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„Empirical Contract Analysis in Franchising“

Verfasst von

Corinna Neubach, BSc

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Betreuer:	ao. Univ.-Prof. Mag. Dr. Josef Windsperger

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RPM	Resale Price Maintenance
USA	United States of America

1. Introduction

Franchising can nowadays be found in almost all commercial areas, i.e. in clothing, furniture, hotels and restaurants, service areas, etc. Franchising basically consists of a contract-giving firm (the franchisor) and autonomous contract takers (the franchisees). The franchisor warrants the right to use trademarks, labels, production procedures, names, technological know-how, etc. against payment by the franchisee (Hempelmann, 2006, p. 449).

A contractual agreement between both parties is essential since franchising involves a certain degree of interdependence. An efficient assignment of property rights is a central feature of every franchise contract because it implicates the allocation of resources between the franchisor and the franchisee. Property rights ensure system conform behavior, give incentives to invest in the business and have a motivational effect on the involved parties. In general, property rights can be divided into decision rights and ownership rights. Decision rights are the rights to determine the distribution and use of firm assets. They are allocated depending on the distribution of intangible knowledge assets between the franchisor and the franchisee. The franchisor’s intangible know-how is system-specific business practices and intellectual assets, whereas the franchisee’s intangible know-how is experience, local market knowledge and managerial skills. Ownership rights can be interpreted as residual rights of control. They can further be differentiated into residual income rights and ownership surrogates. In franchise relationships, residual income rights refer to royalties and initial fees. If contracts are incomplete, some residual rights will remain that are not included in the agreement. In franchising, residual income rights are diluted because of the division of residual surplus between the franchisor and the franchisee. Ownership surrogates are additional devices that increase the incentive effect of diluted residual income rights and motivate the franchisor or the franchisee to undertake additional investments (Windsperger, 2008, p. 20) (Windsperger, 2003, p. 292) (Windsperger, 2002, pp. 132, 139). The aim of this thesis is to evaluate property rights based on a database of 208 franchise agreements. More precisely, the distribution of decision and ownership rights and their incentive effect on the franchisor and franchisee are analyzed.

This master thesis is divided into four major parts. The first part deals with the concept of franchising, its definition and historical origin. It further focuses on the different types of franchising. Generally speaking, franchising can be divided into product franchising, distribution franchising and service franchising. This chapter also addresses the different explanations for franchising and its differentiation from related systems. Moreover, an elaborate part is dedicated to the different provisions which are commonly included in franchise contracts.

The following part provides a theoretical outline of the different neo-institutional approaches. The three main theories are the property rights theory, the transaction cost theory and the principal-agent theory. Property rights determine how a good is used and owned. The right of ownership consists of the right to use an asset, the right to capture benefits from that asset, the right to change its form and substance and the right to transfer the good to others. Transaction costs are the costs of obtaining a good or service via the market. These costs are higher than the actual price of the good. Costs like search and information costs, bargaining costs, keeping trade secrets as well as policing and enforcement costs, can all add to the cost of acquiring something through the market system. By means of these costs, the most efficient organizational form for the underlying transaction has to be chosen. According to the transaction cost theory, transaction costs form the basis for setting up contractual agreements (Besanko, Dranove, Shanley, & Schaefer, 2010, p. 137) (Williamson, 1985, pp. 20-21). The principal-agent theory focuses on the relationship between the principal and the agent. The principal delegates the exercise of certain activities and decision-making authority to the contractor, which is the agent. At the heart of this relationship is a franchise contract. Based on the theories of neo-institutional economics, obstacles and difficulties encountered in the distribution of property rights can be explained.

The third part consists of the different property rights in franchise contracts. Usually, franchise contracts impose quality standards, common opening hours, tying arrangements, payment plans through initial fees and percentage of revenues, etc. on the franchisee and its business product while the franchisor usually handles employee training programs, national marketing and acts as an advisory and monitory body (Mathewson & Winter, 1985, p. 503). Furthermore, it is evaluated whether ownership surrogates can create some sort of balance between the franchisee and the franchisor with respect to franchise-specific problems and opportunism.

The last part focuses on the empirical contract analysis. First of all, the choice and derivation of the hypotheses is explained. A special focus is put on the relationship between residual decision rights, residual income rights and ownership surrogates. The same relations are analyzed in the different franchise sectors, i.e. in product franchising, distribution franchising and service franchising. In addition, the methodology of the analysis is explained, including the research design and objective as well as the analytical approach of assessing the results. Last but not least, the available data is extensively analyzed. A frequency and descriptive analysis is conducted to give a better understanding of the data set. Finally, the results are interpreted and possible limitations of the study are presented. The results show that in this particular set of data, no clear connection between residual decision rights, ownership surrogates and residual income rights can be found. Only few theoretical explanations could be affirmed when looking at the hypotheses independently. In general, no sustainable support for the applicability of the property rights theory in franchising could be obtained.

2. Franchising

2.1 The concept of Franchising

Franchising is a form of cooperation between legally independent operators which allows the realization of economies of scale, the restriction of opportunistic operational scope and the simplification of system adjustments. Aside from fast food chains and car dealerships, businesses like gas stations, hotel chains, home improvement centers, etc. are also organized based on the concept of franchising (Picot, Dietl, & Franck, 1999, p. 182).

2.1.1 Historical Origin

The word ‘franchising’ originates from France, where it used to and still relates to the exemption of taxes and tariffs. In the post-Middle Ages, the term franchising referred to the cultivation of a territory which belonged to the State or the granting of a right to do commerce, which was usually reserved to the higher authority. Furthermore, the term was used to denote the granting of immunity from an obligation. Nowadays, the term has spread internationally and has been adopted to indicate a business system (European Franchise Federation). Franchising in the new sense was first introduced in the USA through the Singer Sewing Machine Company in the 1860s by implementing a comprehensive distribution system of sewing machines. Around the turn of the last century, different car manufacturers started to organize their dealership network through a franchise system; distribution systems for fuel and bottling distribution systems for Coca Cola followed. Today, this form of franchising is described as distribution franchising, which will be discussed in detail in the next chapter but one. In the original practiced form of franchising the main focus lay on the distribution of goods. Currently, there are many different forms of franchising, e.g. product franchising, service franchising, master franchising, business format franchising and many more (Skaupy, 1995, pp. 1-2).

In 2013, there were around 445 Franchise systems in Austria. However, this number fluctuates quite strongly since the market is dynamic and quickly growing. In 2010, there were 420 Franchise systems active in Austria. Around 46% originate from Austria, around 38% from Germany and the rest from an international background. From the 420 franchise systems, 180 can be assigned to commerce. Around 170 systems can be allocated to the service industry. Only around 45 systems originate from the food service industry and only 25 from the production industry. In 2010 the net annual turnover accounted for 7.9 billion euros (Hajek & Siegl, 2013, pp. 3-5) (Gittenberger, Eidenberger, & Talker, 2011, p. 3).

2.1.2 Definition

Nowadays, franchising can be described as a vertical relationship between a franchisor and one or more franchisees. The franchisor sells the right to market goods or services or to use his business practices under his brand name to the franchisee (Combs, Michael, & Castrogiovanni, 2004, p. 907). The franchisor therefore exchanges the right to use his brand name for a share of the franchisee's profits (Mathewson & Winter, 1985, p. 504).

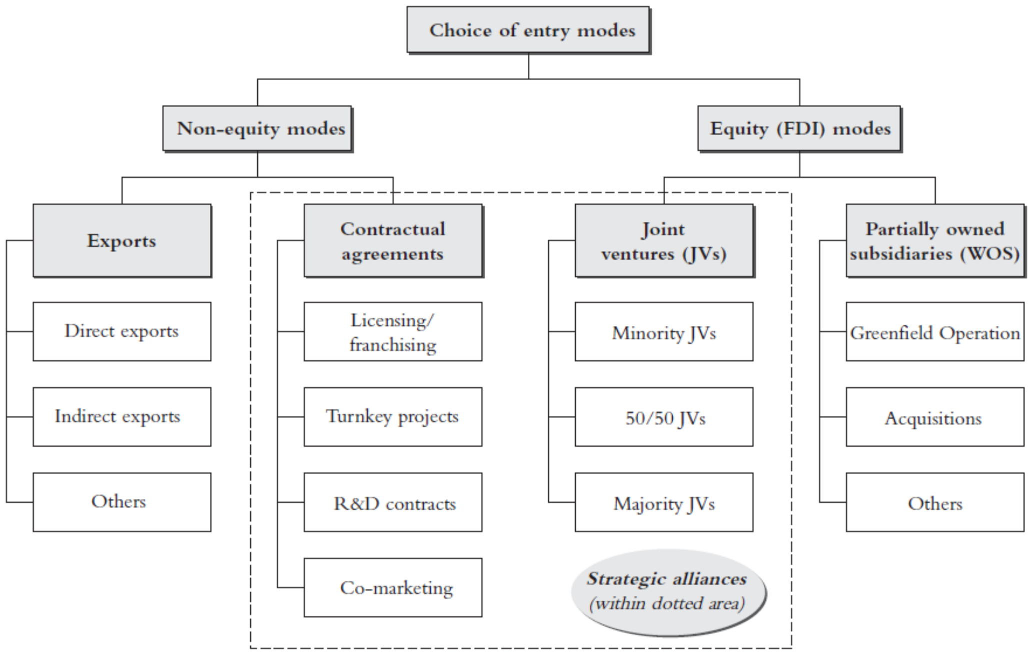
The term franchising is used in many different sectors and industries. Therefore, a generally agreed-upon definition does not exist. The European Franchise Federation characterizes franchising as follows:

> *"Franchising operates on the basis of a contractual agreement between two independent business parties, the franchisor and the franchisee, in which the franchisor grants the franchisee, for the term of the contract, the right to buy and operate the franchisor's branded and formatted business system for a fee and according to the prescribed rules and procedures developed for the system by the franchisor."* (European Franchise Federation).

The franchisee is an economically and legally independent businessman. He has no authority to represent the franchisor but acts on his own behalf and own account. The franchisee earns profit from the difference of purchase and selling price (Vortmann, 1990, p. 16).

Furthermore, franchising can be seen as an international strategy for entering foreign markets but also as an expansion mode for the domestic market. Franchising is a non-equity mode based on a contractual agreement. The following figure puts franchising in relation to other expansion modes.

Figure 1: Franchising and other Expansion Modes



Source: (Peng, 2009, p. 168)

For the franchisor, the franchise is an opportunity to build new stores and to distribute goods while avoiding the investments and liability of a fully owned affiliate (Peng, 2009, p. 139). The franchisor typically gives managerial assistance and advice on site selection, training programs, operating procedures, advertising and design of the store layout. The franchisee in return agrees to run the business according to the franchise agreement. This gives the franchisor substantial control over the franchisee. However, the franchisor's success indirectly depends on the performance of the franchisee. Nevertheless, the franchisee still has a greater incentive than an employee to outperform because he holds a direct stake in the business (Norton, 1988, p. 199) (Rubin, 1978, p. 224).

Franchising has two components that distinguish it from other organizational systems e.g., joint ventures. On the one hand, franchising is typically used in the service industry, for example in fast food chains. These services usually have to be executed close to the customer. On the other hand, franchise contracts are a unique form of allocating ownership and decision rights, profits and liabilities (Combs, Michael, & Castrogiovanni, 2004, p. 908). The statement of rights and obligations of the franchisor and the franchisee form the most important part of a franchise contract. This will be discussed in detail in chapter 2.4.

2.1.3 Differentiation from related systems

A typical franchise contract mandatorily consists of a license agreement which gives permission to use industrial property rights (trademarks, service marks, naming rights, patents, registered designs, etc.), a know-how agreement which covers commercial, technical and managerial knowledge and finally a representation relationship. Complementary contracts can be lease agreements, tenancy agreements, option contracts, tripartite or multilateral agreements, company agreements, etc. (Skaupy, 1995, pp. 11-12). A distinction from similar organizational forms is important, especially to comprehend and draft the empirical analysis of the contracts, which will be discussed in chapter 6.

Alongside franchising, there exist several other forms of vertical cooperation. In a **license agreement** a licensor grants permission to the licensee to use his industrial property rights. These range from technical property rights like patents or utility models, trademarks, service marks and graphic characters to brand names. In return, the licensee pays a royalty. Licenses can be transferred with a geographical, temporal and contentual limitation (Wirtschaftslexikon, Stichwort: Lizenzvertrag). What differentiates a license agreement from a franchise agreement is primarily its lack of a uniform market presence. Similar to a dealership, there is no organizational, marketing or advertising concept. Unlike a franchise system, a license agreement does not include a right to monitor, control and supervise the licensee. But, as already mentioned, license agreements are always part of a franchise agreement (Garmaier, 2009, p. 11) (Skaupy, 1995, p. 14).

Dealerships are probably the most similar organizational form and show various commonalities to franchise systems. They consist of a cooperation between a manufacturer and several legally independent dealers. The dealer acquires the right to distribute the manufacturer’s products in his own name and at his own expense (Wirtschaftslexikon, Stichwort: Vertragshändler). The main differences to a franchise system are, however, that a dealer uses the trademark, name or label of a company only to a certain degree. A dealership lacks the complete identification with the exactly specified group image of a distribution system. In addition, there is no tightly handled organizational system, which is the case in a franchise system. Moreover, there is no uniform marketing and advertising concept and no ongoing support and guidance by the manufacturer. In a franchise system, the franchisor has the right to monitor and give instructions, which is not the case in a dealership. In general, a dealership is a much looser system than franchising and usually aims for a long-term cooperation. A common example is independent car dealerships (Garmaier, 2009, p. 10) (Skaupy, 1995, pp. 13-14).

2.1.4 Basic types of Franchising

The basic types of franchising can be differentiated according to the object of the franchised system, i.e. in line with the nature of the business. As a consequence, three broad categories of franchise systems can be classified. This distinction is useful because the character and legal/contractual approach of these basic types often differ (Skaupy, 1995, p. 30).

Product franchising involves the production, handling, processing and refinement of a product by the franchisee. The franchisee has to comply with directives, production-technical knowledge, the experience of the franchisor and the distribution of the product. The franchisee then offers the goods on the market under the name and trade mark of the franchisor. The beverage industry, for example, provides its franchisees with various commodities (e.g., cola concentrate) as well as the know-how for bottling. Other examples are cosmetics, drugstores, sweets and textile shops.

