REFGOV

Reflexive Governance in the Public Interest

Institutional Frames for Markets

Delegation and Autonomy in Franchising

By Begoña López-Fernández and Susana López-Bayón

Working paper series : REFGOV-IFM-79

Delegation and Autonomy in Franchising

Begoña López-Fernández and Susana López-Bayón*

Abstract. This article provides evidence on the determinants of delegation of decision rights in franchise relationships. We suggest that the franchisor chooses the level of delegation to leverage the intangible assets of the franchisees and the franchisor 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 model on decentralization. The results show that the franchisee's autonomy varies negatively with the franchisor's intangible assets and brand name and positively with the inter-firm trust and the franchisees' intangible assets. Finally, autonomy also varies negatively with the specific investments of the franchisees.

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 net-

* Begoña López-Fernández / Susana López-Bayón, Facultad de CC. Económicas y Empresariales, Universidad de Oviedo, Avda. del Cristo, s/n, 33071 Oviedo, Spain; blopez@uniovi.es, sbayon@uniovi.es

Acknowledgments. This research has received support from the MCYT, through grant SEJ2007-63706/ECON, and from the EU's Framework Programme for Research and Technological Development through grant CIT3-513420.

works (Manolis et al., 1995). 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 factors on franchisee's 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 1998), little is known about how this delegation is actually crafted. There are some case studies (Bradach 1997; 1998; Pizanti and Lerner 2003; Azevedo 2009) that examine the balance between control and autonomy. There is also some empirical evidence on the importance of the knowledge advantage to decide the proper allocation of decision rights (Windsperger 2004; Azevedo 2009). But these studies are focused either on a single industry or variable. We build on these results by adding explanatory variables related to self-enforcement [1]. Although investigating the interaction between formal and informal (i.e. relational) mechanisms of governance is not a central focus in our study, our analysis provides evidence on the substitution effect between trust and formal restrictions on franchisee's 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. Section two deals with the theoretical bases of our model for explaining franchisees' 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.

2 Control versus Autonomy in Franchise Relationships

The delegation of decision rights to the franchisees depends on the free-riding hazards, the role of self-enforcement mechanisms and the importance of the franchisees' and franchisor's intangible assets. Franchisors delegate decision rights to franchisees because they have valuable knowledge about the local market environment. On the other hand, the hazards of free-riding on the common brand name constrain franchisees' authority for managing the local outlets. However, self-enforcement mechanisms reduce this opportunism risk.

---

1 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.

2.1 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 and hence they are more motivated than managers of company-owned outlets (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, the transfer of ownership rights may result in an increase in free-riding problems: To maximize their individual profits, 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, 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 the brand name value (Caves and Murphy 1976; Rubin 1978; Bradach 1997). 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, recommendation) may affect franchisors' effective control over decision-making (Azevedo 2009).

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 risk of free-riding will be higher. Summarizing, in circumstances where the brand-name value results in high free-riding risk, 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 Relational Governance and 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[2]. 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)" [3]. 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 is effective if the profits from the relationship-specific investments exceed those that can be realized from short-term opportunistic behavior (Klein 1996; Klein and Leffler 1981). Therefore, performance will not be assured 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 social norms that emerge from previous trade, such as *reciprocity* and *social embeddedness,* in prompting dealer cooperation in the present (Gulati 1995; Nootebom et al. 1997; Uzzi 1997). Consequently, both perspectives (economic and sociological) conclude that relational governance is sustained by the *trust* that emerges from the norms and values encouraged by repeated exchange (past or future) among traders[4].

Within the context of inter-firm relationships, scholars have long understood that 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 (Gulati and Nikerson 2008; Mesquita and Brush 2008). In this case, the presence of trust may make complex contracts unproductive or redundant, since it may offer a less costly safeguard[5].

---

2 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), Goldberg (1980), Baker, Gibbons and Murphy (2002), Levin (2003).

3 See also Dyer and Singh (1998), Poppo and Zenger (2002), Gulati and Nickerson (2008), Mesquita and Brush (2009).

4 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 et al., 1997).

5 Other authors suggest a *complementary* relationship between the relational and the formal modes of governance (Klein 1996, 2002; Poppo and Zenger 2002; Lazzarini et al. 2004; 2007). From this point of view, a firm will not abandon legally enforceable safeguards even

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 and Leffler 1981; Klein 1995; 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 2004). Shorter contract duration and extensive termination conditions could achieve this (Klein and Leffler 1981). We therefore propose that:

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

2 3 Knowledge Assets and Autonomy

The residual income 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 the partners, due to the franchisor's and franchisees' intangible knowledge assets.

In order to analyse how responsibilities are allocated throughout the chain, scholars have 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 operational decisions. The former are mostly made by the franchisor (commonly cited

---

though it is increasingly embedded in a relationship of trust with another firm. Nevertheless, we agree with Gulati 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.

examples are national advertising, site selection, and product development). The latter include marketing tasks (price, assortment, promotion), 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 operational decisions will depend on the anticipated gains from leveraging the franchisee's specific knowledge (Windsperger 2004; Cochet 2008; Azevedo 2009). It is suggested, particularly, that the responsibility for a decision must be matched with the agent who has the relevant 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. On the other hand, when the decision-making requires more outlet-specific know-how, it will be more decentralized (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 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 search costs that would otherwise be incurred by the franchisor (Azevedo 2009).

