

Decentralization, Output Control, and Process Control in Franchise Networks
Zeinab Esmaeili, The 9th EMNet 2021 Conference, September 2021 – Vienna, Austria

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Abstract

Based on the Transaction Cost Theory and Resource-Based Theory, this study extends a new perspective of franchisors for decision-making and control and their impact on system performance in international franchise networks. All factors were gathered with a standard questionnaire from 162 global franchise systems headquartered in the US, UK, Germany, Austria, the Netherlands, Italy, France, and Spain. The results emphasize the importance of Environmental Uncertainty, Behavioral Uncertainty, Transaction-Specific Investment, Franchising System-Specific Know-How, and Local Market Assets on international franchise firms' control. The second study also extends a new vision of higher decentralization of decision-making related to output control and higher decentralization regarding process control and their impact on system performance in international franchise networks, raised for the first time in international franchise networks.

Keywords: International Franchise Networks, Centralization, Decentralization, Output Control, Process Control, System Performance

Introduction

In a franchising network, long-term sustainability and balance among all elements are critical, because building a healthy franchising system and an efficient network structure requires alignment between decision-making and control. Furthermore, the franchisor must allocate decision rights between the headquarters and local franchise partners (Windsperger, 2004).

This research focuses on examining and tracking relationship development in international franchise firms from a new perspective. The quality of relationships in franchise networks plays a crucial role in the long-term success of such systems. However, the nature of international franchise firms and their relationships remains underexplored, and the literature has not paid sufficient attention to the multidimensionality of these relationships.

Although previous research on global franchise networks has referred to several theories, no prior study has specifically examined the relationship between centralization versus decentralization of decision-making and control (output control and process control), nor their impact on system performance in international franchise networks. This study addresses this gap and develops an extended perspective on international franchise networks. We evaluate the antecedents of control in international franchise networks. In the second study, we analyze the relationship between centralization versus decentralization and their impact on system performance in international franchise networks.

Theoretical Framework

The study extends a new perspective on the franchisor's point of view based on Transaction Cost Theory and Resource-Based Theory. Based on the Transaction Cost Theory, franchisors prefer to decrease the risk of environmental and behavioral uncertainty and transaction-specific investment and have strong decision-making in the challenging international franchise networks. Franchisors' decision-making, based on centralization or decentralization and the degree of them, will be precise knowledge. Based on Resource-Based Theory, franchisors attempt to use the knowledge market to develop intangible assets such as local market assets and system-specific know-how. Franchisors are required to know which degree of control and monitoring is needed, and output control and process control should be analyzed very precisely. Centralization and decentralization refer to the organizational design structure in the network, and control (input control and output control) refers to monitoring and evaluation of the partner in the network, and this relationship is important.

Based on Property Rights Theory, if you have high uncertainty and high local market knowledge from the partners (Aulakh & Kotabe, 1996). Output and process controls are considered various formal controls (Anderson & Oliver, 1987). Centralization of decision rights is efficient if the franchisor can easily access local market knowledge and monitor the local partners' value chain processes and behavior. In this case, the franchisor uses more process control. On the other hand, decentralization of decision rights is efficient if the franchisor cannot access the specific local market knowledge. Hence, it requires the local partner for local information acquisition and

decision-making. In this case, instead of monitoring the behavior and value chain processes, the franchisor uses more output control as incentives.

In prior empirical work, Esmaeili has demonstrated that intangible and service-based assets can shape organizational performance outcomes in networked systems. For example, earlier research in the banking sector showed that service marketing mix elements and customer-experience variables can function as strategic intangible resources that influence performance constructs such as brand equity (Esmaeili, 2010a; Esmaeili, 2010b; Abbasi, Kavousi, & Esmaeili, 2012)². These findings support one of the central premises of the Resource-Based Theory—that system-specific know-how and locally embedded market assets can serve as capability-based drivers of advantage. More recently, empirical research in international franchising confirmed that the alignment between decision-rights allocation (centralization vs. decentralization) and control mechanism type (output vs. process) also has implications for performance outcomes (Esmaeili, Jell-Ojobor, & Windsperger, 2021)³. Together, these studies reinforce the combined RBV–TCT logic that both intangible resources and governance structures contribute meaningfully to system performance in international franchise networks.

Control in this study refers to the monitoring concept. Control is defined based on Anderson and Oliver's (1987) definition as a collection of methods that let managers and franchisors, etc., control and evaluate franchisees and partners, etc. Control is one of the variables that franchisors

² Note. The 2010 and 2012 studies were originally developed as part of Esmaeili's master thesis research.

