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Transaction Cost Theory Determine the Choice of
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List of Abbreviations

AAFD	American Association of Franchisees and Dealers
BUNC	Behavioral Uncertainty
CD	Cultural Distance
CEO	Chief Executive Officer
ED	Economic/Market Distance
EU	European Union
FTSI	Franchisor Transaction-Specific Investments
GDP	Gross Domestic Product
ID	Institutional Distance
INTEXP	International Experience
KMO	Kaiser-Mayer Olkin
PTSI	Partner Transaction-Specific Investments
UK	United Kingdom
USA	United States of America

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1. Introduction

1.1. Franchising in general

In general, a franchising agreement is understood to be a vertical relationship between two parties, i.e. the franchisor and the franchisee. The latter receives the right to retail goods or services under the franchisor's brand name, as well as instructions as to how the franchisor's business practices are to be used. The franchisee has to pay an initial lump-sum fee and royalties (Combs et al., 2004).

The EU defines three attributes of franchising, specifically: “...*a common name or sign with a uniform presentation of premises, communication of know-how from franchisor to franchisee and continuing provision of commercial or technical services by the franchisor to the franchisee.*” The noun franchise is defined in the Oxford Dictionary of English as an: “*authorization granted by a government or company to an individual or group enabling them to carry out specified commercial activities, e.g., providing a broadcasting service or acting as an agent for a company's products.*” (p. 693 Oxford Dictionary English 3rd Edition 2010).

There are various points of view concerning franchising. The entrepreneur-view point perceives franchising as a remedy to initiate company ownership. From a marketing point of view, it is regarded as a crucial distribution canal (Kaufmann and Rangan, 1990). From an economic perspective, it is seen as a setting to understand the construction of contracts (Lafontaine, 1992). From the strategic management perspective franchising is an important type of organization (Combs and Ketchen, 1999a).

Franchising, as we know it today, began in the United States of America when the entrepreneur, Isaac Merrit Singer (1811-1875), who had improved an existing sewing machine model, was looking for a wider distribution possibility to sell his product. As he lacked the money to increase his manufacturing potential, and there was also the problem that people did not want to buy his machine without knowing how to use it, he had the idea to charge people licensing fees who would then own the rights to sell his machines in certain geographical regions to provide capital to increase production, and these licensees also became responsible for teaching people how to use the sewing machine.

So Isaac M. Singer was the first franchisor in the US as well as the first to create a franchising contract.

At the turn of the century, the creation, and ultimately, the mass production of cars changed everything in America. After other modes of distribution failed, Henry Ford and other automobile manufacturers discovered that franchising was an effective way to distribute their products. More roads were constructed and paved and oil companies opened gasoline service stations en route which were managed by franchisees (<http://www.spadealaw.com/blog/2012/05/09/what-history-franchising-united-states>).

Business format franchising, which is the dominant mode of franchising today, developed after World War 2 and became very popular because of the very great demand for all kinds of products and services at that time. It was in the 1960s that the fast food franchises began to appear because, in 1961, Raymond Kroc (1902-1984), a milkshake mixer salesman, took over the McDonald brothers' fast food business and expanded it so that there are now over 30.000 McDonald franchises worldwide (<http://www.spadealaw.com/blog/2012/05/09/what-history-franchising-united-states>).

Franchising has since become the most rapidly growing way of retailing commercial goods in many other parts of the world (Dant, Kacker, Coughlan and Emerson, 2007). At present, more than 40 % of the overall retail sales in USA is through franchising, which represents one sixth of the GDP. In the USA there are more than 600,000 franchise outlets, accounting for one trillion US dollars in annual sales and the employment of around 8 million people in the US economy (Justis, Tuunanen, Chen and Castrogiovanni, 2003).

This mode of business has also spread throughout the European Continent. France, for instance, has approximately 765 franchise networks with approximately 35000 franchisees (Dant, Perrigot and Cliquet, 2008). In Portugal franchising represents around 3 per cent of the overall GDP, which accounted for more than 3,5 billion Euros in 2008 (Park and Sternquist, 2008). In most of the other European countries there has been a much smaller growth in franchising than in the United States, mainly because they offer a market which is rather small for franchising to be a realizable business (Sidhpuria, 2009).

In general, there are two categories of franchising, namely, authorized franchised systems and business format franchising. In regard to this, Vaughn (1979) distinguishes between four types of franchising channels. The first type is a manufacturer-retailer relationship, as for a

gasoline station. The second type is the relationship between a manufacturer and a wholesaler, e.g. for that of a soft drink manufacturer. The third type is a wholesaler-retailer relationship as for drug stores, and the fourth is a business relationship between a retailer and a licensor particularly in the sale of trademarks. The types one to three belong to the authorized franchised systems, also known as product or trade name franchising, in which the products are sold by retailers who are closely controlled with regard to product presentation by the respective manufacturer.

Business format franchising is not the same, as it is an arrangement in which a franchisor licenses a whole approach of conducting business under a common brand name. It is the most frequently used kind of franchising (Coughlan, et al., 2001). With regard to business format franchising, franchisees might be granted, dependent on the contract terms, access to intellectual property assets and business knowledge of the franchisor. Furthermore, the franchisor usually assists the franchisee with his managerial know-how and might support the franchisee concerning business conduct and training of employees. Also the franchisee might profit from coordinated advertising, purchasing and selling efforts of the franchisor (Burton, Cross and Rhodes, 2000).

As international franchising is an international market entry strategy for those who are unable to export their products, it is the predominant method used to facilitate the growth of a firm. Also it is less risky than other international entry modes, such as foreign direct investment (Aydin and Kacker, 1990). In particular, in retailing, franchising is seen as one of the most preferred methods of foreign entry (Mumdzhev, 2013). Furthermore, it is a crucial factor in the expansion strategies of US service companies (Boddewyn et al. 1986). Therefore the focus of this thesis is on this topic. International franchising can be specified as a business understanding with a franchisee domiciled outside the franchisor's home market (Konigsberg 2008).

An international franchise network is regarded as being an organizational structure controlled by a contract between the parent company acting as the franchisor, and the local branch acting as the franchisee, in charge of product and service sales under a common trademark. The two parties involved are legally separated, but economically mutually dependent (Steven C, 2000).

By penetrating international markets through franchising, firms use this strategy to direct their retail operations vertically without the need for intensive capital investment. It also facilitates the use of hybrid marketing strategies as this makes it possible to standardize those sectors of marketing which are on the franchisor side as well as local adaption on the franchisee side (Sashi and Karuppur, 2002). For this reason, it is regarded as an efficient option to full integration and to non-integration (Norton, 1988b).

However, companies that choose to enter foreign markets by using the franchising strategy need to take into account the advantages and disadvantages of low levels of control against higher levels of control, as these levels affect the returns, potential risks, flexibility and costs of diverse resources. A franchisor can choose between five options of governing franchising agreements, namely, direct franchising, master franchising, area development franchising, joint venture franchising and wholly-owned subsidiaries, which vary from low control to full control (Konigsberg, 2008).

In a direct franchise relationship, arrangements are made with each franchisee individually, and so there is a direct provision of services from the franchisor's domestic market (Burton et al. 2000). Previous research on international franchising led to the opinion that foreign markets must be entered by the use of a direct franchising strategy (Moyné, 1997). Under such an agreement, a franchisee might own and manage numerous outlets; this is referred to as multi-unit franchising. This type can also be classified as area development franchising and sequential franchising (Kaufmann and Dant, 1996).

Area development franchising is incorporated as multi-unit franchising, because a franchisee is granted the right to establish a particular number of franchise outlets in a specific geographic territory over a stipulated period of time. The franchisee, however, is not permitted to offer the franchise business for sale to other sub-franchisees (Burton et al., 2000). In sequential franchising, a franchisee owns the right to successively inaugurate supplementary outlets (Grünhagen and Mittelstaedt, 2005).

An indirect franchise relationship is just the opposite, as it is characterized by an agreement between an intermediary located in the host market and the respective franchisee. Intermediaries deal with the development and organization of the entire network in the foreign market, which involves an indirect provision of franchisor services.

Master franchising is classified as indirect franchising, as a master franchisee (also termed sub-franchisor) appears as the franchisor in the foreign market. (Alon, 2000).

In a joint venture franchising relationship, a joint venture company located in the foreign market is in charge of running the local network in favor of the international franchisor. The franchisor has considerable control owing to his equity stake in the joint venture company. However, the establishment of a wholly-owned subsidiary in a foreign market represents the highest level of control. This way of entering a foreign market is attributed to the franchisor's ability to direct all foreign operations, to the comprehension of system know-how as well as product and trademark utilization by the franchisee. This entry strategy may be implemented only if the franchisor can expect a high growth potential in the foreign market (Konigsberg, 2008).

Companies face the so-called *entrepreneurial capacity problem* which means that they are limited in their abilities to grow. When companies have the intention to expand, additional employees are required, which leads to the issue of an ideal division of labor (Slater, 1980). New employees tend to prefer those functions which, in relation to the work input required, yield the greatest risk-adapted remuneration. For this reason, a company has to acquire relevant and essential information on the future employees, the costs of which, however, increase all the more, the faster the company grows. To ensure the availability of reasonable information on employees, managers have to be hired to monitor the employees. However, as managers do not possess ownership rights, they lack the motivation that company owners have, and this leads to shirking their responsibilities and the necessity to monitor also the managers (Prescott and Visscher, 1980).

In general, the growth of a firm depends on managerial capacity and the assets owned by a firm. According to Penrose (1959), the expansion of a firm is restrained by the pace at which it is able to enlarge managerial capacity. To overcome these restrictions, a firm might make use of contractual organizational methods, which leads to the issue of how much control can be given to contract partners. It is particularly the hybrid organizational methods of retailing, including franchising, that enable firms with resource constraints to gain control over co-specialized assets (Teece, 1986).

Moreover, the elements of both market and hierarchy are included (Williamson, 1991). In franchising, ownership rights are allocated to the managers of franchised outlets. Two problems appear when assigning tasks to others, namely, moral hazard and adverse selection. On the one hand, company owners cannot be certain about the working behavior of employees, i.e. if they shirk their duties and responsibilities or not, and, on the other hand, there is no certainty about an employee revealing his or her true abilities (Eisenhardt, 1988).

There arises the agency problem and the need for monitoring. Transaction costs are also an issue, as it is necessary to find the right mix between markets and hierarchies. Environmental uncertainty in host countries raises a company's transaction costs, consisting mainly of adjustment and information processing costs.

1.2. The Research Target and Research Questions

This thesis is focused on the effects that Agency Theory and Transaction Costs Theory have on the choice of governance modes of international franchising firms. More precisely the aim is to find out which of these two theories has the greatest and also the least effects, respectively, on the selection of low control modes, i.e. indirect franchising, and higher control modes i.e. direct franchising.

Based on Agency Theory and Transaction Cost Theory, respectively, previous studies depict franchising firms as having a higher tendency towards international franchising and that the higher environmental uncertainty is in the host country, as it enables firms to remain flexible, to reduce investment ventures and transaction costs, such as the costs of monitoring or adaption. Additionally, the Transaction Cost Theory provides an explanation of the consequences of transaction-specific investments on control levels in franchising. (Castrogiovanni et al., 2006, Contractor and Kundu, 1998a,b, Fladmoe-Lindquist and Jacque, 1995).

It can be assumed that the franchisor is going to use higher control entry modes the higher his or her transaction-specific investments are in relation to the franchisee, and vice versa. Moreover, as monitoring costs rise as a consequence of behavioral uncertainty, the franchisor has a greater inclination to select lower control entry modes. As a result of environmental uncertainty, higher transaction costs ensue, which also leads to a greater inclination to prefer lower control entry modes on the part of the franchisor.

The following research questions can be deduced from the research results and subject of this thesis:

“How do Agency Theory and Transaction Cost Theory affect the choice of governance mode in international franchising firms?”

“Which theory provides the best explanation for the choice of governance mode and which has only modest effects?”

In order to answer the previously cited research questions, an evaluation of a study on the governance modes of international franchising firms in eight countries was carried out. The main research target is to find out the effects of Agency Theory and Transaction Cost Theory, respectively, and the extent of these effects on the choice of governance modes. The findings of this study should attest that the presumed effects of these theories do indeed influence the selection of governance modes, and to what extent. However, if results are contradictory, they will negate this presumption.

1.3. Research Methodology and Structure

The first half of this thesis is the theoretical introduction, in which current, international franchising literature and the current state of research are covered. This involved extensive research in recently published trade journals, as well as in historically relevant scientific papers. The purpose of combining different kinds of academic literature was to obtain a widespread overview as well as a close view of specific aspects of franchising. The abstract contains relevant definitions, concepts, methods and studies referring to both the advantages and problems of franchising, as well as the research question, all of which serve as a basis for the empirical investigation that follows.

Thematically the thesis is concerned with two main fields of interests a) foreign market entry modes and franchising and b) theoretical approaches relevant to governance modes. Throughout the first half of the theoretical part of the thesis the factors influencing international entry decisions are described and explained, as well as under which circumstances firms prefer the use of franchising as an international entry strategy over vertical integration. In the second half the focus is on governance modes in international franchising, and an explanation is given in some detail of what Agency Theory and

Transaction Cost Theory are, together with the effects each is presumed to have, respectively, on the selection of control modes. To conclude the theoretical part, a comparison of the two theories is made with regard to the unit of analysis, focal dimensions and cost matters, contractual perspectives and theoretical focus, strategic intention and sources of market tensions for classifications.

The second part of this thesis is empirical and contains descriptions of the methods and the approach used to gather data, as well as the definition of the concept of the study. First of all the experimental design, the quantitative research approach and method of probability sampling are explained. This is followed by a discussion on the layout of the questionnaire and phrasing of the hypotheses, and then the acquisition of data, as well as an empirical analysis. Subsequently, the results, in terms of descriptive statistics and the findings of binary logistic regression analysis to test the hypotheses were summarized and assessed with regard to the problems considered in this thesis.

A summary of the empirical findings and their evaluation form the basis on which recommendations for future research were made.

2. Literature Review

2.1. Foreign Market Entry Decisions and Franchising

On account of the competition and technological developments in the product markets, there is a considerable increase in foreign business activities and the evolution of different governance modes to manage them (Contractor and Lorange, 1988). Consequently, the detection of the best foreign entry mode has significant effects on the creation of a competitive advantage (Erramilli and Rao, 1993).

A mode of entry, as defined by Anderson and Gatignon (1986), is an institutional agreement selected by the company to enter a foreign market. Since explored by various researchers, the extent of international participation in host countries, the extent of foreign control of host activities, a company's resource use and the share of profits are all determined by the choice of entry mode (Chang and Rosenzweig, 2001; Alon 2006a). Franchising in this context is defined as a business relationship between a party entering the foreign market, namely the international franchisor, and a party domiciled in a host country, which is the franchisee,

whereas the former contractually transmits a business format to the latter. It is distinguished by a medium control level (Burton and Cross, 1995; Alon, 1999).

When deciding on matters concerning foreign market entry, it is particularly the organizational and environmental factors that determine a franchisor's selection of entry approach. The environmental factors are the host country's economy, overall country risk and cultural distance. Organizational factors involve size, age, growth, dispersions and price bonding. Duniach-Smith (2004) found that the five most crucial environmental factors are the financial position of prospective local associates, economic uncertainty, brand protection issues, local restrictions and size of the market. Market size criteria, such as GDP or purchasing power, have been found to be important determinants in international franchising choices, too (Lafontaine and Leibsohn 2005).

Furthermore, government legislation on tax policy, international trading, currency exchange rates, wages and price policies, has brought about positive effects with regard to the achievements of the franchisor (Aliouche and Schlenrich, 2004). Other crucial determinants in international franchising decision-making processes are the legal and regulatory hazards (Shane 1996; Fladmoe-Lindquist 1996; Boczko 2005; Lafontaine and Liebsohn 2005). In franchising the enforcement of contractual arrangements and intellectual property laws is inevitable, as the franchisor's intangible assets, such as the brand name or trademarks, can be misused by opportunistic franchisees (Shane 1996; Fladmoe-Lindquist 1996).

The foreign operations carried out by the franchisor might also face issues concerning constraints on ownership and the control of company property, barriers to repatriation of profits or inequitable pricing and tax policies (Fladmoe-Lindquist 1996; Boczko 2005). Moreover, the five most crucial organizational factors are the franchisor's financial means, recruitment and training of franchisees, the course taken by the management, HR capabilities and brand image.

An initial foreign market entry is usually characterized by a low degree of resource input and thus entry modes such as exporting or licensing agreements, are preferred. Then it is likely that an ongoing gradual involvement in distant markets will develop.

This is in accordance with the Uppsala model developed by Johanson and Vahlne (1977) in which they state that firms tend to expand by primarily establishing themselves in neighboring

countries. According to the model, the lack of know-how and resources are the major barriers in a company's international expansion process. Therefore, expanding companies tend to apply low resource-intensive strategies in the beginning. As time goes by, it is likely to expand to psychic distant countries. Psychic distance as defined by Johanson and Vahlne (1977, p. 24) as: *"the sum of factors preventing the flow of information from and to the market."*

The eclectic model developed by Dunning (1988) indicates the significance of the criteria specific to a country that is used in the choice of market entry including ownership and location advantages. The Transaction Costs Analysis model (Williamson 1975, Anderson and Gatignon, 1986) suggests a weighting of the costs of resource input and control. It states that highly integrated organizations have lower transaction costs but high international managerial costs, and therefore it proposes the implementation of high degrees of control when asset specificity is high, and lower degrees of control in cases when asset specificity is low. High degrees of control include, for instance, foreign direct investment and medium or low levels of control licensing, franchising or export.

Decisions on strategies are made by top-executives. The Upper Echelons Theory states that these decisions are made with regard, to some extent, to the manager's personal attributes, such as age or personality, education and previous practical know-how. As a consequence, young managers and managers from moderate socio-economic backgrounds have a higher propensity to apply aggressive risk-oriented strategies. Whereas older managers with a rich socio-economic background are more risk averse. As franchising is considered to be riskier than company ownership as a result of control loss (Martin, 1988), such managers are going to avoid the initiation of franchising. Managers that have already gained experience in the management of franchising networks are likely to continue those operations (Hambrick and Mason, 1984).

First of all, a company will perform a transaction cost analysis to discover which functions can be internalized as a consequence of performance at lower costs and which have to be subcontracted as a consequence of a cost advantage of external potential associates.

The integration of international operations is mainly an outcome of market failure caused by opportunism, ambiguity, narrowed rationality and asset specificity. Therefore, a firm has to find a balance between the potential costs and benefits of integration. (Duniach-Smith, 2004).

Pan and Tse (2000) state that international market entry decisions have to be the outcome of a hierarchical decision-making process. In addition, Aliouche and Schlentrich (2009b) have developed an integrated three-phased model when making decisions concerning foreign entry.

The first phase is a macro-level assessment of the environment, consisting of the evaluation of opportunities and risks of, for instance, market size, economic and legal risks, GDP etc. During the second phase, an evaluation of the micro-environment is made. The main aim here should be the enhancement of long-term shareholder value and therefore the generation of high future cash flows in foreign markets. In the third phase, the choice of market entry mode is made on the basis of the outcomes of the phase one and two. The situation of a country with regard to the enforcement of intellectual property laws plays a significant role, as the absence of this prevents companies from making use of the international franchising strategy as a mode of foreign market entry (Aliouche and Schlentrich, 2009b).

