

DECISION-MAKING AUTHORITY IN FRANCHISING

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Abstract

This article provides evidence on the determinants of decision right delegation in franchise relationships. We suggest that the franchisor chooses the level of delegation to leverage the intangible assets of franchisees and, simultaneously, to preserve the value of the brand name. While the empirical literature on franchising has studied these effects separately, we consider them together in a general model on decentralization. The results show that the greater the franchisor's contribution to the business and the weaker inter-firm trust, less autonomy will be allocated to franchisees. We also obtain an unexpected negative effect of specificity on autonomy.

Keywords: delegation, franchisee autonomy, self-enforcement, relational governance.

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1 Introduction

A key issue for franchisors in managing relationships with franchisees is to balance the conflicting forces of control and autonomy. In fact, the delegation of decision rights is an essential component of the organizational design of franchise chains. Nevertheless, the degree of delegation is not fully developed in the research agenda for the field of franchising.

On the one hand, excessive restraints on outlet operation may lessen the intrinsic motivation of franchisees seeking autonomy (Dant and Gundlach, 1999). Furthermore, excessive centralization may prevent leverage of franchisee outlet-specific know-how (Windsperger, 2004). But, on the other hand, increasing levels of autonomy may give rise to the agency problems of free-riding in franchise networks. In fact, decentralization is not homogeneous across different chains, reflecting a variety of responses to these trade-offs.

This paper investigates this topic by empirically testing a model that simultaneously considers the influence of these competing variables on franchisee autonomy. Our study contributes to the literature in the following ways. First, although past work has investigated appropriate functional areas for the autonomy of franchisees, distinguishing core and peripheral elements of the system (Kaufmann and Eroglu, 1999), little is known about how this delegation is actually crafted. There are some case studies (Bradach, 1997; Pizanti and Lerner, 2003; Azevedo, 2007) that examine the balance between control and autonomy. There is also some empirical evidence of the importance of the knowledge advantage to decide the proper allocation of decision rights (Windsperger, 2004; Azevedo, 2007). But these studies are focused either on a single industry or variable. We build on these results adding explanatory variables related to self-enforcement*. Determining the nature of the interaction between formal and informal (i.e. relational) mechanisms of governance is not a central part of our study. However, our analysis provides evidence on the substitution effect of trust for formal restrictions on franchisee autonomy.

Additionally, this work has implications for managers responsible for organizing decision-making processes within the chain. In order to confer autonomy on their franchisees, they should be aware of the linkage among the contractual clauses, the structural conditions and the relational governance processes that shape the need for close coordination.

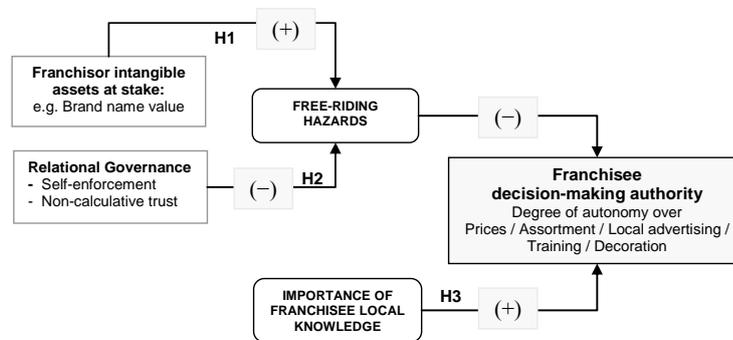
The remainder of the paper is organized as follows. After this introduction, section two deals with the theoretical bases of our explanatory model for franchisee autonomy. The data-gathering process, the sources of information used and the econometric models adopted are discussed in the third section, and the results and conclusions of the study are set out in the fourth and fifth sections respectively.

* Cochet et al. (2008) also examine the relationship between relational governance and decentralization in franchise chains, but their econometric model is constructed to explain relational governance instead of delegation.

2 Control versus autonomy in franchise relationships

According to transaction cost theories, optimal equilibrium is necessary between franchisees' decision rights and franchisor control to develop the brand name of products and services (goodwill) as well as efforts in production and distribution (sales). That is, franchisors delegate decision rights to franchisees because they have valuable, private knowledge about local trading conditions. Nevertheless, the hazards of free-riding on the common trademark constrain franchisees' authority for managing their outlets. Following on from these arguments, the aim of our work is to empirically analyze the determinants of *franchisees' decision-making authority* as a basic feature of the franchise relationship. The figure below summarizes our empirical model.

