Entrepreneurial Autonomy, Incentives, and Relational Governance in Franchise Chains

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Abstract

Franchisee autonomy fosters system-wide adaptability and outlet-owners' motivation but also raises the costs from agency problems present in franchisee-franchisor dyads. Advancing upon the understanding of agency issues involved in franchising, we test the argument that chains counterbalance the loss in control inherent to autonomy with relational governance mechanisms. The empirical results provided strong support for this presumption. In addition and most notably, we found that relational governance becomes more important the weaker agents' incentives are aligned with the interests of the entire network. The moderating effects of five franchisee characteristics influencing goal congruencies were considered: multi-unit ownership, age of the relationship, geographic distance, economic success, and the level of perceived intra-chain competition. Implications for chain management are provided.

1 Introduction

Franchising is an attractive organizational form to pursue growth strategies (Shane, 1996). It does not only permit realizing economies of scale through system-wide standardization in various functional areas such as marketing, purchasing, and product development, but relative to company operations, franchising additionally allows profiting from the expertise of independent entrepreneurs to continuously adapt to local markets (Bradach, 1997; Sorenson and Sørensen, 2001). For their specific knowledge to be leveraged and local market adaptation to

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occur, franchisees should be granted autonomy in various operational aspects of the business.

Leeway for independent action is furthermore important to the prospect of the whole chain since it upholds franchisees' satisfaction in the relationship and hence their motivation to deliver performance (Schul, Little, and Pride, 1985; Dant and Gundlach, 1999). That is, franchisees often choose the franchise option in order to become their own boss and to run a business according to own decisions while profiting from a proven business concept (Peterson and Dant, 1990; Elango and Fried, 1997). Placing too narrow restraints on outlets' operations increases the risk of disappointing hopes for entrepreneurial behavior.

Notwithstanding the above benefits, increasing levels of autonomy equally raise the potential costs from agency problems present in any franchisee-franchisor dyad (for example, Pizanti and Lerner, 2003). In consequence, autonomous decision-making by downstream stores may or may not lead to increased performance from the franchisor's perspective. Success eventually hinges on chains' ability to counterbalance the loss in control inherent to autonomy with mechanisms that achieve goal congruence between the exchange partners. Only under conditions of common economic interests between the parties can the full economic potential of decentralized dyadic decision-making be realized.

A growing body of literature analyzes the importance of social interactions in the governance of channel structures. In particular, the functionality of trust and relational norms – or more generally, the role of relational governance – in coordinating vertical relationships has been subject to scholarly attention (Palay, 1984; Kaufmann and Stern, 1988; Noordewier, John, and Nevin, 1990; Poppo and Zenger, 2002). In this paper, we empirically explore the reliance on relational governance as a control mode to attenuate the agency problems resulting from franchisee autonomy. Most notably, we hypothesize that relational governance becomes more important to accompany autonomy the weaker franchisees' structural incentives are aligned with the franchisor. Hence, individual franchisee-franchisor dyads from different networks are the units of analysis. We focus on the moderating role of five franchisee characteristics which have previously been proposed to affect agency issues in the dyad: (1) multi-unit ownership, (2) age of the franchisee-franchisor relationship, (3) geographic distance between the outlet and the company's head office, (4) franchisees' past economic success, and (5) the level of perceived intra-chain competition.

Our study contributes to the literature in the following ways. First, although past work has investigated appropriate functional areas for independent action by franchisees (Kaufmann and Eroglu, 1999), little is known about the governance of behavior within these limits. Relative to Kaufmann and Eroglu's conceptual study and earlier empirical literature which has been concerned with the question of 'who makes decisions' in chains (Arruñada, Garicano, and Vázquez, 2001; Windsperger, 2004), this paper shifts the research focus to the question of 'how to assure that decision rights are not abused'. Our interest therefore is to investigate empirically how companies assure that franchisees use their autonomy in Pareto-

improving ways such that it leads to better performance at the outlet while having a non-negative impact on the viability of the system.

Second, by incorporating franchisee characteristics such as single- vs. multi-unit ownership in the analysis, this study extends and corroborates earlier research which found incentive effects of these characteristics to be important for channel management (for example, Dant and Nasr, 1998). From a practical point of view, asking how a chain can achieve cooperation with outlet owners of differing expectations and orientations is crucial (Grünhagen and Mittelstaedt, 2005). By focusing on the specific characteristics of each outlet, we advance the theoretical understanding of agency issues in franchising. This knowledge might also provide conceptual guidance to managers in the field when structuring decision rights and control mechanisms.

The paper is organized as follows. First, we define autonomy, elaborate on its various structural sources and discuss the agency issues related to it. Second, the construct of relational governance is introduced and hypotheses about the main and moderated relationships between autonomy and relational governance are derived. Third, an empirical test of our hypotheses is reported. Fourth, we discuss our findings and provide implications for practitioners. We conclude in the last section.

2 Franchisee Autonomy

2.1 Definition and Structural Sources of Autonomy

Autonomy can be conceived of as the extent to which a party, here a franchisee, is unconstrained to independently make decisions (Feldstead, 1991; Strutton, Pelton, and Lumpkin, 1995; Dant and Gundlach, 1999). Independence pertains to the practical fulfilment of a task as far as its content is concerned; more precisely, it relates to the search for different solutions, to the choice of one feasible alternative and to subsequent actions. Autonomy entails leeway not only on how but also as to which task is performed – for example, the latitude of franchised outlets to select a new project (Lewin-Salomons, 1998). Thus, we refer to autonomy as the scope for 'entrepreneurial freedom' franchisees possess to operate affiliated units according to own decisions.

Basically, four structural sources of entrepreneurial autonomy can be identified: (1) the allocation of contractual rights, (2) contractual incompleteness, (3) control costs as well as limited monitoring capacities, and (4) direct acceptance of deviant franchisee behavior by the franchisor. Since formal, legal documents such as contracts and operating handbooks are most often uncustomized within a network, the first two factors above cannot explain differences in autonomy across individual franchisee-entrepreneurs of a same system – which is the focus of this paper. Yet, since control costs may differ among units (Lafontaine and Slade, 1997), differen-

tial scopes for decentralized operations within any chain can emerge. Outlets which are more costly to monitor should then experience higher levels of autonomy compared to stores which are less expensive to monitor and therefore controlled intensely. The degree of autonomy across a focal network's franchisees can as well fall apart for the company could accept deviations from contractually regulated business procedures if beneficial outcomes for the whole channel are expected. Conversely, due to power asymmetries between the principal and the agents, chains can enforce certain restrictions at (potentially opportunistic) stores even if these constraints are not formally incorporated in the contract or the handbooks. Lewin-Salomons (1998) argued and provided some anecdotal evidence that this kind of informal allocation of decision rights is a central source of franchisees' operational realm. Thus, "in a single franchising chain the level of control and autonomy exercised may differ from one franchisee to the next" (Pizanti and Lerner, 2003, p. 138).