However, when the cultural distance is great franchising or management contracts seem to be of a predominant nature. Cultural distance is defined by Hofstede (2001) as: *“the collective programming of the mind distinguishing the members of one group or category of people from another”*. According to Hofstede there are two dimensions of culture: a) *power distance*, i.e. the strength of social hierarchy and b) *uncertainty avoidance*. Companies that are from countries which are characterized by a higher uncertainty avoidance culture, it is more likely that an equity-based entry strategy is chosen. Additionally, in the case of non-separability of production and consumption, as in the hotel industry, equity modes might be preferred over contractual alternatives (Aliouche and Schlentrich, 2009b). Companies that are from countries which are characterized by a lower uncertainty avoidance culture, however, will be more likely to employ contractual entry strategies (Chekitan et al. 2002, Zhu et al. 2009).

2.2. International Growth – Franchising as opposed to Company-Ownership

The franchising strategy is employed in businesses in which services to the customers have to be carried out directly i.e. to the customers. In such case, outlets providing services have to be adapted and distributed geographically (Castrogiovanni and Michael, 2004). Matusky (1990) views franchising as a method to help large companies to improve their responsiveness to customers. Huber (1992) regards it as the favored method for the expansion of small companies.

In general, companies need to attract resources and direct incentives. In the process of foreign company expansion an entrepreneur has the option of inside growth through distribution channels owned by a firm, or external growth through franchising. Compared with passive sources of capital i.e. from lenders or stockholders for the franchisor, the capital of the franchisee is much smaller. However, as franchisees are not able to spread their risk by diversifying portfolios, capital investment in a franchise business is more expensive for franchisees than for passive investors. Franchisees have to invest the whole of their capital in one, or in the case of multi-unit franchising, in various outlets. As a consequence, rational franchisees are going to insist on a higher risk premium on the invested capital that is greater than that which investors might demand (Norton, 1995, Rubin 1978).

For this reason, company ownership is regarded as the less expensive option, particularly if distribution channels are held as shares of a public company, as shareholders have the ability to diversify the borne risk (Fama and Jensen, 1983). Michael (1996) found that in industries, to which high levels of risk are attributed franchising is avoided owing to the fact that franchisees have to take huge hazards into account, and, as a result, risk compensation becomes too expensive for the franchisor.

Apart from this, large distribution channels are only rarely such that they are franchised because companies have the possibility to generate scale economies through monitoring. Furthermore, when initial lump-sum fees are high franchisees face the increased risk that the franchisor shirks his responsibilities. As a consequence, it is unlikely that franchisees can be found, who are prepared to initiate a franchise business (Scott, 1995). However, royalties, as proposed by Lafontaine (1992), increase the likelihood to franchise, as the franchisor's profit is increased and the maintenance of the brand name is ensured.

Regarding franchise performance, Sorenson and Sørensen (2001) examined financial performance and found that the overall chain revenue was augmented when there was growth through company ownership, as in the case of regional operations (within the US), and when there was growth through franchising, as in the case of international operations. Hence, the authors recommend that standardization within company ownership enhances performance, within a homogenous territory, while, when acting in a variety of territories, adaption through learning via franchising should augment performance.

Combs, Ketchen and Hoover (in press) investigated strategic groups in franchised businesses in the restaurant sector, and they discovered that companies which turned to franchising in answer to agency problems distinguished themselves through their performance, which was superior to that of those companies which applied franchising in answer to resource scarcity issues. However, free riding (which is widespread in franchising) is a matter of concern which reduces the concept of quality as a crucial indicator of performance (Buzzell and Gale, 1987).

Quasi-rent is a term used in Transaction Cost Theory and is comprehended as the difference between the yield of an investment, with regard to its best utilization when compared with the yield of its second best utilization. This difference is considered to be a loss, if the investment cannot be used in the intended way. A quasi-rent results if business partners have to make very transaction-specific investments. These are investments which, external to the business partnership, are of little value. If quasi-rents are higher than other franchisee's opportunities, the expected benefit of compliancy exceeds the expected benefit of non-compliancy (Michael, 2000a). Quasi-rents can be absorbed by an opportunistic business partner, when he fixes the price in such a way that the other partner holds on to the contract. The higher the degree of transaction-specificity is, the higher the quasi-rents are (Klein, Crawford and Alchian, 1978).

A number of researchers, such as Kaufmann and Lafontaine (1994) or Kaufmann and Dant (1996), pondered over the question whether to franchise or to go in for company ownership. They based their research on data from the US fast food and gasoline industries. They found that the closer the contract to integration, the higher the control level of the producer towards the retailer, and the closer the contract to the market, the higher the producer's propensity to use incentives to decrease agency issues.

2.3. Agency Theory

2.3.1. The History of Agency Theory

Agency Theory originated between the 1960s and 1970s, when economists observed the sharing of risks between individuals and groups (Arrow, 1971). The basic standpoint is that a so-called risk-sharing issue arises when participants have diverse approaches concerning risks. In Agency Theory this viewpoint was extended by incorporating the agency problem that arises when two co-operating parties have different approaches with regard to the objectives and division of work. The fundament is the relationship between a principal and an agent: the former delegates work to the latter, who has to carry out the given tasks. This relationship is formally contracted (Jensen and Meckling, 1976).

There are two particular scenarios concerning agency issues. The first states that two parties have conflicting objectives and the principal faces the problem of finding out what and how the agent is technically doing to find a satisfactory solution. The second scenario concerns the issue of risk sharing when the parties have different degrees of willingness towards risk. This is based on the theory that people have certain attributes, and includes people who are self-seeking, with restricted rational behavior and averse to taking any risk. It is assumed that the objectives of organizational members diverge to some extent. Also there is an asymmetry of information between principals and agents, and information is viewed as a commodity that can be purchased (Eisenhardt, 1989).

Two research streams are of importance: the positivist Agency Theory and the research on principal-agent relationships. Positivist scientists concentrate on the detection of conflicting situations between principals and agents. They try to discover which governance structure should be applied to overcome the self-interested behavior of agents. Positivist research is focused on the relationship between the owners and executives of corporations. Outcome-based contractual agreements tend to lower opportunistic behavior, as well as information on the part of the principal which verifies the behavior of agents (Jensen and Meckling, 1976).

The principal-agent research concentrates on the generation of a universal theory and the determination of the ideal contract. The basic assumption is that the agent is more risk averse than the principal, as the latter has a number of alternatives to remain employed, whereas the agent has no alternatives and risks the loss of employment.

The principals, however, are assumed to be risk neutral because they have the ability to diversify their investments (Eisenhardt, 1989).

There are two cases: in the first case, there is a report with full information on the behavior of the agent and, in the other case, the report contains incomplete information. In the first case, contracts can be based on behavior. In the second case, there is the moral hazard owing to incomplete information. From an agency perspective, the incomplete contract situation is the main reason for franchising when actions and information are concealed (Chadey and Fadario, 2004). These issues are known as moral hazard and adverse selection. Shirking duties and/or responsibilities, as well as poor performance on the part of an agent are moral hazards. Adverse selection indicates that an agent's true capabilities have been misinterpreted, i.e., when agents assert that they have certain knowledge or skills which they do not possess (Eisenhardt, 1989).

The problem of free-riding is, in particular, an issue with brand name assets as the party providing a service or selling a product is able to utilize a company's good reputation while not meeting the demanded quality standards. Quality, in this case, implies the conformity of production as well as of delivery standards (Caves and Murphy, 1976; Klein and Saft, 1985).

In the case of asymmetric information, the principal has the possibility to invest in information systems, for instance, in reporting processes or outcome-based contracts. These transmit the risk to agents, but performance influenced only to a certain extent by behavior, as other criteria also affect performance, such as competition or politics. For this reason, remuneration based on performance is preferred when outcome ambiguity is low (Holmstrom, 1979). Also job programmability, the extent to which reasonable performance can be predetermined, and performance measurability play an important role in the decision-making process with regard to contracts. If jobs are highly programmable, behavioral contracts are likely to be preferred, whereas low measurability of performance makes outcome-based contracts less attractive (Eisenhardt, 1985, 1988).

2.3.2. Monitoring and Franchising

The actual motivation behind franchising is the necessity to monitor the managers of company-owned units (Mathewson and Winter, 1985; Brickley and Dark, 1987).

The managers are paid a salary, most of which is fixed, and so they have less incentive to perform better than the franchisees. That is why the managers are inclined to shirk their duties and responsibilities. Besides the moral hazard problem, there is also the incapability of the principals to monitor their work efforts adequately. Principals are able to control financial performance based on accounting information, but they are not in the position to know whether an agent's efforts should be assigned to his performance or to factors beyond an agent's control. As a consequence, managers of company units have to be supervised by field employees, whereas franchising rewards the agents, i.e. the franchisees, with the residual claims of their own operating unit. Therefore franchisees have greater incentives which possibly lead to a reduction of variable costs and the maximization of revenues as a result of effective conduct. This is also referred to as dual incentives. The franchisor has symmetrical incentives, as the prediction of royalties is based on the promotion of gross sales, and so the latter is essential. Monitoring is required to only a reduced extent since the efforts of the franchisee are mainly self-enforced and they are encouraged to carry out self-monitoring as they have to bear the costs of shirking duties, which results in reduced net income (Fladmoe-Lindquist and Jacque, 1995).

However, in the beginning of an international expansion it is less risky for a company to operate with a single company-owned unit that is superior to franchising before the foreign environment has been fully explored and comprehended. Thus, it may be easier for a company to monitor its own employees rather than its franchisees, and, therefore, when initiating international operations, companies usually prefer having their own managers in key positions to act in an ethnocentric way (Perlmutter, 1969). As companies gain more experience, they act in a more polycentric way and tend to make use of international franchising strategies (Erramilli, 1991). This was found to be applicable to service firms. Conversely, Root (1987) states that, in the beginning, expanding firms tend to rely more on contractual agreements, such as franchising or licensing, to transfer the risk of uncertainty and monitoring to local partners. This is particularly applicable to manufacturing firms.

In international business operations, monitoring costs are incurred on account of two factors: geographic distance and cultural distance. In an international setting, outlets are dispersed geographically, and so the distance between the outlets and corporate headquarters is great. For an expanding firm across borders, more incomplete information of an agent's behavior is issued, because of the resulting increased uncertainty resulting owing to the distance and time factors. Monitoring expenses increase, because of the increased travel expenditures for the monitoring of employees (Carney and Gedajlovic, 1991).

When distant operations necessitate essential market knowledge, employees who are responsible for monitoring have to fully understand and evaluate decision-making, in addition to behavioral observations (Minkler, 1990). It can be concluded, that the requirement to have a very good knowledge of the local market increases the costs of monitoring and is therefore in favor of franchising (Bradach, 1997). Widely standardized operations, however, restrict inputs and make an observation of the capabilities of the manager to adhere to standards easier. For this reason, company ownership is the favored option (Combs and Ketchen, 1999a).

It must be taken into consideration that cultural distance may well mean that conducting foreign business is impeded in countries whose culture is very different to that in the home country. In foreign operations, service and management components are the means by which the cultural values of the principals may be transposed. Especially when the cultural distance is very great, the transfer of home country values becomes difficult; this is because an intensive training and the knowledge of foreign languages, or else translators, are required. Through franchising, the accountability of cultural adjustment can be transmitted to the local franchisee (Fladmoe-Lindquist and Jacque, 1995).

In conclusion, according to Agency Theory, it seems likely that firm-owned outlets are more efficient when the costs that ensue for monitoring are low. When high local market ambiguity and opportunistic behavior lead to increased monitoring costs, franchising yields superior performance under the assumption of complete contracts (Windsperger, 2004).

2.3.3. Signaling, Information Asymmetry and Franchisor Power

In an agency relationship the agent possesses private information that is of importance to the principal. For this reason, the principal uses contracts as an incentive to disclose this information, thereby adverse selection and moral hazard can be avoided by encouraging the agent to behave appropriately. In a franchise relationship there is a primary information asymmetry that benefits the downstream company, namely the retailer acting as the franchisee. The upstream party, namely the manufacturer, who acts as the franchisor has to create incentives and restrictions by contracting (Chaudey and Fadario, 2004).

Through signaling, information is disclosed to franchisees in order to reduce asymmetric information and disputes owing to deviating interests, as well as to combine innovative power with company hierarchies (Ehrmann and Spranger, 2004). As initially firm-owned channels are going to signal superior quality and engagement to potential franchisees to ensure the value of brand-name assets, there will be a higher fraction of franchised channels (Gallini and Lutz, 1992). According to Michael (2000) there is a process of tapered integration, in which a franchisor's bargaining power is increased because of improved local market knowledge and by signaling quality commitments to franchisees. Lafontaine (1990) carried out a test to find out if there is correlation between signaling high quality to attract franchisees and the demand of high royalties by franchisors. There was no correlation.

In a principal-agent relationship, the principal possesses coercive and non-coercive instruments to execute power. The agent has countervailing power, but only to a small extent and is therefore vulnerable if he has an opportunistic principal (Ehrmann and Spranger, 2004). Coercive power is rooted in the franchisee's expectation of potential punishment by the franchisor when not complying with contract terms. Non-coercive power consists not only of remuneration, but also legal as well as the consultant and professional powers of the franchisor (French and Raven, 1959).

Controlled agents are likely to countervail the power of their principals by showing less compliance to certain given objectives, by the search for optional gratification sources of objectives, by improving their capabilities to adapt the objectives to be in line with their own desires and by the opposition to previous alternative sources to accomplish to the goals of the principal (Emerson, 1962).

The use of non-coercive means increases the satisfaction of the franchisee as it is important to create a compliant environment. If the degree of investment uncertainty is high for the franchisee, it is likely that he or she is not going to join the network ex-ante, or, if treated inadequately, might quit earlier. In order to prevent this, a franchisor can adhere to the standards of the AAFD, by promoting the fair franchising seal. Also long contractual arrangements signal that franchisors are not going to behave opportunistically. A franchisor has to be committed by contract, to attend franchisee councils which enforce the interests of the agents, as franchisees have the collective right to reprimand the franchisor if his behavior is not acceptable (Ehrmann and Spranger, 2004). The power of the principal is therefore dependent on the countervailing power of the agent (French and Raven, 1959; Hunt and Nevin, 1974).

2.3.4. Agency Problems in Franchising Relations

In a franchise relationship there are two kinds of agency problems, namely the vertical and horizontal, in which problems may arise.

A vertical agency is a relationship in which often there are disagreements between a company and its channel managers. Also the business relationship between producers and retailers is attributed to a vertical agency as the supplier's returns are dependent on the distributor's selling abilities (Chaudey and Fadario, 2004). This can be applied to franchising as a franchisor is reliant on its franchisees business acumen. There are hazards for the franchisor as well as for the franchisee. On the one hand, the franchisor can behave opportunistically by establishing outlets too close to one another, by terminating a franchisee's contract owing to a re-opening of a franchisor-owned outlet on the same site, by forcing franchisees to buy inputs from the franchisor or by demanding inordinate royalties. On the other hand, franchisees might make the franchisor's property information known to others, omit the payment of royalties or fail to maintain the required quality standards (Storholm and Scheuing, 1994). Furthermore, the addition of new outlets to increase the overall profits of a chain leads to a reduction of sales from established franchises, and leaves the impression that the franchisor is behaving opportunistically (Zeller, Achabal and Brown, 1980).

In the case of a horizontal agency, franchisees are able to free ride on other franchised outlets within the same franchise chain. This issue arises owing to the fact that all of the outlets operate under a common brand name and the customers transmit their goodwill related to one outlet to the other outlets. For this reason, specific investments made by one franchisee in the chain with the same brand have spillover effects on the other franchisees. These effects can be of a positive or negative nature. The customer's expectations with regard to the state of cleanliness, for instance, may be carried over to all other outlets. In addition, franchisees can benefit from coordinated marketing and operational strategies. Coordinated marketing strategies may lead to advertising spillovers. This is the case when the fractional advertising efforts of one subsidiary improve the demand situation of all the other subsidiaries of the same chain. An intra-brand rivalry may then develop between the network members operating under the same brand-name. This leads to the fact that distributors often free-ride the promotional efforts of their retailers. At the distribution stage the horizontal agency induces sub-optimal advertising (Mathewso and Winter, 1984).

Franchisees can profit from the marketing efforts of other franchisees without bearing the expenses. This leads to the charge of high prices for products and services of low quality, as well as to reduced advertising efforts. Then horizontal agency generally leads to the incapability to organize overall chain incentives. If, on the part of the franchisee, there is an overall underinvestment in the brand, company ownership might be the consequence, as otherwise the reputation of the company's brand is weakened (Brickley and Dark, 1987, Caves and Murphy, 1976).

Hence it can be stated that the degree of externalities between retailers operating within the same network determines the organizational structure of a vertical relationship. Control levels might be lower when operating location sites are large, as there is less free-riding between members of the network. However, as network members are operating independently they are more likely to shirk their duties and responsibilities, which will lead to higher control levels again (Chaudey and Fadarido, 2004).

Customer mobility has a considerable effect on horizontal agency. There are customers who go to only one particular outlet in a chain, whereas there are customers who go to a number of other outlets in the chain. If customer frequency is low, it is all the more likely that the franchisee fails to keep up the stipulated level of quality.

In rural areas, customer frequency is usually higher and more regular purchases of the same product are made so that it is very probable that high quality standards also continue to be maintained. If customer frequency is high, it is also more likely that such outlets are franchised (Brickely and Dark, 1987).

Some industries, for instance the hotel or fast food industry, are expected to provide services to customers who are not regular. This infers that the actions of one channel party can affect the whole network and the brand name. As the value that customers attach to a brand is crucial in non-repetitive industries, compared with single outlets, this means that all of the retailers within a chain are equivalent to each other, which is also the case with standardized products (Chaudey and Fadario, 2004).

2.3.5. Risk Sharing, Moral Hazards and Capital Market Imperfections Models

Risk sharing models assume that both parties, being risk averse, benefit from the insurance, guaranteed by a contractual agreement (Cheung, 1969). In a linear contractual agreement, the ideal royalty rate rises with the increased probability of total risk if the franchisor is characterized by lower risk averseness than the franchisee. If the franchisor has a neutral attitude towards risk, the chain outlets should be company-owned (Lafontaine, 1992).

In one-sided moral hazard models, the behavior of a franchisee cannot be observed, neither with regard to what he invests in local inputs, nor with regard to the sales level, on account of an independent random element in the demand equation (Stiglitz, 1974, Mookherjee, 1984). For this reason, the franchisee is confronted by the moral hazard problem. The most favorable contract consists merely of compensation at fixed rates. Although the franchisee is assumed to be risk averse and the franchisor to be risk neutral, it is the franchisee who is not favored if he has to carry the whole risk. For this reason a shared contract in which the franchisee is guaranteed insurance and motivation, appears to be favorable (Lafontaine, 1992). Stiglitz (1974) argues that the royalty rate will be lower the more significant local inputs are and/or the higher the difficulty to observe their sourcing. It will become more with the increase of risk as in pure risk-sharing models.

Two-sided moral hazard models were developed because of the necessity to create incentives for both of the parties involved. This point of view was first evolved by Rubin (1978) to explain the occurrence of franchising. The model states that the royalty rates will be greater, the more important the franchisor's contribution is, and the more difficult it is to observe his behavior. It will be lower, the more important the franchisee's contributions become and the harder it is to observe his behavior (Lafontaine, 1992).

