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The Structure of Ownership Rights in Franchising: An Incomplete Contracting View*

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Abstract

The paper offers an explanation for the structure of ownership rights in franchising networks which emphasize the role of intangible assets. By applying the incomplete contracting theory of the firm we argue that the structure of ownership rights depends on the distribution of intangible assets between the franchisor and the franchisee. The higher the franchisor's (franchisee's) intangible assets relative to the franchisee (franchisor), the more ownership rights should be transferred to him. This hypothesis was tested by using data from the Austrian franchise sector. The empirical results are supportive of the hypothesis.

Keywords: franchising, ownership rights, intangible assets, residual income

JEL Classification: L22, K0

1. Problem

The franchise relation involves the sharing of intangible assets between the franchisor and the franchisee, i.e., the brand name of the franchisor and the local know-how of the franchisee. These assets represent proprietary knowledge that cannot be easily transferred because investments in such assets are costly if not impossible to observe and monitor (Teece 1980). The franchisor faces the problem of maximizing the returns to his intangible assets when they are dependent on local intangible investments of the franchisee. Therefore, substantial residual risk for local outlets is borne by the franchisee who has the residual rights of control of the local promotion and services. Since these investments cannot be specified in the contract, asset ownership is critical to the market success of the product or service. The present article focuses on a property rights explanation of the ownership structure in franchising networks by emphazising the role of intangible assets as determinant of ownership structure. By applying the incomplete contracting theory of the firm (Hart and Moore 1990; Hart 1995) we argue that ownership should be given to the franchisee when he has to make intangible investments that generate a large fraction of residual income. Ownership increases the bargaining power concerning the division of residual income and therefore gives incentives to make intangible ex ante

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investments. The appropriate incentive structure is provided not only by a mix of franchisee fee and royalties but also by additional incentive devices, such as resale price maintenance, exclusive dealing, exclusive territory and tying arrangements, lease control and buy back and alienation rights. Based on the incomplete contracting approach we derive the hypothesis that the structure of ownership rights depends on the distribution of intangible assets between the franchisor and the franchisee. This hypothesis is tested in the Austrian franchise sector. The empirical results are supportive of the hypothesis.

The paper is organized as follows: In Sections 2 and 3 we use the incomplete contracting theory developed by Grossman, Hart and Moore to analyze the optimal assignment of ownership rights between the franchisor and franchisee. Section 4 explains the different ownership rights in franchise agreements that provide incentives for the franchisor and the franchisee. Finally we test the hypothesis that ownership rights depend on the distribution of intangible assets which is supported by empirical results in the Austrian franchise sector.

2. An incomplete contracting view of ownership rights

Under positive transaction costs the assignment of property rights is relevant for the efficiency of resource allocation (Demsetz 1966, p. 64; Pejovich 1995, pp. 82–84). In this case, the economic agents cannot conclude complete contracts regarding all relevant circumstances because transaction costs are too high to specify them in the contract (Schwartz 1992, p. 81). Incompleteness means that there will remain some residual rights that are not included in the contract. All rights to the asset not specified in the contract accrue to the residual claimant (Fama and Jensen 1983).

2.1. Intangible assets as determinant of ownership structure

The asset characteristics relevant for the determination of ownership structure is the degree of intangibility. Intangible assets refer to knowledge and skills (know-how) largely stored in the mind of men (Nelson and Winter 1982, pp. 75–76; Itami 1984) that cannot be codified and easily transferred to other agents since they have an important tacit component (Polanyi 1962; Lazaric and Marengo 2000). For instance, if the know-how of a sales agent cannot be made fungible, it is critical to the market success of the product to give this person residual rights of control to improve his incentive to undertake intangible investments.

What are the intangible assets in franchising? The franchisee's intangible assets refer to the local know-how, i.e. the franchisee possesses "knowledge of the particular circumstances of time and place" (Hayek 1945, p. 524) that result in efficient marketing strategies in combination with the franchisor's system-specific know-how. The franchisor's intangible assets refer primarily to the system-specific know-how as brand name capital (Klein and Leffler 1981; Norton 1988). If the franchisor's brand name investments (e.g. national advertising) are very important to the market success of the product or service, he has to be given an important ownership stake to provide the necessary investment incentives.

