

Trust, Decision Rights Delegation, and Performance—The Case of Franchising

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Previous research has not examined the relationship between trust, decentralization, and franchisor performance. Complementary to the literature on autonomy and relational governance from franchisees' perspective, this study focuses on the franchisor's perspective on the impact of decentralization and trust on performance. Consistent with the embeddedness view, the results show that trust is a facilitator of decentralization in franchise networks, thereby increasing the positive performance effect of decision rights delegation. Overall, the study offers a new perspective on the relationship between formal governance—through decision rights allocation—and trust as a relational variable in interorganizational networks.

Introduction

In recent years, research on interorganizational networks has focused on the relationship between formal governance mechanisms (e.g., contract rules) and trust as relational governance mechanism (Arranz and Fdez De Arroyabe 2012; Cannon, Achrol, and Gundlach 2000; Faems et al. 2008; Gençtürk and Aulakh 2007; Klein Woolthuis, Hillebrand, and Nooteboom 2005; Poppo and Zenger 2002). Although this literature is very heterogeneous regarding the definition of formal and relational governance mechanisms (e.g., Hoetker and Mellewig 2006, 2009), we use the following definition: formal governance mechanisms refer to contractual, authoritative and ownership rules (Caniels and Geldermann 2010; Hansmann 1996; Wang et al. 2008; Zhang and Zhou 2013), and relational governance mechanisms refer to the role of trust, norms, and solidarity in economic relationships (Cai, Yang, and Jun 2011; Caniels,

Gelderman, and Vermeulen 2012; Heide and John 1992; Kaufmann and Stern 1988; Macneil 1983; Thorgren and Wincent 2011).

According to the interorganizational literature, formal governance mechanisms can vary positively or negatively with trust as relational governance mechanism. Some authors (e.g., Cavusgil, Deligonul, and Zhang 2004; Dyer 1997; Gulati 1995; Gulati and Sytch 2008; Nooteboom, Berger, and Noorderhaven 1997; Wang, Yeung, and Zhang 2011) suggest that trust can be a substitute for formal governance as a safeguard mechanism against opportunism risk under high exchange hazards. In this case, trust leads to lower transaction costs and reduces the need for formal governance through contracts, and more formal contracts decrease trust due to the negative effect on partners' motivation to behave cooperatively. Conversely, trust and formal governance mechanisms may be complements (e.g., Arranz and Fdez De

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Arroyabe 2012; Goo, Kishore, and Rao 2009; Li, Poppo, and Zhou 2010; Liu, Luo, and Liu 2009; Luo 2002; Poppo and Zenger 2002). In this case, trust increases communication and knowledge sharing and thus the knowledge base for designing more specified formal contracts, and more specified contracts support the development of trust by demarcating the self-enforcing range of contracts (Klein 1996).

In this study, we build on the embeddedness view, developed by Granovetter (1985) and Uzzi (1996, 1997), to examine the relationship between trust and formal governance through delegation of decision rights in franchise networks. The embeddedness approach aims to explain the impact of social relations on economic transactions, whereby embeddedness is defined as “degree to which commercial transactions take place through social relations” (Uzzi 1999, p. 482). The embeddedness view argues that trust is a “priming mechanism” (Uzzi 1999, p. 484) that promotes knowledge sharing, relational risk reduction, and consequently facilitates joint problem solving (McEvily and Marcus 2005; Wincent, Thorgren, and Anokhin 2013; Zand 1972). Therefore, trust is a behavioral prerequisite for information sharing and joint problem solving between the network partners (i.e., franchisor and franchisees). Thereby, trust increases the franchisees’ decision autonomy and consequently enhances the positive performance effect of decision rights delegation. Although the role of trust in franchising was examined in numerous previous studies (Chiou, Hsieh, and Yang 2004; Cochet, Dormann, and Ehrmann 2008; Croonen 2010; Dahlstrom and Nygaard 1995; Davies et al. 2011; Dickey, McKnight, and George 2007; López-Fernández and López-Bayón 2011), no prior study examines the franchisor’s perspective on the impact of formal governance through delegation of decision rights and trust on franchisor performance.

Our study makes two contributions. First, complementary to the literature on autonomy and relational governance from franchisees’ perspective (Cochet, Dormann, and Ehrmann 2008), this study adopts the franchisor’s organization design perspective by analyzing the effect of decision rights delegation and trust on franchisor performance. We argue that both trust and decision rights delegation have a positive direct impact on franchisor performance. In addition, we show that trust increases the franchisor’s propensity to delegate decision rights to the franchisees, thereby enhancing the positive performance effect of deci-

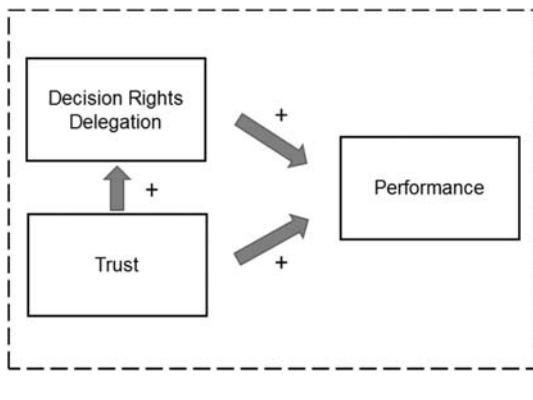
sion right delegation. Second, we contribute to the debate on the relationship between formal and relational governance. Complementary to the substitutability and complementarity perspective of formal and relational governance, we present an embeddedness view by arguing that trust is a behavioral prerequisite of formal governance through delegation of decision rights. Thus, the current study offers a new approach on the relationship between formal governance—that is, decision rights allocation—and trust as a relational variable.

