DETERMINANTS OF FRANCHISING: THE CASE OF SPAIN

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ABSTRACT

In this paper, we analyze the evolution and pattern of ownership in Spanish-franchised chains, and we study some of the key factors or characteristics that can determine—from an organizational view—the proportion of franchised units. First, we represent how the percentage of franchised units varies with time for the 316 chains included in the sample. In order to detect existing differences, we have also divided chains into two basic groups—service and product chains. Second, taking into account data for 2003, we try to identify the key variables that significantly determine the propensity to franchise using ordinary least squares (OLS).

The paper is structured as follows. After a brief introduction, the description and meaning of the different variables used is explained. The third part of the paper is related to the data collection phase and, lastly, we refer to the basic conclusions and possible future extensions.

INTRODUCTION

The existing literature has employed different theoretical perspectives to justify the existence of franchising. Specifically, agency- and resource-based theories have been applied to explain why, in some cases, the franchisor chooses to invest directly in a new outlet of the chain while, in others, decides to franchise it. The existing franchising literature includes numerous papers that have focused on this problem, although, in most cases, data is drawn for the U. S. or the U. K. situation. Therefore, the present study intends to discover if these results can be basically applied to the case of Spain or, alternatively, if the Spanish franchising sector presents relevant differences with respect to other more developed markets.

In this sense, many empirical studies have established that franchised units are efficiently superior to franchisor-owned outlets. This may be due to the fact that franchising enables increased chain growth, while it reduces monitoring costs, especially when units are located in a disperse manner. Geographic dispersion increases, in this sense, difficulties and costs associated with control of managers of franchisor-owned stores (Brickley, Dark, & Weisback, 1991; Jensen & Meckling, 1976; Norton, 1988; Shane, 1996, 1998). More specifically, franchising increases unit performance through the allocation of ownership and control rights

to the same person, the franchisee, and this reduces adverse selection and moral hazard problems (Shane, 1996, 1998; Carney & Gedajlovic, 1991; Blair & Lafontaine, 2005).

Because franchisees are the owners of the units they manage and, therefore, receive the residual rent generated by their outlets, once they have made royalty and other periodical payments to the franchisor, they have strong incentives to be efficient. Compared to this, managers of outlets owned by the chain have weaker incentives because they basically receive a fixed pay (Krueger, 1991) that does not depend on their store efficiency or profit (Rubin, 1978; Brickley & Dark, 1987). Even if compensation includes some type of variable pay, its relative importance is low because chains find that the opposite situation would compromise uniformity through reduction of quality standards (Bradach, 1998; Yin & Zajac, 2004). Therefore, for employees of franchisor-owned units, the reward for being efficient is, essentially, based on the possibility of future hierarchical promotion.

Related to this, monitoring and incentives are seen as substitutes. In this sense, franchised units are subject to less control from central offices and their managers have powerful incentives. This makes them more sensitive to local market needs and conditions, and it enhances profitability and efficiency as major objectives. Lower control over franchisees is evident if we observe that they enjoy wide-ranging powers to make certain decisions, which entails high autonomy. For example, many new actions or promotions are only optional for franchisees. Compared to this, managers of franchisor-owned outlets that usually put into practice decisions adopted centrally by the owner of the chain. Therefore, persuasions, recommendations, and suggestions made to franchisees substitute hierarchy and obligations for employees of franchisor-owned units.

Greater autonomy of franchised outlets is also observed through the greater number of these that are attributed to each area supervisor for monitoring compared to the number of franchisor-owned outlets (Bradach, 1998) or the lower information requirements they are subject to.

Another stream of the franchising literature, far from establishing the superiority of one of these alternative forms of government, has highlighted that the presence of both type of units in the same chain gives rise to relevant synergetic effects (Bradach & Eccles, 1989; Lewin, 1997; Bradach, 1998; Dant et. al., 1996; Lafontaine & Kaufmann, 1994; Pénard et. al., 2003; Yin & Zajac, 2004; Sorenson & Sorensen, 2001). Specifically, franchisor-owned stores are most useful in maintaining and developing brand name quality and homogeneity, exploiting certain economies of scale—for example, those associated with acquisitions from suppliers, providing less opaque information compared to franchisees, etc. On the other hand, franchisees are best in supplying the chain with new ideas and adaptations to local markets. Therefore, the so-called "plural form" or "dual form" is an efficient solution to mitigate asymmetrical information, limited rationality, and incomplete contractual hazards.

