Customization and management control: an analysis of franchise contracts

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Abstract

The aim of this paper is to investigate how service customization impacts on the way in which franchisors control the relationship with their franchised service units. We particularly investigate variation in franchise contract design in terms of the delegation of decision rights, monitoring, incentives and input control in chains offering services with varying levels of customization. We code and analyze a unique sample of 81 contracts of chains from different service industries. The results of our empirical analyses show that there exist important differences in the contractual control system dependent on the level of service customization. Franchisors of chains offering highly customized services delegate more decision rights to their service units, but include higher monetary incentives and more input control items as safeguards in their contracts. Regarding outcome monitoring, we observe no difference in the use of financial outcome monitoring across chains with different levels of service customization. Nevertheless, higher customization is associated with a higher use of subjective nonfinancial outcome monitoring, whereas objective nonfinancial outcome monitoring is used to a higher extent when services are more standardized. In chains offering standardized services, franchisors make higher use of behavior monitoring. Supplementary analyses point to complementary as well as substitutive relationships among the contractual control items in franchising contracts of chains with different degrees of service customization.