2.2. Allocation of ownership rights in franchising

In this section we try to explain the ownership structure between the franchisor and franchisee by emphazising the role of intangible assets as determinant of ownership structure (Hart and Moore 1990). We consider two cases: In the first case agent 0 (franchisor) has an asset with an high degree of intangibility and agent 1 (franchisee) has an asset with a low degree of intangibility. Hence agent 1's asset is relationship-specific but contractible. In the second case we assume both assets have a high degree of intangibility.

Case 1: Integration. We assume the only relevant assets are the marketing assets (a_0, a_1). a_0 are the system-specific capabilities (brand name assets) and a_1 the local market know-how. We now examine the case where agent 1 owns the tangible asset a_1^T and agent 0 the intangible asset a_0^I. If agent 0 makes an intangible investment in system-specific assets and creates residual surplus, agent 1 can expropriate fractions of the surplus value. Under incomplete contracts the franchisor and franchisee must bargain for the division of the residual income. Since each agent only receives a fraction of the residual surplus, they will both underinvest under this allocation of ownership rights (Hart and Moore 1990, p. 1142). Since only the franchisor has intangible assets that create the residual surplus, the franchisee can expropriate a large fraction of the total residual income. Thus under this ownership structure the investment incentive of the franchisor is significantly affected. In this case, the question arises whether the franchisor should have ownership of both assets. If the franchisor owns both assets, his investment incentive is increased because he gets a larger fraction of residual income. At the same time a_1^T is contractible and can be easily acquired by the franchisor. Consequently, the residual rights of control should be given to the franchisor as owner of intangible assets because he creates the residual income stream.

Case 2: Non-integration. We assume that brand name and local market assets show a high degree of intangibility (a_0^I, a_1^I). Therefore the system-specific know-how and the local market know-how cannot be specified in the contract. In this situation the alternative of giving ownership of both assets to agent 0 (franchisor) is not efficient. If both marketing assets were internally coordinated, the total residual surplus would be reduced because the franchisor has not the requisite outlet-specific capabilities. Hence the efficient institutional structure is ownership of asset a_0^I by the franchisor and of asset a_1^I by the franchisee. Although the total residual surplus is divided between the franchisor and the franchisee, the franchisor is better off under non-integration because the franchisee's higher local market capabilities create a higher residual income which could not be realized unter integration. Hence the franchisor's smaller portion of the larger residual income exceeds his larger portion of the smaller total residual surplus.

To summarize: First, if one of the agents is the holder of an intangible asset and the other of a tangible asset, the first should be the residual claimant and hence the owner of both assets. Second, if both agents own intangible assets, ownership rights should be allocated according to the distribution of intangible assets that generate the residual income stream (Alchian 1987; Pagano 1991). Consequently, if both the franchisor's brand name assets and the franchisee's local market know-how are important for the creation of the residual surplus, the franchisor should own asset a_0 and the franchisee should own asset a_1.

3. Incentive effects of ownership rights

We now ask the question which ownership rights provide the appropriate incentives for the franchisee and franchisor to undertake the necessary investments in intangible assets. According to the incomplete contracting framework the allocation of ownership rights should encourage investments in intangible assets that create a large fraction of residual income. When a franchisee has a strong know-how position, franchise terms should transfer a substantial portion of residual rights to the franchisee. On the other hand, when the franchisor's system-specific investments are very important for the creation of residual surplus, the franchise contract must transfer a large fraction of ownership rights to the franchisor to give him incentives to make the requisite marketing investments (Shepard 1993). Incentives are provided by ownership rights that include residual income rights (royalties and fees) and ownership surrogates that increase the incentive effect of the diluted residual income rights. Residual income rights are diluted because the residual surplus is divided between the franchisor and franchisee by the payment of fees and royalties. The following ownership surrogates may exist in franchise relationships: Exclusive dealing, exclusive territory, tying arrangement, resale price maintanence, lease control, approval and buy back rights, alienation rights and the right to control the network entry. In the following we examine the incentive effects of the residual income rights and the different ownership surrogates.

3.1. Residual income rights

Royalties. By linking the franchisor's residual income to the franchisor's investments in noncontractible assets, he has an incentive to undertake the requisite investments during the contract period. Therefore, the more important the franchisor's intangible investments are relative to the franchisees's intangible investments, the higher is the fraction of residual income created by him, and the higher should be the royalties (Rubin 1978; Sen 1993; Lutz 1995). Conversely, the more important the franchisees' intangible investments are relative to the franchisor's intangible investments, the higher should be their fraction of the residual income and the lower should be the royalties to provide the necessary incentive for the franchisees.

