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„Allocation of Decision Rights in Franchising Networks: An Agency Theoretical Perspective”

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For my daughter Tara
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I) Introduction

“Analytically, franchising is a way to allocate decisions within the franchise system between the franchisor and the franchisee in order to promote efficiency and provide incentives.” This statement of Michael (1996) depicts that franchising is an instrument for allocating decision rights. Commonly franchisees take decisions in the local operations areas, such as hours, prices, and locations, because they have the specific knowledge about local trading conditions. Franchisors usually make decisions regarding the product, its production, and associated marketing efforts that create standardization in order to maintain the value of the trademark. But this allocation varies within the different franchise networks with regard to contents and it is carried out gradually.

Although agency theory is probably the theory which is used the most toy to examine franchising, relatively few agency-theorists have focused on the allocation of decision rights. It seems that especially from the perspective of property rights empirical research on this topic has been done (e.g. Windsperger (2004)). The purpose of this paper is to explain the allocation of decision rights in franchising networks from an agency-theoretical point of view and thus to fill this gap. In the field of centralization of decision rights in franchising, agency theory focuses on the threat of free-riding, monitoring costs and the amount of royalties. The aim is to answer the questions: 1) If franchisors tend to grant the franchisees more decision rights in order to motivate them to induce effort in an environment of high behavioral uncertainty (where monitoring costs are high). 2) If franchisors tend to centralize decision rights in order to protect the value of the brand name when the franchise network has a good reputation, because high value-brand names evoke the threat of franchisees’ free-riding. 3) If franchisors tend to centralize the decision rights in the network when they parallel charge high royalties from the franchisees as a sign for a very centralized system that gets close to company ownership.

The first part is devoted to the topic of franchising and decision rights in general. The second part depicts franchising from an agency perspective. The third part contains the theory of the allocation of decision rights in franchising networks from an agency point of view and includes the 3 hypotheses. Part four provides the empirical analysis of the stated hypothesis and the discussion of the results. Specifically, in the empirical studies we observe on the basis of data from the Austrian, Swiss and the German franchise-sector, the influence of the brand name value (measure for the probability of free-riding\(^7\)), the amount of royalties, and behavioral uncertainty (that escalates monitoring costs\(^8\)) on the allocation of decision rights in franchising networks.

**A) Franchising and Decision Rights**

The aim of this chapter is to explain the topics of franchising and decision rights and the allocation of decision rights in general.

**A.1 Franchising: An Overview**

The driving factor for the use of franchising as a business method is the achievement of operational efficiency.\(^9\) The advantage of franchising is that it permits economies of scale through system wide standardization in the areas of marketing, purchasing, and product development.\(^10\) It also allows profiting from the expertise and responsiveness of small-scale entrepreneurs (franchisees) to adapt to local markets.\(^11\) Additionally the franchisees are more motivated to create profits since

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\(^7\) Azevedo (2009).
\(^8\) Lafontaine et al. (1998:20).
\(^10\) cf. Cochet et al. (2008:50); Dormann et al.(2006:3);Michael (1996:60)
\(^11\) cf. ibid.
residual claimants have higher-powered incentives than salaried outlet managers and thus.\textsuperscript{12}

A.1.1 The Franchise Contract

With the franchise contract a franchisor sells the right to use the franchise-networks brand name, operating methods and product specifications to the franchisee.\textsuperscript{13} The franchisee in return, pays franchise fees as well as advertising fees and royalties\textsuperscript{14} for the right to offer the franchise products or services within a specified region and time period\textsuperscript{15}.

\textit{Royalties} establish a linkage between the success of the franchisee and the franchisor\textsuperscript{16}. They form a percentage of gross sales (typically 5%), to compensate the franchisors for the franchisees’ use of the trademark and associated services\textsuperscript{17} (e.g. training services)\textsuperscript{18}. The royalty rate also acts as a compensation for periodic quality inspections.\textsuperscript{19}

The \textit{franchise fee} is a one-time upfront fee the franchisee pays the franchisor when the franchise contract is signed.\textsuperscript{20} This fee impacts the initial investment and signals relative quality to potential franchisees.\textsuperscript{21}

\begin{flushleft}
\textsuperscript{12} cf. Lopez-Fernandez et al. (2011:3);Rubin (1978); Brickley et al. (1991);Shane (1998)
\textsuperscript{13} cf. Cochet et al. (2008:50).
\textsuperscript{14} Royalties are paid only in business format franchising on which this paper focuses. In traditional franchising no royalty payments are used. Lafontaine et al. (1992:265)
\textsuperscript{15} Combs et al. (2003:443); Lafontaine et al. (1992); Lafontaine et al. (2007:632)
\textsuperscript{17} cf. Michael (1996:57).
\textsuperscript{18} cf. Michael et al. (2008:74).
\textsuperscript{19} cf. ibid.
\textsuperscript{20} cf. Spinelli et al. (1998:46).
\textsuperscript{21} cf. ibid.
\end{flushleft}
The *advertising/marketing fee* is a percentage of gross sales (typically 0 to 6 percent)\(^{22}\) that the franchisee must commit for marketing expenditures.\(^{23}\) The advertising fee drives the economies of scale in marketing.\(^{24}\)

According to Rubin (1978) franchise contracts can include several standard clauses:

1. The franchisor provides differing sorts of assistance to the franchisee such as site selection, training programs, provision of operating manuals, ongoing advice, and advertising. The level of assistance varies from industry to industry.\(^{25}\)

2. The franchisee agrees to run the business in a manner that suits the franchisor and the franchisor may control the franchisees actions regarding products sold, inventory, insurance, personnel, accounting, and auditing.\(^{26}\)

3. In addition to the payment of royalties the franchisee may be compelled to purchase inputs from the franchisor or from approved suppliers.\(^{27}\)

4. The contract can integrate miscellaneous clauses such as a termination clause (whereby the franchisor can terminate the agreement almost at will), the right of the franchisee to sell the franchise, and the right to open a competing business after ceasing to be a franchisee.\(^{28}\)

**A.1.2 Vertical Integration**

Generally within franchise systems there exist company owned and operated outlets besides franchisee owned outlets.\(^{29}\) The number of units owned divided by the total

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\(^{24}\) cf. ibid.
\(^{26}\) cf. ibid.
\(^{28}\) cf. ibid.
\(^{29}\) cf. Brickley et al. (1991:28)
units is called the percentage of vertical integration.\textsuperscript{30} Company owned outlets are vertically integrated while a franchised unit is independent under the law and thus not integrated vertically.\textsuperscript{31} Vertical integration is associated in the literature with concepts such as common governance and leadership, joint planning, and centralized decision making.\textsuperscript{32} Because of these centralized aspects we use vertical integration as an analogy for centralization of decision rights in part D. (Hypothesis).

Agency theory suggests that under conditions of low monitoring costs company owned outlets are more efficient than franchised outlets.\textsuperscript{33} When monitoring costs rise due to behavioral/environmental uncertainty and opportunism, franchise outlets are more efficient because of the incentive effects (residual claims) on franchisees.\textsuperscript{34}

**A.2 Decisions and Decision Rights in Franchising**

The following chapter focuses on the explanation of decisions and decision rights in general and in the case of franchising in particular.

**A.2.1 Decision Rights: An Overview**

Jensen et al. (1992) define a decision right as the right to decide on, to take an action, the “power” to make decisions and to take actions with regards the resources.\textsuperscript{35}

For efficient decision-making specific knowledge is necessary which is costly or difficult to transmit.\textsuperscript{36}

\textsuperscript{31} cf. Lafontaine et al. (2007:632)
\textsuperscript{32} cf. Feng, Hendrikse (2008:20)
\textsuperscript{33} cf. Windsperger, Dant (2006:261)
\textsuperscript{34} cf. Windsperger, Dant (2006:261); Lopez-Fernandez et al. (2011:3)
\textsuperscript{35} cf. Jensen et al. (1992:9).
\textsuperscript{36} cf. Windsperger (2004:1362).
The crucial point is that the person with the specific knowledge should have the right to decide on providing efficiency.\textsuperscript{37} This collocation of decision rights is possible by transferring the specific knowledge to the person who has the decision right or by transferring the decision right to the person with the specific knowledge.\textsuperscript{38} The principal as the owner of the decision rights has to delegate (decentralize) specific decision rights due to lack of specific or tacit\textsuperscript{39} knowledge: \textsuperscript{40} “Due to the CEO’s limited information-processing capabilities organizations must delegate decision-making power.”\textsuperscript{41}

With the delegation of decision rights 2 problems arise:

- the rights assignment problem
- the agency problem\textsuperscript{42}

The \textit{rights assignment problem} is the difficulty of determining by whom the decision right should be exercised.\textsuperscript{43} The \textit{agency problem} is how to ensure weather the opportunistic agent exercises his decision rights in a manner satisfying for the principal.\textsuperscript{44}

\textbf{A.2.1.2 Formal and Real Authority}

Aghion et al.\textsuperscript{(1997)} distinguish between the allocation of formal authority (the right to decide) and real authority (the effective control over decisions).\textsuperscript{45} The determinant of this distinction is also information (specific knowledge):

\textsuperscript{37} cf. Jensen et al. (1992:2).
\textsuperscript{38} cf. Windsperger (2004:1362).
\textsuperscript{39} cf. Windsperger (2004:1361).
\textsuperscript{40} cf. Jensen et al. (1992:1).
\textsuperscript{41} Windsperger (2004:1362).
\textsuperscript{42} cf. Jensen et al. (1992:2).
\textsuperscript{43} cf. Jensen et al. (1992:2).
\textsuperscript{44} cf. ibid.
\textsuperscript{45} cf. Aghion et al. (1997:1).
“A principal who has formal authority over a decision (or activity) can always reverse
her subordinate’s decision but will refrain from doing so if the subordinate is much
better informed and if their objectives are not too antinomic.”\textsuperscript{46}