Relationship between Trust, Formal Governance, and Performance

Trust and Formal Governance: An Embeddedness Perspective

Though the concept of trust has been assessed from various perspectives (e.g., Kramer 1999; Seppänen, Blomqvist, and Sundqvist 2007; Yamagishi and Yamagishi 1994; Zaheer, McEvily, and Perrone 1998), we define franchisor’s trust in line with Mayer, Davis, and Schoorman (1995) as the franchisor’s willingness to be vulnerable to the actions of the franchisee based on the expectation that the franchisee will perform a particular action important to the franchisor, irrespective of the ability to monitor or control the network partner. Therefore, the concept of trust represents the franchisor’s perception of the franchisees’ trustworthiness. Trust only influences formal governance if contracts are incomplete due to uncertainty and tacitness of knowledge (Blomqvist, Hurmelinna, and Seppänen 2005; Dhanaraj et al. 2004). Hence, the importance of trust for formal governance, that is, decision rights delegation, is driven by the degree of tacitness and environmental uncertainty. For instance, if the franchisor’s system-specific knowledge is codifiable, trust has only a weak influence on decision rights delegation, as exchange hazards are very low and the franchisor can explicitly specify the relevant knowledge in the contract (Gulati and Nickerson 2008). If the franchisor’s system-specific knowledge and the franchisees’ local market knowledge are tacit, the franchise contracts are very incomplete and the franchisor will delegate decision rights according to the intangibility of knowledge (Hendrikse and Windsperger 2011). Based on the embeddedness view (Granovetter 1985; Macneil 1983; Uzzi 1997, 1999), we argue that trust between network partners should address both appropriation and

Figure 1
Conceptual Framework



coordination-costs concerns (Gulati and Singh 1998). Accordingly, we distinguish two effects of trust on formal governance:

- First, trust reduces the exchange hazards by reducing relational risk and mitigating agency problems (Gulati 1995; Yu, Liao, and Lin 2006). When the franchisor trusts the franchisees a lot, the tolerance level of perceived relational risk will be higher for the franchisor, and the franchisor will more probably delegate a higher fraction of decision rights to franchisees. Hence, in a situation of high trust, the franchisor is likely to delegate decision-making to the franchisees because in this low relational risk situation the franchisee will use local market knowledge to increase the residual income stream of the network. Conversely, in a situation of low trust, the franchisor's tolerance level of perceived risk will be lower, and the franchisor is more likely to centralize decision-making to reduce relational uncertainty and agency problems. Consequently, the franchisees' autonomy will be increased by the relational risk reducing effect of trust.
- Second, trust overcomes communication barriers and facilitates knowledge sharing and joint problem solving (Blomqvist, Hurmelinna, and Seppänen 2005; Seppänen, Blomqvist, and Sundqvist 2007; Yeh, Lai, and Ho 2006; Zand 1972), thereby enabling the franchisor to delegate decision rights. In addition, more communication may lead to more trust between the network partners (Ben-Ner and Puttermann

2009). Consequently, in a situation of high trust, the franchisor will delegate more decision rights to the franchisees, as trust creates an incentive for the exchange of accurate and timely information (Uzzi 1996; Zand 1972). In conclusion, both the relational risk reduction and the knowledge sharing effect of trust will reduce hierarchical control (Gulati and Singh 1998) and increase the franchisor's propensity to delegate decision rights (see Figure 1).

Impact of Trust and Decision Rights Delegation on Performance

According to the governance literature (e.g., Gençtürk and Aulakh 2007; Li, Poppo, and Zhou 2010; Poppo and Zenger 2002; Wang, Yeung, and Zhang 2011), the performance of interfirm networks depends on formal governance and trust as a relational variable. First, by applying property rights and transaction cost reasoning, formal governance increases network performance through delegating decision rights according to the distribution of intangible knowledge assets between the franchisor and franchisees, and to the level of environmental uncertainty. Second, trust as an element of relational embeddedness increases information sharing and decreases relational risk and agency problems between the franchisor and franchisees, thereby increasing the performance of the franchise system. In addition, trust impacts performance also indirectly by facilitating decision rights delegation in the network. It promotes communication and joint problem solving and, therefore, increases the franchisor's propensity to delegate decision rights to the franchisees. We can conclude that both decision rights delegation and trust have a positive impact on performance for the franchisor (see Figure 1). In the following, we develop the hypotheses in detail.

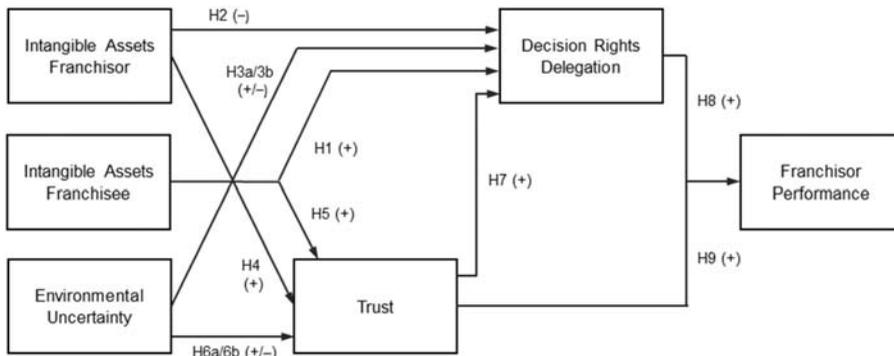
Research Model

The present research model explains the determinants of decision rights delegation and trust and their effects on franchisor performance. Figure 2 gives an overview of our research model.

Determinants of Decision Rights Delegation: Intangible Assets and Environmental Uncertainty

Decision Rights Delegation and Intangible Knowledge Assets. According to the property rights approach (e.g., Barzel 1989; Grossman and

Figure 2
Research Model



Hart 1986; Mumdziev and Windsperger 2011; Windsperger 2004), the allocation of decision rights between the franchisor and franchisees depends on the relation between tangible and intangible knowledge assets. Based on Hall's view (Hall 1993), the franchisor's intangible knowledge assets refer to the system-specific know-how and the brand name assets (Klein and Leffler 1981) that are characterized by a high degree of intangibility. The franchisees' intangible knowledge assets refer to the outlet-specific know-how, such as quality control, administrative capabilities, human resource management capabilities, local market knowledge, and innovation capabilities.