Based on the above, the franchising decision will not represent a transitional strategy that will disappear with time. In this sense, franchisors do not choose to grow through franchised units as a minor temporarily evil to overcome certain resource restraints (Oxenfeldt & Kelly, 1969; Caves & Murphy, 1976; Norton, 1988; Lafontaine & Kaufmann, 1994). Ultimately, total integration is not the aim because, as we have mentioned, synergetic benefits arise from the simultaneous presence of both type of outlets.

However, many studies have found that as chains reach maturity, they open less franchised units and, therefore, choose to grow, in greater extent, through franchisor-owned establishments (Oxenfeldt & Kelly, 1968-1969; Rubin, 1978; Caves & Murphy, 1976; Ozanne & Hunt, 1971). Time and chain age enable franchisors to acquire the necessary resources—financial, local market knowledge and management talent—to undergo new unit opening directly.

With the objective of understanding the growth pattern of franchised chains, we have chosen to represent it graphically. For this purpose, we analyze the evolution in Spain of the proportion of franchised units as the age of the chain increases. We find that this percentage increases more in the first years and becomes more or less stable after five years since the first franchised outlet was opened. These results are comparable to those obtained by Lafontaine & Shaw (2005) or Pénard et. al. (2002).

After observing the evolution of chain composition, we try to answer the question as to why some chains grow through more franchised units and others employ, almost exclusively, franchisor-owned outlets. To shed some light over this, our intention is to discover which variables have a significant influence over the proportion of franchised establishments. For this purpose, a multiple regression model is developed.

VARIABLES

After plotting the pattern for the evolution of outlet ownership, we conduct an OLS regression using SPSS 11.5. The dependent variable—proportion of franchised outlets—is modeled as the natural log of the ratio of the percentage of franchised units with respect to the percentage of company-owned outlets. This transformation has been used in many other empirical studies (see, for example, Shane, 1998, or Michael, 1996) and Berry (1994) demonstrated, through a series of Montecarlo experiments, that it constituted a more robust and precise measure of the distribution compared to the simple percentage variable both for OLS and Tobit regressions.

The independent variables include the basic contractual conditions employed by the chain to regulate the relation with franchisees along with other chain characteristics. A brief description of independent variables and the expected influence over the proportion of franchised units is provided below.

SECTOR.

It is equal to one when the chain is basically dedicated to the distribution of products and equal to zero when its object consists in the commercialization of services.

We expect to find that service activities have higher percentages of franchised outlets (Sen, 1998; Lal, 1990). This is because in this type of chains, local production has greater relevance and, therefore, tasks to be done at each outlet are, on the whole, more labour-intensive. This type of activities are subject to greater relax and opportunism; thus, given that franchisees have high-powered incentives, it will be more efficient to grow through a higher proportion of franchised units. On the other hand, when activities to be done locally have a significantly lower importance—in the case of product distribution chains—local agent effort is less important and we should find chains with higher integration percentages.

Related to the above, service chains face greater supervision difficulties or monitoring costs. This causes that franchisors will choose to substitute behaviour control with output control through more franchised units.

Given the above, service chains should present higher proportions of franchised outlets.

AGE.

This variable represents the number of years since the franchisor opened the first unit. Therefore, it is the difference, in years, between 2003 and the year the firm was established.

It is quite evident that, in general, the longer this period is, the greater the proportion of franchised units will be. This is not only due to the simple fact that time just goes by. *AGE* has been used as a proxy for franchisor experience (Weaven & Frazer, 2003), brand name value, or reputation (González-Díaz & López, 2003; Affuso, 2002; Lafontaine, 1992), and for franchisor accumulated resources (Alon & McKee, 1999; Carney & Gedajlovic, 1991; Combs & Ketchen, 1999). This way, given that the number of potential franchisees willing to join the chain increases as chain perceived value does, we expect to find a positive relation over the proportion of franchised units.

YNOTF.

It represents the number of years the chain initially remained without franchising any outlets at all. Therefore, it is the difference, in years, between the year the chain was established—this is, the first franchised outlet was opened—and the year the firm was created—the first year the franchisor was in business-.

