Delegation and Performance of Franchise Relationships

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Abstract

Franchisors empower franchisees to take decisions on a bundle of management issues. This autonomy produces counter effects: While it allows capitalizing on franchisee local knowledge, it can also deteriorate system homogeneity. This paper aims to assess a wise assignment of these rights to enhance performance, particularly, the reduction of early terminations promoted by the franchisor. To these end, it studies the direct effects of delegating a number of decisions (pricing, human resource practices, assortment decoration and local advertising) of the number of early terminations. Moreover, the paper tests the moderating effects of the value of brand name and of the tacitness of the value transferred to franchisees on these variables. Results support that delegation of pricing decisions increases terminations within the chain whereas delegation of decisions related to assortment and local advertising tend to diminish early terminations. Moreover, this effect is more pronounced the larger is the chain, except for local advertising. Delegation of local advertising reduces terminations and delegation of pricing tends to increase them regardless the size of the system.

Keywords: Delegation, early terminations, local adaptation, moderating effect.
Delegation and Performance of Franchise Relationships

1. INTRODUCTION

Franchising involves running a standardized system with widely dispersed outlets by means of an entrepreneurial partnership. Localized operations are often managed by franchisees who are independent owners and not employees, and this creates singular opportunities and hazards for both members of the relationship, the franchisor and his franchisees (Davies et al., 2011). In particular, this condition poses a critical challenge to franchisor headquarters when allocating decision rights: to achieve image consistency while leaving room to franchisee autonomy.

This paper explores how the allocation of decision rights influences the performance of franchise relationships. To this end, we focus on the effect that autonomy of franchisees has on an objective measure of performance: the number of disputes that result in early terminations of franchise contracts. Then we deal with the performance of franchise chains in terms of (negative) relational performance, that is, the level franchising failure.

We theorize that an appropriate allocation of control (i.e. autonomy) in the franchise system may prevent disputes under certain conditions. Autonomy could reduce early terminations if franchisees feel more satisfied in the relationship and satisfaction enhances their compliance. On the contrary, it could increase negative franchise exits if it impedes franchisors to enforce their implicit contracts, where they expect franchisees not to free-ride on the brand. That is, autonomy will leave room for future franchisees’ misbehaviors otherwise directly controlled by the franchisors.

Nevertheless we consider that the balance of control and autonomy may shift throughout different aspects of the franchise relationship. In this sense, the literature argues that there are certain peripheral aspects of the franchise business format that can be managed by franchisees in order to favour local adaptations more easily, that is without increasing noncompliance (Kaufmann and Eroglu, 1999). Still, differences among these operative decision areas have been underexplored. Our contribution here is to analyse the dissimilarities that these peripheral domains may have on the conflicting forces of control and autonomy. We also provide empirical evidence on the diverse implications that the allocation of different operative decision rights has on franchise terminations.

Accordingly, we distinguish five different types of decision at local level: Price decisions, human resource decisions (recruiting and training) and decisions concerning merchandising, which comprise assortment, decoration, and local advertising decisions.

Additionally, we propose that the direct effects of franchisees’ autonomy on franchise failure may be moderated by the value of the brand name that franchisors have at stake and, besides, they would be different depending on the type of decision involved. That is, an opportunistic behaviour of franchisees would be more harmful the more valuable is the brand. Even so, local adaptations driven by franchisees’ autonomy will be also more beneficial as the brand name value increases in certain domains.

The remainder of the paper is structured as follows. The second section discusses the expected influence of the delegation of our five decision rights on early terminations. The third section describes the data collection process, the econometric models used and the results. Some brief conclusions are given in the fourth section.
2. THEORETICAL BACKGROUND AND HYPOTHESES

Decentralization of decision rights in franchise systems

Franchising creates specific hazards in management of chains because franchisors exploit market opportunities through independent entrepreneurs, the franchisees. Franchisors need their effort and they also need an image consistency to protect the integrity of their brand on overall franchise operations. However, franchisees sometimes would prefer to free-ride on the brand in order to save costs or to operate in other way that they consider more profitable. As Davies et al. (2011) put it, the “necessary balance between process conformity and entrepreneurial autonomy (is) a major challenge in franchising”. In this regard, franchisors try to gain franchisee compliance by several means. Contracts and operation’s manuals specify to some degree the limits of franchisee autonomy. Centralization and monitoring can alleviate non-compliance with the standards. Also relational contracting can reduce free-riding in those aspects not covered by contracts. Finally, training can reduce non purposeful free-riding.

