Franchisees’ Financial Constraints and Franchisors’ Franchising Decisions

Ying Fan
Department of Economics
University of Michigan
611 Tappan Street
Ann Arbor, MI 48109
Email: yingfan@umich.edu

Kai-Uwe Kühn
Department of Economics
University of Michigan
611 Tappan Street
Ann Arbor, MI 48109
Email: kukuhn@umich.edu

Francine Lafontaine
Professor of Business Economics
Stephen M. Ross School of Business
University of Michigan
701 Tappan Street
Ann Arbor, MI 48109
Tel: 734-647-4915
Email: laf@umich.edu

Presented at the 27th Annual
International Society of Franchising Conference
Franchise Management School
Beijing Normal University-Zhuhai
People’s Republic of China

March 13-16, 2013
Abstract

We study how the financial constraints of agents affect the behavior of principals in the context of franchising. We develop an empirical model of franchising, simultaneously considering the effect of franchisees’ financial constraints on chain growth but also on the franchisors’ decision about when to begin franchising. We estimate the model by combining data on franchised chains and data on local macroeconomic conditions. In particular, we use collateralizable housing wealth at the state level as an inverse measure of the average financial constraints of potential franchisees. We find that a decrease in collateralizable housing wealth in the local economy leads to both later entry into franchising by local franchisors, and slower growth in the number of franchised outlets in these chains. We then show that the corresponding job losses can be substantial.

Keywords: collateralizable housing wealth, financing, local, growth, selection