How does the distribution of intangible knowledge assets influence the delegation of decision rights to franchisees? If the system-specific and local market knowledge cannot be codified due to its tacitness, residual decision rights must be allocated between the franchisor and franchisees because tacit knowledge cannot be easily communicated and specified in contracts. As it is difficult to specify decision actions in franchise contracts under intangible knowledge assets, the person who has the intangible knowledge assets generating the residual surplus should have the residual decision rights to maximize the residual income. Based on this property rights reasoning (Windsperger 2004), we can formulate the following relationships: (1) if the franchisee's intangible local market assets are very important relative to the franchisor's intangible knowledge assets, the degree of delegation of decision rights in the franchising network should be relatively high and (2) if the franchisor's intangible assets,

specifically brand name assets, have a high impact on the residual surplus relative to the franchisee's intangible local market assets, the degree of delegation of decision rights should be relatively low. We therefore hypothesize the following:

- H1: Franchisees' intangible assets are positively related to the delegation of decision rights.*
- H2: Franchisor's intangible assets (such as brand name assets) are negatively related to the delegation of decision rights.*

Decision Rights Delegation and Environmental Uncertainty. Environmental uncertainty refers to the market and competitive uncertainty that influence the choice of the governance mode (Sutcliffe and Zaheer 1998). Transaction cost theory differentiates two views: the adaptation view and the control view of governance. According to the *adaptation view* of governance (Gibbons 2005; Gulati, Lawrence, and Puranam 2005; Simon 1947; Williamson 1991), higher environmental uncertainty requires more adaptability and hence more local information processing capacity through delegating coordination tasks to the local agents. If environmental uncertainty is high, firms tend to choose lower control to retain flexibility to be able to react to environmental changes (Erramilli and Rao 1993; Hippmann and Windsperger 2013; Klein, Frazier, and Roth 1990). When applied to franchising, we expect that the franchisor delegates more decision rights to the franchisees in the situation of high environmental uncertainty:

H3a: Environmental uncertainty is positively related to the delegation of decision rights.

Conversely, according to the *control view* of governance (Williamson 1971, 1975), firms will increase their information-processing capacity if the coordination requirements increase with environmental uncertainty. Stinchcombe (1990) asserts that organizations implement more elements of hierarchy when the degree of uncertainty increases. Similarly, Noordewier, John, and Nevin (1990) show that environmental uncertainty is positively related to the level of control in interfirm alliances. Therefore, when franchisors perceive increased environmental uncertainty (such as market volatility and low predictability of sales volume), they tend to increase control over operational decisions at the local markets. We therefore formulate an alternative hypothesis:

H3b: Environmental uncertainty is negatively related to the delegation of decision rights.

Determinants of Trust: Intangible Assets and Environmental Uncertainty

Existing literature on alliances highlights the importance of trust for the efficiency of interorganizational relationships by mitigating opportunism risk and increasing information sharing (e.g., Alvarez, Barney, and Bosse 2003; Bradach and Eccles 1989; Dant 2008; Gulati 1995; Gulati and Nickerson 2008; Heide 1994; Hibbard et al. 2001; Lui and Ngo 2004). Thereby, findings indicate that trust may lower transaction costs and increase transaction value in interorganizational relationships (Dyer 1997; Dyer and Chu 2003; Nooteboom 1996; Nooteboom, Berger, and Noorderhaven 1997; Zaheer and Venkatraman 1995; Zajac and Olson 1993).

Trust is particularly relevant when contracts are incomplete due to uncertainty and tacitness of knowledge assets (Becerra, Lunnan, and Huemer 2008; Blomqvist, Hurmelinna, and Seppänen 2005). Trust leads to cooperative behavior and facilitates communication and sharing of tacit (intangible) knowledge (Droege, Anderson, and Bower 2003). Consequently, the importance of trust for the success of franchise networks depends on the intangibility of franchisor's and franchisees' knowledge assets and the degree of environmental uncertainty.

Trust and Intangible Knowledge Assets. According to the knowledge-based view (e.g., Becerra, Lunnan, and Huemer 2008; Dhanaraj et al. 2004; Inkpen and Dinur 1998; Kogut and Zander 1992; Paswan and Wittman 2009; Zander and Kogut 1995), trust facilitates the transfer of tacit knowledge. If the franchisor's knowledge assets (system-specific and brand name assets) are codifiable, the franchisor can rely on formal contracts because exchange hazards are very low and the franchisor can explicitly specify the relevant knowledge in the contract (Gulati and Nickerson 2008). However, if the franchisor's system-specific and brand name knowledge is highly intangible, the franchise contracts are very incomplete and the franchisees have difficulties to understand and successfully apply the system-specific knowledge. Similarly, if the franchisees, local market knowledge is highly intangible, the franchisor has difficulties getting access to the local market knowledge. In this case, trust is an important relational mechanism that facilitates knowledge sharing between the franchisor and the franchisees. This view is compatible with Hoetker and Mellewigt (2009), who show that in an alliance there is a positive relationship between the presence of knowledge-based assets and relational governance. Hoetker and Mellewigt (2009) do not include brand name in the knowledge-based assets. However, as argued in previous franchising research, the franchisor's brand name is a highly intangible asset (e.g., Norton 1988; Windsperger 2004). Similarly, Inkpen and Dinur (1998), as well as Becerra, Lunnan, and Huemer (2008), argue that the transfer of tacit knowledge in joint ventures and alliances is more likely in the context of high trust. Consequently, we can formulate the following hypotheses:

H4: Franchisor's intangible assets are positively related to trust.