We expect *YNOTF* to have a negative influence over the proportion of franchised units because this period of time can reflect, in a certain manner, franchisor difficulties to adequately design and develop the complete franchise package (González-Díaz & López, 2003). Moreover, during that period the franchisor has installed a totally centralized organizational form, and it can result difficult for him to let in quasi-independent businessmen that will make their own decisions.

INTERN.

This independent variable will be equal to one when the chain has some sort of international presence and equal to zero when it has outlets only in the domestic Spanish market.

If the franchisor has chosen to expand activities overseas, we should find a higher proportion of franchised units because, in most cases, he will not have the sufficient local market knowledge to undertake unit opening by himself. Local franchisees will have much better and complete information about demand conditions, governmental procedures, etc. Moreover, they have powerful incentives to keep it up to date.

Therefore, we expect to find that chains with international presence present higher values for the proportion of franchised outlets.

SIZE.

In order to measure the size of the chain, we have chosen to use the total number of outlets of the chain—franchised and franchisor-owned. Chain size has been used, in many occasions, as a proxy for geographical dispersion and, in this sense, for monitoring difficulties (Agrawal & Lal, 1995; Minkler, 1992; Brickley, Dark & Weisbach 1991; Lafontaine, 1995; Kehoe, 1996; Hoffman & Preble, 2001). So, geographical distance affecting the new outlet would make monitoring difficult. This problem would become even more outstanding if expansion is done through franchisor-owned units. However, if the decision is to franchise the new outlet, monitoring needs are reduced; thus, franchising reduces control costs when moral hazards exist (Brickley, Dark & Weisbach, 1991; Lafontaine, 1992).

From another point of view, chain size has also been used as a proxy for brand name value. In this sense, greater chain size will increase the number of potential consumers attracted and served (Lafontaine, 1992). This will convince franchisees, in greater extent, to join the chain.

Given the above, chain size is likely to favor franchising and, therefore, it should have a positive influence over the percentage of franchised units.

ININVEST.

The initial investment is the amount, in euros, the franchisee must invest in his outlet to join the chain. However, we have not taken into account here the initial lump sum entry fee paid to the franchisor; this amount is included in variable *FIXED PAYM*.

Therefore, *ININVEST* reflects the amount the franchisee must invest to adequately lay out and decorate his premises. If the resource scarcity hypothesis for franchising is true, this variable would have a positive influence over the dependent variable. However, it must be taken into account that higher investments increase franchisee´ risk and, this may reduce available franchisees. This would mean that ININVEST would have a negative influence over the proportion of franchised units.

Related to this, it is observed that outlets located in large urban cities—bigger units and that, therefore, entail higher associated investments—are usually franchisor-owned (Hunt, 1973; Thompson, 1992). Maybe this is because the existence of various outlets in the same city reduces monitoring costs and performs as benchmarks. On the other hand, in isolated areas, where only one unit usually exists, ownership is assigned to franchisee because free-riding—one of the basic franchising hazards—is reduced due to the existence of repeating-type customers. In this sense, negative consequences of reducing quality would mainly correspond to the opportunistic agent (Brickley, Dark & Weisback, 1991). This has a certain relation with another dependent variable included in the analysis: *POPUL.*

Results reported by Brickley (1999) are also inconsistent with the general statement that franchising is used to overcome franchisor resource restraints. He finds that the probability of direct investment of the franchisor increases with amount needed. It seems that greater initial investments increase risk and demanded profitability for franchisees, and this reduces advantages of franchising and limits franchisee´ availability. Therefore, we expect a negative influence over the dependent variable.

TOTAL VAR.

To calculate the value of this variable, we have added the percentages of royalties and advertising fees for each chain. When these stipulated payments were not established as a percentage of sales, but through a fixed sum, they were not included here—they were taken into account in *FIXED PAYM*.

Royalty rates contribute to the alignment of both parties interest because both franchisee and franchisor will be interested in increasing sales. Because royalty payments are usually associated to sales, the franchisor signals his intention of undergoing the necessary investments to maintain and increase brand name value and to detect opportunistic behaviors that reduce chain sales. The franchisee is always interested in increasing his sales because his profit is linked to the former.

High royalty payments would serve as a powerful incentive to franchisors to control or monitor activities in order to increase brand name value but would reduce franchisee motivation to be efficient. Moreover, the number of potential franchisees willing to join the chain will be reduced and, from another point of view, part of the advantages associated to franchising will disappear—economic conditions would be closer to that of franchisor-owned units. Therefore, a negative relation is likely to exist between this variable and the proportion of franchised units.

