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## 1. Introduction

Family firms play a powerful role in the world economy and our everyday life: from going shopping at Walmart or Aldi, to driving cars such as Volkswagen or Ford, to travelling with EasyJet or Jet Airways (Bain, 2020) – family firms constitute the majority of businesses around the world, generating about 70 to 90 percent of annual global GDP (De Massis et al., 2018).

Franchise systems are not as prevalent as family businesses, but are a key driver of economic growth in many countries around the globe. A report published by the International Franchise Association (2019) states that franchising accounts for 3% of the total US economy and that the GDP contribution has grown from 406.41 billion dollars in 2016 to 473.41 billion dollars in 2019. In India, franchising is the fastest growing industry with a growth rate of 30-35% and is estimated to account for 4% of India's GDP by 2022 (Grant Thornton India LLP, 2020).

In the European Union, the data concerning franchising is insufficient. The Directorate General for internal policies agrees: *"Franchising, as a business method, seems to be firmly established in the European Union. It is therefore quite remarkable that the available economic data regarding franchising is far from comprehensive."* One of the few things that is clear is that the number of franchising systems in the European Union has grown from 2007 to 2012 (Wiewiórowska, 2016).

Although both types of firms are of great importance on a global level, the combination of the two types, namely the family franchise firm, has been subject to little research. This is quite surprising, as both franchise systems, as well as family firms, have been studied from various perspectives for several years now.

This master thesis seeks to take a step toward an overall understanding of how families can impact the success or failure of franchise systems. To answer this question an analysis of the research on franchise systems and family firms shall be conducted. Subsequently, the two strands of research are conflated to create new insights on how family involvement impacts franchise systems.

For this purpose, it is first necessary to define franchise systems as well as family firms. Defining what distinguishes family firms from non-family firms has been a point of discussion for many years. Hence, Chua, Chrisman and Sharma (1999) reviewed 250 papers in the field of family firm research, pointing out that “ (...) *what makes a family business unique is that the*

*pattern of ownership, governance, management, and succession materially influences the firm's goals, strategies, structure, and the manner in which each is formulated, designed, and implemented.”* (Chua et al., 1999, p.22). They propose using a theoretical definition as well as an operational definition in order to be able to set a theoretical standard for measuring the efficacy of the operational definition. As scholars agree that a firm that is owned and managed by a family is a family firm, but disagree when it comes to the other possibilities, such as a firm owned by a family but not managed by it, Chua, Chrisman and Sharma (1999, p. 25) propose the following definition to include all common variations of family firms: *“The family business is a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families.”*

This rather wide definition entails three essential characteristics of family firms: the ownership, the management, as well as the expectation of succession. However, the family firms' characteristics, the institutional and cultural context vary from country to country and it might therefore be unattainable to find a one-size-fits-all definition. For example, property rights, inheritance laws or norms of primogeniture impact the family firms' functioning (Carney, 2005). The aforementioned definition shall thus serve as a basic approach towards understanding what a family firm entails.

As with family firms, defining franchising is a contentious point because this term describes a whole array of business arrangements (Burton et al., 2000). Combs, Michael and Castrogiovanni (2004) have emphasized two aspects that set franchising apart from other organizational forms used for cooperation purposes: the first one being its frequent occurrence amongst service and customer orientated businesses and the second one: its franchisor-franchisee relationship with contracts defining the mutual rights and obligations.

Generally, one speaks of franchising when one firm, the franchisor, vends the right to market its goods and/or services and the use of its practices to another firm, the franchisee. Whereby the franchisor's tasks are, inter alia, to decide upon performance standards, locations, to manage the brand and to choose franchisees. The franchisees manage and run the day-to-day business in their respective outlets (Combs et al., 2004).

However, the selling of business practices is not part of every franchise agreement. One distinguishes between first generation (traditional) franchising and second generation (business-format) franchising. In the former case, the franchisee has very limited rights and resources, which leads to franchisees only producing or selling one product such as cars or petroleum, or providing one service under one brand name such as bottling soft drinks (Burton et al., 2000; Blair & Lafontaine, 2005). The franchisor hence sells its goods and the franchisee resells them. In the latter case, the franchisee's tasks include much more than just reselling a product. The franchisee buys the business-format and, depending on the kind of business, gets access to the franchisor's know-how, property rights such as trademarks, receives training and support in e.g. financial matters and benefits from the centralised advertising or purchasing of the franchisor (Burton et al., 2000; Blair & Lafontaine, 2005).

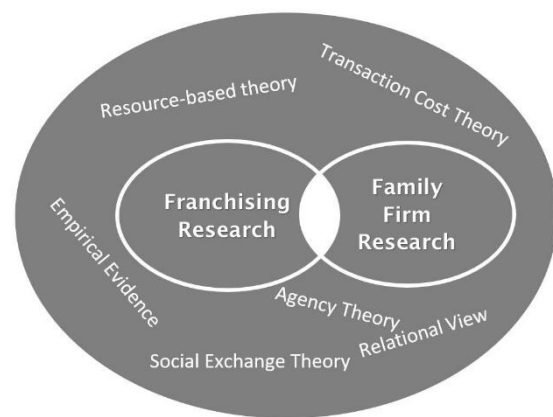
The franchisor, in turn, receives running royalties and often also a fixed fee when entering into the contract. It is evident that a closer relationship is needed in case of business format franchising, the borders between the two types of franchising, however, are blurred. The differentiation between the two should nonetheless be mentioned, as countries like the United States for example do not include first generation franchising in their franchising statistics (Burton et al., 2000; Blair & Lafontaine, 2005).

The remainder of this thesis is structured as follows: in the next chapter, the methodology, as well as the research question are described. Then, the relevant theories and its main propositions are examined. Afterwards, the empirical evidence to date is outlined. It is followed by a thorough analysis of the theoretical and empirical findings and what conclusions can be drawn from them. Lastly, a discussion and conclusion round off this thesis.

## 2. Methodology & Research Question

Despite the worldwide relevance of family firms, there is very limited research concerning families and their influence on franchise systems as well as family franchise systems. This thesis aims at exploring family ties in franchise systems and their impact on the success or failure of the franchise systems, thereby providing more insight into relationships in franchise systems and reducing the current knowledge gap. The research question is therefore as follows: “How do families influence franchise systems?” To answer this question a qualitative approach is used.

By outlining several theories, that both the franchising and the family firm research streams have in common, this thesis complements the existing knowledge and presents a broader perspective of the issue. The theories used will be: transaction cost theory, the resource-based view, agency theory, the relational view as well as social exchange theory. These theories will be used since they have already been applied in both research streams and complement one another well. The results gained from these theories in the franchising and family firm literature will also be presented.



Another aspect that will be included in this thesis are the empirical results of comparisons made between family and non-family firms as well as the comparisons between family and non-family franchise systems. The analysis and the empirical results will then be combined and applied to the research question. By integrating theoretical and empirical knowledge, this master thesis intends to enable an in-depth understanding of the dynamics of families in franchise systems.

### 3. Theoretical Background

Hereinafter the main concepts and propositions of the chosen theories that have been applied to franchising research as well as family firm research are outlined. For each theory the relevant findings when applied to franchise systems and family firms are elucidated.

#### 3.1 Transaction Cost Theory

Transactions are not only an inevitable part of entrepreneurship but also of everyday life. Transaction cost theory suggests that each and every transaction, from negotiating to monitoring, causes costs and that the numerous ways of organizing transactions influence the arising costs (Rindfleisch, 2020). Transaction cost theory has been developed more than 80 years ago, yet it has remained a key theory for analysing organizations and is still being applied to various fields of research.

The father of transaction cost theory, Ronald Coase (1937), used his theory to explain the existence of firms. He argued that using the market mechanism entailed costs and that firms only exist because they are a way of reducing these transaction costs – markets and firms do therefore cause different costs (Coase, 1937; Madhok, 2002). Coase (1937) gives two explanations for the possible cost advantages of firms. One is that less contracts are needed within the firm since there is one long-term contract with the co-operating party (e.g. the employee) instead of a series of contracts that would be necessary in the market.

The second reason is that the relevant prices of the transactions are known, as they take place in the firm and not in the market, thus leading to the omission of the costs of discovering the relevant prices. The differences between the market and the firm can be traced back to their means of coordination: the market is coordinated by the price mechanism while the firm is coordinated by authority relations (Coase, 1937; Madhok, 2002).

Oliver Williamson drew attention to the fact that Coase's concept of transaction costs does neither explain why the market is not replaced by internal organization nor the factors leading to the cost savings. Hence, Williamson greatly developed transaction cost theory by adding important human and environmental dimensions such as uncertainty, frequency, opportunism, bounded rationality and asset specificity, thus distinguishing the attributes that define transaction costs (Williamson, 1983; Williamson, 1991; Rindfleisch, 2020). Williamson (1983)

uses the term opportunism to refer to *“a lack of candor or honesty in transactions, to include self-interest seeking with guile”* (Williamson, 1983, p. 9).

Bounded rationality is used to describe the fact humans have limited (neurophysiological) capacities for solving complex problems as well as language limits, meaning the inability to express knowledge or feelings (Williamson, 1983). Williamson further explains that *“When, however, transactions are conducted under conditions of uncertainty/complexity, in which event it is very costly, perhaps impossible, to describe the complete decision tree, the bounded rationality constraint is binding and an assessment of alternative organizational modes, in efficiency respects, becomes necessary.”* (Williamson 1983, p. 23). Bounded rationality and the complexity of the environment are thus crucial factors in deciding between the market and the firm.

Especially important in transaction cost theory is asset specificity. This is because it creates bilateral dependency. It describes the possibility of redeployment of an asset to different uses or users and the resultant positive or negative change in value (Williamson, 1991; Madhok, 2002). Asset specificity increases the transaction costs of all governance modes as it causes additional contracting problems (Williamson, 1991). Asset specificity can take on various forms: human, physical, site, dedicated or brand name. This is of importance because as Williamson (2002, p. 175) states: *“Given that transactions differ in their attributes and that governance structures differ in their costs and competencies, the aforementioned that- transactions should be aligned with appropriate governance structures- applies.”* (Williamson, 2002, p. 175).

Williamson (1971, 1983) argued that the market is more advantageous when the price summarizes the relevant information, whereas the firm has the important advantage of having more control instruments such as promotions or remuneration and being able to solve conflicts more easily. Moreover, he complemented the criticized polarity of transaction cost theory – markets and hierarchies – by a third organizational form: the hybrid (Williamson, 1991; Rindfleisch 2020). Whether the market, a hierarchy or a hybrid is chosen as governance mode, is a question of comparative efficacy and thus the economizing on transaction costs. Williamson (1991) names franchising as a hybrid form of governance.



Contracts are the main form of transaction. Before entering into the contract, ex ante transaction costs, e.g. from negotiating, arise. After entering into the agreement, ex post transaction costs such as operating costs occur (Rindfleisch, 2020).

Because of Williamson's work, transaction cost theory was examined in a massive number of studies (Rindfleisch, 2020). Williamson thus laid the foundation for exploring franchise systems from a transaction cost perspective and for comparing the efficiency of alternative forms of organizations (Gedajlovic & Carney, 2010).

### 3.1.1 Transaction Costs in Franchise Systems

Multiple aspects of franchising have been examined through the lens of transaction cost theory, but no universal transaction cost theory of the franchise system has been developed. Therefore the key findings applicable to this thesis are outlined hereinafter.

Instead of each franchisee owning one unit of the franchise system, the franchisor can decide to have franchisees that own more than just one unit. This kind of franchising is called multi-unit franchising and has become more and more important over time (Boulay et al., 2020). There are two types of multi-unit franchising. Firstly, the franchisor can grant the franchisee more units one after another – this is called sequential multi-unit franchising. Secondly, master franchising could be chosen where the franchisor can decide between sub-franchising and area development agreements. In sub-franchising, the franchisor allows the franchisee to act as a franchisor by granting him/her the right to grant units to others. In area development agreements, the franchisee is obliged to open a certain number of outlets of the franchise system in a pre-defined area (Gomez et al., 2010).

Why the franchisor chooses multi-unit franchising over single-unit franchising has been one of the questions researches have been concerned with in recent years (Hussain & Windsperger, 2010; Hussain et al., 2012; Boulay et al., 2020). Using transaction cost theory, Hussain et al. (2012) argue that, as both, the franchisor as well as the franchisee invest in transaction-specific assets, they enter into a close relationship which serves as a basis for a continuous cooperation between the parties. When the specific investments are high, the franchisor and franchisee are greatly dependent on each other and exiting the contract would cause losses since the transaction-specific assets lose value outside the relationship (Boulay et al., 2020; Hoffmann et al., 2010).

Hussain, Moritz and Windsperger (2012) showed that due to coordination economies of scale, the resultant bonding effect is even stronger in multi-unit franchising as the transaction-specific investments for every outlet are reduced with the number of outlets run by one franchisee. The bonding effect results in the franchisor choosing multi-unit franchising over single-unit franchising. Another reason for choosing multi-unit franchising over single-unit franchising is the degree of investment specificity. This is however only the case when franchisors have difficulties finding franchisees (Boulay et al., 2020).

This bonding effect as well as transaction-specific investments have been used by Hendrikse, Hippmann and Windsperger (2015) to explain contractual incompleteness in the context of franchising. The specific investments made by both sides can be protected by having a strong contract. But due to transaction costs, bounded rationality and the impossibility to prepare for all contingencies, complete contracts that enable ex ante as well as ex post efficiency are unfeasible (Saussier, 2000; Scott & Triantis, 2005). Having a more complete contract than a more incomplete one can safeguard against opportunism and reduce (re-) negotiation costs (Saussier, 2000).

For franchise contracts, Hendrikse, Hippmann and Windsperger (2015) define contractual completeness as the relationship between residual decision rights and specific decision rights; whereby more specific decision rights and less residual decision rights lead to a more complete contract. Specific decision rights refer to detailed provisions which determine the decision rights and courses of action under certain circumstances for both the franchisor and the franchisee. Residual decision rights pertain to the general division of decision rights for the duration of the contract (Hendrikse et al., 2015).

In order to find out how transaction-specific investments by the franchisor and the franchisee affect the contractual completeness in terms of specific and residual decision rights, the mutual dependencies of the two parties were analysed. In bilateral dependence, the franchisor and the franchisee are mutually dependent on one another as both have heavily invested in transaction-specific assets which leads to the cited bonding effect and an increase in cooperative behaviour (Hendrikse et al., 2015; Boulay, 2020). This implies that less control is needed, leading to less specifications, hence more residual decision rights in the contract, and more contractual incompleteness.

In unilateral dependence, one party has invested more than the other one. When the franchisor invests heavily, more residual decision rights are implemented in the contract, making it less complete, which has the advantage that the franchisor can maintain flexibility in case of ex-post changes. When the franchisee undertakes many transaction-specific investments, less specific decision rights are necessary as the transaction-specific investments cause the bonding effect as well as a self-enforcing effect (Hendrikse et al., 2015).

Here, the highly important factor of trust comes into play since it impacts contract design as well as transaction costs, the structure of the firm and its performance. Trust reduces transaction costs because the risk of opportunistic behaviour gets diminished (Hoffmann et al., 2010). Trust refers to the expectation of the exchange partner that the other party will not behave opportunistically even in case of temptation (Hoffmann et al., 2010; Mumdziev & Windsperger, 2013). A trustful relationship does therefore not mean that there is no need for monitoring and control, but that the expected degree of opportunistic behaviour is lower than in relationships with no or little trust. Trust has a moderating effect since it can lead to less monitoring and control costs (Hoffmann et al., 2010).