H5: Franchisees' intangible assets are positively related to trust.

Trust and Environmental Uncertainty. According to the relational view, high environmental uncertainty creates adaptation problems and increases the need for mutual adjustment between the network partners (Gulati, Lawrence, and Puranam 2005). Flexible adaptation requires relational embeddedness through trust that enables the parties to adjust to an uncertain

task environment. Nooteboom, Berger, and Noorderhaven (1997) argue that in case of frequent environmental changes, relational governance is more efficient as it copes better with adaptation problems. High flexibility facilitates sequential adaptation and mutual adjustment thereby reducing transaction costs under high environmental uncertainty. In line with Hill (1990), we argue that high uncertainty results in high transaction costs that can be reduced by developing trust. Thus, we hypothesize the following:

H6a: Environmental uncertainty is positively related to trust.

In contrast to the previous argument, high environmental uncertainty may negatively impact the level of trust. Under high environmental uncertainty, the franchisor may have difficulties to evaluate the competencies, behavior, and performance of the franchisees that may result in higher relational risk and a lower level of trust. In addition, based on the over-embeddedness view of Uzzi (1997), higher flexibility to use new knowledge is supported by a lower level of trust because high trust implies embedded ties between the network partners which lead to high adjustment costs (Larson 1992). This view is consistent with results in management literature (Krishnan, Martin, and Noorderhaven 2006) and in marketing literature (Geysken, Steenkamp, and Kumar 1998; Kumar, Scheer, and Steenkamp 1995; Noordhoff et al. 2011; Selnes and Salis 2003). Hence, we derive the following hypothesis:

H6b: Environmental uncertainty is negatively related to trust.

Trust and Decision Rights Delegation

In franchise networks, contracts are relational in their nature (Hadfield 1990). In this perspective, the franchisor views the relationship as an opportunity to generate relational rents by encouraging cooperation and trust (Dyer and Chu 2003; Dyer and Singh 1998). Franchisors who trust franchisees will perceive lower relational risk and have easier access to local market information, thus, reducing the requirements for formal control (Gulati and Singh 1998). In these relationships, trust mitigates coordination costs and appropriation concerns and consequently facilitates joint problem solving and delegation

of decision rights in the network (Dant and Gundlach 1998; Lopez-Fernandez and Lopez-Bayon 2011). Thus, we expect that a higher level of trust by the franchisor will lead to a higher fraction of decision rights delegated to franchisees, leading to the following hypothesis:

H7: Trust is positively related to delegation of decision rights.

Impact of Trust and Decision Rights Delegation on Performance

Decision Rights Delegation and Franchisor Performance. Though there is scarce research on the link between allocation of decision rights and performance in networks (Windsperger 2009), we expect that, due to the local network partners' higher local information processing capacity and entrepreneurial orientation, delegating decision rights to local network partners (that is, franchisees), will lead to better decisions for both the franchisor and franchisees, which in turn leads to higher performance. The positive impact of decentralization on performance is compatible with results of Kidwell, Nygaard, and Silkoset (2007). Hence, we formulate the following hypothesis:

H8: Delegation of decision rights is positively related to franchisor performance.

Trust and Franchisor Performance. A large number of studies on interfirm alliances show that trust as a relational variable is positively associated with performance (e.g., Dant 2008; Dyer and Chu 2003; Hibbard et al. 2001; Laaksonen, Jarimo, and Kulmala 2009; Liu, Luo, and Liu 2009; Poppo and Zenger 2002; Poppo, Zhou, and Zenger 2008; Robson, Katsikeas, and Bello 2008; Schumacher 2006; Spralls, Hunt, and Wilcox 2011; Wang, Yeung, and Zhang 2011). According to the relational view, trust reduces relational risk (Das and Teng 2004) and increases information sharing between the network partners. Relational risk reduction is associated with agency and transaction cost savings, and information sharing is associated with the creation of relational rents (Dyer and Singh 1998) leading to higher performance. Applied to franchising, a high level of franchisor's trust in the franchise partners is supposed to have a positive effect on franchisor performance. Consequently, we state the following hypothesis:

H9: Trust is positively related to franchisor performance.

With regard to the causality of trust, decision rights delegation and performance, the present model is built on a managerially driven perspective. Several authors (e.g., Gulati and Nickerson 2008; Mohr and Puck 2013) have critically discussed the causality of trust, decision rights delegation and performance. Yet from a managerially driven perspective, performance is modeled as key outcome that can be affected by management action (here the selected allocation of decision rights). In line with the embeddedness perspective, trust is an antecedent of the franchisor's selected decision rights delegation, as well as a positive driver of franchisor performance (Gulati and Singh 1998).

Empirical Analysis

Sample

To test the hypotheses, we collected data from the German franchise sector. The directory of the German Franchise Federation (DFV) and "Franchise Wirtschaft" (Verzeichnis der Franchise Wirtschaft 2009/2010) (a Bond's Franchise Guide type directory published in Germany) list all franchise systems including various descriptive data about each franchise system (e.g., year of system establishment, number of outlets, business sector). Overall, the directories hold a list of 837 franchise systems operating in Germany. The selection criteria for the sample frame were (1) at least five franchise outlets to secure nonexclusive partnership between franchisees and the franchisor and (2) an established franchise relationship of at least four years. To ensure a more confident level of knowledge on the relevant variables about the franchise partner, specifically on trust, we assume that a minimum number of outlets or a minimum number of years of inter-organizational experience is necessary. The resulting sampling frame contained 491 franchise systems. The respondents within these franchise systems were selected based on their expertise and relevance to the subject under investigation (McKendall and Wagner 1997) and included only senior managers, who are mainly responsible for franchise expansion. Self-administered questionnaires were mailed to the key informants of all 491 relevant franchise systems in Germany. We received 137 questionnaires leading to a final response rate of 28 percent. Due to missing values, 12 cases of the initial sample had to be dropped, leading to a

final sample of 125 cases. Based on Podsakoff et al. (2003), we used Harman's single-factor test to examine whether a significant amount of common method variance exists in the data. Common method bias could not be corroborated.