The problem with delegation of \textit{formal authority} is that there exists a trade-off
(influenced by the structure of information) between initiative of the agent and a loss
of control for the principal.\textsuperscript{47} Thus, authority is more likely to be delegated for
unimportant decisions and decisions the agent can be trusted with.\textsuperscript{48}

\textbf{A.2.2 Decision Rights in Franchising}

Within a franchise system specific decisions are divided between the franchisor and
the franchisee and the appropriate level of residual claims is allocated to each of
them.\textsuperscript{49} Decision rights can be incorporated in the franchise manual or in contractual
clauses and can prescribe a large number of detailed tasks the franchisees must
perform in each outlet.\textsuperscript{50}

Typical decision rights in franchising networks include the procurement decision,
pricing and product decisions, advertising decision, human resource decisions
(recruitment and training), investment and finance decisions, and decisions
concerning accounting systems.\textsuperscript{51}

The franchisor usually makes decisions on key issues such as product, production,
and associated marketing efforts in order to maintain standardization that signals the
trademark.\textsuperscript{52} With specific knowledge about the local market conditions the
franchisee is capable to make decisions “regarding local operating policies such as

\textsuperscript{46} cf. Aghion et al. (1997:2).
\textsuperscript{47} cf. Aghion et al. (1997:27).
\textsuperscript{48} cf. ibid.
\textsuperscript{50} cf. Lopéz-Fernandez et al. (2011:4).
\textsuperscript{51} Windsperger (2004:1365).
\textsuperscript{52} cf. Michael (1996:57).
location, pricing, hours of service, and hiring." In return he bears the residual claims of these decisions – the outlet’s net profit after expenses (royalty payments). These residual claims act as an incentive for the franchisee to operate the unit efficiently. Thus the franchisee has more motivation to devote effort than employed outlet managers who receive a fixed salary.

A.2.3 Franchisee’s autonomy

The allocation of decision rights in franchise chains is an indicator of the degree of the franchisees’ autonomy and a basic control mechanism to maintain uniformity across the units. Through allocating decision rights the franchisor can vary the level of autonomy of the franchisee in order to achieve the required standardization level. There exist four basic structural sources of franchisees’ autonomy: allocation of contractual rights, contractual incompleteness, control costs and limited monitoring capacities, and direct acceptance of deviant franchisee behavior by the franchisor.

Contractual rights are often standardized within a network and detailed in handbooks (because of legal costs, concerns of equity and franchisor moral hazard) and restrict the franchisees’ decision rights.

Contractual incompleteness as a result of bounded rationality, unforeseeable contingencies, writing costs and difficulties of verification through third-party enforcers means that franchise contracts do not completely specify the obligations of the two parties.

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54 cf. ibid.
58 cf. ibid.
60 cf. ibid.
Control costs and limited control capacities of the systems' head offices lead to a substantial amount of de facto autonomy of the outlets.  

Direct acceptance of deviant franchisee behavior by the franchisor can occur if beneficial outcomes for the whole channel are expected. A franchisee, for example who is expected to behave very appropriately is less monitored than other franchisees and thus he enjoys more operating autonomy.

B) Agency Theory and Franchising

B.1 Agency Theory: An Overview

The origin of the agency theory lies in the 1960s and early 1970s when economists explored risk sharing among individuals or groups. This risk sharing problem has been described as something that arises when cooperating parties have different attitudes toward risk. Agency theory added to this risk sharing literature the agency problem which deals with the principal-agent relationship.

In principal-agent relationships the agent is called upon to act on behalf of the principal, which involves delegating some decision making authority to the agent. Some examples for such relationships are the relationship between the shareholders of a company and it’s CEO (the shareholders act as principal who delegate the CEO as agent to maximize their shares), the CEO and the key account manager (the CEO as principal and the key account manager as agent, or the franchisor as principal who delegates the franchisee as agent.

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62 cf. ibid.
63 cf. ibid.
64 cf. ibid.
66 cf. ibid.
67 cf. ibid.
68 cf. ibid.
The agents’ and principals’ interests regularly differ.\textsuperscript{71} If both parties are utility maximizers, it is not a given that the agent acts in the best manner for the principal\textsuperscript{72}. Furthermore it is not possible (at zero cost)\textsuperscript{73} for the principal to evaluate how well the agent has worked or if he has been honest.\textsuperscript{74}

B.1.1 Agency Problems: The Key Assumptions

The important key-assumptions concerning agency theory are self interest, bounded rationality, risk aversion, goal conflict, efficiency as the effectiveness criterion, information asymmetry and information as a purchasable commodity.\textsuperscript{75} These key-assumptions are the basis for the miscellaneous agency problems and potential remedies against them.

B.1.1.1 Self Interest/Opportunism

Self interest/ opportunism (e.g. blame, impression management, lying, etc.)\textsuperscript{76} is differentiated into pre- and postcontractual opportunism.

*Precontractual opportunism* is opportunistic behaviour on the part of the principal or the agent that takes place before a contract is signed.\textsuperscript{77} An example for this would be adverse selection which arises when an agent cheats about his abilities (he may claim to have certain skills or abilities) before the contract is signed.\textsuperscript{78}

\textsuperscript{72} cf. Jensen et al.(1976:5).
\textsuperscript{73} cf. ibid.
\textsuperscript{74} cf. Milgrom et al.(1992:167).
\textsuperscript{75} cf. Eisenhardt(1989:59).
\textsuperscript{76} cf. Eisenhardt (1989:59).
\textsuperscript{77} cf. Milgrom et al. (1992:602).
\textsuperscript{78} cf. Eisenhardt (1989:61); Pizanti et al. (2003)
Postcontractual opportunism is opportunistic behaviour that takes place after the contract is signed.\textsuperscript{79} Examples for postcontractual opportunism are moral hazard and the hold-up problem.

Moral hazard arises from different interests of the contracting parties and non observability.\textsuperscript{80} It refers to the lack of agreed effort on the part of the agent, in other words: the agent is shirking.\textsuperscript{81}

Hold up is the problem in which a party to a contract is forced to accept disadvantageous terms after it has invested.\textsuperscript{82}

\subsection*{B.1.1.2 Bounded rationality}

Bounded rationality defines the fact that people act in an intentionally rational manner\textsuperscript{83} but that they are not able to foresee all relevant factors that would be relevant.\textsuperscript{84} Particularly, it is not possible for them to solve complex problems exactly, free of cost and instant, and their communication is imperfect.\textsuperscript{85}

\subsection*{B.1.1.3 Risk aversion}

The simple principal-agent model assumes that the agent is more risk-averse than the principal (who is risk neutral) because it’s not possible for the agent to diversify his employment while the principal is capable to diversifying his investments.\textsuperscript{86} That means the reason why the principal is seen as risk neutral derives from the

\begin{enumerate}
\item\textsuperscript{79} cf. Milgrom et al. (1992:602).
\item\textsuperscript{80} cf. Milgrom et al. (1992:195).
\item\textsuperscript{81} cf. Eisenhardt (1989:61).
\item\textsuperscript{82} cf. Milgrom et al. (1992:136); Klein (1996:445)
\item\textsuperscript{83} cf. Milgrom et al.(1992:130).
\item\textsuperscript{84} cf. Milgrom et al. (1992:129).
\item\textsuperscript{85} cf. Milgrom et al .(1992:130).
\item\textsuperscript{86} cf. Eisenhardt (1989:60).
\end{enumerate}
assumption that he is better financed than the agent and thus able to bear risk better.\textsuperscript{87}

The agent would rather have a smaller fixed income than an uncertain income that is somewhat larger on average but is subject to unpredictable and uncontrollable variability.\textsuperscript{88} Here arises the problem of risk-sharing because the principal and the agent have different risk preferences and therefore may prefer to choose different actions.\textsuperscript{89} The point here is that the risk-neutral principal is interested in the maximization of his revenues while the risk-averse agent wants to maximize his utility.\textsuperscript{90} Thus the agent has to be paid more on average by the principal to convince him to accept bearing these risks.\textsuperscript{91} From the point of view of the principal this extra income of the agent is considered to be a cost for the incentive payment (agency cost).\textsuperscript{92}

### B.1.1.4 Goal conflicts

Agency theory declares that a goal conflict is inherent when individuals with differing preferences engage in a cooperative effort.\textsuperscript{93} In agency theory goal conflicts are resolved through the realignment of incentives.\textsuperscript{94} An appropriately designed reward system causes the self interested behaviour of the agent to approximate the behaviour desired by the principal.\textsuperscript{95}

### B.1.1.5 Efficiency as an effectiveness criterion

\textsuperscript{87} cf. Milgrom et al. (1992:187).
\textsuperscript{88} cf. Milgrom et al. (1992:187).
\textsuperscript{89} cf. Eisenhardt (1989:58).
\textsuperscript{90} cf. Pfaff et al. (1998:187).
\textsuperscript{91} cf. Milgrom et al. (1992:187).
\textsuperscript{92} cf. Milgrom et al. (1992:187).
If the parties bargain effectively and can implement and enforce their decisions, then the outcomes of economic activity will tend to be efficient.\textsuperscript{96}

\textbf{B.1.1.6 Information asymmetry}

Information asymmetry results because the individual actions of the agent cannot be observed exactly.\textsuperscript{97} Limited information processing capability, limited knowledge and a lack of time force the principal to delegate decisions to the agent.\textsuperscript{98} That means the asymmetrical information allocation between the principal and the agent leads to the danger of conflicts because the agent could use his ledge of information in an opportunistic manner.

Three types of problems can be distinguished concerning the origins of this information asymmetry between principal and agent:\textsuperscript{99}

- Hidden action
- Hidden information
- Hidden characteristics.