Implementing trust as moderator in their transaction cost model, Mumdziev and Windsperger (2013) researched the process of allocating decision rights between the franchisor and the franchisee. Typically, transaction cost theory would predict that the risk of opportunistic behaviour on the part of the franchisee rises with the level of uncertainty. The franchisor then tries to counteract by intensifying control through e.g. centralising decision making.

But the opposite is true: behavioural uncertainty leads to the franchisee getting more decision rights as the franchisor struggles to assess performance. The advantage of this is that “(...) *the franchisor provides incentives and facilitates franchisee’s participation by delegating decision authority instead of tightening control.*” (Mumdziev & Windsperger, 2013, p. 179). When the relationship is characterized by high trust, the franchisor allocates less decision rights to the franchisee in case of high behavioural uncertainty since incentives are not as necessary.

In contrast, under environmental uncertainty, which describes the near unpredictability of the factors of the context in which the transaction takes place and makes it impossible to include them in the contract beforehand, the franchisor’s need for control increases and franchisees have less decision rights. This effect is mitigated when trust prevails in the franchisor-franchisee relationship (Mumdziev & Windsperger, 2013).

And, as mentioned before, transaction specific investments lead to a self-enforcing effect (Hendrikse et al., 2015). The self-enforcing effect is strengthened when the trust between the franchisor and the franchisee is high. Hence, trust plays a crucial moderating role between the allocation of decision rights in franchise systems and the transaction cost variables of behavioural and environmental uncertainty as well as transaction-specific investments (Mumdziev & Windsperger, 2013).

Franchising contracts are also impacted by the investment in transaction-specific assets. Both the franchisor and the franchisee have to undertake transaction-specific investments: while the franchisee has to pay the initial fees and carries the costs for opening a new outlet, the franchisor also incurs costs with the opening of a new outlet as well as for the support of the franchisee (Gorovaia & Windsperger, 2018).

Contract duration may be increased through transaction-specific investments since the motivation for concluding long-term contracts is higher. However, only the transaction-specific investments of the franchisee directly impact the contract duration positively, whereas the franchisor's investments only have a positive effect when the franchisee's investments support the franchisor's investments (Gorovaia & Windsperger, 2018).

Another particularly interesting area of research in the context of franchising and its transaction costs is international franchising since factors such as entry mode choice, cultural distance or the institutional environment add to the complexity of the franchise system and the costs entailed (Altinay & Brookes, 2012).

Burton et al. (2000) point out five factors of transaction costs in cross-border franchising:

1. Ex ante, the franchisor must find a franchisee in the foreign country. The more thorough this step is undertaken, the more likely it is to find a high-quality foreign party, but the higher are the search costs.
2. When transferring the franchisor's know-how to the franchisee, modifying the business model for the foreign market and providing support, servicing costs occur.
3. In order to prevent the franchisee from behaving opportunistically and to protect the intellectual property such as the brand name, the franchisor needs to install some kind of control mechanism which ultimately leads to monitoring costs.

4. Ex post, costs to protect property rights can occur when local firms or even the contracted party tries to copy the business model.
5. When the franchisor decides to work with an intermediary some costs e.g. searching or monitoring costs are reduced but at the same time new costs, for example resource and agency costs, arise.

Concerning the international franchising mode, franchisors can choose between several alternatives. Firstly, the franchisor may choose to use direct international franchising. Secondly, international franchising via intermediary may be chosen. Thirdly, master franchise partnerships, as discussed in 2.1.1, which give franchisees not only the right to open up a unit of the franchise business but also to act as franchisors themselves, may be the franchising system chosen for international expansion (Burton et al., 2000; Altinay & Brookes, 2012).

Direct franchising is chosen over franchising via intermediary when the transaction costs in the form of searching, servicing and monitoring are minimised – which relates to the structure of the franchise: firms with more managerial capacities and greater revenue from international franchising prefer franchising directly. Consequently, intermediaries are used when the franchising firm is smaller and its revenue related to franchising stems from the domestic market. Franchising via intermediary is also preferred when the firm has experience in franchising in the domestic market (Burton et al., 2000).

The fact that transaction costs are a decisive factor when franchising internationally has also been shown by Cho (2005) who studied the impact of transaction costs in terms of asset specificity and environmental and behavioural uncertainty in the context of international hotel franchise systems with a focus on the franchisee's costs. It was found that the potential exchange partner is more willing to become a franchisee when the transaction costs are low. Lowering transaction costs for the franchisees can be done by ensuring that transaction-specific investments are low and by having a system in place that hinders the franchisor from behaving opportunistically (Cho, 2005).

Therefore, the transaction costs in international franchising to some extent depend on the chosen franchising mode and transaction specific investments. The asset specificity is also important for the commitment to invest. Franchisees are more likely to invest in the partnership when specific franchisor assets such as the brand name and reputation are of great value. This

consequently improves the franchisor-franchisee relationship (Altinay & Brookes, 2012). Other factors such as the influence of institutions should also not be underestimated.

The institutions of the host country can lessen or increase transaction costs faced by a franchise firm that wants to expand into the country's market. When a country facilitates the process with sound regulations that are not excessive, transaction costs lessen, whereas when the process is impeded, transaction costs rise. This clearly makes some countries more attractive than others (Hoffmann et al, 2016).

While the location-specific factor of the institutions in the host country clearly influences transaction costs, the factor of proximity – not only in terms of distance but also cultural proximity – is hard to grasp in terms of transaction costs. From a transaction cost perspective, one could argue that entering a market that is culturally or geographically distant increases e.g. monitoring costs due to the difficulties of ensuring compliance (Burton et al., 2000).

Interestingly, at least when it comes to the choice of franchising mode, there is no direct correlation between proximity and the choice of franchising entry mode. Which does not mean that transaction costs are not being influenced by proximity, but rather that a process of self-selection when choosing to enter a foreign market is in place. The franchisor might e.g. decide to only expand the business into markets that are likely to be suitable for the existing franchise model (Burton et al., 2000).

Essential for franchise systems is the relationship between the franchisor and the franchisee. What sets the franchisor-franchisee interfirm relation apart is that they are legally independent businesses, yet entangled as the two firms pursue a joint economic target (Cordobés Madueño & García, 2015). To reduce transaction costs which implies reducing opportunistic behaviour, uncertainty etc. and to make the joint effort work, contractual agreements and control, like in other business relationships, are needed.

Cordobés Madueño and García (2015) studied the special franchisor-franchisee relationship in the context of management control, using transaction cost theory. The revenue of the franchisor comes from the royalty payments the franchisee has to pay (Combs et al., 2004). But royalty payments are also a tool to ensure compliance, particularly in the beginning of the business relationship. Rules and an abundance of information in e.g. the form of written procedures are also essential for compliance. Over the course of the relationship, the franchisor gets to know

the franchisee better and trust is built when the franchisee has reacted positively to the exercised control. Since trust has a moderating effect, it then loosens the tight control mechanisms, enables an increased information exchange and enhances the franchisor-franchisee relationship. However, the individual relationship suffers with rising franchisee numbers (Cordobés Madueño & García, 2015).

To describe the management control mechanisms, Van der Meer-Kooistra and Vosselman's (2000) model, which describes three management control approaches of inter-organizational relationships, is useful. On the basis of transaction cost theory and the phases of a transactional relation – the contact phase, the contract phase and the execution phase – it is argued that there are three determining factors of a business relationship and its control mechanisms, namely: the transaction itself, its environment and the parties involved.

Due to bounded rationality, control mechanisms are necessary, especially in a long-term relationship with transaction-specific investments and under high uncertainty. Since control mechanisms entail e.g. monitoring costs, they also impact transaction costs. The model also takes into account that trust is a crucial factor in long-term interfirm relations and it views interfirm transactional relations as Williamson's hybrid mode of governance. Within this hybrid group of interfirm transactional relations, they differentiate between three (ideal) forms (Van der Meer-Kooistra & Vosselman, 2000):

- Market based: the market mechanism is prevalent, no specific investments needed, competitive bidding, no detailed contracts, no detailed control mechanisms, low uncertainty
- Bureaucracy based: detailed rules, norms and standards, detailed contracts to protect transaction specific investments, system of control with strong intervention by the outsourcing party
- Trust based: trust as control mechanism, suppliers are selected due to friendship, reputation of trustworthiness or from former cooperation, no detailed contract, high asset specificity, high mutual dependency

It is assumed that one of these forms will be predominant in the relationship (Van der Meer-Kooistra & Vosselman, 2000). On this basis, Cordobés Madueño and García (2015) conclude that franchising falls under the category of bureaucracy-based control. This is due to the fact that the franchisor has detailed criteria when looking for franchisees, contracts precisely define

the rights and obligations of the parties to prevent future conflicts and the franchisee is supervised by the franchisor.

### 3.1.2 The Family Firm & Transaction Costs

Until recently, embedding family firm research into transaction cost theory had not been undertaken. Williamson (1996) only very briefly mentions family firms, acknowledging that the governance of family firms has specific advantages as well as drawbacks but without covering the matter in greater detail, therefore not providing a satisfactory contribution to the unique properties of family firms in the context of transaction cost theory.

Gedajlovic and Carney (2010) point out that transaction cost theory (which had not been directly applied to the context of family firms until then) can be helpful in creating a unified theoretical framework of family firms. Criticizing Williamsons' and his adherents' concept of asset specificity within transaction costs, pointing out that they do not consider assets that are specific, yet tradeable and assets that are not easily tradeable, yet generic, they develop a transaction cost theory of family firms by introducing the notion of generic nontradeables (GNTs).

GNTs are on the one hand broadly applicable and on the other hand have to be established and sustained. The firm thus has to develop the GNTs to get value out of them as they are not buyable. They identified four types of generic nontradeables that are particularly important in family firms: tacit knowledge, reputation, bonding social capital and bridging social capital.

To explain how family firms' governance characteristics influence the efficiency of the use of GNTs, they utilize Carney's (2005) three propensities of family governance: parsimony, personalism and particularism. Parsimony results from the usage of the family's wealth, leading to an inducement for minimizing costs. Personalism stems from the fact that the owning family or the owner-manager also exercises organizational authority and faces less internal constraints compared to firms under different governance modes. Particularism describes the propensity of owner-managers to not only take rational-calculative decisions but also decisions based on e.g. social ties (Carney, 2005).

Using Coase's and Williamson's proposition of alternative governance modes having different inherent transaction costs, Gedajlovic and Carney (2010) argue that family governance is, due to its traits of parsimony, personalism and particularism, superior in developing, sustaining and



appropriating value from the four indicated GNTs leading to relative efficiency advantages for family firms compared to other types of firms. They, for example, argue that personalism and particularism help develop bonding social capital, as families have the liberty to make transactions out of noneconomic considerations. However, like other governance modes, family governance also has its respective disadvantages such as constraints in raising external capital (Gedajlovic & Carney, 2010).

Based on Gedajlovic & Carney's work, Verbeke & Kano (2010, 2012) further develop the transaction cost theory of family firms by extending the behavioural assumptions of transaction cost theory and by adding family-based human asset specificity and the bifurcation bias linked to it. Verbeke & Kano (2010) criticize Williamson's assumption of opportunism for being too narrow and lacking evidence. Therefore, they use the notion of bounded reliability which includes opportunism as well as the unintentional non-fulfilment of obligations caused by e.g. overcommitment.

Family-based human asset specificity describes the involvement of family members in the firm long before having a formal employment contract and thus constituting a unique employee base. The family firm therefore has a stable pool of loyal human resources although not being able to decide over the quantity nor the quality of it. Additionally, family firms can less easily adapt to new circumstances by hiring and firing employees as many employees are often also family members. Consequently, non-family members face more obstacles when wanting to take on a managerial position whereas family members experience difficulties when wanting to leave the firm as it can have severe repercussions on private life (Verbeke & Kano, 2010).

Verbeke & Kano (2010) thus predict that large family firms have better chances at being long-standing and successful businesses since they have more options when it comes to the utilization of family members. It is important, however, that the firm invests in professional education of the family members to counteract dysfunctionalities due to kinship as training limits bounded rationality as well as bounded reliability.

Differing treatment of family and non-family employees can lead to the emergence of the bifurcation bias which refers to the default and systematic asymmetric treatment of family and non-family employees (Kano & Verbeke, 2018). To some extent, however, the differing treatment is inevitable as family firms usually also pursue non-economic goals. What

constitutes the bifurcation bias is the systematic and by default applied differing treatment. The underlying cause of bifurcation-biased treatment is the bounded rationality problem.

The bifurcation bias leads to inefficiencies such as unproductive family-based human assets and can affect areas such as product lines. It also increases bounded reliability. Verbeke & Kano (2010) expect bifurcation-biased family firms to have a weaker performance and problems with sustaining their governance structure. This means that family firms on the one hand can make use of unique family-based human assets, while on the other hand having to invest into the professionalisation of human resources to avoid the dysfunctionality that this human asset specificity could lead to. Concomitantly, the professionalisation reduces bounded rationality as well as bounded reliability. It is important, however, to acknowledge that family firms differ greatly in their properties and that the nature of their assets and liabilities, as well as the extent to which they pursue noneconomic goals, greatly influence their performance (Verbeke & Kano, 2012).

In a rather recent study, Sestu and Majocchi (2018) investigate the impact of family involvement on foreign market entry modes by using transaction cost theory as well as family firm research. As previously discussed, minimising transaction costs is an important decision criterion – this also applies to the choice of entry mode. One significant transaction cost factor is asset specificity and the degree of specificity increases in the case of family control. When transaction costs are high, firms favour entry modes such as joint ventures or wholly-owned-subsidaries to retain control over their assets.

Here, once again, the type of asset is crucial as family involvement leads to family-specific non-tradeable assets which results in the previously described GNTs bonding and bridging social capital, tacit knowledge and reputation. The GNTs impact the choice of entry mode as it is almost impossible to detach them from the family firm, causing higher transaction costs (Gedajlovic & Carney, 2010)

On this basis, Sestu and Majocchi (2018) compare the entry modes of family and non-family multinational corporations while also taking into account the family or non-family involvement of the owner of the foreign asset. They find that joint ventures are preferred when both parties are family firms as both firms can keep their family status. When the multinational corporation is a family firm but the foreign firm is not, a wholly-owned-subsidary is the preferred entry mode so that the assets are still controlled by the family of the multinational corporation.

## 3.2 Resource-Based Theory

How firms develop and sustain their competitive advantage is the question the resource-based theory (also capability-based view) tries to find an answer to. The resource-based theory thus presumes that resources are not equally distributed among firms and only imperfectly traded on the markets (Gillis et al., 2014). This implies that every single firm is different since they all have different resources and capabilities. So, compared to transaction cost theory, the resource-based theory does not base the existence of firms on market failure but on the sustained advantages firms have compared to the market (Madhok, 2002).

When a firm possesses a competitive advantage, this advantage stems from a rare resource that increases profitability and that other firms do not have. The competitive advantage turns into a sustained competitive advantage when no (or very little) other firms can imitate it or find substitutes for it (Combs et al., 2004). These resources can be of tangible or intangible nature (Chirico et al., 2011). But resources are harder to imitate the more intangible they are, hence highly intangible resources lead to a stronger performance (Gorovaia & Windsperger, 2013a).