Distribution franchising focuses on the sales of goods that are produced by the franchisor or a third party. The main task of the franchisor is to provide the franchisee with merchandize, which the franchisee then distributes. This type of franchise does not exclusively focus on the individual product, but on the whole package that characterizes the entire distribution system of the franchisee. This form of franchising is mostly found in the retail industry such as furniture, cosmetics, sports equipment, bakery products, etc.

As part of the **service franchising,** the franchisee uses the know-how of the franchisor to provide services according to the specifications and the brand or trademark of the franchisor. The brand name represents the existing know-how and the specificity of the methods used. Service franchising is often used in established service industries such as hotels, catering or car rentals. However, it can increasingly be found in younger service sectors as well (Pohl, 2005, p. 8) (Skaupy, 1995, pp. 31-33) (Garmaier, 2009, p. 14) (Vortmann, 1990, pp. 14-15).

In practice, the basic franchise types often occur in mixed forms, which combine the individual contract types. A franchisee of McDonalds, for example, might be contractually obligated to purchase certain products directly from the franchisor; nevertheless, the franchisee also has the motivation to sell a considerable amount of goods to consumers. This is a case of a mixed form of distribution and service franchising (Garmaier, 2009, p. 15).

2.1.5 Different explanations for franchising

Franchise contracts are a hybrid form of economic organization. There has been a stream of franchise literature concerning the motivation of a firm to rather transact within a semi-integrated, franchised operation, than fully integrate into the company (Hopkinson & Hogarth-Scott, 1999, pp. 830-831). There are different approaches to explain the existence of franchising, which will be discussed in the following.

According to Norton (1988, pp. 199-200), one predominant explanation for franchising is based on **capital market imperfections**. According to this theory, franchising gives the franchisor the opportunity to raise capital. Because of market imperfections and market failure, the franchisor is able to raise capital at lower costs than other arrangements would require. The prerequisite, of course, is shortage of capital. However, this theory of explaining the existence of franchising has been heavily criticized. For starters, it contradicts with the portfolio theory. The franchisee has no incentive to invest in a franchise business since the portfolio is not diversified. Risk-averse franchisees would therefore demand a risk premium of the franchisor, which would diminish his returns (Norton, 1988, pp. 199-200) (Combs, Michael, & Castrogiovanni, 2004, pp. 909-910) (Hopkinson & Hogarth-Scott, 1999, p. 831).

Another explanation centers on incentives that are linked to **market power**. Downstream firms may have the possibility to replace inputs sold under market power with other inputs, given the absence of direct control by an upstream firm with market power. Thus, there is a contractual agreement between the franchisor and the franchisee which prevents the latter to defect. This theory, however, lacks empirical evidence since market power is hard to measure (Norton, 1988, p. 200).

Some researchers argue that franchising is based on **resource-scarcity**. It enables the franchisor to overcome internal resource constraints by gaining access to the franchisee's resources, e.g. knowledge. Franchising therefore allows for quick expansion. Internal resource constraints can come in the form of capital or human resources. It is important to mention that franchising is viewed as a second-best solution or as an alternative form of organization. It is considered a short-term strategy for expansion, with the goal of integrating in the long-run. However, not much evidence has been found to support this form of franchise redirection (Hopkinson & Hogarth-Scott, 1999, pp. 831-832).

A different theory gives an **agency-based explanation** for franchising. It centers on contractual relationships, where a principal delegates tasks to an agent. The underlying assumptions are incomplete information and unknown decision risks. Furthermore, both players are driven by self-interest and problems may arise through diverging objectives. The goal is to minimize the costs of the contract and to ensure efficiency for the principal. The objective of the principal-agent theory is to give recommendations for the structuring of contracts which is why it is connected to franchise relationships (Hopkinson & Hogarth-Scott, 1999, p. 833) (Taheri, 2002, pp. 39-41). There are certain agency costs that can be associated with franchising. Horizontal free riding arises when franchisees reduce quality within their own unit and therefore gain personal benefits by saving costs. The loss that is caused by the reduced service is spread throughout the brand and suffered by all franchisees operating under the same name. The other form is termed vertical free riding. Here, the franchisor saves money by decreasing the quality of his inputs; the costs, however, have to be borne by all franchisees. The threat of free riding can be eliminated by specifying the quality in contracts and by monitoring both parties. Another agency problem is the risk of opportunism, which expresses itself through moral hazard or adverse selection (Hass, 2010, pp. 56-61).

Another explanation that is often given to explain franchising is **transaction cost economics**. Transaction costs emerge because of bounded rationality in a complex and constantly changing environment. Because of high environmental uncertainty, the franchisor is circumvented from defining complete contract terms which lead to an increased necessity for subsequent adaptations by allocating residual decision rights. The bigger the environmental uncertainty, the less complete the franchise contract (Hendrikse & Windsperger, 2011, p. 17). Franchising is viewed as a hybrid organization form that contains market und hierarchal elements. The goal is to design the franchise contract in such a way that transaction costs are minimized (Taheri, 2002, pp. 41-42).

2.2 Significant provisions of Franchise Contracts

The franchise contract forms the juridical basis for a cooperation between the franchisor and the franchisee. The contract determines all rights and obligations of the contracting parties for the duration of the contract and sometimes even after that. Franchise contracts contain numerous more or less standard clauses. One focus is the statement of obligations from both parties. However, a complete declaration of obligations in case of all eventualities is impossible due to environmental uncertainties. Franchise contracts are therefore incomplete. However, a thorough ex post monitoring of a franchise system is also hard to realize (Hempelmann, 2006, p. 450). The higher the intensity of mutually agreed upon commitments, the more extent are the contractual provisions (Tietz, 1987, p. 507).

Franchise agreements cannot be classified according to the typical contract types of civil or commercial law. They usually are a combination of three types of contracts, including elements from know-how agreements, license agreements and agency agreements. Know-how agreements are insofar part of a franchise agreement, to the extent that the use of technical, operational and commercial experience is left to the franchisee. The component of the license agreement is equal to a trade mark, trade name or other identification of the franchise system. The contractual element of the agency agreement refers to the franchisor supplying the franchisee with products, which the latter then distributes. Other contract elements that may occur in franchise agreements result from sales contracts, work contracts or retentions of title (Skaupy, 1995, pp. 11-15).

2.2.1 The Commencement Clause

A preamble is found in almost every franchise agreement. This introductory element is sometimes excluded in more simple contracts. Here, the distinctive basis and important features of the franchise system are presented. Alongside the range of activities, the trade mark rights of the franchisor are specified. It is important to state this information as accurately as possible in order to clarify which components of know-how are transferred from the franchisor to the franchisee. This helps specify the services of the franchisor and determines the amount of admission fee which the franchisee has to pay the franchisor at the beginning of the franchise relationship. A preamble normally contains the following information:

- The industrial property rights such as trademarks, patents, patterns, etc. which are relinquished to the franchisee
- The organizational, marketing and advertising concept of the franchisor which is standardized throughout the franchise system
- The specific service package containing operational and technical know-how
- The ongoing support of the franchisee including the later specified service of the franchisor
- The training courses and seminars which are available for the franchisee and his employees concerning technical, commercial, business and promotional difficulties.

To state these system features in the preamble helps facilitate the legal clarity between the involved parties (Skaupy, 1995, p. 132).

2.2.2 Granting of Franchise Rights

The granting of franchise rights can be regarded as the foundation of the franchise agreement. In this part of the contract, the franchise item is defined and clearly outlined. A detailed denomination is essential, so that manner and extent of usage can be determined. Territorial clauses ensure that a specific region around the franchise operation is defined. Sometimes, even an exclusivity clause is included. Furthermore, it is important to state the exact location where the franchise operation will be active. Under certain circumstances a clause is added which specifies that the franchisor has to approve of the choice of business space. Moreover, the franchisee is recognized as an independent businessman, who acts in his own name and on his own account. The contract further includes the extent to which the franchisee can or must use the brand name or other distinguishing indicators of the franchisor. It is often prohibited that the franchisee solely carries the brand, or other indicators of the franchisor, in the name of his company. Some sort of name affix that relates to the franchisee is usually required. Some contracts further include facts regarding a possible no-competition clause for the duration of the partnership, a confidentiality obligation for the franchisee and a post-contractual competition clause. Most franchise systems are based on the exclusivity of know-how; it is therefore contractually regulated that this knowledge is kept confidential. Because of the diversity of franchise systems, there are various franchise rights that could be added here (Skaupy, 1995, pp. 132-133) (Vortmann, 1990, pp. 17-19).

2.2.3 Rights and Obligations of the Affiliates

This part of the contract lists the detailed rights and obligations of the franchise partners and is therefore the most essential component. Here, mutual obligations and permissions are listed. A successful franchise heavily depends on a relationship of trust. To disregard contractual duties can have a negative influence on the trust relationship between the parties which in turn can lead to a failure of the entire franchise system.

Obligations of the franchisor

An extensive transfer of know-how is the key prerequisite of a successful franchise business. It is therefore the franchisor’s primary duty to transfer the promised know-how to the franchisee. This particular knowledge is not available to the public. In addition, the franchisor has to hand over all documents, recordings, price lists, recipes and operating instructions that are necessary to run an effective business. Furthermore, the franchisor contractually guarantees ongoing support and advice. This is important because it can help establish a successful operation from the first day on. The extent of advisory duties goes as far as the franchisor cautioning against bad business investments. Often, the franchisor is required to help with the establishment of the franchise operation or provide a turnkey construction solution. A common provision includes trainings provided for the franchisee and sometimes even his employees. Contractual regulations also concern the extent of advertising and promotional measures that are provided by the franchisor. Of course, the franchisor is additionally required to provide the franchisee with stipulated products, equipment and spare parts on time or in contractually agreed upon intervals (Vortmann, 1992, pp. 18-20) (Skaupy, 1995, p. 133) (Fernández, González-Busto, & Castano, 2013, p. 4).

Obligations of the Franchisee

In principle, the rights and obligations of the franchisee are freely compatible. However, it is important that the contractual agreement does not limit the franchisee in his actions. A franchise agreement should not favor the franchisor unilaterally. Nevertheless, the franchisee has to comply with contractual arrangements to enable the functioning of the franchise system. He has to pay a franchise fee for receiving the franchisor's know-how and guidance. The nature and amount of the franchise fee can be individually determined by the contracting parties. In a distribution franchising agreement, the purchasing price the franchisee has to pay is usually contractually regulated. Moreover, there is an additional front-end or admission fee. In service or production franchise agreements, the franchisee usually pays the franchisor a percentage share of turnover. It is also worth mentioning that the franchisee has to follow the instructions of the operating manual and other provisions regarding the establishment and maintenance of the franchise operation. Furthermore, the franchisee has to allow the franchisor insight into business documents and disclose desired information at all times. If the franchisor proposes initiatives that are likely to improve the efficiency of the franchise operation, then the franchisee is obligated to implement these measures. In addition, training seminars have to be attended by the franchisee and sometimes even senior management. Recommended advertising and promotional measures have to be executed and local advertising campaigns have to be organized. Moreover, the franchisee has to preserve and maintain the image of the franchise system. However, the implementation has to be exactly coordinated with the franchisor (Vortmann, 1992, pp. 21-24) (Skaupy, 1995, p. 134).

The set of obligations of the franchisee heavily depends on the type of franchise system. The same holds true for the responsibilities of the franchisor. In general, it is the franchisee's duty to support the sales target of the franchisor and to safeguard the company's image (Vortmann, 1992, p. 23).

2.2.4 Contractual duration and termination

The duration of franchise contracts depends on various variables, e.g. the business branch, the nature of the business, the extent of initial investments and so on. Since the initial investments of a franchisee can be considerable high, it is important to safeguard interests in a contractual agreement. This includes sufficient time to amortize the initial investments. Franchise objects that require high capital investments, like hotel-franchises, certain gastronomic franchises or large home improvement markets, have long duration contracts (Skaupy, 1995, p. 137).

Franchise agreements usually have an initial maturity of 5 – 10 years. There exists a prolongation option which normally amounts up to 2 – 5 years. In the case of high initial investments, the duration ranges from 10 – 20 years. However, a contract duration of more than 20 years is not recommended since there is the possibility of violating moral principles (Garmaier, 2009, p. 16). If the franchisee does not dispose of the necessary experience and the success and duration of the franchise is uncertain, then the contract length can be indefinite. In this case, a clause that covers a statutory period of notice should be included.

Another option is a termination without notice if certain conditions are neglected. Reasons for this drastic measure can be a serious breach of contract, the initiation of a bankruptcy proceeding, the suspension of payments, legal enforcement that harms the image of the business etc. These circumstances can, of course, occur on both sides of the agreement and can result in damage compensation claims (Vortmann, 1992, pp. 28-29) (Skaupy, 1995, pp. 137-139).

Lorelle Frazer (2001, pp. 227-229) finds two possible reasons for a franchise disruption: the lack of franchisor support and the franchise life cycle stage. The success of a franchisee’s outlet depends largely on the help and support of the franchisor. However, it is not a significant cause of system disruption. Franchises evolve and develop in different stages of their life cycles. The classic life cycle ranges from an introductory stage to growth and eventually through decline. Results show that the stage of life cycle development is significant, whereby older and bigger franchises experience a greater level of disruption.

2.2.5 Conclusion of the franchise relationship

There are several contractual provisions concerning the termination of a franchise relationship. A precise notation of these provisions is necessary since the termination of franchise relationships often go hand in hand with problems and contentions. Regulations that concern the franchise conclusion are listed below.

- Direct consequences are, e.g., the handing out of all documents, especially those concerning know-how or classified instructions
- The franchisee has to terminate the utilization of the brand, the name or other brand specific indicators
- The acquisition of the business or the premise by the franchisor or a third party and possibly its equipment and inventory
- The right to a compensation for the franchisee for handing over its customer base
- A post-contractual competition clause.

In certain cases it is possible to prolong the franchise contract, especially if the franchisee has been in the business for quite some time. This is based upon fiduciary duties of the franchisor. However, it is not an automatic process but dependent on mutual agreements between the franchisor and the franchisee and subject to contractual freedoms (Skaupy, 1995, pp. 139-145) (Vortmann, 1992, pp. 24-25, 28) (Vortmann, 1990, pp. 27-28).

3. Review of important Neo-Institutional Approaches

New institutional economics concentrates on the effect of institutions e.g. contracts or organizational structures on human behavior. Its main focus lies on the efficient design of institutions. There is no consistent theoretical concept to explain new institutional economics, only several methodologically related approaches (Picot, Dietl, & Franck, 1999, pp. 54-55). Franchise systems and their successful implementation heavily depend on the allocation of decision-making power and property rights. The allocation of disposition rights in franchise systems can be explained based on the theories of new institutional economics. The three main branches are the property rights theory, the transaction cost theory and the principal-agent theory.