\textit{Hidden action} defines the problem where the principal cannot (or cost free) observe the actions of the agent, and distinguish the agents’ level of effort from the results of the agents’ efforts because the results are significantly dependent on random circumstances.\textsuperscript{100}

\textit{Hidden information} describes the case in which the agents efforts could probably be observed but the principal is not able to evaluate them because of a lack of expert knowledge.\textsuperscript{101}

\textsuperscript{96} cf. Milgrom et al. (1992:24).
\textsuperscript{97} cf. Holmström (1979:74).
\textsuperscript{98} cf. Pfaff et al. (1998:184).
\textsuperscript{100} cf. Picot (1991:151).
\textsuperscript{101} cf. ibid.
Hidden characteristics are the quality characteristics of the agent which are important for the principal (e.g. abilities, credibility, etc.) that are not known a priori and which could lead to adverse selection.\textsuperscript{102}

B.1.1.7 Information as a purchasable commodity

“In agency theory, information is regarded as a commodity: It has a cost, and it can be purchased.”\textsuperscript{103} In other words, the principal is able to invest in information systems in order to control the agent’s opportunism.\textsuperscript{104} These investments are referred to as monitoring costs.

B.1.2 Agency Costs

The focus of the agency theory lies in the determination of the most efficient contract governing the principal-agent relationship.\textsuperscript{105} This contract deals with tasks like people (e.g. self interest, bounded rationality, risk aversion), organizations (e.g. goal conflict among members) and information (e.g. information is a commodity which can be purchased).\textsuperscript{106} The aim of the contract is to minimize the agency costs. According to Jensen et al. (1976) this agency costs consist of

- the monitoring expenditures of the principal
- the bonding expenditures of the agent
- the residual loss.\textsuperscript{107}

\textsuperscript{102} cf. ibid.
\textsuperscript{103} Eisenhardt (1989:64).
\textsuperscript{104} cf. Eisenhardt (1989:64).
\textsuperscript{106} cf. ibid.
\textsuperscript{107} cf. Jensen et al. (1976:5).
There is a trade-off relationship between these 3 components which never has a negative value. Residual loss for example can be reduced through greater monitoring expenditures while monitoring expenditures can be reduced through bonding expenditures on the part of the agent.

B.1.2.1 Monitoring Costs

It is generally impossible for the principal at zero cost to ensure that the agent will make optimal decisions from the principal’s point of view. The costs that arise here are the monitoring expenditures. Monitoring is used to evaluate or view the agents’ fulfilment of the contract by the principal. It can be used to punish social inefficient behaviour, for example one could reduce the payment of employees who come late or stop work earlier or in order to reward good behavior. It also includes efforts on the part of the principal to ‘control’ the behavior of the agent through budget restrictions, compensation policies, operating rules, etc.

B.1.2.2 Bonding Costs

Bonding expenditures on the part of the agent arise for example when the principal requires a guarantee sum from the agent in order to induce a good performance. This bond is forfeited if inappropriate behaviour on the part of the agent is detected. A problem could arise during bonding is that the agent may lack monetary resources in order to provide a sufficiently large bond. The bonding

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111 cf. ibid.
115 cf. ibid.
116 cf. ibid.
expenditures of the agent can be seen as principals’ expenditures because in fact the principal remunerates the effort of the agent.\textsuperscript{117}

B.1.2.3 Residual Loss

The monetary equivalent of the reduction in welfare experienced by the principal as a result of the divergence between the agents’ decisions and the decisions which would maximize the welfare of the principal is called the \textit{residual loss}.\textsuperscript{118}

B.2 Agency Theory and Franchising

“It appears that one major advantage of a franchise is the information it provides to consumers: when I take my family to a McDonald's I know what to expect, no matter where it is located. Thus, it would be worthwhile for McDonald's to spend a fair sum to maintain this situation and to curtail any local variation.”\textsuperscript{119}

Within franchising networks franchisors act as principals, who delegate authority to outlet level agents – either to employee managers or franchisees.\textsuperscript{120}

The goals of the principal in franchising networks include maintaining uniformity and accomplishing system wide adaption.\textsuperscript{121} \textit{Maintaining uniformity} is important to fulfil the expectations of the customers while \textit{system wide adaption} is necessary for survival in industry competition.\textsuperscript{122} “These two challenges interact with each other: as new opportunities and threats arise, the pressures for changing the system grow; and

\textsuperscript{117} cf. Sharma (1997:762).
\textsuperscript{118} cf. Jensen et al. (1976:5).
\textsuperscript{119} Rubin (1978:230).
\textsuperscript{120} cf. Combs et al. (2003:446).
\textsuperscript{121} cf. Bradach (1997:282);Rubin(1978)
as those pressures grow and innovative ideas emerge, the issue then becomes how to get the system to adopt a new uniform standard." 123

The goal of the franchisee is to maximize the net income of the outlet because his compensation varies in direct relationship with the income of the outlet. 124 Thus, he has an incentive to manage the outlets variable costs tightly. 125

The goal of an outlet manager in a company owned outlet is to receive his fixed salary and to maximize his utility-function which is independent of the outlet’s performance. 126 Therefore (from principal’s point of view) he has no powerful incentive to perform efficiently. 127

B.2.1 Agency Problems in Franchising Networks

“The franchise relationship presents a potential for conflict between franchisor and franchisee in that the franchisor seeks standardization and control of franchisees so as to maintain brand reputation whereas franchisees strive for autonomy in operating their own entrepreneurial ventures.” 128

Agency problems are subdivided into vertical and horizontal agency problems. 129 Vertical agency problems occur when salaried outlet managers shirk and reduce efforts while horizontal agency problems arise when non-company owner agents like franchisees gain benefits while damaging the brand name (free-riding). 130

The differing goals of franchisor and franchisee/outlet manager combined with conditions of uncertainty, incomplete information and opportunism create the three

125 cf. ibid.
126 cf. ibid.
127 cf. ibid.
129 cf. Combs et al. (2004:91); Brickley et al. (1987); Kidwell et al. (2007:525);
major agency problems in the management of organizational design in a franchising network:\textsuperscript{131}:

1. Moral hazard
2. Adverse selection
3. The hold-up problem.\textsuperscript{132}

\textbf{B.2.1.1 Moral Hazard in Franchising Networks}

The difficulty for principals to view agent’s level of effort leads to the problem of \textit{moral hazard}.\textsuperscript{133} In franchising this problem consists out of three particular issues:

- Shirking
- Free-riding
- Inefficient investment\textsuperscript{134}

\textbf{B.2.1.1.1 Shirking and free-riding}

\textit{Shirking} of outlet managers\textsuperscript{135} arises because of their fixed salary which encourages them to deliver reduced effort to maximize their utility.\textsuperscript{136}

\textit{Free-riding} occurs when a franchisee maximizes his private income opportunistically, he “free-rides” on other units by withholding effort or reducing costs while at the same time counting on other franchisees to invest in quality in order to maintain the brand

\textsuperscript{133} cf. ibid.
\textsuperscript{134} cf. Carney et al. (1991:609).
\textsuperscript{135} Combs et al. (2004:911) argue that franchisees do not shirk (reduce effort) because their income is tied to their effort while employee managers will shirk because they do not possess strong ownership incentives (residual claims).
\textsuperscript{136} cf. Carney et al. (1991:609).
name of the system. \textsuperscript{137} Some examples of free-riding include underinvestment in advertising, failure to comply with production standards, and insufficient staff supervision. \textsuperscript{138}

The common example for the \textit{free-rider problem} is the ‘superhighway problem’ \textsuperscript{139} in which a fast food chain restaurant is located in an area where the probability of a repeated sale to a customer is low. \textsuperscript{140} “Under these circumstances, the franchisee may lure customers in on the basis of an established brand name, but deliver an inferior quality product or service.” \textsuperscript{141} Such behaviour is beneficial to an individual franchisee, which does not rely upon repeated customers because the majority of his customers are walk-in customers. \textsuperscript{142} The cost savings from providing lower quality go directly to the free-riding franchisee while in the case of franchisees his practice leads to a loss in customer patronage and a less valuable trademark to franchise for the franchisor: \textsuperscript{143} “If a franchisee withholds effort and successfully free rides on the franchisor’s brand name, this may reflect poorly on perceived brand quality and lead to poor organizational performance.” \textsuperscript{144}

\subsection*{B.2.1.1.2 Inefficient investment}

\textit{Inefficient investment} of franchisees arises because they are forced to consider the full risk of undertaking any marginal investments \textsuperscript{145} while the owners of multiple units (i.e.: franchisors) only have to consider the systematic risk of a particular investment. \textsuperscript{146} “For example, a franchisee often has the flexibility to implement local advertising (billboards, newspaper ads, etc.) and promotion campaigns (e.g., two-for-one specials). It is easy to envision a situation in which a large local advertising

\begin{flushleft}
\textsuperscript{137} cf. López-Fernández et al. (2011:4)
\textsuperscript{138} cf. Cochet(2005:61).
\textsuperscript{139} cf. Brickley et al. (1987:406).
\textsuperscript{141} Carney et al. (1991:610).
\textsuperscript{142} cf. Carney et al. (1991:610).
\textsuperscript{143} cf. Brickley et al. (1991:29).
\textsuperscript{144} Kidwell et al. (2007:523).
\textsuperscript{145} cf. Carney et al. (1991:609).
\textsuperscript{146} cf. Brickley et al. (1987:405).
\end{flushleft}
A campaign would have a positive net current value from the viewpoint of a diversified decision maker (franchisor), but not for the relatively undiversified manager (franchisee). This means that such investments which have spill-over effects on other system units will not appropriate the full return to the franchisees. Thus a rational franchisee should be expected to under-invest in certain assets.

B.2.1.2 Adverse selection

*Adverse selection* describes the difficulty to ascertain the agent's (outlet manager or franchisee) quality level, abilities and honesty ex ante for the principal:

> “Adverse selection occurs when the principal cannot ascertain if the agent accurately represents his ability to do the work for which he is being paid.”

The principal bears the risk of choosing an inadequate agent before the contract is signed. For example the right franchisee to own and operate a single store may be not the right person to operate two or more stores.