In sum, if the franchisees intangible knowledge assets generate a high residual income for the network, it is desirable to allocate a high portion of decision rights to the franchisees. On the contrary, if franchisor's intangible system 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 Barbadillo 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 provides information on the franchise chain as a whole, including advertising expenditure, degree of specificity of investments per outlet, customer loyalty, franchisee profile in terms of selection and training 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[6]. By adding up the scale values for the five items, we obtained a summated index for the level of franchisees' autonomy within each chain.

Independent variables

The 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 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 (Lafontaine and Shaw 2005). We also included the value of other knowledge assets provided by the franchisor but not integrated in the brand name. As proxy for 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 his specialization in the franchising business. In addition, the number of employees may indicate that system-specific knowledge is very important for the generation of the residual income. Large firms can better control the local outlets than small firms. Small firms do not have the minimum efficient scale (MES) to sustain 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 1993; Bai and Tao 2000; Bercovitz

6 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%.

2004). 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 sunk investments could act as hostages preventing opportunism. 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 by 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-calculative 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 (Gulati 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 the franchisor's and 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.

Three dummy variables represent the sub-sectors typically identified in franchising: restaurant, retail 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. Retail franchising firms possess a higher proportion of intangible system-specific assets of the franchisor compared to the intangible local market assets of franchisees. In fact, it is suggested that monitoring difficulty increases as one moves from product to combined product/service offerings.

4 Methods and results

Table 1 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 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. Retail 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 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 consistent with Windsperger (2004) results. Moreover, the greater the importance of franchisor' system-specific knowledge, the fewer the advantages of allocating decision rights to franchisees.

The data provide partial support to our self-enforcement hypotheses that indicate 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 effect on the level of delegation, as found by Azevedo (2009). 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.

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. The higher the franchisee's investment, the higher is their dependency, and the lower is the franchisor's motivation to transfer more decision rights (as incentives) to the franchisees. In addition, the interaction term is not significant either.

Finally, hypothesis 3 regarding the relative importance of franchisees' knowledge is partially supported. Compared to the restaurant sector, within the retail in-

dustry 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.

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

		Multicollinearity control			Interaction effect (% specific investment * Initial Investment)
	Model 1	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

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 negatively influence 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 exploit the profit opportunities from their knowledge of lo-

cal conditions. Our industry proxies that measure the impact of franchisee's intangible knowledge assets may not fully capture the importance of franchisee local market investments. Additionally, it is possible to have a high level of resource and domain-specific autonomy in certain areas and, simultaneously, a high level of dependence on other domains (Dant and Gundlach 1998). 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. In contrast, our findings do not confirm the value of franchisees' specific investments as an economic hostage resulting in more decentralization.

Finally, while our study offers new insights about decision-making authority in franchising, it also has some limitations. Especially, the measurement of the dependent variable can be improved by including the whole range of operational decisions in the decision index. Additionally, the proxy for the franchisee's intangible knowledge assets must better cover the franchisee's local market know-how. Future research should also investigate the relationship between the allocation of decision rights and performance of franchise systems.

References

Azevedo PF (2009) Allocation of authority in franchise chains. International Studies of Management and Organization, 39(4): 31 – 42

Bai C, Tao Z (2000) Contract mixing in franchising as a mechanism for public-good provision. Journal of Economics & Management Strategy, 9(1): 85 – 113

Baker G, Gibbons R, Murphy KJ (2002) Relational contracts and the theory of the firm. Quarterly Journal of Economics, 117: 39 – 84

Barbadillo S (dir.) (2008) Guía de franquicias de España: Barbadillo Asociados Consultores, S.L., Madrid

Bercovitz JEL (2004) The organizational choice decision in business format franchising. In Windesperger, Cliquet, Hendrikse and Tuunanen (Eds.), Economics and management of franchising networks (pp. 38 – 68), New York: Springer-Verlag

Bradach JL (1997) Using the plural form in the management of restaurant chains. Administrative Science Quarterly, 42: 276–303

Bradach JL (1998) Franchise Organizations. Boston, Ma.: Harvard Business School Press.