A more traditional point of view is the capital market imperfection perception that companies use franchising to overcome binding capital constraints (Oxenfeldt and Kelly, 1969). However, this perspective is often criticized as sometimes franchisors do offer financial assistance to their franchisees, a case in which they do not use franchising as a financial means. Apart from this, franchisors are supposed to rely on company-owned operations when maturing and regaining greater access to capital (e.g. Caves and Murphy, 1976).

Additionally, as Rubin (1978) states, investments in one outlet are riskier than investments in a portfolio of shares from all of the chain outlets, which points to the fact that a risk-averse franchisee is going to demand a much higher rate of return, and this might infer that a franchisor is going to be better off by offering shares to stock managers for chain outlets. Consequently, the capital market imperfection argument is not valid with regard to the choice of franchising, but in combination with the downstream incentive issue it becomes more declarative. In the portfolio case, as a share of the total number of stores, every retailer profits only marginally when increasing his own endeavors.

For this reason, there is a low effort level but greater return rates. An upstream firm could therefore profit from franchising as a cheaper source of capital, as store managers are likely to demand high return rates, even though they bear less risk. There remains an incentive issue on the franchisee side which can be met by offering fixed-rate contracts. If the franchisor requires more capital, the contract should be drawn up to secure high franchise fees and a lower royalty rate.

According to Klein (1995), pricing power is generated through the reputation of a chain's brand name, which enables franchisors to compensate franchisees with quasi-rents. These are payments above the required amount to make sure franchisees keep to their contracts, i.e. above a franchisee's opportunity costs.

For the case that a contract is terminated because the franchisee has failed to comply with the quality standards stipulated by the franchisor, the franchisee suffers the loss of an estimated quasi-rent. Therefore interests in a franchise relationship are vertically arranged by means of quasi-rents.

Brickely and Dark (1987) observed that the outlets located close to observant head offices are mostly company-owned outlets. Whereas, outlets that are located far away, are mostly franchised owing to the fact that monitoring is becoming increasingly difficult and expensive. Hunt (1973) found out that the distance from head offices, as well as the size and possible efficiency of the outlets are what differentiate firm-owned and franchised channels.

Lafontaine (1992) identified incentive problems that confront both, the franchisor as well as the franchisee. Her findings are in line with Dark and Norton (1987 and 1988), and illustrate that the prevalence of franchising is greater, the more downstream incentives and/or monitoring issues there are. Furthermore, the number of terminated outlets, as a measurement of risk, reveals the contrary effects that one would have to anticipate based on risk-sharing or one-sided moral hazard arguments. The outcomes show that a higher risk leads to more franchising and diminishes the ratio of franchisor to franchisee. That is how Lafontaine (1992) interprets these results, which show how the increasing inability to observe the behavior of franchisees owing to outlets located at some distance and widely diffused, lead to a further spread of franchised outlets and consequently to the franchisees claim to greater residual rights.

The research findings confirm the assumption that the more important the franchisor becomes through the acquisition of more knowledge or inputs, the higher the royalty rates become and the less franchising is used. The results concerning the capital requirement argument are quite controversial, as a negative relationship in connection with the use of franchising was observed. This is consistent with Murphy (1976) and Brickley and Dark (1987) who argued that, as franchisees face a higher risk owing to higher capital requirements in opening an outlet, they are going to ask for compensation for a higher risk. They refer to this as the “*inefficient risk-bearing cost of franchising*”. Thus, franchisors should demand a lower initial lump-sum fee to reduce the cost of risk that a franchisee must pay, although, usually the higher the capital requirements are, the higher the fee will be (Lafontaine, 1992).

2.4. Transaction Cost Theory

2.4.1. The History of Transaction Cost Theory

Transaction Cost Theory is widely used in the social sciences, which include economics, finance, marketing, organizational theory, politics and strategic management (Carroll et al., 1999). The history of Transaction Cost Theory goes back to 1935 when Hicks first stated that: *“The most obvious sort of friction, and undoubtedly one of the most important, is the cost of transferring assets from one form to another.”* (Hicks, 1935, p. 6).

One year later, Coase published his paper entitled *“the nature of the firm”* in which he explains the existence of the firm by the cost of applying the price mechanism. From the perspective of owners of a firm, they, as owners, do not have to conclude an agreement on all of the factors of co-operation that are made inside their firm, as this would necessitate the market mechanism. As a consequence, the costs of market transactions would cause each person to be the lacking residual claimant to its particular production decisions, thus making the existence of the firm necessary. What is more, transaction costs determine what kinds of contracts apply within a firm and constrain the size and range of the firm.

In his early researches, Oliver Williamson tried to solve the so-called *organizational problem* which poses the question how necessities and competences should be communicated to come to an agreement on trading conditions and to ensure that this is respected, especially with regard to bargains accordingly. In international business, the presumption of there being no transaction costs, as in neoclassical studies, is constrained.

In particular, the interdependence existing between business partners domiciled in diverse countries, and the distance between them and their homelands in geographical, institutional, cultural or political terms, influence governance structures (Hennart, 2010).

Williamson (1975) states that natural market imperfections emerge when people act in a rationally restricted way and behave opportunistically. This view is further extended by Bergen, Dutta and Walker (1992), who declare that business partners seek to maximize their own benefits, which leads to self-interested and opportunistic conduct. Therefore, the exchange of goods between parties will always result in positive transaction costs which, to be precise, are those for information, bargaining and enforcement.

There is a limit to the extent to which persons in a business can be controlled (Simon, 1958). In hierarchies, information channels pass through a great number of employees, therefore the risk of information loss or information distortion is increased (Williamson, 1967).

Fundamentally, there are two main possibilities to carry out transactions, namely through hierarchies and markets, the latter representing the price system (Hennart, 2010). In addition, multinational firms are acting as agents for the transfer of resources (Chang and Rosenzweig, 2001). In general, according to the Transaction Cost Theory, companies internalize the functions that can be performed efficiently and sub-contract those to external parties which are able to fulfill them more efficiently (Hollensen et al., 2011).

To ensure efficiency, with regard to positive transaction costs, the allocation of property rights among partners is essential (Coase, 1960; Demsetz, 1966). In this scenario business transactions cannot consist of complete contracts as the incurred transaction costs would be too high to determine all of the potential scenarios contractually. Incomplete contracts signify the continuance of residual rights not covered by contract conditions (Hadfield, 1990). For this reason the rights to assets that are not declared contractually accumulate to benefit the residual claimants (Fama and Jense, 1983).

2.4.2. Transaction-Specific Investments and Environmental Uncertainty

Transaction-specific inputs give rise to quasi-rents, which less contingent partners can expropriate (Williamson, 1985; Klein et al. 1978). In a franchising relationship, franchisors and franchisees have to invest in transaction-specific assets to a great extent. This leads to mutual dependence (Windsperger, 1994). When explicit investments result in high quasi-rents, a potential hold-up problem can be overcome as the benefit obtained through behaving opportunistically decreases, and the self-enforcement of contracts increases. Therefore high transaction-specific inputs create a bonding effect (Klein, 1996).

In addition, the switching costs of the franchisee and the franchisor are higher when huge investments in highly specific assets are made. Typically, for the franchisee, investments in a franchise business are of greater specificity than for the franchisor. In cases in which the franchise contract is terminated, investments made especially in accordance with the format of the business are of no use in other business transactions, except in cases in which the franchise business is sold to new franchisees, or the franchisor buys back the business.

These issues can be overcome, when the franchisee is granted a guarantee for an adequate duration of the business partnership so that he has the possibility to regain his investments. Furthermore, the franchisee can be granted the exclusivity to run his business within a certain geographic area, without the intervention of other franchisees of the same franchise chain or of the franchisor (Croonen, 2004).

When transaction-specific properties are very precious, it is further stated that functions should be integrated in order to prevent a situation of lock-in in a degenerative relationship with external partners, as there then arises the danger of opportunism (Anderson and Gatignon, 1986; Williamson, 1981). Apart from this, with technologically, highly sophisticated assets implying a high proprietary know-how, a codification is complicated, as there are the hazards of appropriate assessment and transfer (Calvet, 1981). Therefore transmission costs through licensing, for instance, are very high, and thus high levels of control in foreign markets are preferred (Contractor, 1990).

In regard to environmental uncertainty, the degree of competition in the host market is important too. It is assumed that a firm entering a foreign market is going to prefer a low-control entry mode in a market characterized by high levels of competition (Chang and Rosenzweig, 2001). As Bergen, Dutta and Walker (1992) found that in such markets, the franchisee has a greater motivation to make a good profit. As a consequence, the franchisee is going to disclose more information to the franchisor, in order that the latter can provide better advice for the success of foreign operations. A lower degree of competition has the opposite effect, i.e. a reduced disclosure of information. However, it is more beneficial for an expanding firm to apply high-control entry modes when the probability of market failure is high, because the supplier's incentives to behave opportunistically and contract enforcement costs are increased (Zou, Taylor and Cavusgil, 2005; Caves, 1982).

Environmental uncertainty strongly influences the choice of governance structure, as well as the contract design. In a complex and changing environment, the environmental insecurity of the host country's conditions increases. Political risk is defined as the unpredicted changes in government strategies ranging from *friendly* to *hostile* (Kobrin, 1982).

The franchisor faces the issue of being unable to exactly predict local market development. Hence, under great environmental unpredictability, contractual completeness decreases and more residual decision rights will then be transferred to franchisees, since full-integration would result in high switching costs if environmental developments are undesirable. Foreign policies and regulation laws concerning franchise agreements and trademark rights are thus essential. But also currency risks can have serious negative effects on transaction costs. Currency risks ensue when the exchange rates between the currency of the principal and the local currency of the agent fluctuate, as this affects income either positively or negatively. There are three exposures to currency risk, and these are the transaction, translation and economic risks. There is a *transaction risk* when the goods of a company are sold on credit because, in the period of time between the sale and the receipt of payment, the value of the payment could result in a loss when the foreign currency is translated back to the initial currency of the transaction if, in the meantime, the initial currency has dropped in value in relation to the foreign currency. In foreign operations, a company has to translate the foreign currencies into the vendor's own country, and this might also lead to reduced values. This is dependent on the exchange rate developments and is referred to as *translation risk*.

The macroeconomic conditions (i.e. exchange rates, government policies, economic stability), which have either positive or negative effects on the foreign operations are referred to as *economic risk* (Jacque, 1987).

Since royalties are calculated as a proportion of foreign revenues, currency fluctuations are generally hedged if revenues are indexed to inflation. Long-term overvaluation of the currency of a host country leads to a reduction of the reference currency royalties on the franchisor side until exchange rates are again balanced in the equilibrium of Purchasing Power Parity. This means that different currencies have the same purchasing power owing to exchange rates and it is therefore possible to purchase the same basket of goods (Shapiro, 1983; Fladmoe-Lindquist and Jacque, 1995).

2.4.3. Hierarchies, Markets and Hybrids

Williamson (1985) differentiates between *high-powered* and *low-powered* incentives. Market transactions are characterized by high-powered incentives, as transaction outcomes directly benefit the parties involved. Within hierarchies there are low-powered incentives, as those employees who are involved in particular transactions receive only part of the turnover, which

is usually a salary or a promotion. However, there is no direct claim. Therefore transactions made through hierarchies have the disadvantage that employees do not instantly profit from the information which they hand over. The bargaining problem is solved through exogenous pricing by markets and through fiat by hierarchies (Hennart, 1993; Williamson, 1975). In addition, Carney and Gedajlovic (1991) predict that three agency issues will arise if there are high-powered incentives. These issues are *inefficient investment*, *free-riding* and *quasi-rent appropriation*.

In business transactions it is essential that contracts are complied with. When applying the market mechanism, agents are compensated for the outcomes at market prices. However, there is the risk of cheating, as agents might overstate their turnover through higher prices for goods of poorer quality. When transactions are made within company hierarchies, the compensation that the employees receive is based on their behavior and not on their business success which might result in shirking as there is then less incentive to work hard (Hennart, 1982, 1993).

There are two possible ways to curb someone's behavior. For internal control there is *clan* (Ouchi, 1979) or *socialization* (Bartlett and Ghoshal, 1989). In the case of clan, employees with the same values and objectives as the managers are selected, whereas in the case of socialization the employees with diverging objectives are persuaded to modify these and to internalize those of the managers. Alternatively, external control is understood to be the curbing of behavior by means of direct surveillance or bureaucratic rules and processes. Either way to restrict behavior is cost-intensive and reduces returns. The costs of restricting behavior vary according to the attributes of transactions. External control is facilitated when employees are centered on site. Internal control is facilitated when employees have the same culture or social contacts (Ouchi, 1979).

To engage in foreign operations involves supplementary costs which exceed those that ensue in the home country (Hymer, 1976). Hierarchy should generally be the preferred option when asset specificity is very high, and the market mechanism when it is very low. When specificity is intermediate, hybrids seem to be the best alternative as they are defined as institutions that can concurrently apply the two fundamental organizing techniques of output and behavior control (Williamson, 1991). The significance of governing international operations through

hybrids might be the result of high expenses when hierarchical supervision over agents is extended throughout the countries in which they are operating (Hennart, 1991b).

Hybrids are seen as organizational innovations, with the existence of *quasi-markets* and *quasi-hierarchies* in the middle of the two extremes of markets and hierarchies. As Norton (1988) declared, transactions in a franchise relationship can be compared to those of an intra-company vertical integration, owing to the self-enforcement attributes of a franchise contract to behave in the interests of the franchisor. Formally, such kinds of organizing business transactions are dependent on the dimension of transaction costs that ensue owing to the opportunistic conduct of partners, the explicit investments the business relationship requires and the insecurities inherent to the relationship (Gulati, 1995).

In an international context, hierarchical organization prevails over franchising, especially with regard to reputation, under the following conditions: when imitations can be limited, and possible benefits owing to a good reputation are high, when it is hard to enforce behavioral regulations that, when met, generate a high output level, and if it is a simple matter to prevent shirking behavior at work (Hennart, 1982 and 2000; Fladmoe-Lindquist and Jacque, 2005).

According to Buckley and Casson (1976), multinational enterprises achieve higher efficiency than markets do, owing to the use of internal pricing. Therefore benefits can be achieved regarding the transfer of knowledge, since it is possible to exercise discriminatory pricing, to overcome governmental constraints by transfer pricing and by replacing non-profitable future markets. Because of price discrimination and the circumvention of taxes, monetary externalities can be internalized. Non-monetary externalities are internalized through internal pricing. These benefits have to be balanced at the expense of creating internal markets that are much smaller with, as a consequence, a loss of scale economies, and so the need for local supervision might also arise.

In particular value chains, which are necessary and successive operations to launch a product or service at the market, and when located in various countries, are processed by contracts (Campbell and Parisotto, 1995). However, in some situations, value chains might be organized within a multinational company. These situations require a certain number or all of the concerned parties to make transaction-specific investments, the difficult evaluation of the possibility to free-ride owing to the different effects of output on the reputation of the brand

and the difficult negotiation of temporal exchange of tacit knowledge between chain partners (Hennart, 2010).

According to Norton (1995), franchising is a good alternative to reduce operating and financial transaction costs. Operating transaction costs include the acquisition of exploration and exploitation properties of local partners. Bradach (1998) states that “*self-correction and control*” define exploitation, whereas “*self-renewal or innovation*” define exploration. Company managers usually exploit existing assets and knowledge, as, having a fixed salary and being under a higher degree of control by the company, they have fewer incentives. Franchisees, however, are likely to explore new local market knowledge and to make innovations.

In an earlier study, Bradach (1997) examined five franchisors, each with a vast network of franchised fast food businesses and found four cases in which the franchise and company-owned outlets benefited each other. A multi-unit franchisee profited by the adoption of the franchisor’s organizational structure and control procedures. Both parties profit from fair competition.

The franchisor is able to learn from the innovativeness and market knowledge of the franchisee, and the best qualified employees of a company can improve the business of the franchisee, if they are promoted to take on franchisee consultant jobs or are employed by multi-unit franchisees.

Nooteboom (1999) adapted his model, developed for strategic alliances, to the case of franchising. The model reveals the increasing relevance of learning and the acquisition of expertise that are considered to be of great importance in a changing external environment. Furthermore, both the franchisee and franchisor should be viewed as equally intelligent business partners, both having the ability to ensure the success of the business.

In addition, according to the Transaction Costs Theory, the propensity to vertically integrate operations is negatively correlated to the degree of the franchisee’s transaction-specific inputs, as large branch-specific investments augment the self-enforcement of arrangements and diminish the hold-up risk for the franchisor (Klein 1980 and 1995; Williamson, 1985; Lafontaine and Raynaud, 2002).

The hazard of opportunistic behavior on the part of the franchisor is also reduced, as there is a “hostage-effect” owing to outlet-specific investment, necessitating a lower extent of vertical integration. In contrast to this, large brand name resources are positively correlated to vertical integration (Minkler and Park, 1994). Especially in the service industry, the brand name of a company is potentially the most crucial of the intangible assets to protect it from potential hazards, as a reliance on patents regarding technology is not possible (Fladmoe-Lindquist and Jacque, 1995).

2.4.4. Transaction Cost Theory and International Market Entry

The majority of franchise businesses market products or services related to branding. For this reason it is important to expand to countries with a population which is able to afford these brands in order to make the survival and success of a business possible by franchising (Alon and McKee, 1999, Alon, 2006a, Baena, 2009). There are economies that are becoming wealthier which will bring about a greater shift towards services that offer a greater opportunity for companies to expand (Hoffman and Preble, 2001). Economic development depends to a great extent on the growth of a business (Alon, 2010) as well as on intelligent property execution (Contractor and Kundu, 1998b). Taking everything into account, these matters reduce transaction and monitoring costs.

Nations that are highly developed economically are usually less exposed to economic and business hazards (Hermann and Datta, 2002).

Williamson (1975) demonstrates a set of interdependent transaction costs linked to international franchising. This involves the ex-post costs of monitoring and expenses for the identification and evaluation of potential franchise partners in the host market. The costs of property rights protection that prohibit franchise partners from running a similar business in a particular location and/or time as soon as the arrangement is signed, as well as the service costs incurred owing to the transfer of technology and know-how to franchise partners, are taken into account.

Service costs include those for the codification through manuals of the business format, as well as the modifications that the foreign market requires. In the case of indirect franchising, intermediary-related costs ensue. In general, operating through intermediaries decreases most of the majority of the monitoring, search, and service expenses but it does incur supplementary expenses. These consist of agency and resource costs for the maintenance of

the organizational structure of the franchise system. In an indirect franchise relationship, much control is delegated to the foreign sub-franchisor, which is not so much the case in a direct relationship (Konigsburg, 1991). With regard to this, agency costs arise owing to the divergent objectives or sub-optimal performance of the franchisee, such as to regain control of the system (Mendelsohn, 1992).

Furthermore, if a contract is terminated or a partnership fails, the franchisor has to establish a completely new franchise structure in the foreign market, which increases management and monetary expenses (Abell, 1990). In addition, the franchisor does not receive all of the fees and royalties paid by the franchisees, as a fundamental fraction of these is appropriated by the sub-franchisor (Konigsburg, 1991).

Based on the Transaction Cost Theory, some researchers were able to demonstrate that the adequate governance structure when expanding to foreign markets is mainly influenced by the extent of total transaction costs (e.g. Anderson and Gatignon, 1986, Hennart, 1988).