B.2.1.3 The hold-up problem

*Hold-up* deals with the problem that at least one party could act opportunistically to alter an agreement after a relationship-specific investment has been made. For example, if a franchisor purchases a building that is the symbol of the franchise and leases it to the franchisee, the franchisee could refuse to pay the agreed-upon lease payment and offer to pay a lower fee, the franchisor would find it in his interest to accept this offer, if the costs of enforcing the contract are larger than the benefits.

147 Brickley et al. (1987:405).
149 cf. ibid.
When the investment is made the owner wants to uphold the value of the trademark because the salvage value of the asset is low.\(^{155}\)

**B.2.2 Agency costs in Franchising**

“The franchisor has two possibilities to reduce the agency costs: On the one hand, to reduce the residual loss by increasing the monitoring activities and, on the other hand, to increase the incentive by allocating a higher fraction of residual income to the franchisee.”\(^{156}\)

**B.2.2.1 Monitoring**

A primary remedy against shirking of outlet managers and free-riding of franchisees is *monitoring*.\(^ {157}\) Monitoring is used by the principal to reward superior performance and to control underperformance.\(^ {158}\)

In restaurant chains for example there exist multiple systems for monitoring the performance of outlet managers such as automated management information systems (MIS), field audits and mystery shoppers.\(^ {159}\)

*Automated management information systems (MIS)* link all company outlets to the headquarters where food and labour costs are calculated and analyzed daily as a percentage of sales in a restaurant, region, or division.\(^ {160}\) When numbers vary from the plan outlet managers are asked to provide explanations and action plans.\(^ {161}\)

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\(^{156}\) Hussain, Windsperger (2011:104).


\(^{160}\) cf. ibid.

\(^{161}\) cf. ibid.
Field audits focus on quality, service, and cleanliness. The field audit form for Hardee’s, for example, included 295 items pertaining to the operation of the restaurant and took from two to four hours to complete; the audit was conducted at least once a month.

Mystery shoppers are evaluators who make unannounced, anonymous visits to the outlets and rate the dining experience from the customer's perspective.

Franchisees are monitored for quality substitution (free-riding) via purchase reports and product samples sent to the central headquarters.

Spinelli et al. (2004) additionally name field support, external service audits, peer review, analytical tools and customer feedback as instruments to monitor franchisees.

Field support personnel act as liaison between franchisor and franchisee whose function is similar to that of district or regional managers in non-franchise companies but with less authority. These representatives evaluate franchisees, identify potential problems, and evaluate necessary corrective actions. Field support personnel may alternatively have an internal audit function which inspects individual store operations using a set of specified criteria. Franchisors operate usually with a designed rating system in order to communicate the franchisees how well they perform relatively to the company standards. If a franchisee regularly falls below these standards he allowed some time to improve performance otherwise the franchise contract is terminated. Field support staff is most effective when there is a high ratio of personnel in relation to the number of franchised stores - on the other

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167 cf. ibid.
168 cf. ibid.
169 cf. ibid.
170 cf. ibid.
171 cf. ibid.
side: the greater the number of these personnel the greater is the costs of this monitoring instrument.\textsuperscript{172}

*External service audits* are performed by outside agencies to evaluate franchisee operations.\textsuperscript{173} Because of economies of scale these outside evaluations can be less expensive than they would be if performed by the franchisor.\textsuperscript{174} One example of such an external service audit is that of mystery shopping.

*Peer reviews* are conducted by the franchisees without the participation of the franchisor in order to maintain the brand name which is also very important for the franchisees.\textsuperscript{175} The results of these reviews are shared among the franchisees but not with the franchisor.\textsuperscript{176}

*Analytical Tools:* Franchisor performance expectations are based on the performance of the franchisor’s own stores and compared with that of the franchisees.\textsuperscript{177} For example they measure what food and labour costs should calculated as a percentage of sales in the fast food industry.\textsuperscript{178} A store that falls outside the parameter of the expectation reports is analyzed in order to determine weather its performance is below or above the franchisors expectations.\textsuperscript{179} If a store is above franchisors expectations, for example if it has lower labor costs, the whole franchise system could learn from the better performance of this outlet.

*Customer feedback:* Customers are asked how well their needs are served using quantitative customer ratings for example.\textsuperscript{180} This monitoring tool shows reasons for customer’s level of satisfaction and dissatisfactions and where might the opportunities for increasing the service level lie.\textsuperscript{181}

\textsuperscript{172} cf. Spinelli et al.(2004:85).
\textsuperscript{173} cf. ibid.
\textsuperscript{174} cf. ibid.
\textsuperscript{175} cf. ibid.
\textsuperscript{176} cf. ibid.
\textsuperscript{177} cf. Spinelli et al.(2004:86).
\textsuperscript{178} cf. ibid.
\textsuperscript{179} cf. ibid.
\textsuperscript{181} cf. ibid.
B.2.2.1.1 Monitoring costs

“This monitoring is costly, requiring owners to hire individuals to verify the behavior of agents, and to invest in systems, like computers, budgets, and procedures, that enhance the ability of principals to monitor agents.” ¹⁸²

Monitoring costs result from behavioural uncertainty due to misbehaviour of the network partners ¹⁸³ (or outlet managers) because a lack of monitoring can lead the agent to opportunistically engage in it. ¹⁸⁴

The most frequently cited driving factor for monitoring cost is geographic dispersion. ¹⁸⁵ “Large geographic distance induces high travelling costs of the franchisor's representatives who conduct direct observations, thus increasing information gap and uncertainty.” ¹⁸⁶

B.2.2.2 Incentives

“The simplest way to motivate the franchisee is to give him a share of the profits of the franchise. Then he will work as hard as is efficient; any leisure he consumes will clearly be worth the true cost. Thus, we would expect the franchise contract to be written in such a way as to give the franchisee much of the profits in the operation.” ¹⁸⁷

To give the franchisee a bigger share of profits in order to stimulate his motivation means to increase his residual income. ¹⁸⁸ This is possible with a lower royalty rate. ¹⁸⁹ However, the problem with low royalty rates is that franchisors may neglect to

¹⁸⁵ cf. Combs et al. (2003:447); Dnes (1996:320)
¹⁸⁶ Mumdziev (2009:10).
franchise outlets at low royalty rates because royalties also act as incentives for them.\textsuperscript{190}

**C. Agency Theory and DR in Franchising Networks**

The following chapter discusses the relationship between decision rights and the agency theory by examining the theoretical background, the brand name value (which is an important factor for the threat of free-riding), the monitoring costs, incentive contracting, bonding, and the assignment to other theories.

**C.1 Brand name value and DR**

The value of the brand name derives from the fact that it transmits relevant and reliable information which would be costly to acquire otherwise.\textsuperscript{191}

As already mentioned, it is very important for the franchisor to preserve the brand name value\textsuperscript{192} via maintaining uniformity for products offered, building design, ambience, service, and price.\textsuperscript{193} To achieve this goal the franchisees have to meet the quality standards required for these features. Non maintaining uniformity leads to the risk of brand name loss.\textsuperscript{194} Brand name loss depends on customers sensitivity to the various quality standards which are affected by the franchisees’ actions on these product attributes.\textsuperscript{195}

Here arises the threat of free-riding because franchisees could maximize their own profits via withholding efforts complied with the quality standards.\textsuperscript{196} "For example,

\textsuperscript{190} Shane (1998:721); Royalties: below Chapter C.3.
\textsuperscript{191} cf. Azevedo (2009).
\textsuperscript{192} cf. Sen (1993:177).
\textsuperscript{193} cf. Azevedo (2009).
\textsuperscript{194} cf. Azevedo (2009).
\textsuperscript{195} cf. Azevedo (2009).
\textsuperscript{196} cf. Kidwell et al. (2007:523).
franchisees may use lower-quality inputs or advertise less to reduce their costs but, in the process, lower brand name value. Franchisees may also alter their product offerings to better suit their local markets, or oppose the implementation of new production processes and new product offerings that they don’t think will do well in their market even if the innovation benefits other stores in the chain. All these behaviors affect the extent of standardization in the chain and thus the value of operating under a common brand.\textsuperscript{197}

The basic control mechanism for alleviating this problem is the allocation of decision rights (the degree of the franchisees autonomy).\textsuperscript{198}

There exist two main factors on which the level of potential free-riding depends on:

- the value of the brand name
- spillover potential associated with consumer mobility\textsuperscript{199}

A strong brand name enables the franchisee to sell the franchise products at higher prices which makes free-riding on the brand name more attractive.\textsuperscript{200} The spillover potential (or externality effect)\textsuperscript{201} affects the tendency for free-riding insofar that if customers tend to consume across outlets, the costs for under-providing quality standards will be shared by all outlets notwithstanding the fact that its benefits only go to the single franchisee.\textsuperscript{202} On the other hand, if consumers tend to consume frequently in the very same outlet, sub-performance in quality would hit the future demand for that outlet, which is an adequate motivation for the franchisee to comply with good quality standards.\textsuperscript{203}

Lopez et al. (2011) and Azevedo (2009) argue that the franchisor could achieve the required standardization level across outlets by increasing the degree of control over decisions.\textsuperscript{204} For example the franchisor can indicate the real\textsuperscript{205} and formal decision

\textsuperscript{197}Lafontaine et al. (2005:139).
\textsuperscript{198}cf. Lopez-Fernandez et al. (2011:2).
\textsuperscript{199}cf. Lopez-Fernandez et al. (2011:4).
\textsuperscript{200}cf. Lopez-Fernandez et al. (2011:4).
\textsuperscript{201}cf. Lafontaine et al. (2002:14).
\textsuperscript{202}cf. Azevedo (2009).
\textsuperscript{203}cf. Azevedo (2009).
\textsuperscript{204}cf. Lopez-Fernandez et al. (2011:4); Azevedo (2009).
\textsuperscript{205}cf. Formal and real authority: Chapter A.2.1.2
making authority in the franchisee’s manual by prescribing in detail the various tasks to be performed by the franchisees in each outlet.\textsuperscript{206}