Fig. 1 Hypotheses scheme



2.1 Franchisee autonomy and free-riding hazards

It is widely accepted that franchising is an efficient organizational response to the shirking problems faced by a chain of geographically dispersed units. Franchisees are local entrepreneurs that pay an up-front franchise fee and ongoing royalties in exchange for the right to use the brand name and operating system of the franchisor. As outlet owners, franchisees have a claim on the profits generated by their franchised outlets. Consequently, they are endowed with high-powered incentives so they have every reason to be more motivated than hired managers (who, typically, receive compensation in the form of a salary and bonuses) (Caves and Murphy, 1976; Rubin, 1978; Mathewson and Winter, 1985; Brickley, Dark and Weisbach, 1991; Lafontaine, 1992; Shane, 1996). Nevertheless, this higher

motivation comes at the cost of an increase in free-riding problems: To maximize their private results, franchisees could free-ride on other units, withholding effort or reducing costs while counting on other franchisees to invest in quality to maintain the brand name of the system (Klein, 1980; Lafontaine, 1992; Bercovitz, 2004; Garg, *et al.* 2005). In sum, the franchisees' status as residual claimants is precisely what promotes their tendency to free-ride on the brand name (Lafontaine and Raynaud, 2002; Bercovitz, 2004).

Therefore, once franchising has been selected as a vehicle for growth, franchisors must decide how to manage franchisees in order to maintain uniformity across units and thereby to preserve brand name value (Caves and Murphy, 1976; Rubin, 1978). The allocation of decision rights in the chain –i.e. the degree of franchisee autonomy– is a basic control mechanism to deal with this problem. That is, the franchisor may achieve the required standardization across outlets by increasing the degree of control over decisions. Specifically, franchisors may retain the “legal” or “formal” rights to decide by prescribing a large number of very detailed tasks that franchisees must perform in each outlet. These prescriptions can be incorporated either in the franchise manual or in contractual clauses. Additionally, the intensity of monitoring of franchisees (e.g. inspection and auditing rights, advertising approvals, recommendations...) and also franchisors' private information on the business environment may affect franchisors' effective control over decision-making (Azevedo, 2007).

Nevertheless, the *level* of the free-riding hazard depends on two factors, both the value of the franchisor's intangible assets at stake (i.e. the common brand name) and the spillover potential associated with customer mobility (Brickley and Dark, 1987; Klein, 1995). For instance, stronger brand-names enable franchisees to sell products at higher premium prices, making free-riding more attractive. Likewise, if negative reputation effects (caused by the substitution of lower quality inputs) are largely dispersed across outlets, returns to cheating and thus the threat of free-riding will be higher. Summarizing, in circumstances where the brand-name value or the spillover potential makes free-riding appealing, we would expect a significant reduction in franchisee autonomy. Thus, the following hypothesis:

H1: *The higher the value of the franchisor's intangible assets at stake, the lower the franchisee autonomy.*

2.2 The role of relational governance on franchisee autonomy

Relational contracts are characterized by the fact that they rely little on what is written down, and disputes are settled with reference to informal or social norms[†]. Accordingly, relational governance can be defined as the “informal agreements and unwritten codes of conduct that powerfully affect the behaviour of individuals (Baker *et al.*, 2002, p. 39)”[‡]. Scholars have realized that such informal codes of conduct can be both economic and sociological in nature (Dyer and Singh, 1998; Poppo and Zenger, 2002). On the one hand, economists have pointed to self-enforcement as the principal mechanism by which relational governance operates (Klein and Leffler, 1981; Williamson, 1985). In general, self-enforcement acts by making profits obtained in the long term, if the relationship is maintained, exceed those that can be obtained in the short term from opportunistic behavior (Klein, 1996; Klein and Leffler, 1981). Therefore, performance will not be secured here by the threat of legal enforcement but by the threat of termination of the business relationship. On the other hand, the sociology literature has pointed out the value of the social norms that emerge from previous trade, such as *reciprocity* and *social embeddedness*, in prompting dealer cooperation in the present, even if it is not in their self-interest to do so (Gulatti, 1995; Nooteboom, et al. 1997; Uzzi, 1997). Nonetheless, both perspectives (economic and sociological) agree that relational governance is sustained by the *trust* that emerges from the norms and values encouraged by repeated exchange (past or future) among traders[§].