Next, we checked for the late and nonresponse bias: first, nonresponse bias was estimated by comparing early versus late respondents (Armstrong and Overton 1977), where late respondents serve as proxies for nonrespondents. Second, the respondents were compared to nonrespondents in terms of age, size, advertising fee, and royalties to determine whether nonresponse was a serious problem for the data. We used this data to run independent sample t-tests to check whether the sample is representative and found no significant difference between the respondents and the nonrespondents.

Measurement

All constructs were assessed via multi-item measures. Franchisors were asked to rate all items on a seven-point Likert scale (see Appendix for measurement details). The items of each construct are discussed in the following:

- **Franchisor Performance.** We used subjective measures of franchisor performance as objective performance data is fraught with difficulties because most of the franchise systems in the survey do not disclose financial data. According to previous studies (e.g., Dess and Robinson 1984; Glaister and Buckley 1998), subjective performance measures are highly correlated with objective performance measures. Franchisor performance is measured as an average of three items: reduction in operational costs, savings in coordination and control costs, and increase in innovation. Reduction in operational costs and savings in coordination and control costs refer to the static (or exploitation) efficiency and increase in innovation to the dynamic (or exploration) efficiency of the network (Ghemawat and Ricart I Costa 1993; Miller, Washburn, and Glick 2013; Sorenson and Sørensen 2001).
- **Decision Rights Delegation.** To assess the delegation of decision rights, the franchisor indicates the franchisee's influence on a number of decisions (Windsperger 2004), for example, selection of suppliers, product/service offering, resale price, advertising, equipment, procurement, new products and the application of accounting and controlling systems.

- **Trust.** In line with previous studies, we operationalize trust using multiple scale items designed to measure the extent to which the franchisor trusts the franchisees (Anderson and Narus 1990; Dyer and Chu 2000; Zaheer and Venkatraman 1995). Franchisors' trust was measured by asking franchisors to rate the level of trust based on their interaction experience with the franchisees.
- **Franchisors' Intangible Assets.** Franchisor's intangible assets are operationalized by the brand name of the franchise system. Adopted from Barthélemy (2008), franchisors were asked to rate their systems on brand strength, brand recognition, reputation for quality, and the importance of the brand name for achieving competitive advantage.
- **Franchisees' Intangible Assets.** Franchisees' intangible assets refer to the franchisees' local market know-how consisting of exploration and exploitation capabilities (Bradach 1997; Sorenson and Sørensen 2001). Franchisors were asked to evaluate franchisees' intangible local market know-how regarding innovation, local market knowledge, quality control, administrative capabilities, and human resource management (Mumdzhev and Windsperger 2011; Windsperger and Dant 2006).
- **Environmental Uncertainty.** Adapted from Celly and Frazier (1996) and John and Weitz (1988), franchisors were asked to provide their perception regarding fluctuations in the outlet sales, unpredictability of the market and volatility of the local economic environment to assess the overall environmental uncertainty.

Control Variables

We considered the possibility that additional variables characterizing the franchise-systems could also impact our focal variables decision rights delegation, trust, and franchisor performance. In accordance with existing literature (e.g., Gillis, Combs, and Ketchen 2014; Windsperger 2004), we examined how age, size, and franchise sector influence our focal variables. Age measures the number of years the franchise system is operating, size measures the number of franchised and company-owned outlets, and sector refers to product or services franchising. Analyzed separately, none of the three control variables is significantly correlated to franchisor performance ($p > .10$), trust ($p > .10$), or delegation of decision rights ($p > .10$). When all three

control variables are entered simultaneously in a multiple regression predicting performance, none of them is statistically significant ($p > .10$) and the adjusted R -squared is 0.3 percent. The same holds for trust (adjusted R -squared = 0.2 percent), and delegation of decision rights (adjusted R -squared = 0.1 percent). Therefore, we can conclude that the considered control variables do not predict our focal variables.

Measurement Assessment

Exploratory factor analysis assessed the dimensionality of the items. Review of the factor loadings, reliabilities, and item-to-total correlations for each scale led to the removal of six initial items, establishing unidimensionality for each of our six constructs (Netemeyer, Bearden, and Sharma 2003). A confirmatory factor analysis reconfirmed a six factor solution for the 27 items (Anderson and Gerbing 1988), explaining 64.09 percent of the variance. Reliabilities of the employed constructs exceed the critical Cronbach's alpha value of 0.70 (Cronbach 1951; see Appendix). Table 1 provides descriptive statistics and correlations for the constructs. All constructs exceed the guideline of 0.60 for composite reliability (Bagozzi and Yi 1988).

We conducted discriminant validity tests employing Fornell and Larcker's (1981) criterion. For each construct, the highest amount of shared variance with other constructs is remarkably lower than the corresponding average variance extracted, supporting discriminant validity (see Table 2).

Structural Equation Model

To test our proposed model, we applied structural equation modeling using LISREL 8.80. The overall model fit is highly satisfactory, with major fit indices showing good values ($\chi^2 = 459.32$, $df = 312$, RMSEA = 0.048; SRMR = 0.084; NNFI = 0.93; CFI = 0.94).