Initial fees. Initial fees are the remuneration for the system-specific know-how transferred to the franchisee at the beginning of the contract period. The higher the franchisor's intangible assets (brand name capital [Klein and Leffler 198l]) at the beginning of the contract period, the higher are the rents generated by his know-how and the higher are the initial fees. In addition, a further proposition about the relationship between fees and royalties can be derived: The franchisor's specific investments depend on the initial stock of assets because a franchise with a high brand name capital requires more system-specific investments to assure a certain franchise value compared to a franchise with a low brand name capital. Therefore, the higher the franchisor's brand name capital, the higher are his intangible investments during the contract period, and the higher are the fees and royalties as residual income generated by the system-specific knowhow. These results are consistent with Dnes (1992a, 1993) view. According to Dnes the franchisor may recover his sunk investments through the initial fee because high sunk investments may arise when the system-specific know-how is very important for the success of the franchise. On the other hand, this incomplete contracting view is not compatible with the agency theory (see Lafontaine, Slade 1998) which predicts a negative relationship between fees and royalties.

3.2. Ownership surrogates

Exclusive dealing clause. If the franchisee sells competing products that are not part of the franchise network, the franchisor's incentive to undertake relationship-specific investments will be reduced because the franchisee can benefit from the franchisor's investments without paying fees or royalties. In this case, the franchisees appropriate some of the value of the franchisor's investment in brand name capital. One solution of this interbrand free rider problem is to forbid the franchisee to sell competing products or open up additional outlets. Exclusive dealing arrangements are used to prevent franchisees from appropriating the benefits of the franchisor's intangible investments and therefore provide the franchisor with a property right to his marketing investment (Marvel 1982, p. 7; Goldberg 1984, p. 745).

Exclusive territory arrangements. If the franchisor wants to encourage sales efforts by franchisees that increase the demand for the product and hence the residual surplus, the franchisor has to design contract terms that enable the franchisee to reap the benefits of its intangible investments (Mathewson and Winter 1994; Muris, Scheffman and Spiller, 1992, pp. 96–98). Exclusive territory and customer terms create a property right in intangible assets so that the franchisee can earn returns on investments in local advertising and services. In addition, territorial restraints—especially combined with resale price maintence—reduce intrabrand free riding and encourage the franchisee to undertake intangible investments (Mathewson and Winter 1998). Furthermore, the franchisor can transfer the right to control network entry to the franchisees when the investments in local assets are very crucial for the success of the system (Mathewson and Winter 1994).

Tying arrangement. Tying arrangements are frequently used when quality control through quality specifications is very costly (Klein and Saft 1985). The more important the franchisor's brand name for the creation of the residual surplus, the more critical is quality control to protect his intangible investments in the franchise network. Therefore, the tying clause provides an incentive for the franchisor to undertake intangible investments in his franchise business by ensuring that a minimum quality standard is maintained at all franchised outlets.

Resale price maintenance. Competition among franchisees can reduce the investment incentives by creating an externality among franchisees (Klein and Murphy 1988). Resale price maintanence eliminates this intrabrand free rider effect by reducing consumers' incentives to buy from franchisees that do not provide the local marketing investments, such as promotion and after-sale services (Mathewson and Winter 1986, p. 214). Consequently, the resale price maintenance agreement prevents the franchisees from free riding and hence creates an incentive for the franchisor to undertake important intangible marketing investments.

Lease control. Under lease control of the franchisor the franchisee hands over the business premises upon leaving the network. Due to the quality control and hostage function it provides high incentives for the franchisor to undertake specific investments (Klein 1980; Dnes 1992b). On the other hand, the franchisee will be reluctant to invest in specific local assets unless he expects that any future residual surplus in his lease will be generated for his own account (Adams and Jones 1997, p. 260). Therefore, when franchisee's outlet-specific investments are very important relative to the franchisor's system-specific investments for the generation of residual surplus, lease rights should be transferred to the franchisee to increase his motivation to undertake specific investments.

Approval and buy back rights. When a franchised business is sold the franchisor retains the right to approve the purchaser, frequently he has a right of first refusal to acquire the franchise. The approval and buy back rights ensure that the franchisee cannot expropriate the quasi rents generated by the franchisor's intangible assets. In addition, the right of first refusals allows the franchisor total control over an outlet by matching any third-party offer for it (Dnes 1993, p. 380). Therefore these rights "assure that the franchisor can recapture a franchise at renewal time without any capitalized brand name value accruing to the franchisee" (Caves and Murphy 1976, p. 580).

