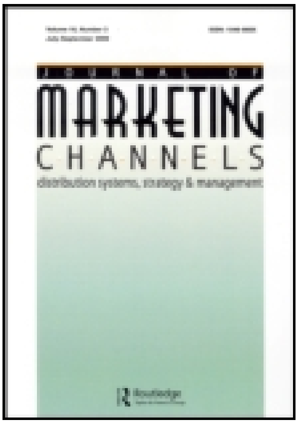

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Contractibility, Strategy, and Network Dynamics: From Franchising to Licensing

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Contractibility, Strategy, and Network Dynamics: From Franchising to Licensing

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The article examines the network dynamics from franchising to licensing due to the increase of contractibility of the franchiser's system-specific assets as determinant of the allocation of decision rights between the network partners. Based on the property rights approach, residual decision rights must be allocated according to the distribution of intangible knowledge assets between the franchiser and franchisee. Our analysis derives the following hypothesis: The more contractible the franchiser's system-specific assets, the higher is the tendency from franchising toward licensing. In addition, we investigate the impact of strategy change on the standardization (contractibility) of system-specific assets and the network governance. We argue that a change of strategy may increase the contractibility of system-specific know-how and consequently the tendency toward licensing. This study presents empirical evidence from company Getifix on the network dynamics from franchising to licensing.

KEYWORDS *decision rights, franchising, governance form, licensing, network dynamics, strategy*

INTRODUCTION

The objective of the article is to explain the network dynamics from franchising to licensing due to the increase of contractibility of the franchiser's system-specific know-how as determinant of the allocation of decision rights between the network partners. In the last two decades, many researchers in marketing, organization economics, and strategic management investigated the influence of transaction costs, agency costs, and resources on the degree

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of vertical integration of franchising networks (e.g., Brickley & Dark, 1987; Norton, 1988; Dahlstrom & Nygaard, 1994; Lafontaine & Kaufmann, 1994; Bradach, 1997; Cliquet, 2000; Dant & Kaufmann, 2003; Lafontaine & Shaw, 2005; Castrogiovanni, Combs, & Justis, 2006). In addition, starting from Grossman and Hart (1986), Hart and Moore (1990), Hart (1995), and Barzel (1997), Windsperger and Dant applied the property rights theory to explain the allocation of decision and ownership in franchising firms (e.g., Windsperger, 2004; Windsperger & Dant, 2006). However, no study investigated the determinants of network dynamics from franchising to licensing. Under given asset ownership, this study examines the network dynamics from franchising to licensing by applying the property rights theory in combination with research results from strategic management and organization theory (Nonaka, 1994; Teece, Pisano, & Shuen, 1997; Zajac, Kraatz, & Bresser, 2000; Nickerson, Hamilton, & Wada, 2001; Kraatz & Zajac, 2001; Yin & Zajac, 2004; Helfat & Peteraf, 2003).

According to the property rights theory, the structure of decision rights depends on the distribution of intangible knowledge assets that generate the firm's residual surplus. In franchising, intangible knowledge assets refer to the brand name assets and the system-specific know-how of the franchiser and the local market know-how of the franchisee. The franchisee's intangible assets refer to the outlet-specific know-how in local advertising and customer service, quality control, human resource management, and product innovation. The franchiser's intangible assets refer to the system-specific know-how and brand name assets (Hall, 1993; Sorenson & Sorensen, 2001). We argue that the franchiser will change its governance form from franchising to licensing, if the contractibility of system-specific assets increases, due to organizational learning and strategy change during the organizational life cycle. In this case, the franchiser requires fewer residual decision rights concerning the use of system-specific assets at the local outlets because he can more completely specify the use of system-specific assets in contracts. The thesis of our article is: The more contractible the franchiser's system-specific assets compared to the franchisee's local market assets, the lower is the franchiser's proportion of residual decision rights in the network and the higher is the tendency toward licensing.

Our main contribution to the literature is to apply the property rights theory in combination with the strategic management view of the firm to explain the change of governance form from franchising to licensing. First, we develop a property rights view on the dynamics of decision rights from franchising to licensing. Second, we extend the property rights view by integrating results from organization theory and strategic management. We argue that, under given market environment, resources and capabilities of the firm determine the firm strategy, and the strategy influences the asset characteristics and the governance form. Therefore, this research advances the theoretical view on network dynamics by stating that the change of governance form from franchising to licensing depends on the change of asset contractibility due to organizational learning and strategy change. Third, we fill the gap between the levels of analysis of property rights theory and strategic theory of the firm. While the property rights theory focuses on the explanation of governance forms under given strategy, the strategic management view tends to emphasize on the relation between strategy and governance form. Our work tries to bridge this gap by analyzing the impact of strategy on assets contractibility and governance form.