3.1 Property Rights Theory

According to Picot, Dietl and Franck (1999, p. 55), the value of a good is not only determined by its physical attributes but also by its property rights, i.e. the rights to access and use a good. Property rights can be transferred between individuals via contracts. They are socially sanctioned behavioral relations between individuals which are born from the existence of goods and scarce resources (Buhbe, 1980, p. 3). Alchian (1967, pp. 2-3) defines it as follows:

> "*In essence, economics is the study of property rights over scarce resources […] the allocation of scarce resources in a society is the assignment of rights to uses of resources*" (Alchian, 1967, pp. 2-3).

3.1.1 Basic assumptions of the property rights approach

Property rights or disposition rights are theoretical constructs for determining how a resource is used and owned. They constitute a relationship between individuals that arises from the existence of scarce resources. These rights are shaped by manners, social customs and formal laws and rules of the state (Pejovich, 1997, p. 3). Individuals can either respect property rights implicitly, in which case they are called customs or traditions, or explicitly through a contract (Pejovich, 1997, p. 123). The definition and allocation of property rights are, from an economic point of view, relevant for the amount and distribution of wealth within a society (Wirtschaftslexikon, Stichwort: Verfügungsrechte).

There are four elements relevant to the right of ownership: the right to use an asset, the right to capture benefits from that asset, the right to change its form and substance and the right to transfer the good to others (Pejovich, 1990, p. 28). Exclusivity of ownership consists of the right to choose how to use a good and bearing the consequences of that decision. The owner of a good further has the right to transfer or sell a good to another individual under agreed upon terms. In addition, the owner can of course earn income from a good or enforce his property rights (Pejovich, 1997, pp. 3-5). The behavioral characteristics of the actors are bounded rationality and individual utility maximization (Picot, Dietl, & Franck, 1999, pp. 55-60).

From a property rights perspective, contracts between economic subjects fulfill the function of assigning property rights of goods. The more complete the property rights of a good are assigned to one actor, the more efficient he will behave. The combination of the rights to use, change and sell a good together with the right to earn profits and losses, ensures that the actor bears the consequences of his own behavior. He therefore has a strong motivation to employ all resources efficiently (Picot, Dietl, & Franck, 1999, pp. 56-58).

3.1.2 Attenuation of Property Rights

The rights of disposition of an asset can be allocated to one person or to more than one individual. Property rights are then defined as either concentrated or diluted. In franchising, the rights of disposition are attributed to more than one person; therefore, this chapter focuses on the attenuation of property rights. Property rights are diluted if the extent of available rights to access and use a good are limited. There are two possibilities of diluted property rights: on the one hand, not all rights have to exist at the same time or have to be ascribed to the same actor; on the other hand, rights can be distributed among several actors at the same time (Ganske, 1996, pp. 21-23) (Picot, Dietl, & Franck, 1999, pp. 55-56). If several economic subjects share a good, this also relates to the profits made from selling or using the good. The value of the good therefore decreases for the individual, which is the delineation of diluted property rights.

Figure 2 shows the degree of attenuation of property rights dependent on the amount of actors involved and the completeness of allocation of property rights.

Figure 2: Two Dimensions of Attenuated Property Rights

		Amount of individuals carrying property-rights	
		Low	High
Degree of completeness of allocating property rights	High	**Concentrated property-rights structure** e.g.: individual enterprise	**Diluted property-rights structure** e.g.: public limited company
	Low	**Diluted property-rights structure** e.g.: foundation	**Strongly diluted property-rights structure** e.g.: large associations like ADAC

Source: (Picot, Dietl, & Franck, 1999, p. 56)

Every alteration of the utility level of an individual based on external decisions is therefore an attenuation of property rights. Already the deliberate delegation of decision-making power can be regarded as a dilution of property rights. The employment of a manager, for example, is optional and occurs under the knowledge that he will have his own agenda (Ganske, 1996, p. 21). Ownership rights in franchising networks are therefore especially diluted. The dilution of residual income rights of franchised outlets, however, is offset by residual income rights of company-owned outlets. Under dual ownership, low royalties increase the investment incentives for the franchisee and wholly-owned outlets offset the disincentive effect of low royalties for the franchisor (Windsperger & Yurdakul, 2007, p. 1).

3.1.3 External Effects and Ownership Surrogates

External effects arise because the consequences of economic activity not only affect the actor himself but also other individuals. Negative external effects occur if those affected sustain a decrease in utility; positive external effects accompany an increase in utility. In the first case, the overall accruing social costs are higher than the costs for the acting individual. In the second case, the social benefit outweighs the personal benefit. The extent of external effects concomitant with welfare losses are hard to measure and are only directly assignable if the consequences of the actions of individual economic actors can be specifically attributed to that person. This, however, depends on the allocation of property rights to the economic actors. If property rights are completely allocated to the actors, then external effects or welfare losses are eliminated. A complete allocation in a world of environmental uncertainty and transaction costs is, however, unrealistic. Therefore, ownership surrogates are employed (Picot, Dietl, & Franck, 1999, pp. 57-58).

Ownership surrogates refer to factors that have similar incentive effects as real ownership does. The owner of a good will always act in an efficient manner. Ownership surrogates are implemented to mitigate external effects or welfare losses that arise due to diluted ownership rights. They are an effective measure against opportunistic behavior. The most efficient ownership surrogates are cultural factors or the disciplinary effects of competition. If, for example, team members maintain a strong friendship, then they are more likely to interact fairly and not in a shirking manner. The impact of competition can be explained by the behavior of a manager of an incorporated company. If competitive pressure dominates the market, it is hard for the manager to deviate from profit-maximizing behavior. He would otherwise risk his own position in the company (Picot, Dietl, & Franck, 1999, pp. 61-62).

3.1.4 Application to the Franchise System

The assignment of property rights is relevant for an efficient allocation of resources. If contracts are incomplete, some residual rights will remain that are not included in the contract. In franchise relationships, residual income rights refer to royalties and initial fees that are used as incentives. Contracts are used to relocate decision rights from one firm to another. For example, authority is transferred to the franchisee to realize local advertising and training choices (Windsperger & Mumdžiev, 2011, p. 449). According to the property rights view, the extent of intangibility of an asset is relevant for determining the ownership structure. The franchisee's intangible assets can be outlet-specific knowhow, quality control, human resource management, product innovation etc. The franchisor's intangible assets relate to system-specific know-how and trade mark assets (Windsperger & Dant, 2006, pp. 261-262). Consistent with the property rights view, decision rights should be assigned depending on the distribution of intangible knowledge assets between the franchisor and the franchisee. Ownership rights, however, should be allocated according to residual decision rights (Windsperger & Yurdakul, 2007, p. 1).

Moreover, Windsperger and Dant (2006, p. 260) derive the theory that if a franchisor’s intangible assets are more relevant to creating residual income compared to the franchisee’s, more ownership rights should be assigned to the franchisor. The amount of wholly-owned subsidiaries should then be higher.

3.2 Transaction Cost Theory

Previous remarks have shown that in order to reach an ideal state with no welfare losses, all property rights would have to be completely assigned to the economic actors. This is, however, unrealistic because of transaction costs. Ronald Coase was the first to describe the concept of transaction costs in his article “The Nature of the firm” from 1937. He questioned why individuals form partnerships within firms rather than to trade through contracts on a competitive market, which according to economic theory is efficient. His economic explanation for this phenomenon is transaction costs, which are costs related to using the market mechanism rather than using the firm (Besanko, Dranove, Shanley, & Schaefer, 2010, p. 136).

3.2.1 Basic theoretical concept

Transaction costs are the costs of obtaining a good or service via the market. These costs are higher than the actual price of the good. Expenditures like search and information costs, bargaining costs, keeping trade secrets and policing and enforcement costs, can all potentially add to the cost of acquiring something through the market system. The existence of firms is explained through cheaper internal production costs which avoid the costs of the market (Besanko, Dranove, Shanley, & Schaefer, 2010, p. 137). Williamson (1985, pp. 20-21) distinguishes between transaction costs that arise ex ante and ex post. Ex ante costs are drafting and negotiating costs or costs of forming a contract; ex post costs are setup and running costs related with governance structures, the costs of effecting secure commitments, negotiating costs to correct misalignments, maladaptation costs etc. By means of these costs, the most efficient organizational form for the underlying transaction has to be chosen. Transaction costs usually form the basis for setting up contractual agreements.

There are two central behavioral assumptions attributed to transaction cost theory. First of all, individuals act under bounded rationality, meaning that the absorption and analytical capacity of individuals is limited. Second, economic subjects aim at maximizing their individual utility and are inclined to act opportunistic (Dietl, 1993, p. 109). Williamson (1985, p. 47) characterizes it as follows:

> *"By opportunism I mean self-interest seeking with guile. […] More generally, opportunism refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse. It is responsible for […] information asymmetry".*

The third assumption of transaction cost economics is risk neutrality. From a transaction cost viewpoint, problems especially arise from bounded rationality of individuals which directly affects the completeness of long term contracts. Incomplete contracts emerge because not all eventualities can be considered ex ante. This again gives leeway for opportunistic behavior. According to Chiles and McMackin (1996, pp. 76-77), transaction cost theory is about the choice of governance structures made by managers who are confronted with fixed levels of asset specificity, uncertainty and regularity of interaction.

From a transaction cost and property rights viewpoint, the rights pertaining to an object are the main focus of a transaction, not the physical exchange of the good itself. The relation between property rights and transaction costs can be explained insofar that the formation, the usage and the purchase of a good create transaction costs. Property rights and transaction costs can therefore not be separated (Taheri, 2002, p. 13).

3.2.2 Application to the Franchise System

As mentioned before, transaction costs help choose the most efficient organizational form for the underlying transactions. In a franchise system, this corresponds with the option of a franchisor to choose a franchisee (market organizational form) or a wholly-owned subsidiary (hierarchical organizational form). At high transaction costs, company-owned stores will be the preferred organizational form. At low transaction costs, franchise systems will be favored. Determinants of transaction costs are asset specificity and the uncertainty of a transaction. Organizational uncertainty can be, for example, lack of experience. In systems with highly specific transactions, wholly-owned subsidiaries tend to be predominant. In systems with low specific transactions, however, franchises tend to be the prevailing organizational form. An increasing (especially environmental) uncertainty reinforces the tendency for corporate-owned operations. Environmental uncertainty can be classified into political risk and currency risk (Hass, 2010, pp. 75-76) (Fladmoe-Lindquist & Jacque, 1995, pp. 1238-1242).

3.3 Principal-Agent Theory

The principal-agent theory, similar to the property rights theory, presents an extension to the neoclassical approach. Whereas the transaction cost theory looks at the performance relationship between economic agents from a general viewpoint, the principal-agent theory characterizes these relations more specifically as a client and contractor relationship (Picot, Dietl, & Franck, 1999, p. 85).

3.3.1 Basic theoretical concept

The principal-agent theory addresses the relationship between two parties: the principal and the agent. The principal delegates the exercise of certain activities and decision-making authority to the contractor, which is the agent. This relationship is maintained through a contract. Such contractual relations between principal and agent are common in all institutions, for example, in the market between buyers and sellers or in companies between employees and their superiors.

Distinctive for a principal-agent relationship is that the actions of the agent not only influence his own well-being but also the utility level of the principal. The underlying assumptions are incomplete information, uncertainty and bounded rationality. Furthermore, individuals want to maximize their utility. This induces opportunistic behavior. The principal therefore needs to consider that the agent will exploit opportunities for his own benefit, even when actively harming the principal by doing so (Picot, Dietl, & Franck, 1999, pp. 85-87). Moreover, the principal-agent theory determines risk preferences of individuals, which is important when setting up a contract. In general, the agent is classified as risk averse and the principal as risk neutral (Dietl, 1993, pp. 134-135).

An uneven distribution of knowledge and expertise leads to the emergence of agency costs. These consist of signaling costs for the agent, monitoring costs for the principal and welfare loss. The more information asymmetry there is, the more suspicious the principal. There exists a trade-off relationship between the three agency costs: If, for example, the agent increases his signaling costs, then the principal can reduce his monitoring costs. Or the principal can reduce welfare losses by increasing his monitoring costs, even without the agent increasing his signaling costs (Dietl, 1993, pp. 135-137).

3.3.2 Application to the Franchise System

In a franchise system, the franchisor takes the position of the principal and the franchisee represents the agent. Analogous to the main agency problems, business objectives between the two franchising partners vary and information is unequally distributed. The primary goals of the franchisor are to uphold the uniform company image, the standardized quality of the products and services and the implementation of system-wide adaptations. The franchisee, however, has the goal to maximize his individual profits. These divergent goals can be linked to information asymmetries. Because of agency problems, opportunistic behavior may arise. Opportunism expresses itself through moral hazard and adverse selection. Ex post opportunistic behavior or moral hazard can, for example, take the form of free-riding. The franchisee decides to reduce costs by investing less in the quality of a product or a service. Ex ante opportunistic behavior or adverse selection manifests itself through, for example, the choice of a wrong franchisee as a partner (Carney & Gedajlovic, 1991, pp. 609-610) (Bradach, 1997, p. 282) (Hass, 2010, pp. 64-68). Franchisors protect their interests by forming relatively elaborate and one-sided contracts determining the franchisee’s responsibilities before, during and after the franchise relationship. Often there is little scope for negotiating the contract since franchisees can often be easily replaced (Antia, Zheng, & Frazier, 2013, p. 578).

4. Property Rights in Franchise Contracts

Compared to traditional market exchanges, franchise contracts generally impose quality standards, common opening hours, tying arrangements, payment plans through initial fees and percentage of revenues, etc. on the franchisee and its business product. The franchisor usually handles employee training programs, national marketing and acts as an advisory and monitory body (Mathewson & Winter, 1985, p. 503). The contracting parties can basically choose the obligations of the franchisee freely. It is, however, important to make sure that the agreement does not limit the franchisee unilaterally. A franchise contract that strongly discriminates the franchisee in his entrepreneurial mobility without an appropriate form of compensation might violate moral principles (Vortmann, 1990, p. 20).

As mentioned before, property rights can be distinguished into decision rights and ownership rights. Decision rights are the rights to determine the distribution and use of firm assets. Ownership rights can be interpreted as residual rights of control. They are comprised of residual income rights, i.e. initial fees and royalties and ownership surrogates. The latter are additional devices that increase the incentive effect of the diluted residual income rights and motivate the franchisor or the franchisee to perform additional investments (Windsperger, 2002, pp. 132, 139).

