

Effective Franchise Contracts: The Role of Contractual Relational Norms

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Cite as:

Mani Sudha, Alshamrani Areej, Feng Shanfei (Sophie) (2023), Effective Franchise Contracts: The Role of Contractual Relational Norms. *Proceedings of the European Marketing Academy*, 52nd, (113437)

Paper from the 52nd Annual EMAC Conference, Odense/Denmark, May 23-26, 2023



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Abstract

Franchise system viability depends on franchisor's ability to design contracts that facilitate the governance of the franchisor-franchisee relationship. However, research on the impact of contract design on franchisor performance is limited. We integrate research on contracts, transaction cost analysis, and relational governance to examine how contract dimensions influence franchisors' performance. We study the extent to which contract dimensions – contingency adaptability and franchisees' roles and responsibilities – are codified in a contract. Prior literature integrates noncontractual relational governance to complement the contracts. In this research, we examine the embedding of relational governance in the contract, i.e., contractual relational governance. We examine the moderating effect of the extent to which relational norms – information exchange and flexibility – are embedded in a legally enforceable contract. This study provides a comprehensive investigation of the influence of contract dimensions and contractual relational governance on franchisors' performance. We develop a custom database of 334 franchisors. State-of-the-art machine learning algorithm (Bidirectional Encoder Representations from Transformers - BERT) is used to code over 200K contract clauses. The results, consistent with our hypotheses, show that contractual relational norms complement the TCA-motivated governance dimensions. Our findings have implications for both theory and practice.

Subject Areas: *Business-to-Business Marketing, Inter-organizational Collaboration, Retailing*

Track: Business-To-Business Marketing & Supply Chain Management