The article is structured as follows: Section two discusses the main differences between franchising and licensing as governance forms. Section three develops the hypotheses concerning the network dynamics from franchising to licensing (a) under given strategy and (b) under change of strategy of the franchiser. In section four, we apply this framework to the case study Getifix. Section five presents the conclusions.

DIFFERENCES BETWEEN FRANCHISING AND LICENSING AS GOVERNANCE FORM

What are the major differences between franchising and licensing as alternative governance forms? According to the International Franchise Association (2009), franchising is a method of distributing products or services:

> At least two levels of people are involved in a franchise system: the franchiser, who lends his trademark or brand name and a business system, and the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchiser's name and system.

We can distinguish between two different forms of franchising: In product and trade name franchising, the franchisee is granted the rights either to sell a product under the franchiser's brand name or to manufacture a product according to the process defined by the franchiser (e.g., the recipe in the food industry) and also to market the product under the franchiser's brand name. In business format franchising, the franchiser grants to the franchisee not only the right to use the franchiser's brand name but, the right to use an entire business format—"a marketing strategy and plan, operating manuals and standards, quality control, and continued two-way communications." (Konigsberg, 2008, pp. A.1–5; Burrone, 2006).

Franchising can be defined by the following three constitutional elements (Rubin, 1978; Townsend, 2009; Brouthers & McNicol, 2009): The franchisee's goods and/or services are to be offered and sold under the trademark of the franchiser, the franchiser maintains significant control of, or provides significant assistance to, the franchisee's operation methods, and the franchiser requires the franchisee to pay a fee as condition of obtaining the franchise or of beginning initial operations. Therefore, franchising is characterized by the franchiser's transfer of the system-specific brand name to the local franchisees and the franchiser's significant control over the partners' local market operations.

Hadfield (1990) differentiates between franchising and licensing by focusing on two key dimensions: Ownership and control. Franchising is a hybrid relationship: "With respect to control, franchising relationships are closest to the employment end of the continuum .... With respect to ownership, however, franchising is much closer to the independent contracting model" (Hadfield 1990, p. 932). The franchiser exercises not only control over the use of its system-specific assets but some control over the use of complementary local market assets. Conversely, licensing is a form of market contracting (Teece, 1986, 1998; Williamson, 1991; Grindley & Teece, 1997; Fosfuri, 2006). Both the licensor and licensee own some of the assets, and both exercise control as independent decision makers regarding the use of their assets (Hadfield, 1990; Brouthers & McNicol, 2009). Therefore, licensing is characterized by the fact that the licensor does not permit the licensee to use the licensor's brand name, trademark, and/or logo as the name of licensee's business, respectively, in a substantive or primary way, and the licensor does not exercise control on the partners' local market operations and marketing activities (use of local market assets).

THEORY DEVELOPMENT

Before we present the hypotheses on the dynamics of decision rights from franchising to licensing, we develop the property rights propositions on the allocation of decision rights in franchising and licensing.

Structure of Decision Rights in Networks: A Property Rights View

According to the property rights approach, the structure of decision rights depends on the distribution of intangible (non-contractible) assets between the partners (Lerner & Merges, 1998; Aghion & Tirole, 1997; Aghion, Dewatripont, & Rey, 2004; Baker, Gibbons, & Murphy, 2008; Hendrikse & Windsperger, 2009). The person who has intangible knowledge that generates the residual surplus should have residual decision rights to maximize the residual income. In addition, specific decision rights are explicitly stipulated in contracts (Demsetz, 1998). For instance, specific user rights over a computer may be rights to use it to run a particular program in a particular manner in a particular time period for some specific purpose (Foss & Foss 1998). Therefore, they refer to the use of explicit knowledge of the parties that can be easily written down and specified in contracts. The relationship between knowledge and decision rights can be stated by the following proposition: The more intangible and hence less contractible a person's knowledge assets, the more residual income is generated by the knowledge assets and the higher is the fraction of residual decision rights relative to specific decision rights assigned to that person.

We apply this approach to the choice of the governance form between two partners, A and B. We compare four possible forms of governance: Franchising, licensing, company ownership of a chain, and market contracts. We assume that the only relevant assets are a_0, the system-specific assets (owned by A) and a_1, the local market assets (owned by B); in addition, decision rights (DR) refers to specific decision rights (sDR) and residual decision rights (rDR; see Figure 1).