4.1 Residual Income Rights

The payment of fees and royalties divides the residual surplus between the franchisor and the franchisee. Residual income rights are therefore diluted. Franchise fees are usually composed of a fixed or initial fee and a variable fee (Windsperger, 2002, p. 132). In general, the different types of franchise fees – dependent on turnover, quantity, minimum amount or initially – can be combined randomly and are determined by the interests of the contracting parties. Evaluating factors are for example product demand, retail price, expenditures for factory equipment and the franchisee’s performance capability. There are four categories: the coupling of an entry fee with a sales royalty, no explicit lump sum payment, fixed weekly or monthly fees and a fee that is included in the transfer prices of goods (Dnes, 1993, p. 382).

For instance, in a pure distribution franchise, which includes a tying arrangement of goods the franchisee has to buy from the franchisor, the purchase price is usually contractually regulated. In addition, the contracting parties agree on an initial fee which covers the relinquishment of the system-specific know-how. In service and production franchising, however, the contracting parties determine a percental royalty dependent on turnover which the franchisee has to pay. The turnover fee is sometimes combined with a minimum remuneration which is yielded to the franchisor independent of revenue or the quantity of produced goods. This minimum franchise fee is therefore independent of the success of the franchisee (Vortmann, 1990, pp. 20-21).

4.1.1 Initial fees

Initial fees are a form of compensation to the franchisor for transferring system-specific knowledge and associated rights after the franchise contract is signed. The higher the rents generated by the franchisor’s intangible assets as a brand name, the higher the initial fees. The type and extent of the initial fee is contingent to the contracting parties and depends on the type of franchise (Windsperger, 2001, p. 221) (Dnes, 1993, p. 393). The franchisor’s investments depend on the initial value of assets. To guarantee a certain franchise value, a franchise with high trademark capital demands more system-specific investments than a franchise with low trademark capital. The franchisor can recover his sunk investments through the initial fee. High sunk investments may arise if system-specific knowledge is crucial for the success of the franchise. However, the initial fee also protects the franchisor’s system-specific assets since it prevents the franchisee from appropriating quasi rents. Furthermore, the higher the franchisor’s trademark asset, the higher are the fees and royalties and the greater are his intangible investments during the contract duration. The property rights approach therefore suggests a positive connection between entry fees and royalties (Windsperger, 2003, p. 296).

4.1.2 Royalties

The royalty is a variable fee which is usually based upon the revenue of the franchisee. It enables the franchisor to secure his residual rights of the franchise business in question. The agency theory of franchising defines royalties as a function of risk and incentives, whereas the initial fee extracts rents left by the royalty rate.

Principal-agent models suggest that the franchise fee should be inversely related to the royalty rate. However, empirical results do not support this theory. The property rights theory views royalties as the return of the franchisor's intangible marketing investments. Windsperger (1996, p. 139) argues that the more important the franchisor's intangible investments are, relative to the franchisee's intangible investments, the higher the royalties should be. Therefore, the importance of intangible assets for the success of the franchise defines the distribution of residual rights of control. If the franchisor's noncontractible investments in promotion and services have a big influence on the total residual surplus compared to the franchisees' noncontractible investments, then the franchise contracts should include clauses like exclusive dealing, tying arrangements, resale price maintenance and high royalty fees. The different vertical constraints can therefore be considered as an incentive tool to realize the best outcomes for both parties and to distribute residual rights (Windsperger, 1996, p. 140). The distribution of residual income rights is subject to the importance of the franchisor's system specific assets compared to the franchisees' local market knowledge to create residual surplus.

In summation, high trade name assets require more system specific investments. For example, advertising expenditures are viewed as trade name investments that indicate the existence of firm-specific assets. Therefore, the magnitude of initial fees and royalties depends on the extent of system-specific assets and as a consequence thereof on the amount of intangible investments (Windsperger, 2001, pp. 221-222).

4.2 Complementary Ownership Surrogates

As mentioned before, the complete allocation of property rights is nearly impossible in reality and under normal circumstances. Ownership surrogates are therefore employed to counteract welfare losses and external effects. The reason for this is that complementary ownership surrogates cause similar incentive effects as completely allocated property rights. They motivate the franchisee and the franchisor to perform necessary investments in intangible assets. Intangible assets generate the residual income stream by dissembling the motivational effect of undiluted ownership rights. For instance, the franchisor's diluted residual income rights can be neutralized through resale price maintenance, lease control, exclusive dealing clauses, tying arrangements etc. Exclusive customer clauses or territorial constraints, however, can alleviate the disincentive effect of the franchisee's diluted residual income rights (Windsperger, 2003, pp. 291-292) (Windsperger, 2002, p. 132) (Windsperger, 1996, p. 140).

4.2.1 Exclusive Territory Clause

An exclusive territory clause gives the retailer the exclusive right to operate in a certain geographic area. The franchisor guarantees that he will not open a second outlet under his name or grant a franchise to another franchisee in this specific territory. This form of a vertical restraint can provide the dealer with an incentive to, for example, invest ex ante in specific facilities or human capital. Exclusive territories can, however, create monopoly power, insulate retailers from competition or prevent market entry (Lafontaine & Slade, 2005, pp. 3, 7) (Skaupy, 1995, p. 169).

There are two general explanations for exclusive territory restrictions. On the one hand, the franchisee is protected from opportunistic behavior by the franchisor, which is especially likely if the franchisee effected specific investments regarding the franchise. The exclusive territory clause guarantees the franchisee the sole right to the revenues from his specific investments. On the other hand, it eliminates distortions which emerge from competition among franchisees (Mathewson & Winter, 1994, p. 181).

Empirical evidence shows that exclusive territory clauses are commonly found in franchise contracts where the performance/input of the franchisee is crucial for the franchise's success (Mathewson & Winter, 1994, p. 189).

Furthermore, exclusive territory clauses frequently go hand in hand with other forms of restriction. It is often argued that franchisees are compensated with exclusive territory clauses for enduring other vertical restraints. Mathewson and Winter (1994, p. 191), however, reason that this is not the case since revenue is transferable through, e.g., franchise fees. Any benefits from the exclusive territory clause could therefore be retrieved through higher fees. The authors therefore justify this phenomenon through higher efficiency and profit maximization.

According to Windsperger (1996, p. 138), a franchisee will not be willing to make specific intangible investments and pay franchise fees if there is competition within the territory the franchisee operates in. The franchisee will only increase his sales effort if he is the only one benefitting from his investments. An exclusive territory clause therefore creates a property right in intangible assets; it reduces free riding and motivates the franchisee to carry out intangible investments.

4.2.2 Resale Price Maintenance

Resale price maintenance (RPM) is a restraint which specifies that an upstream firm retains the right to control the price at which a product is sold downstream. The distributor agrees to sell the manufacturer's product at a certain price, at or above a price floor (minimum resale price maintenance) or at or below a price ceiling (maximum resale price maintenance). Even today, RPM remains illegal in some states. In the past, however, it was used in a variety of retail markets, for example, in clothing, jewelry, sports equipment, automobiles, gasoline etc. Nevertheless, it is one of the most important vertical restraints. In markets with extensive distribution systems, RPM is often implemented in the early part of a product’s life cycle to facilitate the establishment of the distribution system. In this case, RPM lowers the barriers of entry into upstream markets (Mathewson & Winter, The Law and Economics of Resale Price Maintenance, 1998, pp. 58-60).

According to Mathewson and Winter (1998, pp. 65-66), there are three theories to explain resale price maintenance:

1. *Resale price maintenance serves to support a cartel of manufacturers;*

In reality, over time the costs of retailing diverge, which leads to fluctuating retail prices. Nevertheless, RPM facilitates an increase in cartel stability.

2. *The practice is a manifestation of retailers’ monopsony power, supporting a cartel at the retail level;*

This explanation has been applied to retail drug stores in the USA and grocery outlets in Europe. The theory, however, does not have much empirical evidence. The requirements for this hypothesis were that retailers had considerable assets invested in traditional, low-volume outlets and earnings were exposed to the entry of discount chain stores. Retailers therefore used manufacturers to align cartel prices at the retail level. RPM served the cartel as an entry barrier against low-price, large-volume outlets.

3. *The practice is implemented unilaterally by manufacturers as part of an efficient distribution system, necessary to elicit adequate service from retailers.*

This last theory has been intensively discussed in literature. As an alternative to price-fixing, Tesler published an argument on special services in his paper from 1960. He argues that manufacturers want to safeguard dealer margins through RPM in order to prompt competition between dealers by providing special presale services. Without protection, these services would be subject to free-riding by inexpensive dealers who offer the same product minus the services to customers who have already profited from the service provision of the full-service distributors. This argument is a reasonable explanation, especially when tangible services provided by dealers increase the demand for a manufacturer's product. These services would not be made available without margin protection (Marvel & McCafferty, 1984, pp. 346-348).

Marvel and McCafferty (1984, p. 348) also give an explanation why manufacturers would encourage fair trade. Their argumentation is based on the different functions of retailers. By adding a product to their portfolio, distributors attest to the quality and suitability of the product with their reputation. RPM is therefore an indicator or guarantee of quality of the product for the retailer. However, this dealer certification is also subject to free-riding similar to more tangible presale services. This problem can be solved by granting retailers a margin that is sufficient to cover their costs through RPM.

Mathewson and Winter (1998, p. 82) also find an explanation for RPM and its potential for efficiency enhancement. In their opinion, a resale price floor is an instrument used by manufacturers to reach the right balance between price and service levels by their distributors. Without RPM, the incentive of retailers to obtain the appropriate balance would be biased by externalities. Price ceilings can be efficiency enhancing through larger outputs or if more desirable price or quality equilibria are achieved when implemented in competitive markets.

Competition among franchisees can reduce investment incentives since sales efforts by one franchisee can directly benefit the others. The franchisee who increases his sales effort through intangible investments charges a higher price, which prompts customers to buy the same product from another franchisee for a lower price. RPM reduces this form of free riding by setting a fixed price which motivates the franchisee to effect intangible investments, e.g. in marketing (Windsperger, 1996, p. 139).

4.2.3 Exclusive Dealing Clause

Exclusive dealing refers to a contractual clause where the distributor or franchisee guarantees to only handle the goods of one supplier – in this case the franchisor. The retailer can therefore not distribute goods of competing suppliers. Unlike an exclusive territory clause or a resale price maintenance clause, exclusive dealing does not necessarily limit competition among dealers handling the same brand. The first two clauses have been termed as devices to protect dealers from intrabrand competition. However, under exclusive dealership, the dealer agrees to handle no rival products but may face competition from other exclusive distributors of the same brand. Exclusive dealing arrangements often go hand in hand with territorial restrictions and resale price maintenance clauses.

Conventional explanations determine exclusive dealing as a device to increase dealer effort and induce dealer services like advertising. Since dealers are limited to only one brand, their incentive to perform with maximum effort is higher. Furthermore, it also erects a barrier for competing manufacturers to enter a market. However, both explanations benefit the manufacturer and not the distributor. A common explanation why dealers would consent to this restrictive clause is that they are compensated through other vertical constraints, e.g. territorial restrictions. This justifies the dealer's willingness to limit himself to one product line (Marvel, 1982, pp. 1-4) (Skaupy, 1995, pp. 168-169). However, Marvel (1982, pp. 4-5) refutes the special services approach by pointing out that manufacturers can only obtain additional promotional services by compensation – otherwise the problem of free-riding occurs. Marvel further states that the market barrier argument only poses an important barrier to entry in the unlikely case that a substantial portion of an industry's retail outlets are thereby foreclosed. In addition, most contracts involved are of short duration, which would give potential entrants the possibility to enter the market after termination. Marvel (1982, p. 2) interprets exclusive dealing clauses as a possibility to prevent opportunistic behavior because distributors cannot avoid paying for ancillary services related to the product.

The efficiency rationale states that it is a device to create property rights for the manufacturer, especially with regard to his promotional investment. Franchisors want to make sure that marketing and promotional measures exclusively benefit their own products. The purpose of exclusive dealing is therefore to safeguard the suppliers' tie-in charges to dealers for the benefits of the supplier's intangible capital investments. (Marvel, 1982, pp. 6-7, 23) (Windsperger, 1996, p. 138).

4.2.4 Tying Arrangement

Tying arrangements ensure that the franchisee purchases an input from the franchisor or from a supplier determined by the franchisor. Under certain circumstances, tying arrangements are declared illegal because they suppress competition. There are three conditions that have to be met in order to declare a tying arrangement illegal: two separate products have to exist, the tying good has to hold sufficient market power and a substantial amount of commerce in the tied good market has to be affected (Klein & Saft, 1985, p. 345).

The main characteristic of a franchise distribution arrangement is a standardized product. With a standardized product the consumer can expect to receive the same quality at various retail locations. This creates valuable information for the consumer. However, this quality information creates a free-riding problem. If the inputs of each franchisee influence the quality of a product and if the standardized product holds a certain reputation, then each franchisee will try to cut costs and lower the price on inputs supplied. The individual franchisee will gain from the sales of lower product quality but eventually other franchisees will be negatively affected by lower demand when consumers detect the inferior quality (Klein & Saft, 1985, pp. 349-350). Dnes (1996, p. 299) explains this problem as follows: “If one franchisee allows quality to deteriorate, he benefits by the full amount of the savings from reduced quality but incurs only part of the costs as other franchisees will suffer some of the loss of business”. This free-riding problem harms the overall reputation of the brand and therefore the franchisor. To eliminate the problem of free-riding is complicated. Even if quality standards were complete and specifiable, the incentive for the franchisee to cheat would still exist. In addition, the franchisor would have to monitor the adherence of the specifications, which is expensive. Given the incentive for free riding, a tying arrangement is an efficient and easy tool to maintain product quality throughout the franchise system (Klein & Saft, 1985, p. 353) (Vortmann, 1990, pp. 21-22).

Windsperger (1996, p. 138) argues that the importance of the franchisor's brand name for the creation of residual surplus is related to the necessity of quality controls to protect his intangible investments. The only way to ensure a standardized product quality under a high degree of asset intangibility is by means of tying arrangements. It gives the franchisor an incentive to undertake intangible investments in the franchise system while guaranteeing a standardized quality.

In some franchise contracts, a minimum purchasing obligation exists. These serve as forecasts and guidelines for the franchisee to regulate his orders. It further functions as an incentive mechanism to increase turnover (Skaupy, 1995, p. 134).