### 3.2.1 Franchise Systems in the Resource-Based View

From a resource-based view, franchising has the benefit of enabling access to various resources of other firms. Both, the franchisor and the franchisee benefit from each other's tangible and intangible resources so that they can overcome the limits of their own resources and grow their respective businesses (Madhok, 2002).

What the resources behind superior performance of some franchise systems compared to others is, has been the subject of a study conducted by El Akremi, Perrigot, and Piot-Lepetit (2015). For their study, they used the dynamic capabilities view, which is an offshoot of the resource-based view. An emphasis is laid on the importance of the processes of the utilization and replication of knowledge resources as a key performance-drivers of franchise systems.

Value is created through the formation and manipulation of resources, whereby knowledge, which is defined as *“original and proven business concepts, as well as operational, technical, and marketing know-how”* (El Akremi et al, 2015, p. 147), is a particularly important resource for competitive advantage of franchise systems. The transfer of this knowledge from the franchisor to the franchisee is crucial for performance. This aspect has also been highlighted by Gillis and Combs (2009). Through knowledge-sharing routines the franchisor is able to learn

from the franchisee and the adjustments made at the outlet level. The franchisor can subsequently spread this knowledge chain-wide. Trust is also necessary for the implementation of the franchisor's operating routines. However, a distinction between turnkey and chain-builder franchise systems must be made.

The turnkey franchise system does not own outlets whereas the chain-builder does own outlets but also uses franchisees to run outlets. Gillis and Combs (2009) found that in the case of a turnkey franchise, investing in operating routines leads to increased performance whereas investing in knowledge-sharing routines worsened performance. In the case of the chain-builder strategy, knowledge-sharing routines and building franchisee trust is of high importance for performance, and investments in operating routines weakened performance. Chain builders need innovation while keeping a certain standard, whereas turnkey franchises have little need for innovation (Gillis & Combs, 2009)

It is thus evident that the resources must match the used strategy. A strong brand reputation, larger and faster growth, as well as low start-up costs are additional beneficial factors for the performance of a franchise system (Gillis & Combs, 2009; Gorovaia & Windsperger, 2013a). In their paper, however, Gillis and Combs (2009) do not clarify how exactly they measured franchisors' performance.

Experience is required in order to attain great performance and to develop the resources needed to match the strategy. Through gaining experience over time, franchisors can develop more effective practises and gain more knowledge of how to run the system better, by understanding processes, customers, competitors etc. (El Akremi et al., 2015). The gained knowledge does then help in developing, sustaining and manipulating resources. To transfer this knowledge to the franchisees, initial training is necessary.

A longer initial training period affects performance positively. Though it is time- and resource-consuming, thorough training leads to enhanced unity, effectiveness and brand reputation. As a result of the positive relationship between experience and know-how, the maturity of the franchise system impacts performance positively, as organisational routines are more easily implemented and more efficiently utilised, which decreases costs. This positive effect of long-term experience does not, however, apply to the length of the franchisor-franchisee relationship, since conflicts may increase in-long term contracts as franchisees may want more autonomy (El Akremi et al., 2015).

While El Akremi et al. (2015) use global sales as the indicator of performance, Ghantous and Das (2018) use the satisfaction with the relationship from the view of the franchisor and the performance compared to other franchise systems as indicator of performance. The resources and capabilities impacting international performance are found to be reconfigurational capabilities, international relational capabilities and franchisor-owned resources. The ability to use the available resources for other purposes than initially intended is of utmost importance for long-term survival in changing environments and for internationalisation.

This ability to reconfigure resources in the context of international franchising is, according to Ghantous and Das (2018), composed of two capabilities: innovativeness and organisational responsiveness. The latter refers to the ability to react to the markets' needs by using the information gathered by the franchisees, whereas the former describes a proactive approach that aims at influencing the market. These reconfigurational capabilities improve the satisfaction with the relationship because franchisors respond to the franchisee's information and thus their difficulties, while also anticipating their respective needs through the received information. Innovativeness also significantly positively impacts comparative performance whereas organisational responsiveness only affects the satisfaction with the franchisor-franchisee relationship (Ghantous & Das, 2018).

Relational capabilities refer to capabilities that arise due to the franchisor-franchisee relationship. They can be a source of competitive advantage and impact performance as they are rather rare, hard to imitate and create value (Gillis et al., 2014). Ghantous and Das (2018) investigated three relational capabilities: knowledge transfer, contract design and monitoring. All three capabilities positively impact the satisfaction with the franchisor-franchisee relationship. Franchisees expect a transfer of knowledge when buying a franchise and the franchisor uses knowledge transfer to ensure the correct replication of the system.

The franchise contract is of great value in the context of performance as it intends to safeguard against opportunism by using appropriate terms of contract. A real option clause in the contract, which provides the franchisor with the possibility of buying the franchised outlet at the end of the contract period, for example, can increase performance by giving the franchisor more flexibility and incentive to invest in intangible assets. It can, on the other hand, also negatively impact franchisees as their incentives to invest in e.g. quality control or innovation may be weakened. The contract design must therefore include provisions for the inducement of franchisee effort (Gorovaia & Windsperger, 2013a).

The duration of the contract as part of the contract design also has a significant impact as *“It mitigates the costs of exchange hazards due to uncertainty and relationship-specific investments and facilitates knowledge creation and exchange in franchise networks.”* (Gorovaia & Windsperger, 2018, p. 125). Two intangible resources of the franchisor, system-specific know-how and brand name, have been shown to positively influence the duration of a franchise contract. The reason for this is that long-term orientation is necessary to create strong franchisee commitment for brand name advancement and to transfer the system-specific know-how from the franchisor to the franchisee, especially when the intangible know-how is crucial for strategic value creation. The efforts of the franchisor, as well as those of the franchisee, are higher under long-term contracts (Gorovaia & Windsperger, 2018).

Monitoring is a second mechanism designed to counter opportunistic franchisee behaviour while also complementing the contract and revealing the difficulties franchisees face, making adequate assistance by the franchisor possible (Ghantous & Das, 2018). Knowledge transfer and monitoring do not, however, impact comparative performance, only contract design does.

The brand and know-how of the franchisor pertain to the franchisor-owned resources. With a strong brand, consumers as well as potential franchisees are more easily attracted, which leads to better comparative performance (Ghantous & Das, 2018). The value of the brand might however be diminished if too many franchises are sold (Gillis et al., 2014). A valuable brand does not impact the relationship satisfaction. These findings thus partially confirm Gillis and Combs’ (2009) results.

### 3.2.2. Family Firms in the resource-based view

The systematic influence which family members have on the business leaves not only an imprint on the resources and capabilities of the firm, but also on its performance. The interaction between the subsystems business entity, the family and individual family members, leads to complex intangible resources and therefore to potentially unique competitive advantages (Habbershon et al. 2003).

Carney (2005) argues that one basis of the competitive advantage of family-controlled firms lies in their system of corporate governance. The system of corporate governance refers to *“distinct incentives, authority structures, and norms of accountability that generate specific organizational propensities.”* (Carney, 2005, p. 249). By family-controlled firms Carney (2005) refers to the ability of family members to affect the decision making processes due to possessing

certain control rights over assets of the firm. As shortly explained in 2.1.2, Carney (2005) attributes three dominant propensities to the family-controlled governance system: parsimony, personalism and particularism.

These propensities lead to competitive advantages in family-controlled firms: parsimony, for example, leads to advantages in scarce environments, as family firms try to minimize costs to increase returns and therefore control their employees thoroughly. Personalism facilitates the pursuit of opportunistic investments since resources can be deployed without having got to go through extensive internal and external accountability processes. The accumulation of intangible skills is nonetheless limited to the extent to which the family lets outsiders take part in the decision-making processes. The limitation of the inclusion of outsiders does, nevertheless, speed up the decision-making process (Carney, 2005).

It is pointed out that family-controlled firms face disadvantages due to capital and managerial constraints stemming from the involvement of personal wealth and family ties (Carney, 2005). These constraints can e.g. be an obstacle for the development of the success-inducing capacity to innovate, as the propensity for wealth preservation of the family firm opposes the expenditures that are often necessary for innovation. But this innovativeness capacity is of great importance since it improves organizational learning, firm growth and creates barriers for competitors, strengthening the firm's market position. Family firms that lack innovativeness may over time lose their customers due to evolving customer needs (Eddleston et al., 2008).

According to another point of view, the basis of the competitive advantage of family firms arises from the family relationships and the resultant resources. These resources are called "familiness" (Cabrera-Suárez et al., 2001; Habbershon et al., 2003; Eddleston et al., 2008, Chirico et al. 2011).

#### 3.2.2.1 Familiness

The concept of familiness is widely used among scholars and lies at the heart of family firm research (Monroy, 2015; Zellweger et al. 2010). Familiness is an intangible resource that cannot be replicated and is only prevalent in family firms, hence differentiating family from non-family firms. Familiness stems from the ongoing interactions between the family members and the business (Chirico et al., 2011). *"More specifically, familiness is defined as the unique bundle of re-sources and capabilities a particular organization possesses because of the family firm"*

*system's interaction among the family, its individual members, and the business.*" (Cabrera-Suárez et al., 2001, p. 38).

In their unified systems model of firm performance, Habbershon, Williams and MacMillan (2003) even use distinctive familiness, the family-specific resources and capabilities that lead to an advantage, as defining function. Familiness is of such significance as it is a unique source of competitive advantage. A sustainable competitive advantage however, can only be reached when the resource bundle of familiness is properly administered and frequently augmented.

Since a lot of the resources included in familiness such as commitment or trust are tacit, understanding the underlying processes and a proper transfer of knowledge are crucial (Cabrera-Suárez et al., 2001). Tacit knowledge is embedded in the family firm, hence it is very difficult to imitate and to separate out for sale on the market. When the tacit knowledge is so valuable that it leads to a competitive advantage, superior performance can be sustained for a longer period of time (Tokarczyk et al., 2016).

Familiness can therefore be a key factor for the success of the family firm as it e.g. impacts effective market orientation (Tokarczyk et al., 2016). It is important to note that the relationship between familiness and performance may also be neutral or negative. In a meta-analysis of 23 studies concerning familiness and performance Rutherford et al. (2008) found that nine studies observed a positive effect of familiness, one found a negative effect, nine found neither a positive nor a negative effect and four found a partially positive effect.

Eddleston et al. (2008) have found that families characterised by reciprocal altruism (for more on altruism see 3.3.2) display high commitment, a strong sense of identification and reciprocal help. The interaction between the family, its members and the business might lead to a transfer of these characteristics to the firm. In an altruistic family firm, the members are devoted to the family firm and view it as their responsibility to make the firm successful (Eddleston et al., 2008).

Since not all families show this kind of behaviour, this example shows the extent of the concept of familiness. It covers a very broad range of resources and characteristics of family firms, making differentiation necessary. To clarify the underlying sources of familiness, three dimensions can be of great use (Zellweger et al., 2010):



- The components of family involvement: ownership, management and governance give the family the potential to influence the firm and thus also the potential for the creation of familiness
- The essence of involvement: the behaviour, resources and capabilities with which the family influences the firm and from which familiness is created; the willingness to transfer the business to future generations while the family is in control of the firm is central in the essence dimension as it leads to the family putting the firm first
- Organisational identity: refers to the unique identity of the family firm, shows how the family views the firm and , if desired, creates familiness by creating a family firm image, unique values, beliefs and practices

The family involvement, its essence, as well as the organisational identity vary from firm to firm, which does not only help in explaining the familiness and the potential competitive advantage stemming from it, but also the heterogeneity of family firms. A family controlled firm with little input from the family and an identity that does not relate to the family will ultimately have very different resources and capabilities than a firm with strong family involvement, essence and identity. Hence, the ability to create familiness also differs profoundly – depending on how involved the family is in each of these dimensions (Zellweger et al., 2010).

A firm with strong family identity highlights the familiness, builds a competitive advantage and indirectly influences performance as “(...) *family identity and reputation become a sustainable legacy that is passed on to subsequent generations.*” (Craig et al., 2008, p.356). However, this only applies when the family firm actively builds and sustains its family-based identity and promotes its values and beliefs to customers (Craig et al., 2008). The family identity is thus one of the family-firm specific resources in the bundle of familiness.

A family firm, where the main input of the family is in monetary terms but not in terms of behaviour or identity, e.g. a firm with non-family management but family ownership, the creation of a competitive advantage through familiness is limited. Likewise, a company that has family involvement components and a family-based organisational identity may be able to create familiness to some extent but lack resources such as a transgenerational vision and thus e.g. full family support. Family firms that are most likely to create familiness are, therefore, those that draw resources from all three dimensions (Zellweger et al, 2010). Ingram et al. (2020)

found that especially ownership, management and control as part of familiness is a contributor to enhanced performance.

With respect to franchising, the concept of familiness is a novelty even though an abundance of franchise systems are run by families (Combs et al, 2011). Combs et al. (2011, p. 419) summarise this research gap as follows: *“not only does familiness open opportunities to compare family and non-family franchisors and franchisees, investigating the effect of ownership changes on familiness appears warranted.”* So far, only Chirico, Ireland and Sirmon (2011) have comprehensively discussed familiness as an important part of franchising.

Drawing from familiness research in family firms, agency theory and the resource-based view, they argue that family franchise systems with long-time orientation use resources more efficiently than non-family franchises. Since family firms have a long-time orientation they are more willing to train and support franchisees and thus maintain strong relationships to secure the survival of the franchise. Familiness thereby is a basis for complementary resources and serves as a cultural base for the franchisor-franchisee relationship as it facilitates resource sharing (Chirico et al., 2011).

Familiness may also lead to a self-selection process between franchisor and franchisee. If both parties are a family firm, both have logics, behaviours and values based on familiness. This may reduce learning barriers and lead to better mutual understanding. The synergies gained from the integration of these resources have the potential to create a unique competitive advantage (Chirico et al., 2011). They expect the family franchise to be more successful than its non-family counterpart since *“the presence of the family in a business operation and the resulting “familiness” focus attention on and increase commitment to the overall well-being and continuity of the franchising system.”* (Chirico et al, 2011, p. 488).

### 3.2.2.3 Human & Social Capital

Within the scope of the resource-based view, another potential source of competitive advantage is ingrained in the human and social capital of the organisation. Human capital refers to the knowledge, skills and abilities embedded in individuals which can be tacit or expressible (Crook et al., 2011). Social capital pertains to the relationships individuals have and the resources stemming from them (Sanchez-Famoso et al. 2015).

In their meta-analysis of 66 studies concerning the relationship between human capital and performance, Crook et al. (2011) show that high-performing human capital is indeed vital for the performance of the organisation. The firm-specificity of human capital has also been shown to improve performance. Hence, individuals with lots of firm-specific knowledge are more valuable to a firm than individuals with more general knowledge.

This is due to the fact that individuals with general knowledge, skills and abilities can more easily switch to another firm (Crook et al., 2011). Human capital was also found to have an important role in the establishment of a business. Nascent entrepreneurs with high tacit and explicit knowledge have been found to be superior at discovering opportunities, whereby tacit knowledge is more influential (Davidsson & Honig, 2003).