Within the context of inter-firm relationships, trust can be broadly defined as “an organization’s expectation that another firm will not act opportunistically” (Bradach and Eccles, 1989). Scholars have long understood that this trust (whether “calculative” or “non-egoist”) may serve as an informal safeguard that facilitates complex exchange and enhances performance. This is because goodwill trust ultimately fosters behavioral norms of flexibility, solidarity and information exchange among individuals, thereby reducing transaction costs and facilitating coordination (Dyer and Singh, 1998; Poppo and Zenger, 2002). Moreover, recent papers have found that relational governance is a good substitute for formal contracts (Gulatti and Nickerson, 2008; Mesquita and Brush, 2008). Indeed, the pres-

[†] Relational governance has been examined from a wide array of disciplinary viewpoints. For a review of this diverse literature, see, e.g., Milgrom and Roberts (1992) Williamson (1996), Baker, Gibbons & Murphy (2002), Goldberg (1980), Macaulay (1963) and Levin (2003).

[‡] See also Dyer and Singh (1998); Poppo and Zenger (2002); Gulati and Nickerson (2008), Mesquita and Brush (2009).

[§] The distinction between the roles of expected future trade and social norms as alternative forces supporting trust (i.e. relational governance) has produced a theoretical distinction between a “calculative” and a “non-egoist” form of trust respectively (Williamson, 1993, Nooteboom, 1997).

ence of trust may make complex contracts unproductive or redundant, since it may offer a less costly safeguard**.

From this point of view, for franchising relationships, it has been suggested that if there are efficient relational mechanisms for dealing with the free-riding hazards of franchisees, the franchisor will use less formal (or less hierarchical) controls over decision-making processes, conferring greater franchisee autonomy. Particularly, such informal safeguards will operate when franchisees refrain from opportunistic actions to preserve their “reputation capital” and avoid the termination of a valuable, long-term franchise agreement. Previous studies have found some evidence on this topic. Thus, Cochet *et al.* (2008) construct a model to empirically explain the intensity of relational governance as perceived by franchisees, finding a positive and significant relationship between this perception and their autonomy.

In our model, however, the degree of franchisee autonomy is explained by the intensity of the self-enforcement mechanisms developed by the franchisor. Note that self-enforcement requires two elements to effectively safeguard an agreement. (1) A bond, i.e. a mechanism that creates relation-specific rents that exceed the expected short-term gains from cheating. Specific franchisee investments, territory rights and multi-unit ownership possibilities could provide such a bond (Klein, 1995; Klein and Leffler, 1981; Brickley, 1999). (2) A threat, i.e. a disciplinary device that provides the franchisor with the means to credibly threaten termination of the relationship if opportunistic behaviour is detected (Klein, 1995; Bercovitz, 2003). Shorter durations and extensive termination conditions could achieve this (Klein and Leffler, 1981; Williamson, 1980). In fact, Azevedo (2007) finds that certain factors related to reputation and trust building exert positive effects on the degree of decentralization. We therefore propose that:

H2: *Self-enforcement mechanisms and trust positively affect the degree of franchisee autonomy (decentralization of franchise system).*

2.3 Franchisee knowledge assets and autonomy

The overall result of the franchise system depends not only on the lack of free-riding and shirking hazards (i.e. on the provision of an adequate and sufficient level of effort by franchisor and franchisees), but also on how decision rights are allocated between them in order to capitalize their private and intangible knowledge assets.

** Other authors suggest a *complementary* relationship between the relational and the formal modes of governance (Klein, 1996, 2002; Lazzarini, et al., 2004; Mayer, 2007; Poppo and Zenger, 2002). From this point of view, a firm will not abandon legally enforceable safeguards even though it is increasingly embedded in a relationship of trust with another firm. Nevertheless, we agree with Gulatti and Nickerson (2008) and Mesquita and Brush (2008) that unless inter-firm trust can always *complement* any mode of governance so as to improve exchange performance, relational governance is also a good substitute for a more hierarchical (formal) governance mode.