Based to these assumptions the following Hypothesis is derived:

\begin{equation}
H1: \text{“The higher the value of the brand name of the franchise network, the higher the potential threat of franchisees’ free-riding and the lower the residual decision rights allocated to them.”}
\end{equation}

\section*{C.2 Monitoring costs and DR}

As noted above\textsuperscript{207} the main driving factors for monitoring costs are the environmental and behavioral uncertainty.\textsuperscript{208} Monitoring costs in turn influence the allocation of residual decision rights:

Windsperger, Jell (2005) examined the relationship between residual income and decision rights in the Hungarian trucking industry where they argue that the higher the environmental uncertainty, the higher the degree of asymmetric information between the carrier and the driver and the more expensive the central control of a transportation, the more should the residual decision rights be transferred to the driver.\textsuperscript{209}

In their study of banking industry in Texas, Brickley et al. (2003) argue that large banks should grant local managers significant decision-making authority if the costs of monitoring are high.\textsuperscript{210}

\begin{flushright}
\textsuperscript{206} cf. Lopez-Fernandez et al. (2011:4); Azevedo (2009).
\textsuperscript{207} cf. Decision rights in franchising: chapter A.2.2
\textsuperscript{208} cf. Windsperger, Jell (2005:298)
\textsuperscript{209} cf. ibid.
\textsuperscript{210} cf. Brickley et al. (2003:353)
\end{flushright}
Lafontaine et al. (1998) depict that higher behavior monitoring costs lead to more vertical separation (analogy for residual decision rights\textsuperscript{211}).\textsuperscript{212} "This reflects the fact that when behavior monitoring is costly, firms rely on it less, and rely more on residual claims to compensate their agents."\textsuperscript{213}

According to these assumptions the following hypothesis is derived:

| H2: "The higher the behavioural uncertainty, the higher the monitoring costs, and the higher the residual decision rights allocated to the franchisees." |

C.3 Royalties and DR

Royalties have a two-folded impact: First they act as an incentive for franchisors to promote the system brand name.\textsuperscript{214} They also act as an incentive for the franchisees to provide service at the outlet level.\textsuperscript{215} This means that there is a trade-off between these two incentives provided by royalties: If the royalty rate is relatively high, the franchisor has a higher stake in franchising his outlets (i.e.: franchisors supply of franchised units increases), if the royalty rate his relatively low the franchisees have a higher stake in purchasing franchised outlets (i.e.: franchisees’ demand for franchised units increases).\textsuperscript{216} The problem of the franchisee with growing royalty rates is that they quickly eliminate his or her profit margins due to which willingness to undertake a franchised outlet decreases.\textsuperscript{217}

Another important point in this regard is that the degree of the royalties influences the nature of the franchising network: “...the higher the royalty rate, the more similar franchising becomes to company ownership and hence the smaller the advantages

\textsuperscript{211} Feng, Hendikse (2008:20/21).
\textsuperscript{212} cf. Lafontaine et al. (1998:20)
\textsuperscript{213} Lafontaine et al. (1998:20)
\textsuperscript{214} Shane (1998:721)
\textsuperscript{215} Michael (1996:57); Shane (1998:721)
\textsuperscript{216} Shane (1998:721)
\textsuperscript{217} Shane (1998:721)
of franchising over company ownership."\(^{218}\) The crucial question here is whether royalties evoke similarity to company ownership, or could they also be seen as an indicator for the fraction of the franchisees’ decision rights? In the case of company ownership (vertical integration), the agents regularly have less decision rights than in franchising because:” In particular, franchisees’ residual claim on the profits of their unit (net of royalty payments) induces greater effort than is provided by a company employee who receives mainly a fixed salary and who therefore seeks to minimize costs of effort.”\(^{219}\)

The answer to this question was supported by Shane (1998) who found (contradictory to his hypothesis) a negative relationship between the royalty rate and the proportion of franchised outlets (vertical integration).\(^{220}\) Hence, the higher the royalty rate, the lower the degree of vertical separation and therefore the higher the grade of vertical integration (analogy for residual decision rights\(^{221}\)).

Rubin (1978) also goes in the same direction:
“...where there are relatively few managerial decisions to be made, we would expect more of the income of the franchisor to come from royalties.”\(^{222}\) The reverse of this expression is: if the royalties are high, there would be fewer managerial decisions to be made.

Analogical to this background the next hypothesis ends in:

H3: “The higher the royalty rate the franchisees’ have to devote to the franchisor, the lower their residual decision rights.”

\(^{218}\) Lafontaine et al. (1992:274)
\(^{220}\) cf. Shane (1998:736)
\(^{221}\) cf. Feng, Hendrikse (2008:20/21).
\(^{222}\) Rubin (1978:230)
C.4 Other Theories: Relational Governance Perspective

“Transaction costs, property rights and agency models can be enriched by research results from the relational governance perspective.”

The relational governance perspective (e.g. Kaufman and Stern 1988; Dyer and Singh 1998; Gulati 1995; Poppo and Zenger 2002; Gulati and Nickerson 2008) characterises social interactions in the governance of channel structures (i.e. the coordination of vertical relationships), specifically the role of trust and relational norms.

Zaheer et al. (1998) define trust as the expectation that an actor 1) can be relied upon to fulfil promises 2) will behave a predictable manner, and 3) to act and negotiate fairly where the possibility for opportunism is present. Furthermore they distinguish between relational and dispositional trust, whereas dispositional trust reflects the individual assumptions about the trustworthiness of others in general, while relational trust pertains specifically to expectations of the counterpart in the network.

According to Windsperger (forthcoming) trust as a mechanism of relational governance could influence the franchisor’s allocation of decision rights because it reduces the relational risk and increases information sharing which in turn enables the franchisor to reduce formal control over operational decisions.

In their study about decision making authority López-Fernández and López-Bayón (2011) state that trust can serve as an “informal safeguard” that can assure franchisee performance. They found that the duration of previous franchise relationships is trust-building and favours the degree of decentralization.

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223 Windsperger (forthcoming)
224 cf. Cochet (2005:68)
225 cf. Zaheer et al. (1998:143)
226 cf. ibid.
227 cf. Windsperger (forthcoming)
228 cf. Lopez-Fernandez et al. (2011:13)
229 cf. ibid.
D. Empirical Study

D.1. Introduction

Part D is devoted to the statistical analysis of the stated hypothesis. The empirical analysis is implemented based on the three parts A) Franchising B) Agency theory and Franchising and C) Agency theory in Franchising Networks. The first section provides information on the sample and data, measures and the variables used. The next section shows the results, the last section integrates the conclusion.

D.1.1 Sample, Data and Survey instrument

The data used comes from the Austrian, German and Swiss franchise sector and was obtained via an ad-hoc questionnaire about the ownership strategy of franchise companies in Germany. The questionnaire originally was developed for a study of Univ-. Prof. Dr. Josef Windsperger and Dildar Hussain.

The questionnaire is comprised of 120 questions stated to the franchisors. The questionnaire is comprised of single choice (7 point Likert-type) and open questions and it takes an average of 20 – 25 minutes to complete it.

D.1.2 Measures

The questions include information on the investments of the franchisors and franchisees at the beginning and during the contractual relationship, advantages of multi-unit franchising compared with single-unit franchising, the importance of the brand name, relational and general trust, know-how, goal accomplishments in the last year, advantages of franchising, the contractual allocation of franchisees’ decision rights, the level of franchisees’ decision rights, behavioral and environmental
uncertainty, the number of company owned and franchised outlets, the age of the franchise system, the royalties and the training of franchisees.

D.2 Variables

D.2.1 Dependent variable: DR

The dependent variable DR stands for the decision rights allocated to the franchisees. It is calculated from an index of 12 questions regarding the different areas of decision rights that are granted to the franchisees. The level of the particular decision right is subdivided into a scale from 1-7 (Likert-type), whereas 1 relates to “not at all” and 7 for “to a great extent.” The questions posed refer to the extent of decision making by the franchisees.

1) Implementation of investment activities at the outlet level.
2) Financing of investment projects at the outlet level.
3) Selection of suppliers
4) Hiring of employees at the outlet level
5) Training of the employees at the outlet level
6) Product / service offering in the local market
7) Sales price at the outlet level
8) Use of advertising and sales promotion
9) Equipment at the franchised outlets
10) Procurement of inputs
11) Introduction of new products in the local market
12) Use of accounting systems at the outlet level

The reliability analysis of the questions regarding DR results in a Cronbach’s alpha value of 0.883.

D.2.2 Independent Variables

*Brand name value*

The variable BRANDNAME reflects the value of the brand name. It is used to measure whether the potential threat of free-riding that occurs with an augmenting brand name value could have a negative influence on franchisees’ decision rights. The variable contains the information of 4 questions regarding the value of the franchise systems’ brand. The questions posed (via 7 point Likert-type) to the franchisors for the variable BRANDNAME where:

1) “Our brand name is very strong compared to our competitors.”
2) “Our franchise system enjoys higher brand recognition compared to our competitors.”
3) “Our franchise system enjoys a good reputation for quality.”
4) “Our brand name is very important to achieve a competitive advantage.”

The reliability analysis of the questions regarding the BRANDNAME results in a Cronbach’s alpha value of 0.815.

*Monitoring Costs*

MONCOST refers to the monitoring costs that rise with the uncertainty of the franchisees behavior. The participating franchisors where asked 3 questions regarding the difficulty of:

1) “Measuring the performance of the outlet manager (franchisee or manager).”
2) “Controlling the behavior of the outlet manager (franchisees or managers).”
3) “The assessment of the competencies and capabilities of the outlet manager (franchisee or manager).”

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232 cf. Windsperger, Jell (2005:298)
The franchisors could choose between 1 - 7 grades for each particular question, 1 relates to: “not at all” and 7 “to great extent”.