Social capital is not only embedded in the individual but also in organisations as the latter also represent a network from which individuals can extract benefits (Davidsson & Honig, 2003). Amongst other things, these benefits include access to information, influence, facilitation of business processes and solidarity (Augusto Felício et al., 2014). A firm possesses internal and external social capital. Internal social capital refers to the relationships between members of the firm. Internal social capital can lead to advantages because these internal relationships are unique to the firm and thus inimitable (Chisholm & Nielsen, 2009).

External social capital refers to the relationship between the firm and members of the external environment such as suppliers, customers, government or banks. These relationships are also particularly valuable since they facilitate the exchange, combination and allocation of resources (Chisholm & Nielsen, 2009). Additionally, these relationships can be classified as weak or strong ties. Weak ties pertain to loose relationships such as the membership in an organisation, whereas strong ties refer to very close relationships such as between parents and children (Davidsson & Honig, 2003).

Furthermore, the concept of social capital is divided into two sub-categories: bridging social capital and bonding social capital. Bridging social capital pertains to the relationship between actors of two otherwise unrelated organisations, thus providing access to external social capital. Bridging social capital can provide brokerage opportunities when the heterogeneous actors act as a bridge between individuals or organisations and offer resources such as access to valuable information (Gedajlovic & Carney, 2010; Herrero, 2018).

Bonding social capital, on the other hand, refers to the relationships between actors within a group or organisation characterized by trust, commitment and the pursuit of common goals. This bond increases the power of the social capital (Davidsson & Honig, 2003; Herrero, 2018; Kraft & Bausch, 2018; Chang, 2019). Social capital, especially bridging social capital, has been shown to greatly impact nascent entrepreneurs: *“(...) having parents and/or close friends or neighbors in business, as well as encouragement from friends and family, was strongly associated with probability of entry.”* (Davidsson & Honig, 2003, p. 322).

However, bonding and bridging social capital have been shown to be intertwined. Categorising network mobilisation as bridging social capital, and the quality of relationships and a shared owner vision as bonding social capital, Uhlaner et al. (2015) found a positive association between the two forms of social capital. Network mobilisation thereby describes making use of one's outside network to confer an advantage on a group or organization. It was also found that firms with a low shared vision but high family identity have the least network mobilisation. Therefore it does not matter whether the owner is also a manager, as family firm identity combined with a shared vision leads to a moderator effect regarding network mobilisation nonetheless (Uhlaner et al., 2015).

In family firms, the relationships between members of the family have been assumed to be a resource of a unique kind of social capital, namely family social capital. Family social capital can be attributed to the essence dimension (see 3.2.2.1 Familiness; Arregele et al., 2007; Herrero, 2018). Family social capital can be an advantage or a liability for the family firm.

Provided that positive common beliefs, values, practises and trust prevail, family social capital can be an important asset. As a source of encouragement and information, financial support and help, social capital can enhance performance by fostering trust with stakeholders. Social support can be build and sustained as a resource by establishing a good reputation through committing to certain responsibilities, expectations and ethical norms (Sorenson et al., 2009).

But when e.g. conflicts overshadow the relationships between family members, family social capital can have a negative impact on the firm (Sorenson & Bierman, 2009). Danes et al. (2009), who view family social capital as a combination of human, social and financial capital, analysed family firm success based on the family capital of the owning family. Their study did not only include the capital of family members, but also the capital of family members not working in

the firm. The study's findings show that family capital plays a key role in the achievement and sustainability of the family firm (Danes et al., 2009).

It is thus the interplay between the family and the business that leads to family social capital which then influences the creation of organisational social capital in the family firm. Organisational social capital provides access to external resources and benefits the firm in several ways, such as facilitating coordination or leveraging the firm's resources which may then impact performance directly or indirectly. Organisational social capital cannot be acquired but has to be developed and sustained (Arregele et al., 2007).

According to Herrero (2018), the coexistence of various social groups in the family firm in the form of non-family members and their social capital does not influence performance. This may be due to the fact that the strong family social capital leads to a disadvantage for non-family members (Herrero, 2018). These findings contradict the results of the study conducted by Sanchez-Famoso et al. (2015) who conclude that the social capital of non-family members affects family firm performance positively “(*...*) *because of the diversity, professionalism and innovative behaviours of members of the non-family group.*” (Sanchez-Famoso et al., 2015, p. 1731).

It has also been found that the non-family social capital has a stronger effect on firm performance and that it has a mediating effect between family social capital and firm performance (Sanchez-Famoso et al., 2015).

In the context of franchising, the resource of social capital is hardly researched, even though the nature of the franchisor-franchisee relationship leads to a complex social environment (Combs et al., 2011). Nonetheless, Parker et al. (2019) researched the personal and contextual resources and their impact on franchisee performance using conservation of resources theory, but without referring to these resources as social capital. Their findings suggest that family and organizational support positively impact franchisee performance, pointing out that “*Family support appears to be a valuable resource for franchisees that may not be currently tapped into by franchisors.*” (Parker et al., 2019, p. 615). Dyer (2006) has used the resource-based theory and agency theory to develop a categorisation of family firms. This categorisation can be found in chapter 3.3.2.

### 3.3 Agency Theory

The basic presumption of the principal-agent-theory, for short agency theory, is that conflicts arise when the ownership and the management of a firm are separated, since the interests of the owner, the principal, and the manager, the agent, differ due to self-interest, bounded rationality and risk aversion (Eisenhardt, 1989; Chrisman et al., 2004). In more general terms, a principal-agent relationship exists as soon as a principal delegates authority/work to an agent (Eisenhardt, 1989; Combs et al., 2004).

An agency problem not only arises from the differing interest of the parties but also from the fact that the principal cannot fully retrace whether the agent has behaved as agreed upon. There are two main types of agency problems: moral hazard and adverse selection. Moral hazard is a form of opportunism and occurs when the principal does not know whether the agent is putting in the agreed-upon effort or is shirking, it is thus a problem of post-contractual opportunism. Adverse selection occurs when the agent misrepresents his/her skills and abilities. Such agency problems can damage relationships and inhibit cooperation (Eisenhardt, 1989; Karra et al., 2006; Gomez et al., 2010).

The principal can try to overcome this information asymmetry and the resultant agency problem by setting incentives for the agent to act in the principal's favour or by monitoring the agent. Either way, costs arise. These agency costs are the sum of the monitoring costs borne by the principal, the bonding costs borne by the agent and the residual loss (Jensen & Meckling, 1976).

#### 3.3.1 Agency Theory on Franchising

The principal-agent framework is categorised by Combs et al. (2011) as one of the three theoretical milestones in explaining franchise systems and serves as a basic gateway to exploring the challenges the franchisor, as well as the franchisees, can face in the system. Agency theory is of such importance in franchising as it, on the one hand, explains why firms decide to use franchising and, on the other hand, which outlets get franchised (Perryman & Combs, 2012).

One option to solve an agency problem, besides monitoring, is to contract on the outcome in order to align the principal's and the agent's interests (Eisenhardt, 1989). In franchising, the outcome-based contract is the royalty rate the franchisee has to pay the franchisor. In exchange, the franchisee gets residual claims (Perryman & Combs, 2012). Some scholars therefore

consider franchising as a way to solve agency problems. Since the franchisees are given residual claims on the outlet's profits, franchisees have a higher interest in the outlet going well than salaried managers. Franchisees also have to use their own capital to be able to open up an outlet. Thus, there is a risk for franchisees of losing their own money. Consequently, the monitoring costs and the costs for deterring adverse selection problems for the franchisor are reduced. Agency theory thus predicts that franchising is used when the monitoring costs of a salaried manager are very high (Shane 1996, Garg & Rasheed, 2003; Combs et al., 2011; Perryman & Combs, 2012).

However, the franchisor gives the franchisee certain decision rights and as the interest of both parties will never be perfectly aligned, principal-agent-problems also occur in franchising (Combs et al., 2004). The agency problem in franchising is twofold: on the one hand there is the franchisor-franchisee conflict, on the other hand there is the conflict between franchisees. The latter case describes the problem of franchisees all operating under the same system which could lead to a franchisee free riding on the efforts of other franchisees. Especially the brand name and its capital can lead to free-riding since a spillover effect occurs (Garg & Rasheed, 2003; Combs et al., 2004).

Conflicts between the franchisor and the franchisee can be far-reaching as the failure of a franchisee unit impacts the entire franchise system (Frazer & Winzar, 2005). Using the resource-based view as well as agency theory, López-Fernández and López-Bayón (2018) have researched the underlying factors of the premature termination of franchise contracts. Initial investment and ongoing training efforts were found to reduce franchisee's premature exit.

Experienced franchisees were more likely to prematurely terminate the agreement. This may be due to increased bargaining power and an unwillingness to learn new things. Franchisors with experience, on the other hand, had a conflict diminishing effect which can be attributed to the ability of finding suitable franchisees and/or the ability to build positive relationships (López-Fernández & López-Bayón, 2018). However, when the franchise is of a larger size, franchisee exit becomes more likely even when the franchisor has experience (Frazer & Winzar, 2005).

Agency-theoretical explanations of franchising start to falter when addressing the issue of multi-unit franchising since *“Allowing franchisees to operate multiple outlets dilutes the incentive advantages at the heart of agency theory by shifting the agency problem from the*

*franchisor to multi-outlet franchisees, who still must hire a manager for each outlet”* (Perryman & Combs, 2012, p. 373). Garg and Rasheed (2003), however, have argued that multi-unit franchising, especially in an international context, can reduce the adverse selection problem because the franchisor only has to find a few appropriate franchisees and can therefore concentrate his/her managerial resources on finding the best partners. And when the franchisor wants to open new units he/she can decide to work with a current franchisee to mitigate searching and training costs as well as adverse selection and moral hazard issues (Gomez et al., 2010).

Information asymmetries may also be reduced because the franchisor has less franchisees to monitor, the franchisee has to prove his/her knowledge and the goals can be more easily aligned than with many single-unit franchisees (Garg & Rasheed, 2003). The risk of free-riding may also be diminished since the franchisee has to bear the risk of one of the outlets not complying. Yet, it has to be taken into account that multi-unit franchising is not homogenous, as there are several types such as master franchising or sub-franchising as seen in 3.1.1 (Garg & Rasheed, 2003; Gomez et al., 2010). The question therefore is not whether to use multi-unit franchising or not but *when* it may be advantageous to use it.

Gomez et al. (2010) have found that, from an agency perspective, multi-unit franchising is beneficial when the geographical concentration of the units is high, the size of the franchise system is big and when the customer base is non-repetitive. When franchised outlets are close to one another and the customer base is non-repetitive but all outlets belong to one single franchisee, the probability of free-riding is reduced because the one franchisee also has to bear the consequences of it (Gomez et al, 2010). Since multi-outlet franchisees like to keep their outlets close to one another, monitoring cost advantages may be achieved (Perryman & Combs, 2012).

The outlets owned by franchisees are also geographically more distant and more isolated from the headquarter, which confirms agency theory's prediction that monitoring costs are pivotal for franchising (Perryman & Combs, 2012). A bigger franchise system usually also has a well-known brand name and reputation which attracts more potential franchisees which, in turn, increases the adverse selection problem. But multi-unit franchising reduces the number of franchisees and thus the adverse selection and free-riding hazards. (Gomez et al, 2010).



However, Hussain, Moritz and Windsperger (2012) studied whether there is a correlation between the monitoring cost, shirking and the use of multi-unit franchising. The results showed little support for it. There was also no significant relation between the brand name value and the use of multi-unit franchising found. It has to be mentioned, however, that data from the German franchise sector - a relatively young one - was used and that the results might look different when using data from e.g. the USA (Hussain et al., 2012).

Another contradiction of agency-theoretical explanations for franchising are company-owned outlets close to franchised outlets. Perryman & Combs (2012) argue that company-owned outlets are needed when the franchise system's planned growth is not achieved. So when franchisees fail to grow, the franchisor steps in and opens a company-owned outlet. Outlets owned by the franchisor are usually found in populated areas so that the monitoring of several outlets is less expensive (Perryman & Combs, 2012).

### 3.3.2 Agency Theory on Family Firms

Since the principal and many of the agents frequently come from the same family, agency theory may predict that agency problems and their subsequent costs are greatly reduced to non-existing in family firms because the interests of principals and agents are aligned (Schulze et al., 2001; Dyer, 2006). This is, however, not always the case: “ (...) *family members may have competing goals and values, which may spring from complex conflicts and family dynamics that arise from a family's psychosocial history.*” (Dyer, 2006, p. 260). Family firms are thus not resistant against principal-agent problems. Conversely, kinship adds a layer of complexity to the matter.

One factor for the complexity of family firms' agency issues lies within kinship and the altruism arising thereof. From an economic perspective, altruism can be described as a utility function where the welfare of one individual is related to the welfare of another or several individuals. Altruism is therefore not selfless because it has self-reinforcing aspects (Schulze et al., 2011; Siebels & Aufseß, 2011; Karra et al., 2006). Parents, for example, may act generously towards their children not only out of love but also because of self-interest which, in a family firm context, might e.g. be the well-being of the business. A positive dynamic of altruism is that it e.g. leads to increased loyalty and commitment. Accordingly, altruistic behaviour can increase or decrease agency costs (Schulze et al., 2001; Siebels & Aufseß, 2011; Karra et al., 2006; Dyer 2018).

Schulze et al. (2001) argue that altruism is a root cause for agency problems because altruistic behaviour inhibits family members from enforcing agreements out of fear of the possible negative consequences in regard to the family relations. This self-control issue leads, for instance, to the unwillingness of family members to monitor each other. Which, in turn, increases the leeway for free-riding and shirking and thus, agency costs (Schulze et al., 2001, Dyer, 2006).

Monitoring efforts may also be less effective because family members are biased and may view an agent's failure as not self-inflicted but as a result of outside circumstances. The assessment of performance may even be altered to adapt to the perceived circumstances (Gomez-Mejia et al., 2001). Such inefficiencies are also due to an internal labour market that is often created within a family firm. Even when the competencies of the family employees are inferior to the competencies of potential employees coming from the external labour market, the family employees are preferred. And since there is less outside pressure for corporate control compared to public companies, the monitoring costs increase even further (Van den Berghe & Carchon, 2003).

Moreover, when the family firm is managed by an owner-manager, this owner-manager usually has all the decision-making power concerning the usage of the firm's assets and does not have to report to e.g. a board of directors (Lubatkin et al., 2005). Owner-managers therefore have *"(...) incentives to make decisions that may inadvertently lead to a misalignment of goals among the firm's minority insiders. They also have power and authority to unilaterally change the terms of an agreement, which makes it more difficult, and hence costly, for agents and other minority owners to rely upon them."* (Lubatkin et al., 2005, p. 318). Hence, owner-management can be an aggravating factor for agency problems in family firms, especially in the case of family ties linked to strong altruism such as parent-child relationships (Lubatkin et al., 2005).

This is due to the fact that owner-management parents have even more means to be generous towards their children. Parental altruism thus reinforces the self-control issues of family firms (Lubatkin et al., 2005). The dynamics of parental altruism in family firms have various facets. Lubatkin, Durand and Ling, (2007) distinguish between five different forms of parental altruism: principal-based altruism, ideal-typic altruism, family-oriented altruism, paternalistic altruism and psychosocial altruism. These types of parental altruism differ, amongst other things, with regard to the agent's motivation, the control mechanisms, the scope of the family bond and the type of good allowance (Lubatkin et al., 2007).