In order to analyse how responsibilities are allocated throughout the chain, scholars have firstly pointed out that franchise systems are generally characterized by “divergent scale economies”. Therefore, the franchisor will retain control over those tasks that are best centralized and supplied to the entire system (Caves and Murphy, 1976). This usually implies distinguishing between strategic and operative decisions. The former are mostly made by the franchisor (commonly cited examples are national advertising, site selection, and product development). The latter include marketing tasks (price, assortment, promotions...), human resources management, and procurement decisions, which may be allocated either to the franchisor or the franchisee.

Following the property rights approach, the degree of decentralization of operating decisions will depend on the “anticipated gains from leveraging the franchisee’s specific knowledge” (Windsperger, 2003; Azevedo, 2007; Cochet, 2008). It is suggested, particularly, that the responsibility for a decision must be matched with the agent who owns the knowledge that is valuable for that decision (Jensen and Meckling, 1992). If the valuable knowledge about the local market is not specific to the franchisee, it could easily be communicated to the franchisor and the decision would be centralized. Nevertheless, when the decision-making requires more outlet-specific know-how, it will be efficiently decentralized to the franchisees (Jensen and Meckling, 1992; Windsperger, 2004).

Additionally, if the franchisor retains too much authority, franchisees may lack incentives for appropriate use of their local knowledge. Although they are only semi-independent owners, as entrepreneurs they expect to be endowed with authority (Peterson and Dant, 1990; Dant and Gundlach, 1999; Cochet, et al., 2008). Thus, the more autonomy franchisees have, the more incentives they will have to search for innovative solutions. Although decisions adopted by franchisees are likely to be biased towards their own interests, they nevertheless may bring about savings in research costs that would otherwise be incurred by the franchisor (Azevedo, 2007).

In sum, if the private, relevant knowledge for decision-making is held by franchisees, it will be desirable to allocate decision rights throughout the chain. On the contrary, if franchisor’s private knowledge is more important, there will be limited gains from delegation. As a result, the following hypothesis can be put forward.

H3: *The more important the franchisees’ outlet-specific knowledge compared to the franchisor’s system-specific know-how, the more decentralized the franchise system will be.*

3 Data and procedures

The dataset contains information from a survey on Spanish franchising carried out by the authors in 2008. Questionnaires were sent to firms previously taken from the two main professional guides edited in Spain (Tormo 2008 and Bar-

badillo 2008). 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.

In total, 870 questionnaires were sent out. The response rate was about 20%, but 4 of the respondents had closed down. Of the active respondents, 19 used alternative forms of distribution such as licensing. Finally the sample covered 163 franchise chains.

The dataset was compiled for the purposes of a broader research project on franchising contract design. It provides information on (a) the franchise chain as a whole, including advertising expenditure, degree of specificity of investments per outlet, customer loyalty (b) franchisee profile in terms of selection and training (c) and contractual clauses related to the degree of delegation, monitoring and enforcement terms.

Dependent variable

The paper aims to analyze the determinants of franchisees' decision-making authority. Our proxy for the level of delegation is built on franchisor ratings for the level of authority they consider their franchisees to have. Particularly, franchisors rated (on 5-point Likert scales) their franchisees' authority regarding five operative decision rights: a) pricing, b) assortment, c) local advertising, d) decoration and e) employee training^{††}.

By adding up the scale values for the five items, we obtained a summated index for the level of franchisees' autonomy within each chain. The reliability of the index was assessed by Cronbach's alpha. The value of 0.660 exceeds the limit of acceptability for newly-developed scales set at 0.6 (Hair *et al.*, 1998).

Independent variables

The theoretical explanatory variables are related to the potential free-riding hazards of the franchise relationship and to the importance of franchisees' local knowledge. They were operationalized as follows.