The reliability analysis of the questions regarding PARTNERTRUST results in a Cronbach’s alpha value of 0.763 (p > 0.7).

**ROYALTIES**

The last independent variable ROYALTIES is the amount of payments in % of sales the franchisees devote to the franchisors. It is used to show the impact (a potential negative relationship) of the amount of royalties on the grade of decentralization of decision rights in franchising networks.

**D.2.3 Control Variables**

**AGE**

AGE depicts the maturity of the franchise system. The franchisors where asked when the first franchised outlet was opened. AGE is used to control the impact of the networks age that could influence the level of franchisees’ decision rights positive because of the effects of experience.\(^{233}\)

**Sectoral effects**

SECTOR represents the differences of the two sectors of distribution franchising and service franchising. The franchisors had to answer which kind of franchising was

\(^{233}\) cf. Lafontaine et al. (2005:134); Azevedo (2009); Arrunada et al. (1999:21)
operated by their company. The possible answers where production, distribution, and service. Production franchising was not integrated into the variable because only 8 out of 167 questioned franchisors claimed to operate production franchising.

SECTOR measures a potential influence of the kind of franchising on the grade of decentralization of decision rights.\textsuperscript{234} A value of 0 refers to distribution franchising while 1 refers to service franchising.

**Relational Trust**

PARTNERTRUST measures the influence of the franchisors’ relational trust on DR. As already mentioned relational trust could lead to granting of more decision rights to the franchisees.\textsuperscript{235} Specifically, it refers to 4 questions regarding which kind of relationship the network partners have. The grade of relational trust was measured with a 1-7 Likert-type scale. The 4 questions posed to the franchisors were:

1) “The cooperation is based on a partnership basis.”
2) “The exchange of information between us and the partners goes beyond the agreed scope.”
3) “There is great trust between ourselves and the partners.”
4) “There is an atmosphere of openness and honesty between us and the partners.”

The reliability analysis of the questions regarding PARTNERTRUST results in a Cronbach’s alpha value of 0.876 (p>0.7).

\textsuperscript{234} cf. Windsperger (2004:1365)
\textsuperscript{235} cf. Zaheer et al. (1998:143)
In contrast to the variable PARTNERTRUST, the INITIALTRUST variable does not indicate the franchisors relational trust in the network partners, but their trust in people in general.\textsuperscript{236} INITIALTRUST is also an index of 4 questions whereas the grade was measured with a 1-7 scale. The 4 questions regarding general trust are:

1) “We trust the people we have long relationship with.”
2) “The majority of people trust others.”
3) “Most people are trustworthy.”
4) “Most people behave cooperatively if they are trusted.”

The \textit{reliability analysis} of the questions regarding INITIALTRUST results in a Cronbach’s alpha value of 0.761 (p>0.7).

\textsuperscript{236} cf. Zaheer et al. (1998)
D.3 Results

D.3.1 Descriptive Statistics of the franchise networks

The franchisors from the Austrian, German and Swiss franchise sector sent back 167 valid responses. The responses indicate that 4.8 % percent of the franchisors use production-, 28,1% distribution and 59,3 % service franchising. Table 1 shows the data regarding type of franchising.

Table 1: Type of franchising

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
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<tr>
<td>Valid Product</td>
<td>8</td>
<td>4.8</td>
<td>5.2</td>
<td>5.2</td>
</tr>
<tr>
<td>franchising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distribution</td>
<td>47</td>
<td>28.1</td>
<td>30.5</td>
<td>35.7</td>
</tr>
<tr>
<td>Service</td>
<td>99</td>
<td>59.3</td>
<td>64.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>154</td>
<td>92.2</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Missing</td>
<td>-9</td>
<td>7.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>167</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In average the responding franchise systems have 27 company owned- , and 109 franchisee owned outlets. That is a total average of 136 outlets per network. The mean date of the first outlet opened is 1998. The franchise/entry fee amounts to € 13.614,- The average investment (excluding franchise/entry fees) required by a franchisee to start a new outlet amounts to € 394.610,- The variable royalties are in average 5,65 % of sales and the fixed advertising/marketing fee € 61,- per month. The average length of the franchise contract is 6,5 years. The mean of initial training days a franchisee has to absolve to open an outlet amounts to 18,5 days yearly. Table 2 shows the descriptive statistics of the respondent franchise networks.
Table 2: Descriptive statistics of the respondent franchise networks

<table>
<thead>
<tr>
<th>Attributes</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of company owned outlets in Germany/Swi/Aut in 2009</td>
<td>27.50</td>
<td>87.485</td>
<td>0</td>
<td>700</td>
</tr>
<tr>
<td>Number of franchised outlet in Germany/Swi/Aut in 2009</td>
<td>109.42</td>
<td>279.726</td>
<td>0</td>
<td>2500</td>
</tr>
<tr>
<td>Year when first franchised outlet was opened in Germany/Swi/Aut</td>
<td>1998</td>
<td>8.491</td>
<td>1968</td>
<td>2009</td>
</tr>
<tr>
<td>Franchise/entry fee in Euro</td>
<td>13614.65</td>
<td>16597.326</td>
<td>0</td>
<td>120000</td>
</tr>
<tr>
<td>Average investment (excluding franchise/entry fee) required by a franchisee to start a new franchised outlet (Euro)</td>
<td>394610.87</td>
<td>3274880.901</td>
<td>100</td>
<td>38500000</td>
</tr>
<tr>
<td>Variable royalties (% of sales)</td>
<td>5.6473</td>
<td>7.92266</td>
<td>.00</td>
<td>50.00</td>
</tr>
<tr>
<td>Fix advertising / marketing fee (Euros per month)</td>
<td>61.03</td>
<td>269.369</td>
<td>0</td>
<td>2300</td>
</tr>
<tr>
<td>Franchise contract length in years</td>
<td>6.69</td>
<td>3.248</td>
<td>1</td>
<td>20</td>
</tr>
<tr>
<td>Initial training days</td>
<td>18.52</td>
<td>21.645</td>
<td>0</td>
<td>120</td>
</tr>
</tbody>
</table>

D.3.2 Descriptive Statistics of the Variables

This part provides the frequency analysis of the franchisors’ answers concerning the brand name, behavioral uncertainty, relational trust, general trust, and the decision rights allocated to the franchisees.

D.3.2.1 Brand name

The following graph 1 describes the frequency analysis of the variable BRANDNAME, which was built from the following 4 questions:
1) “Our brand name is very strong compared to our competitors.”
2) “Our franchise system enjoys higher brand recognition compared to our competitors.”
3) “Our franchise system enjoys a good reputation for quality.”
4) “Our brand name is very important to achieve a competitive advantage.”

Graph 1: Frequency analysis of BRANDNAME

1) 7,9% of the franchisors believe that the brand name of their franchise system is very strong compared to their competitors, 38,2% are indifferent, and 53,9 % state that the brand name is not strong.
2) Regarding the brand name recognition compared to the competitors 1,5% answered that they are more recognized than the competitors 27,9% are indifferent and 70,6 % define their system as less recognized.
3) 1.3% highly agree to the question indicating a very high quality reputation 22.7% neither agree nor disagree and 76% disagree.
4) 2.4% of the interviewees claim that the brand name is very important to achieve a competitive advantage, 10.7% are indifferent, and 86.9% disagree.

D.3.2.2 Monitoring Costs

The variable MONCOST is an index of 3 questions regarding behavioral uncertainty. The questions posed to the franchisors were:

1) “It is very difficult to measure the performance of the outlet manager (franchisee or manager).”
2) “It is very difficult to control the behavior of the outlet manager (franchisees or managers).”
3) “It is very difficult to assess the competencies and capabilities of the outlet manager (franchisee or manager).” Graph 2 shows the frequency analysis of the answers concerning behavioral uncertainty.
1) About 36,1% of the responding franchisors state “...that it is very difficult to measure the performance of the outlet manager”, 52,8% are indifferent, and 11,1% disagree.

2) Around 15,7 % of the respondents claim that it is very difficult to control the behaviour of the outlet manager/franchisee, 68,6% neither agree or disagree, and 15,7 % disagree.

3) 14,0% agree with the statement that it is very difficult to assess the competencies and capabilities of the franchisees, 55,8 % are indifferent, and 30,2 % reject this statement.
D.3.2.3 Initial Trust

The variable INITIALTRUST represents the general trust the franchisors have in people. INITIALTRUST is build based on the following 4 expressions:

1) “We trust the people we have long relationship with.”
2) “The majority of people trust others.”
3) “Most people are trustworthy.”
4) “Most people behave cooperatively if they are trusted.”

Graph 3 shows the frequency analysis of the variable INITIALTRUST.
1) 4,5 % of the asked franchisors generally trust the people they have a long relationship with, 42,4 % are indifferent and 53,0 % disagree.

2) Regarding the question that the majority of people trust others 17,0 % agree, 67,9 % neither agree nor disagree and 15,1 % disagree.

3) About 9,2 % think that “most people are trustworthy”, 72,3 % are indifferent and 18,5 % reject this statement.

4) Around 9,8% agree to “most people are cooperative if they are trusted”, 56,9% are neutral, and 33,3% disagree to the question.

D.3.2.4 Partner Trust

In contrast to INITIALTRUST the variable PARTNERTRUST does not represent the trust of the franchisors in general but in their network partners (franchisees).

PARTNERTRUST integrates 4 questions:

1) “The cooperation is based on a partnership basis.”

2) “The exchange of information between us and the partners goes beyond the agreed scope.”

3) “There is great trust between us and the partners.”

4) “There is an atmosphere of openness and honesty between us and the partners.”
1) Concerning the question regarding a partnership basis, 2.2% of the participants agree while 13.5% are neutral and 84.3% disagree.

2) 4.3% of the information exchange goes beyond the agreed scope, 37.7% are neutral, and 58.0% deny.

