OLS regressions were estimated (Aiken and West 1991). These are appropriate to reveal whether a certain variable, the moderator, has an influence on the strength and/or form of the relationship between an independent and a dependent variable.

To assure that our results are reliable, we controlled that the assumptions of multivariate regression techniques were met. Variance inflation factors, Kolmogorov-Smirnov as well as Breusch-Pagan tests gave no indications for any of the assumptions being violated.

We first regressed relational governance on the system dummies and the independent variables except for autonomy (Model 1 in Table 5) and found this estimation to be highly significant (adj. $R^2 = 0.418$, $p < 0.001$).

[Insert Table 5 about here]

Distance (b = -0.001, $p < 0.01$), success (b = 0.255, $p < 0.001$), and competition (b = -0.103, $p < 0.01$) came out significant.[5] In a second step, we added autonomy to the regression equation (Model 2). The coefficient for this variable was positive (b = 0.489) and highly significant ($p < 0.001$). *H1* was therefore strongly supported. With an adjusted R^2 of 0.48, explanatory power of Model 2 was high. Compared to the null model in column 1, Model 2 added 5.2 percentage points to the explanation of variance in the data. Significance of the overall model lay at the 0.1 percent level.

The results of the moderated regression models are presented in columns three to seven of Table 5. H2a stated that franchisors would invest less in shared exchange norms for every level of decision-making authority of multi-unit compared to single-unit franchisees since incentives of the former are more closely aligned with the network. The coefficient of the interaction term was expected to be negative, attenuating the strength of the positive relationship of *H1*. Model 3 displayed a negative (b = -0.397) and marginally significant coefficient ($p < 0.10$) of the interaction term between autonomy and multi-unit ownership. Hence, *H2a* was weakly supported by the data. The unique variance explained by the interaction term amounted to 0.6 percentage points.

H2b supposed that the older the franchisee-franchisor relationship, the weaker would be the need for relational safeguards. Although the coefficient of the interaction term was negative (b = -0.009), as expected, it was not statistically significant (see Model 4). The data therefore did not support *H2b*.

H2c suspected geographic distance between an outlet and the chain's head office to positively moderate the strength of the relationship between autonomy and relational

[5] Note that System Dummy 1 and 4 were positively and significantly related to relational governance. The dummy variables may capture the general or average level of franchisee autonomy within a chain and therefore be related significantly to relational governance. This average level of autonomy, in turn, is determined by the business the franchise system operates in, the level of competition the franchise system faces, and environmental uncertainty.

governance. While the sign of the coefficient was in the direction expected (see Model 5), the influence was not different from zero on statistical grounds. *H2c* was therefore not supported.

The data however lent support for *H2d* which presumed that it would become less important to accompany decision-making independence with relational control mechanisms the more successful the franchisee (see Model 6). The coefficient of the interaction term was negative (b = -0.142) and statistically significant ($p < 0.05$). The amount of unique variance explained amounted to 1.1 percent.

H2e suggested a positive coefficient of the interaction between the level of intra-chain competition perceived by a franchisee and autonomy. Indeed, Model 7 revealed a positive (b = 0.083) and statistically significant ($p < 0.05$) coefficient. *H2e* was therefore supported. The interaction term explained 0.8 percent of unique variance in the dependent variable.

Post Hoc Analyses. For Models 3, 6, and 7, which revealed significant coefficients of the interactions between autonomy and multi-unit ownership, success, and competition, respectively, we conducted *post hoc* analyses (Aiken and West 1991). From these analyses, we found that multi-unit ownership, success, and competition influenced, as proposed in our hypotheses, the strength but not the form of the relationship between the autonomy and the dependent variable. It is especially noteworthy that autonomy was, consistent with our predictions, not related at all to relational governance for the group of multi-units owners. In addition, while the simple slope at low levels of competition was insignificant, it was statistically different from zero at mean and high levels of rivalry.

Discussion

Findings and null findings

The empirical results were fully supportive for our main thesis that franchisors would confront agency problems triggered by franchisee autonomy with relational forms of governance. However, we found only mixed evidence for franchisee incentive characteristics

to affect the severity of these problems at every given level of local decision-making independence such that the intensity of observed exchange norms would differ accordingly. While multi-unit ownership and success attenuated, and competition exacerbated the need for relational control as expected, age of the relationship and geographic distance did not emerge as significant moderator variables.