Parents aware of the linkage of their welfare and the children's free-riding like to use self-control and tied transfers to mitigate this problem. Parents assume that children know that it is better to comply and that the parents would otherwise take action. Both assumptions are false since children can, for example, recognize altruism and manipulate their parents (Schulze et al, 2003). But to solve the monitoring and disciplining issues arising from altruism, family firms also use tied transfers. Schulze et al. (2003) found that 71% of the 883 relatively large family-owned and -managed firms used payments linked to performance as incentives for family employees.

In contrast to the hitherto mentioned research, which largely views altruism in a negative light, scholars such as Van den Berghe and Carchon (2003) argue that altruism in family firms also has very positive effects and reduces agency costs. Information asymmetries can be diminished since altruism encourages family members to cooperate. Through setting incentives to look after one another and the shared identity arising thereof, altruism can make family firms unique.

When family members work in the firm, there may be a sense of collective ownership and the commitment as well as the loyalty towards the firm can, in the long run, advance the stability and performance of the firm (Van den Berghe & Carchon, 2003). In a case study conducted by Karra, Tracey and Phillips (2006), it has been shown that agency costs can also be reduced by transferring altruistic behaviour to a quasi-family. Hence, altruism impacts non-family employees as well.

Overall, it can be deduced that altruism may increase or decrease agency costs, depending on the particular characteristics of the family and the family firm. The results of Karra, Tracey and Phillips (2006) suggest that the size of the firm matters: altruistic behaviour decreased with firm size, while agency costs increased. And while family members' misbehaviour fell under the agency problem of moral hazard, the main agency problem with non-family members was adverse selection (Karra et al., 2006).

Just like altruistic behaviour, agency problems of family firms can be further divided. Villalonga et al. (2015) have identified four types of agency problems in family firms: firstly between owners and managers, secondly between controlling (family) shareholders and non-controlling shareholders, thirdly between shareholders and creditors and lastly between family shareholders and family outsiders.

The first type of problem can be eradicated when the owners are also the managers of the firm. This can lead to different problems though, such as when the family managers are not in their position due to qualifications but because of kinship (Villalonga et al., 2015). The second agency issue appears in widely-held firms that have many minority shareholders and a few big shareholders. The big shareholders have more means and a greater interest in controlling the management since they have more at stake. They thus have more power over the managers and are able to pursue their interests at the expense of the minority shareholders since the latter do not have the same influence (Andres, 2008). When a family is the large shareholder the motivation for expropriation and monitoring is amplified (Villalonga et al., 2015).

In family firms, the third agency problem refers to the better alignment of creditor and family objectives compared to those of other shareholders. The fourth agency problem between family shareholders and family outsiders occurs when the interests of the controlling family members, who are the agents of the family to which they belong, do not match those of the family at large (Villalonga et al., 2015). The importance of the family at large is especially noticeable in later-generation family firms since : “ (...) *just like shareholders have the power to appoint the managers who act as agents for them, it is the family that, subject to the limits of the law, appoints a subset of its members as shareholders to perform certain tasks on its behalf.*” (Villalonga et al, 2015, p. 644).

These four agency problems in family firms are a good gateway for understanding and exploring the multifarious problems that surface in family firms. The respective difficulties and the resultant costs vary due to e.g. firm size, the management structure or the degree of altruism in the firm (Herrero, 2011; Dyer, 2006, 2018).

For instance, Herrero (2011) examined the agency costs of small firms in the fishing industry compared to similarly small non-family firms in the same sector. Her findings show that the number of family members on board related positively to the ship's efficiency and that family ties between the owner and the manager also led to better performance. This supports the idea that agency costs are reduced when the agents are family members. However, the fact that the analysed firms have a simple structure and are small should not be disregarded since these factors influence the agency costs (Herrero, 2011). Problems, such as between controlling and non-controlling shareholders, cannot exist in very simple structures. This shows that the particular family firm setting is essential for analysing family firms.

Highlighting the family's characteristics and their importance for the family firm, Dyer (2006) has combined agency theory with the resource-based theory (see 3.2) and argued that agency costs, as well as the resources, differ based on the characteristics of the family, thereby distinguishing between four different types of family firms:

1. Clan family firms: low agency costs and high assets due to owner-management and high interpersonal trust; family resources and the family's human & social capital is essential for survival
2. Professional family firms: high agency costs and high assets due to professionalisation and the arising monitoring costs; resources are better protected
3. Mom & pop family firms: low agency costs and high liabilities due to aligned goals but with a lack of family-specific assets because of nepotism and inefficient usage of resources, therefore little to no firm growth
4. Self-interested family firms: high agency costs and high liabilities due to conflicting goals, adverse selection, moral hazard and nepotism, the firm is subordinated to the individual family interests, resulting in dissipated assets (Dyer, 2006, 2018)

From this categorisation, it is clear that clan family firms, as opposed to self-interested family firms, should have the best performance. Although this categorisation cannot depict reality and the categories may merge into one another, it can be a helpful tool when analysing family firms, their agency costs and the influence the family has on the firm. However, factors such as firm characteristics (like the firm size) have to be held constant, otherwise the results are inconclusive (Dyer, 2006, 2018).

### 3.4 Relational View

Developed by Dyer & Singh (1998), the relational view suggests that the relationship between firms potentially leads to an interorganisational competitive advantage. To achieve such an advantage, firms have to either invest in relation-specific assets, have knowledge sharing routines, combine complementary resources and capabilities or use effective governance mechanisms to lower transaction costs. The relational rent stemming from a partnership is defined as: *"(...) a supernormal profit jointly generated in an exchange relationship that cannot be generated by either firm in isolation and can only be created through the joint idiosyncratic contributions of the specific alliance partners."* (Dyer & Singh, 1998, p. 662).

The initial relational view was static as it did not take into account changes over time. But time is essential in partnerships since knowledge-sharing routines and trust are usually built over time. But long standing alliances can also have negative effects such as complacency (Dyer et al., 2018). To implement the considerations concerning these issues, Dyer, Singh and Hesterly (2018) have re-conceptualised the relational view to be more dynamic by incorporating e.g. time as a factor. They argue that value creation attenuates over time because the complementarity of resources declines when the alliance is repeated.

In the dynamic relational perspective, complementary resources and their interdependencies are considered to be more important than the other three factors. The reason being that resources, unlike the other factors, create value and their interdependencies influence the governance mechanism, the relation-specific assets as well as the knowledge-sharing routines. Additionally, complementary resources are a main-driver for entering into a business-to business relationship (Dyer et al., 2018). *“We highlight interdependence between the complementary resources of partners as the critical factor determining the pattern of alliance value creation, notably how quickly alliances generate value and how quickly they are likely to dissolve.”* (Dyer et al., 2018, p. 3159).

Since resources are one of the main aspects of the relational view, there has been disagreement on whether the relational view is just a spin-off of the resource-based theory or whether it constitutes a separate theory. What is clear, however, is that the two views complement each other: while the resource-based view explains the advantages stemming from a firm’s resources, the relational view explains how these advantages may be connected to other firms (Mesquita et al., 2008).

In the relational view, the governance mechanism plays a critical role in generating relational rents. The governance mechanism does thereby not only refer to formal safeguards but also to informal ones which e.g. stem from trust or goodwill (Dyer & Singh, 1998). As a self-enforcing safeguard, trust can be more effective and less costly than formal contracts. The latter may even signal distrust. This is because the alliances and the inter-firm exchanges are embedded in social relations. Social processes and the resultant norms such as solidarity, flexibility or information exchange are therefore the mechanisms for enforcing relationally-governed agreements (Poppo & Zenger, 2002).

### 3.4.1 The relational view of franchising

De Castro, Mota and Marnoto (2009) have argued that the traditional franchising theories such as agency theory or the resource-based theory assume the franchise system as too homogenous and overlook the role of the franchisee in the franchisor-franchisee relationship, as well as the dynamics in the franchise system. These theories thus presume that franchisors and franchisees have heterogeneous goals and resources but are otherwise homogenous (Combs et al., 2004).

A relational perspective on the matter takes a different approach: *“Franchising as an organizational form can be described as a network of active and heterogeneous firms that interact within a context of business relationships.”* (De Castro et al., 2009, p. 23). Hence, the franchise system is embedded in a network of relationships which influences the franchise’s capabilities. The franchise’s capabilities do, in turn, influence other firms in the network. Inter-firm relationships thus also impact the industry (Mota & De Castro, 2004).

It is argued that an explanation for the inter-firm cooperation of franchisors and franchisees is the need to coordinate the complementarity, as well as the dissimilarity of their activities. Since activities are dissimilar, they should not be coordinated by one firm, nor by the market due to requirements concerning quality and quantity – hence, franchising is the solution (De Castro et al., 2009).

While the franchisor is e.g. concerned with the brand management, the franchisee takes care of day-to-day business. Whereas agency theoretical approaches (see 3.3) predict that due to this division of responsibilities and the resultant information asymmetry, franchisors have to cope with moral hazard, De Castro, Mota and Marnoto (2009) argue that it may actually be a perception and interpretation asymmetry. The various experiences, capabilities and relationships in the franchise network constitute the differences within and between franchise networks.

To explain multi-unit franchising, the aspect of trust has been examined from a relational viewpoint by Griessmair, Hussain and Windsperger (2014). Trust has been found to be very helpful when parties cooperate but also crucial for the productive solution of conflicts (Dickey et al., 2008). As with so many other factors, an excess or a lack of trust can be harmful, however: *“(...) within reasonable bounds, and accompanied by other governance, mechanisms, trust can produce favourable franchisee perceptions.”* (Dickey et al., 2008, p. 253).

Trust has also been shown to increase the amount of knowledge-sharing between the franchisor and the franchisee with the franchisor using more knowledge-transfer mechanisms with a high degree of information richness. This effect of trust is even stronger when the franchisor and the franchisee both have more experience with inter-organisational relationships (Gorovaia & Windsperger, 2013b).

But trust is not one generic factor, it takes several forms whereby a distinction into two main categories can be made: knowledge-based trust and general trust. The former refers to trust that has built up over time through the interaction with the exchange partner. As a result of several positive experiences with the exchange partner, credibility, fairness and reputation are formed (Griessmair et al., 2014). The ongoing relationship between the franchisor and the franchisee also constitutes a relational contract where the expectations that can otherwise not be explicitly formulated are determined (Dickey et al., 2008).

General trust refers to trust that is based on the character traits as well as cultural context of the trustor, and to a situation of trust without previous interaction history. An individual that perceives other individuals as trustworthy, even when not having had any interactions beforehand, therefore represents the ideal type of general trust. Griessmair, Hussain and Winsperger (2014) have shown that franchisors prefer single-unit franchising over multi-unit franchising in case of high general trust. This is because the franchisor trusts his/her franchisees more and considers the relational risk to be low which makes the use of multi-unit franchising as a screening tool superfluous.

Multi-unit-franchising on the other hand is preferred when knowledge-based trust is high. In such a case multi-unit franchising is used to reward the franchisees that, through the franchisor-franchisee relationship and the consequent interactions, have shown that they are a credible, fair partner and have built a good reputation (Griessmair et al., 2014).

The relational view was also used by Frazer et al. (2012) to disclose the causes of conflict between franchisors and franchisees by conducting eleven multiple case studies. Trust, relational satisfaction, the differences in expectation, as well as the perception of conflict, were found to be major factors.

A large part of the franchisees had expectations that did not meet reality in the beginning of the franchisor-franchisee relationship, the information given by the franchisor was thus found to be



highly important. The openness of the franchisor was revealed to impact the trust, as well as the satisfaction with the relationship. Moreover, franchisees with more experience were more prone to being unsatisfied with the franchisor-franchisee relationship and consequently were more often in conflict with the franchisor (Frazer et al., 2012). This result is consistent with López-Fernández and López-Bayón's (2018) findings (see 3.3.1).

### 3.4.2 The relational view of family firms

In the context of family firms, the relational view has been used to explore the organisational social capital in family firms. Organisational social capital refers to the relationships a firm has with external stakeholders due to its social capital (Arregele et al., 2007; see 3.2.2.3). It thus creates relational capital that can be a source of knowledge and opens up new opportunities. For family firms, it is especially important not to get caught up in inward-looking thinking and an over reliance on family ties (Zahra, 2010). Developing relationships with new ventures through organisational social capital can be essential for the survival and success of family firms (Sirmon & Hitt, 2003).

By connecting and establishing a good relationship with new ventures such as start-ups, family firms can gain access to new ideas and tacit knowledge that would otherwise be unattainable. An option to not only have a loose connection but to be closely linked to the new ventures is to acquire stakes in the business (Zahra, 2010).

High organizational social capital in family firms increases the likelihood of such investments since it also serves as “(...) *a major bridge to other stakeholders (e.g. bankers and venture capitalists) who might have first-hand knowledge of target new ventures, enabling family firms to accurately appraise the potential of these ventures.*” (Zahra, 2010, p. 348).

It has also been shown that a high degree of organisational social capital increases the number of alliances and joint ventures with new businesses, as well as the representation of the family firm's members on the boards of new ventures. Additionally, family firms have an advantage over non-family firms when it comes to the exploitation of organisational social capital (Zahra, 2010). Apart from Zahra's (2010) analysis, little studies have used the relational view as developed by Dyer and Singh in the family firm research sector.

### 3.5 Social Exchange Theory

The question of why individuals enter into a business relationship and why they decide to stay or leave said relationship has been attempted to be answered through social exchange theory (Meek et al., 2011). The basic ideas for the social exchange theory are roughly a hundred years old and have bridged several research areas such as leadership or board independence (Cropanzano & Mitchell, 2005).

However, it is not one single theory but a family of concepts with common characteristics (Cropanzano et al., 2017). Social exchange theory has evolved to be one of the most important theories to understand the behaviour of individuals at their workplace and subsequently workplace relationships. Social exchange theory presumes that the exchange relationship develops into a mutual commitment characterised by trust and loyalty (Cropanzano & Mitchell, 2005).

The basic supposition of social exchange theory is that individuals as well as organisations expect rewards from relationships (Meek et al., 2011). This is due to the rules and norms of exchange that the parties in the relationship have to follow (Cropanzano & Mitchell, 2005). Relational norms help with goal alignment and goal interdependence as well as the realisation of future rewards (Mignonac et al., 2015). Hence, the relationship between the involved parties influences the exchange (Cropanzano et al., 2017).

In social exchange theory, it is suggested that one party of the exchange relationship has to respond to the other party's action in a similar fashion (Cooper & Morrison, 2018). This rule of reciprocity means that both, good and bad actions, may be repaid (Cropanzano et al., 2017). Accordingly, *"(...) a series of successful reciprocal exchanges may transform an economic exchange relationship into a high-quality social exchange relationship."* (Cropanzano et al., 2017, p. 2). The fact that the various exchanges that inevitably happen in business relationships do not only have economic outcomes, but also social ones, is therefore a basic premise in social exchange theory (Madanoglu, 2018).

Three differentiations of reciprocity can be made (Cropanzano & Mitchell, 2005):

- a) Reciprocity as interdependent exchanges: the parties and thus the transactions are linked to one another, a self-reinforcing cycle is created; no explicit bargaining, either party can start the exchange

- b) Reciprocity as a folk belief: people believe that they and others get what they deserve, this belief is culturally embedded
- c) Reciprocity as a moral norm: while this kind of reciprocity is also a part of culture, it is about how people should behave rather than what they expect to happen; individual preferences exist, for instance: an individual is more likely to reciprocate a good deed when he/she has a strong exchange orientation

The degree to which reciprocity rules are abided thus depends on cultural, as well as individual characteristics. Other rules and norms have also been described in social exchange theory such as status consistency, competition, altruism or negotiated rules. The main concept, however, is reciprocity (Cropanzano & Mitchell, 2005).