Franchising

We assume that both system-specific assets, a_0, and local market assets, a_1, show a high degree of intangibility and hence a high degree of non-contractibility. In this case, a_0 and a_1 cannot be specified in a contract between A and B. Under this bilateral dependency, the residual decision rights must be divided between the two partners because both assets are important for the generation of residual income of the network. Under low contractibility of both assets, A (the franchiser) has a high portion of residual decision rights concerning the use of the system-specific assets, and B (the franchisee) has a high portion of residual decision rights concerning the use of the local

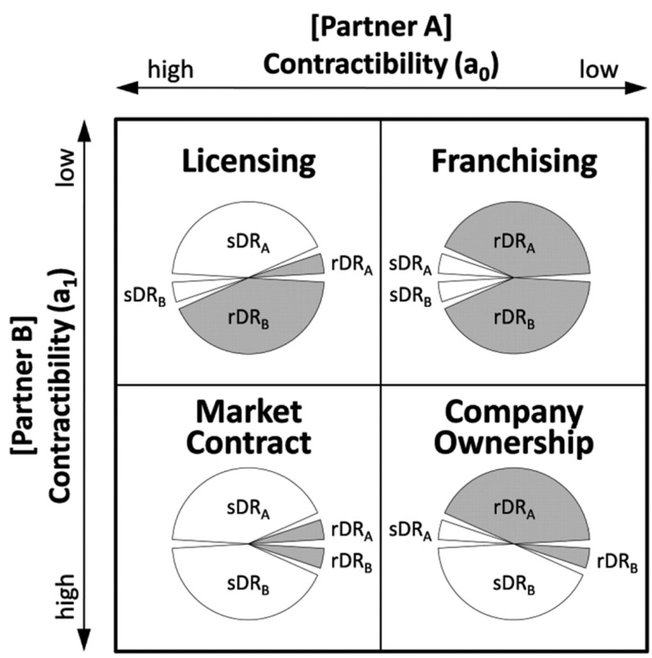

FIGURE 1 Contractibility and allocation of decision rights.

market assets (see Figure 1). If both assets were internally coordinated under A's asset ownership, the total residual surplus would be reduced because A has no access to the requisite market-specific assets. A is better off under non-integration because B's higher local market know-how creates a higher residual surplus of the network that cannot be realized under integration. If the assets were coordinated by using a license agreement, the total residual surplus would be reduced because the non-contractible system-specific know-how cannot be (easily) transferred to B; therefore, the system-specific assets cannot be used efficiently at the local market.

Licensing

We assume that the system-specific know-how, a_0, has a low degree of intangibility and the local market assets, a_1, show a high degree of intangibility. Hence, the use of a_0 can be more completely defined in the contract between A and B, while a_1 cannot be easily specified in contracts. Due to the high contractibility of a_0, more specific decision rights concerning the use of system-specific know-how can be included in the contract. Conversely, a_1 is non-contractible and generates a high proportion of the residual income of the network. Under more contractible assets of A and less contractible assets of B, A's residual decision rights concerning the use of the system-specific assets are low, and B's residual decision rights concerning the use of the local market assets are high (see Figure 1). Hence B has a higher proportion of residual decision rights in the network. Consequently, under contractible system-specific assets and non-contractible local market assets, A (the licensor) will license B (the licensee).

Company Ownership

We assume that the system-specific know-how, a_0, has a high degree of intangibility and the local market assets, a_1, show a low degree of intangibility. Hence a_0 cannot be specified while a_1 can be more completely defined in the contract between A and B. Due to the high contractibility of a_1, more specific decision rights concerning the use of local market assets can be included in the contract. Since a_0 is more non-contractible and a_1 is more contractible, A should have a high proportion of residual decision rights because the system-specific assets are very important for the generation of the residual surplus. Consequently, A will more likely internally coordinate the transactions. In this case, B is the employee as manager of the company-owned outlet and A is the owner of the chain.

Market Contracts

We assume that both system-specific know-how, a_0, and local market assets, a_1, show a high degree of contractibility. Therefore, the use of assets can be almost completely specified in a contract between A and B. Hence the ratio between specific and residual rights is very high.

From this property rights approach, we can derive the following propositions on the allocation of decision rights in franchising and licensing:

- If A's system-specific assets and B's local market assets are more non-contractible, both have important residual decision rights concerning the use of their assets in the network; consequently, the efficient governance form is franchising.
- If A's system-specific assets are more contractible and B's local market assets are less contractible, B's (A's) proportion of residual decision rights is high (low); consequently, the efficient governance form is licensing (i.e., A will license B).

This view explains the governance form under given asset characteristics. In the following, we extend this static property rights view by applying research results from strategic management and organization theory. We examine the impact of organizational learning and strategy change on asset contractibility and hence the tendency from franchising to licensing.