Alienation rights. When the franchise business is sold, franchisee retains the right to transfer outlet ownership. In addition, when the franchisee dies, the contract may specify the right to transfer outlet ownership to relatives of the franchisee. These rights provide an incentive for the franchisee to undertake outlet-specific investments by expecting to capture the rents generated by his investments during the contract period.

As a result, ownership rights include both residual rights and complementary ownership surrogates: The franchisor's incentive to invest in intangible assets (system-specific know-how) is higher, the higher the fees are and the more the diluted residual income rights are compensated by ownership surrogates, such as tying arrangements, resale price maintenance, exclusivity clauses, lease control, buy back and approval rights. On the other hand, the franchisee's incentive to invest in intangible knowledge assets (local market know-how) is higher, the lower the initial fees and royalties are, and the more ownership surrogates are included in the franchise agreement, such as exclusive territory arrangement, exclusive customer clauses, lease and alienation rights and the right to control network entry.

The incomplete contracting approach of the ownership structure in franchising can be summarized by the following proposition:

The higher the portion of franchisor's (franchisee's) investments in intangible knowledge assets (know-how) are relative to the franchisee's investments to generate the residual surplus, the more ownership rights should be transferred to the franchisor (franchisee):

(a) If the franchisor's investments in intangible assets (promotion, advertising, management support) are high relative to the franchisee's intangible assets, the franchisor should have a large fraction of ownership rights. Therefore, the franchisor should conclude contracts with ownership rights that strengthen his investment incentive, such as relatively high initial fees and royalties, exclusive dealing clause, tying arrangement, resale price maintenance, lease control and buy back and approval rights.
(b) If the franchisee's intangible assets (investments in local services, promotion, human resources and procurement management) are high relative to the franchisor's intangible assets, the franchisee should have a large fraction of ownership rights as residual rights of control. Hence the contract should include provisions that increase the franchisee's investment incentive, such as relatively lower franchisee fees and royalties, exclusive territory and customer clause, lease rights, alienation rights and option rights in the case of increasing the number of outlets.

The following testable hypothesis can be derived from this approach:

The allocation of ownership rights depend on the distribution of intangible assets between the franchisor and franchisee:

(a) The higher the intangible assets of the franchisor are relative to the franchisee, the higher is the franchisor's portion of ownership rights. The franchisor's ownership position is strengthened by relatively high royalties and fees (as residual income rights), and resale price maintenance, exclusive dealing clauses, tying arrangements, lease control, buy back and approval rights (as ownership surrogates).
(b) The higher the intangible assets of the franchisee are relative to the franchisor, the higher is the franchisee's portion of the network's ownership rights. The franchisee's ownership position is improved by relatively low initial fees and royalties as residual income rights, and exclusive territory arrangements, exclusive customer clauses, lease rights, alienation rights and the right to control network entry as ownership surrogates.

4. Empirical analysis

This study is the first empirical evidence that the structure of ownership rights in franchising may be explained by the distribution of intangible assets between the franchisor and the franchisee. The empirical setting for testing this hypothesis is the franchise sector in Austria. The data set was collected in 1997. After several preliminary steps in questionnaire development and refinement, including in-depth interviews with franchisors and representatives of the Austrian franchise association, the final version of the questionaire was pretested with 10 franchisors. The revised questionaire, which incorporated the alterations suggested by the pretest, was mailed to 216 franchisors in Austria. We received 83 completed responses with a response rate of 38.4%.

4.1. Measures

To test our hypotheses two groups of variables are important: Intangible assets and ownership rights.

Intangible assets. They refer to the non-contractible system-specific assets of the franchisor and the outlet-specific assets of the franchisee. As argued in organization theory, information and knowledge transfer methods vary with the degree of ambiguity (equivocality) of the decision situation (Daft and Macintosh 1981; Daft and Lengel 1986). As shown by Simonin (1999), greater ambiguity is associated with assets that are more tacit. The higher the degree of tacity, the lower is the degree of codification of knowledge, and the more personal (face-to-face) knowledge transfer methods are used, such as telephone, meetings, visits and personal training. By applying this approach the intangibility of franchisor's assets are operationalized by the number of training days per year. A similar measurement concept was used by Inkpen and Dinur (1998) and Darr, Argote and Epple (1995). The assumption behind these measures is that as intangibility of assets increases, so does the number of days of face-to-face interaction. Intangible assets of the franchisee refer to the franchisee's local market know-how. The higher the degree of intangibility of franchisees' know-how, the larger is the local market knowledge advantage of the franchisee compared with the manager of a franchisor-owned outlet. Therefore, we use the local market knowledge advantage of the franchisee as indicator of the degree of intangibility of franchisee's outlet-specific assets. In the questionnaire the franchisors were asked to rate on a five-point scale the franchisee's local market knowledge advantage compared with the manager of a franchisor-owned outlet.