DUR.

Longer contractual duration contributes, from a transaction costs view, to reduce advantages of hierarchy compared to that of the market. Transaction costs associated to this last option will be reduced and, as an intermediate case, the same will occur in the case of franchising.

Besides, longer contractual duration also reduces agency costs for various reasons (Shane, 1998). First, the franchisor has more powerful incentives to collect information on suitable potential franchisees and, in this manner, lower adverse selection hazards (Eisenhardt, 1989). Second, the possibility of moral hazard is reduced because informational problems disappear with time. Lastly, the agent has mayor incentives to be diligent and to reduce opportunism because the relative importance of short-term profits obtained as a consequence of opportunistic behavior is diminished.

Franchise contracts usually fix a determined initial duration for the relation between parties or establish that it will be unlimited. In the first case, possible renovations are contemplated; thus, the franchisee can consider his investment as long-termed. This acts as a stimulus for him to try to discover his customer tastes and characteristics in order to recover the undergone investment (Bradach, 1998).

Based on the above, we expect contract duration to have a positive influence over the dependent variable.

SURFACE.

This variable expresses the minimum surface, measured in square meters, fixed by the franchisor in order to allow for the opening of a new unit of the chain. Therefore, to some

extent, it can reflect effort required from the franchisee and, in this manner, reduce the number of potential franchisees willing to join the chain.

The expected negative relation between *SURFACE* and the dependent variable can also be due to the fact mentioned above that the franchisor is usually the owner of the larger outlets located in big cities, while the franchisee is left with the smaller more disperse units.

POPUL.

This variable reflects the minimum population fixed by central offices in order to allow for the opening of a new outlet of the chain. We already referred to the high probability of large units to be owned by the franchisor. Smaller units located in little villages or towns—where only one outlet of the chain usually exists—are more commonly franchised. Therefore, the minimum population fixed by the franchisor to open a new store in a given location should have a negative influence over the dependent variable.

FIXED PAYM.

The value of the last independent variable is the sum of the necessary initial lump sum entry fee and the actual or present value of fixed periodical payments—essentially royalties and advertising fees when they are not determined as a percentage of sales.

This variable is also positively related to franchisee effort. Therefore, we expect to find a negative influence over the proportion of franchised units.

However, initial entry fee compensates the franchisor for selection and initial training costs while the remaining periodical payments are justified as being remuneration for brand value and on-going support (Lafontaine, 1992; Lafontaine & Shaw, 1999). It is for this reason that we may find a positive relation between FIXED PAYM and the proportion of franchised units, given that the latter may be willing to make larger payments in exchange for greater support and intangible resource transfer from the franchisor.

DATA

Due to the non existence of a ready-to-use database related to franchising in Spain, data employed has been collected—in collaboration with a working group at the University of Oviedo (Spain) coordinated by Prof. Manuel González and Prof. Begoña López—from the four annual franchise guidebooks published for the period 1997-2003.

First, to represent the evolution pattern of ownership for Spanish indigenous chains, the proportion of franchised units was calculated as the quotient between the number of franchised outlets in Spain and the total number of outlets the chain has in Spain. This was done for each chain and for each year from 1997 to 2003. However, from more than 1300 existing Spanish-franchised chains found, only around 500 fulfilled the necessary condition of having started to franchise in 1997 or before, and continue to do so in 2003. Moreover, it was only possible to collect sufficient data for 316 of these; this was the size of the final sample employed.

Likewise, the time, in years the chain had been franchising, was calculated as the difference between the year the data was observed (1997, 1998…) and the year the chain was

established. To the value obtained, we added one because, in some cases, we had an incongruent situation in which the chain had been franchising for zero years and, despite this, did have franchised units. This did not seem correct.

Given the impossibility of graphically representing data directly, we divided chains into groups according to the number of years franchising. For each group, we calculated the average value of the proportion of franchised outlets and this was what was finally represented. Additionally, we also divided the sample into two groups according to chain activity—service or product—and repeated the above process again for each one.

Related to data collection, we must refer to important incongruent information. In this sense, in some cases, for the same year and variable, guidebooks contained very different values. To give solution to this problem, we contacted the franchisor, on the telephone or via its Web page, with the aim of reflecting the true value of the variable. Nevertheless, when this was not possible, we chose to take the value proportioned by the Spanish Association of Franchisors because this guidebook had resulted, on other occasions, in the most accurate data.