However, autonomy and control are naturally incompatible and can derive in conflict. If autonomy leads to free-riding, the ultimate solution for conflicts is termination of the contract of the franchisee, just in case the franchisor cannot convince him to respect franchising standards (Marrow, 2009). This is not a desirable output. Ishida and Brown (2010) found that the franchisor’s enforcement of sanctions weakened relational solidarity. Terminations create ill will not only for the franchisee involved but also for the remaining franchisees. Additionally, early terminations make necessary to invest anew in set-up costs for the candidate that should replace the former franchisee. Moreover, those conflicts may deteriorate the chain image during the conflict.

Nevertheless, autonomy could exert a counter effect reducing terminations if franchisees are more willing to meet compliance requirements in other aspects of business. An absence of autonomy that comes with monitoring of standardized activities places pressure on the franchisee and can have an undesirable output: the crowding out effect (Ishida and Brown, 2010). Monitoring is costly to implement and it circumvents the incentives of franchisees for running their own businesses (Barthélemy, 2008).

Given these two possible effects, it is useful to distinguish different fields where autonomy should be more or less advisable. Franchisors would be less intrusive focusing solely on those tasks that are critical to the relationship and leaving autonomy on the rest. We chose to examine those aspects highlighted by Cox and Mason (2007) in their field study as the decisions that can be delegated to the franchisees: Pricing, human resource management and merchandising (comprising decoration, assortment and local advertisement). They are similar to the ones mentioned by Michael (1996) and, except for finance decisions, to the ones considered by Windsperger (2004). All of these aspects should be peripheral to business because core elements should be standardized, following Kaufmann and Eroglu’s (1999) terminology. However, the allocation of these decisions may have different implications in terms of the conflicting forces of control and autonomy.

**Pricing autonomy**

Despite EU antitrust laws forbid franchisors to impose prices, they can recommend minimum or maximum pricing structures. In fact, franchisors can design barriers to price changes improving control over their franchisees. Such control includes
labels with suggested prices in the products they sell to franchisees or promotional materials such as menus in restaurants that mention the prices of the different meals. In this regard, Ater and Rigbi (2007) showed that chains could use advertising to inform customers about prices, thereby inducing franchisees to adopt the advertised low prices. Actually, in this paper we argue that both franchisors and franchisees will prefer a higher degree of centralization in price decisions.

Past research has found higher prices in franchised outlets due to (1) double marginalization, and (2) to positive externalities among them (Lafontaine 1999, Ater and Rigbi 2007). Whenever an outlet reduces prices, it leads to an increase in quantity demanded at many locations, not only the one responsible of that change. Therefore, franchisors would like to take advantage of the overall effect whereas franchisees can only benefit from the increase in sales experimented in their own outlet. Since promotions likely result in an intra-brand competition detrimental for individual franchisees (Kalnins, 2004), it is in their interest to have somewhat uniform price policies (i.e. centralized pricing).

Besides discouraging intra-firm competition, to centralize price decisions displays additional advantages for chain operators. Specifically, franchisors could prefer uniform prices in order to maintain image standardization and also to simplify national advertising (Lafontaine, 1999).

Summing up, we expect that franchisees that have more autonomy fixing prices would tend to be more dissatisfied if there is intensive price competition leading to less compliance or worse practices. Moreover, since franchisors also prefer uniform prices, we expect the number of disputes within the chain to increase when decentralization of price decision is high. In fact, it is our contention that pricing policies should be more centralized than other operative decisions. Therefore, we establish the following hypothesis:

\[ H_{1.1}: \text{The number of early terminations by the franchisor will be positively related to the pricing autonomy of their franchisees.} \]

**Human resource decisions**

Franchisors may develop recruitment policies to assist franchisees with interview processes or with the design of incentive loyalty programs for their prospective employees. However, recruitment and retention difficulties are more sensitive to the local circumstances of labour markets (i.e. to the franchisees’ local specific knowledge) than to the franchisor’s standardised procedures.