4.2.5 Specific Investments

Franchisors often require their franchisees to undertake a specific investment when agreeing to the franchise relationship. In case of a premature termination of the contract or a business failure, this investment is lost since it is so specific that it cannot be used in another context. Examples are technical investments in specific machines or operating and business equipment.

Specific investments are sunk investments that ensure that franchisees are profit motivated. Only those franchisees who are able to perform and are most likely to be successful will be willing to pay this sunk investment. This enables the franchisor to save on monitoring and supervision costs. If the franchisee overrates his own capabilities, the investment is lost. A required specific investment therefore ensures that only qualified franchisees sign a franchise contract. This is similar to a selection process. Dnes compares it to job-market signaling, where those looking for employment invest in college degrees to demonstrate their capabilities (Dnes, 1993, p. 392).

4.2.6 Approval and Buy Back Rights

Approval and buy back rights give the pertaining party the option to acquire the franchise business before any other potential buyers in case of a disposition. There are different ways to include these rights in a franchise contract. One possibility gives the franchisor the right to buy the franchise business. In this case, the franchisor can either take over the business himself or a third party denoted by the franchisor can do so. In another case, the franchisee may suggest a potential successor but the franchisor may withhold approval. If the franchisee is unable to provide a suitable successor, then the franchisor may introduce one. This, however, requires a transfer fee, which is usually lower if the franchisee finds the replacement since no search costs arise for the franchisor. Approval and buy back rights also serve as protection for the franchisor since he has the last say in the transfer process. The franchisee is therefore prohibited from indulging in opportunistic behavior (Dnes, 1993, pp. 380-381).

The implementation of an alienation right without an approval and buy back right would give the franchisee the power to sell the franchise to whomever he chooses. This could negatively affect the franchisor since he is not able to control the new franchise relation. This could result in a loss of corporate identity.

A franchise contract can also include approval and buy back rights for the franchisee. If the franchisor plans on expanding and opening a new franchise subsidiary in the territory of the franchisee, then he first has to offer the new branch office to the franchisee. Although in this case the franchisee does not benefit from an exclusive territory, he still has a similar motivation to perform well in his business since he can avoid direct competition in his territory. He will therefore invest more in local advertising or effect specific investments since no other franchisee can benefit from these investments (Tietz, 1987, p. 523) (Taheri, 2002, pp. 68-70).

4.2.7 Alienation Right

One possibility to create long-term performance incentives, next to profit-sharing rights, is to transfer the alienation right of the franchise business to the franchisee. If the franchise license is made tradable, the franchisee is more likely to transact system specific investments because he can one day reap the benefits (Picot, Dietl, & Franck, 1999, p. 183).

If one franchise partner wishes to partially transfer or assign his rights from the franchise contract to a third person, then the approval of the other contracting party is necessary. The same holds true for a contract modification concerning the insertion of rights and obligations of newly formed or already existing companies (Vortmann, 1990, p. 31). The franchisee's option to resell individual entities is an important growth factor for the franchise system. However, the franchisor usually reserves the right to conduct the sales negotiations, to interfere and to make the disposition dependent on his consent. The franchisor can furthermore ascertain the control over location and equipment through a contractual purchase option. The amortization value of equipment and stock on hand and a proportionate goodwill usually serve as a basis for fixing the price (Tietz, 1987, p. 511).

Beside the regular distribution activities, the franchisee should also invest in marketing activities. Every sales effort directly affects the revenue; nevertheless, marketing activities are often neglected. If, however, the residual right of the marketing efforts are appropriated to the franchisee, this would increase the franchisee's marketing investments since the certainty of alienating the business one day is an incentive to administer the franchise efficiently. By selling the franchise, the franchisee can materialize his share of the company value (Picot & Wolff, 1995, p. 232).

4.2.8 Contract provisions concerning buildings, properties and equipment

Franchise contracts often contain provisions concerning the ownership structure of buildings, properties and equipment. The allocation depends on the specific characteristics of the franchise system. The purpose behind this contract element is to allocate the ownership of buildings, properties and equipment in such a way that both contracting parties aim towards system efficiency. Aside from the motivational function for the involved parties, this clause also serves as a control function. The allocation of ownership rights can make one contracting party dependent on the other party by creating a hostage situation. If the affected party is aware of the hostage situation, this will evoke system efficient behavior.

One example of such a contract provision would be that the franchisor owns the building and the property that accommodate the franchise business, which he then rents out to the franchisee. The franchisee, however, owns the equipment. The franchisor can then control the franchisee by terminating the contract relationship in case of a conflict and thus depriving the franchisee of its investment in the furnishing. The furnishing is usually custom-made for the franchise system and can therefore not be used for other businesses. Even though the franchisee does not hold all property rights concerning the franchise, the possibility of losing its special investment is a strong incentive to act efficient. The same theory holds true for other ownership constellations. A franchisee that is aware of the consequences of his opportunistic behavior will try to avoid an early termination following a breach of contract and instead act efficiently and in accordance with the contract (Taheri, 2002, pp. 70-73).

4.2.9 Competition Clause

Most contracts comprise a non-compete clause for the duration of the franchise relationship. This is a logical element of a franchise agreement since no franchisee would compete with a system he himself partakes in. This would go against his fiduciary duties towards the franchise arrangement (Skaupy, 1995, p. 180).

However, some contracts also contain a non-compete agreement after contract termination. In the free market economy, however, this is considered immoral when it comes without any form of compensation. The franchisee renounces his economical existence when signing a non-compete by relinquishing his operations in the former contract territory. He should therefore be granted a compensation to start a new existence in a different territory or branch. Any other regulation would adversely affect the franchisee (Vortmann, 1990, p. 30). Nevertheless, non-competition clauses are legal in franchise contracts on condition that they do not restrict the franchisee excessively, they consider the freedom of competition and their purpose is objective and temporally necessary. By law, a non-compete agreement after contract termination is restricted to a maximum of 2 years and is limited to the exclusive territory or clientele (Skaupy, 1995, pp. 180-181).

Most non-compete agreements prevent the franchisee from working in a company that directly competes with the franchisor or one of his franchisees (Tietz, 1987, pp. 511-512). Non-compete agreements can also prohibit the franchisee to alienate personnel from the franchisor or other system-specific franchisees within a certain time frame (Tietz, 1987, p. 524).

4.2.10 Inheritance Right, Contract Duration and Exclusive Customer Clause

Many contracts include an inheritance right, which, in case of bereavement, allows the successor of the franchisee to take over the legal position of the afflicted contracting party. The legal successor then assumes all underlying rights and obligations of his predecessor with regard to the franchise contract. In most cases, the franchisor, however, has the option to object to the successor if he does not fulfill the same prerequisites as his predecessor (Vortmann, 1990, p. 31). This clause also has a motivational function for the franchisee to act effectively and to invest in marketing activities. His successor will directly benefit from his actions.

Franchise contracts are often subject to a limited duration. Since both parties are interested in a long-term cooperation, the contracts usually include a prolongation option. After the first period, the contract is prolonged for an agreed upon time frame which can be terminated by one party within a certain respite (Vortmann, 1990, p. 27). The contract duration depends on many different factors, e.g. the line of business, the type of business (wholesale, retail, craft etc.), the personal preferences and notions of the involved parties, the level of investment by the franchisee and many more. If the franchisee's capital investment is extensive, as in the hotel industry, certain gastronomies, large home improvement markets, etc. then the contract duration is usually longer. A longer duration gives the franchisee the guarantee to not have to exit the system after a short period and losing the invested money. Moreover, long-term contracts often contain currency or indexation clauses. In practice contracts between 1 and 10 years are the most common, with a concentration on 3 to 5 year-long contracts. Contracts that require an extensive investment usually range from 10 to 20 years. In some cases an open-ended duration is agreed upon; this is typically the case if the franchisor does not have considerable experience and the length of a successful system is hard to predict. In this case, an effective date of ordinary termination is important (Skaupy, 1995, pp. 137-138).

Some contracts contain an exclusive customer clause which regulates the allocation of customers. This clause often goes hand in hand with an exclusive territory clause. The franchisee receives the exclusive right to the customers in his territory. The aim of this contractual arrangement is to avoid competition over customers among the franchisees by assigning an exclusive customer base to each franchisee (Nault & Dexter, 1994, pp. 412-413).

4.2.11 Advisory Board and other Obligations

Some franchise contracts include the formation of an advisory board which guarantees an optimal communication between both parties and other franchisees. This committee is of consultative character and serves as a platform to exchange information and experiences. Furthermore, it promotes a loose cooperation and contact maintenance which enhances the system collaboration and overall success of the franchise. The advisory board also prevents a hostile and competitive relationship between the franchisees. These committees are organized depending on the needs of the respective system and mediate a structure through dialog. However, they do not have any decision-making power. In bigger distribution systems franchise assemblies are often co-organized and induced by the franchisor in order to defend the franchisees interests (Skaupy, 1995, pp. 123-125; 182) (Vortmann, 1990, pp. 16-17).

In general, the franchisee's obligations can be extended at will. Often, the franchisee is obligated to visit a training course provided by the franchisor. Moreover, the franchisee has to conclude necessary insurance policies to run the business. Frequently, the franchisor reserves the right to check up on the franchisee and to gain access to his books at any given time. This form of monitoring is important for the franchisor since he has an interest in controlling the correct application of his good or service. In other cases, the franchisor demands some form of security pertaining to the financial situation of the franchisee. This is of importance to the franchisor since the survival of the franchise system depends on a stable capital amount of the franchisee. Examples for this are bank guarantees or bonds (Vortmann, 1990, p. 23).

5. Empirical Contract Analysis

This chapter focuses on the empirical contract analysis. First of all, the choice and derivation of the hypotheses is explained. A special focus is put on the relationship between residual decision rights, residual income rights and ownership surrogates. The same relations are analyzed in the different franchise sectors, i.e. in product franchising, distribution franchising and service franchising. Furthermore, the methodology of the analysis is explained, including the research design and objective as well as the analytical approach of assessing the results. Last but not least, the available data is extensively analyzed. A frequency and descriptive analysis is conducted to give a better understanding of the data set. Finally, the results are interpreted and possible limitations of the study are presented.

5.1 Hypotheses Derivation

Ownership rights can be divided into residual income rights and ownership surrogates. According to the property rights theory, a relationship exists between residual income rights, i.e. initial fees and royalties and ownership surrogates. The property rights theory views initial fees as the compensation for transferring system-specific knowledge. Royalties, however, are incentives to encourage intangible investments that warrant a certain trademark value. Therefore, the higher the trademark capital of a franchise business, the more system-specific investments are necessary during the continuation of the franchise relation and the higher the royalties and initial fees. In the following, the different relationships between residual income rights and ownership surrogates shall be investigated (Windsperger, 2002, pp. 138-139).

5.1.1 Incentives and Residual Income Rights

A closer look at the above mentioned ownership rights reveals that some rights provide incentives for the franchisor or the franchisee to undertake investments in intangible assets. Intangible assets are non-contractible system-specific assets of the franchisor and outlet-specific assets of the franchisee. If, for example, a franchisor's trademark investments are important for the success of the franchise, then a significant ownership stake is required to provide the necessary investment incentives. The appropriate incentive structure is not only based on a mix of franchise fees and royalties but also on additional incentive services, i.e. ownership surrogates. Some ownership surrogates increase the incentive effect of diluted residual income rights. As mentioned before, income rights are diluted because the residual surplus is allocated between the franchisor and the franchisee through initial fees and royalties (Windsperger, 2002, pp. 136, 130-132). The following figure shows the allocation of ownership surrogates according to their incentive effects for the franchisor and the franchisee (Windsperger, 2002, p. 136).

Figure 3: Residual Income Rights and Incentive Effects

Incentive effects for Franchisor	Incentive effects for Franchisee
Tying Clause	Exclusive Territory Clause
Exclusive Dealing Clause	Exclusive Customer Clause
Resale Price Maintenance	Lease Right
Lease Control	Option Right Extension
Approval and Buy Back Rights	Extension Right
Control Rights	Alienation Rights
Advisory Board	Inheritance

Source: (Windsperger, 2002, p. 136)

<u>Incentive effects for the franchisor</u>

Tying arrangements are usually applied when quality controls and monitoring is quite costly. Quality controls are especially of importance if the franchisor's trademark is essential for the creation of residual surplus and his intangible investments therefore have to be protected. The tying clause thus provides an investment incentive for the franchisor by warranting a minimum quality standard (Klein & Saft, 1985, pp. 349-351) (Windsperger, 2002, p. 133).

Exclusive dealing clauses prohibit the franchisee from selling products of competing firms. If this clause is not in action and the franchisee is allowed to sell competing products, then the franchisor's incentive to conduct specific investments is limited. A franchisor will more readily invest in advertising and other promotional and brand-enhancing features if the franchisee can only benefit from these investments by paying for them. This free-riding problem can be avoided through an exclusive dealing clause (Marvel, 1982, pp. 6-7) (Windsperger, 2002, p. 133).

Resale price maintenance protects marketing or advertising services by the franchisee that otherwise would be subject to free-riding. Competition among franchisees would reduce investment incentives because consumers would prefer to buy their product from the more inexpensive franchisee while still benefiting from the services of more expensive franchisees. By preventing the franchisees from free-riding, the franchisor's willingness to engage in intangible investments increases (Marvel & McCafferty, 1984, pp. 346-348).

Lease control constitutes a high incentive for the franchisor to undertake specific investments due to the hostage function it provides. In case of a termination of the franchise relation, the franchisor is in control of all business premises. This, however, decreases the franchisee's incentive to undertake outlet-specific investments because he does not receive future residual surplus of his investments (Windsperger, 2002, p. 134) (Klein B. , 1980)

Approval and buy back rights offer the franchisor the option to acquire the franchise business in case of a disposition before any other potential buyers. In certain cases the franchisee may suggest a potential successor which the franchisor may refuse. This clause serves as a protection for the franchisor since he controls the transfer process and the franchisee is prevented from acting opportunistically (Dnes, 1993, pp. 380-381).

Control rights give the franchisor the right to control the franchisee. This can occur announced or unannounced and may include the right to control the office space, the storeroom, accounting records etc.

An **advisory board** guarantees an optimal communication between both parties and is of consultative character. It promotes a loose cooperation and contact maintenance which enhances the system collaboration and overall success (Skaupy, 1995, pp. 123-125; 182) (Vortmann, 1990, pp. 16-17). The establishment of an advisory board is beneficial for both sides; however, it helps the franchisor to indirectly control the franchisee.