Strategy, Contractibility, and Dynamics of Decision Rights in Networks

According to Chandler (1962), the governance structure is closely related to strategy of the firm (Galunic & Eisenhardt, 1994). In recent years, Zajac et al. (2000) and Kraatz and Zajac (2001) extended the static strategy-structure framework and developed a model of dynamic strategic fit based on a contingency logic. Starting from this dynamic perspective, we extend the property rights view of allocation of decision rights in network relations by considering the impact of strategy change on asset contractibility. By applying Chandler's "structure follows strategy" framework in combination with the resource-based and organizational capability view (Wernerfelt, 1984; Argyres, 1996; Teece et al., 1997; Argote & Darr, 2000; Winter & Szulanski, 2001; Zollo & Winter, 2002; Helfat & Peteraf, 2003), we argue that, under given market structure, resources and capabilities determine the firm's strategy (see Figure 2). Further, following Muris, Scheffman, and Spiller (1992) and Nickerson et al. (2001), the realization of a certain strategy requires a certain bundle of assets (physical assets, knowledge assets, financial assets, etc.), and the asset characteristics (specificity and contractibility) influence the choice of governance form. Under a dynamic perspective, the chosen governance form enables the firm to develop a new strategy through upgrading its bundle of resources and capabilities during the organizational life cycle (Mintzberg, 1990; Russo, 1991; Galan & Sanchez-Bueno, 2009).

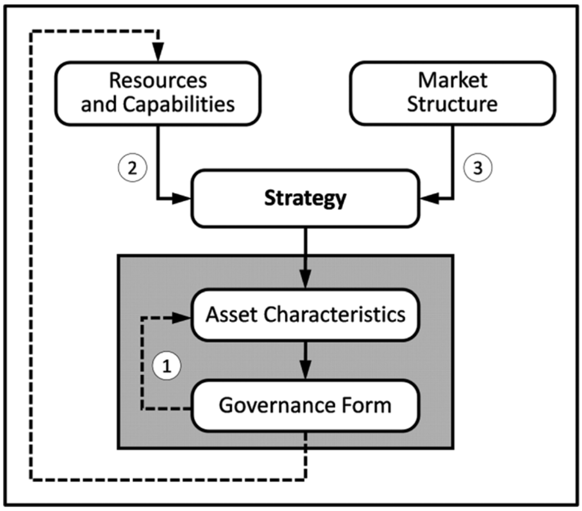

FIGURE 2 An extended strategy/structure model.

Based on this strategy-structure perspective, more detailed discussion is needed. In the following, we investigate the network dynamics from franchising to licensing (a) under a given strategy and (b) under a change of strategy.

Organizational Dynamics Under a Given Strategy

How can the property rights approach explain the organizational dynamics from franchising to licensing under a given strategy of the franchiser? Baker, Hubbard, and Wernerfelt (Baker & Hubbard, 2001; Baker, Gibbons, & Murphy, 2003, 2006, 2008; Wernerfelt, 2002) argue that changes in residual decision rights result from changes in contractibility. Similarly, Hennart (1988) already discussed the impact of marketability of assets on the change of governance form from licensing to joint ventures. Applied to franchising, changes in residual decision rights are based on changes in contractibility of assets, due to organizational learning of the franchiser who develops and standardizes the system-specific know-how during the organizational life cycle. According to Nonaka's knowledge conversion model (Nonaka, 1994; Nonaka, Toyama, & Konno, 2001), organizational learning triggers a knowledge conversion process that changes the nature of system-specific know-how from tacit to more explicit knowledge. Therefore, contractibility of system-specific know-how increases during the organizational life cycle. Under more contractible system-specific know-how, the system-specific assets are less important for the creation of residual surplus of the network. On the other hand, more residual decision rights must be transferred to the local network partners to motivate them to undertake high investments in local market assets. Consequently, due to this change from less contractible to more contractible assets, the franchiser's proportion of residual decision rights declines during the organizational life cycle. We derive the following hypothesis (this effect is illustrated in Figure 2; see ①):

H1: If the franchiser's organizational learning results in a higher degree of contractibility of system-specific know-how, more specific and less residual decision rights will be assigned to the franchiser, and, consequently, the tendency from franchising toward licensing will increase.

Organizational Dynamics Under Strategy Change

While the property rights view focuses on asset contractibility and how changes of contractibility influence the allocation of residual decision rights under given strategy of the franchiser, we additionally ask the question about how a strategy change will influence the governance form. We assume that the franchiser changes its strategy, due to changes of the internal resources and capabilities and/or changes of the market environment (see ② and ③ in Figure 2). A strategy change may lead to a misfit between strategy and governance form and, therefore, requires organizational adjustments in the network (Yin & Zajac, 2004). Starting from franchising, we analyze the case in which a strategy change increases contractibility of system-specific assets due to standardization of system-specific know-how. According to the property rights view (see Figure 1), a higher contractibility of the system-specific assets decreases the franchiser's proportion of residual decision rights in the network. Hence, due to the higher contractibility, the tendency toward licensing increases. As a result, starting from franchising, we can derive the following:

H2: If the franchiser's strategy change leads to higher contractibility of system-specific know-how, the tendency toward licensing will increase.