2.2 Agency Issues Related to Autonomy

Agency theory is concerned with the resolution of trading hazards inherent to "a contract under which one or more persons (principals) engage another person (the agent) to perform some service on their behalf" (Jensen and Meckling, 1976, p. 308). In distribution, the organizational form of franchising circumvents an important agency problem which would arise between a system's head office and an employee managing an outlet (Rubin, 1978). In particular, franchisees' residual claim on the profits of their unit (net of royalty payments) induces greater effort than is provided by a company employee who receives mainly a fixed salary and who therefore seeks to minimize his costs of effort. Notwithstanding, residual claims create another goal conflict, namely incentives to free-ride on the chain's brand name (Lafontaine and Raynaud, 2002). Examples of free-riding include underinvestment in advertising, failure to comply with production standards, and insufficient supervision of staff. Franchisees cheating on investments in the brand name by lowering the quality of output reduce their costs and thereby augment profits since they are unlikely to loose (short-term) sales if other units follow through with obligations. The reason is that consumers credit the goodwill they attach to the trade name even to stores which fail to deliver promised quality. Michael (2000) provided empirical evidence that the horizontal externality problem related to a shared trademark combined with the residual claim status of franchisees have a negative impact on overall system quality. He reported that the quality experienced by consumers was negatively related to the incidence of franchising within any network. The extent of autonomy allocated to franchised dealers determines the potential costs resulting from the goal conflicts described above (see, generally, Jensen and Meckling, 1992) since decentralized decisions involve a control loss for the franchisor. In the following, we describe how relational

forms of governance curb agency conflicts by aligning the economic interests of the dyadic partners.

3 Hypotheses

3.1 Controlling Franchisees: Relational Forms of Governance

We define relational forms of governance, also referred to as informal institutions (North, 1990), as norms of behavior and unwritten codes of conduct which safeguard exchanges against potential conflicts. Norms, in turn, are defined as expectations of behavior shared by dyadic partners (Heide and John, 1992). They emerge from the social embeddedness of a contractual relationship (Macneil, 1980; Granovetter, 1985; Ring and Van de Ven, 1994; Jones, Hesterley, and Borgati, 1997) and/or are conditioned by the prospect of realizing a higher transaction value in the future than would be possible without such norms (Baker, Gibbons, and Murphy, 2002). While formal governance arrangements such as explicit contract terms are in general discrete (that is, they either exist or are absent), relational forms of governance are continuous since they differ in degree rather than in kind (Zenger, Lazzarini, and Poppo, 2001). An intensification of the specific norms considered below conforms to more pronounced relational content in a business liaison (Macneil, 1980). The major reason why relational governance is suitable to control the behavior of dispersed franchisees is that control in the day-to-day operations is guaranteed by means of persuasion – not authority (that is contracts). Bradach (1997, p. 288) cited one franchise consultant – franchisor personnel charged with managing the contact to outlets – who described that "relationships are crucial and when they deteriorate it becomes extremely frustrating to try to get the company's goals across".

Most studies on relational governance in distribution channels have drawn from the atmospheric dimensions initially proposed by Macneil (1980), though none considered all of the elements simultaneously (see, for a review, Ivens and Blois, 2004). Concerns about the consequences of incompleteness in the consideration of codes of conduct can be partially accommodated. Noordewier, John, and Nevin (1990, p. 84) noted that individual norms tend to be highly related to one another and might thus be part of a "single higher order" relational syndrome. Our relational governance conceptualization contains elements alluding to the following norms: (1) the harmonization of conflict norm, defined as the extent to which a franchisee and a franchisor find mutually satisfying, non-opportunistic solutions to conflicts (Macneil, 1980; Mohr and Spekman, 1994; Brown, Dev, and Lee, 2000); (2) the intensity of cooperation, referring to the extent to which exchange parties carry out their respective tasks in a coordinated and cooperative way, thereby acknowledging that outcomes from joint effort exceed those achievable through

self-interest seeking and opportunism (Anderson and Narus, 1990; Heide and John, 1990; Lambe, Spekman, and Hunt, 2000); and (3) the prevalence of trust also acting as a mechanism against the risk of opportunistic action (Bradach and Eccles, 1989; Granovetter, 1985; Bromiley and Cummings, 1995; Zaheer and Venkatraman, 1995; Zaheer, McEvily, and Perrone, 1998). The construct of relational governance encompasses these three aspects.

The observation that theoretically derived predictions about opportunistic action in franchising translate into empirical facts (for example, Michael, 2000) suggests that relational norms (but also formal controls) cannot perfectly enforce cooperative behavior. Nevertheless, the above cited studies also indicate that relational norms do define acceptable limits to behavior, taking the preservation of the relationship as a constraint, and thus constitute a partial safeguard against the exploitive abuse of decision rights (see, also, Heide and John, 1992; Gundlach, Achrol, and Mentzer, 1995). We therefore argue that in a cross-section of franchisees within chains, relational governance becomes more intense where stores possess more autonomy and thus more room for opportunistic behavior. Formally:

> H1: The extent of franchisee entrepreneurial autonomy is positively related to the intensity of relational governance in any dyad.

3.2 The Moderating Role of Franchisee Incentive Characteristics

Thus far, we implicitly assumed that franchise networks accompany autonomous decision-making at the outlets with equal relational governance intensity irrespectively of franchisees' incentives to engage in opportunistic behavior. However, past research revealed idiosyncratic incentive characteristics across stores of a same chain (Gal-Or, 1995; Lafontaine and Slade, 1997). In addition, we ignored any costs being brought about by relational control. Yet, the setup of dense ties with focal partners consumes time and resources (Larson, 1992; Heide, 1994; Ring and Van de Ven, 1994; Poppo and Zenger, 2002). It is a planned activity and may not only include costs of trust building but also those of failing to reach minimal levels of trust (Das and Teng, 1998). Thus, investments necessary to shape exchange norms constitute sunk certification costs (Mills and Ungson, 2003) to be borne primarily by the systems' headquarters. As a consequence, franchisors should commit resources to the development of intense linkages only in the presence of significant incentives of franchisees to deviate from the company's interests. In sum, franchisees with incentive structures more closely aligned to those of the company should be awarded entrepreneurial autonomy with less counterbalancing through relational forms of governance. Formally:

> H2: The degree of structural incentive congruence in a dyad will moderate the relationship between the extent of franchisee auton-

omy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be less strong the closer franchisees' incentives are aligned with the franchisor.

In the following, five incentive characteristics are considered with regard to their impact on the link between autonomy and relational governance: multi-unit ownership, age of the franchisee-franchisor relationship, geographic distance between a franchisee's outlet and the chain's head office, past franchisee success, and the level of intra-brand competition faced by a unit.

3.2.1 Multi-Unit Ownership

Multi-unit ownership describes a situation where one franchisee owns, operates or controls more than one outlet (Kaufmann and Dant, 1996). While some multi-unit franchisees start a single unit in the beginning and acquire the rights to operate additional outlets over time, referred to as sequential expansion, others are entitled to run multiple units from the outset, referred to as master franchising (Kaufmann and Kim, 1995).