3) Only 5% of the franchisors state that there is great trust between them and the partners, 16.7% neither agree nor disagree, and 78.3% state that they disagree.

4) About 2.8% of the franchisors claim that there is an open atmosphere between them and the partners, 19.7% are neutral and 77.5% disagree.
D.3.2.5 Decision Rights

The variable DR is an index consisting of 12 questions regarding the extent to which the franchisees can decide in the following domains:

1) Implementation of investment activities at the outlet level.
2) Financing of investment projects at the outlet level.
3) Selection of suppliers
4) Hiring of employees at the outlet level
5) Training of the employees at the outlet level
6) Product / service offering in the local market
7) Sales price at the outlet level
8) Use of advertising and sales promotion
9) Equipment at the franchised outlets
10) Procurement of inputs
11) Introduction of new products in the local market
12) Usage of accounting systems at the outlet level

Graph 6 describes the frequency analysis of the answers for the independent variable decision rights (DR).
1) Around 63.2% of the franchisees decide to great extent about the implementation of investment activities while 23.0% decide partially, and 13.8% do not.

2) In financing of investment projects 62.6% can decide to great extent, 23.2% partially, and 14.1% not.

3) About 33.3% of them can select their suppliers to great extent, 48.3% partially, and 18.4% can’t decide at this point.

4) An amount of 84.3% can decide over the hiring of employees at the outlet level, 6.5% partially, and 9.3% not.

5) 68% of the network partners can decide about the training of their employees completely, while 24.1% partially decide and 7.2% not.
6) The product and service offering at the local market is decided to great extent by around 49.3% of the franchisees, 36.0% of them can decide partially and 14.7% are not allowed to make decisions.

7) 61.0% decide over the sales price at the outlet level, 27.3% partially, and 11.7 do not.

8) About 56.3% of the franchisees can decide about their advertising and sales promotion, 36.6% just partially decide, and 7.0% not.

9) Equipment at the franchised outlets: 48.6% to great extent, 31.1% partially, 20.3% not.

10) The procurement of inputs is decided to 45.5% from the franchisees, 35.2% just partially decide, and 19.3% do not decide.

11) New products in the local market are introduced to great extent by around 39.5% of the franchisees, partially by 40.7%, and not by 19.8%

12) In the usage of accounting systems at the outlet level 45.3% of the franchisees are allowed to decide while 33.3% partly decide and 21.3% do not decide.

D.4 Regression Analysis

This chapter provides first the correlations and then the regression analysis in three steps:

1) Regression analysis with only the control variables SECTOR and AGE
2) Regression analysis with the control variables SECTOR, AGE, INITIALTRUST, PARTNERTRUST
3) Regression analysis with all variables

The following hypotheses are tested:

Hypothesis 1: “The higher the value of the brand name of the franchise network, the higher the potential threat of franchisees’ free-riding and the lower the residual decision rights allocated to them.”
Hypothesis 2: “The higher the behavioural uncertainty, the higher the monitoring costs, and the higher the residual decision rights allocated to the franchisees.”

Hypothesis 3: “The higher the royalty rate the franchisees’ have to devote to the franchisor, the lower their residual decision rights.”

To examine the hypotheses a linear regression analysis is conducted. The dependent variable DR is interpreted with help of the independent variables, BRANDNAME, MONCOST, ROYALTIES, and the control variables AGE, SECTOR, INITIALTRUST, and PARTNERTRUST. The dependent variable DR is the grade of decision rights allocated to the franchisees, BRANDNAME reflects the value of the networks brand, MONCOST shows the difficulty to observe the franchisees’ behavior, ROYALTIES describes the amount of fees the franchisees’ devote in percent. The variable AGE is used to integrate the duration of the age of the franchise system, SECTOR the franchise sector, the additional control variables INITIALTRUST and PARTNERTRUST enrich the model with the relational governance theory and reflect the general and relational trust of the franchisors.

The regression equation reads as follows:

$$DR = \alpha_0 + \alpha_1 \text{BRANDNAME} + \alpha_2 \text{MONCOST} + \alpha_3 \text{ROYALTIES} + \alpha_4 \text{INITIALTRUST} + \alpha_5 \text{PARTNERTRUST} + \alpha_6 \text{AGE} + \alpha_7 \text{INITIALTRUST} + \alpha_8 \text{SECTOR}$$

Based on the 3 hypothesis the variable BRANDNAME should be negatively correlated with DR reflecting the fact that a valuable brand name decreases the franchisees’ decision rights while MONCOST should have a positive predictor, indicating that with a rising difficulty to observe the franchisees behavior the decisions rights of them also rise. The variable ROYALTIES should decrease with the use of DR, thus it should have a negative predictor. The control variable AGE should have a positive influence on DR. The variable SECTOR represents the differences of the franchise sectors distribution and service. In the distribution sector the franchisees may have less decision rights than in the service sector. For SECTOR
the value of the distribution sector is 0, and for the service sector 1. Thus the tendency towards service franchising should be positively correlated with decision rights and a positive predictor of the variable SECTOR is expected. The additional control variables INITIALTRUST and PARTNERTRUST lent from the relational governance theory also should have positive predictors, reflecting the positive influence of trust on the decision rights of franchisees.
D.4.1 Results

D.4.1.1 Correlations

Table 3 shows the correlations of all variables with each other. The variable BRANDNAME correlates (positively) significantly with DR, and also highly significant with PARTNERTRUST which could indicate coherence between the value of the brand name and the trust in the network. MONCOST also correlates with DR highly significant. INITIALTRUST is highly correlated with MONCOST and INITIALTRUST. The control variable SECTOR is significantly correlated with the variable ROYALTIES which could be a sign for differing grades of royalties (in % of sales) in the franchise sectors of distribution and service.

Table 3: Correlations

<table>
<thead>
<tr>
<th></th>
<th>DR</th>
<th>Brand-Name</th>
<th>MONCOST</th>
<th>Royalties</th>
<th>Partner-Trust</th>
<th>Initial-Trust</th>
<th>Age</th>
<th>SECT 0=Sales, 1=Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>DR</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BrandName</td>
<td>,167*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MONCOST</td>
<td>,264**</td>
<td>,080</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROYALTIES</td>
<td>-.131</td>
<td>-.007</td>
<td>-.082</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PartnerTrust</td>
<td>,348**</td>
<td>,411**</td>
<td>-.011</td>
<td>,042</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>InitialTrust</td>
<td>,026</td>
<td>,100</td>
<td>-.221**</td>
<td>-.023</td>
<td>,234**</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>,049</td>
<td>,148</td>
<td>,139</td>
<td>-.105</td>
<td>,101</td>
<td>-.040</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>SECTOR</td>
<td>-.045</td>
<td>-.083</td>
<td>,103</td>
<td>,204**</td>
<td>,004</td>
<td>,098</td>
<td>-.121</td>
<td>1</td>
</tr>
</tbody>
</table>
D.4.1.2 Regression with Control Variables

Table 4 shows the model summary of the regression analysis of DR including only the control variables SECTOR and AGE. The value of R square amounts to 0.010 which indicates that 1% of the variance of the regression model can be explained.

Table 4: Model Summary 1

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.100&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.010</td>
<td>-.004</td>
<td>1.27283</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), SECTOR, Age

Table 5 contains the anova of the regression with the control variables. The significance level amounts to 0.496, the F value to 0.705

Table 5: Anova 1

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>2,285</td>
<td>2</td>
<td>1,142</td>
<td>.705</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>226,814</td>
<td>140</td>
<td>1,620</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>229,099</td>
<td>142</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), SECTOR, Age
b. Dependent Variable: DR

Table 6 shows the coefficients of the control variables: the variable AGE has a positive coefficient and the significance level is 0.643, the predictor of the variable SECTOR is negative and the significance level amounts to 0.303.
Table 6: Coefficients 1

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>5,007</td>
<td>.231</td>
<td>21,652</td>
<td>.000</td>
</tr>
<tr>
<td>Age</td>
<td>.006</td>
<td>.013</td>
<td>.039</td>
<td>.465</td>
</tr>
<tr>
<td>SECTOR</td>
<td>-.232</td>
<td>.225</td>
<td>-.087</td>
<td>-1.033</td>
</tr>
</tbody>
</table>

a. Dependent Variable: DR

D.4.1.3 Regression with Control Variables and Trust Variables

Table 7 displays the model summary of the regression analysis with the variables AGE, SECTOR, INITIALTRUST, and PARTNERTRUST. Now R square has increased to the value of 0.93 hence, 9.3% of the regression model with the control variables and the trust variables can be explained.

Table 7: Model Summary 2

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.304a</td>
<td>.093</td>
<td>.066</td>
<td>1.22742</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), SECTOR, PartnerTrust, Age, InitialTrust

The next tab shows the anova of the regression with the 4 control variables. Now the significance level has a value of 0.009 which shows that this model is more significant than the model with only the two variables SECTOR and AGE (0.496).
Table 8: Anova 2

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>21,194</td>
<td>4</td>
<td>5,299</td>
<td>3,517</td>
<td>.009a</td>
</tr>
<tr>
<td>Residual</td>
<td>207,905</td>
<td>138</td>
<td>1,507</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>229,099</td>
<td>142</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), SECTOR, PartnerTrust, Age, InitialTrust
b. Dependent Variable: DR

Table 9 shows that PARTNERTRUST is highly significant (0.001) and has a positive coefficient while INITIALTRUST is not significant and has a negative coefficient. The significance level of AGE is lower (0.951) compared with the first model (0.643). The significance of the variable SECTOR (0.339) is almost the same than in the first mode (0.303).