Decisions concerning the hiring of labour are among the operating policies where franchisees usually can exert their initiative (Michael, 1996). As independent entrepreneurs, they are responsible for their personnel. Additionally, labour is very difficult to monitor at distance so headquarters would be eager to leave this task to franchisees as part of daily operations. In fact, it is widely accepted that the greater the cost of direct supervision by the franchisor, the more the franchisor will rely on expansion through franchising (Brickley and Dark, 1987; Norton, 1988; Brickley et al., 1991; Lafontaine, 1992; Lafontaine and Shaw, 2005).

Moreover, lack of autonomy in contracting employees could disturb franchisees that should work together and pay their salaries. Similarly, issues related to the training of workers may also be decentralized taking into account that franchisees are directly
responsible for them. They are franchisees’ and nor franchisor’s employees. As a result, the following testable hypothesis can be derived:

\[ H_{1.2}: \] The number of early terminations by the franchisor will be negatively related to the degree of decentralization of human resource decisions.

**Merchandising decisions**

Franchisees may be an interesting source of innovation because they know better their local markets. In fact, many franchisors select franchisees on the basis of their business or sales ability and provide them with technical background (Frazer and Winzar, 2005).

This knowledge advantage could make advisable to leave them some autonomy (Windsperger, 2004). Franchisors could then encourage a certain degree of experimentation allowing some autonomy in issues related to merchandising. We chose those marketing aspects highlighted by Cox and Mason (2007) in their qualitative investigation, that is, decoration, assortment and local advertisement. These are among the aspects considered as peripheral by Kaufmann and Eroglu (1999) as we see in figure 1.

Autonomy in those decision areas can favour franchisee satisfaction and compliance and, in turn, it can enhance the results of the franchisor. This leads us to the following three hypotheses:

\[ H_{1.3}: \] The number of early terminations by the franchisor will be negatively related to the degree of decentralization of assortment decisions.

\[ H_{1.4}: \] The number of early terminations by the franchisor will be negatively related to the degree of decentralization of outlet decoration.

\[ H_{1.5}: \] The number of early terminations by the franchisor will be negatively related to the degree of decentralization of local advertising.

![Figure 1. Examples of core and peripheral component elements](image)

<table>
<thead>
<tr>
<th>CENTRALITY</th>
<th>Product/Service Deliverables</th>
<th>Benefit Communicators</th>
<th>System Identifiers</th>
<th>System Facilitators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core</td>
<td>Basic menu</td>
<td>Clean uniforms</td>
<td>System name</td>
<td>Sales reporting procedure</td>
</tr>
<tr>
<td></td>
<td>Accuracy of work</td>
<td>Professional certification</td>
<td>Trademark</td>
<td>Operating manuals</td>
</tr>
<tr>
<td>Peripheral</td>
<td>Hours of operation</td>
<td>Mint on pillow</td>
<td>Colour scheme</td>
<td>POS equipment</td>
</tr>
<tr>
<td></td>
<td>Parking</td>
<td>Display of professional certificates</td>
<td>Décor of unit</td>
<td>Local advertising</td>
</tr>
</tbody>
</table>

Note: what might be peripheral in one system could be core to another

Source: Kaufmann and Eroglu (1999)
Franchisor resources and terminations

Franchise literature establishes that “the franchise package essentially consists of two resources: brand name and business practices” (Barthélemy, 2008; Combs et al., 2004; Lafontaine, 1992) and franchisees’ autonomy has the drawback of a possible deterioration in both of them.

Accordingly, the implications of the allocation of decision rights mentioned, that indicate layers of autonomy, would differ depending on the value of the brand name. Our corresponding hypothesis is that the value of the brand name makes autonomy less advisable in pricing and in merchandising but not in personnel management.

Since they are not well-known among consumers, franchise formats will incur in fewer costs in deviating from uniformity in their early stages. That is, benefits of franchisees’ adaptations and experimentations will be lower as the franchise brand image gains in value (Bradach, 1998; Cox and Mason, 2007). In other words, as reputation and brand image increase franchisees’ autonomy will become more troubled in the fields of price and merchandising decisions.

