Abstract

The objective of this study is to explain the franchisor's choice of using call option rights as a contractual clause in franchise relationships by applying transaction cost and real options theory. The call option clause gives the franchisor the contractual right, but not the obligation, to acquire franchisee outlets after contract termination. We argue that the franchisors more likely use a real option clause in franchise contracts under the following conditions: high environmental uncertainty, high behavioral uncertainty, high franchisor's transaction-specific investments relative to franchisees, and long contract duration. The results of the regression analysis based on 111 German and Swiss franchise systems provide support of hypotheses. This is the first study that applies real option reasoning to explain the call option clause in franchise contracting.

Keywords: transaction cost theory, real options theory, call options, franchising networks