Incentive effects for Franchisee

An **exclusive territory clause** gives the franchisee the exclusive right to operate in a certain geographic area. This form of a vertical restraint can provide the dealer with an incentive to invest ex ante in specific facilities or human capital. This clause guarantees the franchisee the sole right to the revenues from his specific investments and therefore protects him from opportunistic behavior by the franchisor (Lafontaine & Slade, 2005, pp. 3, 7) (Skaupy, 1995, p. 169) (Mathewson & Winter, 1994, p. 181).

An **exclusive customer clause** offers the franchisee the exclusive right to the customers in his territory. This avoids competition over customers among franchisees by assigning an exclusive customer base to each franchisee (Nault & Dexter, 1994, pp. 412-413). It further guarantees the franchisee that each outlet-specific investment he undertakes will only reach his own potential customer base and will not benefit the competition. The franchisee's incentive to invest is therefore higher.

Lease rights allow the franchisee to lease the rental space after contract termination. This increases the franchisee's motivation to conduct outlet-specific investments, for example renovations.

If the franchisor plans to open a new franchise in the contract area of the franchisee, then an **option right to extend** gives the franchisee the first option to become the owner of this new franchise. If he refuses, a new franchisee will run the franchise business. **Extension rights**, however, provide the franchisee with the explicit right to open new outlets in his specific territory. This can increase the franchisee's motivation to perform well in his current franchise business to then further expand.

An **alienation right** allows the franchisee to transfer his outlet ownership. This clause provides a high incentive for the franchisee to carry out outlet-specific investments. It enables the franchisee to capture the rents of his investments and to materialize his share of the company value (Picot & Wolff, 1995, p. 232).

An **inheritance right** allows the successor of the franchisee to take over the legal position of the afflicted contracting party in case of bereavement. The successor then assumes all underlying rights and obligations of his predecessor with regard to the franchise contract. (Vortmann, 1990, p. 31). This clause has a motivational function for the franchisee to act effectively and to invest in marketing activities since his successor will directly benefit from his actions.

In the following, the complementary effect between royalties and ownership surrogates will be tested. Complementarity between residual income rights and ownership surrogates requires a positive correlation between the franchisor's fraction of ownership surrogates and royalties, and a negative relationship between the franchisee's fraction of ownership surrogates and royalties. Incentivizing ownership surrogates were allocated according to figure 3. Residual income rights are measured by the royalty rate (as percentage of sales) (Windsperger, 2002, p. 137/138). The following hypothesis can be derived:

> **H1: The higher the royalty, the more incentivizing ownership surrogates are assigned to the franchisor relative to the franchisee**

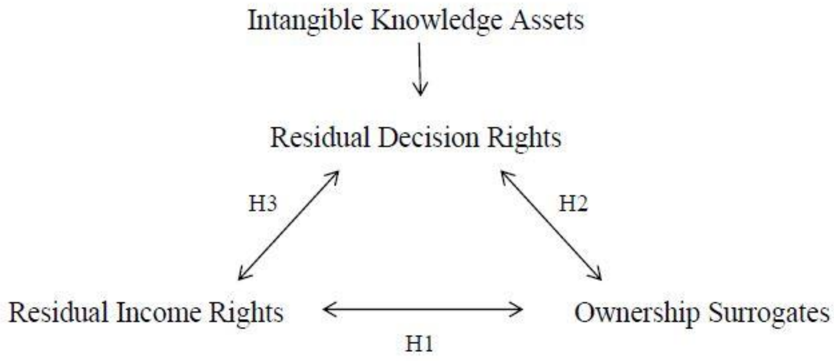
5.1.2 Incentives and Decision Rights

Overall, the franchise contracts were tested for 46 variables, which can be found in detail in the appendix. Property rights are comprised of two dimensions: ownership rights and decision rights. As we have seen, ownership rights can be divided into residual income rights and ownership surrogates. Some of these variables were already assigned to ownership rights; others can be allocated to the category of decision rights. Here, the relationship between ownership rights and decision rights shall be tested.

Non-contractible **decision rights** are procurement decisions, advertising and marketing decisions, production decisions, human resource decisions (training and recruiting), investment and finance decisions and decisions concerning the implementation of accounting systems. For the following hypothesis, the residual decision rights were summarized according to the variables which were deemed decision rights and which can be found in detail in the appendix. Decision rights are a measure of centralization of decision making in the network if they can be attributed to the franchisor and a measure of decentralization if they can be attributed to the franchisee (Windsperger, 2008, p. 29).

According to the property rights theory, the person holding specific knowledge assets should also have ownership and residual decision rights. Decision rights are allocated depending on the distribution of intangible knowledge assets between the franchisor and the franchisee. The complementarity between ownership rights and decision rights are the drivers of an efficient institutional structure. The following figure depicts the relationship between residual decision rights, residual income rights and ownership surrogates:

Figure 4: Interactions in the Franchise Relationship



Source: (Windsperger, 2003, p. 301)

Since the data of this study does not provide the possibility to investigate the distribution of specific knowledge assets, the complementarity between ownership and decision rights is investigated next. In case of a complementary relation, this could be interpreted as an indicator for knowledge-specific assets (Windsperger, 2008, p. 20) (Windsperger, 2003, p. 292). Consequently, the second hypothesis is as follows:

> **H2: The higher the franchisor's portion of residual decision rights, the more incentivizing ownership surrogates are assigned to him**

5.1.3 Residual Income Rights and Decision Rights

The last relationship that is of interest is the complementary effect between residual decision rights and residual income rights. Residual income rights are again measured by the royalty rate. Therefore, the following hypothesis is derived:

> **H3: The higher the franchisor's portion of residual decision rights, the higher the royalty**

5.1.4 Different Franchise Sectors

The above-mentioned hypotheses can also be tested for the different franchise sectors. It is of interest if any of the above mentioned relations are more significant or less significant in certain franchise sectors, i.e. in product, service or distribution franchising. We can therefore conclude:

a. Product franchising

> **H1a: The higher the royalty in product franchising, the higher the franchisor's portion of incentivizing ownership surrogates**
>
> **H2a: The higher the franchisor's portion of residual decision rights in product franchising, the more incentivizing ownership surrogates are assigned to him**
>
> **H3a: The higher the franchisor's portion of residual decision rights in product franchising, the higher the royalty**

b. Service franchising

> **H1b: The higher the royalty in service franchising, the higher the franchisor's portion of incentivizing ownership surrogates**
>
> **H2b: The higher the franchisor's portion of residual decision rights in service franchising, the more incentivizing ownership surrogates are assigned to him**
>
> **H3b: The higher the franchisor's portion of residual decision rights in service franchising, the higher the royalty**

c. Distribution franchising

> **H1c: The higher the royalty in distribution franchising, the higher the franchisor's portion of incentivizing ownership surrogates**
>
> **H2c: The higher the franchisor's portion of residual decision rights in distribution franchising, the more incentivizing ownership surrogates are assigned to him**

H3c: The higher the franchisor's portion of residual decision rights in distribution franchising, the higher the royalty

5.2 Methodology

In the following, the theoretical observations of the previous chapters will be linked to the data from the empirical analysis. Overall, the sample size included 208 franchise contracts which were evaluated by five students. Professor Windsperger was able to obtain these contracts from the cartel court in Vienna in 2006.

5.2.1 Research design & objective

The available franchise contracts were tested for various different property rights, i.e. residual income rights and complementary ownership surrogates. Furthermore, the contracts were analyzed for residual decision rights. In order to do so, each franchise contract was analyzed for altogether 46 variables. Results were entered in SPSS in order to operationalize the hypotheses.

The following figure gives an example of an ownership surrogate variable and a decision right variable. A detailed list of all variables can be found in the appendix.

Figure 5: Ownership Surrogate and Decision Right Variable

tying_arrangement

		Value
Standard Attributes	Label	tying_arrangement
	Measurement	Scale
Labeled Values	1	yes
	2	no
	3	mixed, after approval
	9	not mentioned

marketing_decisions

		Value
Standard Attributes	Label	marketing_decisions
	Measurement	Nominal
Valid Values	1	franchisor
	2	franchisee
	3	both, after internal communication
	9	not mentioned

The objective of the study is to find a relationship between the above mentioned additional contractual elements, i.e. complementary ownership surrogates and residual income rights. Moreover, a possible relationship between the different property rights and contractual decision rights is investigated.

5.2.2 Analytical Approach

As mentioned above, the analysis of the data was conducted with SPSS. The Pearson Correlation test was used to assess the hypotheses since all variables are continuous scale variables, are normally distributed and have a linear relationship. A correlation between sets of data is a measure of how well they are related.

The Pearson's r is the actual correlation coefficient and shows the linear relationship between both variables. When it's close to 1 or -1, there is a strong relationship between the two variables. This means that changes in one variable are strongly correlated with changes in the second variable. Results ranging between 0.1 and 0.3 have a weak relationship, outcomes between 0.3 and 0.5 show a moderate relationship and anything above 0.5 indicates a strong relationship.

However, based on this number no other conclusion can be made about the relationship. When the Pearson's r is close to 0, there is a weak relationship between the two variables. This means that changes in one variable are not correlated with changes in the second variable.

When the Pearson's r is positive (+), this means that as one variable increases in value, the second variable also increases in value. Similarly, as one variable decreases in value, the second variable also decreases in value. This is therefore called a positive correlation. When the Pearson's r is negative (-), this means that as one variable increases in value, the second variable decreases in value. This is called a negative correlation.

The significance value, sig (2-Tailed), shows a statistically significant correlation between the two variables. If the value is below or equal 0.05 a significant correlation can be observed.

5.3 Data Analysis

The following chapter is divided into three parts. The first provides an overview over the frequencies in the data set. Here, especially the frequency of the residual income rights and the ownership surrogates as well as the decision rights are of interest. Furthermore, an outline of the different franchise sectors and branches in our data set will be given. The second part consists of the analysis of the general hypotheses and the interpretation of its results. The last part focuses on the analysis of the same hypotheses but within the different franchise sectors, i.e. product, service and distribution franchising.

5.3.1 Frequency and Descriptive Analysis

A frequency analysis of the data set shows that from 208 contracts, 102 (49%) require an entry fee and 129 contracts require a royalty (62%). 86 contracts require both an entry fee and a royalty.

Figure 6: Frequency Analysis Entry Fee

entry_fee_required

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	102	49,0	49,0	49,0
	no	13	6,3	6,3	55,3
	yes, amount not defined/to be negotiated	49	23,6	23,6	78,8
	not mentioned	44	21,2	21,2	100,0
	Total	208	100,0	100,0	

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
entry_fee_amount	100	254,00	145345,00	14004,7937	19720,02619
Valid N (listwise)	100				

Figure 7: Frequency Analysis Royalty

royalty_required

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	129	62,0	62,0	62,0
	no	10	4,8	4,8	66,8
	yes, amount not defined/to be negotiated	33	15,9	15,9	82,7
	not mentioned	36	17,3	17,3	100,0
	Total	208	100,0	100,0	

Descriptive Statistics

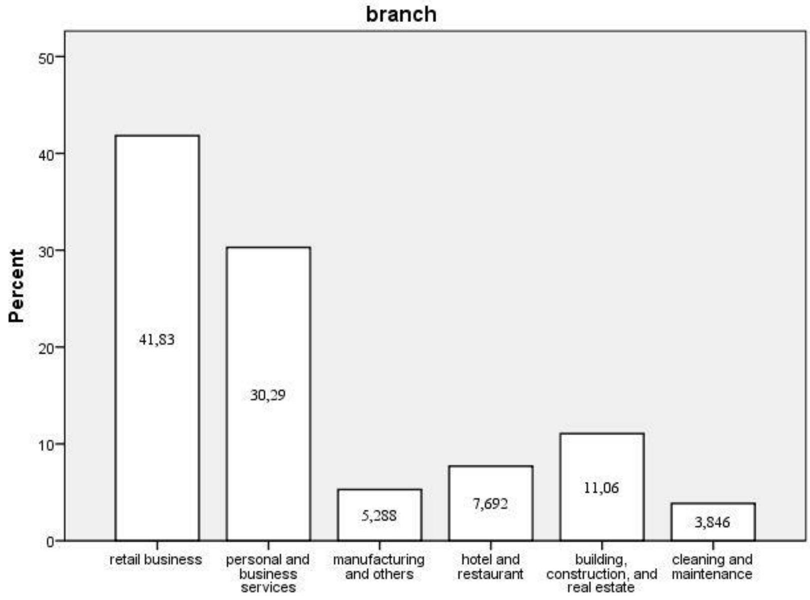
	N	Minimum	Maximum	Mean	Std. Deviation
royalty_percentage	112	,0400	50,0000	6,232946	6,0280250
Valid N (listwise)	112				

The set of data can be further analyzed according to the franchise sector. Overall, there are 12 franchise businesses corresponding to a product franchise. Distribution franchising accounts for 92 businesses and a total of 104 franchise systems belong to the service industry.

Figure 8: Frequency Analysis Franchise Sector

The different branches, the franchise systems can be assigned to, are also of interest. In total, 87 franchise systems operate in the retail business, 63 in the personal and business services, 11 in manufacturing and other, 16 in hotel and restaurant, 23 in building, construction and real estate and 8 in cleaning and maintenance.

Figure 9: Frequency Analysis Franchise Branch



The following figure gives an overview of the frequency of the incentive effects of the individual ownership surrogates on the franchisor and the franchisee.

Figure 10: Frequency Analysis Incentives

Ownership Surrogates	Frequency	
Franchisor	Yes	No
Tying Clause	142	14
Exclusive Dealing	113	17
Resale Price Maintenance	23	128
Lease Control	43	1
Approval and Buy Back Rights	127	1
Control Rights	147	0
Advisory Board	56	0
Franchisee	Yes	No
Exclusive Territory Clause	149	26
Exclusive Customer Clause	43	18
Lease Rights	32	15
Option Right Extension	29	6
Extension Rights	23	33
Alienation Rights	5	25
Inheritance	32	20

Figure 11 shows the frequency of decision rights pertaining to the franchisor, the franchisee and both. The most repeated frequent decision rights for the franchisor are marketing decisions with 166, whereas the franchisee only has 3. The most common decision rights for the franchisee are recruiting decision rights with 113, while the franchisor only has 3.