CASE ANALYSIS: THE FRANCHISE SYSTEM GETIFIX

Methodology

The main objective of this case study is to provide empirical evidence of the dynamics of decision rights from franchising to licensing by examining the foreging hypotheses. In organization and management research, the aim of the case study method is to generate and test theories (Eisenhardt, 1989; Eisenhardt & Graebner, 2007; Gilbert, Ruigrok, & Wick, 2008). In our case study, the methodical approach is to use the case study research for the purpose of theory testing (Yin, 2003; Johnston, Leach, & Liu, 1999). The case study was conducted at Getifix, a franchise system in the building conservation and remediation business in Germany. Our case selection was primarily determined by the fact that—at least in the Austrian and German franchise sector—we could not identify any other franchise system that changed its governance form from franchising to licensing.

The data collection was mainly based on an in-depth interview with the CEO of Getifix, Mr. Bernd Osmers. The 5-hour interview was based on a semi-structured questionnaire, which we developed on the basis of our theoretical framework. This interview was recorded and transcribed into written form. The complete interview text, the list of the categories and subcategories, and the link of the individual text fragments to the categories and subcategories of the text analysis can be received from the authors.

By applying the principles of triangulation (Jick, 1979; Modell, 2005), we additionally collected data from other sources (e.g., samples of the Getifix franchise and license contracts, websites of the franchise network and its competitors, websites and other archival data of franchise associations, federal statistical offices). Furthermore, we used press releases of the franchise network and articles on the franchise network, published in journals, magazines, and newspapers between 1990 and 2006. Additionally, we compared actual and target numbers of franchisees/network partners, released by the founder of the franchise network, Mr. Tietjen, in interviews, and compared these numbers with the ex-post data extracted from the interview with the CEO of Getifix.

Organizational Life Cycle of the Franchise System Getifix

Founded in 1985, the franchise system Getifix, one of Germany's first franchise systems, is active in the building conservation and remediation business. The main focus of the services of the franchise network is on structural repair and maintenance of buildings. Based on the organizational life cycle view (Greiner, 1972), we divide the evolution of the franchise system Getifix into five stages.

Origin of the system (1970–1984)

The founder of the firm, Wolfgang Tietjen, a young dynamic entrepreneur, started his business in 1970. The original business concept was to manufacture high-pressure cleaners. Tietjen's company, Geti-Technik, is located in Bremen (a city in northern Germany). After 2 years at the market, he subcontracted the production of pressure washers to a local company and concentrated his activities on marketing and sales. In 1975, he signed a wholesale contract with Kärcher, a German manufacturer based in southwest Germany. Since 1975, Geti-Technik exclusively sold Kärcher products in the region of northern Germany. Kärcher was the market leader for pressure washers, steam/vacuum cleaners, and spray extraction units and had an excellent reputation in the market for its high-quality products. However, pressure washers were very expensive during that time. Potential buyers with only sporadic cleaning demand, especially private households, could not be attracted to purchase these high-quality/high-priced products. Tietjen then decided to rent the Kärcher products to this group of potential customers. The demand for this service grew rapidly, which was one of the main reasons why Tietjen's company became one of the largest and most profitable wholesalers of Kärcher products in Europe within a few years. In the early 1980s, the business model of franchising was still quite uncommon in Germany, but Tietjen was fascinated with the idea of expanding his business through franchising.

GROWTH OF THE SYSTEM (1985–1989)

The territorial restrictions, negotiated in the contract with Kärcher, limited Tietjen's sales activities to northern Germany. In order not to violate these territorial restrictions, Tietjen convinced Kärcher to produce a special product range of pressure washers. This product range was differentiated from the original Kärcher products by color (white instead of yellow-black) and brand name (Getifix brand name instead of original Kärcher). This differentiation allowed Tietjen to expand his activities to other regions in Germany. He developed a marketing concept around the new product range, enhanced by using select chemical detergents for professional cleaning purposes. In 1985, Tietjen established the franchise firm Getifix. The existing rental business was incorporated into Getifix. To expand his franchise business, Tietjen contacted drugstores, do-it-yourself stores, and petrol stations. In a short time, he acquired a few hundred rental stations located all over Germany, which were operated by franchisees. The rapid expansion during the first 3 years of the franchise system and its overwhelming success were mainly due to his innovative business concept. In 1987, the franchise system Getifix already had more than 500 rental stations owned by independent franchisees.

At the end of 1980s, one of the most important factors in gaining competitive advantage began to decline: The market price for pressure cleaners dropped strongly, due to the increasing supply of pressure cleaners in do-it-yourself stores and supermarkets. This environmental change endangered the foundation of the franchise system. An increasing number of franchisees terminated their franchise contracts, and no new franchisees could be attracted. Instead of ending the business, Getifix strengthened its product portfolio: Getifix franchisees offered cleaning services, which was incorporated into the product portfolio of the whole network. By further diversifying its product range (e.g., adding "graffiti removal"), Getifix gradually entered the building conservation and remediation business (see Figure 3). This change was more the result of an unintended strategy than of an intended strategy (Mintzberg, 1978).

