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RESEARCH NOTES AND COMMENTARIES

ORGANIZATION GOVERNANCE FORM IN FRANCHISING: EFFICIENT CONTRACTING OR ORGANIZATIONAL MOMENTUM?

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We examine firms' choice of organizational governance form. Using longitudinal data on a sample of business format franchisors operating in North America, we show that the cross-sectional evidence commonly used to demonstrate support for efficient contracting explanations for organizational governance form is not robust to the year of investigation, firm effects, or selection effects. We theorize that this outcome may result from dynamic processes through which a firm's organizational governance form evolves. We develop and test two hypotheses for the effects of organizational momentum on organizational governance form, and find that organizational momentum is a robust predictor. Our results suggest that researchers consider the dynamics of momentum in explaining the form of firm governance. Copyright © 2008 John Wiley & Sons, Ltd.

INTRODUCTION

Organization theorists have long been concerned with firms' choice of organizational governance form (Williamson, 1985) because it is a key strategic decision that firms must make, and because it impacts firm performance (Yin and Zajac, 2004). Thus, past research has examined why firms use different governance mechanisms to control the value chain in a variety of settings, such as franchising, sales and distribution channels, make-or-buy decisions, research and development, technology transfer, and subcontracting (Shelanski and Klein, 1995).

Over the past 25 years, the dominant explanation for the choice of governance mechanism has been efficient contracting (Williamson, 1985), which holds that the choice of organizational governance form depends largely on a cost-benefit trade-off between contractually based and hierarchically based governance arrangements at the margin (Mahoney, 1992). However, some researchers have found that efficient contracting theories explain only a small portion of the variance in firms' governance choices (Combs and Ketchen, 2003), perhaps because these theories

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do not take into account the dynamic processes through which a firm's organizational governance form evolves and how these processes shape current organizational decisions (e.g., Kogut and Zander, 1992). Because organizational structure is path dependent, with early experiences and actions sending organizations down a path that is difficult to change, organizational momentum—'the tendency to maintain or expand the emphasis and direction of prior strategic actions' (Amburgey and Miner, 1992: 335; Beckman, 2006)—is likely to account for a significant portion of the differences in governance form across organizations (Miller and Friesen, 1984).

We examine the effect of organizational momentum on an organization's governance form by predicting the proportion of outlets franchised—a dependent variable often used to explore the factors that influence governance choice (Lafontaine and Slade, 1997)—for 1,510 business format franchise systems operating in North America between 1991 and 1997. We find that organizational momentum accounts for some of the variance in governance choice, however, our findings also conclude that six efficient contracting variables found to be significant in prior cross-sectional research are not robust to the inclusion of momentum and firm effects, or to a correction for selection effects. We conclude that researchers should incorporate dynamic processes, such as organizational momentum, into explanations for organizational governance forms that rely primarily on static efficient contracting arguments (Combs and Ketchen, 2003).

THEORY AND HYPOTHESES

Past research has found strong momentum effects for a variety of organizational actions (Amburgey and Miner, 1992), but has generally overlooked how these processes affect the type of governance form an organization uses. However, firms typically 'reinforce or extend their past structures and strategy-making practices, adhering to previous directions of evolution' (Miller and Friesen, 1984: 28). Therefore, firms' governance choices should be influenced by how they have operated historically, rather than just by efficient contracting at the margin.

Organizations repeat actions taken previously for several reasons. First, in order to save time and cognitive resources, managers confronted with decisions similar to those made in the past rely on methods and solutions found to be satisfactory in those similar past circumstances rather than reanalyzing each decision situation (March and Simon, 1958; Fiske and Linville, 1980; Simon, 1981). Second, repeated engagement in the same activity develops experience-based capabilities and organizational routines. To reap the benefit of past experience, organizations tend to use existing routines and to engage in activities in which they have competencies, regardless of whether such routines and activities constitute the 'best approach' (Arthur, 1994). Finally, repetitive experience in similar environments shapes the mindsets of organizational members, resulting in cognitive schemas, or mental models that connect particular tasks or problems with readily available solutions (Simon, 1981). Decision makers rely on schemas to make sense of problems and to form a course of action (Fiske and Linville, 1980), constraining the actions that they are willing to consider to less than the complete portfolio of alternatives (Amburgey and Miner, 1992).

Franchising experience

Managers of firms that have franchised in the past are more experienced with that governance form and have developed capabilities that support franchising, and thus seek to grow their firms through franchising. Franchising demands particular organizational routines, structures, and knowledge (Ingram and Baum, 1997). Because franchised outlets are owned by independent entrepreneurs, franchisors need to develop contractually based standards and processes for monitoring, correcting, and enforcing standard levels of quality across units within the chain (Combs and Ketchen, 1999). Moreover, franchisors need to gather information from franchisees about customer demand for products and services as well as accurate financial information about sales and costs. Efficiently gathering accurate information in an organization owned and operated by another party while minimizing the disruption caused by such activities requires a delicate balance of rules, communication, and monitoring. Franchisors also need to develop a field staff with communication and negotiation skills in order to gather information about operations and customer demands from

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independent businesses (Bradach, 1997). Furthermore, selling franchises requires a marketing team that both understands the product and the market, and can distinguish buyers of high potential that can adequately support and manage the franchise from low potential buyers who may fail and hurt the franchise reputation. Finally, franchisors need to have robust capabilities in contract design and enforcement (Combs and Ketchen, 2003).

Running a company-owned chain, on the other hand, draws on a different set of organizational capabilities (Ingram and Baum 1997). It requires a robust human resource management capability to hire, train, and manage the staff responsible for operating outlets, as well as the capability to oversee day-to-day operations in diverse and often distant locations (Bradach, 1997). Moreover, organizations that grow through store-owned outlets must manage the process of financing multiple outlets and develop the necessary physical infrastructure for new outlets in diverse locations. Accomplishing these tasks requires formal structures, information pathways, and physical infrastructure not needed in franchising.