The results of the hypotheses testing are presented in Figure 3. The influence of both franchisees' and franchisors' intangible assets (H1, H2) on the delegation of decision rights is weak and nonsignificant. In line with H4, franchisors' intangible brand name assets have a significant positive effect on trust ($\beta = 0.25$). Surprisingly, franchisees' intangible local market assets have no impact on trust, thus, failing to support H5. Hence, the role of franchisees' intangible local market assets does not matter in the present setting for the delegation of decision rights and trust. In addition, environmental uncertainty

Table 1
Descriptive Statistics and Correlation Coefficients for the Model Constructs

	Mean (S.D.)	1	2	3	4	5	6
1 Franchisor's Intangible Assets	5.61 (1.130)	1.000					
2 Franchisee's Intangible Assets	3.64 (1.227)	-0.057	1.000				
3 Environmental Uncertainty	3.72 (1.368)	-0.112	0.116	1.000			
4 Decision Rights Delegation	4.86 (1.363)	0.117	-0.046	0.008	1.000		
5 Trust	5.78 (1.046)	0.286**	-0.157	-0.292**	0.357**	1.000	
6 Franchisor Performance	4.55 (0.986)	0.353**	-0.035	-0.236**	0.402**	0.349**	1.000

**Correlations significant at the 0.01 level (two-tailed). All constructs were measured on seven-point Likert scales with 1 = strongly disagree to 7 = strongly agree.

shows no significant influence on the delegation of decision rights, thus, failing to support H3a and H3b; yet environmental uncertainty has a strong significant negative effect on trust ($\beta = -0.31$), supporting H6b. Trust has a strong positive influence ($\beta = 0.41$) on the delegation of decision rights, supporting H7. Furthermore, we find a significant positive influence of trust ($\beta = 0.22$) and delegation of decision rights ($\beta = 0.38$) on franchisor performance, supporting H8 and H9. Overall, delegation of decision rights and trust explain 26 percent of the variance of franchisor performance. Notably, the aim of the model was not to find the main drivers of performance, but to explore the effects of delegation of decision rights and trust in fran-

chise networks. Therefore, an explained variance of 26 percent of franchisor performance can be regarded as noteworthy and strong. The proposed mediating effect of trust is empirically supported by the data, as we find strong influence of environmental uncertainty and franchisor's intangible assets on trust, and at the same time, a strong link between trust and decision rights delegation.

Discussion and Implications Findings

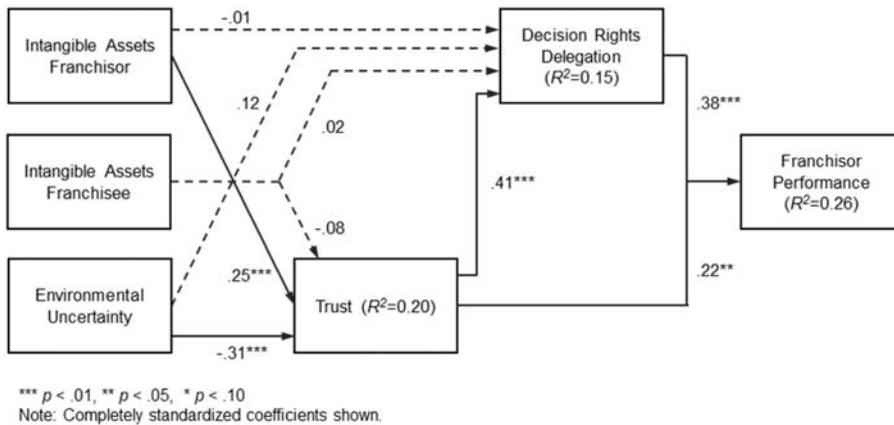
In this study, we build on the embeddedness view, developed by Granovetter (1985) and

Table 2
Discriminant Validity

	1	2	3	4	5	6
1 Franchisor's Intangible Assets	0.600					
2 Franchisee's Intangible Assets	0.003	0.419				
3 Environmental Uncertainty	0.013	0.012	0.533			
4 Decision Rights Delegation	0.002	0.014	0.000	0.463		
5 Trust	0.001	0.125	0.056	0.162	0.673	
6 Franchisor Performance	0.025	0.082	0.085	0.127	0.122	0.490

Bold values on the diagonal show the average variance extracted, numbers below the diagonal represent squared correlations.

Figure 3
Findings



Uzzi (1996, 1997), to examine the relationship between trust and formal governance through delegation of decision rights in franchise networks. Compared to Cochet, Dormann, and Ehrmann (2008), who adopted a franchisees' perspective on autonomy and trust, this study focuses on the franchisor's perspective by investigating the effect of decision rights delegation and trust on franchisor performance. Building on the present empirical investigation, we derive the following results:

- First, intangible brand name assets positively impact franchisor performance via a high level of trust, as high trust functions as a facilitator of intangible knowledge transfer to the local network partners. This result is consistent with the knowledge-based view (e.g., Dhanraj et al. 2004; Paswan and Wittman 2009; Zander and Kogut 1995) arguing that trust enables the franchisor to transfer highly intangible system knowledge to the local network partners.
- Second, high environmental uncertainty will negatively impact franchisor performance via a lower level of trust. Increasing environmental uncertainty makes franchisors skeptical, leading to lower trust toward their franchisees. This result is compatible with the over-embeddedness view of trust (Uzzi 1997). Research results have shown that strongly embedded ties between partners may enhance "the opportunity for malfeasance" (Granovetter 1985, p. 491). Thereby franchi-

sor's vulnerability will increase with environmental uncertainty. In this case, the problem of hidden costs of trust arises (Gundlach and Cannon 2010; Selnes and Sallis 2003).

- Third, trust impacts performance not only directly but also indirectly by facilitating decision rights delegation in the network. Trust promotes communication and joint problem solving and increases the franchisor's propensity to delegate decision rights in the franchise network. Therefore, there is a trade-off between efficient exploitation of the existing system knowledge that requires more embedded ties, which facilitate delegation, and efficient exploration of new local market knowledge under a highly uncertain business environment that is compatible with fewer embedded ties.