Firstly, for H1 and to capture the effect of the value provided by the franchisor, we used the brand-name value. To identify its effects, we included the franchisor's advertising expenses per outlet. We also included the value of other knowledge and intangible assets provided by the franchisor but not integrated in the brand name. To proxy the importance of these intangible assets, we used the percentage of the franchisor business devoted to franchising and the number of franchisor employees at the headquarters. These variables are intended to estimate the significance of franchisor knowledge assets derived from (1) his specialization in the franchising business and (2) his investment efforts in labour. The number of headquarter employees can also measure the effect of size on centralization. In fact, very small firms are much less likely to hold complex contracts (i.e. contracts needed to formally restrain franchisee autonomy) than bigger ones. In part, this

^{††} The results of a principal component factor analysis confirmed that these characteristics were part of single higher-order construct (*decision-making authority*). All variables had a loading in excess of 0.51. The total amount of variance explained by the factor solution is 43.81%.

may reflect informality and an absence of bureaucracy, but it is more likely to be due to a lack of legal expertise (Lyons, 1994). That is, small firms do not have the minimum efficient scale (MES) to sustain legal staffs to deal with the job of formalizing and supervising franchisees' tasks.

Secondly, as suggested in H2, incentives for free-riding are shaped by relational governance mechanisms that alienate franchisor and franchisee interests, making opportunism less appealing. In fact, free-riding hazards might diminish if self-enforcing mechanisms were in place. We included as explanatory variables for self-enforcement both economic hostages and disciplinary devices. In franchise relationships, particularly, specific investments and multi-unit ownership possibilities might play the role of a "hostage" in the transaction, credibly committing the franchisee in the contract (Williamson, 1983; Bai and Tao, 2000; Bercovitz, 2004a). Additionally, there is a need for disciplinary devices to make self-enforcing necessary and we consider the possibilities of relationship termination to capture this effect. Finally, we also include the past experience of the franchisor with its franchisees as a proxy for the non-calculative form of trust that determines their relationship.

- We measured specific investments using a Likert-type scale. We asked franchisors which percentage of their investments franchisees would lose if they closed down. Such sunken investments could act as hostages preventing opportunism. Interaction effects are also possible. We expect the level of specificity to increase with the size of the initial investments. Accordingly, we include the interaction term between the level of specificity and initial investment.
- We measured multi-unit ownership possibilities and termination at will using a dummy variable to show whether or not the franchisor offered additional licenses to standing franchisees (1=yes) and whether they can terminate the franchise agreement without penalization (i.e. after an initial term, parties can rescind the contract with the sole requisite of prior notice) (1=yes).
- To approximate the importance of other non-egoist forms of trust we used the age of the chain –i.e. number of years franchising–. The assumption behind this is that this form of trust arises from previous contacts and dealings (*Gulatti, 1995*). Companies with more franchising experience tend to have older franchisees. As a consequence, they may develop a non-calculative form of trust giving rise to a relational mechanism of governance not captured in our other self enforcement proxies..

Finally, as suggested in H3, the required autonomy is expected to depend not only on free-riding hazards but also on the importance of franchisees' local knowledge. If the franchisor retains too much authority, franchisees may lack incentives for the appropriate use of local specific knowledge or, simply, they may have no means to apply it in the decision-making processes. To identify the importance of franchisee local knowledge, we used sector dummies and the amount of initial investment – i.e. the amount paid to install the outlet.

Three dummy variables represent the sub-sectors typically identified in franchising: restaurant, retailing and service industries. We assume that services and restaurants require franchisee expertise to satisfy local demands. Retailing is much more standardized because the product is centrally produced. Retailing franchising firms possess a higher proportion of intangible system-specific assets of the franchisor compared to the intangible local market assets of franchisees (Windsperger, 2003). In fact, some authors suggest that monitoring difficulty increases as one moves from product to combined product/service offerings (Williamson, 1981).

Additionally, larger investments may imply a greater variety of tasks that the franchisee has to deal with, thus requiring more local coordination at the outlet level (Azevedo, 2007) and indicating that local knowledge is more important. As a result, we expect initial investment to have a positive effect on autonomy.

4 Methods and results

Table 2 presents descriptive statistics on the variables. The dependent variable shows a high range of scores, from 1.2 to a maximum of 5 (mean=2.97, SD=0.80). This variance across chains shows us that our scale captures “true” autonomy aspects and not a common feature to all franchising business.