We do not expect the same effect, however, for human resource decisions. That is, local personnel management at store level will require even more decentralized decision-making in well-established and mature systems. Therefore, we propose a second group of hypotheses regarding the moderator influence of franchisors’ brand name on the relationship between autonomy and terminations:

H.2.1: Franchisors’ brand name capital positively moderates the relationship between price autonomy and early terminations.
H.2.2: Franchisors’ brand name capital positively moderates the relationship between decentralization of human resource decisions and early terminations.
H.2.3: Franchisors’ brand name capital negatively moderates the relationship between the decentralization of assortment decisions and early terminations.
H.2.4: Franchisors’ brand name capital negatively moderates the relationship between the decentralization of assortment decisions and early terminations.
H.2.5: Franchisors’ brand name capital negatively moderates the relationship between the decentralization of assortment decisions and early terminations.

In addition, we also explore the direct effect of the franchisors’ resources (i.e. business format and brand-name) on termination. Firstly, provided that the potential for free-riding tends to be larger when brand name is valuable, we expect more non-compliance across franchisees and thus more terminations as the value of brand name increases. We therefore establish the following hypothesis:

H.3: Franchisors’ brand name capital will be positively related with early terminations by the franchisor.

Secondly, along with brand name, system-specific know-how of the franchisors constitutes the other intangible resource that they put at stake in the relationship (Windsperger, 2003). It refers to the tacit practices that comprise part of the business format transferred to the franchisees. This know-how cannot be easily codified and transferred however, since it has an important tacit component. For instance, it cannot
be included in the operation manuals (Knott, 2003). Accordingly, chain operators have to use different training tools to transmit their tacit business practices to their franchisees. But, as Barthélemy highlights, because franchisees are independent entrepreneurs, “persuading them (franchisees) to attend training sessions and implement new business practices is often costly in terms of time and effort (2008:1454)”. Therefore, in the franchise context we expect that the number of disputes will increase with highly tacit business practices.

\[ H_4: \text{The degree of tacitness of the franchisor business practices will be positively related with early terminations.} \]

3. DATA AND PROCEDURES

Data collection and sample

The hypotheses were tested on a representative sample of 71 franchise chains.

The methodology used for data collection was a mail survey. The formulation of the Likert-type questionnaire items emerged from in-depth interviews with franchisors, consultants and franchisees and the final version of the questionnaire was pretested with six franchisors.

The questionnaires were sent to the 847 franchisor firms previously identified by the two main professional guides edited in Spain (Tormo, 2008 and Barbadillo, 2008). In all cases, the individuals asked to fill in the questionnaire were the franchising directors or the CEOs directly responsible for the administration of the chain. Each mailing included a questionnaire and a cover letter describing the purposes of the study and guaranteeing anonymity to participants. This letter was co-signed by the Spanish Franchisors Association that supported the study. Both documents were sent first by e-mail and, secondly, a reminder was forwarded by regular mail adding a postage-paid reply envelope. In order to enhance response rates, we conducted a third wave of data collection with in-person surveys made in the main franchising fairs of Spain. We used always the same survey instrument.

The request for information was finally closed having received information about 163 chains. To test for a potential response bias in our sample, we followed the Armstrong and Overton (1977) procedure. We compared several variables in early-returned questionnaires and late-returned questionnaires. This comparison assumes that late respondents share similar characteristics and response biases with non-respondents. t-test analyses indicated that no significant mean differences existed between early and late respondents. Furthermore, we tested for a potential response bias by comparing respondents and non-respondents on two key features: System size and sub-sector of activity. None of these test results showed significant differences at the 0.05 level thus, the results from our research can be generalized to the whole population.

Our final dataset is sensibly smaller however. This is because we excluded from the analysis both chains that only had company owned outlets and chains that weren’t old enough to have mid-agreement terminations. Since we analyse conflict through the

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\(^1\) Four of the respondents had ceased operations. Out of the responding and active firms, 19 used alternative forms of distribution such as licensing.
number of early terminations, we focused on established franchisors with at least one franchisee. In addition, in order to eliminate cancelations typically due to the inexperience and beginner difficulties of new franchisors, we required the firms to have been running their chains for four years as a minimum. This limited our initial sample to 71 valid cases with complete information for all variables included in the study.

**Measurement**

*Dependent variable*

The paper aims to analyze the effect of franchisee’s decision-making authority on the number of early terminations in franchise relationships. The dependent variable is directly built on the franchisor responses for the following item: (i) *Number of early terminations by the franchisor over the last four years* (NUMBTERM).