In conclusion, the overall performance effect of trust and decision rights delegation depends on the attribute of system knowledge (e.g., intangible brand name assets) and the level of environmental uncertainty. If a franchise network is characterized by low environmental uncertainty and highly intangible brand name assets, the positive direct and indirect performance effect of trust, due to highly intangible brand name assets, will likely exceed the negative performance effect of environmental uncertainty. In this case, the "hidden costs of trust" (Selnes and Salis 2003, p. 80) are relatively low. Conversely, if the environmental uncertainty is high and the brand name assets are more

codifiable, the transfer of system know-how to the local partners does not require a high level of trust (Gorovaia and Windsperger 2011). Simultaneously, high environmental uncertainty requires high entrepreneurial flexibility of the franchisor and lower embeddedness of the network partners to flexibly respond to new information. Therefore, under high environmental uncertainty, over-embeddedness (Uzzi 1997) of the network partners will reduce entrepreneurial responsiveness and hence increase the hidden cost of trust.

The present empirical results do not support the hypotheses regarding the direct impact of environmental uncertainty and intangible local market knowledge on the delegation of decision rights. This may be due to the imbalance of power between the franchisor and the franchisees (Michael 2000). In this situation, franchisor's allocation of decision rights to franchisees may not fully reflect the importance of local market conditions (environmental uncertainty and outlet-specific know-how) for the success of the system. In addition, there might be other factors that impact franchisor's allocation of decision rights, such as the intrinsic value of authority (Herz, Bartling, and Fehr 2011) or the leadership style (Anderson and Brown 2010).

Furthermore, our results indicate that the franchisor will not increase control by centralization of decision-making when the importance of franchisor's intangible assets increases. This might be due to the fact that in a high trust situation the franchisor perceives lower relational risk and hence increases the knowledge flow from the headquarters to the franchisees resulting in less formal control.

Moreover, franchisor's trust toward their franchisees is not related to the franchisees' intangible local market assets, as proposed by the knowledge-based theory. One reason could be that trust as facilitator of the transfer of local market knowledge from the franchisees to the franchisor may be less suitable if the importance of franchisees' intangible local market knowledge increases. In this situation, the franchisor transfers more decision rights regarding operational activities to the partners with the intangible local market knowledge because the costs of transferring knowledge are high. Additionally, this result might be due to availability biases of the franchisors (Tversky and Kahnemann 1974), who may not consider trust as enabler of access to local knowledge.

Finally, the control variables (age, size, and sector) do not significantly influence our focal variables. These results deviate from previous research (e.g., Mumdziev and Windsperger 2011).

Implications and Limitations

This study has important implications for both researchers and franchisors. First, to the best of our knowledge, it is the first study that adopts a franchisor's perspective on performance implications of delegation of decision rights and trust in franchise networks. The present findings show a strong positive influence of delegation of decision rights and trust on franchisor performance. The more decision rights are delegated to the franchisees and the higher the level of trust, the better the performance of the franchisor.

Second, trust is positively related to delegation of decision rights. This result is consistent with the embeddedness view (Granovetter 1985; Uzzi 1996, 1997). Trust is a priming mechanism that facilitates joint problem solving and delegation of decision rights (Uzzi 1999). In other words, trust increases information sharing and reduces relational risk and thus mitigates agency problems between the franchisor and the franchisees, thereby enabling the franchisor to increase the level of franchisees' autonomy in operational decision-making.

Third, this study contributes to the relational governance literature on interfirm alliances. According to the relational view of governance (e.g., Faems et al. 2008; Gulati 1995; Klein Woolthuis, Hillebrand, and Nooteboom 2005; Poppo and Zenger 2002), trust may influence the use of formal governance mechanisms. Our study shows that trust is a facilitator of delegation of decision rights to the network partners. Therefore, trust as an element of relational embeddedness, creates the informational and motivational prerequisites for improving network performance through delegation of decision rights (Uzzi 1997; Wincent, Thorgren, and Anokhin 2013). Consequently, our results extend the literature on formal and relational governance in interfirm alliances by arguing that there is a causal relationship between trust and decision rights delegation as trust is a priming mechanism that promotes decision-making autonomy.

On the managerial front, the present results suggest that delegation of decision rights in franchise networks strongly increases franchisor performance if it is supported by a high level of

trust, because trust creates an internal network environment that increases information sharing and reduces franchisor's agency problems. Therefore, the franchisor has to set up a governance structure that is characterized by embedded ties based on trust, which enables the transfer of tacit system knowledge and increases the positive performance effect of delegation of decision rights. Simultaneously, the franchisor should be cautious to retain entrepreneurial flexibility when the local market environment is very dynamic. In this case, over-embedded ties may negatively impact performance by reducing local responsiveness.

Finally, several limitations have to be acknowledged. First, we used only brand name assets as indicator for the franchisor's intangible assets as our data set does not provide appropriate indicators for system-specific assets. Future research has to consider both brand name and system-specific assets. Second, intangible assets of the franchisees show nonsignificant effects on the decision right allocation. This could be a measurement issue, as only franchisors were asked. As particularly the intangible assets and trust strongly depend on subjective perceptions, it is recommended to ask both sides, as in a franchisor-franchisee network both parties may have deviating individual perceptions. Third, a performance measure can be based on objective or subjective indicators (e.g., Combs et al. 2011; Kidwell, Nygaard, and Silkoset 2007). In this study, the performance measurement is based on subjective indicators. Though objective measures have greater validity, most of the franchise systems in this survey do not disclose financial data. Although the literature has demonstrated that there is a strong positive correlation between objective and subjective performance indicators, future studies should test the research model using both subjective and objective performance indicators that are closely related to the theoretical framework (Crook et al. 2008). Fourth, though the test of our research model provides interesting results, we were able to explain 26 percent of the variance of our performance measure. This indicates that there are additional variables, not included in this study that impact franchisor performance.