Geographical distance incurs the costs of communication, and the management of distant sites increases transaction costs (Chen, Yan, Hsu and Wang, 2009). Also the lack of information between franchisor and franchisee is increased, so that there are also higher costs to obtain information and for monitoring (Alon, 2006b). Countries that differ very much culturally generate internal uncertainty and difficulties in guidance (Anderson and Gatignon, 1986). As the cultural distance increases, selection and supervision costs also increase owing to a greater extent of asymmetric information and a greater propensity to behave opportunistically. Consequently, geographic and cultural distance increase transaction costs (Welsh, Alon and Falbe, 2006; Demirbag, Tatoglu and Glaister, 2009).

Furthermore, in culturally very diverse countries, the franchisors expanding their businesses have to adapt these to foreign norms, for example, with regard to business practices. In order to facilitate the international expansion process it is likely to apply low-control modes (Luo et al., 2011). What is more, the findings in previous research have shown that the propensity to franchise directly increases when cultural as well as geographic distance is low, and in the cases in which rather small franchise businesses are operated abroad (Mendelsohn, 1992). As cultural and geographic distance increase, indirect franchising modes are assumed to be preferred, as indirect franchising requires only one contract with the sub-franchisor, who has a

good knowledge of the foreign market and can make whatever modification is necessary to adapt to the particular conditions of the host country. Therefore, in particular legal obstructions might be overcome (Falbe and Dandridge, 1992).

2.4.5. Recent developments of Transaction Cost Theory

Opportunism, a major assumption of the theory, is viewed as a behavioral attribute of economic parties by Williamson (1985). However, contrary to this view, more recent research streams suggest that the business context itself has, to a great extent, brought about the occurrence of opportunistic behavior (e.g. Grundlach et al. 1995). In this regard, the background to business parties is of importance. Deeds and Hill (1999) found that firms sense business partners as less opportunistic if they have a similar profile in common.

Luo (2007) discovered that firms are more offended by partners that have a very diverse culture. Johnson et al. (1996) found that, on the contrary, firms have a higher propensity to opportunistic behavior when they share a similar culture.

Another contextual behavior was found by Ross et al. (2000) who declared that vendors tended to behave more opportunistically towards their channel partners than towards their customers. In addition, perceptions play a significant role. Wang (2002) states that business parties attributed to have a reputation for fair trade tend to be regarded as less opportunistic. Likewise, business partners that are considered to be reliable are supposed to behave less opportunistically (Cavusgil et al. 2004).

Regarding the type of transaction, not only the extent of asset specificity and environmental uncertainty, but also the governance of outsourced R&D should be considered. Carson (2007) put forward, that R&D transactions cannot be governed in an efficient way through hierarchical structures owing to their tacit and poorly defined attributes.

R&D transactions are characterized by the exchange of intellectual property rights, for which reason Carson and John (2009) state that these property rights can be applied to create safeguards based on incentives in order to diminish the hazards of certain investments without applying the hierarchy mechanism. Concerning R&D matters, Bercovitz and Taylor (2009) focused on companies centered on coordination and not on control.

In the traditional Transaction Cost Theory, the individual transaction is viewed as the unit of analysis (Williamson, 1985). Recent research suggests, that the focus should be on a more comprehensive view of transactions by involving the history of previous transactions which might lead to constraints or enable the governance of those that follow (Poppo and Zenger, 2002; Ryall and Sampson, 2009).

Williamson (1996) classifies economic transactions on four levels. These consist of the agent's resource assignment, contractual governance, institutions and the condition of being embedded. The assumption made in most Transaction Cost Theory literature, is that there appears to be only one decision-maker who is responsible for the selection and determination of governance types. However, most transactions consist of more than one decision-maker and involve not only upper-level managers but also operational or technical employees (Argyres and Mayer, 2007). Hence, multi-level decision-making generates the coordination costs to manage adequate governance modes (Sampson, 2004). Therefore, the transaction exchange level has to be considered, when answering the question on how transactions differ between different organizational levels (Zollo and Winter, 2002).

Formerly, the decision on which governance mode was to be preferred was dependent, to a very great extent, on the structural attributes of a transaction. It was thought that the governance mode was determined solely by these attributes such as the amount of specific investments or degree of environmental insecurity. However, this presumption does not take the transaction capabilities, motives or resources of the partner into account. Furthermore, to economize on transaction costs, decisions on governance structure might be affected by the leverage or protection of precious resources and abilities (Helper and Levine, 1992). For this reason, a company's resources and abilities affect transaction costs and thus also the selection of the governance mode (e.g. Foss, 2005, Williamson, 1999).

2.5. A Comparison of Agency Theory and Transaction Cost Theory

This section consists of a comparison of the two theories. It is carried out based on the method developed by Kim and Mahoney (2005) using the unit of analysis, focal dimensions and cost matters, contractual perspectives and theoretical focus, strategic intention and sources of market tensions for classification purposes.

The unit of analysis: Agency Theory focuses on the contractual relationship between the principal and the agent. In this relationship it is especially the economic incentives that are of importance. Transaction Cost Theory, on the contrary, focuses on the transaction itself, which is the contract. It illustrates the selection of a particular organizational type in order to match certain transactions with the appropriate governance mechanism (Hennart, 1993; Williamson, 1996). Both theories focus in particular on the mathematical principal-agent frameworks (Kim and Mahoney, 2002).

Focal dimensions and cost issues: Agency Theory centers on the alignment of the economic incentives of agents with the incentives of the principals to attempt a maximization of aggregated economic benefits for the principal. The main focus is to channel high-powered market incentives of individuals to productive utilization by arranging those incentives with common goals, such as the maximization of produced units. Monitoring an agent's behavior in order to reduce residual losses by means of ex ante contracts is also crucial (Kim and Mahoney, 2005).

In the Transaction Cost Theory a distinction is made between hierarchies and markets, as the incentives are qualitatively different. As a consequence, economic collaboration is superior in cases where high-powered market incentives alone would result in inefficient outcomes. Contractual issues are faced when assets are very specific, as this might lead to hold-up problems, and so there is opportunism (Kim and Mahoney, 2005).

Contractual perspectives and the theoretical focus: In Agency Theory importance is laid on the ex-ante arrangement of incentives as complete contracts and no ex post enforcement issues are assumed. The theoretical orientation of this theory is the design of contracts that reduce agency costs under different constraints.

Agency costs include the monitoring expenses of the principal, bonding expenses of the agent and residual losses (Jensen and Meckling, 1976, p. 308).

For Transaction Cost Theory, the assumption is that contracts are incomplete and therefore the focus lies on ex post transaction costs involving adaption costs, setup and operating costs attributed to governance structures, bonding costs and haggling costs (Williamson, 1996). Governance selection is not an optimal mixture of monitoring and enforcement efforts, but a better selection between imperfectly disposable alternatives of bundles of these efforts (Williamson, 1991). In this regard, transaction cost theory has a wider holistic perspective of governance structure choice that comprises ex ante and ex post issues.

Strategic intention: In the Agency and Transaction Cost Theory, it is assumed that efficient contractual outcomes with long-term horizons represent the shareholder perspective. (Kim and Mahoney 2005).

Sources of market tension: If one party does not carry the whole economic expense for its actions, negative externalities arise. This becomes apparent when agents carry out actions that might not profit the principals, owing to the fact that they do not carry the whole economic expense for them. With regard to this, Agency Theory illustrates the cases of asymmetric information and non-observability. The selection of a unit worker implies the alignment of economic incentives and the implementation of a suitable monitoring technique. Insufficient observability of the unit worker creates market tensions as a consequence of hidden action; therefore there arises the need for different governance modes. Economic loss, however, results out of information asymmetry and non-observability.

Also different attitudes towards risks play an important role. Transaction attributes, such as asset specificity and opportunistic behavior too, are taken into consideration in Transaction Cost Theory (Kim and Mahoney 2005)

In conclusion, the two theories point out the various contractual attributes of a business relationship (Barney and Ouchi, 1986). Transaction Cost Theory and, in particular, Agency Theory represent a positively balanced point of view (e.g. Alchian and Demsetz, 1972, 1973). Complete contracts are assumed in Agency Theory, whereas the theory tries to discover the best mixture of governance mode to ensure efficient outcomes.

In both Transaction Cost Theory and Agency Theory the assumption is made that the selected organizational output is balanced. In Agency Theory no distinction is made between markets and firms, for which reason Jensen and Meckling (1976, 1979) regard the firm as *a nexus of contracts* whereas, in Transaction Costs Theory shared ownership is regarded as a hybrid of markets and hierarchy characterized by an intermediate asset specificity (Williamson, 1996).

3. Research Model

3.1. Hypotheses

Based on the previously described theory, the research model is based on behavioral uncertainty with regard to Agency Theory and on environmental uncertainty, the transaction-specific investments of the franchisor, as well as the transaction-specific investments of the franchisee with regard to Transaction Cost Theory.

Behavioral uncertainty is manifested in particular in the shirking of duties and responsibilities, free-riding on the brand name and the moral hazard problem. According to Williamson (1985), behavioral uncertainty appears owing to the potential of “*strategic nondisclosure, disguise or distortion of information*” by business partners. If monitoring becomes increasingly expensive and difficult, the franchisor is likely to use low control entry modes i.e. indirect franchising. Therefore the following can be hypothesized:

H1: The higher the monitoring costs are owing to behavioral uncertainty, the higher the franchisor's propensity to use lower control entry modes.

The hypotheses to test Transaction Cost Theory are based on environmental uncertainty, the transaction-specific investments of the franchisor and the transaction-specific investments of the franchisee.

Environmental uncertainty involves cultural distance, (i.e. differences in business practices, norms and values as well as language barriers), institutional distance, (i.e. the legal protection of intellectual properties, the uncertainty of the foreign political environment, as well as the extent of risk of ownership restrictions) and economic/market distance (i.e. demand fluctuations, competition and stability of market shares). Environmental uncertainty is assumed to increase transaction costs, and therefore it is assumed that the franchisor uses low control modes i.e. indirect franchising, as it becomes expensive to process transactions. Also franchisees have usually a better knowledge of the foreign market and of the political and legal restrictions with which they are confronted in foreign countries and so the franchisor might better overcome these hurdles by granting a franchisee more control.

With regard to the environmental uncertainty, the following is hypothesized:

H2: The higher the transaction costs are owing to environmental uncertainty, the higher the franchisor's propensity to use lower control entry modes.

The transaction-specific investments of the franchisor are investments very specific to the relationship, such as investments in the training of foreign partners, in the maintenance of the brand name, or in foreign location sites. If these investments are high, it is more likely that the franchisor is going to use higher control modes, i.e. direct franchising should be preferred in this case. The hypothesis is as follows:

H3: The higher the franchisor's transaction-specific investments are relative to the franchisee's investments, the higher the propensity to use higher control entry modes

The transaction-specific investments of the franchisee are investments in tools, equipment and procedures specifically for the franchise partnership and training of employees in franchise-specific techniques. High transaction-specific investments on both sides are useless when the franchise relationship is terminated. Therefore these are supposed to strengthen the business relationship. If the transaction-specific investments of the franchise partner are very high, it is likely that opportunistic behavior is prevented, as this would have negative consequences, if the franchisor terminates the relationship. Because of this, it is supposed that the franchisor uses lower control modes, i.e. indirect franchising, as the risk of opportunistic behavior and the shirking of duties is then reduced. This is phrased in hypothesis H4:

H4: The higher the franchisee's transaction-specific investments are relative to those of the franchisor, the higher the propensity to use lower control entry modes.

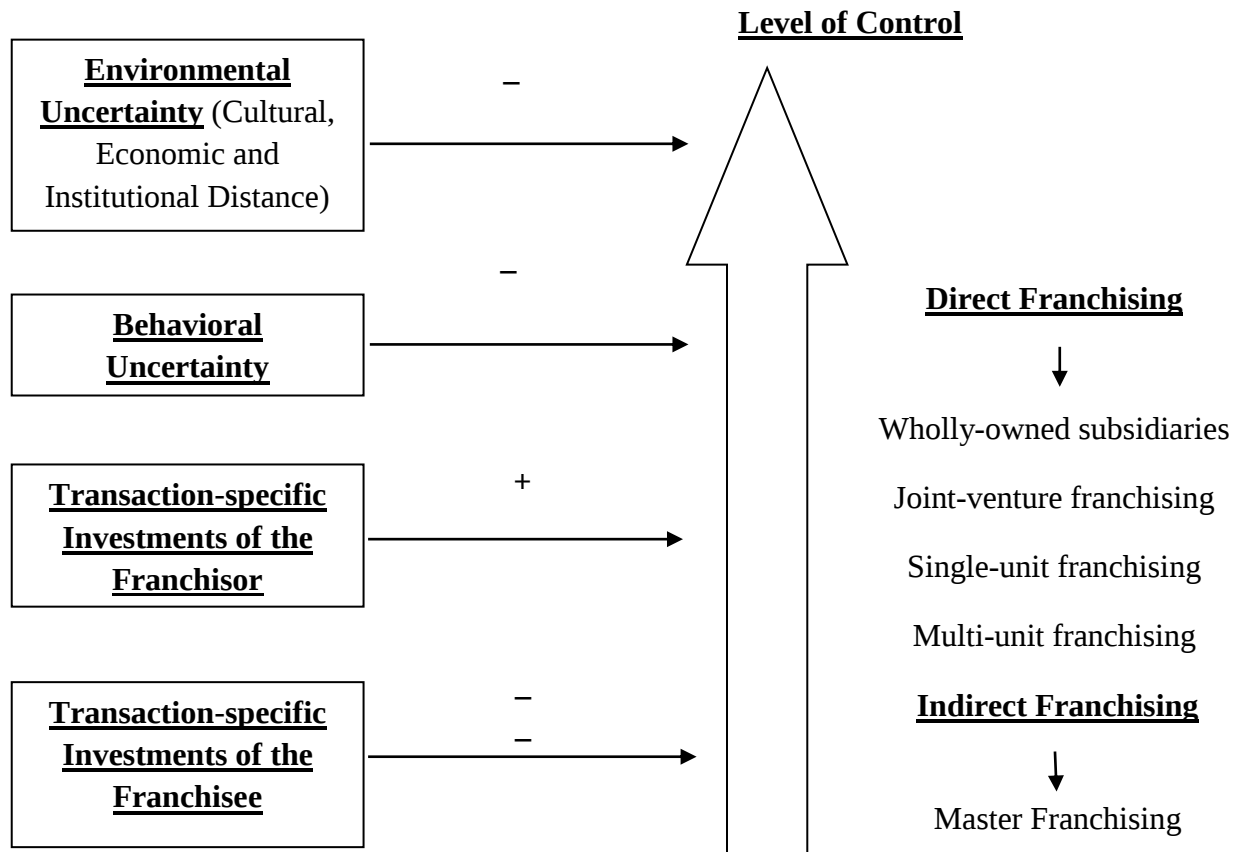


Figure 1: Effects of EUNC, BUNC, FTSI and PTSI on the choice of governance mode (Jell-Objodor and Windsperger, 2013)

Figure 1 gives an overview of the influences of environmental uncertainty, behavioral uncertainty, the transaction-specific investments of the franchisor as well as the transaction-specific investments of the franchisee on the choice of governance mode of international franchise firms. It can be seen that both environmental as well as behavioral uncertainty have a negative influence on the choice of higher control governance modes i.e. direct franchising. As derived from the respective hypotheses H1 and H2, if these uncertainties are high, there is a negative effect on the choice of high control entry modes and therefore the franchisor is likely to choose low control entry modes, thus indirect franchising.

Transaction-specific investments of the franchisor have a positive effect on the choice of high control governance entry modes. As assumed in hypothesis H3, the franchisors prefer high control entry modes. Transaction-specific investments of the franchisee have a negative effect on the choice of governance modes.

The higher they are, the more likely it is that a franchisor is going to choose a low control entry mode. In conclusion it can be stated that a high environmental uncertainty in the host market, as well as a high behavioral uncertainty of the franchise partner are going to increase transaction and monitoring costs which, in turn, will mean that the choice of low control entry modes i.e. indirect franchising will be preferred. What is more, high transaction-specific investments of the franchisee are also assumed to have a positive effect on the choice of indirect franchising as they increase the self-enforcement of contracts.

3.2. The Measurement of Variables

3.2.1. The Dependent Variable

Indirect franchising was chosen as the dependent variable. As described earlier in this thesis, direct franchising is characterized by a higher level of control by the franchisor (than that of the franchisee). Indirect franchising is the mode in which the franchisor operates with the aid of intermediaries located in the host country. These intermediaries, known as sub-franchisors, are given a great deal of control over international franchise operations. It can be stated that in the case of direct franchising, more control remains with the franchisor than in the case of indirect franchising in which more control is given to the sub-franchisors. The aim of the test is to find out if and how the independent variables influence the choice of the direct entry mode in comparison with that of the indirect entry mode.

The variable dominant mode was recoded as follows: 1 for master franchising, 2 for multi-unit franchising, 3 for single-unit franchising, 4 for joint-venture franchising and 5 for wholly-owned subsidiary. These vary from low control (1=master franchising, indirect franchising) to high control (5=wholly-owned subsidiary, direct franchising). With regard to the analysis by means of a binary logistic regression, the variable dominant mode had to be re-coded into a new variable, i.e. indirect franchising that has values of 1 and 0 only. The value *one* was used for indirect franchising, which is master franchising, and *zero* for all of the other entry modes.

3.2.2. Independent Variables

With regard to the Transaction Cost Theory and its influence on the choice of the mode of governance, the relevant independent variables are environmental uncertainty, the transaction specific investments of the franchisor and the transaction specific assets of the partner. Pertaining to agency theory, the relevant independent variable is behavioral uncertainty.

Environmental Uncertainty: In the beginning, this consisted of eleven items. The various environmental conditions found in foreign countries had to be evaluated on a seven Likert-scale (strongly disagree 1-7 strongly agree, -9 not answered). Cultural distance was evaluated with regard to the extent of differences in culture, in business practices and in languages. Institutional distance was evaluated with regard to the weakness of the legal protection of intellectual properties in foreign countries, political uncertainty, the risk of ownership restrictions, and the quality of local infrastructure, had also to be assessed. The uncertainty of customer demand, the difficulty of sales forecasts, stability of market shares and the number of existing and potential competitors had to be evaluated with regard to environmental distance. The category of the variables is numerical and the measurement is a scale. After the factor analysis, these items could be assigned to three factor variables. The first factor variable is referred to as cultural distance (CD), the second factor variable is referred to as institutional distance (ID) and the third factor variable is referred to as economic/market distance (ED). For this reason, environmental uncertainty consists of three variables after the factor analysis, and they are used as independent variables in the binary logistic regression.

Franchisor transaction specific investments: This consisted of four items before the factor analysis. The resource commitments of headquarters in the foreign countries had to be evaluated again on a seven Likert-scale. The investments in personnel is for foreign partners, as well as in layout for foreign relationships, the development of specialized procedures and systems for the foreign partners to follow and the amount of time and money in training and qualifying foreign partners should be evaluated. The category of the variables is numerical and the measurement is a scale. After the factor analysis, all of the items could be assigned to one factor variable which is referred to as FTSI.