MATURITY OF THE SYSTEM (1990–1994)

After the end of communism and Germany's reunification in 1989, the franchise system of Getifix expanded continuously and quickly. During the first half of the 1990s, the number of franchisees increased, and the product

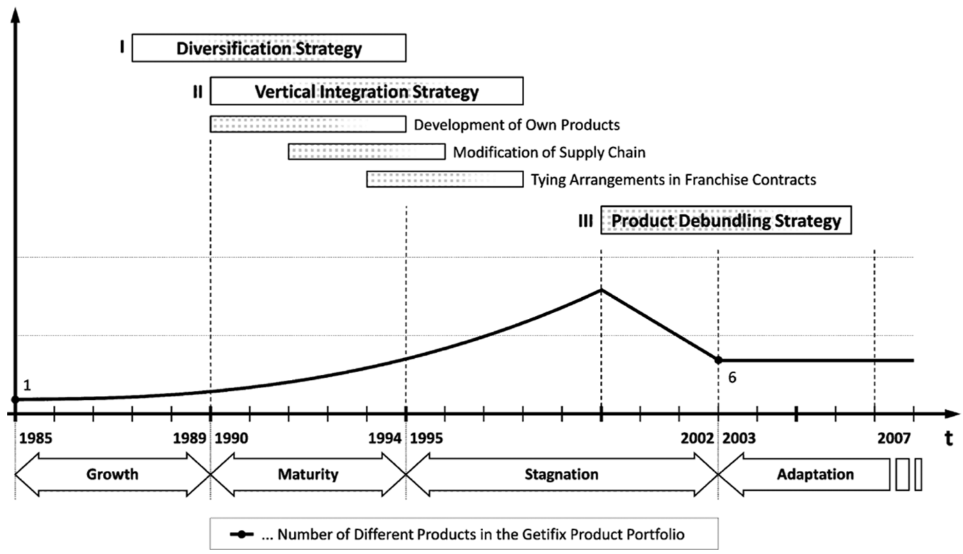

FIGURE 3 Strategy change during the organizational life cycle.

portfolio became broader and broader. The franchiser's headquarters had some difficulties in coordinating and integrating the large number of new franchisees. Getifix, therefore, invested in the quality of the franchise system, mainly by increasing the management capabilities of its headquarters.

During 1990s, raw material requirements were specified by the franchiser, and Getifix set up long-term contracts with capable industrial suppliers. The franchisees ordered raw materials at the franchiser's headquarters, and the delivery of input goods to the franchise outlets was carried out by the industrial suppliers. The suppliers' raw material prices and the prices charged by the franchiser to franchisees were almost identical. Getifix deducted only the "del credere" discount, which was a few percent points. Getifix headquarters practically operated as a wholesaler for the franchisees. Although this logistics process was quite advanced, Getifix earned extremely low margins and had to cover high administrative expenses and bear the financial risk. Furthermore, this process did not prevent some franchisees from purchasing less-expensive and low-quality raw materials from other sources not approved by the franchiser and charging customers the full price for lower-quality goods. This opportunistic behavior by the franchisees caused serious risks to the reputation and brand name of Getifix.

Consequently, Getifix developed a new strategy: The aim was to develop its own products with Getifix label. These products and raw materials were developed in cooperation with the existing industrial suppliers who delivered these products to the Getifix warehouse. The franchisees were obliged to purchase the products directly from the franchiser. This enabled the franchiser to exercise more control over the franchisees' sales volume. In contrast to the logistics process in the former stage of the life cycle, raw materials were exclusively delivered from the Getifix warehouse to the franchisees. With this new strategy, Getifix improved its bargaining power with its industrial suppliers: Due to pooling effects, the delivery quantities increased, and high economies of scale were realized; additionally, the use of the Getifix brand name enabled a multi-sourcing purchasing strategy. These measures resulted in a reduction of the purchase prices of raw materials. Conversely, the franchisees had to pay "hidden" royalties under the tying arrangements. Consequently, the structure of residual income of the franchiser changed: The importance of "hidden" royalties (i.e., residual income from tying arrangements) increased, while the importance of initial fees and royalties (as percentage of the sales of the franchisees) decreased in the maturity phase.