*Decision making authority*

We hypothesize that the capacity of franchisees to make local adaptations and its impact on the number of terminations is contingent on the type of decision right considered. The measure of the franchisee’s autonomy is built on franchisor ratings for the level of authority they considered their franchisees to have. Particularly, franchisors rated (on 5-point Likert scales) their franchisee’s authority regarding the five operative decision rights identified in Section 2 (Cox and Mason, 2007): 1) human relations practices (DELEGPersonnel), 2) pricing (DELEGPricing), 3) product assortment (DELEGAssortment), 4) decoration (DELEGDecor) and, 5) local advertising (DELEGAdvertising).

*Brand name value*

In order to proxy the market reputation of the chain, we used the SIZE of the system, namely, the total number outlets held by each franchisor comprising both company owned and franchised stores. Several papers have used this variable as a proxy for the value of the trademark. In this sense it is assumed that the value of the trade name will increase with the number of establishments displaying it, and so with the number of people that are exposed to it (Lafontaine 1992). This relationship had been particularly checked in Spain by Solís and González (2011), who found significant and important correlations between the estimated trade values of franchisable business in Spain and their chain size.

*Tacitness*

Compared to explicit knowledge, which is easy to codify and to transfer through the operation manuals, tacit practices are difficult to transmit to franchisees and they must be acquired through experience or face-to-face training (Knott, 2003; Barthélemy, 2008). Accordingly, our proxy for the importance of tacitness is built on the franchisors answer for the following item: (i) *Training time that your current franchisees must devote to maintain and/or develop the franchise business practices (weeks per year).*

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2 Agrawal and Lal (1995); Arruñada et al. (2001); Baucus et al. (1993); Lafontaine(1992); Penard et al. (2003); Perales and Vázquez (2003); Solís and González (2011).

3 Particularly these authors found that the correlation was 0.79 excluding financial business and 0.71 including it.
Control variables

To strengthen empirical tests, we controlled for the age of the systems and for the sector. Maturity or age is progressive and it is subject to a diminishing effect, since the increment is slower from year to year. Therefore, we used the logarithm of the age instead of the untransformed value of the number of years since inception. Last, we created an industry dummy variable that distinguishes between retailing and services. It took the value 1 for retail-type chains so it accounts for variations idiosyncratic to retailing vs. service sectors.

Analytical Procedure

The hypotheses introduced in Section 2 imply the following equation:

\[
\text{NUMBTERM} = (\text{Controls}) \ b_0 + b_1 \text{AGE} + b_2 \text{RETAIL-type chain} + \\
b_3 \text{ChainSIZE} + \\
b_4 \text{TRAININGTime} + \\
b_5 \text{DELEG-Pricing} + \\
b_6 \text{DELEG-Personnel} + \\
b_7 \text{DELEG-Assortment} + \\
b_8 \text{DELEG-Decor} + \\
b_9 \text{DELEG-Advertising} + \\
b_{10} (\text{SIZE} \times \text{DELEG-Pricing}) + \\
b_{11} (\text{SIZE} \times \text{DELEG-Personnel}) + \\
b_{12} (\text{SIZE} \times \text{DELEG-Assortment}) + \\
b_{13} (\text{SIZE} \times \text{DELEG-Decor}) + \\
b_{14} (\text{SIZE} \times \text{DELEG-Advertising}) 
\]

We estimated Equation 1 using de moderated OLS approach (Jaccard, Turrisi and Wan, 1990; Aiken and West, 1991). An important concern in using this approach is the possible multicollinearity between the interaction terms and its components. To avoid this problem, we used the conventional mean-centering procedure suggested by Aiken and West (1991). As a result, variance inflation factors (VIF) associated with each regression coefficient ranged from 1.2 to 2.2, which suggest that multicollinearity is not a major issue in this research (Neter, Wasserman and Kutner, 1985).