Partner transaction specific investments: This consisted of three items before the factor analysis. The resource commitments of foreign partners had to be evaluated using a Seven-Likert scale. With regard to this, the respondents had to evaluate the significance of investments in tools, equipment and procedures, for exclusive use in the franchise relationships. Also the extent of training in franchise-specific techniques and the loss of investments made to develop the local franchise network if the franchise relationship were to be terminated, had to be assessed. The category of the variables is numerical and the measurement is a scale. After the factor analysis, all of the items could be assigned to one factor variable which is referred to as PTSI.

Behavioral uncertainty: It consisted of four items before the factor analysis. The monitoring in foreign countries had to be evaluated on a seven Likert-scale. In regard to this, the qualification of foreign partners, the monitoring of franchise product and service quality in foreign countries, the monitoring of the misuse of proprietary knowledge by foreign partners, as well as the performance assessment of foreign partners could be answered. The category of the variables is numerical and the measurement is a scale. After the factor analysis, the items could be summarized under one factor variable, which is referred to as BUNC.

3.2.3. Control Variables

In addition to the previously described dependent and independent variables, various control variables with regard to agency costs and transaction costs, were added to the analysis. With regard to agency costs, a variable *system size* was introduced, which summed up the number of company-owned outlets and franchise outlets a company operates abroad as well as in the home country. According to Shane (1998) the size of the system is a representation of the costs of monitoring. It is assumed that a very large system increases the costs of monitoring which should lead to the use of low control entry modes, i.e. indirect franchising. Furthermore, the variable *international experience* was added. This variable was calculated by subtracting the year when the internationalization of the franchise firm started from the current year (2015). As mentioned earlier in this thesis, companies that have more international experience tend to make use of international franchising strategies (Erramilli, 1991). Also Lafontaine (1992) found that the proportion of franchised-units increases with geographical distance, age and the rate of growth. Therefore it can be concluded that more experienced firms are going to choose franchising more often as an international market entry strategy and might also prefer the use of low-control entry modes.

4. Empirical Study

4.1. Operationalism

Operationalism determines the way in which a theoretical construct can be made observable and measurable. The acquisition of measurements is based on this and determines what kind of measuring instrument is required to quantify the various characteristics of the dimensions under examination. Apart from the chosen indicator, the method of data collection, the research method and, in particular, the components with which empirical information is gathered, are described. The method, with which the information for the main analysis is processed, has to be explained. Furthermore, the kind of measurement to be used for the indicators has to be determined. Throughout the process of quantification, one or several characteristics of an item are rephrased in measurable dimensions and numerical values (Jürgen Bortz: Lehrbuch der empirischen Forschung. Springer-Verlag).

The measuring instrument used in this thesis is a questionnaire which is described in detail in the following paragraphs. The theoretical construct *Choice of Governance Structure* is put into operation through the indicator, i.e. indirect franchising and the predictors i.e., environmental uncertainty, which is further classified into political/institutional uncertainty, market/economic uncertainty and cultural uncertainty, as well as the transaction specific investments of the franchisor, the transaction specific investments of partners and behavioral uncertainty. These will be described in more detail in the section on the *Measurement of Variables*.

4.2. Quantitative Research

In order to answer the prior cited research questions, an empirical study on the governance structure of international franchising firms was carried out in the course of a research project in the Department of Management at the University of Vienna. This research project is based on the paper “*The Choice of Governance Modes of International Franchise Firms – Development of an Integrative Model*” (Jell-Objodor and Windsperger, 2014).

A quantitative approach by means of a standardized questionnaire, which was sent out by e-mail, as well as by conventional post service, was chosen. The research questions determined the choice of a quantitative research design. The main objective is to measure the correlations and the extent to which the related variables are effective. The existence of significant correlations between Agency Theory and Transaction Cost Theory were used to provide an explanation for the choice of governance mode of international franchising firms with regard to the use of direct and indirect franchising.

The main objective is to achieve, by means of a relatively large sized sample, answers based on which it is possible to test the hypotheses. Unit of quantity, numerical, quantifiable and statistically evaluable data are essential to measure meaningful correlations and to deviate equivalent statements. This is aimed to test the theoretical knowledge and to accept the generated hypotheses, or, if applicable, reject them. A qualitative research approach would rather be suited to conduct motivation research, as well as evaluate reasons behind certain actions (Diekmann 2007, p. 437-439). Based on these considerations and owing to the utility of the quantitative method with regard to answer the research questions, it was decided to use a standardized questionnaire and a quantitative research design.

In the course of the survey, e-mails with a link to the questionnaire were sent out to international franchise firms. The franchise firms involved in the survey have their headquarters in Austria, Germany, Spain, France, the USA, the UK, the Netherlands and Italy. The choice of an online survey has various advantages over other ways of carrying out an offline survey. By means of an online survey, falsifications, owing to the so-called “interviewer effect”, can be largely excluded. Further advantages result from the lower costs of data collection and analysis. The participants have access to the questionnaire by way of a link and so they have the possibility to take part in the survey online. This makes it possible to obtain a multiplicity of data and information in an efficient and quick way.

The choice of the standardized online survey enables the accessibility of a greater number of participants. At the same time, various different participants are able to take part in the survey, without the need to limit the random sample with regard to geographic barriers (Kotler et al. 2011, S. 383-384). The only limitations ensue owing to the necessity of an internet access, which nowadays is common practice, particularly within companies.

Despite the large coverage, it is not possible to act on the assumption that this acquisition of data is representative.

The main disadvantages of the online survey should also be pointed out. There is a considerable loss of control concerning the execution of the survey. It cannot be figured out which person filled out the questionnaire, for instance the CEO or the secretary of a company. Also it is not possible to discover the conditions under which the survey was carried out, as the participants remain anonymous. The most important aspect, however, is the occasionally high rupture rate regarding online surveys as “drop-outs” are particularly problematic if the questionnaire is over long (Thielsch and Weltzin, 2012, p. 117).

4.3. Probability Sampling

For the quantitative online-survey, the sample consists of all of the franchising firms in the previously mentioned countries which are characterized by international franchising activities, and so the data list excluded those firms which operate in only one country.

For this reason the homepages of the franchising companies were examined to see whether franchising was used in an international context or not, as to have those with only national franchise operations would have been of no use to provide answers to the research questions and to test the hypotheses. Also the data pool had to be reduced to a reasonable size. Ultimately the decision was made to base the study only on those companies that have international franchise operations and so, for this thesis, the data was obtained and evaluated solely from firms with international franchising operations. This was because the data that was obtained and evaluated exclusively from international franchise companies was exactly what was required, as the focus in this thesis is on the governance structure of international franchise firms.

In Germany, the number of franchise foundations increased by 5.2 percent in 2009 and, as a consequence, the number of franchisors increased so that, according to the German Franchise Association there are now approximately 980 franchisors. This is an increase of 3.2 percent as compared to that in the previous year. Around 49 percent of the franchisors in Germany operate in the service sector, 16 percent in the gastronomy and hotel sector together, 8 percent in handicrafts, and around 27 percent in the trading sector.

In Austria, the number of franchise systems has increased since the accession of Austria to the European Union in 1994. In the mid-eighties, the Austrian franchise sector accounted for around 30 franchise systems only.

In 2010, according to a survey of the *Small- and Medium Enterprises Research Austria*, it was estimated that there were 420 franchisors with 6,700 franchise partners and 61,000 employees. The total revenue of the Austrian franchise economy was estimated to be 7.9 milliard Euros. Approximately 54 percent of the franchise systems have foreign origins, whereas it was in particular the German companies with around 38 percent, which extended their franchise businesses to Austria. Eleven percent of the franchise systems have their origins in other European countries and approximately 5 percent in the USA or Canada. Around 55 percent of the franchisors in Austria operate in the trading sector, and a further 34 percent in the service sector. The hotel industry has approximately 500 franchisors.

Franchising in Europe developed very fast in the recent years. According to the European Franchise Association, there are approximately 7,150 franchise systems within Europe. The rate of growth was around 8.7 percent in 2014. In comparison with the USA, where franchise systems operate in a large national market that accounts for one third of the global market, European franchise systems operate in rather small national markets. Around 80 percent of the European franchise systems originate in their home countries. The differences in legislation between European countries and American countries, lead to a lower extent of internationalization of many European franchise companies, as this is usually cost-intensive and risky. International expansion of European franchise companies is generally limited to neighboring countries that are culturally similar. Furthermore, overseas franchise companies expand by using predominantly master franchising and area development franchising, whereas European franchise companies use predominantly direct franchising and wholly-owned subsidiaries

In the USA there are two franchise legislations, one at the federal level and one specifically for each state to avoid misuses of power. The USA are leading in the franchise business, accounting for a revenue of 880 billion US dollars in 2014 and a growth rate of 10 percent, as well as 2,500 franchise systems and 909,000 franchisors.

40 percent of the retail businesses in the USA use franchising as a distribution strategy. Every twelfth new business foundation is a franchise agreement.

(<http://www.franchiseportal.at/grundlagen/situation-des-franchising.htm>)

4.4. Data Collection

As the response rate after the first mailings in December was rather low, a second mailing round was undertaken in February. This was additionally supported by telephone activities in the course of which the relevant persons of those companies which had first been contacted by e-mail were called and requested to participate in the survey. This resulted in a slightly higher response rate. Some of the companies contacted were not prepared to participate in the survey, either because of the time factor or because, on principle, they do not participate in any kind of survey. Unlike others who requested that the link be sent again by e-mail and also agreed to fill in the questionnaire. In addition, postal mailings were sent out to increase the response rate. On average it took 15 to 20 minutes to complete the questionnaire. What is more, the questionnaire could be interrupted at any time and continued at some time later. The respondents were able to modify their answers afterwards by simply returning to the earlier pages, before sending off the questionnaire.

4.4.1. The Questionnaire

The questionnaire is divided into a number of subsections, whereas only those are described in detail, which were relevant for the data evaluation.

First of all there is an introduction, which includes information on the survey and the main objectives of the study on the governance structure of international franchising firms. This is followed by the actual part of the survey. The first subsection consists of questions to obtain general information on the franchise company, as well as the characteristics its franchise system. The aim is to find out the location of headquarters of the franchise system as well as the industry in which the franchise company is operating and also what kind of business the franchisor does. There are also questions that are specifically on the franchise system. The answers to these questions should make it possible to find out in which year the franchise was founded, the number of company-owned as well as franchised outlets and also the number of franchisees in the home country.

The questions on the characteristics of the franchise system were multiple choice, which meant that the respondents' answer could be made by choosing one of the given response options and/or by the input of a free text.

Afterwards, the essential question, whether the franchise business has international operations or not were asked, as only the international franchise operations are of interest for the research questions. This is a classical *yes or no* question. Then the questions on the international franchise business were asked to find out the starting date of international franchise operations, the number of company-owned as well as franchised outlets in foreign countries. Again, for the response, a free text is requested.

The second subsection of the questionnaire concerns the structure of the franchise system, and this also includes the choice of entry mode in foreign countries. The respondent is able to choose between five response-options: wholly-owned subsidiaries, joint-venture franchising, single-unit franchising, multi-unit franchising and master-franchising - referred to as sub-franchising. Then the respondents were asked to state the number of countries (as well as the respective regions) in which the particular entry modes are used.

Following the respondent has to choose the predominant, most used, franchise governance mode in foreign countries. The subsequent questions refer only to the mode that is predominant.

In the next section of the questionnaire, environmental uncertainty in the host country is discussed with regard to cultural, institutional and environmental distance. Here the differences between cultures, business practices, language barriers, the legal and political environment, foreign demand situation, stability of market shares, and the competitive situation should be assessed.

This is followed by questions concerning behavioral uncertainty, the evaluation of monitoring in foreign countries, the difficulty to evaluate the qualifications of foreign partners, of monitoring the franchise product/service quality in foreign countries, of monitoring the misuse of proprietary knowledge by foreign partners and of performance assessment: the answers to all of these questions have to be evaluated.

Another subsection concerns the transaction specific investments on the part of the franchisor, as well as on the part of the franchisee. On the part of the franchisor, the amount of investments in personnel, which is solely for foreign partners, as well as the amount of investments in foreign location sites and in training, besides qualifying procedures, were assessed.

On the part of the franchisee, the amount of the investments in tools, equipment and procedures for the sole purpose of the franchise business, as well as the training of employees to be able to make use of franchise-specific techniques. In addition, the extent of loss has to be assessed if the franchise relationship is terminated.

The questions discussed have to be assessed on a seven-digit Likert-scale as well, in which 1 signifies *(I) strongly disagree*, and 7 *(I) strongly agree*.

Respondents can receive a copy of the report of the international study if they wish by disclosing the name of the company, as well as the company's e-mail address. Otherwise, the data is completely anonymous.

The entire questionnaire can be found in the appendix. In this thesis, however, questions with regard to agency theory and transaction cost theory are only evaluated. The questions are on environmental uncertainty, behavioral uncertainty, the transaction-specific investments of the franchisor, as well as of the franchisee. It is aimed to see if those factors have a significant influence on the choice of the organizational mode of international franchise companies. Furthermore questions on the system characteristics were important for the measurement of the control variables.

4.5. Evaluation Methods

4.5.1. Binary Logistic Regression

In this thesis the method of a binary logistic regression was used as the dependent variable is a categorical and not a continuous variable. Therefore the classic OLS regression could not be used. Nevertheless, logistic regression is, in many respects, quite similar to OLS regression as it is also used to examine the relationship between a dependent variable and one other or a variety of independent variables. The objective is to find out how a number of different independent variables together can predict the dependent variable. With a binary logistic regression it is possible to see whether there is a significant correlation between the respective variables. The coefficient of the logistic regression is consistent with the b coefficients of the OLS regression. The standardized coefficients are consistent with the beta weights of the OLS regression (Garson, 2014).

The main difference, in comparison with the OLS regression, is that within an OLS regression the method of ordinary least squares is used to estimate the regression weights. Therefore, the differences between the observed responses of a dataset and the predicted responses by linear approximation of data are minimized. Within a logistic regression, however, the probability of the occurrence of an event is estimated. In this thesis, the event that is examined is whether the international franchisor is going to choose direct, as opposed to indirect, franchising to enter the foreign market or not. What is more, the logistic regression does not require a normal distribution of variables and, in general, fewer conditions are attached (Garson, 2014).

Although the probability (p) that a certain event occurs (value=1) or does not occur (value=0) was considered, no exact numerical value of the dependent variable Y was predicted. This is contrary to the OLS regression.

Furthermore, the basic linear relationship between the dependent and independent variables in an OLS regression is not assumed in a logistic regression.

(<https://www.strath.ac.uk/aer/materials/5furtherquantitativeveresearchdesignandanalysis/unit6/whatislogisticregression/>)

The binary logistic regression makes use of the logistic regression function which is formulated as follows:

$$\ln \frac{p_i}{1 - p_i} = a + b_1 * x_{j1} + b_2 * x_{j2} + \dots + b_i * x_{ij}$$

There are J different independent variables x_j (indexed with $j=1 \dots J$), a is the constant and b_i describe the regression coefficients. The effect of a particular characteristic x_{ij} of X_j on the probability of occurrence of p_i can be predicted only under the condition that all the other variables remain constant (<http://www.fh-bingen.de/uploads/media/Logreg.pdf>). Then the odds are that a value of one divided by the probability of receiving a value of zero will be the result. The value zero is referred to as the *reference category* and the value one as the *predicted category*. The $\ln$ -value is referred to as *log-odds* or *logit*, and is the predicted coefficient value of the logistic regression, hence the natural logarithm of the odds (Garson, 2014).

The main requirement for the use of a binary logistic regression is the absence of multi-collinearity. This is a common problem in regression analysis and is present if one or more independent variables are highly correlated with each other. The interpretation of the model is not explicit in the case of multi-collinearity. Therefore the independence of observations as well as a linear relationship of the independent variables to the logit of the dependent variable are basic assumptions to successfully implement a logistic regression (Garson, 2014).

The regression coefficients of a binary logistic regression are estimated on the basis of the maximum likelihood method. This is a parametrical estimation method which chooses the parameter for an estimation that according to its distribution is the best for the realization of the observed data. Inferential statistic methods are used for the single regression coefficients as well as for the overall model. Those inferential methods involve the Wald-Test and the Likelihood Ratio Test.

The Wald-Test is a statistical test, developed in 1943 by Abraham Wald. It is a method to find out whether a certain independent variable is significant or not. The binary logistic regression used in this thesis has a binary dependent variable (i.e. only values of one and zero) and a variety of independent variables. The zero hypothesis is tested to show whether an unknown parameter of the main population θ is equal to a specified value θ_0 or not.

According to Polit (1996) and Agresti (1990) it is a good way to find out if the parameters that belong to a group of independent variables have the value zero. If the Wald Test shows significant results for one or more independent variables, the conclusion can be drawn that the respective parameters do not have a value of zero. This means that the variables have to be considered in the model. If the Wald-Test shows no significant results for an independent variable, this variable can be eliminated from the model.

Altman (1991) used a t-test to verify the significance of a variable. If there is only one independent variable, the Wald-Test represents the square of the values of the t-statistic. If there is more than one independent variables, the Likelihood Ratio Test is used. According to Agresti (1990) the Likelihood Ratio Tests brings better results if the size of the sample is small, or if there are large parameters. The Likelihood Ratio Test is used to assess the goodness-of-fit between two statistical models. The comparison between a rather complex model and a rather simple model is made to find out which model fits a specific dataset in a significantly better way (<https://evomics.org/resources/likelihood-ratio-test/>)

4.5.2. Factor Analysis

The factor analysis is a method which belongs to multivariate statistics. It serves as a means to reduce a few underlying, latent variables (also called factors) from the empirical observations of many different manifest variables (also called observable statistical variables). The detection of mutual independent variables, is indispensable for the application of the data reducing or dimension reducing method. In general, there are two kinds of factor analysis: exploratory and confirmatory. In this thesis, exploratory factor analysis is used to discover the essential structure of a large number of variables. Confirmatory factor analysis has another function: it is used to test whether the data is consistent with a predefined model of measurement made by the researcher, and it has a more sophisticated approach (Garson, 2013).

Exploratory factor analysis was used to reduce the number of variables pertaining to environmental uncertainty, behavioral uncertainty, transaction specific investments of franchisors, as well as the transaction specific investments of partners.

Environmental uncertainty is summarized below and assigned to two factor variables, whereas behavioral uncertainty, transaction specific investments of the franchisor and transaction specific investments of the partner are summarized below, respectively, and each assigned to one factor variable. Therefore, the factor variables are used as independent variables in the subsequent binary logistic regression. The results of the factor analysis, as well as the applied tests are described later on in detail.

5. Empirical Results

5.1. Descriptive Statistics

The table on the next page (=table 1) shows the descriptive statistics with regard to the number of company-owned outlets abroad and in the home country, the year when the franchise system was founded, the year when the internationalization started and the number of franchise outlets in the home country as well as abroad. Furthermore it illustrates the franchise agreement terms with regard to the initial investment fee, the total investment required to open a franchise outlet and the development fee for a master franchise. The column N shows the total number of cases considered which depended on the number of useful answers, and the average number of data that could be used was around 111 cases.

The number of company-owned outlets abroad has a mean value of around 34 and the number of franchise outlets abroad has a mean value of about 101. The average year when the franchise system was founded was 1995 with a standard deviation of approximately 16 years. The average number of company-owned outlets in the home country was approximately 44 and the average number of franchise outlets in the home country was around 247. The initial fee for the start of a single franchise unit accounted on average for around USD 14,565 Dollars with a standard deviation value of approximately USD 17,700. The average total investment amount that was required for opening a franchise outlet was USD 157,807. The mean value for the development of a master franchise business was USD 48,721.