Ownership rights. Ownership rights refer to residual income rights and ownership surrogates. Residual income rights are measured by the initial fees and the royalty rate (as percentage of sales). Ownership surrogates refer to the following contractual arrangements: The first group are ownership surrogates that increase franchisor's investment incentive: Tying clause, exclusive dealing clause, resale price maintenance, lease control, approval and buy back rights. If all five clauses are specified in the contract, the index of franchisor's ownership surrogates is 5. The second group are ownership surrogates that strengthen franchisee's investment incentive: Exclusive territory arrangements, exclusive customer clause, lease rights and option right in the case of increasing the number of outlets and alienation rights. Hence the measure of ownership surrogates ranges between 0 and 5.

4.2. Results

Table 1 presents descriptive data for the sample. The measures of ownership rights are presented in Table 1. The mean of royalties is 4.23% and of intial fees is 3.32% (based on sales). More than 60% of the franchise contracts include exclusive dealing clauses, exclusive territory clauses, resale price maintenance and alienation rights, and more than 50% of contracts include lease control, buy back and approval rights.

Table 1. Descriptive statistics

(a) Intangible assets indicators and fees

	N	Minimum	Maximum	Mean	Standard deviation
Annual training days	73	0	60	15.137	12.8941
Franchisee's local market knowledge advantage	71	1	5	3.8732	1.2754
Initial fees (percentage of sales)	62	.00	28.00	3.3216	4.6573
Initial fees (US$)	79	0	200,000	10,202	23,233
Royalties (based on sales)	73	.00	20.00	4.2305	4.2682

(b) Ownership surrogates in the austrian franchise systems

	N	Relative frequencies
Resale price maintenance (obligatory)	83	18
Franchisee's outlet option right (right to control network entry)	39	21
Exclusive customer clause	82	39
Tie-in arrangement	78	49
Franchisor's lease control	77	52
Franchisee's lease right	77	53
Buck back and approval rights	80	56
Exclusive dealing clause	83	63
Resale price maintenance (facultative)	82	68
Alienation right	79	73
Exclusive territory clause	83	73

4.2.1. Test of hypothesis. *Hypothesis: Ownership rights vary with the distribution of intangible assets.* To test the hypothesis first we carried out a OLS regression analysis with royalties as independent variable and annual training days and franchisee's local market knowledge advantage as explanatory variables. Based on the hypothesis franchisor's (franchisee's) fraction of ownership rights varies positively (negatively) with the royalty rate. Further, royalty rates are higher, the higher the number of annual training days and the lower the local market knowledge indicator. Therefore the coefficient of annual training days (as franchisor's know-how indicator) has a positive sign and of local market knowledge advantage (as franchsiee's know-how indicator) has a negative sign. Second, if the result of this regression analysis is significant, the question to ask is which relationship exists between royalties and initial fees. Our property rights hypothesis suggests a positive correlation between fees and royalties because higher system-specific know-how in the precontract period requires more intangible investments of the franchisor during the contract period to maintain a certain brand name value.

Third, our hypothesis implies complementarity between ownership surrogates and royalties indicating that ownership surrogates increase the incentive effect of diluted residual income rights. As argued above, ownership surrogates are measured by the index of ownership surrogates ranging between 0 and 5 for the franchisor and the franchisee. We differentiate between two groups of franchise systems: Systems with a relatively higher portion of ownership surrogates of the franchisor and systems with a relatively higher portion of ownership surrogates of the franchisee. The portion of ownership rights is measured by the difference between the index of ownership surrogates of the franchisor and the franchisee. Hence if this difference is positive, more ownership surrogates are in the hands of the franchisor, and if it is negative, more ownership surrogates are in the hands of the franchisee. Complementarities between contractual provisions are tested by using correlation coefficients (Aurora and Gambordella 1990). Complementarity between residual income rights and ownership surrogates requires a positive correlation between the franchisor's fraction of ownership surrogates and royalities and a negative relationship between the franchisee's fraction of ownership surrogates and royalities.