Empirical evidence suggests that franchise companies must not worry about opportunistic abuses of autonomy by multi-unit agents (Dant and Gundlach, 1999). This is because the interests of multi-unit owners are closely aligned with those of the entire network. Most notably, incentives to free-ride on the common brand name are weakly pronounced, even in nonrepeat customer industries (Dant and Nasr, 1998). By cheating on quality, multi-unit partners would jeopardize their own sales to a greater extent than would their single-unit counterparts. In other words, multi-unit ownership internalizes a large fraction of specific investments in the trade name. Furthermore, due to higher stakes in question, head offices are less likely to terminate or non-renew contracts of multi-unit than those of single-unit franchisees. Therefore, the former should project their channel membership farther into the future than the latter. Consequently, foregoing investments in quality would impair future sales of franchisees owning multiple units to a relatively large degree (Dant and Nasr, 1998).

Dant and Gundlach (1999, p. 45) summarized the argument as follows: when allocated decision-making authority, multi-unit franchisees "are not likely to exploit such opportunities to deviate from the prescribed procedures because they can directly appreciate the rationale for discipline and standardization within a franchising context from the franchisor's perspective". Anticipating this incentive structure, the marginal benefits from investments in relational quality with multi-unit owners should be smaller for every given level of autonomy compared to the benefits derived from investments in good dealings with single-unit operators.

H2a: The number of outlets owned by a franchisee will moderate the relationship between the extent of autonomy and relational gov-

ernance intensity: specifically, the positive relationship between autonomy and relational governance will be less strong among multi-unit than among single-unit franchisees.

3.2.2 Age of the Franchisee-Franchisor Relationship

Age of the relationship defines the time period since a franchisee started operating an outlet. Relationship length has been argued to positively influence the expectations on both sides of the dyad about the continuity of the exchange in the future (Dant and Nasr, 1998). Franchisees' incentives to invest in system-specific assets, thereby refraining from free-riding, increase as the future time horizon over which such investments can be amortized extends. Also, potential pecuniary advantages from opportunistic deviation that would accrue in the short-run are more likely to be evened out by the gains from cooperation the longer the discounting period.

From the perspective of the chain, the age of a relationship can also be interpreted as an indicator for past agent behavior, namely whether autonomy has been utilized constructively (see, generally, Eisenhardt, 1989). Franchisors' unilateral discretion about periodical contractual renewal provides a bond to punish opportunism. Thus, the track record of franchised partners which have been part of the system over two or more contractual periods should certify their quality (Dant and Nasr, 1998).

Besides the risk of opportunism, downstream decision-making independence can also damage a system's reputation due to a lack of knowledge about routines and procedures on behalf of inexperienced franchisee-entrepreneurs. In this sense, relational governance can be understood as a communication and cooperation mechanism amenable to assist the outlets as they gain in control over decisions. With the passage of time, the dispersed units acquire proficiency and specific knowledge about operations and assistance should become less important.

The preceding arguments support a negative relationship between relationship length and the need for shared behavioral norms. From the knowledge-based rationale above, however, one can also derive a positive relationship between age of the relationship and the severity of agency issues. Since, over time, franchisees gain in experience regarding specificities of local demand and efficient operating processes, they develop own beliefs about quality and behavioral standards and increasingly challenge the franchisor's authority (Knight, 1986; Baucus, Baucus, and Human, 1996). Their willingness to comply with imposed standards may decrease as a result, augmenting agency conflicts.

In sum, however, we feel that the motivation for franchisors investing less in relational governance at every level of autonomy when relationship length increases are more compelling and we therefore expect the following hypothesis to hold.

H2b: Age of the franchisee-franchisor relationship will moderate the relationship between the extent of autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be less strong among older than among younger dyads.

3.2.3 Geographic Distance

Geographic distance denotes how far an outlet is physically remote from the franchisor's monitoring head office. Distance raises the level of behavioral uncertainty about the agent and widens the information gap in the dyad (Fladmoe-Lindquist, 1996). This is because monitoring is costly. More precisely, the costs of sending a company representative to inspect a unit's operations (for example, cleanliness, product quality) increase in the number of kilometers between the system's head office and the outlet.

Monitoring costs are central to agency theory's prediction about the choice of vertical integration versus franchising. The argument assumes that managers of owned units have weak incentives to perform efficiently since a large fraction of their salary is fixed. Although financial performance of a store can be gauged by the company in each period, performance may not be attributable to either the outlet's manager or to other factors beyond his control, for example the general economic environment. Where behavior-based monitoring is difficult, the franchisor may, in consequence, franchise an outlet. Franchisees have higher incentives to perform since they claim the unit's residual profits. Brickley and Dark (1987) as well as Fladmoe-Lindquist and Jacque (1995) provided empirical evidence in line with the agency theoretic argument that physically removed outlets tend to be franchised whereas those in proximity to headquarters are company-owned. Monitoring costs thus have an important bearing on the organization of distribution channels.

The behavioral uncertainty associated with increased distance should amplify agency problems associated with a shift of decision rights from the franchisor to the outlets. Agrawal and Lal (1995) showed that monitoring costs negatively affect the frequency of inspections by the franchisor and the level of service provided by franchisees. Since behavior-based monitoring is costly, outcome-based controls may be a valuable substitute. However, electronic data transmission is often inadequate to communicate information that accurately reflects the outlet's operations (Fladmoe-Lindquist and Jacque, 1995). In addition, franchisees seldom integrate their information systems with the head office (Bradach, 1997). If relational governance is a mechanism to reduce information asymmetries and behavioral uncertainties, we would expect the relationship between autonomy and relational governance to be stronger for distant franchisees than for those partners located close to the network's head office.

H2c: Geographic distance between a franchised outlet and the franchisor's monitoring head office will moderate the relationship between the extent of autonomy and relational governance intensity: specifically, the positive relationship between autonomy and relational governance will be stronger among distant franchisees than among those located closer to the monitoring head office.

3.2.4 Franchisee Success

Success pertains to franchisees' satisfaction with past economic performance relative to comparison levels (Anderson and Narus, 1990). Drawing from power-dependence theory, Dwyer and Oh (1987) noted that because of their criticality for systems' access to growing markets, franchisee-entrepreneurs operating in munificent environments (that is, those who are generally successful) have power over the extent of control exercised by the principal. Conversely, poor performing outlets are more likely to actively seek centralized franchisor support (Peterson and Dant, 1990). Indeed, empirical evidence indicates that munificence in local markets decreases bureaucratization (that is, formalization and centralization) thereby favoring downstream independent decision-making (Dwyer and Oh, 1987). In a similar vein, it could be argued that networks' dependence on successful franchised stores also increases these agents' bargaining power in case of conflict; bargaining power which franchisees can exploit to their advantage and at the expense of the chain. This line of reasoning would suggest relatively strong requirements for relational exchange norms to accompany autonomy of successful franchisees.