Descriptive statistics shows that there are around two-thirds more franchise outlets in the home country as well as abroad than there are company-owned outlets.

	N	Minimum	Maximum	Mean Value	Standard Deviation
Founding year of franchise system	131	1896	2014	1994,73	15,815
Number of company-owned outlets in the home country	130	0	620	44,31	103,510
Number of franchise outlets in the home country	128	0	8000	246,87	805,956
Year when internationalization started	129	200	20014	2128,14	1595,008
Number of company-owned outlets abroad	128	0	1277	33,78	144,956
Number of franchise outlets abroad	131	0	3000	100,93	314,261
Initial fee for a single franchise unit in US \$	80	0	100000	14564,86	17669,772
Total investment required for opening a franchise outlet in US \$	67	0	1500000	157806,78	246566,197
Development fee for a master franchise license in US \$	48	0	300000	48721,41	76789,140

Table 1: Descriptive Statistics

5.2. Factor Analysis – Results

The factor analysis was carried out for the variables with regard to environmental uncertainty (i.e. cultural distance, institutional distance, economic/market distance), behavioral uncertainty, the transaction-specific investments of the franchisor as well as the transaction-specific investments of the franchisee. In the course of the explorative factor analysis, the principal component analysis was used. The KMO and Bartlett Test is the basis for the factor analysis to show if the data set with the respective variables can become through the factors. The Kaiser-Meyer-Olkin (=KMO) criteria indicates whether the data set is suited for the factor analysis or not. If the KMO value is more than 0.6, the data set is suited for the factor analysis as suggested by Tabachnick and Fidell (2001).

Communality describes the sum of the squared factor loadings of a variable. It specifies to what degree the variance of one variable is explained by all factors. A variable with low communality is, in general, poorly represented for the whole model. This is the case when the variable has a value below 0.5. At the beginning of the principal components analysis it is assumed that the variance of each variable that is analyzed can be completely explained. This is why the first column of the communality table has values of 1. The second column shows the variables after the factor extraction (<http://www.empirical-methods.hslu.ch/h-faktoranalyse.htm>).

The total mean square table is an illustration of the eigenvalue development and the variance explained by the factors. The eigenvalue is the share of the total variance that is explained by a factor. The general rule is that, if the values amount to a total sum of 1, they should be included in the factors. This rule is termed the Kaiser's criterion, which suggests that all of the factors that are greater than 1 should be included in the analysis (Pallant, 2005).

The component matrix is an illustration of non-rotated factor loadings. It illustrates the loadings of the variables with the factors (components). The greater the load of a variable on a factor, the greater is the representation of this factor by the variable. The variables are scaled down according to the size of their factor loadings. Values exceeding 0.5 should be assigned to a factor. Ideally, every variable should have a high correlation with only one factor, as this

facilitates the interpretation of the factors. All of the factors described in this section were created by the sum of the items per factor and then divided by the number of items per factor.

5.2.1. Environmental Uncertainty

5.2.1.1. Cultural Distance

The first factor analysis was carried out for the variable with regard to cultural distance. As the KMO value for this factor analysis is at 0.612 more than 0.6 the data set is valid for the analysis. This KMO value measures a good inter-correlation between all of the variables. The H_0 Hypothesis was tested with the results that there is no correlation between the variables of the population. If H_0 can be rejected, owing to a significant correlation, the probability of error is, at most, five percent. This factor analysis shows a zero probability of error.

Kaiser-Meyer-Olkin-Measure of Sampling Adequacy		,612
Bartlett-Test of Sphericity	Approx. Chi-Square	142,642
	df	3
	Sig.	,000

Table 2: KMO and Bartlett-Test – Cultural Distance

The communality result for the factor analysis shows, that after extraction, all of the variables should be included, as only variables with a communality value of less than 0.5 should generally be dropped, as this indicates that the factor model is not representative for this indicator variable. As shown below, in particular, cultural differences and differences in business practices have a value which is at around 0.8 and therefore much greater than 0.5.

	Initial	Extraction
Cultural differences between our home and the foreign countries are high such as norms, values and habits.	1,000	,801
The business practices in our home and the foreign countries are quite different.	1,000	,813
The language barriers between our home and the foreign countries are high.	1,000	,551

Table 3: Communalities – Cultural Distance

The table below shows the total variance explained, in which the first component has a value that is more than 1 and explains around 69 percent of the total variance. For the rest the value is less than 1. For this reason, one factors should be included.

Components	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	2,065	68,824	68,824
2	,703	23,436	92,260
3	,232	7,740	100,000

Table 4: Total Variance Explained – Cultural Distance

The matrix shows that the all of the variables have high loadings on component 1. This indicates that the differences in business practices between the home and foreign countries, the cultural differences and the language barriers between the home and the foreign country should be summarized under one factor, which is called Cultural Distance (CD).

	Component
	1
The business practices in our home and the foreign countries are quite different.	,902
Cultural differences between our home and the foreign countries are high such as norms, values and habits.	,895
The language barriers between our home and the foreign countries are high.	,671

Table 5: Component Matrix – Cultural Distance

5.2.1.2. Institutional Distance

The second factor analysis was carried out for the variable with regard to institutional distance. Again, in the course of the explorative factor analysis, the principal component analysis was used. The KMO value for this factor analysis is at 0.777 more than 0.6 the data set is valid for the analysis. This factor analysis shows again a zero probability of error.

Kaiser-Meyer-Olkin-Measure of Sampling Adequacy		,777
Bartlett-Test of Sphericity	Approx. Chi-Square	238,850
	df	6
	Sig.	,000

Table 6: KMO and Bartlett-Test – Institutional Distance

The communality result for the factor analysis shows, that after extraction, all of the variables should be included, as only variables with a communality value of less than 0.5 should generally be dropped, as this indicates that the factor model is not representative for this indicator variable. The table below illustrates that all of the variables have a communality value which is greater than 0.5.

	Initial	Extraction
The legal protection of intellectual properties such as patents and trademarks is weak in the foreign countries.	1,000	,624
The political environment is quite uncertain in the foreign countries.	1,000	,760
The risk of ownership restrictions is high in foreign countries.	1,000	,804
The quality of local infrastructure, such as phones, roads and IT, is under-developed in foreign countries.	1,000	,567

Table 7: Communalities – Institutional Distance

The total mean square table shows that the first factor explains 68.887 percent of the total variance and has an overall sum of 2.755. The first component has a value that is more than 1 and for the rest the value is less than 1. For this reason, one factors should be included.

Components	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	2,755	68,887	68,887
2	,592	14,797	83,684
3	,422	10,539	94,223
4	,231	5,777	100,000

Table 8: Total Variance Explained – Institutional Distance

The component matrix for institutional distance shows that all of the variables have a high loading on component 1 which is greater than 0.5. This means that all of the variables should be included and assigned to one factor, called institutional distance. This factor includes the risk of ownership restrictions in foreign countries, the uncertainty of the political environment, the legal protection of intellectual properties and the quality of the local infrastructure. Institutional distance is referred to as ID in the ensuing Logistic Regression Analysis.

	Component
	1
The risk of ownership restrictions is high in foreign countries.	,897
The political environment is quite uncertain in the foreign countries.	,872
The legal protection of intellectual properties such as patents and trademarks is weak in the foreign countries.	,790
The quality of local infrastructure, such as phones, roads and IT, is under-developed in foreign countries	,753

Table 9: Component Matrix – Institutional Distance

5.2.1.3 Economic/Market Distance

The third factor analysis was carried out for the variable with regard to economic/market distance. Again, in the course of the explorative factor analysis, the principal component analysis was used. The KMO value for this factor analysis is at 0.687 more than 0.6 the data set is valid for the analysis. This KMO value measures a good inter-correlation between all of the variables. This factor analysis shows a zero probability of error.

Kaiser-Meyer-Olkin-Measure of Sampling Adequacy		,687
Bartlett-Test of Sphericity	Approx. Chi-Square	130,149
	df	6
	Sig.	,000

Table 10: KMO and Bartlett Test – Economic/Market Distance

The communality result for the factor analysis shows, that after extraction, only the first three variables should be included. Variables with a communality value of less than 0.5 have to be excluded as this indicates that the factor model is not representative for this indicator variable. The table below illustrates that the first three variables have a communality value which is greater than 0.5. The fourth variable, which is with regard to foreign competition, has a value of 0.130 which is less than 0.5. For this reason the variable is not taken into consideration in the ensuing analysis.

	Initial	Extraction
Customer demand is strongly changing in foreign countries.	1,000	,582
Sales forecasts are not easily predictable in foreign countries.	1,000	,745
Market shares are pretty unstable in foreign countries.	1,000	,725
The number of existing and potential competitors is high in foreign countries.	1,000	,130

Table 11: Communalities – Economic/Market Distance

The total mean square table shows that the first factor explains 70.300 percent of the total variance and has an overall sum of 2.109. The first component has a value that is more than 1 and for the rest the value is less than 1. For this reason, one factors should be included.

Components	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	2,109	70,300	70,300
2	,514	17,149	87,449
3	,377	12,551	100,000

Table 12: Total Variance Explained – Economic/Market Distance

The component matrix for economic/market distance shows that after the exclusion of the variable with regard to the number of existing and potential competitors in the foreign market, all of the variables have a high loading on component 1 which is greater than 0.5. This means that all of the three remaining variables should be included and assigned to one factor, called economic/market distance. This factor includes the stability of market shares in the foreign

country, the predictability of sales forecasts, as well as the variability in customer demand. Economic/market distance is referred to as ED in the ensuing Logistic Regression Analysis.

	Component
	1
Market shares are pretty unstable in foreign countries.	,859
Sales forecasts are not easily predictable in foreign countries.	,854
Customer demand is strongly changing in foreign countries.	,802

Table 13: Component Matrix – Economic/Market Distance

5.2.2. Behavioral Uncertainty

Next the factor analysis with regard to behavioral uncertainty was carried out. The KMO value for this factor analysis is at 0.773 more than 0.6 the data set is valid for the analysis. This factor analysis shows a zero probability of error.

Kaiser-Meyer-Olkin-Measure of Sampling Adequacy		,773
Bartlett-Test of Sphericity	Approx. Chi-Square	279,083
	df	6
	Sig.	,000

Table 14: KMO and Bartlett-Test – Behavioral Uncertainty

The communality result for the factor analysis shows, that after extraction, all of the variables should be included. The table below illustrates that all of the four variables have a communality value which is considerably greater than 0.5.

	Initial	Extraction
Evaluate the qualification of foreign partners.	1,000	,656
Monitor the franchise product/service quality in foreign countries.	1,000	,804
Monitor the misuse of proprietary knowledge by foreign partners.	1,000	,678
Assess the performance of foreign partners.	1,000	,768

Table 15: Communalities – Behavioral Uncertainty

The total mean square table below shows that the first factor explains 72.680 percent of the total variance and has an overall sum of 2.907. The first component has a value that is more than 1 and for the rest the value is less than 1. For this reason, one factors should be included.

Components	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	2,907	72,680	72,680
2	,540	13,503	86,183
3	,323	8,067	94,250
4	,230	5,750	100,000

Table 16: Total Variance Explained – Behavioral Uncertainty

The component matrix for behavioral uncertainty shows that all of the variables have a high loading on component 1 which is greater than 0.5. This indicates that the monitoring of the franchise products/services, performance assessment, the monitoring of misuses of proprietary knowledge and the qualification of foreign partners should be summarized under one factor, which is called behavioral uncertainty (BUNC).

	Component
	1
Monitor the franchise product/service quality in foreign countries.	,897
Assess the performance of foreign partners.	,877
Monitor the misuse of proprietary knowledge by foreign partners.	,823
Evaluate the qualification of foreign partners.	,810

Table 17: Component Matrix – Behavioral Uncertainty

5.2.3. Franchisor Transaction-Specific Investments

The factor analysis with regard to the transaction-specific investments of the franchisor shows a KMO of 0.799 which is greater than 0.6. For this reason the data set is valid for the factor analysis.

Kaiser-Meyer-Olkin-Measure of Sampling Adequacy		,799
Bartlett-Test of Sphericity	Approx. Chi-Square	206,262
	df	6
	Sig.	,000

Table 18: KMO and Bartlett-Test Franchisor Transaction-Specific Investments

The communality result for the factor analysis shows, that after extraction, all of the variables should be included. The table below illustrates that all of the four variables have a communality value which is considerably greater than 0.5.

	Initial	Extraction
FTSI: invested heavily in personnel dedicated to our foreign partners.	1,000	,663
FTSI: made significant investments in displays etc. dedicated to our franchise relationships.	1,000	,690
FTSI: developed very specialized procedures and systems for our foreign partners to follow.	1,000	,620
FTSI: involved considerable commitment of time and money in training and qualifying our foreign partners.	1,000	,764

Table 19: Communalities – Franchisor Transaction-Specific Investments

The total mean square table below shows that the first factor explains 68.412 percent of the total variance and has an overall sum of 2.736. The first component has a value that is more than 1 and for the rest the value is less than 1. For this reason, the variables should be assigned to one factor.

Components	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	2,736	68,412	68,412
2	,552	13,807	82,218
3	,393	9,815	92,034
4	,319	7,966	100,000

Table 20: Total Variance Explained – Franchisor Transaction-Specific Investments

The component matrix for the transaction-specific investments of the franchisor shows that all of the variables have a high loading on component 1 which is greater than 0.5. The four variables, which are investments in displays, the development of specialized procedures that foreign partners have to follow, investment in personnel and commitment in training, and the qualification of foreign partners, are summarized below in FTSI (franchisor transaction specific investments).

	Component
	1
FTSI: involved considerable commitment of time and money in training and qualifying our foreign partners.	,874
FTSI: made significant investments in displays etc. dedicated to our franchise relationships.	,830
FTSI: invested heavily in personnel dedicated to our foreign partners.	,815
FTSI: developed very specialized procedures and systems for our foreign partners to follow.	,787

Table 21: Component Matrix – Franchisor Transaction-Specific Investments

5.2.4. Partner Transaction-Specific Investments

The factor analysis with regard to the transaction-specific investments of the franchisee shows a KMO of 0.660 which is greater than 0.6. For this reason the data set is valid for the factor analysis.

Kaiser-Meyer-Olkin-Measure of Sampling Adequacy		,660
Bartlett-Test of Sphericity	Approx. Chi-Square	131,554
	df	3
	Sig.	,000

Table 22: KMO and Bartlett-Test Partner Transaction-Specific Investments

The communality result for the factor analysis shows, that after extraction, all of the variables should be included. The table below illustrates that all of the three variables have a communality value which is considerably greater than 0.5.

	Initial	Extraction
PTSI: have made significant investments in tools, equipment and procedures dedicated to the franchise relationship.	1,000	,758
PTSI: have committed substantial time and money in employees` (or sub-franchisees`) training of the franchise-specific techniques.	1,000	,810
PTSI: would lose a lot of their investment made to develop the local franchise network, if they decided to stop working with us.	1,000	,587

Table 23: Communalities – Partner Transaction-Specific Investments

The total mean square table below shows that the first factor explains 71,837 percent of the total variance and has an overall sum of 2.155. The first component has a value that is more than 1 and for the rest the value is less than 1. For this reason, the variables should be assigned to one factor.

Components	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	2,155	71,837	71,837
2	,575	19,158	90,995
3	,270	9,005	100,000

Table 24: Total Variance Explained – Partner Transaction-Specific Investments

The component matrix for the transaction-specific investments of the franchisee shows that all of the variables have a high loading on component 1 which is greater than 0.5. This indicates that the commitments in the training of employees, investments in tools, equipment and procedures, as well as investment loss if the relationship is terminated are summarized below in PTSI (partner transaction specific investments).

	Component
	1
PTSI: have committed substantial time and money in employees` (or sub-franchisees`) training of the franchise-specific techniques.	,900
PTSI: have made significant investments in tools, equipment and procedures dedicated to the franchise relationship.	,871
PTSI: would lose a lot of their investment made to develop the local franchise network, if they decided to stop working with us.	,766

Table 25: Component Matrix – Partner Transaction-Specific Investments

5.2. Binary Regression Analysis – Results

The Binary Regression was used to test the hypotheses because of the categorical character of the dependent variable. Indirect Franchising was used as the dependent binary variable, with a value of one for master franchising, as this is characterized as indirect franchising, and zero for all of the other entry mode choices. The independent variables that were entered are: institutional distance, cultural distance and economic distance, behavioral uncertainty, transaction-specific investments of the partner and transaction-specific investments of the franchisor. System size, international experience and system performance were entered as control variables.

The SPSS output for the interpretation of the Binary regression analysis consists of various tables which are interpreted below.

The general levels of significance that were used are as follows:

- if the p-value is smaller or equal to 10 percent the result is weakly significant
- if the p-value is smaller or equal to 5 percent the result is significant
- if the p-value is smaller or equal to 1 percent the result is very significant and
- if the p-value is smaller or equal to 0,1 percent the result is highly significant.

The Case Processing Summary illustrates the number of cases that were included in the analysis and the number of missing cases. The Dependent Variable Encoding table shows how the dependent variable is encoded which is 1 for indirect franchising and 0 for direct franchising (<http://www.ats.ucla.edu/stat/spss/output/logistic.htm>).

The beginning block, which is referred to as Block 0, shows the initial model in which the independent variables are not taken into consideration. This model prognosis is made on the basis of the category that appeared most frequently in the dataset. In the Classification Table below, the correctness of the model is shown as a percentage. It can be seen that in 64 percent of all cases, the dependent variable could be predicted correctly, and the frequency of the values *zeros* and *ones* that with regard to the dependent variable are also given.

Furthermore, it was predicted that all cases are zero within the null model (<http://www.ats.ucla.edu/stat/spss/output/logistic.htm>).

			Predicted		
			Indirect Franchising		Percentage correct
			0	1	
Step1	Observed				
	Indirect	0	71	0	100,0
	Franchising	1	40	0	,0
	Overall Percentage				64,0

Table 26: Classification Table Nr. 1

The next table shows the variables used in the equation Nr. 1 and also the constant, which is the coefficient B_0 . This can be interpreted only in a limited way as the correctness of the model is rather low. It shows a statistical significance for only one constant. In this case, the Wald-Test is used to find out if the constant is zero or not. It shows a significant value of 0.004 which is less than 0.05 and so the zero hypotheses can be rejected. This, however is not representative as only the dependent variable was considered.

		B	Standard Error	Wald	df	Sig.	Exp(B)
Step 0	Constant	-,547	,198	8,424	1	,004	,563

Table 27: Variables in the Equation Nr. 1

The Omnibus Test of Model Coefficients compares the new model with the initial model, to see if that model is improved by involving independent variables. With regard to this, the Chi-Square test is used to determine whether a statistically significant difference between the 2-Log-Likelihood of the beginning model and the new model exists. If there is a significant difference i.e. the 2-Log-Likelihood is reduced in comparison to the initial model, it means that the new model provides a better explanation of a greater part of the variance of the results. The first Omnibus Test of Model Coefficients shows the results of Block 1, in which the control variables were added. There was no significant improvement in the model as the 2-Log-Likelihood value was not statistically significant. The value is 0.201, greater than 0.1, and thus not significant.