Figure 11: Frequency Analysis Decision Rights

Decision Rights	Frequency		
	Franchisor	Franchisee	Both
Marketing Decision	166	3	25
Production Decision	149	16	2
Accounting System Decision	85	26	23
Advertising Decision	52	32	94
Employees Training Decision	103	39	40
Investment Decision	20	34	21
Recruiting Decision	3	113	27

5.3.2 Correlation Analysis

H1: The higher the royalty, the more incentivizing ownership surrogates are assigned to the franchisor relative to the franchisee

Descriptive Statistics

	Mean	Std. Deviation	N
royalty_percentage	3,356202	5,4024700	208
Difference Incentives	1,13	1,775	208

Correlations

		royalty_percentage	Difference Incentives
royalty_percentage	Pearson Correlation	1	,029
	Sig. (2-tailed)		,680
	N	208	208
Difference Incentives	Pearson Correlation	,029	1
	Sig. (2-tailed)	,680	
	N	208	208

Based on the hypothesis, the franchisor's (franchisee's) fraction of ownership surrogates varies positively (negatively) with the royalty rate. If the correlation is positive between the franchisor's fraction of ownership surrogates and the royalty and negative between the franchisee's fraction of ownership surrogates and the royalty, a complementary relationship exists between ownership surrogates and residual income rights indicating that ownership surrogates increase the incentive effect of residual income rights. Unfortunately, in our data set this theory does not prove to be true. The correlation coefficient shows the strength of the linear relationship between the royalty and the incentivizing ownership surrogates. As we can see, the value of 0.029 is close to zero and below 0.1, meaning that there is basically no relationship between the two variables. Furthermore, the significance value of 0.680 is far above the level of 0.05, which is the upper limit of a statistically significant correlation. Therefore, the correlation is not significant and the hypothesis of complementarity can be rejected.

H2: The higher the franchisor's portion of residual decision rights, the more incentivizing ownership surrogates are assigned to him

Descriptive Statistics

	Mean	Std. Deviation	N
Difference Decision Rights	1,51	2,162	208
Difference Incentives	1,13	1,775	208

Correlations

		Difference Decision Rights	Difference Incentives
Difference Decision Rights	Pearson Correlation	1	,118
	Sig. (2-tailed)		,090
	N	208	208
Difference Incentives	Pearson Correlation	,118	1
	Sig. (2-tailed)	,090	
	N	208	208

According to the property rights theory, the amount of specific knowledge assets is positively related to the amount of ownership and residual decision rights. Decision rights are allocated between the franchisor and the franchisee depending on their knowledge assets. The complementarity between ownership rights and decision rights are the drivers of an efficient institutional structure. The results of Hypothesis 2 suggest that some complementarity might exist between the two variables. The strength of the correlation is weak with a value of 0.118. However, the significance value of 0.090 is above the significance level of 0.05 and therefore has to be interpreted as insignificant even though there might be a marginal complementarity. Nevertheless, hypothesis 2 has to be ruled out.

H3: The higher the franchisor's portion of residual decision rights, the higher the royalty

Descriptive Statistics

	Mean	Std. Deviation	N
royalty_percentage	3,356202	5,4024700	208
Difference Decision Rights	1,51	2,162	208

Correlations

		royalty_percentage	Difference Decision Rights
royalty_percentage	Pearson Correlation	1	-,129
	Sig. (2-tailed)		,064
	N	208	208
Difference Decision Rights	Pearson Correlation	-,129	1
	Sig. (2-tailed)	,064	
	N	208	208

As mentioned above, according to the property rights theory, there exists a positive relationship between property rights and decision rights. Property rights are again measured based on the royalty percentage. Interestingly, the correlation value of -0.129 is not only weak but negative. The significance level of 0.064 is only just above the significance level of 0.05, meaning that it can be interpreted as being slightly significant. Hypothesis 3 can therefore be confirmed as true. However, it seems like that the amount of decision rights is negatively correlated with the amount of royalty. The higher the amount of decision rights the franchisor holds, the lower the royalty. And the higher the amount of decision rights the franchisee holds, the higher the royalty payments. This somewhat surprising result is not in line with the property rights theory.

5.3.3 Correlation Analysis Franchise Sectors

a. Product franchising

H1a: The higher the royalty in product franchising, the higher the franchisor's portion of incentivizing ownership surrogates

Descriptive Statistics

	Mean	Std. Deviation	N
Difference Incentives	,92	2,021	12
royalty_percentage	6,083333	14,0094665	12

Correlations

		Difference Incentives	royalty_percentage
Difference Incentives	Pearson Correlation	1	-,241
	Sig. (2-tailed)		,451
	N	12	12
royalty_percentage	Pearson Correlation	-,241	1
	Sig. (2-tailed)	,451	
	N	12	12

Product franchising involves the production, handling, processing and refinement of a product by the franchisee. The franchisor's trademark is essential for the creation of residual surplus. It would therefore make sense if the franchisor protected his intangible investments through ownership surrogates. In the case of product franchising a tying arrangement seems to be an indispensable contract clause as a guarantee of quality is essential. Nevertheless, the results show that with a significance value of 0.451 this hypothesis has to be rejected. There is clearly no correlation between the two variables.

H2a: The higher the franchisor's portion of residual decision rights in product franchising, the more incentivizing ownership surrogates are assigned to him

Descriptive Statistics

	Mean	Std. Deviation	N
Difference Decision Rights	1,25	1,815	12
Difference Incentives	,92	2,021	12

Correlations

		Difference Decision Rights	Difference Incentives
Difference Decision Rights	Pearson Correlation	1	-,217
	Sig. (2-tailed)		,498
	N	12	12
Difference Incentives	Pearson Correlation	-,217	1
	Sig. (2-tailed)	,498	
	N	12	12

Decision rights that are especially of importance for product franchising are procurement decisions and production decisions. Decision rights are centralized in the network if they can be attributed to the franchisor and decentralized if they can be attributed to the franchisee. However, this hypothesis also has to be rejected. With a significance of 0.498 there is no correlation between the two variables, i.e. there is no complementary effect between decision rights and the amount of ownership surrogates.

H3a: The higher the franchisor's portion of residual decision rights in product franchising, the higher the royalty

Descriptive Statistics

	Mean	Std. Deviation	N
royalty_percentage	6,083333	14,0094665	12
Difference Decision Rights	1,25	1,815	12

Correlations

		royalty_percentage	Difference Decision Rights
royalty_percentage	Pearson Correlation	1	-,290
	Sig. (2-tailed)		,360
	N	12	12
Difference Decision Rights	Pearson Correlation	-,290	1
	Sig. (2-tailed)	,360	
	N	12	12

Unfortunately, this hypothesis has to be rejected as well since the value of 0.360 is far above the significance level of 0.05. Again, the two variables are not correlated. It is interesting to see that in product franchising none of the three hypotheses is even remotely significant.

b. Service franchising

H1b: The higher the royalty in service franchising, the higher the franchisor's portion of incentivizing ownership surrogates

Descriptive Statistics

	Mean	Std. Deviation	N
royalty_percentage	4,410481	5,1322043	104
Difference Incentives	,91	1,844	104

Correlations

		royalty_percentage	Difference Incentives
royalty_percentage	Pearson Correlation	1	,119
	Sig. (2-tailed)		,228
	N	104	104
Difference Incentives	Pearson Correlation	,119	1
	Sig. (2-tailed)	,228	
	N	104	104

In service franchising the franchisee uses the know-how of the franchisor to provide services according to the specifications and the brand or trademark of the franchisor. The brand name represents the existing know-how and the specificity of the methods used. One would assume that there is a positive relationship between the royalty and the amount of ownership surrogates. In service franchising, incentives like exclusive dealing clauses or resale price maintenance are especially of importance since they create uniformity and protect the franchisor's reputation and brand name. Nevertheless, this hypothesis has to be rejected since the value of 0.228 is insignificant. The two variables do not correlate.

H2b: The higher the franchisor's portion of residual decision rights in service franchising, the more incentivizing ownership surrogates are assigned to him

Descriptive Statistics

	Mean	Std. Deviation	N
Difference Incentives	,91	1,844	104
Difference Decision Rights	1,38	2,244	104

Correlations

		Difference Incentives	Difference Decision Rights
Difference Incentives	Pearson Correlation	1	,196*
	Sig. (2-tailed)		,046
	N	104	104
Difference Decision Rights	Pearson Correlation	,196*	1
	Sig. (2-tailed)	,046	
	N	104	104

*. Correlation is significant at the 0.05 level (2-tailed).

Decision rights that are of significant importance for service franchising are advertising and marketing decisions. In this case, the hypothesis can be confirmed. The correlation value of 0.196 is weak but existent and the significance value of 0.046 is below the level of 0.05, meaning that the two variables correlate. In service franchising, the portion of residual decision rights is therefore positively related to the amount of ownership surrogates.

H3b: The higher the franchisor's portion of residual decision rights in service franchising, the higher the royalty

Descriptive Statistics

	Mean	Std. Deviation	N
royalty_percentage	4,410481	5,1322043	104
Difference Decision Rights	1,38	2,244	104

Correlations

		royalty_percentage	Difference Decision Rights
royalty_percentage	Pearson Correlation	1	-,108
	Sig. (2-tailed)		,276
	N	104	104
Difference Decision Rights	Pearson Correlation	-,108	1
	Sig. (2-tailed)	,276	
	N	104	104

This next hypothesis, however, has to be rejected. With a value of 0.276 and a correlation coefficient of -0.108 there is no significant correlation between the extent of royalties and the amount of decision rights.

c. Distribution franchising

H1c: The higher the royalty in distribution franchising, the higher the franchisor's portion of incentivizing ownership surrogates

Descriptive Statistics

	Mean	Std. Deviation	N
royalty_percentage	1,808696	2,8604792	92
Difference Incentives	1,41	1,638	92

Correlations

		royalty_percentage	Difference Incentives
royalty_percentage	Pearson Correlation	1	,203
	Sig. (2-tailed)		,052
	N	92	92
Difference Incentives	Pearson Correlation	,203	1
	Sig. (2-tailed)	,052	
	N	92	92

Distribution franchising focuses on the sales of goods that are produced by the franchisor or a third party. Additionally, this type of franchise focuses on the whole package that characterizes the entire distribution system of the franchisee. In this case, the extent of the royalty is positively correlated with the extent of the franchisor's portion of incentivizing ownership rights. The hypothesis can be confirmed. The significance value of 0.052 confirms the correlation of the two variables. The correlation strength is weak with a value of 0.203.

H2c: The higher the franchisor's portion of residual decision rights in distribution franchising, the more incentivizing ownership surrogates are assigned to him

Descriptive Statistics

	Mean	Std. Deviation	N
Difference Incentives	1,41	1,638	92
Difference Decision Rights	1,70	2,116	92

Correlations

		Difference Incentives	Difference Decision Rights
Difference Incentives	Pearson Correlation	1	,033
	Sig. (2-tailed)		,751
	N	92	92
Difference Decision Rights	Pearson Correlation	,033	1
	Sig. (2-tailed)	,751	
	N	92	92

Decision rights that are especially of importance for distribution franchising are advertising and marketing decisions and human resource decisions. A good example can be taken from the retail industry such as cosmetics. Here, it is extremely important that the franchisee has an efficient marketing plan and that he hires qualified and well-trained salespersons. The results show, no correlation whatsoever exists between the amount of incentives and the amount of decision rights. The two variables are completely independent of each other and this hypothesis, therefore, has to be rejected.

H3c: The higher the franchisor's portion of residual decision rights in distribution franchising, the higher the royalty

Descriptive Statistics

	Mean	Std. Deviation	N
Difference Decision Rights	1,70	2,116	92
royalty_percentage	1,808696	2,8604792	92

Correlations

		Difference Decision Rights	royalty_percentage
Difference Decision Rights	Pearson Correlation	1	-,098
	Sig. (2-tailed)		,354
	N	92	92
royalty_percentage	Pearson Correlation	-,098	1
	Sig. (2-tailed)	,354	
	N	92	92

This last hypothesis also has to be rejected. In distribution franchising, there does not seem to exist a correlation between the amount of decision rights and the extent of royalty payments. With a value of 0.354 the correlation is insignificant.

As we have seen, only few hypotheses are significant when looking at the different franchise sectors. This result is somewhat disappointing, since it would have been interesting to find some of the hypotheses to be more significant in a certain sector. This would imply that property rights, i.e. residual income rights and ownership surrogates as well as decision rights are more important in this certain franchise format.

6. Conclusion & Limitations

This study focuses on 208 franchise contracts and their underlying individual property rights. The latter were analyzed according to their frequency and distribution among the contracting parties.

The thesis consists of a theoretical part and an empirical elaboration. The theoretical part focuses on an introduction to franchising and general related terms and the most common provisions contained in franchise contracts. As we have seen, there are no legal regulations for the formation of a franchise contract. Nevertheless, there are certain integral parts of the contract that occur more frequently. These components depend on various factors, e.g. the franchise item, the franchise sector, the distribution of intangible knowledge assets between the franchisor and the franchisee and many more. Furthermore, an overview of neo-institutional theories is given and a conjunction to franchising found. The theories highlight the problems that arise with the formation of franchise agreements.

After discussing the essential elements of a franchise agreement, an explanation and distinction of ownership rights was given. They can further be distinguished into residual income rights, i.e. initial fees and royalties and complementary ownership surrogates, e.g. exclusive territory clauses, resale price maintenance etc.

The empirical part initially concentrates on the hypotheses derivation. Here, the relationship and interdependencies between residual decision rights, ownership surrogates and residual income rights are analyzed. The same relations are investigated in the different franchise sectors, i.e. product, service and distribution franchising. The different ownership surrogates were assigned to the franchisor and the franchisee according to their incentivizing effect as explained in chapter 5.1.1. The decision-making powers were divided according to their centralization or decentralization degree and summarized as explained in chapter 5.1.2. After focusing on the methodology, the data was analyzed. Unfortunately, the analysis of the interactions of residual decision rights, ownership surrogates and residual income rights did not render the expected results. According to the complementarity view, the residual income generating effect of decision rights is enhanced by allocating ownership rights (residual income rights and ownership surrogates) to the party that is best able to maximize the residual income stream. Ownership surrogates are included in franchise contracts because they compensate the disincentive effect of diluted residual income rights. However, no clear or sustainable proof of this theory could be obtained. It is therefore questionable if the property rights perspective is the best approach when assessing franchise contracts. Only some theoretical explanations could be affirmed when looking at the hypotheses independently.

However, there could be several explanations for these results. For starters, there might be other variables, not included or at least not analyzed in this study, that influence the allocation of decision and property rights. It would be of interest to investigate the variables from a transaction cost or principal-agent perspective. Unfortunately, because of the limited extent of this study, the integration of other theoretical views was not possible. This could, however, be an interesting approach for future research.