Since social exchange theory has such a broad scope it has frequently been criticised for being too simple and imprecise (Cropanzano et al., 2017, Cooper & Morrison, 2018). Nonetheless, it is a useful approach for analysing business relationships.

### 3.5.1 Social Exchange Theory on Franchising

When the franchisor and franchisee enter into the franchise contract, there is not only an economical relationship being developed, but also a social one (Madanoglu, 2018). The social exchange differs significantly from the economic relationship. The focus of the social relationship is on trust and socio-emotional value; to maintain the relationship, personal investment is necessary and to make sure that the mutual responsibilities are met, a long-term orientation is essential. Though there are already many incentives and investments through the economic franchisor-franchisee relationship, the social exchange and its relational norms can play a key role for the future outcomes of the relationship (Mignonac et al., 2015).

Since the franchisor and the franchisee and the success of each parties' business are interdependent, reciprocity as interdependent exchange is of high importance in franchise systems (Madanoglu, 2018). Central to such an ongoing interdependent business-to-business relationship is the commitment of the parties. The reasons for the displayed commitment in the relationship differ based on the values of the individual or the firm. Consequently, there are different types of commitment (Meek et al., 2011).

Affective commitment refers to an emotional attachment to the exchange relationship. This type of commitment is an indicator for a symmetrical, fair relationship with continuous effort of both

sides (Mignonac et al., 2015). Normative commitment pertains to relationships that are characterised by a great sense of obligation. Continuance commitment describes a calculative, economic approach to the relationship: the fact that switching costs occur when leaving the relationship is the main reason to stay (Meek et al., 2011).

Especially affective commitment has proved essential in franchisor-franchisee relationships since it enhances performance in regards to sales revenue and product sales per square meter. Affective commitment thus shows that the franchisor as well as the franchisee invest into the relationship for it to be mutually beneficial (Mignonac et al., 2015). Franchisees are more likely to engage in affective commitment when the franchisor communicates frequently, formally rationally and reciprocally with them (Meek et al., 2011). The affective commitment of franchisees is also positively linked to multi-outlet ownership. Opportunistic behaviour also decreases when the franchisees are affectively committed (Mignonac et al., 2015).

The second type of commitment, continuance commitment, has been shown to reduce the likelihood of a franchisee leaving the exchange relationship. Meek et al.'s (2011) study has shown no such effect concerning affective, as well as normative commitment. This may however be due to the economic situation at the time the study was conducted. Mignonac et al. (2015, p. 480) on the other hand have found that “(...) *continuance commitment acted as a boundary condition, and that affective commitment had a stronger and negative impact on exit intention when continuance commitment was low.*”

When the initial costs for the franchisees are low it is thus very important to build affective commitment since the franchisees are otherwise more likely to leave the franchise system. Start-up costs are, apart from conflict and size of the system, one important reason why franchisees leave the franchise system (Mignonac et al., 2015; Frazer & Winzar, 2005).

Weaven, Baker and Dant (2017) view commitment and satisfaction with the franchisor-franchisee relationship as a result of gratitude. It is defined as “*the (positive) emotion that is provoked when a beneficiary perceives the receipt of a benefit motivated by the (a) benefactor's benevolence. This emotion stimulates (motivates) a desire within the beneficiary to reciprocate (also motivated by benevolence) with behaviors of equal or greater benefit for (to) the benefactor.*” (Weaven et al., 2017, p. 279). Gratitude is therefore a relational norm that can strengthen the relationship. It has been found that gratitude does indeed advance trust and

commitment and subsequently satisfaction with the franchisor-franchisee relationship (Weaven et al., 2017).

As their success and subsequently their confidence increases, the commitment of franchisees may fade over time because the franchisor is increasingly viewed as less important and dissatisfaction with the relationship arises. This can lead to issues concerning commitment and compliance across the franchise system. This circumstance as well as the mutual interdependence and the information asymmetries in the franchisor-franchisee relationship makes trust between the partners indispensable. It has been shown that satisfaction and conflict affect franchisee trust with the franchisor and that trust decreased non-compliant conduct (Davies et al., 2011).

### 3.5.2 Social Exchange Theory on Family Firms

In family firm research, the social exchange theory and its principle of reciprocity has been used to examine the relationship between family members to explain e.g. a family firm's ethics, succession practices or performance issues at the individual level. Long and Mathews (2011) have argued that the exchange system in family firms creates group cohesion which is then linked to e.g. non-economic goals or transgenerational sustainability; thereby taking into account that *"The particular form of exchange that predominates in any specific interaction depends on both the history of relationships among members of the group and upon each individual member's personal history and experience."* (Long & Mathews, 2011, p. 297).

The exchange systems can thereby be separated into two broad groups: generalised exchange systems and restricted exchange systems. The former describes a covenant-like system with long-term relationships where no direct or immediate return in a transaction is expected but indirect reciprocity prevails. The latter refers to systems based on self-interest and direct, quid pro quo reciprocity (Barnett et al., 2012, Long & Mathews, 2011).

Barnett, Long and Marler (2012) argue that in restricted exchange systems the family vision is weak, meaning that the willingness to transfer the family firm to other generations is non-existent as is the commitment to the firm's policies, values and goals. At the other end of the spectrum is the strong family vision which is the opposite and may make altruistic behaviour more likely to be reciprocal. A strong family vision is thus more likely to thrive under a generalised exchange system. Overall, a generalised exchange system is often more desirable than a restricted one (Daspit et al., 2016).

It is further argued that the combination of the vision and the exchange system have an impact on the procedural justice climate. Procedural justice climate describes the perception of the fairness of decision-making processes. It is achieved by engaging with the employees and their opinions when making decisions and by implementing rules of fair treatment, e.g. bias suppression or consistency. It impacts, inter alia, commitment, job satisfaction and performance; not only on a personal level but also in teams (Colquitt et al., 2002). The exchange system is thus of great importance for the development of trust, cohesion and collective goals.

It is therefore proposed by Barnett, Long and Marler (2012) that when it comes to succession in family firms, the procedural justice climate among non-family managers “(...) *will be associated with family firm succession such that a positive overall perception of PJC fosters supportive behaviors of nonfamily managers during the succession process and such that a negative collective perception makes it more likely that nonfamily managers will hinder the succession process.*” (p. 1219). Hence, it is suggested that the exchange system and its norms do not only impact the family but also some non-family employees of the family firm.

Reviewing 191 quantitative family firm succession articles, Daspit, Holt, Chrisman and Long (2016) have found that generalised exchange relationships support knowledge-transfer and decrease information asymmetries among family members. Generalised exchange is also beneficial for succession planning as the goals of family and non-family members in the firm align more easily. It also has its drawbacks: among family members it can lead to bifurcation bias (see 3.1.2), it depends on the personal as well as contextual resources of individuals and sometimes it might be an obstacle for the succession, due to relationships that are agitated by the successor choice.

Restricted exchange systems, on the other hand, do not necessarily lead to problems with succession. A restricted exchange can give a sense of security when a potential successor starts working at the firm due to its contractual basis and the associated formal succession planning, it “(...) *may also limit the threat of expropriation owing to asymmetric altruism within the family or a lack of self-control on the part of the incumbent or successor.*” (Daspit et al., 2016, p. 57).

In their very recent contribution, Löhde, Campopiano and Calabrò (2020) have used social exchange theory as well as the 4C model to explain the owner-manager relationship in family

firms and how it changes over time. The 4C model was developed to describe family controlled firms and their priorities of continuity, community, connections and command.

Continuity refers to a long-term orientation with a substantive mission, community describes a caring culture to have motivated employees, connections pertain to long-lasting relationships with stakeholders and command describes adaptive, speedy and original decision making. Each of these conceptualised priorities also have disadvantages: continuity can lead to stagnation or overcommitment, community may increase narrow-mindedness, and connection could lead to nepotism and command to overconfidence and excessive risk-taking. The 4Cs are not limited to family firms but can also be attained by non-family firms (Miller & Le Breton-Miller, 2005).

The model proposed by Löhde, Campopiano and Calabrò (2020) entails two scenarios: firstly the transition from an owner-founder to a family manager and secondly, the transition from an owner-founder to a non-family manager. There are three phases:

1. The set-up phase: the exchange relationship (generalised or restricted) between the owner and the manager determines the governance structure
2. The action phase: the influence of the 4Cs on the relationship
3. The change phase: how the governance structure is influenced by the relational changes

It is argued that when the business is transferred to a family member there are two main possibilities: either the generalised exchange system is strengthened, or a shift to a more restrictive exchange system happens due to asymmetric altruism, self-serving behaviour or the patriarchy (Löhde et al., 2020).

As explained in 3.2.2, altruism can be a source of deviant behaviour because family members are unwilling to monitor and punish one another. Especially the parent-child relationship is a root cause since parental favouritism endures, even when the children are adults, which leads to differential treatment within and outside the family.

To counter issues that arise from this parental altruism, the child has to view the altruistic behaviour as reciprocal (Eddleston & Kidwell, 2010). Asymmetric altruism, when the parents' altruistic behaviour is stronger than that of their children, leads to inadequate monitoring which then increases the likelihood of self-interested behaviour, such as free-riding or shirking (Schulze et al., 2001, Löhde et al., 2020).

When the owner realises that the family manager behaves opportunistically it leads to more control, thus to a more restricted exchange system and a shift from a stewardship to a more agency-based governance. Deviant behaviour also damages the relationship, as is the case with patriarchy. Patriarchy leads to the owner not wanting to withdraw from the business and using the familial relation to interfere. The generalised exchange system, that characterises the owner-family manager relationship, is strengthened when neither asymmetric altruism, workplace deviance nor patriarchy disrupt the relationship (Löhde et al., 2020).

When the management of the business is transferred to a non-family member, the initial relationship is characterised by a restricted exchange system with contractual obligations, low trust and self-interest. Hence, the governance mode is agency-based (Löhde et al., 2020). Over time, when the manager actively signals the intention to align the goals with the goals of the family and with those of the firm, trust is built (Blumentritt et al., 2007). However, interactions between a non-family CEO and the family “*depend on the orientation of family members toward the business and each other.*” (Blumentritt et al, 2007, p. 329).

Pro-organizational behaviour, long-term commitment as well as investing into the relationship can, over time, lead to an owner-manager relationship characterised by generalised exchange. If these proactive behaviours are absent, the restricted exchange is reinforced. The governance mode may therefore remain agency-based or it may change to a more stewardship-oriented mode which is based on trust and commitment (Löhde et al., 2020).

Therefore the model does not only take into account the dynamic nature of relationships within family firms by incorporating time as a factor, but also how the respective behaviours may change the governance mode as well as the owner- (family) manager relationship.

Not only the owner-manager relationships are of importance in (family) firms, but also the supervisor-subordinate relationships since performance depends on both types of relationships. Employing social exchange theory and its presumption that a positive relationship leads to a positive outcome, McLarty, Vardaman and Barnett (2019) argue that the congruence of the familial status of the supervisor and his/her socio-emotional wealth influences employee commitment and consequently, performance.

Socioemotional wealth is a broad concept that refers to the utility the family derives from non-economic goals such as the pride of the company having a positive public image or providing



jobs for other family members. A family's desire to maintain socioemotional wealth can be either beneficial or detrimental for the firm, as it influences the strategic decision-making (Kalm & Gomez-Mejia, 2016). For instance, family firms are more likely to be risk-averse as their socioemotional wealth is at stake. Conversely, family firms may also take very risky decisions to ensure the survival of the socioemotional wealth. It also impacts the diversification decisions of family firms as diversification reduces family control and thus potential socioemotional wealth (Kalm & Gomez-Mejia, 2016; Debicki et al., 2016).

Due to the large extent of the concept of socioemotional wealth Debicki et al. (2016) have developed a scale of socioemotional wealth importance. It consists of three dimensions: the prominence, enrichment and continuity of the family. Family prominence pertains to the outside view, the opinion of the community of the family whereby *“Recognition and social support from extended family, friends, acquaintances and the community have been identified as important aspects of the firm's prominence and reputation in the community.”* (Debicki et al., 2016, p. 54). Family enrichment indicates how important it is for the family firm to not only enhance the lives of family members working for the firm, but also for those outside the firm - it is linked to altruism (Debicki et al., 2016).

The third dimension – family continuity – describes the family decision maker's respective focus on maintaining the firm under family control and keeping the family involved in the business (Debicki et al., 2016). Since socio-emotional wealth is so closely tied to the family members, McLarty, Vardaman and Barnett (2019) argue that the familial status of the supervisor and the respective importance of socioemotional wealth goals influence the performance of employees. They further reason that non-family supervisors can also profit from pursuing the socioemotional goals of the firm: family prominence may enhance their social status and family enrichment may make them an extended member of the family.

However, non-family supervisors have little to no possibilities to profit from family continuity, *“(...) making perceptions of its incongruence most relevant to employee and supervisor interactions.”* (McLarty et al., 2019, p. 306). Which, in turn, influences the internal supervisor-employee relationship dynamics since employees expect family and non-family supervisors to value the socioemotional dimension of continuity differently. When a non-family supervisor attaches great importance to family continuity, employees perceive it as insincere. Which leads to the employees not knowing how to transform their commitment into performance. The same

applies to family supervisors that do not view family continuity as important (McLarty et al., 2019).

It has thus been shown that family supervisors negatively impact the performance of committed employees when not considering the socioemotional wealth dimension of family continuity as important. Non-family supervisors, on the other hand, hinder committed employee performance when viewing it as important and if they do not, this enhances employee commitment and thus their performance. Results also showed that employees with less commitment are not affected by this effect of incongruence - they showed better performance under conditions of incongruence (McLarty et al., 2019).

Long (2011) has argued that social exchange theory should also be considered when researching family social capital since it stems from individual relationships that are developed and maintained by repeatedly engaging in exchanges over time. Social exchange theory “(...) *more precisely pinpoints areas for assessment, as well as needed intervention and development. Social exchange theory can also provide insights into questions regarding the impact of particular member behaviors on the development of social capital.*” (Long, 2011, p. 1233). However, family firm research has yet to deal with this suggestion.

## 4. Empirical Evidence: Family vs. Non-Family Firms

To date, there is an ongoing debate of what exactly makes family firms distinct from non-family firms. Many aspects of firms have been empirically researched to settle the debate, such as financial performance (O’Boyle et al, 2012; Wagner et al., 2015), firm reputation (Deephouse & Jaskiewicz, 2013) or resilience (Amann & Jaussad, 2012). Hereinafter, some of the results shall be outlined to understand the underlying difficulties of conceptualising the differences between family and non-family firms.

In a meta-analysis of 78 articles, O’Boyle, Pollack and Rutherford (2012) have examined the relation between the performance of the firm and the involvement of families. Neither a positive nor a negative relation has been found as the very small positive effect is statistically insignificant. In another meta-analysis of 380 studies, Wagner et al. (2015) have observed a positive connection between the financial performance of a firm and its status as a family business, whereby family ownership appeared to be more beneficial than other family governance modes. However, this “(...) *effect is statistically significant but economically relatively small.*” (Wagner et al., 2015, p. 3).