(<http://www.restore.ac.uk/srme/www/fac/soc/wie/research-new/srme/modules/mod4/12/>)

The model summary shows the 2-Log-Likelihood, the Cox and Snell R Square as well as the Nagelkerke R Square. The Cox and Snell R Square are referred to as *pseudo R Squares* as there is no correspondent to the R Square of the OLS regression (<http://www.restore.ac.uk/srme/www/fac/soc/wie/research-new/srme/modules/mod4/12/>). When looking at the Nagelkerke R-Square it can be seen that with the control variables involved only 3.9 percent of the variation can be explained by the model

		Chi-Square	df	Sig.
Step 1	Step	3,209	2	,201
	Block	3,209	2	,201
	Model	3,209	2	,201

Table 28: Omnibustest of model coefficients Nr. 1

Step	-2 Log-Likelihood	Cox & Snell R-Square	Nagelkerke R-Square
1	141,896 ^a	,028	,039

Table 29: Model Summary Nr. 1

The Hosmer and Lemeshow Test, is a goodness of fit test and shows how well the model fits the data. If the test has a p-value greater than 0.05, the model has a good fit. As the Hosmer and Lemeshow test is based on the chi-squared statistic, it depends to a great degree on the size of the sample, so this has to be taken into consideration as it is not possible to interpret the value independently of the size of the sample.

(<http://www.restore.ac.uk/srme/www/fac/soc/wie/research-new/srme/modules/mod4/12/>)

The Hosmer-Lemeshow Test below shows that the model fits the data fairly well as the value is 0.305 and therefore greater than 0.05.

Step	Chi-Square	df	Sig.
1	9,465	8	,305

Table 30: Hosmer-Lemeshow-Test Nr. 1

		B	Standard Error	Wald	df	Sig.	Exp(B)
Step 1	SYSTEMSIZE	,000	,000	1,544	1	,214	1,000
	INTEXP	,009	,016	,329	1	,566	1,009
	Constant	-,880	,373	5,580	1	,018	,415

Table 31: Variables in the Equation Nr. 2

The second table of variables in the equation shows that in the first step *system size* and *international experience* were included in the model. The values are not significant as they are lower than all of the four previously mentioned significant levels. Therefore in the next step, all of the independent variables are entered into the model. The results for the final model are shown and interpreted below.

The Omnibus Test of Model Coefficients for the second block shows that, as the other independent variables were added the model becomes significant with a value of 0.006, which is smaller than the significance level 0.05. The Hosmer-Lemeshow-Test, however, has a better value than with the two variables only, and is at 0.431 greater than 0.05. This means that, compared with the first model, the model has improved.

The Model Summary shows that the Nagelkerke R-Square has a value of 0.200 which means that 20 percent of the variation is explained by the model. The -2 Log-Likelihood value is 127,618 and is compared with the value from the previous model 141,896 which shows that the value decreased and the new model, which includes the independent variables, has a significantly better fit.

		Chi-Quadrat	df	Sig.
Step 1	Step	16,143	5	,006
	Block	16,143	5	,006
	Model	18,654	7	,009

Table 32: Omnibustest of Model Coefficients Nr. 2

Step	-2 Log-Likelihood	Cox & Snell R-Square	Nagelkerke R-Square
1	127,618 ^a	,146	,200

Table 33: Model Summary Nr. 2

Step	Chi-Square	df	Sig.
1	8,026	8	,431

Table 34: Hosmer-Lemeshow-Test Nr. 2

The Classification Table shows that, with all of the relevant variables entered, 73 percent of the outcome is classified correctly, which is higher when compared with the first model. The reference category, which is zero, has a percentage of 90.1 and the predicted category, which is one has a percentage of 42.5 percent.

			Predicted		
			Indirect Franchising		Percentage correct
			0	1	
Step 1	Indirect	0	59	9	90,1
	Franchising	1	23	21	42,5
	Overall Percentage				73,0

Table 35: Classification Table Nr. 2

		B	Standard Error	Wald	df	Sig.	Exp(B)
Step 1	SYSTEM-SIZE	,000	,000	,714	1	,398	1,000
	INTEXP	,000	,017	,000	1	,999	1,000
	BUNC	,409	,195	4,395	1	,026	1,505
	FTSI	,275	,159	2,987	1	,084	1,316
	PTSI	,137	,153	,804	1	,370	1,147
	CD	,067	,224	,090	1	,457	1,070
	ED	-,296	,132	5,038	1	,025	,744
	ID	,145	,318	,209	1	,648	1,157
	Constant	-3,142	1,205	6,800	1	,009	,043

Table 36: Variables in the Equation Nr. 3

The results of the Variables in the Equation Table show that three independent variables, which are Behavioral Uncertainty (BUNC), transaction-specific investments of the franchisor (FTSI) and Economic Distance (ED) are statistically significant. BUNC has a value of 0.026 which is smaller than 0.05 and therefore significant. Also the regression coefficient has a positive value. FTSI has a value of 0.084 and is therefore only of low significance at the level of 0.1. The corresponding regression coefficient is positive too. Economic distance has a value of 0.025 and is significant as the value is smaller than 0.05. The respective regression coefficient has a negative value. The value for the transaction-specific investments of the partner (PTSI) is 0.370, it is therefore not significant as it is greater than 0.1. The regression coefficient of PTSI is positive. Similarly to PTSI also Cultural Distance (CD) has no significantly statistical value. The value of CD is with 0.457 far greater than the significant p-value level. At last, Institutional Distance (ID) has no significantly statistical value. This value is with 0.648 also far greater than the significant p-value level. In the next section, these results are discussed with regard to the respective hypotheses.

5.3. Discussion of the results

The main objective of the international study, carried out over a period of seven months (November 2014 until May 2015), was to get a deeper insight and understanding into the choice of governance mode of international franchising firms. It represents empirical evidence from the franchise sectors of eight countries, i.e. Austria, Germany, France, Italy, Spain, the Netherlands, the USA and the UK. The empirical results of the international study showed partial support for the hypotheses that were tested and rely strongly on Agency Theory.

The two uncertainties that confront a franchisor are behavioral uncertainty on the part of the franchisee and environmental uncertainty owing to different market conditions in the host countries. As Williamson (1985) stated, the transaction specificity of investments on the part of the franchisor as well as on the part of the franchisee and environmental uncertainty are the main factors that affect the choice of governance structure of a firm i.e. governance through hierarchies, markets or hybrids. In particular, transaction-specific investments of the franchisee made in the beginning of the franchise business strengthen the franchise relationship ex-post as they would be of no further use in another contractual relationship.

As Klein (1996) stated, this fact increases the self-enforcement of contracts and reduces a potential hold-up problem. Therefore high transaction-specific investments of the franchisee should lead to the choice of low control entry modes i.e. indirect franchising owing to this self-enforcement mechanism. This was predicted by the hypothesis H4 which has to be rejected, as the transaction-specific investments of the franchise partner did not have a significant influence on the choice of indirect franchising with the data that were analyzed. Transaction-specific investments of the franchisee are not significant with a positive regression coefficient. This means that they have a positive effect on the choice of low control entry modes i.e. indirect franchising but as the results are not significant there is no support for H4.

If the transaction-specific investments on the part of the franchisor are high, and those of the franchisee are low, higher control entry modes, i.e. wholly-owned subsidiaries or joint-venture franchising, should be chosen, and this was predicted by the hypothesis H3. Although the transaction-specific investments of the franchisor are statistically significant the variable has a positive coefficient which leads to conflicting results compared to previous research outcomes. High transaction-specific investments should have a negative effect on the choice of low control entry modes, i.e. indirect franchising. Therefore it can be stated that transaction-specific investments of the franchisor are weakly significant but do not support the hypothesis H3.

Environmental uncertainty was expressed by cultural distance, economic distance and institutional distance. Environmental uncertainty showed significant results for economic distance but not for cultural and institutional distance. Although economic distance has a significant value, the regression coefficient is negative. As hypothesis two (H2) states the higher transaction costs owing to environmental uncertainty are, the higher is the tendency of the franchisor to use low-control entry modes. The statistical result for economic distance, however, show contrary findings as this would indicate that a high economic distance would not favor the choice of indirect franchising, but the choice of direct franchising, which is rather characterized by high levels of control. For these reasons, H2 also has to be rejected.

The results for behavioral uncertainty show statistical significance. Also the presumed positive effect on the choice of governance modes is supported as the regression coefficient has a positive sign. It can be stated that a high behavioral uncertainty has a positive effect on the choice of indirect franchising. For this reason if behavioral uncertainty is high, low control entry modes should be preferred by the franchisor. This is in line with the hypothesis H1, which can therefore be supported.

The results for the control variables, i.e. international experience and system size were not significant but led to an improvement of the significance of the other independent variables.

The study represented in this thesis has limitations as cross-sectional data were used instead of panel data to discover the factors that influence the governance structure choice of international franchise firms. The difference is that cross-sectional data are gathered from many different entities at a particular point of time, whereas panel data involve data that describe particular entities (for instance companies) more than once, i.e. repeatedly for a number of given times (<http://wirtschaftslexikon.gabler.de/Definition/paneldaten-und-paneldatenmodelle.html>).

Therefore, by the use of panel data a much deeper empirical insight could have been gained. What is more, of the 280 filled in questionnaires only around 110 could be used for data evaluation purposes as most of the companies that participated in the study had national franchise operations only, and were therefore useless for the purpose of testing the hypotheses. Some of the participants also started the questionnaire but stopped already very early on and so much basic data was missing.

5.4. Implications for Agency Theory

The hypothesis with regard to Agency Theory which states that the higher the monitoring costs owing to behavioral uncertainty are, the higher the propensity of the franchisor to use lower control entry modes is, can be supported as the independent variable behavioral uncertainty has a significant and positive regression coefficient. This gives evidence that if monitoring becomes increasingly difficult and expensive because of geographically dispersed outlets, behavioral uncertainty is going to increase and is going to have positive effects on the choice of low control entry modes i.e. as tested indirect franchising.

Behavioral uncertainty includes the danger of opportunistic behavior, shirking of duties and responsibilities, free-riding on the brand name and the moral hazard problem on the part of the franchisee. All these problems increase when monitoring becomes difficult as the franchisee is less controlled and has more opportunities for behaving opportunistically. For this reason the franchisor is assumed to choose low control entry modes i.e. indirect franchising. In this case more control is given to the franchisee who appears as the sub-franchisor in the foreign market.

As mentioned earlier in this thesis Fladmoe-Lindquist and Jacque (1995) stated that less monitoring is in general required in franchising relationships because franchisees have to bear the costs of shirking their responsibilities as this results in a reduced net income. If therefore a franchisee is granted more control, shirking of responsibilities or free riding on the brand name, have greater impacts on the net income. Because of this behavioral uncertainty can be reduced as a franchisee has more incentives to behave appropriately even though geographic distance is great and control is difficult. Also Wathne and Heide (2000) stated that behavioral uncertainty is lower when there is a better alignment of incentives between business parties. This tends to be the case when franchisees are granted more control.

However, if behavioral uncertainty and thus monitoring costs are low, the franchisor is going to choose higher control entry modes i.e. direct franchising like wholly-owned subsidiaries. The research findings of the study described in this thesis suggest that Agency Theory with regard to behavioral uncertainty and monitoring costs, does explain to a good extent the choice of governance modes of the international franchisor.

5.5. Implications of Transaction Cost Theory

The hypotheses with regard to Transaction Cost Theory can be supported only to a limited extent. The variables that concern environmental uncertainty, i.e. cultural, economic and institutional distance do, however, show statistical significance to some extent. Economic distance shows a statistically significant result, but does not support the hypothesis with regard to environmental uncertainty, owing to the negative coefficient. All of the distances described in this thesis should have a positive effect on the choice of indirect franchising, because when those distances are great, more control should be granted to the local franchisee.

Therefore, the results of the international study represented in this thesis do not support the assumption that high transaction costs owing to environmental uncertainty increase the propensity of the franchisor to use lower control entry modes.

It can be stated that the significant result for economic distance suggests that environmental uncertainty partially explains the choice of governance mode of the franchisor but contrary to the assumed effect. For this reason, it is suggested that a high economic distance has a negative effect on the choice of indirect franchising as an international market entry mode and therefore favors the choice of direct franchising.

Also the research findings for the hypothesis with regard to the transaction-specific investments of the franchisor are quite conflicting. They show statistical significance but a positive correlation coefficient although it is assumed that the higher the transaction-specific investments of the franchisor relative to the franchisee's investments, the higher should be the propensity to use higher control entry modes. The relationship should therefore be negative as the franchisor is assumed to choose indirect franchising when his transaction-specific investments in comparison with those of the franchisee are low. The empirical result predicts a significance of the transaction-specific investments of the franchisor on the choice of indirect franchising but a positive one. This means that the franchisor is going to choose indirect franchising if his transaction-specific investments are high. In which case he was supposed to choose high control modes, i.e. direct franchising.

If however the transaction-specific investments of the franchisor are high, in comparison to those of the franchisee, the franchisor has a higher risk to lose the investment when the franchise relationship is terminated, or when the franchisee behaves opportunistically, as he has to bear the cost of free-riding or shirking to a greater extent. Also the self-enforcement range of the contract is reduced when the transaction-specific investment of the franchisee are low in relation to those of the franchisor. All of this should be in favor of a direct-franchising entry mode when the transaction-specific investments of the franchisor are high and to an indirect franchising entry mode when those investments are low. Therefore the hypothesis with regard to the transaction-specificity of the investments of the franchisor cannot be supported.

The results with regard to the transaction-specific investments of the franchisee do not support the respective hypotheses. This states that high transaction-specific investments of the franchisee in relation to those of the franchisor increase the propensity to use lower control entry modes. The independent variable PTSI has a non-significant and positive regression coefficient. High transaction-specific investments of the franchisee have a positive effect on the use of indirect franchising, i.e. a low control level. This is in line with previous research findings of for instance Williamson (1985), Klein (1996) or Windsperger (1994). It was stated that a great extent of transaction-specificity on both parts leads to mutual dependence between parties and a self-enforcement effect of contracts as the benefits that can be obtained through opportunistic behavior decrease.

Although the empirical results for the transaction-specific investments of the franchise partner predict a positive relationship on the choice of indirect franchising, there is no statistical significance of this finding. Therefore the respective hypothesis cannot be supported. The research findings of the study with regard to Transaction Cost Theory can only explain to a limited extent the choice of governance structure of international franchise firms. Cultural and institutional, as well as transaction-specific investments of the franchisee do not have a significant effect on the choice of indirect franchising. Because of this non-significance neither institutional and cultural distances, nor the transaction-specific investments of the franchisee explain the choice of governance mode of international franchising firms with regard to this particular study.

Economic distance and the transaction-specific investments of the franchisor do have a significant effect, but one which is contrary to what was assumed throughout the thesis. The findings reveal the negative effect of economic distance and a positive effect of the franchisor transaction-specific investments on the choice of indirect franchising. In conclusion, according to the findings of this international study, it can be said that a great economic distance increases the propensity to use direct franchising, which means that higher control levels are to be expected. Also because the franchisor's high transaction-specific investments favor indirect franchising, the control levels are lower. These results do not support the hypotheses presented in these thesis as the findings are contradictory. Also the literature review throughout the theoretical part is based on different assumptions and results.

6. Conclusion

The main objective of this thesis was to investigate the presumed effects of Agency Theory and Transaction Cost Theory on the choice of governance modes of the international franchise firm. It was questioned, how Agency Theory and Transaction Cost Theory affect the choice of governance mode chosen by international franchising firms and which of the two theories provided the best explanation for this choice and which had only modest effects. On the basis of the empirical results of the international study that was carried out in eight countries, the research questions which were presented in the beginning of this thesis could be answered, if only partially.

When entering a foreign market, a franchisor can choose among four major franchising strategies that vary from full control to low control. These are wholly-owned subsidiaries, joint venture franchising, area development franchising and master franchising as defined by Konigsberg (2008). These can be classified as direct and as indirect franchising. Direct franchising is when the franchisor provides services directly to the franchisees located in the host country. Indirect franchising is an agreement between an intermediary which is located in the host market and the international franchisee. This intermediary is referred to as a master franchisee or sub-franchisor who operates as the franchisor in the host market. As, within an indirect franchising agreement, the master franchisee is granted a considerably high degree of freedom with regard to foreign operations, such an agreement indicates a very low level of control. Direct franchising is characterized by higher control levels in which the franchisor chooses between wholly-owned subsidiaries (i.e. the highest level of control), joint-venture or area development franchising. For this reason, the effects of Agency Theory and Transaction Cost Theory on the choice of indirect franchising, which implies low control levels, was chosen. On the basis of these results also conclusions can be drawn as to the choice of direct franchising, which implies higher levels of control.

Four hypotheses were derived on the basis of previous research with regard to Agency Theory and Transaction Cost Theory. These were tested by means of a binary logistic regression analysis. The data were acquired in the process of an international study of international franchise systems located in Europe and the U.S.

The results contribute to a better understanding of how Agency Theory and Transaction Costs Theory influence the governance structure of international franchising firms, as only one hypothesis could be supported, and all of the others had to be rejected, on account of the contradictory results, and/or the lack of significant values.

It can be concluded that, with regard to the results of data analysis, Agency Theory provides a satisfactory explanation of the choice of governance structure of the international franchise firm. It has a significant positive effect on the choice of indirect franchising. Owing to this fact, it can be stated that the hypothesis H1, i.e. the higher the monitoring costs owing to behavioral uncertainty, the higher the franchisor's propensity to use lower control entry modes can be supported. Therefore, when monitoring costs are low, which leads to a lower behavioral uncertainty, higher control entry modes are going to be preferred. Transaction Cost Theory provides no reasonable explanation for the choice of the governance structure of international franchise firms, as most of the results, as described in the previous section, were not significant or, as in the case of economic distance and the transaction-specific investments of the franchisor, brought about significant but contradictory findings. The hypotheses with regard to Transaction Cost Theory had to be rejected, which is why the results based on the international study, did not confirm the assumed effects of Transaction Cost Theory on the choice of governance structure. For these reasons, it can be stated that Agency Theory has a significant positive effect on the governance structure choice and Transaction Cost Theory did not bring about the supposed results and has therefore only modest effects.

The result for Agency Theory led to a better understanding of the choice of low control entry modes when monitoring becomes difficult and the free-riding problem, as well as agency problems arise. Surprisingly the transaction-specific investments of the franchise partner had no significant effect on the choice of indirect franchising. This contradicts the findings of a number of researchers for instance Klein (1980 and 1995), Williamson (1985) or Lafontaine and Raynaud (2002) who predicted a negative correlation of high transaction-specific investments of the franchisee with the tendency to vertically integrate operations. Also owing to the "hostage-effect" of investments specific to the franchise relation, opportunism on the part of the franchisor should also be reduced, which should lead to a lower extent of vertical integration. However, also the results for the franchisor's transaction-specific investments do not support these previous research findings.

What is more, as Chang and Rosenzweig (2001) found, there is a preference for low control entry modes when a market has a high level of competition. This can be referred to as economic distance, but the results of this study yielded to the opposite effects. Cultural and institutional distances had no significant effect on the choice of indirect franchising. This is opposed to Fladmoe-Lindquist and Jacque (1995), who found that in culturally very different countries the responsibility for cultural adjustment can be transferred to the local partners.

In conclusion it can be said that, on the basis of the data evaluation of the international study, it was possible to obtain a deeper insight into the choice of the governance structure of international franchise firms. In particular, the results of behavioral uncertainty help to explain the governance choice and, concerning this matter, also the control level of international franchise firms. Unfortunately, the results based on the Transaction Cost Theory were not very satisfactory as they were not significant and the findings were contradictory.