Concerning age of the relationship, one important shortcoming of our measurement instrument may provide an explanation for the null finding. Measuring age of the relationship as the number of years elapsed since the first outlet was opened by any franchisee does not capture the full length of the relationship for every sampled dyad. It is a frequent phenomenon that the career path of franchisees involves employment by the company prior to starting an outlet (Bradach 1997). In addition, even if the full relationship length had been grasped, the measure would not plainly reflect the severity of agency issues at hand. For equal relationship lengths, the goal discrepancies are more severe for a franchisee not previously working at the chain's head office compared to a former employee. In this regard, prior socialization into an organization can be an effective way of aligning interests (Ouchi 1980).[6] From a theoretical perspective, the insignificant interaction term may stem from the two conflicting incentive effects possibly resulting from an increase in relationship length as outlined in the argument leading up to *H2b*. On the one hand, age of the relationship positively influences the expectations about the continuity of the liaison in the future and thus the time horizon over which system-specific investments can be amortized. On the other hand, franchisees gain in experience over time and may therefore be increasingly reluctant to comply with imposed standards.

As regards distance, we already acknowledged a methodological problem related to its operationalization for we relied only on the first two out of five digits of franchisees' postal

[6] A statement of the COO of one chain studied by Bradach illustrates this point: "The company people know the system. They are proven operators and they appreciate the importance of maintaining standards and running the business right" (p. 292). Hence, former company managers understand the requirements to operate an outlet and their experience as company managers allows them to appreciate the importance of maintaining standards.

codes to determine the geographical position of each outlet. Put into perspective, however, the inaccuracy of the measure did not appear to be a serious concern as plausible and significant correlations of distance with other variables emerged from the data; for instance with autonomy (see Table 5). One theoretical account for the insignificant interaction term stresses that information asymmetries may have become more independent of physical distance with the rise in information technologies in the late 1990's (Ehrmann 2002). As a result, the severity of agency issues for remote and nearby outlets and the subsequent need for relational safeguards are likely to have converged to some degree.

Implications for managers

The present study bears clear implications for the management of franchised distribution channels. First, since our results revealed that multi-unit franchisees necessitate less governance intensity in light of decision-making independence, limiting the number of single-unit partners could lead to efficiency gains.[7] As a consequence, the extent of intra-chain competition faced by each outlet would also be reduced. Benefits may be derived from lower intra-chain competition as the findings indicated that those franchisees facing few competing outlets require less control. Furthermore, the data made a good case for the presumption that high performance relative to comparison levels fosters incentive alignment with the company. Hence, it may potentially pay-off to leave rents downstream to induce efficient decentralized operations.

Second, against the backdrop that the incentive characteristics of franchisees are not easily modifiable in the short-run, franchisors should carefully pay attention to selectively grant decision rights to those partners which are expected to behave appropriately. This could help to increase returns from local adaptation as smaller control costs should be incurred to achieve

[7] Note, however, that multi-unit ownership also reintroduces some of the problems franchising seeks to solve in the first place, namely shirking on effort on behalf of employed outlet managers. These agency problems then occur between the (non-managing) multi-unit owner and his employee-managers at the stores under his control.

Pareto-improving results. More generally, managers should be aware of the linkage between structural (that is, autonomy) and behavioral (that is, relational governance) processes in the management of channel members.

Finally, our research draws attention to the value of relationships in governing dispersed outlets. Though we did not provide empirical evidence on the performance effects of relying on relational governance to control decentralized decision-making structures, our findings suggest that norms of behavior provide a powerful safeguard against opportunistic abuses of decision rights. Companies which invest in the relationships to their dyadic partners in the presence of exchange hazards brought about by downstream autonomy should outperform those chains foregoing close ties, ceteris paribus.

Limitations

This study is subject to several limitations. First, standard criticisms of data from perceptual survey-type measures such as ambiguity of questions, nonresponse biases, and common methods variance apply. We sought to minimize the ambiguity of questionnaire items by means of extensive pre-tests with franchisees and experts. Comparison of average sampled franchisees in each chain with the average computed from the systems' populations revealed no evidence for obvious response biases. To deal with common method variance from social desirability, guarantees of anonymity were provided to respondents. Normally distributed summated scales were indicative of social desirability effects being negligible.