Nonetheless, it has to be taken into account that the majority of studies conducted in this field have focused on westernised countries. One study that was conducted in the emerging markets of South Africa and Zimbabwe, compared the impact of managerial interpersonal competencies on the performance of small to medium sized family and non-family owned firms in the furniture manufacturing sector. It was found that family-owned firms in South Africa were the most innovative, contrary to those in Zimbabwe which “*can be explained by the fact that furniture and solid wood processing is a well-established manufacturing industry within South Africa (...). This suggests not only better resourced firms but a conducive environment for innovation as well, translating to better performance (...)*” (Mashavira et al., 2019, p. 11). The study also found that, in South Africa, as well as in Zimbabwe, the interpersonal competencies of the manager influenced the performance of both family and non-family firms (Mashavira et al., 2019).

Looking at the performance differences after an economic crisis by analysing 98 Japanese family firms and comparing them to 98 similar Japanese non-family firms during the downturn, recovery period and after recovery, Amann & Jaussaud (2012) found that family firms perform better in all three crisis periods. Family firms appeared to be far ahead of non-family firms at the end of the downturn and were able to keep some of their advantages over time. Family firms

also invested more and controlled costs more effectively. These results suggest that family firms adapt their strategy and their risk preferences more quickly than non-family firms (Amann & Jaussaud, 2012).

Concerning risk preferences, family firms have been found, inter alia, to differ from non-family firms in several ways: they are more accepting of downside risk (Alessandri et al., 2018), tend to diversify risk in case of several decisions (Fang et al., 2021), can be risk averse and inclined to risk at the same time (Gómez-Mejía et al., 2007) and have a greater positive impact on their innovation output when being proactive (Craig et al., 2014). Most authors argue that these differences stem from the long-term orientation and the socioemotional wealth goals of family firms (Alessandri et al., 2018; Gómez-Mejía et al., 2007; Craig et al., 2014).

Trying to create a more conclusive picture of risk aversion in family firms, Hiebl (2012) conducted a literature review of 29 papers concerned with the risk preferences of family firms. His results suggest that family firms are more risk averse as they invest less in research and development projects and, since debt could threaten survivability, seek low debt levels.

Although contradictory, the underlying factors of risk aversion were found to be family involvement, family members' goals and behaviours, the environment, the characteristics of the family manager as well as the firm's characteristics. It remained unclear when family involvement increases risk and when it diminishes it (Hiebl, 2012). Gómez-Mejía et al. (2007), however doubted many of the previous findings, arguing that: *"family firms frame the relinquishing of socioemotional endowment as a major loss and, (...), are willing to accept a greater performance hazard to mitigate that loss."* (Gómez-Mejía et al., 2007, p. 129).

Looking at the capital structure of over 2000 Spanish private family firms, Acedo-Ramirez, Ayala-Calvo and Navarette-Martínez (2017) have shown that family firms are more indebted than non-family firms which may be due to not wanting to lose control over the business. They differentiated between small, medium and large family firms, showcasing that, compared to medium and large family firms, small family firms can more quickly change their debt level. It has also been shown that younger family firms have higher debts than older ones.

Conversely, Ntoun et al. (2019) obtained a different result concerning the indebtedness of family firms. Using the data of 888 small and medium sized Spanish firms, they found that family firms use less debt financing and prefer equity investments over debt financing. Their

results also suggest that family firms prefer lower operational risk and “*that the proportion of failure of family firms as opposed to their counterpart firms is relatively low.*” (Ntoun et al., 2019, p. 16).

Using data from 36 small family and 28 small non-family firms, Mahto et al. (2018) analysed the internal and external performance enhancing strategies and their relationship to performance. Thereby internal strategies refer to employee training and efforts to increase commitment, whereas external strategies pertain to marketing efforts and learning orientation. It was found that employee training impacts sales performance especially positive in family firms. Marketing was found to negatively relate to sales performance in family firms but neither learning orientation nor commitment showed any such relation. The contrary is true for non-family firms (Mahto et al., 2018).

Comparing the exploitation of opportunities, De Massis, Eddleston, Rovelli (2021) found that family firms realise fewer entrepreneurial opportunities than non-family firms. This is due to the fact that the former often use a CEO-centric way of organising the top management team whereas the latter use a more participative top management team organisation. Consequently, results also showed that family firms that use a participative top management team configuration are not significantly different from non-family firms when it comes to the exploitation of opportunities.

Similarly, some scholars (Gomez-Mejia et al., 2010, Zahra, 2020) found that family firms tend to internationalise less and are also less diversified domestically. When family firms decide to internationalise they prefer countries that are culturally close. The explanations for this usually revolve around socio-emotional wealth preservation and avoidance of outside control (Gomez-Mejia et al., 2010; Zahra, 2020).

Other studies, such as the meta-analysis of Arregele et al. (2017) found a very complex relation between family firms and more or less internationalisation. When the firm is controlled by a family, meaning that the family has significant ownership and management control over the company, there is a negative relation to internationalisation. This implies that the definition of what a family firm is, matters a lot: “*(...) there is a significant diversity in the family firm-internationalization relationship depending on the definitions used for the family firm and internationalization constructs (...)*” (Arregele et al., 2017, p. 820)

No differences to non-family firms were found in the number of foreign subsidiaries. Moreover, results showed that the institutional context is of high importance: the internationalisation of a family firm is constrained when minority shareholders are highly protected by the firms' home country. This is due to the power it gives minority shareholders which can e.g. lead to conflicts between family and non-family shareholders or to short term strategies being preferred over long-term strategies (Arregele et al., 2017).

Zahra (2020) found that family firms have less technological capabilities, which may hinder internationalisation processes. The study also found that family firms had lower organisational social capital than non-family firms and that family-controlled firms with technological capabilities as well as organisational social capital internationalise more than their counterparts.

Another factor, touched upon before, that should not be underestimated is the reputation of firms which “ (...) *is the general level of favourability towards a firm held by its stakeholders; it indicates how much stakeholders admire and trust a firm relative to their expectations and to other firms.*” (Deephouse & Jaskiewicz, 2013, p.338). A great reputation can not only be a competitive advantage, it can also be a very important goal for family firms due to its socioemotional wealth (see 3.5.2; Kalm & Gomez-Mejia, 2016). Therefore, family members may identify more with the firm and may be more motivated to achieve a good reputation.

In a study of 197 firms from eight culturally distinct countries, it was confirmed empirically that family firms have better reputations than their non-family counterparts and that a higher level of family ownership yields a better reputation. Moreover, a positive relationship between the family's name in the firm name and reputation was found. Additionally, results were not affected by the different cultural backgrounds which leads to the conclusion that reputation is an important factor globally (Deephouse & Jaskiewicz, 2013).

The involvement of the family also has an impact on the family firms' corporate social responsibility. For instance, family firms were found to donate more to charity (Dou et al., 2014) and have a better environmental performance compared to non-family firms (Berrone et al., 2010). Cui et al. (2018) argue that the level of investment in corporate social responsibility in family firms depends on the incentives of the decision makers. Whether or not the CEO of the firm is a family member does, thereby, play an important role: “*If a CEO is a member of the controlling family, family involvement does improve the firm's overall CSR performance. If*

*the CEO is not a family member, by contrast, the firm is less likely to pursue CSR activities.”* (Cui et al., 2018, p. 305).

The empirical results of comparisons between family and non-family firms are thus multifaceted, partially contradictory and require further research. Moreover, many studies have concentrated on a single country (e.g. Dou et al., 2014; Gómez-Mejía et al., 2007; Amann & Jaussaud, 2012; De Massis et al., 2021) or on firms of a particular size (e.g. Alessandri et al., 2018, Deephouse & Jaskiewicz, 2013) which means that results are only generalisable to a limited extent.

#### 4.1 Family vs Non-Family Franchising

Since franchise systems are so distinct from other types of firms, it may be worthwhile to compare the differences between family and non-family-led franchises. However, the empirical studies that have been conducted so far have not been numerous. Henceforth, the evidence obtained to date shall be outlined.

Comparing 11,654 small family franchisees and 4,122 small non-family franchises from the United States and South Korea, Patel et al. (2018) found that the financial performance of non-family-owned franchises was superior to that of their counterparts. The employees in family franchises had a lower sales performance, at least 6.7% per employee which indicates “inefficiencies resulting from pursuing noneconomic goals.” (Patel et al., 2018, p. 241).

The lower performance of family firm franchisors in the United States was confirmed by a very recent study conducted by Chirico et al. (2020). This is despite the finding that family franchise systems invest more in the training of their franchisees. This suggests that the training effort does not show in their performance. However, the consideration of the age and size of the family firm franchisors reverses this finding: older and larger family franchises outperform non-family franchises. The study also found that family franchises have a better relationship with their franchisees since less contracts are terminated in comparison with non-family franchise firms (Chirico et al., 2020).

## 5. Analysis

From a transaction cost perspective, family involvement in franchise systems may lead to certain transaction cost savings. When a close relative of the franchisor decides to open an outlet, costs such as negotiating or monitoring costs may be reduced, as trust is high and such measures may be deemed as less important.

The bonding effect stemming from the investment in specific assets described by Hussain, Moritz and Windsperger (2012) may be reinforced by the close franchisor-franchisee relationship in case of family ties. Hence, multi-unit franchising may often be the preferred choice, even when the investments in specific assets are not as high.

A close relative might also not have to invest as much as a stranger who wants to open a franchise outlet or may even get substantial resources from the franchisor. This could then also lead to a weakened bonding effect. When the franchisor heavily invests in the family franchisee's outlet and trust is high, Hendrikse, Hippmann and Windsperger's study (2015) predicts a contract with many residual rights so that the franchisor can adjust more easily to a change in circumstances.

The transaction costs of international franchising may also be lowered when the family of the franchisor is dispersed geographically and its members are willing to work for the family franchise. Searching costs, monitoring costs and costs for an eventual intermediary can be reduced greatly by working with family members. But costs such as servicing costs or the costs to protect the property may still occur. These advantages may, however, only apply when the family members do not engage in opportunistic behaviour.

Therefore, a family franchise might, contrary to its non-family counterpart, not only fall under the category of bureaucracy-based control, but also under that of trust-based control, when family members are also franchisees.

The generic non-tradeables introduced by Gedajlovic and Carney (2010) do point out a possibly valuable area of research. However, their study applied transaction cost theory incorrectly. Their arguments of a relative advantage gained through GNTs fit better with the resource-based theory than with transaction cost theory. It is also not clear how GNTs are supposed to lower or raise transaction costs. The studies that base their theoretical approach on GNTs are therefore



not part of this analysis of transaction cost theoretical approaches. Important elements shall, however, be discussed later on. Based on these points, I offer the following proposition:

**Proposition 1:** Family involvement in franchising lowers transaction costs, especially when family members become franchisees. This is only valid under the condition that trust prevails and family members do not engage in opportunistic behaviour.

The resource-based theory gives insight into many important aspects of the potential advantages and disadvantages of family involvement in franchise systems. The basic assumption that franchising offers the opportunity to access the resources of other firms is likely to depend on the organisational design of the family franchise. For instance, it will make a difference whether franchisees are family members or not. Family members may have very similar resources and may therefore be less valuable than non-family members in that regard. Other aspects such as the transfer of knowledge might, on the other hand, be less of an effort.

The development of reconfigurational capabilities, that were found to be important for franchise performance by Ghantous and Das (2018), may be hindered by family involvement because the family may strive for wealth preservation (Eddleston et al., 2008). Because the family does not want to lose control, the possibility of having a performance-enhancing effect through having a real option clause in the franchise contract (Gorovaia & Windsperger, 2013) may be non-existent as the real option clause may not be included in the contract.

In line with Chirico, Ireland and Sirmon's (2011) propositions, I suggest that familiness in the franchise system may lead to a competitive advantage since it can be a source of very unique resources. Especially the long-term orientation, as well as the commitment and trust that stems from familiness may be performance-enhancing.

Thereby the heterogeneity of family franchises and the differences concerning the components and essence of involvement as well as the organisational identity must be taken into account (Zellweger et al., 2010). Additionally, like Craig, Dibrell and Davis (2008) discuss in reference to customers, family franchisors may have to promote their distinct familiness to franchisees, as well as employees in order to stimulate a positive effect.

I therefore make the following proposition:

**Proposition 2:** A family franchise with high family involvement, strong essence and organisational identity and subsequently high familiness is more likely to develop unique resources such as a distinct brand and reputation. This subsequently leads to less franchisees leaving the franchise system compared to non-family franchises.

Concerning the human and social capital of family franchises, it is clear that it will differ significantly from that of non-family franchises. What matters in this respect is not only whether the franchise is family-led or family-owned but also how many family members are employed and how they relate to the franchisor as, for example, the social as well as the human capital of the nuclear family will be different from that of the family at large.

The bridging social capital of family members should also not be underestimated. In a study with forty-two Asian Indian franchisees in the US, Parker (2013) found that most of the time the franchisees were introduced to the franchising concept through a family member, friend or acquaintance. Usually, these bridge builders were also of the same ethnicity. The access to external resources through bridging social capital will thus also be dependent on the size of the franchise: the more employees, the more potential bridges can be built.

Overall, one may still expect family franchises to have more difficulties with leveraging social and human capital due to problems triggered by e.g. the bifurcation bias or wealth preservation goals. Carney (2005, p. 256) has summarized this as follows: *“(...) to the extent that top executives are selected and rewarded on the basis of family ties rather than professional expertise (...), that family members are compensated, monitored, and disciplined differently (...) and that family firms are less likely to use stock options to compensate top managers over concerns of diluting family control, then family firms are less likely to attract top quality external managers than their counterparts (...).”* Family franchises thus have to be aware of bifurcation bias and have to try not to let it happen by professionalising the business practices (Verbeke & Kano, 2012). This does not only concern the top management but also the rest of the employees.

Here, I would like to add the GNTs developed by Gedajlovic and Carney (2010) as they encompass bridging and bonding social capital. The other two resources categorised under GNTs, reputation and tacit knowledge also fit with the resource-based theory. I would therefore suggest that GNTs are just a subcategory of familiness with the characteristic of not being tradeable.

The resources in family franchises thus have a multitude of sources, are dependent on several factors and are not easily traceable as they are intertwined with one another.

Agency theory adds another important dimension to this analysis: it introduces the franchisor-franchisee relationship. The franchisor-franchisee relationship of family franchises may differ greatly from those of non-family franchises, due to the advantages and disadvantages arising from familiness. For instance, the information asymmetries that occur in franchise systems may be mitigated through altruism and high trust. As argued by Van den Bergh and Carchon in the context of family firms (2003), the sense of collective ownership, strong commitment and loyalty of the family members may have a stabilising effect on the franchise system.

As Karra, Tracey and Phillips (2006) have suggested, altruism may also be transferred to a quasi-family. So when the family franchisor manages to develop a quasi-family within the business, advantages such as commitment and trust may arise thereof which, in turn, may increase the sustainability of the franchise.