³ Note: This research was undertaken during Esmaeili's doctoral dissertation research development period in the field of management.

and franchisees at all levels of an organization evaluate for better output and increased performance. Control is divided into three groups, which are output control, process control, and social control (Ouchi, 1978). In socially controlled partnerships, monitoring occurs through interpersonal interactions, and these repeated interactions over time lead to systematized and shared organizational values that help build centralization between the partners (Aulakh & Kotabe, 1997).

Some researchers investigate decision-making and transaction-specific investment and the difference between foreign partners (Kersi & Frazier, 2001; Hendrikse, Hippmann & Windsperger, 2015; Glaser, Jirasek & Windsperger, 2020). Mumdziev and Windsperger (2013) describe the role of trust in transaction cost and explain its relationship with decision-making in franchising. They have shown in some cases that if franchisors are not able to clarify the amount of performance and control for franchisees, they prefer to delegate more decision-making to simplify these problems. From the franchisor's perspective, the franchisor cannot easily control the partner. The only way is to provide output control in this sense because process control is not possible. The governance structure of franchising networks requires an alignment between decision-making and control mechanisms. The franchisor has to allocate decision rights between the headquarters and the local franchise partners (Windsperger, 2004), and research refers to output and process control (Anderson & Oliver, 1987).

Before extending the relationship between decision-making and control, it is necessary to explain three types of control mechanisms identified by Ouchi (1978): output control (defined as the

degree to which the focal firm monitors the results or outcomes produced by the foreign partners); process control (monitoring the behavior or means used to achieve the desired ends); and social control (represents an informal control mechanism based on prevailing social perspectives and interpersonal interaction patterns). In socially controlled partnerships, monitoring occurs through interpersonal interactions, and these repeated interactions over time lead to systematized and shared organizational values, which help build centralization between partners. Regarding the franchise system's performance variable, Gorovaia and Windsperger (2018) examine franchise networks' performance based on real options theory. In their research, an explicit call option from the franchisors had a positive effect on network performance. Baldi (2016) investigates actual options logic in multi-unit franchising, and he shows that more flexibility increases performance. Some studies have demonstrated the effect of decision control and contractual restrictions on performance (Hajdini et al., 2017; Hajdini & Raha, 2018), and they find positive results between decision control and performance.

Previous studies have primarily examined control mechanisms in franchise networks at a conceptual level, focusing on the balance between centralization and decentralization of decision rights. This paper serves as a follow-up to Esmaeili, Windsperger, and Jell-Ojobor (2021), which examined decision-making and control in international franchise networks. Building on that foundational study, the present research explores the control mechanisms in greater detail, focusing specifically on the three core dimensions of control: process control and output control.

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While the earlier work established the conceptual relationship between decentralization and system performance, this paper provides a deeper empirical analysis of how these distinct control variables interact within international franchise structures, highlighting their combined impact on coordination efficiency, partner alignment, and overall network performance.

Although previous research investigated the franchising system's intangible assets and performance (Baldi, 2016; Gorovaia & Windsperger, 2012), no previous study has used control and decision-making constructs to empirically explain whether franchisors should have centralized or decentralized decision-making in their networks. Investigating the determinants of a franchisor's use of centralized or decentralized control with a complementarity or substitute approach provides a closer look at the relationship between decision-making and control and their impact on performance. Franchise management capabilities with a mediator of franchisor ownership positively affect franchisor performance (William E., James G., & Xiaoli, 2020). Franchise management capabilities with franchisor ownership mediators positively affect franchisor performance (William E., James G., & Xiaoli, 2020).