Table 1 reports the means, standard deviations, and correlations between the independent and control variables.
Table 1: Means, standard deviations, and correlations

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>S.d.</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. LOG (Age)</td>
<td>1.19</td>
<td>.325</td>
<td>1</td>
<td>.023</td>
<td>.147</td>
<td>-.165</td>
<td>.196</td>
<td>.183</td>
<td>.184</td>
<td>.065</td>
<td>-.021</td>
</tr>
<tr>
<td>2. RETAIL-type chain</td>
<td>.49</td>
<td>.503</td>
<td>.023</td>
<td>1</td>
<td>.203*</td>
<td>-.030</td>
<td>.258**</td>
<td>-.321**</td>
<td>.077</td>
<td>-.022</td>
<td>-.004</td>
</tr>
<tr>
<td>3. ChainSIZE</td>
<td>52.87</td>
<td>70.596</td>
<td>.147</td>
<td>.203</td>
<td>1</td>
<td>.297**</td>
<td>.002</td>
<td>-.079</td>
<td>.026</td>
<td>-.030</td>
<td>.033</td>
</tr>
<tr>
<td>4. TRAININGTime</td>
<td>1.84</td>
<td>2.015</td>
<td>-.165</td>
<td>-.030</td>
<td>.297</td>
<td>1</td>
<td>.001</td>
<td>.018</td>
<td>-.083</td>
<td>.084</td>
<td>.098</td>
</tr>
<tr>
<td>5. DELEGPersonnel</td>
<td>8.25</td>
<td>1.4414</td>
<td>.196</td>
<td>.258</td>
<td>.002</td>
<td>.001</td>
<td>1</td>
<td>.202*</td>
<td>.113</td>
<td>.305**</td>
<td>.295**</td>
</tr>
<tr>
<td>6. DELEG Pricing</td>
<td>2.82</td>
<td>1.291</td>
<td>.183</td>
<td>-.321</td>
<td>-.079</td>
<td>.018</td>
<td>.202</td>
<td>1</td>
<td>.413**</td>
<td>.429**</td>
<td>.312**</td>
</tr>
<tr>
<td>7. DELEG Assorment</td>
<td>3.01</td>
<td>1.293</td>
<td>.184</td>
<td>.077</td>
<td>.026</td>
<td>-.083</td>
<td>.113</td>
<td>.413</td>
<td>1</td>
<td>.431**</td>
<td>.341**</td>
</tr>
<tr>
<td>8. DELEG Decor</td>
<td>2.34</td>
<td>1.068</td>
<td>.065</td>
<td>-.022</td>
<td>-.030</td>
<td>.084</td>
<td>.305</td>
<td>.429</td>
<td>.431</td>
<td>1</td>
<td>.563**</td>
</tr>
<tr>
<td>9. DELEG Advertising</td>
<td>3.72</td>
<td>1.111</td>
<td>-.021</td>
<td>-.004</td>
<td>.033</td>
<td>.098</td>
<td>.295</td>
<td>.312</td>
<td>.341</td>
<td>.563</td>
<td>1</td>
</tr>
</tbody>
</table>

N= 71; *p<.05; **p<.005

Results and discussion

Table 2 reports the results of using OLS moderated regression to estimate Equation 1. The estimated equation explains 25.1% of the variation in the franchisor early terminations (Model 4) (Adjusted R² =.251; F=2.676; p =.005).

As noted previously, we believed that early terminations might be affected by two control variables: The age of the chain (AGE) and the franchise sector in which it operates –i.e. the distinction between retail-type and service-type chains (RETAIL-type chain)–. **Model 1** includes only these control variables. The results show that neither of the two variables was statistically significant. Thus, the number of early cancellations bears little relation either to the experience of the franchisor or to the governance difficulties that might arise in service-type compared to retail-type chains.

The direct effects of, first, the brand name value (SIZE) and, second, the tacitness of franchisor know-how (TRAINING) are entered in **Model 2**. The inclusion of these variables explain additional variance (ΔR²=0.122*), but only the regression coefficient of TRAINING is statistically significant (b=2.204; p=.008). This result supports our Hypothesis 4. That is, the difficulties surrounding the transfer of implicit knowledge seem to be particularly problematic for franchise relationships. In other words, to attend training sessions in order to learn tacit business practices and subsequently to give an appropriate use to such practices constitute a source of conflict, which, in turn, undermine the franchisor-franchisee relationship.