Furthermore, additional information could be obtained through a questionnaire. Respective intentions and incentives of certain contractual clauses could be investigated in more detail. In particular, certain property surrogates provide incentives for the franchisor and the franchisee as well. However, a clear assignment is often difficult because certain clauses can be incentivizing for both sides. Additionally, intangible knowledge assets and their distribution between the involved parties could be measured and analyzed.

The data set was evaluated by five students using the same variables and guidelines how to assess the contracts. However, only few variables were specific with a fixed amount, e.g. royalty_percentage or entry_fee_amount. Other variables, such as decision rights, were harder to assess and left room for interpretation. Therefore, not all variables were evaluated objectively but rather subjectively by the students. Even though a lot of time was invested to prevent this effect, the individual assessment might nevertheless differ when compared. When working with the different franchise contracts it also became clear that some contracts were very imprecise compared to others. Moreover, some contracts comprised as much as 120 pages while others were only 7 pages long. This illustrates the difference in available information. The contracts were therefore not ideally comparable.

The available data base did not leave room to interpret the intangible knowledge assets of the franchisor or the franchisee. The only information available was that included in the contracts. This was not the case for know-how, since it is not easily quantifiable. It would, however, be of interest to investigate the existence of a relationship between the above analyzed hypotheses and the amount of knowledge assets distributed among the two players.

In addition, a follow-up study with the franchise firms could be conducted to see how successful their businesses currently are, after such a long time span has passed. Maybe some evidence can be found as to why some businesses were successful while others were not.

In conclusion, the analysis of the interactions of residual decision rights, ownership surrogates and residual income rights did not provide support of the property rights theory approach. Nevertheless, this thesis provides important insights into the contract design in franchising. The allocation of ownership and decision rights is an essential component of each franchise contract. It emphasizes the interactive and complex relationship between the franchisor and the franchisee. Franchising is and continues to be an important and indispensable form of distribution. Franchising has grown tremendously in recent years and will continue to do so. Future research in this context is therefore necessary, since there are still many variables and relationships which have not yet been analyzed.

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Appendix

1. Statutory Declaration

I declare that I have developed and written this Master Thesis completely by myself and have not used sources or means without declaration in the text. Any thoughts from others or literal quotations are clearly marked. The Master Thesis was not used in the same or in a similar version to achieve an academic grading or is being published elsewhere.

Vienna, January 2015

Corinna Neubach

2. Abstract

Eine vertragliche Regelung zwischen Franchisegeber und Franchisenehmer ist in Franchising von besonderer Bedeutsamkeit, da Franchisebeziehungen mit einer großen gegenseitigen Abhängigkeit einhergehen. Hierbei steht die Ausarbeitung eines möglichst vollständigen Vertrages im Vordergrund. Eine effiziente Zuordnung der Property Rights (Handlungs – und Verfügungsrechte) ist ein zentrales Merkmal aller Franchiseverträge. Property Rights gewährleisten systemkonformes Verhalten, sie schaffen Anreize in die Franchisebeziehung zu investieren und haben eine motivierende Wirkung auf die beteiligten Parteien. Im Allgemeinen, können Property Rights in Eigentums- und Entscheidungsrechte unterteilt werden. Entscheidungsrechte sind Rechte, die über die Verteilung und die Nutzung von Vermögenswerten bestimmen. Ihre Zuordnung ist abhängig von der Verteilung der immateriellen Vermögenswerte zwischen dem Franchisegeber und dem Franchisenehmer. Das immaterielle Wissen des Franchisegebers bezieht sich auf systemspezifische Geschäftspraktiken und geistiges Eigentum, während das immaterielle Wissen des Franchisenehmers seine Erfahrung, lokale Marktkenntnisse und Führungsqualitäten sind. Eigentumsrechte können als residuale Kontrollrechte interpretiert werden. Diese wiederum lassen sich in residuale Einkommensrechte und Eigentumssurrogate unterteilen. Residuale Einkommensrechte bestehen aus Royalties und anfänglichen Gebühren. Da Franchiseverträge unvollständig sind, gibt es residuale Rechte die nicht Bestandteil des Vertrages sind. Residuale Einkommensrechte sind verdünnt, da der residuale Überschuss zwischen dem Franchisegeber und dem Franchisenehmer aufgeteilt wird. Aus diesem Grund werden Eigentumssurrogate in Verträgen eingesetzt, da sie die Anreizwirkung der verdünnten residualen Einkommensrechten erhöhen und den Franchisegeber oder Franchisenehmer motivieren, zusätzliche Investitionen zu tätigen (Windsperger, 2008, p. 20) (Windsperger, 2003, p. 292) (Windsperger, 2002, pp. 132, 139).

Das Ziel dieser Arbeit ist, 208 Franchise-Verträge auf ihre Property Rights zu untersuchen. Genauer gesagt werden die Verteilung der Entscheidungs- und Eigentumsrechte und deren Anreizwirkung auf den Franchisegeber und Franchisenehmer analysiert.

3. Curriculum Vitae

Name: Corinna L. Neubach

Date of birth: 04.10.1987 in Göttingen, Germany

EDUCATION

University of Vienna, Austria *Oct. 2012 – Jan. 2015*

Master in International Business

Main focus: Strategic and Industrial Management

University of Passau, Germany *Oct. 2008 – Dec. 2011*

Bachelor of Science in Business Administration and Economics

Main focus: Economics, Marketing and Management

University of Budapest, Budapest, Hungary *Aug. 2010 – Dec. 2010*

Exchange Semester

Coursework in Strategic Management, Marketing and Economics

Universidad de las Americas (UDLA), Puebla, Mexico *Jan. 2008 – June 2008*

Semester abroad

Coursework in Business Administration and Spanish

EXPERIENCE

Prisma Kreditversicherung *Feb.2013 – June 2014*

Working student in the Marketing Department

Hamburg Institute of International Economics (HWWI) *Feb. 2012 – July 2012*

Internship in the Global Economy Department

Volkswagen, Puebla, Mexico *Jan. 2011 – May 2011*

Internship in the Logistics Department

Giesecke & Devrient, Munich, Germany *March 2010 – April 2010*

Internship in the Human Resources Department

Surgical clinic, Munich, Germany *July 2007*

Clinical Trainee/Volunteer

ACTIVITIES

UNICEF *March 2009 – August 2011*

Active Member of the student organization

Rothof Tennis Club *January 1997 - Present*

Active Team Member

4. Variables

student

		Value
Standard Attributes	Label	student
	Measurement	Nominal
Valid Values	1	alex
	2	corinna
	3	lennart
	4	madeleine
	5	philipp

ID

		Value
Standard Attributes	Label	ID
	Measurement	Nominal

company

		Value
Standard Attributes	Label	Company
	Measurement	Nominal

cash_required

		Value
Standard Attributes	Label	Cash_required
	Measurement	Nominal
Valid Values	1	yes
	2	no
	3	yes, amount not defined/to be negotiated
	9	not mentioned

cash_amount

		Value
Standard Attributes	Label	Cash_amount
	Measurement	Nominal

investment_required

		Value
Standard Attributes	Label	Investment_required
	Measurement	Nominal
	1	yes
	2	no
	3	yes, amount not defined/to be negotiated
Valid Values	9	not mentioned

investment_amount

		Value
Standard Attributes	Label	Investment_amount
	Measurement	Scale

special_investment_required

		Value
Standard Attributes	Label	special_investment_required
	Measurement	Nominal
	1	yes
	2	no
	3	yes, amount not defined/to be negotiated
Valid Values	9	not mentioned

special_investment_amount

		Value
Standard Attributes	Label	special_investment_amount
	Measurement	Scale

entry_fee_required

		Value
Standard Attributes	Label	entry_fee_required
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	2,0	no
	3,0	yes, amount not defined/to be negotiated
Valid Values	9,0	not mentioned

entry_fee_amount

		Value
Standard Attributes	Label	entry_fee_amount
	Measurement	Nominal

entry_fee_percentage

		Value
Standard Attributes	Label	entry_fee_percentage
	Measurement	Nominal

royalty_required

		Value
Standard Attributes	Label	royalty_required
	Measurement	Nominal
Valid Values	1	yes
	2	no
	3	yes, amount not defined/to be negotiated
	9	not mentioned

royalty_amount

		Value
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	Measurement	Nominal

royalty_percentage

		Value
Standard Attributes	Label	royalty_percentage
	Measurement	Nominal

advertising_fee

		Value
Standard Attributes	Label	advertising_fee
	Measurement	Nominal
Valid Values	1	yes
	2	no
	3	yes, amount not defined/to be negotiated
	9	not mentioned

advertising_fee_amount

		Value
Standard Attributes	Label	advertising_fee_amount
	Measurement	Nominal

advertising_fee_percentage

		Value
Standard Attributes	Label	advertising_fee_percentage
	Measurement	Nominal

exclusive_territory

		Value
Standard Attributes	Label	exclusive_territory
	Measurement	Nominal
Valid Values	1	yes
	2	no
	9	not mentioned

resale_price_maintenance

		Value
Standard Attributes	Label	resale_price_maintenance
	Measurement	Scale
Labeled Values	1	yes
	2	no
	9	not mentioned

tying_arrangement

		Value
Standard Attributes	Label	tying_arrangement
	Measurement	Scale
Labeled Values	1	yes
	2	no
	3	mixed, after approval
	9	not mentioned

exclusive_dealing

		Value
Standard Attributes	Label	exclusive_dealing
	Measurement	Scale
Labeled Values	1	yes
	2	no
	3	mixed, after approval
	9	not mentioned

approval_and_buy_back_rights

		Value
Standard Attributes	Label	approval_and_buy_back_rights
	Measurement	Nominal
Valid Values	1	yes
	2	no
	9	not defined

alienation_right

		Value
Standard Attributes	Label	alienation_right
	Measurement	Nominal
Valid Values	1	yes
	2	no
	3	yes, after approval
	9	not mentioned

contract_duration_type

		Value
Standard Attributes	Label	contract_duration_type
	Measurement	Nominal
Valid Values	1	yes
	3	yes, open-ended
	9	not defined

contract_duration

		Value
Standard Attributes	Label	contract_duration
	Measurement	Scale

option_right_extention_franchisee

		Value
Standard Attributes	Label	option_right_extention_franchisee
	Measurement	Nominal
	1	yes
	2	no
Valid Values	9	not mentioned

extention_right_franchisee

		Value
Standard Attributes	Label	option_right_extention_franchisor
	Measurement	Nominal
	1	yes
	2	no
	3	yes, after approval
Valid Values	9	not mentioned

lease_right_outlet_after_franchisee

		Value
Standard Attributes	Label	lease_right_after_franchisee
	Measurement	Nominal
	1	yes
	2	no
Valid Values	9	not mentioned

lease_control_outlet_after_franchisor

		Value
Standard Attributes	Label	lease_control_after_franchisor
	Measurement	Nominal
	1	yes
	2	no
Valid Values	9	not mentioned

marketing_decisions

		Value
Standard Attributes	Label	marketing_decisions
	Measurement	Nominal
	1	franchisor
	2	franchisee
	3	both, after internal communication
Valid Values	9	not mentioned

production_decision

		Value
Standard Attributes	Label	production_decision
	Measurement	Nominal
	1	franchisor
	2	franchisee
	3	both, after internal communication
Valid Values	9	not mentioned

acounting_system_decision

		Value
Standard Attributes	Label	acounting_system_decision
	Measurement	Nominal
	1	franchisor
	2	franchisee
	3	both, after internal communication
Valid Values	9	not mentioned

advertising_decision

		Value
Standard Attributes	Label	advertising_decision
	Measurement	Nominal
	1	franchisor
	2	franchisee
	3	both, after internal communication
Valid Values	9	not mentioned

employees_training_decision

		Value
Standard Attributes	Label	employees_training_decision
	Measurement	Nominal
	1	franchisor
	2	franchisee
	3	both, after internal communication
Valid Values	9	not mentioned

training_days_annual

		Value
Standard Attributes	Label	training_days_annual
	Measurement	Scale

investment_decision

		Value
Standard Attributes	Label	investment_decision
	Measurement	Nominal
	1	franchisor
	2	franchisee
	3	both, after internal communication
Valid Values	9	not mentioned

recruiting_decision

		Value
Standard Attributes	Label	recruiting_decision
	Measurement	Nominal
	1	franchisor
	2	franchisee
	3	both, after internal communication
Valid Values	9	not mentioned

franchise_sector

		Value
Standard Attributes	Label	franchise_sector
	Measurement	Nominal
	1	product franchising
	2	service franchising
Valid Values	4	distribution franchising

branch

		Value
Standard Attributes	Label	branch
	Measurement	Nominal
	1	retail business
	2	personal and business services
	3	manufacturing and others
	4	hotel and restaurant
	5	building, construction and real estate
Valid Values	6	cleaning and maintenance

exclusive_customer_clause

		Value
Standard Attributes	Label	exclusive_customer_clause
	Measurement	Nominal
	1	yes, franchisor defines
	2	no
	3	yes, after internal communication
Valid Values	9	not mentioned

inheritance

		Value
Standard Attributes	Label	inheritance
	Measurement	Nominal
	1	yes
	2	no
	3	yes. after approval
Valid Values	9	not mentioned

ownership_rent_facility_franchisor

		Value
Standard Attributes	Label	ownership_facility
	Measurement	Nominal
	1	yes
	2	no
Valid Values	9	not mentioned

competition_clause_after_termination

		Value
Standard Attributes	Label	competition_clause_after_termination
	Measurement	Nominal
	1	yes
	2	no
	3	no, after approval
Valid Values	9	not mentioned

competition_clause_during_contract

		Value
Standard Attributes	Label	competition_clause_during_contract
	Measurement	Nominal
Valid Values	1	yes
	2	no
	3	no, after approval
	9	not mentioned

advisory_board

		Value
Standard Attributes	Label	advisory_board
Valid Values	1	yes
	2	no
	9	not mentioned

minimum_turnover

		Value
Standard Attributes	Label	minimum_turnover
Valid Values	1	yes
	2	no
	9	not mentioned

minimum_quantity

		Value
Standard Attributes	Role	Input
Valid Values	1	franchisee must buy minimum quantity from franchisor
	2	franchisee must produce minimum quantity
	3	franchisee must sell minimum quantity to customers
	4	no
	9	not mentioned

control_rights

		Value
Standard Attributes	Label	control_rights
	1	yes, unheralded
	2	yes, heralded
	3	yes, connected IT
	4	no
Labeled Values	9	not mentioned