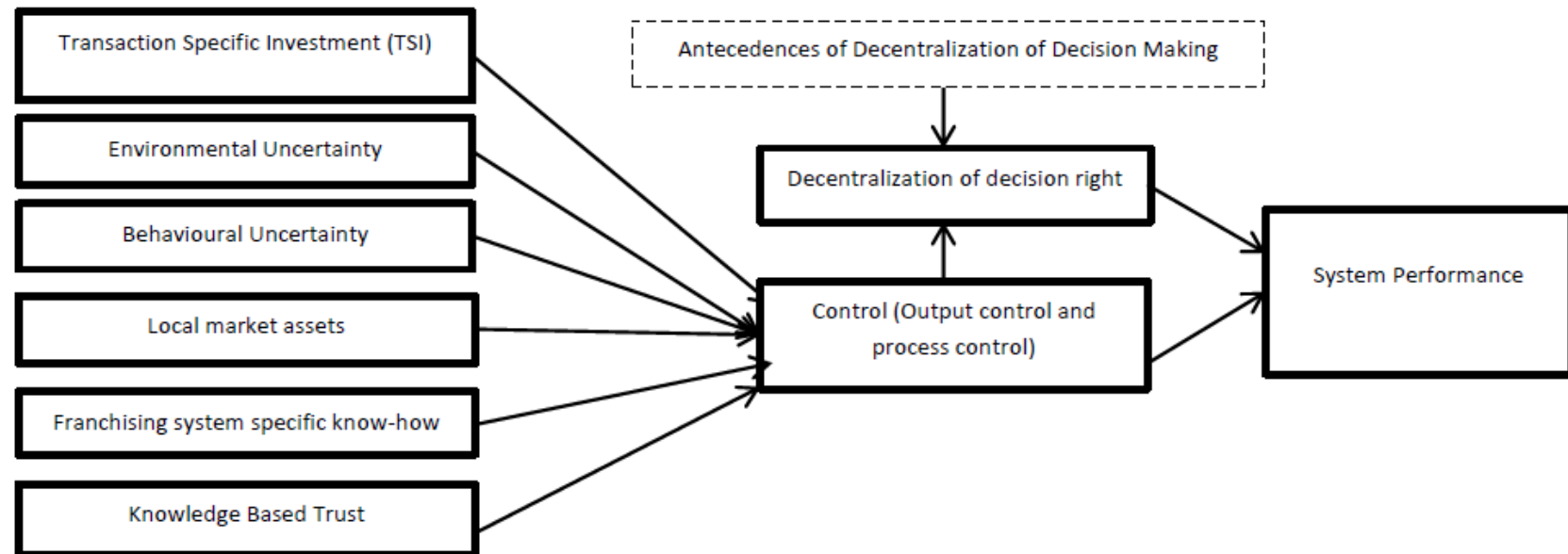
Hypothesis and Conceptual Model

Based on the literature that we mentioned before, we developed the following conceptual model:

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Figure 1

Conceptual Model.



Source. Author's own work.

Data Collection

The hypotheses are tested using a quantitative method and a standardized questionnaire. The data were collected from Western Europe and the United States, and the questionnaires were sent out by email and postal mail. The franchise firms were selected from those headquartered in the US, UK, Austria, Germany, Spain, France, Italy, and the Netherlands. The online survey helped us gather a large sample, and with the support of national and international franchise associations, accessibility to all franchise firms in the selected countries resulted, after excluding missing data, in 162 completed questionnaires from eight countries (24 in the US, 8 in the UK, 41 in Germany, 16 in Austria, 10 in the Netherlands, 18 in Italy, 22 in France, and 23 in Spain).

Measurement

The confirmatory factor analysis section examines the relationships between latent variables and explicit model variables and conducts convergent validity, hybrid reliability, and Cronbach's alpha. The factor load, representing the strength of the relationship between a factor (latent variable) and an observed variable, is indicated by the factor load. The factor load is a value between zero and one. If the factor load is less than 0.3, a weak relationship is considered and ignored. A factor load between 0.3 and 0.6 is acceptable, and if it is greater than 0.6, it is highly desirable (Klein, 2011).

For research variables, there is reliability when Cronbach's alpha (CA) values are above 0.7. The following table presents confirmatory factor analysis and Cronbach's alpha based on measurement sources conducted in this study. Cronbach's alpha for Environmental Uncertainty (Brown, Dev & Zhou, 2003; Bello & Gilliland, 1997; Luo, 2001; Esmaeili et al., 2021; Erramilli et al., 2002; Kim & Hwang, 1992; Ganesan, 1994; John & Weitz, 1989) is 0.886; for Behavioral Uncertainty (Agarwal & Ramaswami, 1992; Brouthers & Brouthers, 2003; Chen & Chen, 2003) is 0.911; for Control (Aulakh, Kotabe & Sahay, 1996) is 0.748; for Transaction-Specific Investment (Kersi & Frazier, 2001; Anderson, 1985) is 0.827; for Decision Making (Kersi & Frazier, 2001; Heide & Stump, 1995; Anderson, 1985) is 0.843; for System-Specific Know-How is 0.780; for Local Market Assets (Hoffman & Preble, 2003; Altinay & Wang, 2006; Windsperger, 2009) is 0.783; for Knowledge-Based Trust (Lazzarini et al., 2008; Yamagishi & Yamagishi, 1994) is 0.717; and for System Performance (Brouthers, 2002; Katsikeas, Samiee & Theodosiou, 2006) is 0.931. The factor loadings were at an appropriate level.

Before entering the hypothesis testing stage, it is necessary to determine the normality status of the data to decide which tests to use based on whether they assume normality. The significance level should be greater than the error value, i.e., $\alpha = 0.05$, which is appropriate based on Table 1.

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Table 1

Kolmogorov–Smirnov Test for Skewness and Kurtosis

Variables	Kurtosis	Skewness	Sig.
Environmental Uncertainty	-0.553	-0.032	0.093
Behavioural Uncertainty	-0.644	0.267	0.109
Output Control	1.011	-0.421	0.053
Process Control	1.015	-0.424	0.051
Transaction Specific Investment	-0.066	-0.725	0.106
Decision making	-0.194	-0.293	0.062
Franchising system specific know-how	0.318	-0.570	0.098
Local market assets	-0.305	-0.314	0.100
Knowledge-Based Trust	-1.055	0.370	0.098
System Performance	-0.085	-0.363	0.082

Source: Author's own work.