Table 9: Coefficients 2

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>3.437</td>
<td>.692</td>
<td>4.968</td>
<td>.000</td>
</tr>
<tr>
<td>PartnerTrust</td>
<td>.353</td>
<td>.101</td>
<td>.289</td>
<td>3.506</td>
</tr>
<tr>
<td>InitialTrust</td>
<td>-.093</td>
<td>.092</td>
<td>-.084</td>
<td>-1.017</td>
</tr>
<tr>
<td>Age</td>
<td>.001</td>
<td>.012</td>
<td>.005</td>
<td>.062</td>
</tr>
<tr>
<td>SECTOR</td>
<td>-.209</td>
<td>.218</td>
<td>-.079</td>
<td>-.960</td>
</tr>
</tbody>
</table>

a. Dependent Variable: DR

D.4.1.4 Regression with all Variables

The following table 10 shows the model summary of all integrated variables. Now the R square lies at 0.214, indicating that 21.4% of the final models’ variance can be defined.
Table 10: Model Summary 3

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.463\textsuperscript{a}</td>
<td>.214</td>
<td>.170</td>
<td>1.11853</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), SECTOR, PartnerTrust, MONCOST, Age, ROYALTIES (% of sales), InitialTrust, Brandname

The next anova (table 11) displays a significance level of 0.00 of the final regression model. The F-value has increased to 4.794 compared to the first (0.703) and the second regression (3.517) model.

Table 11: Anova 3

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
<th>\textsuperscript{a}</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>41,988</td>
<td>7</td>
<td>5,998</td>
<td>4.794</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>123</td>
<td>1,251</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>195,876</td>
<td>130</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), SECTOR, PartnerTrust, MONCOST, Age, ROYALTIES (% of sales), InitialTrust, Brandname
b. Dependent Variable: DR

The final table 12 shows the coefficients of the whole regression model, integrating all variables. The accordant histogram of the regression standardized residual/frequency and the p-plot of the expected cum prob. / observed cum prob. are attached in appendix C.
Table 12: Coefficients 3

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>1.878</td>
<td>.844</td>
<td>2.224</td>
</tr>
<tr>
<td></td>
<td>Brandname</td>
<td>-.010</td>
<td>.099</td>
<td>-.009</td>
</tr>
<tr>
<td></td>
<td>MONCOST</td>
<td>.318</td>
<td>.083</td>
<td>.330</td>
</tr>
<tr>
<td></td>
<td>ROYALTIES (% of sales)</td>
<td>-.015</td>
<td>.012</td>
<td>-.097</td>
</tr>
<tr>
<td></td>
<td>PartnerTrust</td>
<td>.353</td>
<td>.101</td>
<td>.305</td>
</tr>
<tr>
<td></td>
<td>InitialTrust</td>
<td>.024</td>
<td>.090</td>
<td>.023</td>
</tr>
<tr>
<td></td>
<td>AGE</td>
<td>.004</td>
<td>.013</td>
<td>.026</td>
</tr>
<tr>
<td></td>
<td>SECTOR</td>
<td>-.208</td>
<td>.216</td>
<td>-.080</td>
</tr>
</tbody>
</table>

a. Dependent Variable: DR

**Hypothesis 1:** “The higher the value of the brand name of the franchise network, the higher the potential threat of franchisees’ free-riding, and the lower the residual decision rights allocated to them.”

The variable BRANDNAME has a negative coefficient and a significance level of 0.923. The variable represents the value of the franchise networks’ brand name. The negative coefficient of the variable was predicted but the significance is far above p>0.05. Thus, the hypothesis that the value of the brand name influences the decision rights of the franchisees negatively is not supported.

**Hypothesis 2:** “The higher the behavioural uncertainty the higher the monitoring costs, the higher the residual decision rights allocated to the franchisees.”

The prefix of the variable MONCOST is positive and the significance value amounts to 0.000. The predicted positive relationship to the independent variable DR and the high significance level support the second hypothesis, the higher the monitoring costs the higher the franchisees’ decision rights.
**Hypothesis 3:** “The higher the royalty rate the franchisees' have to devote to the franchisor, the lower their residual decision rights.”

The B value of the variable ROYALTIES in table 12 shows a negative coefficient and the significance value shows 0.241. The negative coefficient was predicted, but the value of 0.241 is above 0.05. That means the third hypothesis that the variable ROYALTIES have a negative effect on DR could not be confirmed.

**Control Variables**

As predicted, the variable PATNERTRUST is positively related to the independent variable. The high significance value of 0.01 indicates that trust between the partners in franchising networks influences the decision rights allocated to franchisees' positively.

The variable INITIALTRUST is positively related to DR, the significance level is 0.784 (not significant).

The control variable AGE has a positive coefficient and is not significant (Sig = 0.753).

The last control variable, SECTOR has a negative coefficient, but with the value of 0.336 it is not significant.
D.5 Discussion and Conclusion

The intention of this thesis was to examine the decision rights allocated to franchisees in franchise systems from an agency-theoretical point of view. Specifically, the topics of free-riding, the role of monitoring costs, and the influence of royalties where studied. The instruments in the empirical part used for that purpose where the brand name value, behavioral uncertainty of the franchisee, and the amount of the variable royalties in % of sales. These instruments where compared with the amount of decision rights allocated to the franchisees. In addition to that, a gaze on the role of trust, lent from the relational governance theory has been taken.

The empirical study was able to prove a positive relationship between monitoring costs and franchisees’ decision rights. It failed however to support the hypotheses of a negative relationship between royalties and franchisees’ decision rights and the negative relationship of the threat of free-riding and the decentralization of decision rights. Additionally, an interesting and incidental finding was the positive correlation of the relational trust between the network partners and the grade of decision rights granted to the franchisees.

A reason why the study has failed to prove a negative relationship between the brand name value and franchisee’s decision rights could be that franchisors of high-value networks seek to avoid to signal a lack of trust in their network partners. Following Kidwell (2006) this lack of trust enhances the threat of free-riding because the franchisees tend to misbehave in a climate of low trust.237

The failure to prove the positive relationship between royalties and franchisees’ decision rights shows that there is probably no coherence between centralization of decision rights and the assumption that higher royalties evoke similarity to company ownership238. This could reflect that franchisees stay entrepreneurs eager how high their royalty payments are.

Managerial implications are: 1) That in an environment of high behavioral uncertainty it is better to grant franchisees more decision rights in order to reduce monitoring

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237 Kidwell et al. (2007:527).
238 Lafontaine et al. (1992:274)
expenditures, respective: agency costs. 2) Franchisors should provide a climate of trust between the partners in the network because if they can trust the franchisee they can decentralize the decision making authority and avoid agency costs.

This paper is limited by the fact that agency theory only provides a narrow view of franchisees' decision rights. The exclusive usage of this theory is not sufficient to examine an extremely diversified topic (such as the allocation of decision rights in franchising networks) which is influenced by a variety of different factors.

Future research questions could focus on an interaction between environmental and behavioral uncertainty compared with decision rights and determining factors on decision rights that also should be considered like the performance of the franchising network and the role of trust (relational governance perspective).
4. References


Appendix

Appendix A: Abstract in German


Appendix B: Curriculum Vitae

Name: Daniel Gebhart  
Adresse: Favoritenstraße 37/4 - 1040 Wien  
Geburtstag: 20.02.1978  
Geburtsort: Oberndorf bei Salzburg  
Staatsangehörigkeit: Österreich  
Familienstand: ledig  
Präsenzdienst: abgeleistet  
E-Mail: gebhartdaniel@hotmail.com  
Telefon: +43/650/8228229

Schulbildung / Studium

Seit 1999 Rechtswissenschaften  
19.06.1998 Matura in Informatik, Mathematik, Englisch, Deutsch, Geschichte  
1993 – 1998 Oberstufenrealgymnasium Salzburg mit Fachzweig Informatik  
1988 – 1993 Hauptschule Hallein Stadt  
1984 – 1988 Volksschule Hallein Stadt

Sprachkenntnisse

Deutsch: Muttersprache  
Englisch: Verhandlungssicher  
 Französisch: Fließend

EDV-Kenntnisse

MS-Office (Excel, Word, Powerpoint, Frontpage)  
Lotus Notes, Bildaufbereitung in Adobe Photoshop, SAP

Soziale Fähigkeiten und Kompetenzen

Gute Kommunikationsfähigkeit, Freude an Teamarbeit, Empathie, Selbstständiges Arbeiten, Stressresistenz, Strukturierte Arbeitsweise

Besondere Fähigkeiten

Führerschein B  
Kranführer­schein  
Staplerschein
Beruflicher Werdegang
Seit Jänner 2009

Byting Handler OEG (Angestellt)

Assistent der Geschäftsleitung

In dieser Position wurde ich mit folgenden Aufgaben betraut:

- Sekretariats- und Backofficetätigkeiten
- Durchführung internationaler Korrespondenz
- Organisation von Meetings und Events
- Buchhaltung

Oktober 2006 – Dezember 2008:

Schindler Fahrtreppen International GmbH (Angestellt)

November 2005 - September 2006:

Schindler Aufzüge und Fahrtreppen GmbH (Freiberuflich)

Assistenz der technischen Dokumentation / Forschung und Entwicklung

In dieser Position wurde ich mit folgenden Aufgaben betraut:

- Sekretariats- und Backofficetätigkeiten
- Durchführung internationaler Korrespondenz
- Organisation von Meetings und Events
- Verwaltung von internen Datenbanken, sowie die Ordnerstrukturen auf den öffentlichen Laufwerken
- Bildbearbeitungen mit Photoshop
- Erstellen von Powerpointpräsentationen, Exceltabellen und Inhaltsverzeichnissen von Handbüchern
- Veröffentlichung von Handbüchern und Verkaufsbroschüren im Firmenintranet
- Auswertung von Fragebögen

SONSTIGE INTERESSEN

Laufen, Bergwandern, Tourenski, Reisen, Geschichte, Wirtschaft
Appendix C: Charts of the Regression

Normal P-P Plot of Regression Standardized Residual
Dependent Variable: DR

Histogram
Dependent Variable: DR

Mean = -1.20E-15
Std. Dev. = 0.973
N = 731