Once the data collection from annual guidebooks for period 1997-2003 is concluded, we are now merged in completing this information with financial and economic data taken from Annual Accounts (profits, advertising costs, sales, etc.).

Second, for OLS regression, we introduce the key variables described in the previous section. In some cases, data for some variables was available in interval terms. In these cases, franchisors reported a maximum and minimum because exact numerical value depended on other circumstances like unit location or dimension; thus, we introduced the average of the variable. This analysis was conducted for data corresponding to year 2003.

RESULTS

First, we represented the evolution of the proportion of franchised outlets for Spanish indigenous chains in our sample for period 1997-2003. For this aim, data was calculated and regrouped as explained above.

FIGURE I shows that the dependent variable increases with respect to the number of years the chain has been franchising. After five years, this value is stabilized round a value of 74% —alternatively, the proportion of franchisor-owned outlets reaches 26%. In the first years, franchising is used in a much more intensive manner—it must be taken into account that we are representing the evolution of the dependent variable with respect to the number of years franchising. However, chains usually initially remain some years without franchising; during this time period, all units are franchisor-owned. These results are consisted with that of López et. al. (2000); the only differences are that here stabilization takes place a little earlier and the percentage of franchised units is slightly lower.

Because we expected to detect different ownership evolution patterns with respect to the type of activity, chains were divided into two groups, namely, service and product chains.

**FIGURE I: THE EVOLUTION OF THE PROPORTION OF FRANCHISED UNITS
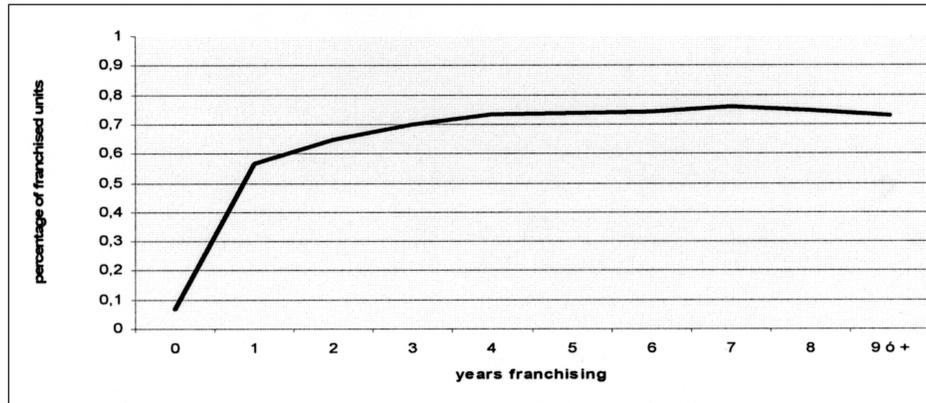FOR SPANISH CHAINS (1997-2003).**

FIGURE II shows that service chains, at average, present a higher proportion of franchised outlets compared to product distribution chains. This is in line with results obtained by Pénard et. al. (2002) and Lafontaine & Shaw (2005), although the percentage of units franchised is slighter higher in our case—nearly 80% for service chains and 70% for product chains. Nevertheless, these results are fairly similar to that obtained by research applied to more franchise developed countries—U.S. or U.K.; the main difference is that in Spain the franchising activity has only been generalized after the late nineties.

**FIGURE II: THE EVOLUTION OF THE PROPORTION OF FRANCHISED UNITS FOR SPANISH
SERVICE AND PRODUCT DISTRIBUTION CHAINS (1997-2003).**
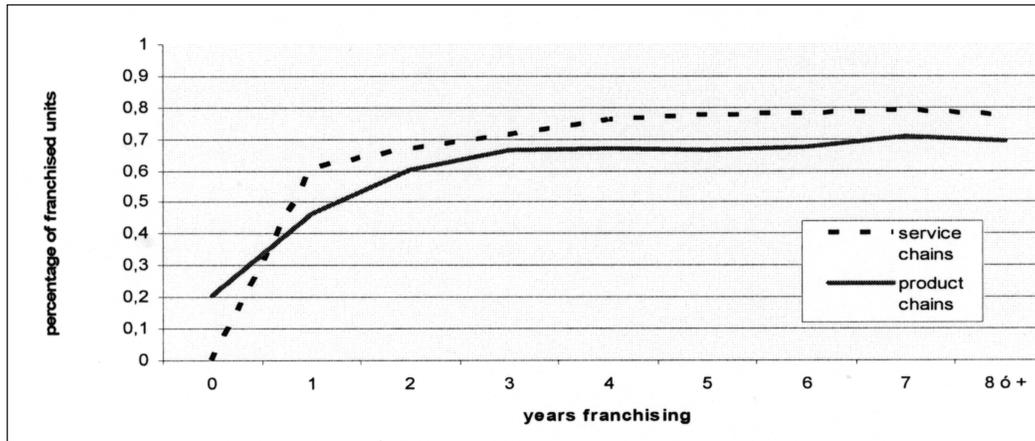
In order to detect additional differences between chains according to their activity, we considered, based on the classification provided by annual franchise guidebooks, various sector of activities. In this sense, we divided the sample of chains into eight sectors, four of the service type and another four for product distribution. However, results are not displayed