Conclusion

Our research suggests that delegation of decision rights and trust are important drivers of franchisors' performance. The study offers a

new perspective on the relationship between formal governance—through decision rights delegation—and trust. Based on the embeddedness view, trust is a facilitator of information sharing, joint problem solving and delegation of decision rights in franchise networks, thereby increasing the positive performance effect of decision rights delegation.

Finally, we turn to some more general remarks and relate our paper to the original transaction cost theory of Williamson (1975) and its extension by Ouchi (1979, 1980) who already argued that trust is not a governance mechanism but a behavioral prerequisite for formal governance. Williamson's organizational failure framework (1975) shows that internal and interfirm governance forms are influenced by bounded rationality, uncertainty/complexity, transaction-specificity, and opportunism. Although opportunism is a major explanatory variable in the transaction cost framework, Williamson also argues that alternative governance modes "differ in nontrivial atmospheric respects" (Williamson 1975, p. 38). In Williamson's work, atmosphere refers to "quasimoral involvements" (Williamson 1975, p. 38), which may include trust and norms. The importance of atmosphere for governance modes has been further developed by Granovetter (1985) and Uzzi (1997) in economic sociology. They argued that economic transactions are embedded in social relations. Especially, trust is an element of embeddedness (Chiles and McMackin 1996) facilitating information exchange and cooperation, consequently influencing formal governance. Hence, we can conclude that trust, as an element of embeddedness, is a primal factor influencing formal governance (Uzzi 1996, 1999), which is compatible with Williamson's concept of atmosphere (Williamson 1975).

Ouchi (1979, 1980) extended the market failure framework of Williamson by including clan as alternative governance mechanism, in addition to market and bureaucracy. According to Ouchi (1979), clan control is based on agents' common agreement on values and norms in an exchange relationship. Shared values and beliefs imply a high level of trust and reduce the necessity of using the price mechanism of the market and the explicit rules of bureaucracy leading to lower transaction costs. However, in reality, all governance forms contain a combination of features of each of the three control modes (Bradach and Eccles 1989; Stinchcombe 1985). For instance, networks (such as strategic alliances, joint ventures, franchising) always combine all

three control modes to a certain extent. Ouchi's framework (1979, 1980) is closely related to the embeddedness view because clan control is only possible under highly embedded relationships characterized by high trust between the exchange partners. Conversely, Ouchi's framework (1979, 1980) shows that trust is not a governance mechanism but a prerequisite for the functioning of governance mechanisms. Depending on the level of trust between the network partners, interorganizational governance forms (such as franchise networks) are characterized by a combination of price, bureaucracy, and clan control components. As highlighted by our results, high-trust franchise networks are more decentralized, implying a high clan control-component in the network structure.

Overall, we can conclude that, based on the embeddedness view, our results show that trust is a priming mechanism facilitating formal governance through delegation of decision rights. We hope that our contribution inspires further research on the role of trust and formal governance in franchise chains and other interorganizational networks.

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Appendix : Measures

Construct	Items	Measurement
Franchisor's Intangible Assets $a = 0.846$ C.R. = 0.854 AVE = 0.600	<ol style="list-style-type: none"> 1. Our brand is very strong compared to our competitors. 2. Our franchise system enjoys higher brand recognition compared to our competitors. 3. Our franchise system enjoys a good reputation for quality. 4. Our brand name is very important for us for achieving competitive advantage. 	Four seven-point items, anchored by "strongly disagree" [1] and "strongly agree" [7], adapted from Barthélemy (2008).
Franchisee's Intangible Assets $a = 0.773$ C.R. = 0.772 AVE = 0.419	Franchisee's know-how advantage compared to the manager of a company-owned outlet evaluated by the franchisor with regards to: <ol style="list-style-type: none"> 1. Innovation 2. Local market knowledge 3. Quality control 4. Administrative capabilities 5. Human resource management 	Five seven-point items, anchored by "strongly disagree" [1] and "strongly agree" [7], adapted from Mumdzhev and Windsperger (2011).
Environmental Uncertainty $a = 0.747$ C.R. = 0.762 AVE = 0.533	<ol style="list-style-type: none"> 1. The sales at the outlet level are very fluctuating. 2. It is very difficult to predict the market development at the outlet level. 3. The economic environment in the local market changes rapidly. 	Three seven-point items, anchored by "strongly disagree" [1] and "strongly agreed" [7], adapted from Celly and Frazier (1996) and John and Weitz (1988).
Decision Rights Delegation $a = 0.867$ C.R. = 0.872 AVE = 0.463	To which extent are the following decisions influenced by the franchisee? <ol style="list-style-type: none"> 1. Supplier decision 2. Product/service decision 3. Resale price decision 4. Advertising decision 5. Equipment decision 6. Procurement decision 7. New product decision 8. Accounting and controlling system decision 	Eight seven-point items, anchored by "not at all" [1] and "very large extent" [7], based on Windsperger (2004) and Mumdzhev and Windsperger (2011).
Trust $a = 0.876$ C.R. = 0.889 AVE = 0.673	<ol style="list-style-type: none"> 1. The cooperation is based on partnership basis. 2. The exchange of information between us and the partners goes beyond the agreed scope. 3. There is great trust between us and the partners. 4. There is an atmosphere of openness and honesty between us and the partners. 	Four seven-point items, anchored by "strongly disagree" [1] and "strongly agree" [7], derived from Anderson and Narus (1990), Dyer and Chu (2000), Zaheer and Venkatraman (1995).
Franchisor Performance $a = 0.714$ C.R. = 0.733 AVE = 0.490	To which extent have you realized the following goals in the last year? <ol style="list-style-type: none"> 1. Reduction in operational costs 2. Increase in innovation 3. Savings in coordination and control costs 	Three seven-point items, anchored by "much worse than planned"[1] and "much better than planned" [7], derived from Ghemawat and Ricart I Costa (1993) and Sorenson and Sørensen (2001).

¹ a , Cronbach's alpha; C.R., Composite reliability; AVE, Average variance extracted.