The data provide support for the hypothesis. First, consistent with the hypothesis, the coefficient of franchisee's local market knowledge advantage is negative and slightly significant ($p < 0.1$) indicating that franchisee's local market knowledge advantage results in a higher portion of residual income of the franchisee (see Table 2). Further, the cooefficient of annual training days is positive and highly significant ($p < 0.01$) indicating that more training days due to intangible system-specific know-how result in a higher fraction of residual income of the franchisor. In addition, tests for heteroskedasticity were performed and the hypothesis of homoskedasticity could not be rejected.

Second, the data show a positive and slightly significant relationship beween royalties and initial fees ($r = 0.23$ and $p = 0.087$). This is consistent with the property rights view because initial fees are the remuneration for the transfer of the brand name capital and royalties provide the incentives to untertake intangible investments to maintain a certain brand name value during the contract period. In addition, the data indicate complementarity beween royalties and ownership surrogates ($r = 0.252$; $p = 0.043$). To examine the interactions between the different contractual provisions and royalties in more detail we carried out a correlation analysis (see Table 3). Positive correlations exist between the royalty rate and the following provisions: Tie-in clause, resale price maintenance, buy back and approval rights and lease control. On the other hand, negative correlations arise between the royalty rate and the following contractual provisions: Exclusive dealing clause, franchisee's lease right, alienation right, exclusive customery and territory arrangements and the right to control network entry. Only the negative correlation between royalties and exclusive dealing contradicts the complementarity condition between royalties and ownership surrogates.

Table 2. OLS regression results

Dependent variable: Royalties	
Independent variable	Cooefficients
Intercept	4.839**
	(1.761)
Annual training days	0.443**
	(0.04)
Local market knowledge	−0.216+
	(0.405)
F	8.023
Significance	0.001
R^2	0.236

** $P < 0.01$; + $P < 0.1$; values in parentheses are standard errors.

Table 3. Correlations between royalties and ownership surrogates

Ownership surrogates	Royalties
Franchisor	
Resale price maintenance	0.026
Approval and buy back rights	0.176
Lease control	0.142
Tie-in arrangement	0.051
Exclusive dealing clause	−0.165
Franchisee	
Exclusive territory	−0.047
Lease right	−0.144
Exclusive customer clause	−0.02
Alienation right	−0.323**
Right to control entry	−0.14

** $P < 0.01$.

4.3. Discussion

This study presents the first empirical evidence that the structure of residual income rights in franchising may be explained by the distribution of intangible assets as firm-specific resources and capabilities. The data suggest that the allocation of ownership rights results from the different distribution of brand name and local market assets between the franchisor and the franchisee. Ownership rights (as residual rights of control) include not only residual income rights, i.e., royalties and fees, but also ownership surrogates as additional devices to increase the incentive effect of the diluted residual income rights. As suggested by our data, system-specific assets and the local market know-how have a strong influence on the allocation of ownership rights in franchising networks. In addition, to offering a solution to an anomaly in the literature, the property rights view shows new insights about the relationship between royalties and initial fees. Contrary to the agency theoretical view, a positive relationship between royalties and initial fees results from this perspective. According to the property rights theory initial fees are the remuneration for the transfer of system-specific know-how and royalties are the incentives to stimulate intangible investments to ensure a certain brand name value. Hence the higher the brand name capital of the franchise, the more system-specific investments are required during the contract period, and the higher are the royalties and fees.

5. Conclusions

The paper offers a property rights explanation for the structure of ownership rights in franchising networks. We argued that the structure of ownership rights depends on the distribution of intangible assets between the franchisor and the franchisee. The franchisee's intangible assets refer to the local market know-how and the franchisor's intangible assets to the system-specific know-how as brand name assets. The higher the franchisor's (franchisee's) intangible assets relative to the franchisee (franchisor), the more ownership rights should be transferred to the franchisor (franchisee). This hypothesis was tested by using data from the Austrian franchise sector that support the hypothesis. Since the emprical test shows a significant relationship between royalties and the distribution of intangible assets between the franchisor and the franchisee, the next step should be to include additional explanatory variables from other approaches, such as agency theory (Rubin 1978; Mathewson and Winter 1985; Lal 1990; Bhattacharyya and Lafontaine 1995), signalling theory (Gallini and Lutz 1992), screening theory (Dnes 1992b) and transaction cost theory (Williamson 1985; Klein 1980, 1995), to examine the robustness of our results.

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