because we did not find relevant differences given that all four groups of chains of each type presented comparable evolution patterns.

Several tests were performed in order to determine the convenience of conducting the OLS analysis. First, the correlation matrix between the different independent variables shows small values; thus, multicolinearity problems are reduced. Second, normality distribution of the sample was checked through the K-S and S-W tests; both Sig-values were higher than 0.05; thus, the null hypothesis of normality cannot be rejected.

Next, **TABLE I** displays OLS regression results. The dependent variable measures the proportion of franchised units of chains. Within the independent variables, *SECTOR, AGE, YNOTF, INTERN, SIZE,* and *POPUL* are found to have a significant influence over the proportion of franchised outlets. All of the former present the expected signs.

Therefore, we can say that service chains choose to franchise a higher proportion of outlets. This seems to confirm that when necessary local activities are of more relevance and more labor-intensive, the given incentive system makes franchising the best organizational option.

Second, chains that have been in business for a longer time (*AGE*) tend to present larger proportions of franchised establishments. It is obvious that, as time since the franchisor opened the first outlet of the firm goes by, the greater the value of the dependent variable. Moreover, this effect can also be due to increased franchisor experience and brand name value as chain age is longer; this would surely have a positive influence over the number of franchisees willing to join the chain.

The number of years the chain initially remained without franchising at all (*YNOTF*) has a significant negative influence over the proportion of franchised units. Therefore, as the number of initial years during which all outlets are franchisor-owned and no franchised units are opened increases, franchisors seem to be reluctant to let franchisees in. They get used to a centralized organizational form where central offices make all decisions and this situation reduces future franchising activity.

Another significant independent variable is the presence of chain outlets in foreign markets; *INTERN* has a positive influence over the dependent variable. This means that when the chain has outlets abroad, it chooses to grow, more intensively, through franchised units. Geographical dispersion and reduced franchisor local market knowledge reduces the proportion of franchisor-owned units.

SIZE, measured as the total number of chain units, has a significant positive relation over the percentage of franchised outlets. Therefore, larger chains exhibit a higher proportion of the latter, probably because these chains are subject to increased geographical dispersion.

The quantity of initial investment (*ININVEST*) needed to adapt store premises to franchisor requirements reduces the proportion of franchised outlets of chains. Franchisee risk aversion and the impossibility for these to diversify investment adequately seem to reduce the number of potential franchisees willing to join the chain. We do not, therefore, find any empirical evidence to prove that franchising exists due to resource restraints of franchisors. The franchisor directly invests in the opening of new outlets when the necessary investment is higher.

The last significant independent variable to explain the proportion of franchised units is the minimum population fixed by the franchisor as the necessary minimum in order to open a new outlet in a given city or town (POPUL). It has a negative relation over the dependent variable; thus, we can say that the franchisor tends to be the direct owner of units located in the larger cities, while outlets situated in smaller towns are chosen to be franchised.

The remaining variables included in the analysis—the total royalty and advertising percentages, the initial contractual duration, the minimum surface of the outlet and the amount of the fixed payment—do not help to explain, in a statistically significant manner, variations in the proportion of franchised units. However, the signs displayed by the first three of these are as expected. On the contrary, the amount of the fixed payments the franchisee must make presents a positive relation; this seems to indicate that larger periodical fixed payments do not reduce franchisee interest to join the chain. Maybe, this is because they are willing to pay more in exchange for greater intangible resource transfer and support from franchisor.