Stagnation of the system (1995–2002)

In the mid 1990s, the number of conflicts between the franchisees and the franchiser significantly increased. Franchisees complained about the high royalties they had to pay to the franchiser. Franchise contracts were originally concluded for a period of 10 years, which included the option to extend the contract by 5 years. Since the first franchise contracts were signed in 1985, when the franchise system was introduced at the market, 10 years later the franchiser was confronted with an increasing number of franchisees, who decided not to extend the franchise contract and to leave the franchise network. These internal conflicts resulted in a lower number of franchisees and reduced the residual income of the franchiser. Simultaneously with these internal difficulties, the following environmental changes occurred:

- Industry downturn: Starting in 1995, the situation of the German construction industry worsened. Industrial demand, employment, investments, turnover, number of enterprises, and so on showed a dramatic decline.
- Market entry of a new competitor: At the same time, another franchise system, Isotec, entered the German market, focusing on the same market niche in which Getifix was successful. However, Isotec's product portfolio was strictly limited to building drying and mold remediation. By applying this strategy, Isotec could achieve a strong competitive position within a few years. Hence, Isotec's market entry additionally reduced Getifix market share during the downturn of the construction industry.
- Difficulties in gaining new franchisees: Isotec also competed with Getifix in attracting new entrepreneurs as franchisees in the construction and building preservation industry. Hence, the German market for these entrepreneurs dried out, and the franchise systems faced difficulties in attracting potential entrepreneurs as new franchisees.

As a result of these environmental changes, the total number of Getifix franchise partners decreased to almost half between 1995 and 2002 and, therefore, the residual income of the franchiser declined significantly.

Beginning in 2000, Getifix restructured its product portfolio once more to cut costs and to compete with the market strategy of its main competitor, Isotec, especially in mold remediation. After reducing the range of the product portfolio ("product debundling" strategy; see Figure 3), Getifix concentrated on the following six product packages: building drying, damp-proofing of buildings, building facade protection/graffiti removal, concrete repair (balconies/patios/floors), mold remediation/repair of damages caused by mold contamination (indoor areas), and (thermal) insulation of indoor areas of buildings. However, these strategic adjustment measures did not significantly improve the financial situation of Getifix. In 2002, at the end of the stagnation phase, the initial fees did not contribute to the residual income, as Getifix was not successful in winning new franchisees, and the residual income from royalties diminished, due to the lower number of franchisees and lower royalty rates.

Adaptation of the system (2003–2007)

Under this negative development of the residual income of the network, Getifix had to adjust its system strategy and organization. Getifix's strategic goal was to increase the number of network partners by setting up a license system in combination with the franchise system. A comparison of the elements of the franchise and license contract is presented in the Appendix. After the licensing strategy was developed, Getifix was able to attract new licensees within a short time. This fundamental change in its organizational strategy resulted in a fast increase of Getifix residual income stream. The most important residual income category was the royalties from tying arrangements, amounting to almost two-thirds of Getifix residual income in 2007. Consequently, the increase of initial fees and "hidden" royalties under the license system contributed to the strong increase of the residual income of the network in the adaptation phase.

Interpretation and Discussion of the Results

Standardization of know-how and licensing

According to H1, we argue that the increasing contractibility of system-specific knowledge during the organizational life cycle of Getifix results in a higher tendency toward licensing. There are two reasons that explain the change from more non-contractible (tacit) to more contractible (standardized) system-specific knowledge during the life cycle of Getifix.

First, consistent with Nonaka's view (Nonaka, 1994; Nonaka & Takeuchi, 1995; Nonaka et al., 2001), we argue that Getifix organizational learning in the maturity and stagnation phases triggered a knowledge conversion process that changed the nature of system-specific knowledge from more non-contractible to more contractible knowledge. Standardization of system-specific assets increased during the life cycle, which reduced the bargaining power of Getifix compared to the franchisees. Under franchise contracts, the lower bargaining power of Getifix also resulted in additional conflicts between the franchiser and franchisees in the stagnation phase, because the royalties were very high. Due to the more standardized system-specific assets, more specific decision rights concerning the use of system know-how could be transferred by using license contracts instead of franchise contracts.

Second, this standardization tendency was increased by economies of learning resulting from the experience of Getifix with the new franchisees during the maturity phase. Due to the system growth in East Germany, Getifix acquired a large number of new franchise partners. Hence, the franchiser had to develop more standardized organizational procedures and routines that enabled a relatively easier transfer of know-how to the new franchisees. Consequently, due to this standardization of the system-specific know-how, more specific decision rights of Getifix could be specified in contracts and, hence, the tendency from franchising toward licensing increased in the stagnation phase.

Strategy, change, and licensing

Based on H2, we argue that the contractibility of system-specific assets further increased during the organizational life cycle because, in addition to organizational learning, Getifix changed its strategy, which resulted in more standardization of the system-specific know-how and a higher tendency toward licensing. There were two strategy changes during the maturity and stagnation phases, which explain the standardization process of Getifix and the increasing use of licensing as governance form (see Figure 3).