Based on self-enforcement theory (Klein, 1995), we alternatively submit that high levels of satisfaction with past performance reduce the risk of opportunism. Self-enforcement operates by leaving sufficient rents downstream such that the threat of termination of the relationship ensures franchisee compliance. Chains must observe performance at stores through monitoring and subjectively decide whether it conforms to the desired level. Specifically, in order for the implicit contract to be self-enforcing, franchisees' discounted extra gain from opportunistic behavior (before being terminated) must be smaller than the discounted rent stream that accrues from cooperation in the long run.[2] The higher a franchised outlet's economic potential the more important the returns foregone upon termination. At every given level of autonomy, opportunism should then be better controlled the higher a franchisee's performance. Therefore, we expect:

H2d: Franchisee success will moderate the relationship between the extent of autonomy and relational governance intensity: specifically,

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[2] Note that a franchisor can credibly promise the payment of rents to franchisees only if the franchising option is more attractive than using company-owned outlets.

the positive relationship between autonomy and relational govern-
ance will be less strong among franchisees which are more success-
ful than among those which are less successful.

3.2.5 Competition

Intra-chain competition usually becomes more pronounced with continued system
growth. Maturing franchisors seek to extract the full economic potential of already
developed areas by increasing the number and thus geographic proximity of affili-
ated outlets (Stassen and Mittelstaedt, 1995). The clustering of peer outlets ampli-
fies horizontal externalities and fosters franchisees' incentives for free-riding. That
is, multiple stores within the same geographic area reduce a focal franchisee's
market size and thereby the fraction of returns from investments in reputation
which can be internalized. By reducing a franchisee's market size and increasing
price pressures, intra-chain competition also compromises the functioning of the
self-enforcement mechanism (Klein and Murphy, 1988). This mechanism, as
outlined above, relies on the provision of an ongoing rent to franchisees to assure
proper behavior. The level of these rents is, however, reduced by lower market
size and product prices associated with increased competition. In consequence,
realizing short-term gains from cheating becomes more attractive for outlet-
owners. In sum, agency issues are reinforced by intra-chain competition. Accord-
ingly, we expect:

H2e: The level of intra-chain competition perceived by a franchisee
will moderate the relationship between the extent of autonomy and
relational governance intensity: specifically, the positive relation-
ship between autonomy and relational governance will be stronger
among franchisees which perceive higher levels of competition than
among those which perceive lower levels of competition.

4 Empirical Test

4.1 Sample

To test the hypotheses, we used cross-sectional data collected from a sample of
franchisees operating in Germany. The data was gathered through mail surveys
and for purposes of a broader research project on franchisee satisfaction during the
years 1999 to 2003. A self-administered questionnaire (see Table A1) was sent to
the whole population of franchised outlets within each of 11 different business-
format franchise chains participating in the study. Franchisors provided the postal
addresses of their partners to the researchers. Each mailing included the question-

naire, a cover letter describing the purposes of the study and guaranteeing anonymity to participants, as well as a postage-paid reply envelope.

The specific formulation of the Likert-type questionnaire items emerged from a qualitative-explorative pre-study involving franchisors, consultants, and franchisee focus groups. A total of four moderated focus groups gathered 15 franchisees from eight different chains. In the framework of these meetings, participants were given the opportunity to express important facets of the relationship to their franchisors. Balance and trust in the partnership were named central criteria regarding relationship quality.

Table 1. Distribution of franchisees in the sample (across chains and sectors)

System	Sector	Number of franchisees in sample	System-specific response rates (in percent)	% of total number of franchisees across systems in sample
1	Retail: Food	17	24	8.17
2	Business services	5	20	2.40
3	Retail: Home furnishings	3	43	1.44
4	Retail: Pet food	21	32	10.10
5	Retail: Building materials	34	18	16.35
6	Retail: Computer equipment	18	30	8.65
7	Repair	10	19	4.81
8	Retail: Other	13	14	6.25
9	Eating places: Full service	5	19	2.40
10	Retail: Tobacco	13	16	6.25
11	Travel	69	18	33.18

The average chain was 13.87 years old, had 104.12 franchised outlets and an entry fee of about 19.000 €.

In collaboration with the participating chains' management teams, channel members had been informed about the study in advance of the mailings to assure that, following the key informant approach, the owners of the outlets personally answered the questionnaire. Despite collaboration with the systems' head offices in conducting the survey, participation in the study remained voluntary. In order to enhance response rates, subjects were offered a copy of the survey results; no other incentives to participate in the study were provided.

In total, questionnaires were sent to 1050 franchisees. After reminder notices, the survey yielded an overall average (weighted) response rate of 21 percent (system specific response rates lay between 13.68 and 42.85 percent). Our final sample consisted of 208 observations. Table 1 provides a breakdown of the number of sampled units across chains. Based on the detailed classification scheme used by Lafontaine and Shaw (2001), each of the networks operated in a different industry sector. The population our sample draws from is defined as the entirety of franchisees from these sectors in Germany.

We tested for nonresponse biases by comparing the average sampled observation in each system with the average outlet-owner computed from the population of each chain along the dimensions age, gender, number of years in business, and multi-unit ownership. To obtain information on the characteristics of the populations, we contacted officials in the chains. For System 4 (10 percent of cases in our sample, see Table 1), we could not discuss our data with the chain's management because the network has dissolved since the survey was conducted. No evidence of obvious nonresponse biases emerged for the remaining systems.

4.2 Variables

4.2.1 Dependent Variable

Relational governance was operationalized using items alluding to the exchange dimensions identified in the theoretical section: harmonization of conflict, intensity of cooperation, and prevalence of trust (see Table A1 in the appendix for the exact wording). The questions relating to the harmonization of conflict norm (5a-5c) evaluated to which degree dyadic partners engaged in problem solving as opposed to cultivating disputes (see Dant and Schul, 1992). Items 5d to 5f assessed the most important element of cooperative behavior, namely, the extent to which mutual interdependence was appreciated by the channel members in their respective business processes (see Anderson and Narus, 1990). The trust specific items (5g-5i) tapped whether vulnerabilities on both sides were mutually exploited by the other, a central theme of trust research (see Bigley and Pearce, 1998).

The 'syndrome' of relational governance was expected to encompass these partially overlapping norms. Results of a principal component factor analysis (see Table 2) revealed that the three dimensions were indeed part of a higher order construct. All of the items loaded highly on one factor (all factor loadings $\geq$ 0.577), suggesting that they were strongly associated with each other. We built a composite measure by summing and averaging – using equal weights – the scores of the individual items.

