

## Contract duration evidence franchise

Franchise is the contract of letting another investor to rent your property right in your parent's brand name and business format at a specific location, terms, and conditions. The franchiser will be the one who provide training, equipment, managing system, and services to the franchisee which the franchisee will give money in return, often be called royalty fee, franchisee have to pay the franchise initial investment, maintenance, etc. which each franchise contract are based differently. In this article, the author discussing about the contract duration based on franchise evidence whether which factors are the factor that made the franchiser provided longer or shorter contract duration. What are the reasons behind all of these factor, and who is going to benefit from these contract. The author also gave the information about what are the median contract duration based on the samples he provided.

Making franchise contract, both of franchisor and franchisee got to be better-off, when the franchisors are usually afraid of underinvest in quality of franchisee who they are taking risk on, because these franchisee can ruin their image, and can also causes free riders, while the franchisees are afraid of franchisors' potential opportunism to take the advantages out of them because they want to earn competitive rate of returns on this sunken franchise investment as enough to cover their average variable costs. Franchise contract will be occurred if the franchisor want to expanding their business but they don't have enough money to invest by themselves, implying that their cost of expanding by themselves is higher than rent it to others. The franchisee will take the franchise contract when they have money to invest but they do not want to take risk by starting investing by themselves which is uncertain on investment paying-off, implying that the cost of taking this franchise contract is less than starting business themselves. For the company which they do not give franchise contract to another investors, they perceiving that the cost of taking risk by letting others running their business would be costly comparing to do it yourself such as Starbuck, McDonald, or even in the first period of Seven-eleven. When the franchisors and franchisees meet the agreement, Franchise contract will be fulfilled, which the franchise contract cannot be change unless with 'good causes' of the franchisors.

Discussing about the factor lengthening or shortening the contract duration. Firstly, relationship-specific investment, or often called as franchise fee. On this first factor the author classified it in 2 main parts which are physical and human capital investment or initial investment and offsite training, respectively. Author set the hypothesis stated that 'the duration of the contract will increase with the franchisee's initial investment requirement' which implying that the more initial up-front franchise fee, the more contract duration incurring. The second hypothesis is that 'the duration of franchise contract will increase with the required amount of offsite training'. By these two hypothesis we can conclude that the initial investment, number of offsite training, and contract duration are positively related. But this hypothesis cannot be applied to every single firm in the industries because there is some case like in the hotel industry, when the higher initial investment would effect only a little to the contract duration.

Second factor, Uncertainty, In this factor the author concerning about the optimal contract provision whether the contract that the franchisor gave to franchisee is efficient for both side or not. The author third hypothesis is that 'The duration of franchise contract will increase as the franchisor gain experience in franchising', implying for the case of franchise contract duration is changing due to no experiencing of franchisor and provided inefficient contract duration into the market which the increasing in uncertainty came with shorter-term contract duration. This hypothesis might be wrong when, the franchisor provided optimal contract duration which has no need for any adjusting. Therefore, the contract duration can be increase, decrease or even constant depends on the first contract duration and optimal contract duration.

Third factor, re-contracting cost, the cost of changing contract which franchisor got to deal with every time they changing some details in every contracts they have been made. The more number of contracts they have made, the more payment they have to pay in order to change all contracts. Author's hypothesis is 'The duration of franchise contract will increase with the number and diversity of units within the franchise system'. The reason is that the more number of units franchisor has, the more opportunities for franchisor to learn about optimal contract provision that related to the second factor about franchisor's experience, effected by the increasing of franchise's experiences and increasing on re-contracting cost are positively related. Author also set another hypothesis stated 'The duration of franchise contract will be longer for firms with a high concentration of units in states that restrict the franchisor's right not to renew franchise contracts' since the state law restrain the franchisor's not to renew contract, forcing them to seek profit from others way, causes them to lengthen contract instead.

Forth factor is exogenous versus endogenous variable, which exogenous in this case assuming to be up-front payment before entering into the market similar to initial investment or franchise fee, etc. For the endogenous variable are the costs which the franchisee got to pay every month like the royalty fee. Author is concerning that contract duration of each franchise would effected differently by endogenous variable or exogenous variables, such as when the franchisor is the one who provide the place for franchisee and counted as additional royalty fee instead, In this case the exogenous cost is less but causes higher endogenous costs. This factor can also be related to the first factor due to less exogenous is less relationship-specific investment causes less contract duration. This hypothesis is differently apply to each cases because each contract has different conditions, vice versa.

Basing on the author's samples, Author found out that the median contract duration is 10 years with the renewal right of another 10 years, which 90 percent of the contract duration sample author found are mostly 5 multiplier that are 5, 10, 15, 20 and over 50 percent of the contract duration is 10 years contract duration. The median for upfront payment is 112,500 dollars which is 3,375,000 baht with the royalty fee of 5 percent and 2 percent of advertising fee. The median of offsite training is 2 weeks with 60 percent of outside training of it's primary state of operation. These information are the numbers which cannot be applied universally because each business sector applied different method of contract duration such as the food industry has higher level of investment with a high median of contract duration. Moreover, Author also provided the conclusion of advantages of longer-term contract and shorter-term contract. The longer-term contract would benefit the franchisee more due to the longer period to recover from sunken initial payment, while the shorter-term contract would benefit the franchisor more due to larger number of contract can be sold in the market.

Otherwise, I also found some similarity in Thai Franchise that the contract of 10 years duration are using as well, but with different upfront investment depends on each parental franchise, skills needed, managing system, etc. There also is a differences of Thai franchise comparing to others is that in food stall franchise industry with a less than 500,000 baht of relationship-specific investment, the franchisors usually don't stated specific contract duration, the contract duration will be over when the franchisee cannot reach the amount of supply buying from the franchisee implying that when the franchisee buying less amount of supply more than what franchisor stated the contract will be over, due to small upfront fee the franchisee had paid, making the franchisor got to make sure that they will have enough money to cover their cost of production in another ways. Therefore, the optimal contract duration in each franchise contract got to be based on relationship-specific investment, uncertainty, re-contracting cost, exogenous and endogenous variables which can be applied differently in each business sector. Franchise contract will be incurred only when the cost of providing and taking of franchisor and franchisee, respectively, is less than another costs.