TABLE I: REGRESSION RESULTS (N=316).

Independent variables (R-squared = 0,39)		Standardized Coefficients Beta
(Constant)	2,338	
SECTOR		-,214 (***)
AGE		,059 (*)
YNOTF		-,109 (**)
INTERN		,106 (**)
SIZE		,336 (***)
ININVEST		-,062 (*)
TOTAL VAR.		-,042
DUR		,071
SURFACE		-,038
POPUL		-,092 (*)
FIXED PAYM		,020

(*) Significant at 0.1.
(**) Significant at 0.05.
(***) Significant at 0.01.

CONCLUDING REMARKS

In this paper, our key aim was to determine some of the basic characteristics and contractual conditions that have a significant influence over the proportion of franchised units in Spanish chains. Results are much in line with those obtained by other researches and other more developed countries. Therefore, although in Spain franchising is a much more recent

organizational form, ownership structure of chains is similar to that of other geographical areas. Results indicate that the ownership pattern for Spanish chains does not differ from that obtained for other countries in which franchising is a much more widespread activity. The basic difference is that, in Spain, this process started up in the late nineties.

We have conducted an OLS multiple regression using data for Spanish indigenous chains published in annual franchise guidebooks for year 2003. Results suggest that chain sector, age, number of years initially not franchising, the presence of outlets overseas, size, required initial investment and minimum population help to explain, in a significant manner, variations in the dependent variable. Therefore, chains that exhibit a higher proportion of franchised outlets are those that are dedicated to the commercialization of services, have been in business for a longer period, have stayed initially a smaller number of years without franchising at all, have decided to internationalize activities in some extent, entail lower initial investments, and fix lower minimum populations to allow for a new unit to open. The remaining independent variables result nonsignificant.

Service chains decide to use franchising more intensively in order to overcome monitoring difficulties. Services entail increased relevance of local labor-intensive activities that, evidently, are subject to greater risk of opportunistic behavior.

The age of the chain or the number of years in business has a positive influence over the percentage of franchised units. This variable is commonly used as a proxy for brand name value or reputation, franchisor experience and for chain accumulated resources and it is obvious that, as the perceived value of the chain increases, so will the number of potential franchisees willing to join.

The number of years the chain has initially remained without franchising exhibits a negative relation over the dependent variable. The longer this time period, the higher the franchisors difficulties to conclude the franchising package and the deeper rooting of totally centralized decision making.

If the chain has units abroad, the propensity to franchise is greater. Expansion towards other countries favors franchising in order to have sufficient local market knowledge.

The size of the chain, measured though the total number of outlets, has a positive influence over the dependent variable. This variable is commonly used as a proxy for geographical dispersion and monitoring difficulties that favor the use of franchised outlets.

The amount of the initial investment the franchisee must undergo in order to join the chain, has a negative influence over the proportion of franchised units. Higher investments reduce franchisee interest in joining the chain because high risk cannot be easily spread. The franchisor can diversify his investments and, in this sense, commonly reduce risk. Both effects work towards reducing the use of franchised outlets.

The last relevant independent variable is the minimum population fixed by central offices to allow unit opening. This minimum population has a negative influence over the dependent variable; thus, smaller locations favor the use of franchising, while in larger cities the presence of franchisor-owned units is more common. This is because free-riding hazards related to franchising are diminished if the local agent does not have other chain stores nearby; the opportunistic agent must suffer the consequences of opportunistic behavior.

This constitutes a preliminary study and, therefore, it is subject to limitations. These include, for example, the low value obtained for Square-R. Even though it is in line with that found in most franchising research, we are convinced that other relevant variables have not been taken into account. Therefore, our intention is to continue working on this in the future.

Another limitation comes from the use of aggregate data at the chain level. A more fine-grained analysis should use outlet-level data within firms to explain why a given outlet is franchised or company-owned. At the moment, this type of information is not available in Spain.

Moreover, we are convinced that deeper sector differences between chains must exist. Therefore, we are working on increasing the size of the sample with the objective of introducing several service and product activities.

Lastly, we must point out that, given that this is a preliminary analysis, we have chosen to employ OLS regression. However, given that relations between variables are quite surely not lineal, it would be convenient to study the use of other types of analysis and control variables. Specifically, our intention is to develop a Systems Dynamics Model to explain chain growth and variable interdependencies with the incorporation of financial data.

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