Table 2. Factor matrix for relational governance

1 factor extracted (Eigenvalue > 1); Kayser-Meyer-Olkin-criterion: 0.885; Bartlett's test of spherity: $Chi^2 = 826.47$, df = 36, p < 0.001.		
Factor	Eigenvalue	% of var.
1	4.698	52.205
Factor matrix	Relational governance	
5a)	0.652	
5b)	0.765	
5c)	0.785	
5d)	0.804	
5e)	0.696	
5f)	0.635	
5g)	0.808	
5h)	0.752	
5i)	0.577	
Absolute values less than 0.3 were suppressed.		

Reliability of the summated scale was assessed by Cronbach's alpha. The alpha value of 0.87 was well above the lower limit of acceptability, set at 0.60 for newly developed scales (Hair, Anderson, Tatham, and Black, 1998). We also investigated item-to-total as well as inter-item correlations. The results confirmed sufficient reliability of the relational governance construct. Furthermore, we assessed (convergent) scale validity by inspecting the correlation between the summated scale and a single item capturing franchisees' overall satisfaction with the quality of the relationship to the provider of the business-format (exact wording: How satisfied are you overall with your relationship to the franchisor? 1-7; very unsatisfied-very satisfied). The strength of the bivariate correlation was substantial ($r = 0.773$, $p < 0.001$). Concerning validity, we caution that we relied on a single source key informant approach. John and Reve (1982) noted that sentiments variables, such as exchange norms, may fail to converge across respondents from the opposite sides of a dyadic relationship. However, we claim that we measured relational governance on the 'right' side of the dyad (with franchisees), for relational governance only safeguards against conflict when the party which has room for opportunism (brought about by franchisee autonomy) perceives the above norms to be relevant for his behavior.

4.2.2 Independent Variables

Respondents assessed their perceived level of autonomy on four separate questionnaire items (see Table A1). These intended to capture two notions of autonomy frequently reappearing in the literature: 1) the leeway to make independent decisions and 2) quasi as a result, the extent to which a franchisee feels to be his

own boss (for example, Schul, Little, and Pride, 1985; Feldstead, 1991). Questions 6a and 6b grasped to what extent franchisees perceived to be unconstrained when making decisions, referring to the first notion above. Items 6c and 6d measured, corresponding to the second notion, whether the franchised partners considered themselves as primarily executing directives, being employees, or rather managing their outlet according to own decisions, being entrepreneurs. Results of a principal component factor analysis (see Table 3) indicated the four items to load highly on one common factor (all factor loadings $\geq$ 0.645). The scores on the four items were summed and averaged – using equal weights.

Cronbach's alpha of reliability for the composite autonomy measure was 0.64. We further assured reliability through item-to-total and inter-item correlations. With all inter-item correlations except one (being r = 0.29) exceeding the threshold of 0.30 and all item-to-total correlations above 0.50 (the smallest correlation being 0.55), we felt confident about reliability of the scale.

We assume that franchisors are aware of the level of autonomy each franchisee disposes of. It could be argued that measuring franchisors' perceived levels of autonomy with regard to each individual outlet would have been more accurate. However, John and Reve's (1982) results accommodate this concern. They showed that perceptions on structural variables such as the degree of centralization of channel dyad decision-making converge across key informants from the different sides of a dyad.

Consistent with earlier literature (for example, Dant and Gundlach, 1999), a nominal no/yes question, coded as a dummy variable (no = 0; yes = 1), was used to ascertain multi-unit ownership, that is, whether a franchisee operated one or more outlets (see Table A1).

Franchisees were asked to indicate the year in which they opened their outlet, from which we calculated the age of the franchisee-franchisor relationship. This measure is consistent with Dant and Nasr (1998).

Following Brickley and Dark (1987) as well as Minkler (1990), geographic distance was calculated as the number of kilometers (instead of miles) that lie in between a franchised outlet and the chain's head office. In the questionnaire, respondents specified the first two digits of their postal code. Although information about the full postal code, comprising five digits, would have added precision to our calculations, only two digits were requested in order to guarantee anonymity. To calculate distance, we used a standard route planning software; introducing franchisees' two-digit postal code as the destination and the five-digit postal code of chains' headquarters as the starting point.[3]

Franchisee success, or the extent of satisfaction with past performance, was measured by four separate questionnaire items (see Table A1). The questions asked respondents to evaluate their recent performance relative to different comparison levels. Comparison levels included 1) alternative activities 2) average industry sales growth 3) own income expectations and 4) own sales objectives.

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[3] A two-digit postal code covers a surface of approximately 6000 square kilometres. There are 99 different two-digit postal codes in Germany.

Anchoring success by reference to comparison levels is in line with Anderson and Narus (1990). The results of a principal component factor analysis (see Table 3) revealed the four items to load highly on one factor (all factor loadings $\geq$ 0.633). We built a scale which averaged – using equal weights – the sum of the scores on the four items. Cronbach's alpha of reliability was 0.83. Inspection of item-to-total correlations and inter-item correlations provided further support for the reliability of the scale. We verified convergent scale validity via the correlation between the summated scale and a single item assessing franchisees' overall satisfaction with performance (exact wording: How satisfied are you overall with your performance? 1-7; very unsatisfied-very satisfied). The correlation can be classified as substantial ($r = 0.713$, $p < 0.001$).

Table 3. Factor matrix for franchisee success and autonomy

2 factors extracted (Eigenvalues > 1); Kayser-Meyer-Olkin-criterion: 0.761; Bartlett's test of sphericity: $Chi^2 = 556.42$, $df = 28$, $p < 0.001$.

Factor	Eigenvalue	% of var.	cum. % of var.	Success	Autonomy
1	3.191	39.893	39.893		
2	1.660	20.747	60.640		
Factor matrix				Success	Autonomy
4a)				0.633	
4b)				0.855	
4c)				0.880	
4d)				0.850	
6a)					0.645
6b)					0.778
6c)					0.762
6d)					0.664

Absolute values less than 0.3 were suppressed.

Our measure evaluated the intensity of competition between franchisees of the same chain, that is, intra-chain competition (see Table A1). Outlet owners were called upon to report whether the number of franchised outlets in the chain exceeded a reasonable size. In our context, a perceptual measure seemed more appropriate than an objective count of the number of outlets in the chain – as previously used by other researchers (for example, Arruñada, Garicano, and Vázquez, 2001). First, a simple count does not capture the geographic dispersion of outlets and thus the level of intra-brand competition faced by each individual unit. Although our measure did not ask respondents to state whether the number of franchised outlets in their geographic area had exceeded a reasonable size, it is sensible to assume that answers were provided with this fact in mind. Second, actual free-riding behavior generally needs to be preceded by the perception of the potential to improve one's own performance at the expense of peer franchisees and/or company-outlets. We checked validity of this measure by correlating it with the number of sampled franchised outlets within each geographic area, as defined by

the two-digit postal codes. This is a measure similar to Minkler's (1990) outlet density, calculated as the number of stores within a five mile radius. The correlation between our two measures amounted to only 0.19, but was significant at the 0.01 percent level. Given that we could only count franchisees which were included in the sample, we felt that the correlation with the perceptual measure indicated sufficient convergent validity.