Our dependent variable was a summated scale of different aspects of franchisees’ decision-making. The structure of each decision right is presented in Table 1. Franchise chains tend to decentralize but there are slight differences depending on the nature of the decision rights. Similarly to Windsperger (2004), we observe that decisions on human resources and local marketing are more decentralized, and assortment, price and decoration choices are more centralized. So franchisees retain higher residual rights over daily decisions that are more related to outlet-specific know-how while the franchisor exercises more control over variables that affect homogeneity.

Table 1. Decision-making autonomy in different areas

	N	Minimum	Maximum	Mean	Standard deviation
Assortment autonomy	166	1	5	2.75	1.37
Pricing autonomy	165	1	5	2.78	1.37
Local advertising autonomy	164	1	5	3.65	1.10
Decoration autonomy	165	1	5	2.16	1.09
Training autonomy	165	1	5	3.5	1.17

Collinearity diagnosis was performed using correlations between the independent variables and VIF statistics. The high correlations among some of the variables and the excessively large VIF statistics ($VIF > 10$) made it desirable to separate those variables in several independent estimations. Table 2 shows bivariate Pearson correlations between the predictors.

Table 2. Pearson correlation coefficients and descriptive statistics

	Mean	S.D.	1	2	3	4	5	6	7	8
1	3	1.559								
2	105293	14064	0.20*							
3	1.96	.20	0.06	0.11						
4	1.56	.50	-0.14	-0.17*	0.06					
5	11.736	38.441	-0.03	0.12	0.04	-0.03				
6	85	28	0.09	0.10	-0.10	-0.07	-0.10			
7	143	807	-0.01	0.33**	-0.00	-0.15	0.5**	-0.14		
8	10	12	-0.06	-0.22**	-0.08	0.02	-0.02	0.23**	-0.03	
9	0.63	0.48	0.10	0.15	-0.11	-0.26**	-0.06	0.18*	0.10	-0.0

1. Specific investments (%) 2. Franchisee investment 3. MUF possibility 4. Termination at will possibility
5. Advertising expense /outlet 6. Percentage of business devoted to franchising 7. Number of franchisor employees 8. Years franchising 9. Retailing sector

* $p < 0,01$ (two-tailed) ** $p < 0,001$ (two-tailed)

To test our hypotheses, we carry out a regression analysis (OLS) with the index of decision rights as the dependent variable. Table 3 presents the results of 5 models with different specifications.

As expected, the three variables that measure the franchisor brand name and, overall, the franchisor's intangible assets at stake –advertising expenses per outlet, percentage of the business devoted to franchising and the size of the franchisor's headquarters— have a robust, negative effect on the level of delegation. If brand-name value is higher, the potential costs of delegation are greater, decreasing the allocation of authority to franchisees. Autonomy varies negatively with advertising expenses as expected in our brand-name value hypothesis. This result is coherent with Windsperger (2004) results although he used advertising fees to measure this effect. Moreover, the greater the importance of franchisor knowledge, the fewer the advantages of allocating decision rights to franchisees.

The data lent partial support to our self-enforcement hypotheses that anticipate a positive relationship between the different self-enforcing measures and decentralization. In fact, two of the three variables that proxy the self-enforcement range are statistically significant and one of them has the opposite sign.

As expected, the variable that approximates the relational governance sustained by the trust arising from past relationships –years franchising—has a positive ef-

fect on the level of delegation, as found by Azevedo (2007). That is, as the franchisor's experience with franchisees increases, so does franchisees' autonomy. However, the influence of multi-unit ownership possibilities is not statistically different from zero. Likewise, although it has the expected positive sign, the coefficient of the "termination at will" variable is not significant. This clause imposes a disciplinary device in case of misbehaviour. But it may not affect the degree of delegation because contract termination is actually so difficult (Bradach, 1997) that franchisors need other mechanisms to prevent opportunism and rarely have to enforce that clause.

Table 3. OLS estimations.