Second, it has to be noted that we relied on newly developed items to operationalize the relational exchange norms. However, care was taken in the construction of the scale. The formulation of the questionnaire items arose from a qualitative-explorative pre-study with franchisee focus groups. In addition, the results from a principal component factor analysis as well as inspection of Cronbach's alpha, item-to-total and inter-item correlations, all reported earlier, accommodated concerns about reliability issues.

Conclusion

Relying on franchised outlets for decision-making in various functional areas such as marketing, product design or pricing can bring about important efficiency gains and enhance system-wide adaptability. These positive effects from entrepreneurial autonomy are threatened to be offset by agency costs which arise from imperfect alignment of interests among the vertical channel partners. The theory led us to infer that franchise companies would use relational forms of governance to counterbalance their loss in control associated with allocating decision-making independence to individual outlets. The results from an empirical analysis based on German franchisees strongly supported this presumption. Furthermore, the data partly confirmed our thesis that franchisee incentive characteristics alleviate or intensify the need for relational safeguards in light of downstream decision control.

Though this study was conducted within the context of franchising, its implications may be extended to other inter- as well as intraorganizational relationships between principals and agents (for example, between sales manager and salesforce agents, between venture capital firms and their portfolio companies, and between employers and empowered employees). While organizations make extensive use of formal control mechanisms such as contracts, monitoring and certification, some degree of residual vulnerability to individual self-interest seeking and organizational goal conflicts often remains. As a consequence, realizing the full economic value of agents' specific knowledge is put into peril. Relational forms of governance can play a prominent role in reducing the costs from trading hazards thereby paving the way for successful decentralized decision structures.

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Appendix

Table 1
Distribution of franchisees in sample across chains[a] and industry sectors

System	Sector	Number of franchisees in sample	System-specific response rates (in percent)	Percent of total number of franchisees across systems in sample
1	Retail: Food	17	24	8.17
2	Business services	5	20	2.40
3	Retail: Home furnishings	3	43	1.44
4	Retail: Pet food	21	32	10.10
5	Retail: Building materials	34	18	16.35
6	Retail: Computer equipment	18	30	8.65
7	Repair	10	19	4.81
8	Retail: Other	13	14	6.25
9	Eating places: Full service	5	19	2.40
10	Retail: Tobacco	13	16	6.25
11	Travel	69	18	33.18

[a] The average chain was 13.87 years old, had 104.12 franchised outlets and an entry fee of about 19.000 €.

Table A1
Details of constructs and measures[b]

Construct	Description of Measures	Cronbach's Alpha
1 Multi-unit ownership	Do you own more than one franchise outlet? (no = 0; yes = 1)	
2 Age of the relationship	In which year did you join the franchise system?	
3 Competition	The number of franchised outlets has exceeded a reasonable size. (disagree-agree, 7-point scale)	
4 Success	a Within another activity and with the same level of effort I could realize an income which is … (higher-lower, 7-point scale). b Compared to the average development of sales in my industry I would rate my last period's sales as being… (lower-higher, 7-point scale). c Compared to my expectations my last period's income was… (lower-higher, 7-point scale). d Compared to my last period's sales objectives my last period's sales were… (lower-higher, 7-point scale).	0.83
5 Relational governance	*Harmonization of conflict* a My franchisor understands my problems and concerns. (disagree-agree, 7-point scale) b My franchisor seeks compromises to accommodate conflicts. (disagree-agree, 7-point scale) c Disputes are not typical for the relationship between me and my franchisor. (disagree-agree, 7-point scale) *Cooperation* d When making decisions which concern me, my franchisor takes into account my opinion. (disagree-agree, 7-point scale) e My franchisor asks me for participation in his long-term planning process. (disagree-agree, 7-point scale) f I receive information from my franchisor on time. (disagree-agree, 7-point scale) *Trust* g My franchisor does not exploit my dependency. (disagree-agree, 7-point scale) h My franchisor's trust in me is high. (disagree-agree, 7-point scale) i I can follow the recommendations of my franchisor without any hesitation. (disagree-agree, 7-point scale)	0.87
6 Autonomy	a The franchisor's standard operating procedures do limit my autonomy… (agree-disagree, 7-point scale) b I am free to implement own ideas. (disagree-agree, 7-point scale) c I am my own boss. (disagree-agree, 7-point scale) d As franchisee I feel more like an entrepreneur rather than like an employee. (disagree-agree, 7-point scale)	0.64

[b] Items have been translated from German to English by a bilingual researcher.