4.2.3 Control Variables

In our empirical models, we did not need to control for contractual variables (for example, royalty rates) usually considered by agency theorists in the study of franchising (for example, Lafontaine, 1992). This is because we focused on variance in autonomy across outlets of a same chain. As an empirical fact, franchisees within any system face homogenous contractual conditions. Variance in contractual terms across the 11 different chains in our sample was captured by 10 system dummy variables. We also included the variables which describe franchisees' incentive characteristics as.

4.3 Methods and Results

4.3.1 Descriptive Statistics

Table 4 shows descriptive statistics on the variables used in this study (only arithmetic means and standard deviations are reported).

Inspection of descriptive statistics on the dependent variable revealed that the average franchisee perceived high relational governance intensity in the past (mean = 5.35). With a minimum of 2.56 and a maximum of seven (s.d. = 1.06) the data showed a high range of scores. The observed variance across franchisees assured us that our measure captured 'true' relational facets. This observation is not trivial since, for instance, Dant and Schul (1992) found – reflecting structural conditions – virtually no variance on other atmospheric variables such as the degree of solidarity within any dyad.

Table 4 shows bivariate Pearson correlations between the variables. We found a positive and highly significant correlation ($r = 0.55$, $p < 0.001$) between autonomy and relational governance, providing preliminary evidence for H1. But, significant correlations among the independent variables suggested using multivariate regression techniques to examine the variance in the endogenous variable uniquely explained by the theoretical constructs of interest to the hypotheses.

Table 4. Pearson correlation coefficients and descriptive statistics

Variable	mean	s.d.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1) System Dummy 1	0.08	0.27																
(2) System Dummy 2	0.02	0.15	-0.05															
(3) System Dummy 3	0.01	0.12	-0.04	-0.02														
(4) System Dummy 4	0.10	0.30	-0.10	-0.05	-0.04													
(5) System Dummy 5	0.16	0.37	-0.13	-0.07	-0.05	-0.15												
(6) System Dummy 6	0.09	0.28	-0.09	-0.05	-0.04	-0.10	-0.14*											
(7) System Dummy 7	0.05	0.21	-0.07	-0.04	-0.03	-0.08	-0.10	-0.07										
(8) System Dummy 8	0.06	0.24	-0.08	-0.04	-0.03	-0.09	-0.11	-0.08	-0.06									
(9) System Dummy 9	0.02	0.15	-0.05	-0.03	-0.02	-0.05	-0.07	-0.05	-0.04	-0.04								
(10) System Dummy 10	0.06	0.24	-0.08	-0.04	-0.03	-0.09	-0.11	-0.08	-0.06	-0.07	-0.04							
(11) Relational governance	5.35	1.06	0.29***	-0.02	0.08	0.36***	-0.04	-0.07	0.07	-0.02	-0.18*	0.09						
(12) Multi-unit ownership	0.23	0.42	0.01	-0.01	-0.07	-0.18**	0.38***	-0.09	-0.12	-0.09	-0.09	0.05	0.00					
(13) Age of the relationship	7.50	5.76	-0.11	-0.05	-0.02	-0.17*	0.66**	-0.06	0.01	-0.06	-0.01	-0.09	-0.03	0.36***				
(14) Geographic distance	309.74	206.77	-0.12	0.21**	-0.17*	-0.18*	0.06	0.11	-0.09	-0.07	0.08	-0.23**	-0.32***	0.02	0.05			
(15) Franchisee success	4.41	1.35	0.26***	-0.03	-0.04	0.31***	0.12	0.07	0.04	0.04	-0.14	0.01	0.51***	0.13	0.09	-0.12		
(16) Intra-chain competition	2.98	2.06	-0.14*	-0.08	-0.04	-0.18*	0.12	-0.06	-0.11	-0.08	0.03	0.11	-0.33***	0.08	0.09	0.04	-0.19**	
(17) Autonomy	5.45	0.70	0.23**	-0.04	0.04	0.28***	-0.04	0.01	0.05	-0.25***	-0.38***	0.10	0.55***	0.03	-0.08	-0.20**	0.37***	-0.25***

$n = 208$. Significance levels (two-tailed): *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$.

4.3.2 Regression Results

As a multivariate dependence technique, we relied on hierarchical ordinary least squares regressions (OLS). For testing the implications of franchisee incentive characteristics on the relationship postulated in the first hypothesis (H2a through H2e), moderated OLS regressions were estimated (Aiken and West 1991). These are appropriate to reveal whether a certain variable, the moderator, has an influence on the strength and/or form of the relationship between an independent and a dependent variable.

To assure that our results are reliable, we controlled that the assumptions of multivariate regression techniques were met. Variance inflation factors, Kolmogorov-Smirnov as well as Breusch-Pagan tests gave no indications for any of the assumptions being violated.

We first regressed relational governance on the system dummies and the independent variables except for autonomy (Model 1 in Table 5) and found this estimation to be highly significant (adj. $R^2 = 0.418$, $p < 0.001$).

Distance (b = -0.001, $p < 0.01$), success (b = 0.255, $p < 0.001$), and competition (b = -0.103, $p < 0.01$) came out significant.[4] In a second step, we added autonomy to the regression equation (Model 2). The coefficient for this variable was positive (b = 0.489) and highly significant ($p < 0.001$). H1 was therefore strongly supported. With an adjusted R^2 of 0.48, explanatory power of Model 2 was high. Compared to the null model in column 1, Model 2 added 5.2 percentage points to the explanation of variance in the data. Significance of the overall model lay at the 0.1 percent level.

The results of the moderated regression models are presented in columns three to seven of Table 5. H2a stated that franchisors would invest less in shared exchange norms for every level of decision-making authority of multi-unit compared to single-unit franchisees since incentives of the former are more closely aligned with the network. The coefficient of the interaction term was expected to be negative, attenuating the strength of the positive relationship of H1. Model 3 displayed a negative (b = -0.397) and marginally significant coefficient ($p < 0.10$) of the interaction term between autonomy and multi-unit ownership. Hence, H2a was weakly supported by the data. The unique variance explained by the interaction term amounted to 0.6 percentage points.

H2b supposed that the older the franchisee-franchisor relationship, the weaker would be the need for relational safeguards. Although the coefficient of the inter-

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[4] Note that System Dummy 1 and 4 were positively and significantly related to relational governance. The dummy variables may capture the general or average level of franchisee autonomy within a chain and therefore be related significantly to relational governance. This average level of autonomy, in turn, is determined by the business the franchise system operates in, the level of competition the franchise system faces, and environmental uncertainty.

action term was negative (b = -0.009), as expected, it was not statistically significant (see Model 4). The data therefore did not support H2b.

H2c suspected geographic distance between an outlet and the chain's head office to positively moderate the strength of the relationship between autonomy and relational governance. While the sign of the coefficient was in the direction expected (see Model 5), the influence was not different from zero on statistical grounds. H2c was therefore not supported.