The significance level for all variables is greater than 0.05, and the amount of skewness and kurtosis is in the range of -2 to 2; therefore, the hypothesis is confirmed. We conclude that the data collected for the research variables came from a normal population. The table below shows the Pearson correlation coefficients between the variables. In this test, if the correlation coefficient between two variables is less than 0.25, the relationship between them is considered weak. If this coefficient's value is in the range of 0.25–0.6, the relationship is average. If this

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relationship is greater than 0.6, there is a strong relationship between the two variables. The variables were Age, Industry, and Size of Businesses.

Table 2

Correlation Matrix

Variables	1	2	3	4	5	6	7	8	9
Environmental Uncertainty	1.000								
Behavioural Uncertainty	**0.588	1.000							
Output Control	**0.219	**0.204	1.000						
Process Control	**0.211	**0.0201	1.000						
Transaction Specific Investment	**0.310	**0.039	**0.584	1.000					
Decision making	**0.270	**0.365	*0.176	*0.191	1.000				
Franchisor system specific know-how	0.130	*-0.158	**0.410	**0.312	0.087	1.000			
Local market assets	**0.372	**0.307	**0.212	**0.184	**0.463	*0.199	1.000		
Knowledge-Based Trust	-0.122	**0.206	*0.174	*0.130	0.082	0.084	-0.001	1.000	
System Performance	*-0.166	**0.325	**0.262	**0.273	0.079	**0.377	0.092	0.003	1.000
*p<0.05 **p<0.01									

Source: Author's own work.

All factors were gathered by questionnaire, and factor analysis was conducted. The control of international franchise firms is influenced by:

Table 3

β -Coefficient and t-Value (Dependent Variable: Control)

Antecedents' variables	β -coefficient	t-value
Environmental Uncertainty	0.17	* 2.15
Behavioural Uncertainty	0.66	**6.64
Transaction Specific Investment	0.75	**8.02
Franchising system specific know-how	0.19	*2.19
Local market assets	0.95	**22.32
Knowledge-Based Trust	0.01	0.04
*p<0.05 **p<0.01		

Source: Author's own work.

Considering the path coefficient of 0.17 and the *t*-statistic of 2.15, with a 95% confidence level, Environmental Uncertainty has a positive and significant effect on control. Behavioral

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Uncertainty, Transaction-Specific Investment, franchising system-specific know-how, and local market assets positively and significantly affect control. Based on the path coefficient of 0.01

and t -statistic of 0.04, at the 95% confidence level, Knowledge-Based Trust has no significant effect on control.

In the second study, the relationship between control, decision-making, and their effect on system performance in international franchise networks was examined. Considering the path coefficient of 0.30 and the t -statistic of 3.16, at the 99% confidence level, decision-making has a positive and significant effect on control. Also, we examined the impact of control and decision rights on system performance.

Table 4

β -Coefficient and t -Value (Dependent Variable: System Performance)

Antecedents' variables	β -coefficient	t -value
Output Control	0.61	**7.03
Process Control	0.63	**7.01
Decision making	0.15	*2.06
* $p < 0.05$ ** $p < 0.01$		

Source: Author's own work.

According to the path coefficient of 0.61 and the t -statistic of 7.03, with a 99% confidence level, output control has a positive and significant effect on system performance. Furthermore, process control has a positive and significant effect on system performance. Also, considering the path coefficient of 0.15 and the t -statistic of 2.06, with a 95% confidence level, decision-making has a positive and significant effect on system performance.

Conclusion

The first study examined the antecedents of control (output control and process control) in international franchise networks. The second study focused on the relationship between control and the decentralization versus centralization of decision-making in international franchise networks and their effect on system performance. The results showed that environmental uncertainty, behavioral uncertainty, transaction-specific investment, franchising system-specific know-how, and local market assets positively and significantly affect control in international franchise networks. Knowledge-based trust had no considerable impact on control in international franchise networks among Western European and U.S. samples.

The second study also presented significant findings that had not been considered in previous research. Earlier studies had not examined the relationship between decision-making (centralization vs. decentralization) and control (output control and process control) in international franchise networks. For the first time, this research addressed this issue in the context of international franchise networks. The study extends this topic by showing that

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decision-making with higher decentralization is positively related to output control and negatively related to process control in international franchise networks. Furthermore, both control and the decentralization of decision-making positively impact system performance in international franchise networks.

Note: This paper is part of the author's Ph.D. thesis project at the Department of Business Decisions and Analytics, University of Vienna.

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