Table 2
Results of Principal Component Factor Analysis

1 factor extracted (Eigenvalues > 1); Kayser-Meyer-Olkin-criterion: 0.885; Bartlett's test of spherity: $Chi^2 = 826.47$, $df = 36$, $p < 0.001$.		
Factor	Eigenvalue	percent of var.
1	4.698	52.205
Factor matrix		Relational governance
5a)		0.652
5b)		0.756
5c)		0.785
5d)		0.804
5e)		0.696
5f)		0.635
5g)		0.808
5h)		0.752
5i)		0.577

Absolute values less than 0.3 were suppressed.

Table 3
Results of Principal Component Factor Analysis

2 factors extracted (Eigenvalues > 1); Kayser-Meyer-Olkin-criterion: 0.761; Bartlett's test of spherity: $Chi^2 = 556.42$, $df = 28$, $p < 0.001$.					
Factor	Eigenvalue	percent of var.	cum. percent of var.		
1	3.191	39.893	39.893		
2	1.660	20.747	60.640		
Factor matrix				Success	Autonomy
4a)				0.633	
4b)				0.855	
4c)				0.880	
4d)				0.850	
6a)					0.645
6b)					0.778
6c)					0.762
6d)					0.664

Absolute values less than 0.3 were suppressed.

Table 4
Pearson Correlation Coefficients and Descriptive Statistics

	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. System Dummy 1	0.08	0.27																
2. System Dummy 2	0.02	0.15	-0.05															
3. System Dummy 3	0.01	0.12	-0.04	-0.02														
4. System Dummy 4	0.10	0.30	-0.10	-0.05	-0.04													
5. System Dummy 5	0.16	0.37	-0.13	-0.07	-0.05	-0.15*												
6. System Dummy 6	0.09	0.28	-0.09	-0.05	-0.04	-0.10	-0.14*											
7. System Dummy 7	0.05	0.21	-0.07	-0.04	-0.03	-0.08	-0.10	-0.07										
8. System Dummy 8	0.06	0.24	-0.08	-0.04	-0.03	-0.09	-0.11	-0.08	-0.06									
9. System Dummy 9	0.02	0.15	-0.05	-0.03	-0.02	-0.05	-0.07	-0.05	-0.04	-0.04								
10. System Dummy 10	0.06	0.24	-0.08	-0.04	-0.03	-0.09	-0.11	-0.08	-0.06	-0.07	-0.04							
11. Relational governance	5.35	1.06	0.29***	-0.02	0.08	0.36***	-0.04	-0.07	0.07	-0.02	-0.18*	0.09						
12. Multi-unit ownership	0.23	0.42	0.01	-0.01	-0.07	-0.18**	0.38***	-0.09	-0.12	-0.09	-0.09	0.05	0.00					
13. Age of relationship	7.50	5.76	-0.11	-0.05	-0.02	-0.17*	0.66**	-0.06	0.01	-0.06	-0.01	-0.09	-0.03	0.36***				
14. Distance	309.74	206.77	-0.12	0.21**	-0.17*	-0.18*	0.06	0.11	-0.09	-0.07	0.08	-0.23**	-0.32***	0.02	0.05			
15. Success	4.41	1.35	0.26***	-0.03	-0.04	0.31***	0.12	0.07	0.04	0.04	-0.14	0.01	0.51***	0.13	0.09	-0.12		
16. Competition	2.98	2.06	-0.14*	-0.08	-0.04	-0.18*	0.12	-0.06	-0.11	-0.08	0.03	0.11	-0.33***	0.08	0.09	0.04	-0.19**	
17. Autonomy	5.45	0.70	0.23**	-0.04	0.04	0.28***	-0.04	0.01	0.05	-0.25***	-0.38***	0.10	0.55***	0.03	-0.08	-0.20**	0.37***	-0.25***

$n = 208$. Significance levels (two-tailed): *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$.