The data however lent support for H2d which presumed that it would become less important to accompany decision-making independence with relational control mechanisms the more successful the franchisee (see Model 6). The coefficient of the interaction term was negative (b = -0.142) and statistically significant (p < 0.05). The amount of unique variance explained amounted to 1.1 percent.

H2e suggested a positive coefficient of the interaction between the level of intra-chain competition perceived by a franchisee and autonomy. Indeed, Model 7 revealed a positive (b = 0.083) and statistically significant (p < 0.05) coefficient. H2e was therefore supported. The interaction term explained 0.8 percent of unique variance in the dependent variable.

4.3.3 Post Hoc Analyses

For Models 3, 6, and 7, which revealed significant coefficients of the interactions between autonomy and multi-unit ownership, success, and competition, respectively, we conducted post hoc analyses (Aiken and West, 1991). From these analyses, we found that multi-unit ownership, success, and competition influenced, as proposed in our hypotheses, the strength but not the form of the relationship between the autonomy and the dependent variable. It is especially noteworthy that autonomy was, consistent with our predictions, not related at all to relational governance for the group of multi-units owners. In addition, while the simple slope at low levels of competition was insignificant, it was statistically different from zero at mean and high levels of rivalry.

Table 5. Regression results of direct and moderated effects

Model	1	2	3	4	5	6	7
			Dependent variable: Relational governance				
Constant	5.183***	5.158***	5.153***	5.152***	5.168***	5.204***	5.184***
	(0.114)	(0.108)	(0.107)	(0.109)	(0.109)	(0.108)	(0.108)
System 1	0.749**	0.630**	0.648**	0.627*	0.633**	0.628**	0.652**
	(0.253)	(0.240)	(0.239)	(0.240)	(0.240)	(0.237)	(0.238)
System 2	0.228	0.318	0.308	0.321	0.316	0.300	0.266
	(0.385)	(0.364)	(0.362)	(0.365)	(0.365)	(0.361)	(0.363)
System 3	0.658	0.620	0.618	0.633	0.635	0.521	0.649
	(0.496)	(0.469)	(0.466)	(0.470)	(0.470)	(0.466)	(0.465)
System 4	0.818**	0.685**	0.652**	0.674**	0.690**	0.778**	0.728**
	(0.247)	(0.235)	(0.234)	(0.237)	(0.235)	(0.236)	(0.234)
System 5	-0.016	0.022	0.033	0.038	-0.022	-0.012	0.018
	(0.228)	(0.216)	(0.215)	(0.219)	(0.220)	(0.214)	(0.214)
System 6	-0.135	-0.100	-0.072	-0.094	-0.106	-0.126	-0.071
	(0.227)	(0.215)	(0.214)	(0.216)	(0.215)	(0.213)	(0.214)
System 7	0.265	0.263	0.262	0.270	0.271	0.186	0.295
	(0.294)	(0.277)	(0.276)	(0.278)	(0.278)	(0.276)	(0.276)
System 8	-0.087	0.317	0.353	0.328	0.304	0.240	0.263
	(0.260)	(0.259)	(0.258)	(0.260)	(0.260)	(0.258)	(0.258)
System 9	-0.593	0.160	0.305	0.158	0.204	0.434	0.175
	(0.378)	(0.389)	(0.395)	(0.390)	(0.395)	(0.403)	(0.387)
System 10	0.466†	0.380	0.396	0.378	0.384	0.405	0.361
	(0.263)	(0.249)	(0.247)	(0.249)	(0.249)	(0.246)	(0.247)
Multi-unit ownership	0.013	0.004	0.020	0.012	-0.001	-0.005	0.003
	(0.155)	(0.146)	(0.146)	(0.148)	(0.147)	(0.145)	(0.145)
Age of relationship	0.007	0.009	0.009	0.007	0.010	0.010	0.008
	(0.013)	(0.013)	(0.013)	(0.014)	(0.013)	(0.013)	(0.013)
Distance	-0.001**	-0.001*	-0.001*	-0.001*	-0.001*	-0.001**	-0.001*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Success	0.255***	0.196***	0.191***	0.194***	0.205***	0.205***	0.207***
	(0.052)	(0.051)	(0.050)	(0.051)	(0.052)	(0.050)	(0.051)
Competition	-0.103**	-0.073*	-0.072*	-0.072*	-0.072*	-0.078**	-0.073**
	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)
Autonomy		0.489***	0.485***	0.490***	0.479***	0.498***	0.477***
		(0.100)	(0.099)	(0.100)	(0.101)	(0.099)	(0.099)
Autonomy x Multi-unit ownership			-0.397†				
			(0.214)				
Autonomy x Age of relationship				-0.009			
				(0.018)			
Autonomy x Distance					0.000		
					(0.000)		
Autonomy x Success						-0.142*	
						(0.062)	
Autonomy x Competition							0.083*
							(0.042)
n	208	208	208	208	208	208	208
F	10.894	12.937	12.533	12.141	12.715	12.750	12.588
Adjusted R²	0.418	0.480	0.486	0.478	0.479	0.491	0.488
Δ in adj. R²		0.062	0.006	-0.002	-0.001	0.011	0.008
F Δ in adj. R²		24.000	3.433	0.293	0.501	5.206	3.881

Standard errors in parentheses. Significance levels (two-tailed): *** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; † $p < 0.1$. Independent variables have been mean centered (all models) in order to circumvent problems of multicollinearity associated with interaction terms.

5 Discussion

5.1 Findings and Null Findings

The empirical results were fully supportive for our main thesis that franchisors would confront agency problems triggered by franchisee autonomy with relational forms of governance. However, we found only mixed evidence for franchisee incentive characteristics to affect the severity of these problems at every given level of local decision-making independence such that the intensity of observed exchange norms would differ accordingly. While multi-unit ownership and success attenuated, and competition exacerbated the need for relational control as expected, age of the relationship and geographic distance did not emerge as significant moderator variables.

Concerning age of the relationship, one important shortcoming of our measurement instrument may provide an explanation for the null finding. Measuring age of the relationship as the number of years elapsed since the first outlet was opened by any franchisee does not capture the full length of the relationship for every sampled dyad. It is a frequent phenomenon that the career path of franchisees involves employment by the company prior to starting an outlet (Bradach, 1997). In addition, even if the full relationship length had been grasped, the measure would not plainly reflect the severity of agency issues at hand. For equal relationship lengths, the goal discrepancies are more severe for a franchisee not previously working at the chain's head office compared to a former employee. In this regard, prior socialization into an organization can be an effective way of aligning interests (Ouchi, 1980).[5] From a theoretical perspective, the insignificant interaction term may stem from the two conflicting incentive effects possibly resulting from an increase in relationship length as outlined in the argument leading up to H2b. On the one hand, age of the relationship positively influences the expectations about the continuity of the liaison in the future and thus the time horizon over which system-specific investments can be amortized. On the other hand, franchisees gain in experience over time and may therefore be increasingly reluctant to comply with imposed standards.