Dependent variable: 5-point scale measuring the degree of franchisee authority concerning: a) Price; b) Assortment; c) Local advertising; d) Decoration; e) Workforce training

	Model 1	Multicollinearity control			Interaction effect (% specific investment * Initial Investment)
		Model 2 Excludes variables with small Tolerance index	Model 3 Coefficients for collinear variables	Model 4 Coefficients for collinear variables	Model 5
Constant	21,067*** (4,330)	20,490*** (3,907)	15,488*** (1,116)	14,592*** (0,409)	19,827*** (3,96)
Z-Specific investments (%)	-0,160 (0,413)	-0,202 * (0,392)	--	--	-0,184 * (0,398)
Z-Franchisee investment	0,032 (0,452)	0,036 (0,364)	--	--	-0,047 (0,478)
Z-Specific investments (%) * Z-Franchisee investment	--	--	--	--	0,125 (0,427)
MUF possibility	-0,111 (1,761)	-0,103 (1,752)	--	--	-0,095 (1,758)
Termination-at-will possibilities	0,122 (0,801)	0,140 (0,768)	--	--	0,155 (0,778)
Advertising expense per outlet (brand name value)	-0,265*** (0,000)	-0,321*** (0,000)	--	--	-0,305 ** (0,000)
Percent of business devoted to franchising (No-Diversification)	-0,265** (0,015)	-0,232** (0,014)	--	--	-0,229 ** (0,014)
Number of franchisor employees (head- quarter size)	-0,157 (0,013)	--	--	-0,153 * (0,000)	--
Years franchising	0,189 * (0,048)	--	--	0,100 (0,025)	--
Sector: Retailing	-0,127 (1,364)	--	-0,237 * (0,915)	--	--
Sector: Services	0,190 (1,365)	--	0,219 * (0,885)	--	--
	N: 96 F: 3,159** Adjusted R ² : 0,18	N: 101 F: 4,342*** Adjusted R ² : 0,17	N: 163 F: 2,47* Adjusted R ² : 0,018	N: 147 F: 2,422* Adjusted R ² : 0,018	N: 101 F: 3,871*** Adjusted R ² : 0,17

On the other hand, contrary to our expectations, the level of specific investments negatively affects decentralization. One plausible explanation is the two-sided moral hazard nature of franchise relationships. Franchisees' specific investments make them more vulnerable to hold-up risks. To mitigate such hazards they could demand more complex, formalized contracts. Such complex contracts may be better at ensuring the franchisor makes sufficient effort but at the cost of flexi-

bility and, therefore, autonomy for the contracting parties. Note also that the interaction term of the amount of specific investments is not a significant moderator variable.

Finally, hypothesis 3 regarding the relative importance of franchisees' knowledge is partially supported. Compared to the restaurant sector, within the retailing industry the level of franchisees' autonomy seems to be lower. The explanation is that retailing is more standardized and so it requires less franchisee knowledge to satisfy local demands. Nevertheless, the size of the initial investments does not condition the level of autonomy. .

5 Conclusions

This paper analyzes the allocation of decision rights in franchise chains. Our results show that franchisors that invest more in their system by providing a valuable brand name, by specialising in the franchise chain (not diversifying) and/or by developing larger headquarters tend to restrict more franchisee's decision rights. So the risk of free-riding and the firm-size effects appear to be determinant in the degree of decentralization.

The requirements of standardization under the common trademark to preserve homogeneity constrain franchisees from fully using their human capital. As a result, they cannot fully profit from their knowledge of local conditions. Moreover, according to our results, the variables that estimate the value of this information have a weak effect in determining the decision rights the franchisor decides to delegate. However, our industry proxies may not fully capture the importance of franchisee activity. Additionally, it is possible to have high levels of resource and domain-specific autonomy in certain areas and, simultaneously, high levels of dependence on other domains (Dant and Gundlach, 1999). So, the importance of franchisee knowledge might affect autonomy in other areas of daily operations not captured in our dependent variable, such as customer service.

Our results also provide evidence on the value of trust as an informal safeguard that can assure franchisee performance. In fact, the duration of previous franchise relationships appears to favour the degree of decentralisation. Since trust emerging from past dealings appears to be related with less formalized franchisee tasks, our result supports the idea that relational governance may substitute for formal mechanisms of governance. In contrast, our findings do not confirm the value of franchisees' specific investments as an economic hostage able to guarantee their performance. On the contrary, franchisees' specific investments appear to introduce more formal restrictions and controls over them.

Finally, while our study renders new insights about decision-making authority in franchising, it also has limitations. It is possible that the effect of our variables would be different depending on the particular decision right considered. Future research should also investigate the relationship between the franchisor's policy decisions on decentralisation and performance of franchise systems.

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