On the other hand, although it is widely accepted in the literature that brand name value increases free-riding hazards and thus potential misbehaviors of franchisees, our results do not show any significant relationship between the system SIZE and early terminations by the franchisor. This result seems to indicate that the free-riding hazards, which typically arise within well-known or reputable chains, are better controlled than the difficulties posed by the tacit character of franchisors’ know-how. This is particularly true if we consider that it is not in the franchisor interest to terminate a franchise unless there is no other choice.
Table 2: Results of OLS regression analysis of early terminations by the franchisors

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>1,360** (0.237)</td>
<td>1,601** (0.241)</td>
<td>1,563** (0.233)</td>
<td>1,609** (0.229)</td>
</tr>
<tr>
<td>Log AGE</td>
<td>-0.214 (0.272)</td>
<td>-0.103 (0.268)</td>
<td>-0.224 (0.269)</td>
<td>-0.331 (0.269)</td>
</tr>
<tr>
<td>Retailing-type chain</td>
<td>0.185 (0.211)</td>
<td>0.183 (0.206)</td>
<td>0.440† (0.227)</td>
<td>0.253 (0.230)</td>
</tr>
<tr>
<td>Chain SIZE</td>
<td>0.097 (0.280)</td>
<td>0.163 (0.269)</td>
<td>0.368 (0.345)</td>
<td></td>
</tr>
<tr>
<td>TRAINING Time</td>
<td>2.204** (0.805)</td>
<td>2.087** (0.778)</td>
<td>1.735† (0.902)</td>
<td></td>
</tr>
<tr>
<td>DELEGPersonnel</td>
<td>-0.205 (0.242)</td>
<td></td>
<td>-0.199 (0.257)</td>
<td>-0.075 (0.258)</td>
</tr>
<tr>
<td>DELEGAssortment</td>
<td>0.670* (0.273)</td>
<td></td>
<td>-0.199 (0.275)</td>
<td></td>
</tr>
<tr>
<td>DELEGDecor</td>
<td>0.398 (0.271)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DELEGAdvertising</td>
<td>-0.517* (0.247)</td>
<td></td>
<td>-0.618* (0.247)</td>
<td></td>
</tr>
<tr>
<td>SIZE xDELEGPersonnel</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE xDELEGAssortment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE xDELEGDecor</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE xDELEGAdvertising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F statistic</td>
<td>0.679</td>
<td>2.713*</td>
<td>2.640*</td>
<td>2.676**</td>
</tr>
<tr>
<td>R²</td>
<td>0.020</td>
<td>0.141</td>
<td>0.280</td>
<td>0.401</td>
</tr>
<tr>
<td>ΔR²</td>
<td>0.122*</td>
<td>0.139†</td>
<td>0.121†</td>
<td></td>
</tr>
</tbody>
</table>

Model 3 adds the main study variables, that is, variables measuring the degree of decision making autonomy of the franchisees within each franchise chain (DELEGPersonnel, DELEGAssortment, DELEGDecor and DELEGAdvertising). The inclusion of these variables significantly improves the model (ΔR²=0.139†), supporting the general contention that the degree of conflict that ends up in termination is actually sensitive to the decision making structure. Particularly, two out of the five decision variables studied are significant, pricing decisions and local advertising decisions, and, as predicted, their coefficients differ in sign. This confirms that the relationship between franchisees’ autonomy and conflict is not always positive. Moreover, results indicate that the analysis of the effect of autonomy on early terminations must focus on each particular decision right instead of focusing on the level of delegation as a whole.

Firstly, regarding pricing structures, H1.1 proposes a positive effect of pricing autonomy on early terminations. The coefficients for this variable (DELEGPricing) remain significant and positive in Model 3 (b5=.670*) and also in Model 4 (b5=.493†), which includes moderator effects of brand name. Thus, H1.1 is supported, indicating that
to allow franchisees to set their own prices without restrictions is a significant source of conflict within the chain, which actually increases the number of negative franchisee exits. In sum, this findings support the claim that, despite the legal restrictions imposed by anti-trust laws, the price policies should be controlled by the franchisor and thus integrated throughout the chain at some extent.

Secondly, the DELEGAdvertising variable has the expected negative sign and is significant in all the models. That is, as postulated in H1.5, the greater the franchisee autonomy on local advertising decisions, the smaller number of terminations. This means that by allowing franchisees to use their own marketing ideas on advertising, franchisors may benefit from their local experience without enhancing the chances of misbehaviours. In fact, the franchisees autonomy ends up in fewer terminations here. However, the other two decision variables regarding merchandising (product-mix and outlet decoration) are not significant. Hence, H1.3 and H1.4 are not supported.