As regards distance, we already acknowledged a methodological problem related to its operationalization for we relied only on the first two out of five digits of franchisees' postal codes to determine the geographical position of each outlet. Put into perspective, however, the inaccuracy of the measure did not appear to be a serious concern as plausible and significant correlations of distance with other variables emerged from the data; for instance with autonomy (see Table 5). One

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[5] A statement of the COO of one chain studied by Bradach illustrates this point: "The company people know the system. They are proven operators and they appreciate the importance of maintaining standards and running the business right" (p. 292). Hence, former company managers understand the requirements to operate an outlet and their experience as company managers allows them to appreciate the importance of maintaining standards.

theoretical account for the insignificant interaction term stresses that information asymmetries may have become more independent of physical distance with the rise in information technologies in the late 1990's (Ehrmann, 2002). As a result, the severity of agency issues for remote and nearby outlets and the subsequent need for relational safeguards are likely to have converged to some degree.

5.2 Implications for Managers

The present study bears clear implications for the management of franchised distribution channels. First, since our results revealed that multi-unit franchisees necessitate less governance intensity in light of decision-making independence, limiting the number of single-unit partners could lead to efficiency gains.[6] As a consequence, the extent of intra-chain competition faced by each outlet would also be reduced. Benefits may be derived from lower intra-chain competition as the findings indicated that those franchisees facing few competing outlets require less control. Furthermore, the data made a good case for the presumption that high performance relative to comparison levels fosters incentive alignment with the company. Hence, it may potentially pay-off to leave rents downstream to induce efficient decentralized operations.

Second, against the backdrop that the incentive characteristics of franchisees are not easily modifiable in the short-run, franchisors should carefully pay attention to selectively grant decision rights to those partners which are expected to behave appropriately. This could help to increase returns from local adaptation as smaller control costs should be incurred to achieve Pareto-improving results. More generally, managers should be aware of the linkage between structural (that is, autonomy) and behavioral (that is, relational governance) processes in the management of channel members.

Finally, our research draws attention to the value of relationships in governing dispersed outlets. Though we did not provide empirical evidence on the performance effects of relying on relational governance to control decentralized decision-making structures, our findings suggest that norms of behavior provide a powerful safeguard against opportunistic abuses of decision rights. Companies which invest in the relationships to their dyadic partners in the presence of exchange hazards brought about by downstream autonomy should outperform those chains foregoing close ties, ceteris paribus.

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[6] Note, however, that multi-unit ownership also reintroduces some of the problems franchising seeks to solve in the first place, namely shirking on effort on behalf of employed outlet managers. These agency problems then occur between the (non-managing) multi-unit owner and his employee-managers at the stores under his control.

5.3 Limitations

This study is subject to several limitations. First, standard criticisms of data from perceptual survey-type measures such as ambiguity of questions, nonresponse biases, and common methods variance apply. We sought to minimize the ambiguity of questionnaire items by means of extensive pre-tests with franchisees and experts. Comparison of average sampled franchisees in each chain with the average computed from the systems' populations revealed no evidence for obvious response biases. To deal with common method variance from social desirability, guarantees of anonymity were provided to respondents. Normally distributed summated scales were indicative of social desirability effects being negligible.

Second, it has to be noted that we relied on newly developed items to operationalize the relational exchange norms. However, care was taken in the construction of the scale. The formulation of the questionnaire items arose from a qualitative-explorative pre-study with franchisee focus groups. In addition, the results from a principal component factor analysis as well as inspection of Cronbach's alpha, item-to-total and inter-item correlations, all reported earlier, accommodated concerns about reliability issues.

6 Conclusion

Relying on franchised outlets for decision-making in various functional areas such as marketing, product design or pricing can bring about important efficiency gains and enhance system-wide adaptability. These positive effects from entrepreneurial autonomy are threatened to be offset by agency costs which arise from imperfect alignment of interests among the vertical channel partners. The theory led us to infer that franchise companies would use relational forms of governance to counterbalance their loss in control associated with allocating decision-making independence to individual outlets. The results from an empirical analysis based on German franchisees strongly supported this presumption. Furthermore, the data partly confirmed our thesis that franchisee incentive characteristics alleviate or intensify the need for relational safeguards in light of downstream decision control.

Though this study was conducted within the context of franchising, its implications may be extended to other inter- as well as intraorganizational relationships between principals and agents (for example, between sales manager and salesforce agents, between venture capital firms and their portfolio companies, and between employers and empowered employees). While organizations make extensive use of formal control mechanisms such as contracts, monitoring and certification, some degree of residual vulnerability to individual self-interest seeking and organizational goal conflicts often remains. As a consequence, realizing the full economic value of agents' specific knowledge is put into peril. Relational forms of

governance can play a prominent role in reducing the costs from trading hazards thereby paving the way for successful decentralized decision structures.

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Table A1. Details of constructs and measures

Construct	Description of Measures	Cronbach's α
1 Multi-unit ownership	Do you own more than one franchise outlet? (no = 0; yes = 1)	
2 Age of the relationship	In which year did you join the franchise system?	
3 Competition	The number of franchised outlets has exceeded a reasonable size. (disagree-agree, 7-point scale)	
4 Success	a Within another activity and with the same level of effort I could realize an income which is … (higher-lower, 7-point scale).	0.83
	b Compared to the average development of sales in my industry I would rate my last period's sales as being… (lower-higher, 7-point scale).	
	c Compared to my expectations my last period's income was… (lower-higher, 7-point scale).	
	d Compared to my last period's sales objectives my last period's sales were… (lower-higher, 7-point scale).	
5 Relational governance	*Harmonization of conflict*	0.87
	a My franchisor understands my problems and concerns. (disagree-agree, 7-point scale)	
	b My franchisor seeks compromises to accommodate conflicts. (disagree-agree, 7-point scale)	
	c Disputes are not typical for the relationship between me and my franchisor. (disagree-agree, 7-point scale)	
	Cooperation	
	d When making decisions which concern me, my franchisor takes into account my opinion. (disagree-agree, 7-point scale)	
	e My franchisor asks me for participation in his long-term planning process. (disagree-agree, 7-point scale)	
	f I receive information from my franchisor on time. (disagree-agree, 7-point scale)	
	Trust	
	g My franchisor does not exploit my dependency. (disagree-agree, 7-point scale)	
	h My franchisor's trust in me is high. (disagree-agree, 7-point scale)	
	i I can follow the recommendations of my franchisor without any hesitation. (disagree-agree, 7-point scale)	
6 Autonomy	a The franchisor's standard operating procedures do limit my autonomy… (agree-disagree, 7-point scale)	0.64
	b I am free to implement own ideas. (disagree-agree, 7-point scale)	
	c I am my own boss. (disagree-agree, 7-point scale)	
	d As franchisee I feel more like an entrepreneur rather than like an employee. (disagree-agree, 7-point scale)	