Brickley J (1999) Incentive conflicts and contractual restraints: Evidence from franchising. Journal of Law and Economics, 42: 745 – 774

Brickley J, Dark FH (1987) The choice of organizational form: The case of franchising. Journal of Financial Economics, 18: 401 – 420

Brickley JA, Dark FH, Weisbach MS (1991) An agency perspective on franchising. Financial Management, 20: 27 – 35

Caves R, Murphy W (1976) Franchising: Firms, markets, and intangible assets. Southern Economic Journal, 42: 572 – 586

Cochet O, Dormann J, Ehrmann T (2008) Capitalizing on franchisee autonomy: Relational forms of governance as controls in idiosyncratic franchise dyads. Journal of Small Business Management, 46(1): 50 – 72

Dant RP, Gundlach GT (1998) The challenge of autonomy and dependence in franchised channels of distribution. Journal of Business Venturing, 14(1): 35 – 67

Dyer J, Singh H (1998) The relational view: Cooperative strategy and sources of interorganizational competitive advantage. Academy of Management Review, 23: 660 – 679

Garg VK, Rasheed AA, Priem RL (2005) Explaining franchisors' choices of organization forms within franchise systems. Strategic Organization, 3(2): 185 – 217

Goldberg VP (1980) Relational exchange: economics and complex contracts. American Behavioral Scientist, 23: 337 – 352

Gulati R (1995) Does familiarity breed trust? The implications of repeated ties for contractual choice in alliances. Academy of Management Journal, 38: 85 – 112

Gulati R, Nickerson JA (2008) Interorganizational trust, governance choice and exchange performance. Organization Science September-October; 19: 688 – 708

Jensen MC, Meckling WH (1992) Rights and production functions: an application to labor-managed firms and codetermination. Journal of Business, 52(4): 469 – 506

Kaufmann PJ, Eroglu S (1998) Standardisation and adaptation in business format franchising. Journal of Business Venturing, 14: 69 – 85

Klein B (1980) Transaction cost determinants of unfair contractual arrangements. American Economic Review, 70: 356 – 362

Klein B (1995) The economics of franchise contracts. Journal of Corporate Finance, 2: 9 – 37

Klein B (1996) Why hold-ups occur: The self-enforcing range of contractual relationships. Economic Inquiry, 34: 444 – 463

Klein B (2002) The role of incomplete contracts in self-enforcing relationships. In E. Brousseau and J. M Glachant (Eds.), The economics of contracts: theories and application (pp. 59–71). Oxford University Press.

Klein B, Leffler KB (1981) The role of market forces in assuring contractual performance. Journal of Political Economy, 89 (4): 615 – 641

Lafontaine F (1992) Agency theory and franchising: Some empirical results. Rand Journal Economics, 23: 263 – 283

Lafontaine F, Raynaud E (2002) The role of residual claims and self-enforcement in franchise contracting, NBER Working Papers No 8868: National Bureau of Economic Research.

Lafontaine F, Shaw KL (2005) Targeting managerial control: Evidence from franchising. The Rand Journal of Economics, 36(1): 131 – 150

Lazzarini SG, Miller GJ, Zenger TR (2004) Order with some law: complementarity versus substitution of formal and informal arrangements. The Journal of Law Economics and Organization, 20(2): 261 – 298

Levin J (2003) Relational incentive contracts. American Economic Review, 93(3): 835 – 847

Manolis C, Dahlstrom R, Nygaard A (1995) A Preliminary Investigation of. Ownership Conversions in Franchised Distribution Systems. Journal of applied business research, 11(2): 1 – 8

Mathewson F, Winter R (1985) The economics of franchise contracts. Journal of Law and Economics, 28: 503 – 526

Mesquita LF, Brush TH (2008) Untangling safeguard and production coordination effects in long-term buyer supplier relationships. Academy of Management Journal, 51(4): 785 – 807

Milgrom P, Roberts J (1992) Economics, organization and management. Prentice Hall. Englewood Cliffs, New Jersey.
Nooteboom B, Berger H, Noorderhaven NG (1997) Effects of trust and governance on relational risk. Academy of Management Journal, 40(2): 308 – 338
Peterson A, Dant RP (1990) Perceived advantages of the franchise option from the franchisee perspective: empirical insights from a service franchise. Journal of Small Business Management, July, 46 – 61
Pizanti I, Lerner M (2003) Examining control and autonomy in the franchisor-franchisee relationship. International Small Business Journal, 21(2): 131 – 159
Poppo L, Zenger T (2002) Do formal contracts and relational governance function as substitutes or complements? Strategic Management Journal, 23: 707 – 725
Rubin PH (1978) The theory of the firm and the structure of franchise contract. Journal of Law and Economics, 21: 58 – 77
Shane SA (1996) Hybrid organizational arrangements and their implications for firm growth and survival: a study of new franchisors. Academy of Management Journal, 39(1): 216 – 234
Tormo & Asociados (2008) Franquicias: Selina Olmedo, Madrid.
Uzzi B (1997) Social structure and competition in interfirm networks: The paradox of embeddedness. Administrative Science Quarterly, 42: 35 – 67
Williamson OE (1985) The economic institutions of capitalism, The Free Press, New York.
Williamson OE (1993) Calculativeness, trust, and economic organization. Journal of Law and Economics, 36: 453 – 486
Williamson OE (1996) The Mechanisms of Governance. Oxford University Press: Oxford, New York.
Windsperger J (2004) Centralization of franchising networks: evidence from the Austrian franchise sector. Journal of Business Research, 57: 1361 – 1