For the franchisor it may also be reasonable to make family members multi-unit franchisees as their skills and knowledge are known and goals can be expected to be aligned. This may lower agency problems and costs. Interestingly, Carney (2005, p. 257) also drew attention to these benefits: *“The franchisor–franchisee relationship (...) is structured to benefit from the numerous agency advantages of family governance, such as tight variable cost management and direct monitoring (...) and the financial and scale advantages of managerial governance (...).”*

However, the “dark side” of altruism and the issues with controlling each other have to be taken into account (Schulze et al., 2001). Family members that have become franchisees may free-ride on the franchisor’s goodwill and/or the efforts of non-family franchisees. This circumstance may even be worse than with non-family franchisees: when the franchisor has helped the family-franchisee with opening the outlet by e.g. bearing a part of the costs or the franchisee only has to pay a lowered royalty rate, the risk the family-franchisee has to shoulder is decreased, which makes opportunistic behaviour more attractive. The altruistic behaviour towards family members may also lead to bifurcation bias which may cause tensions between family and non-family franchisees, as well as family and non-family employees.

At this point, a differentiation between the various forms of family franchises seems appropriate as they, just like family firms, are characterized by heterogeneity. Based on Dyer's (2006) four categories of family firms, I propose the following family franchise differentiation:

1. Clan family franchise: family-owned and managed; nepotism, the franchisor mainly wants family members or friends as franchisees, the franchisor-franchisee relationship is thus characterised by high trust and altruism, monitoring costs are very low, but the growth rate and internationalisation is limited due to constraints in human and social capital, financial capital, reconfiguration capabilities etc.
2. Mixed family franchise: family-owned and managed, franchisees are both family and non-family members, but family members may be preferred; more growth opportunities due to more social and human capital than in clan family franchises
3. Professional family franchise: family-owned and managed, but if family members want to become franchisees, they have to adhere to the same rules as non-family franchisees; agency costs are higher; bifurcation bias is unlikely to occur, but can arise from family members working in the management team
4. Family-owned only franchises: the franchise is professionally managed; family vs. non-family shareholder problems may occur; high agency costs; high growth and internationalisation potential; no bifurcation bias

These four categories may, of course, merge into one another but they give a rough overview of the potential differences between family franchises, the factors that have to be taken into account and the possible implications.

But unlike Dyer's (2006, 2018) conclusion that clan family firms should have the best performance, I would conclude, that in the case of family franchises, the professional family franchises may perform the best as they on the one hand have family firm advantages through e.g. familiness or altruism while they are on the other hand aware of the problems that can occur due to e.g. nepotism and may thus manage it in a way that makes the franchise attractive for non-family franchisees as well. However, other forms of family franchises may also perform well when their characteristics fit the circumstances. Possible factors are e.g. the country or the particular industry.

The heterogeneity of franchise systems is also emphasised by the relational view, whereby the focus lies upon interorganisational relationships and the potential competitive advantage, as

well as the relational rent stemming thereof (De Castro et al., 2009). Establishing a strong relationship with the non-family franchisees in family franchises may be more important than the franchisor-franchisee relationship in non-family franchises, as it may be a main driver of the organisational social capital. The organisational social capital that stems from non-family franchisees may, in turn, increase the number of alliances (Zahra, 2010).

The relational capital can therefore be expected to differ significantly between family and non-family franchisees – like the type of trust that prevails in the relationship. When the franchisees are family members, knowledge-based trust is likely to be high as the exchange relationship did not start with the franchisor-franchisee relationship. Thus, this may be another reason for choosing family members as multi-unit franchisees. As family franchisees may also have more prior knowledge, conflicts caused by an expectation gap may be minimised. The satisfaction with the relationship may also be likely to be higher than with non-family franchisees, especially when the latter have prior experience.

But when there is conflict in the family because of e.g. opportunistic behaviour or diverging opinions and goals, the situation may be more detrimental than when conflict happens in non-family franchises as emotions, personal ties and personal wealth are involved. This also applies when the family only owns and/or manages the franchise.

**Proposition 3:** Conflict is more detrimental in family franchises than in non-family franchises.

Social exchange theory and its concept of reciprocity is a valuable perspective when exploring the involvement of families in franchise systems as it takes into account the underlying social norms and the history of the relationship.

The exchange systems in franchises with heavy family involvement are likely to be long-term oriented and characterised by high reciprocity, especially when family members are contracted as franchisees. Yet, defining these franchises as generalised exchange systems may be imprecise, as family members also have to show performance, and family franchisees may still have to pay the royalty fees.

Additionally, the non-family franchisees may be treated differently, making the respective relationship with the family franchise more of a restricted exchange system. Hence, family franchises may neither fall into the category of a generalised exchange system, nor into the category of restricted exchange system. Creating group cohesion through a generalised

exchange system may therefore be a lot harder for family franchises, as well as for non-family franchises as soon as the franchise has reached a certain size and maintaining a reciprocal relationship with every single franchisee or important manager becomes unattainable. Thereby commitment plays a crucial role, as emphasised by Meek et al. (2011). Notably, affective commitment has many advantages such as an augmented performance. It also makes multi-unit ownership more likely. From this and the points made above, I offer the following proposition:

**Proposition 4:** Multi-unit franchising is used more by family franchises than non-family franchises due to agency cost savings and high knowledge-based trust and affective commitment between the franchisor and the family-franchisee.

Since their socio-emotional wealth, familiness and altruism lead to an emotional attachment, it is likely that family franchises are better at creating affective commitment. Karra, Tracey and Phillips (2006) pointed towards the possibility of transferring a positive behaviour such as altruism to a quasi-family. It may therefore also be possible to transfer other behaviours or values such as affective commitment to a quasi-family, therefore creating an emotional bond. However, as McLarty, Vardaman and Barnett (2019) have shown, a visibly dedicated non-family supervisor may be viewed as disingenuous by employees and may have a negative effect on performance. The same may be the case in family franchises: a non-family franchisee or manager that has a visible emotional attachment to the franchise may be perceived as untrustworthy and thus decrease employee performance.

The theoretical observations as well as the empirical evidence of what differentiates family from non-family firms makes one thing very clear: family and non-family firms are very heterogeneous – from size to risk preferences. The distinction between family and non-family firms is not sufficient to explain the various differences; a more-fine grained differentiation is necessary. It is also important to point out that how e.g. performance is measured and what kind of firms in which industry, country etc. influences the obtained results.

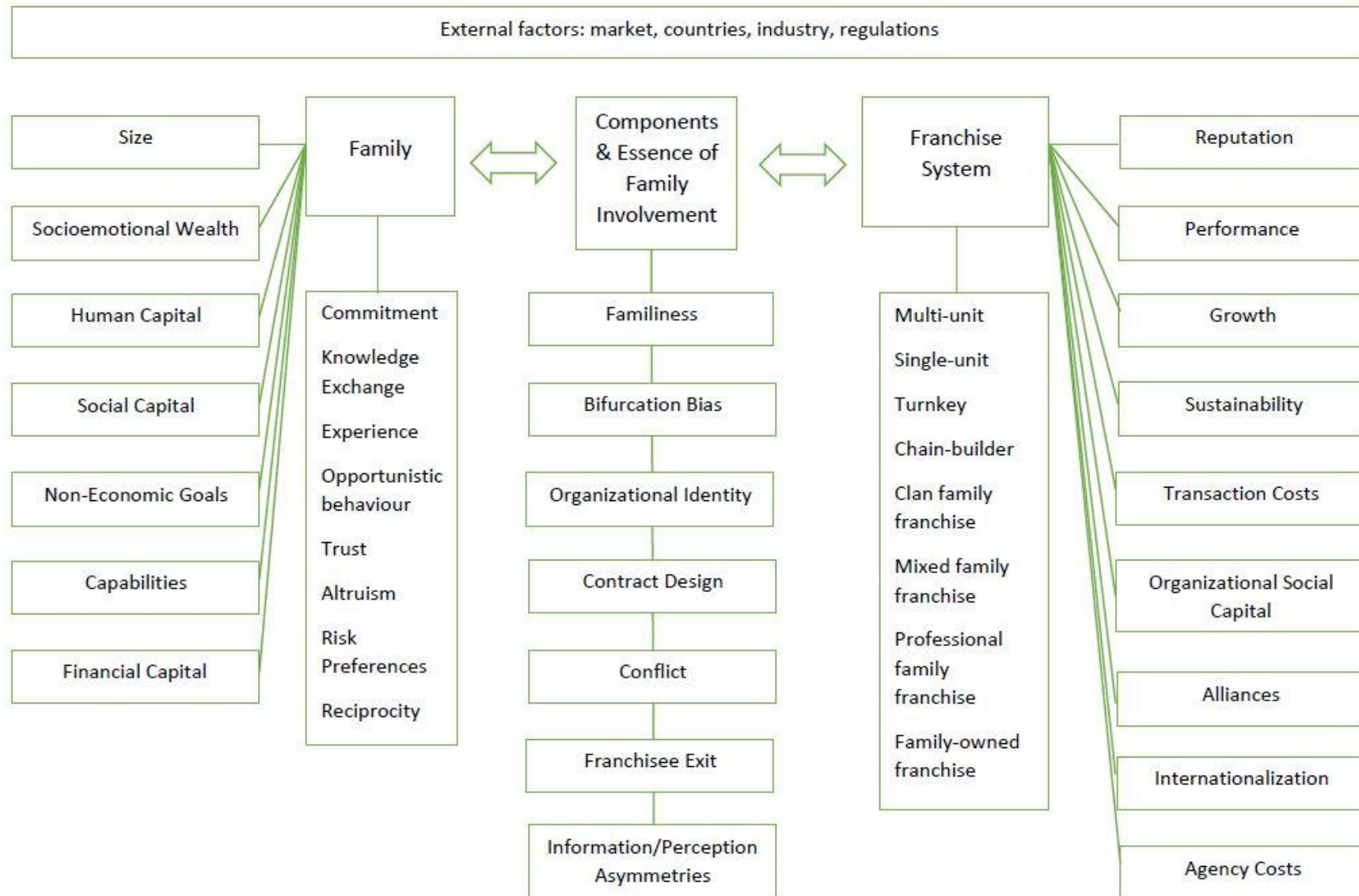
The same is true for franchise systems. The lack of evidence concerning the differences between family and non-family franchises is evident. The weaker performance of family franchises needs more clarification. Which forms of family franchises perform worse than non-family franchises, under which circumstances? What are the underlying issues?

The suggested risk aversion and lower propensity to internationalise due to concerns of a loss of control, may be less relevant for family franchises as having franchisees run outlets always brings along a certain loss of control. Franchisors should be aware of this loss of control and be ready to take a risk. Otherwise opening a franchise would make little sense.

How family involvement may influence franchise systems is summarised in the following diagram. It is an extension of Nijmeijer, Fabbriotti and Huijsman's (2014) analysis of 126 empirical articles that disclose the factors that affect franchise outcomes.

The left side shows the family characteristics, which influence the behaviour of the family in terms of e.g. commitment or opportunistic behaviour. How the family's characteristics and behaviours influence the franchise system is dependent on how involved the family is. Which, in turn, affects the development of e.g. bifurcation bias or the organisational identity.

The form of involvement thus influences the franchise system and its performance, its alliances, reputation and so on. Thereby the type of franchise system is also very relevant. Moreover, I suggest that the franchise system also has the power to influence the family and its characteristics as it becomes a part of the family's identity, hence the double arrows. And last but not least, environmental factors such as the country and the industry have to be taken into account.





## 6. Discussion & Conclusion

*“When families establish a business, beliefs and norms prominent in the family tend to carry over to the business. Thus, one characteristic that makes family firms distinctive is that they inherit or pass on beliefs and norms as part of their social structure.”* (Sorenson et al., 2009, p. 239). This statement addresses an important aspect of what has been discussed in this thesis. Family franchises will ultimately differ from their non-family counterparts – in terms of their resources, their costs, their goals, their management decisions etc. due to e.g. their socioemotional wealth, their behaviour or their goals. The aim was, however, not to find out whether family franchises are better than non-family franchises, but how the involvement of families may affect and shape the franchise system.

It has been shown that families have the ability to significantly impact the franchise system. The exact potential impact depends on many factors that have been discussed through the lens of transaction cost theory, resource-based theory, agency theory, social exchange theory as well as through the relational view. Many of the suggestions made in the subsequent analysis do, however, only apply when family members are also franchisees. When the family franchise does only have non-family franchisees the propositions may not apply or be weakened. Yet, family firm research has shown that family management can also significantly impact the firm.

What remains to be done is to research the discussed issues empirically. It may also be worthwhile to extend the research to include close friends or acquaintances. As Parker (2013) has shown with Asian Indian restaurant and food store franchises, the social structures surrounding the franchisor may be critical for the franchise’s expansion. Franchisors using their social networks to advance their business seems likely, since *“People rely on the support of their friends, children trust their parents, and sellers trust their buyers to pay the bill. (...) Trust also seems particularly important in economic exchanges because it seems obvious that the absence of trust among the trading partners severely hampers market transactions.”* (Fehr, 2009, p. 235). Moreover, Van Auken and Werbel (2006) have argued that the commitment of spouses may be an important factor for the performance of family businesses. The same may apply to franchises. Another insightful area of research may be the cultural influences on franchise systems.

This thesis is of course not without limitations. Firstly, and most obviously, the propositions have not been tested empirically. Secondly, only a few theories have been included, others may prove very valuable as well.

In conclusion, this master thesis has shown that family involvement in franchises can be deemed as very important as it affects many aspects of the business. The currently under-researched area of family franchising has been complemented on a theoretical basis by developing a heterogeneous view of family franchises. This was not only done by researching the topic through the lens of five theories, but also through differentiating between four forms of family franchises and through pointing out the various possibilities with which a family may influence a franchise system.

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## Appendix

### Abstract (German)

Während Franchiseunternehmen in vielen Ländern ein wichtiger Faktor für wirtschaftliches Wachstum sind, sind Familienunternehmen weltweit im Zentrum der Wirtschaftssysteme. Dennoch fehlt es an Forschung, die den Einfluss von Familien auf Franchisesysteme analysiert. Die vorliegende Masterarbeit hat es sich zum Ziel gesetzt, diese Lücke zu schließen, indem die Forschung zu Familienunternehmen sowie zu Franchiseunternehmen kombiniert wird. Um die zwei Forschungsstränge miteinander zu verbinden, werden sie anhand von folgenden Theorien analysiert: Der Transaktionskostentheorie (transaction cost theory), der Prinzipal-Agent-Theorie (agency theory), der Ressourcentheorie (resource-based view), der relationalen Ansicht (relational view) sowie der sozialen Austauschtheorie (social exchange theory). Empirische Resultate werden bei der Analyse miteinbezogen. Die Analyse hat gezeigt, dass Familien, je nach Typ der Einflussnahme, einen signifikanten Einfluss auf Franchiseunternehmen haben können. Zudem wird eine Kategorisierung von Familien-Franchiseunternehmen vorgeschlagen.

**Keywords:** Franchising, Familienunternehmen, Transaktionskosten, Prinzipal-Agent Theorie, relational view, resource-based theory, social exchange theory

## Abstract (English)

While franchises are an important factor for economic growth in many countries, family firms are at the centre of economies worldwide. Yet, there is a lack of research that analyses the impact that families have on franchise systems. This thesis aims at closing this gap by combining family firm research and franchise research. Transaction cost theory, agency theory, the resource-based theory, the relational view, as well as the social exchange theory are used to unite the two research streams. Empirical results are also taken into account. The analysis shows that families can have a significant impact on franchise systems, depending on e.g. the type of involvement. Furthermore, a categorisation of family franchises and their potential advantages and drawbacks is proposed.

**Keywords:** franchising, family firms, transaction costs, agency theory, relational view, resource-based theory, social exchange theory