Finally, the DELEGPersonnel variable has the expected negative sign, but it is not significant. Therefore, although personnel decisions seem to require decentralized decision-making, their delegation to franchisees does not seem to influence sufficiently the tension between standardisation and adaptation.

Model 4 adds interactions between franchisees autonomy and the value of the franchisors’ brand name (SIZE). The model provides general support for the argument that the number of cancelations is contingent on the fit between the importance of the brand name and the level of franchisees’ authority (there is a significant change in the explained variance $\Delta R^2=0.121^*$ between Models 3 and 4). Results for the interactive effects also vary with the type of decision right considered.

The interaction of size and the degree of delegation of both assortment and decoration decisions, have a negative and significant effect on contractual terminations. This suggests that as the system becomes larger, differences in market conditions makes local marketing adaptations more advisable. That is, contrary to our expectations, the advantages of decentralizing decision making counterbalance the hazards of free-riding as brand value increases. Hence, as pointed by Kaufmann and Eroglu (1999), centralization of these decision rights seems to be critical in early stages (when franchisor still have a low valuable brand) in order to assure uniformity and to achieve consistent business formats.

Finally, our results do not support both H2.1 and H2.2. Thus, contrary to our expectations, brand-name value does not aggravate the relationship between pricing autonomy and franchise terminations (H2.1). Similarly, we cannot confirm that system size would make delegation of personnel management more desirable. In contrast, although it is not significant, the coefficient for this interactive effect turns positive in Model 4.

$^4b_9= -.517^* \text{ (Model 3)} \text{ and } b_9= -.618^* \text{ (Model 4)}.$

$^5b_{12}= -.736^* \text{ (Model 4)} \text{ and } b_{13}= -.943^* \text{ (Model 4)}.$
4. CONCLUSIONS

This paper analyzes the relationship between the decision-making structure of franchise chains and their performance. To this end, we explore performance in terms of the number of conflicts that end up in early terminations by the franchisors.

Chain operators may try to mitigate franchisees’ misbehaviors by constraining their decision-making capacity. However, besides being costly to implement, such restrictions deteriorate the franchisees’ motivation and their ability to adapt to local variations. At this point, it is important to realize that operational decisions susceptible of delegation strategically differ on their capacity to address this conflict of interests, a consideration that has often been disregarded.

In this sense we argue that, contrary to pricing and personnel decisions, the delegation of “merchandising decisions” (assortment, decoration and local advertising) will balance the conflicting forces of control and autonomy, reducing early terminations. We also claim that, the relationship between franchisees autonomy and chain performance (whether it is positive or negative) will be moderated or intensified by the value of the franchisor brand-name.

Our results seem to support both arguments. First, we observe direct effects of different signs for our decision variables. In fact, delegation of pricing decisions increases terminations within the chain, whereas franchisees’ autonomy on local advertising decisions has the opposite effect, i.e. it reduces conflict and then franchise terminations.

Second, the influence of brand-name value as a moderator variable is not always supported. Nevertheless, we found empirical evidence for its positive and moderator effect when it interacts with assortment and decoration decisions. Thus, the flexibility advantages resulting from allocating these two decisions on franchisees tend to overcome misbehaviors more easily in large systems, even if brand name is valuable. This is especially true in the case of decoration autonomy, since its sole influence on franchise termination is not significant.

Finally, we also observe that the sole effect of brand-name value is not significant, whereas the degree of tacitness of the franchisor’s business practices increases significantly early terminations.

Although this study is not without limitations, we hope it provides theoretical and practical insights about decision-making authority in franchising. First, a larger sample would be desirable, however it was difficult to get companies eager to collaborate and to grant access to their private information. Secondly, some of the variables used are proxies for real effects and thus they are not perfect measures. Also franchise systems may differ in terms of the distinction between core and peripheral elements. Finally, we are interested in checking how terminations by the franchisor differ from those initiated by the franchisees and in exploring the interaction between decision-making structures with other organizational characteristics of the chain.
5. REFERENCES