First, as argued earlier, Getifix changed its procurement strategy by increasing the degree of vertical integration during the maturity and stagnation phase. In this period, Getifix switched from external suppliers to internal production of products with the Getifix label. Furthermore, all deliveries to the network partners were coordinated by the Getifix central warehouse. This vertical integration strategy enabled Getifix to develop organizational routines and procedures to standardize the logistics processes and the product range.

Second, in the stagnation phase, the competition at the product market and human capital market for franchisees strongly increased, due to the market entry of Isotec and the downturn of the industry. Hence, starting in 2000, Getifix reduced the product portfolio to the following packages: building drying, damp-proofing of buildings, building façade protection/graffiti removal, concrete repair, mold remediation, and thermal insulation of indoor areas of buildings. This reduction of the product range (product debundling strategy) resulted in a higher degree of codification and standardization of the system-specific know-how. This strategy enabled Getifix to enter into a new segment of potential network partners (especially small companies of artisans) that complemented their product portfolio with Getifix products. Due to the higher contractibility of system-specific know-how under the new product portfolio, the new partners had no obligation to invest into the entire product range of Getifix. By concluding a license contract, they primarily invested in complementary products that strengthened their competitive position in the existing product portfolio.

As a result, both the vertical integration and product debundling strategy of Getifix increased the contractibility of system-specific know-how and hence the tendency toward licensing. Therefore, starting in 2003, the number of licensees rapidly increased. The rising number of network partners resulted in economies of scale of procurement, production, training, marketing and coordination and hence improved the residual income stream of the network in the adaptation phase.

To summarize, the results of our case study are compatible with our hypotheses derived from an extended property rights view: Getifix network dynamics from franchising to licensing can be explained by an increase of contractibility of the franchiser's system-specific assets as determinant of the allocation of residual decision rights between the network partners. First, under a given strategy, the conversion from more non-contractible (tacit) to more contractible (standardized) system-specific know-how contributed to the change of network governance. Second, strategy changes, due to vertical integration and product debundling, additionally increased the standardization and contractibility of system-specific know-how and hence the tendency from franchising to licensing.

CONCLUSION

The article examined the network dynamics from franchising to licensing due to the increase of contractibility of the franchiser's system-specific assets as determinant of the allocation of residual decision rights in networks. Based on the property rights view, residual decision rights must be allocated according to the distribution of non-contractible knowledge assets between the franchiser and franchisees. Our analysis developed the hypothesis that the higher the contractibility of the franchiser's system-specific assets, the more specific decision rights are assigned to the franchiser and the higher is the tendency from franchising toward licensing. This hypothesis was examined with data from the German franchise system Getifix. The results from the case study analysis indicate that the network dynamics from franchising to licensing are triggered by an increase in contractibility (standardization) of the system-specific know-how during the organizational life cycle. We show that inter-organizational learning and strategy change increased the contractibility (standardization) of the franchiser's system-specific know-how and hence the tendency from franchising toward licensing.

What is the contribution of our study to the literature? The major contribution lies in the explanation of the network dynamics from franchising to licensing by developing an extended property rights interpretation that integrates research results from strategic management and organization theory (Nonaka, 1994; Zajac et al., 2000; Kraatz & Zajac, 2001; Zollo & Winter, 2002; Helfat & Peteraf, 2003). By applying a strategy-structure perspective, we argue that, under given resources and capabilities and market environment, the firm strategy influences the asset characteristics and the governance form. With only few exemptions (Muris et al., 1992; Nickerson et al., 2001), most of organizational economics literature has not investigated the impact of strategy on the asset characteristics and the governance form. Therefore, our study bridges the gap between the levels of analysis of property rights theory and the strategic view of the firm. While the property rights theory focuses on the explanation of the governance form under given strategy, the strategic perspective tends to emphasize the relation between strategy and governance form. Consequently, starting from this research deficit, the aim of future research should be to integrate results from organizational economics and the strategic theory of the firm to explain the structure and dynamics of governance forms (e.g., Mayer & Salomon, 2006).

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APPENDIX Main Terms of Getifix Franchise and License Contracts

Contract terms	Franchise contracts	License contracts
Initial fee	13.000.-EUR	1.950.-EUR
Royalties	500.-EUR (per month)	50.-EUR (per month)
Advertising fees	153.-EUR (per month)	–
Contract duration	10 years	1 year
Contract extension	3 years	1 year
Territorial restrictions	400,000 inhabitants	100,000 inhabitants
Product range	Whole product range	Maximum 2 products per licensee
Training	Obligatory for whole product range	Only initial training obligatory for product(s) chosen by licensee
Ongoing support by franchiser/ licensor	Ongoing support for franchisees is significantly higher than for licensees	
Tying arrangements	Franchisees benefit from lower input prices (due to higher discounts)	