Table 5
OLS Regression Results

Dependent Variable: Relational Governance							
Model	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Constant	5.183***	5.158***	5.153***	5.152***	5.168***	5.204***	5.184***
	(0.114)	(0.108)	(0.107)	(0.109)	(0.109)	(0.108)	(0.108)
System Dummy 1	0.749**	0.630**	0.648**	0.627*	0.633**	0.628**	0.652**
	(0.253)	(0.240)	(0.239)	(0.240)	(0.240)	(0.237)	(0.238)
System Dummy 2	0.228	0.318	0.308	0.321	0.316	0.300	0.266
	(0.385)	(0.364)	(0.362)	(0.365)	(0.365)	(0.361)	(0.363)
System Dummy 3	0.658	0.620	0.618	0.633	0.635	0.521	0.649
	(0.496)	(0.469)	(0.466)	(0.470)	(0.470)	(0.466)	(0.465)
System Dummy 4	0.818**	0.685**	0.652**	0.674**	0.690**	0.778**	0.728**
	(0.247)	(0.235)	(0.234)	(0.237)	(0.235)	(0.236)	(0.234)
System Dummy 5	-0.016	0.022	0.033	0.038	-0.022	-0.012	0.018
	(0.228)	(0.216)	(0.215)	(0.219)	(0.220)	(0.214)	(0.214)
System Dummy 6	-0.135	-0.100	-0.072	-0.094	-0.106	-0.126	-0.071
	(0.227)	(0.215)	(0.214)	(0.216)	(0.215)	(0.213)	(0.214)
System Dummy 7	0.265	0.263	0.262	0.270	0.271	0.186	0.295
	(0.294)	(0.277)	(0.276)	(0.278)	(0.278)	(0.276)	(0.276)
System Dummy 8	-0.087	0.317	0.353	0.328	0.304	0.240	0.263
	(0.260)	(0.259)	(0.258)	(0.260)	(0.260)	(0.258)	(0.258)
System Dummy 9	-0.593	0.160	0.305	0.158	0.204	0.434	0.175
	(0.378)	(0.389)	(0.395)	(0.390)	(0.395)	(0.403)	(0.387)
System Dummy 10	0.466†	0.380	0.396	0.378	0.384	0.405	0.361
	(0.263)	(0.249)	(0.247)	(0.249)	(0.249)	(0.246)	(0.247)
Multi-unit ownership	0.013	0.004	0.020	0.012	-0.001	-0.005	0.003
	(0.155)	(0.146)	(0.146)	(0.148)	(0.147)	(0.145)	(0.145)
Age of relationship	0.007	0.009	0.009	0.007	0.010	0.010	0.008
	(0.013)	(0.013)	(0.013)	(0.014)	(0.013)	(0.013)	(0.013)
Distance	-0.001**	-0.001*	-0.001*	-0.001*	-0.001*	-0.001**	-0.001*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Success	0.255***	0.196***	0.191***	0.194***	0.205***	0.205***	0.207***
	(0.052)	(0.051)	(0.050)	(0.051)	(0.052)	(0.050)	(0.051)
Competition	-0.103**	-0.073*	-0.072*	-0.072*	-0.072*	-0.078**	-0.073**
	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)
Autonomy		0.489***	0.485***	0.490***	0.479***	0.498***	0.477***
		(0.100)	(0.099)	(0.100)	(0.101)	(0.099)	(0.099)
Autonomy x Multi-unit ownership			-0.397†				
			(0.214)				
Autonomy x Age				-0.009			
				(0.018)			
Autonomy x Distance					0.000		
					(0.000)		
Autonomy x Success						-0.142*	
						(0.062)	
Autonomy x Competition							0.083*
							(0.042)
n	208	208	208	208	208	208	208
F	10.894***	12.937***	12.533***	12.141***	12.715***	12.750***	12.588***
Adjusted R^2	0.418	0.480	0.486	0.478	0.479	0.491	0.488
Δ in *adj.* R^2		0.052	0.006	-0.002	-0.001	0.011	0.008
F Δ in *adj.* R^2		24.000***	3.433†	0.293	0.501	5.206*	3.881*

Standard errors in parentheses. Significance levels (two-tailed): *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; † $p < 0.1$. Independent variables have been mean centered (all models) in order to circumvent problems of multicollinearity associated with interaction terms.