7. Possibilities for Future Research

This thesis makes a contribution to the existing franchising and management literature, because it provides an agency explanation for the choice of the governance structure of the international franchise firm. International franchise systems operating in different industries in eight countries were observed. The focus was especially on the franchisor's propensity with regard to the choice of governance structure mode. Also the data was collected only from franchisors. For future research, it could be of great value to collect data from franchisees as this could contribute to a more extended understanding of the two theories on the choice of governance structure, and especially with regard to the transaction-specific investments of the franchisee, besides incentive issues in connection with the control levels and modes.

A more comprehensive data evaluation could be performed, in which also other theories, for instance property rights theory or organizational capabilities theory, that are assumed to have important effects on the choice of the governance structure of the international franchising firm too, could be involved. Owing to the fact, that the response rate was quite low, data of all countries had to be evaluated together. An analysis specifically for each individual country would most probably reveal some interesting differences in the choice of governance structure, because also the cultural factors and country-specific conditions could be evaluated and compared. It would be of interest to see if there are significant differences in the choice of governance mode between culturally very diverse countries for instance the USA and Asian countries, or from other continents.

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9. Appendix

9.1. Abstract

English:

In this thesis, it was examined how Agency Theory and Transaction Cost Theory determine the choice of governance structure of international franchising firms. The empirical investigation was based on data from international franchising companies whose respective headquarters are located in eight countries, i.e. in the USA and in Europe. Binary logistic regression was used to obtain the empirical results. The different governance structure modes were summarized under direct franchising as opposed to indirect franchising. Indirect franchising (i.e. master franchising) is characterized by low control levels, whereas direct franchising (i.e. wholly-owned subsidiaries, joint-venture franchising, single-unit and multi-unit franchising) is characterized by higher control levels. The empirical results support only the hypothesis for Agency Theory and bring about contradictory findings for Transaction Cost Theory. In conclusion, high monitoring costs owing to behavioral uncertainty increase the use of indirect franchising. The hypotheses with regard to Transaction Cost Theory could not be supported as the results are contradictory and in part not significant.

German:

Die vorliegende Masterarbeit hat die Auswirkungen der Prinzipal-Agent-Theorie, sowie der Transaktionskostentheorie auf die Wahl der Organisationsstruktur von internationalen Franchise-Unternehmen untersucht. Die empirische Untersuchung basiert auf den Daten von internationalen Franchise-Unternehmen, die ihren Hauptsitz in acht Ländern, i.e. in den USA und in Europa, haben. Die binäre logistische Regression wurde als Auswertungsinstrument gewählt. Es wurden die Effekte der Theorien auf die Wahl von direktem im Vergleich zu indirektem Franchising untersucht. Indirektes Franchising (i.e. Master Franchising) impliziert niedrige Kontrolle wobei direktes Franchising (i.e. Tochterunternehmen, Joint-Venture-Franchising, Einheits-Franchising und Mehreinheit-Franchising) hohe Kontrolle impliziert. Die empirischen Ergebnisse belegen nur die Hypothese in Bezug auf die Prinzipal-Agent-Theorie und liefern konträre Schlüsse für die Transaktionskostentheorie. Hohe Überwachungskosten auf Grund von Verhaltensunsicherheit erhöhen die Anwendung von

indirektem Franchising. Die Hypothesen in Bezug auf die Transaktionskostentheorie konnten nicht belegt werden, weil die Ergebnisse konträr und zum Teil nicht signifikant waren.

9.2. Questionnaire



Vienna, 16th March 2015

Faculty of Business, Economics and Statistics

Department of Management

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[Dr. Maria Jell-Ojobor, maria.jell-ojobor@univie.ac.at](mailto:maria.jell-ojobor@univie.ac.at)

Scientific Study on International Franchising

Dear Franchisor,

The Department of Management at the University of Vienna is conducting a research project on INTERNATIONAL FRANCHISING. The goal of our study is to investigate the **CHOICE OF ORGANIZATIONAL MODE** of international franchise companies.

International franchise systems utilize different modes of expansion into foreign markets, such as a WHOLLY-OWNED SUBSIDIARY, SINGLE-UNIT FRANCHISING, MULTI-UNIT FRANCHISING, MASTER FRANCHISING and JOINT VENTURE FRANCHISING.

Our findings will provide new insights on the factors that determine the internationalization strategies of franchise systems headquartered in the USA, UK, SPAIN, ITALY, FRANCE, NETHERLANDS, GERMANY, and AUSTRIA.

The successful implementation of the survey requires continued close cooperation between the corporate industry and science. Achieving the proposed objective of the survey can only be successful if a large number of franchisors fills the questionnaire from which the outcomes and relevant information gathered would become useful to both the corporate community and researchers in the academia.

Our target is to have all questions answered. Kindly find the best possible answer from the set of options available therein.

For any problems in completing the questionnaire, please contact us personally at your disposal through the following contact details:

Josef Windsperger - josef.windsperger@univie.ac.at, Tel: 00431427738180,

Maria Jell-Ojobor - maria.jell-ojobor@univie.ac.at, Tel: 00431427738158.

You find the questionnaire also at the following link:

http://im.univie.ac.at/windsperger/news/?no_cache=1.

You may also fill the questionnaire online following this link:

www.soscisurvey.de/InternationalFranchising/?l=eng

We apologize for receiving this questionnaire should you have already participated in the survey.

We will gladly share the outcome of this study with you in a scientific **Report on International Franchising**. *The information will be used exclusively for research purposes, and the contact details are treated strictly confidential and will not be disclosed to third parties.*

We thank you for your cooperation.

Sincerely yours,

In which country is your franchise system head-quartered?

☐ USA
 ☐ UK
 ☐ Germany
 ☐ Austria
 ☐ France
 ☐ Netherlands
 ☐ Italy
 ☐ Spain

Which industry does your business belong to?

☐ Distribution
 ☐ Service
 ☐ Production

Which type of business do you offer?

e.g. Advertising & promotion, business services, automotive, food & restaurants, etc.

Type of business

Please answer the following questions about your franchise system.

YEAR when your franchise system was founded

Number of company-owned outlets in the HOME COUNTRY

Number of franchise outlets in the HOME COUNTRY

Number of franchisees in the HOME COUNTRY

Do you have international franchise operations?

☐ yes
 ☐ no
 → If NO, please continue with the LAST PART of the questionnaire on page 8.

↓
 If YES, please continue with the questionnaire.

Please answer the following questions about your franchise system.

YEAR when internationalization started

Number of company-owned outlets ABROAD

Number of franchise outlets ABROAD

Which market entry modes did you use when you entered the foreign countries?

Please choose one or more of the following franchising options:

- ☐ We used a WHOLLY-OWNED SUBSIDIARY in the foreign country.
- ☐ We used JOINT VENTURE FRANCHISING in the foreign country.
- ☐ We used SINGLE-UNIT FRANCHISING directly from our home country (...to develop the local franchise network with individual foreign partners = one franchisee with one outlet).
- ☐ We used MULTI-UNIT FRANCHISING directly from our home country (...to develop the local franchise network with foreign partners who own more than one outlet = one franchisee with more outlets).
- ☐ We used MASTER FRANCHISING in the foreign country (= Sub-Franchising).

Please specify the number of countries where you use a particular market entry mode.

Number of countries where you use ...

... a WHOLLY-OWNED SUBSIDIARY	
... JOINT VENTURE FRANCHISING	
... SINGLE-UNIT FRANCHISING	
... MULTI-UNIT FRANCHISING	
... MASTER FRANCHISING	

Please specify in which regions you used a particular market entry mode.

Please choose one or more regions.

	Wholly-owned subsidiary	Joint venture franchising	Single-unit franchising	Multi-unit franchising	Master franchising
Africa	☐	☐	☐	☐	☐
Asia	☐	☐	☐	☐	☐
Oceania	☐	☐	☐	☐	☐
North / Central America	☐	☐	☐	☐	☐
South America	☐	☐	☐	☐	☐
The Carribean	☐	☐	☐	☐	☐
Eastern Europe	☐	☐	☐	☐	☐
European Union	☐	☐	☐	☐	☐
Middle East	☐	☐	☐	☐	☐

Key question of the survey:

Please choose your **DOMINANT** (i.e. most used) **FRANCHISE MODE** to enter foreign countries.

- ☐ Wholly-owned subsidiary
 ☐ Single-unit franchising
 ☐ Master franchising
 ☐ Joint Venture franchising
 ☐ Multi-unit franchising



Please answer the following questions for the foreign markets where you use the **DOMINANT MODE**.

Please assess the following environmental conditions faced in the foreign countries (where you use your **DOMINANT MODE**).

	strongly disagree	1	2	3	4	5	6	strongly agree
Cultural differences between our home and the foreign countries are high such as norms, values and habits.	☐	☐	☐	☐	☐	☐	☐	☐
The business practices in our home and the foreign countries are quite different.	☐	☐	☐	☐	☐	☐	☐	☐
The language barriers between our home and the foreign countries are high.	☐	☐	☐	☐	☐	☐	☐	☐
The legal protection of intellectual properties such as patents and trademarks is weak in the foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
The political environment is quite uncertain in the foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
The risk of ownership restrictions is high in foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
The quality of local infrastructure, such as phones, roads and IT, is under-developed in foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
Customer demand is strongly changing in foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
Sales forecasts are not easily predictable in foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
Market shares are pretty unstable in foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
The number of existing and potential competitors is high in foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐



Please answer the following questions for the foreign markets where you use the DOMINANT MODE.

Please evaluate the monitoring in the foreign countries (where you use your DOMINANT MODE).

It is difficult to ...	strongly disagree strongly agree						
	1	2	3	4	5	6	7
... evaluate the qualification of foreign partners.	☐	☐	☐	☐	☐	☐	☐
... monitor the franchise product/service quality in foreign countries.	☐	☐	☐	☐	☐	☐	☐
... monitor the misuse of proprietary knowledge by foreign partners.	☐	☐	☐	☐	☐	☐	☐
... assess the performance of foreign partners.	☐	☐	☐	☐	☐	☐	☐

Please evaluate the control in the foreign countries (where you use your DOMINANT MODE).

	strongly disagree strongly agree						
	1	2	3	4	5	6	7
We closely monitor the extent to which the foreign partners follow established procedures.	☐	☐	☐	☐	☐	☐	☐
We regularly monitor the quality control maintained by our foreign partners.	☐	☐	☐	☐	☐	☐	☐
We frequently monitor the marketing activities performed by our foreign partners.	☐	☐	☐	☐	☐	☐	☐
We have developed specific procedures for our foreign partners to follow.	☐	☐	☐	☐	☐	☐	☐
The extent of territorial coverage that our foreign partners needs to attain for our products and services is clearly specified in the contract.	☐	☐	☐	☐	☐	☐	☐
The franchise contract specifies sales targets for our foreign partners.	☐	☐	☐	☐	☐	☐	☐
The terms of our agreement require our foreign partners to attain a certain market share for our products and services.	☐	☐	☐	☐	☐	☐	☐
Our future relationship with our foreign partners is contingent on how they achieve the specified goals.	☐	☐	☐	☐	☐	☐	☐



Please answer the following questions for the foreign markets where you use the DOMINANT MODE.

Please comment on the adaptation of your franchise business format in foreign countries (where you use your DOMINANT MODE).

Local adaptation of ...	not at all 1	2	3	4	5	6	to a very large extent 7
... franchise products / services (such as product mix and service offerings)	☐	☐	☐	☐	☐	☐	☐
... brand identity	☐	☐	☐	☐	☐	☐	☐
... operational strategies (such as training of employees and service quality control)	☐	☐	☐	☐	☐	☐	☐
... managerial strategies (such as operation manuals, pricing and marketing)	☐	☐	☐	☐	☐	☐	☐

Please evaluate the headquarters' resource commitments in the foreign countries (where you use your DOMINANT MODE).

Our Headquarters has ...	strongly disagree 1	2	3	4	5	6	strongly agree 7
... invested heavily in personnel dedicated to our foreign partners.	☐	☐	☐	☐	☐	☐	☐
... made significant investments in displays etc. dedicated to our franchise relationships.	☐	☐	☐	☐	☐	☐	☐
... developed very specialized procedures and systems for our foreign partners to follow.	☐	☐	☐	☐	☐	☐	☐
... involved considerable commitment of time and money in training and qualifying our foreign partners.	☐	☐	☐	☐	☐	☐	☐

Please evaluate the resource commitments of your foreign partners (of your DOMINANT MODE).

Our foreign partners ...	strongly disagree 1	2	3	4	5	6	strongly agree 7
... have made significant investments in tools, equipment and procedures dedicated to the franchise relationship.	☐	☐	☐	☐	☐	☐	☐
... have committed substantial time and money in employees' (or sub-franchisees') training of the franchise-specific techniques.	☐	☐	☐	☐	☐	☐	☐
... would lose a lot of their investment made to develop the local franchise network, if they decided to stop working with us.	☐	☐	☐	☐	☐	☐	☐



Please answer the following questions for the foreign markets where you use the DOMINANT MODE.

Please comment on the decision rights of your foreign partners (of your DOMINANT MODE).

Our foreign partners decide over ...	not at all	1	2	3	4	5	6	to a very large extent	7
... the development of new products and processes.	☐	☐	☐	☐	☐	☐	☐	☐	☐
... accounting and control systems.	☐	☐	☐	☐	☐	☐	☐	☐	☐
... HR practices (e.g. recruitment and training).	☐	☐	☐	☐	☐	☐	☐	☐	☐
... marketing and promotion strategies.	☐	☐	☐	☐	☐	☐	☐	☐	☐
... procurement strategies.	☐	☐	☐	☐	☐	☐	☐	☐	☐
... pricing at the local market.	☐	☐	☐	☐	☐	☐	☐	☐	☐
... financial investment strategies at the local market.	☐	☐	☐	☐	☐	☐	☐	☐	☐

How important are the following factors for the competitive advantage of the franchise network?

The Headquarters' ...	unimportant	1	2	3	4	5	6	very important	7
... management competence (like operating policies and procedures and HR management)	☐	☐	☐	☐	☐	☐	☐	☐	☐
... organizational capabilities (like cultural management and information management)	☐	☐	☐	☐	☐	☐	☐	☐	☐
... customer competence (like marketing / advertising / promotion, pricing)	☐	☐	☐	☐	☐	☐	☐	☐	☐
... foreign market competence (like setting up foreign operations, knowledge of foreign markets)	☐	☐	☐	☐	☐	☐	☐	☐	☐
... innovation capabilities (like product and organizational innovations)	☐	☐	☐	☐	☐	☐	☐	☐	☐
... product and service competence (like product/service quality and design)	☐	☐	☐	☐	☐	☐	☐	☐	☐



Please answer the following questions for the foreign markets where you use the DOMINANT MODE.

Please assess the know-how transfer between headquarters and the foreign partners (of your DOMINANT MODE).

It is difficult...	strongly disagree	1	2	3	4	5	6	strongly agree
... to write a manual describing our service delivery processes.	☐	☐	☐	☐	☐	☐	☐	☐
... to document critical parts of our franchise business format.	☐	☐	☐	☐	☐	☐	☐	☐
... to understand how to deliver our franchise products/services by studying blueprints.	☐	☐	☐	☐	☐	☐	☐	☐
... to educate and train new personnel or partners.	☐	☐	☐	☐	☐	☐	☐	☐
... for our competitors to assess the success factors/competitive advantage of our franchise business.	☐	☐	☐	☐	☐	☐	☐	☐
... for our headquarters to acquire the local market knowledge needed to operate the franchise network in the foreign countries.	☐	☐	☐	☐	☐	☐	☐	☐
... to transfer the foreign partners' market know-how to our headquarters.	☐	☐	☐	☐	☐	☐	☐	☐

How important are the foreign partner's know-how and resources for operating the franchise network at the local markets (where you use your DOMINANT MODE)?

The foreign partners' ...	unimportant	1	2	3	4	5	6	very important
... local market knowledge	☐	☐	☐	☐	☐	☐	☐	☐
... organizational know-how	☐	☐	☐	☐	☐	☐	☐	☐
... administrative know-how	☐	☐	☐	☐	☐	☐	☐	☐
... human capital resources and management know-how (recruitment)	☐	☐	☐	☐	☐	☐	☐	☐
... quality control know-how	☐	☐	☐	☐	☐	☐	☐	☐
... innovation know-how	☐	☐	☐	☐	☐	☐	☐	☐
... marketing know-how	☐	☐	☐	☐	☐	☐	☐	☐
... financial capital	☐	☐	☐	☐	☐	☐	☐	☐



Please answer the following questions for the foreign markets where you use the DOMINANT MODE.

Please evaluate the accomplishment of performance goals of your franchise company for the LAST THREE YEARS.

	strongly disagree	1	2	3	4	5	6	strongly agree	7
The relationship with our foreign partners is based on mutual trust.	☐	☐	☐	☐	☐	☐	☐	☐	☐
Generally, a foreign partner with whom I have a longer relationship is likely to help me when I need it.	☐	☐	☐	☐	☐	☐	☐	☐	☐
As a franchisor I feel more secure when I work with a foreign partner I know well than with someone I don't know.	☐	☐	☐	☐	☐	☐	☐	☐	☐
The foreign partners I trust are those with whom I have long-lasting relationships.	☐	☐	☐	☐	☐	☐	☐	☐	☐
Most people will respond in kind when they are trusted by others.	☐	☐	☐	☐	☐	☐	☐	☐	☐
Most people are trustworthy.	☐	☐	☐	☐	☐	☐	☐	☐	☐
Most people are trustful of others.	☐	☐	☐	☐	☐	☐	☐	☐	☐
Most people are basically dishonest.	☐	☐	☐	☐	☐	☐	☐	☐	☐
Most people are basically good and kind.	☐	☐	☐	☐	☐	☐	☐	☐	☐
I trust a person I don't know more than one I know well.	☐	☐	☐	☐	☐	☐	☐	☐	☐
I am trustful.	☐	☐	☐	☐	☐	☐	☐	☐	☐

LAST PART OF THE QUESTIONNAIRE!

Please evaluate the accomplishment of performance goals of your franchise company over the LAST THREE YEARS.

	not at all	1	2	3	4	5	6	7	8	9	10	to a very large extent
Sales volume	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Sales growth	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Profitability	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Return on investment	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

Market share	☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐
Marketing and distribution strategy	☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐
Reputation	☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐
Market access	☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐
Customer satisfaction	☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐

Please answer the last questions on your franchise agreement terms.

Initial fee for a single franchise unit in \$	
On-going royalty rate (% of turnover)	
On-going advertising rate (% of turnover)	
Total investment required for opening a franchise outlet in \$	
Term of the franchise agreement in years	
Number of initial training days for a franchisee	
Number of continuous training days per year for a franchisee	
Number of formal visits per year of a franchise unit	
Number of employees at headquarters	
Development fee for a master franchise licence in \$	

Please provide contact details of your franchise company to receive the report of our study (optional).

The information will be used exclusively for research purposes, and the contact details are treated strictly confidential and will not be disclosed to third parties.

Name of Company	
E-mail address	

Thank you for completing this questionnaire!

For inquiries, kindly contact us at:

internationalfranchising@univie.ac.at, University of Vienna – 2014