In sum, the capabilities needed to manage franchised outlets are different from those required to manage company-owned outlets. Because firms that have franchised in the past have developed a set of routines, capabilities, and cognitive schemata that are *different* from those of firms that have operated their own outlets, they are more likely to franchise in the present. Therefore:

Hypothesis 1: The greater a firm's franchising experience, the greater its current proportion of franchised outlets.

Recent franchising experience

Argote, Beckman, and Epple (1990) suggest that recent experiences of organizations are more prone to be repeated than temporally distant experiences and are more important in shaping current organizational decisions (Sine, David, and Mitsuhashi, 2007). Several factors account for the moderating effect of temporal proximity on organizational momentum (Hayward, 2002). First, strategies and procedures used more recently are more 'cognitively available' to decision makers because memory decays over time (Elliott and Anderson, 1995). Second, organizational capabilities are subject to decay if they are not practiced regularly (Osterman, 1995). Third, because technology (e.g., electronic inventory systems and point-of-sales systems) and regulatory regimes (e.g., state franchising regulations) become obsolete over time, organizational technical capabilities and knowledge developed recently may be more relevant than capabilities developed years earlier. Therefore:

Hypothesis 2: The greater a firm's recent *franchising experience, the greater its current proportion of franchised outlets.*

METHODS

Sample

We obtained data from *The Sourcebook of Franchise Opportunities* (Bond and Bond, 1995) and *Bond's Franchise Guide* (Bond, Bond, Qiu, and Bond, 1998)—guides to business format franchise systems operating in North America—for the years 1991 through 1997. Although these data sources identify only half of the business format franchising population, previous research has shown that the franchisors contained in the dataset are representative of the overall population (Shane, 2001).

Dependent variable

Following previous research (Lafontaine, 1992), we use the proportion of outlets franchised in a given year as a measure of the use of contractual forms of governance, because franchisee outlets are operated by residual claimants and company-owned outlets are operated by salaried managers.

Organizational momentum variables

We use two independent variables to test the momentum hypotheses. The first is the *length of franchising experience*, which is the number of years since the firm began to franchise. The second is *recent franchising experience*, which is the difference between the numbers of franchised outlets at times t and $t-1$. (This measure is alternatively specified as *recent company-owned outlet experience*, the difference between the numbers of company-owned outlets at times t and $t-1$).

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Efficient contracting variables

This study controls for the effects of the following six variables that have been found to support the efficient contracting perspective in several cross sectional tests (Lafontaine and Slade, 1997).

(1) *Total investment*
Efficient contracting theories propose a negative association between the level of investment necessary to open an outlet and the proportion of outlets franchised (Brickley, Dark, and Weisbach, 1991) based on the argument that people who purchase franchised outlets cannot diversify their investments in those outlets, and seek a risk premium that diversified franchisors will perceive as too high (Brickley and Dark, 1987). Following prior research, we measure *total investment* as the log-transformed[1] dollar value of a franchisee's investment to open an outlet (Brickley and Dark, 1987).[2]

(2) *Franchise fee*
Efficient contracting theories propose that the greater the up-front franchise fee, the greater the use of outlet ownership, because franchisors can opportunistically renegotiate franchise contracts by threatening to terminate franchisees while the assets funded by the fee retain value (Combs and Ketchen, 2003). As a result, franchisees are wary of investing in systems that require greater up-front investments in these system-specific assets (Dnes, 1992). We measure *franchise fee* as the log-transformed dollar amount of the up-front fee that franchisees pay for signs, trademarked equipment, and the other assets of the franchise system (Lafontaine, 1992).

(3) *Royalty rate*
Efficient contracting theories propose that the greater the royalty rate paid to the franchisor, the greater the use of outlet ownership, because franchisees keep profits net of royalties paid to franchisors, making the value of the residual claimancy an inverse function of the royalty rate (Scott, 1995).[3] We measure the *royalty rate* as the percentage of sales that franchisees pay to franchisors (Lafontaine, 1992). When franchisors reported flat figures, we divided them by the industry-average sales level.

(4) *Contract term*
Efficient contracting theories propose a positive association between the contract term and the proportion of outlets franchised, because longer-term contracts minimize the ability of the franchisor to opportunistically fail to renew the contract during the useful life of system assets, thus encouraging potential franchisees to invest (Shane, 2001). We measured *contract term* as the length of the contract in years (Lafontaine, 1992).

(5) *Training*
Efficient contracting theories propose that the more training a franchisor requires, the greater the proportion of company-owned outlets, because franchisors can take advantage of franchisees by threatening to terminate them after they have invested in training (Brickley and Dark, 1987). We measure *training* as the total number of hours of training the franchisor requires franchisees to obtain from the franchisor (Shane, 2001).

(6) *Geographic dispersion*
Efficient contracting theories hold that franchised systems that are more geographically dispersed are likely to have a greater proportion of franchised outlets, because outlet monitoring costs increase with distance from headquarters (Brickley *et al.*, 1991; Combs and Ketchen, 2003). We measure *geographic dispersion* as the count of U.S. states and Canadian provinces in which a franchise system has outlets.

Other control variables

We include the natural log of the total number of franchised and company outlets in the prior year to ensure that our measures of the effect of experience are net of the size of the chain. We also include a variable that measures the number of years since firm founding. By including

[1] We use the natural log transformation for total investment, franchise fee, firm age, and total company owned and franchised outlets in the previous year because these data are skewed.

[2] For this and all other efficient contracting variables, when a range was provided, we took the arithmetic mean. All independent variables in the analysis are lagged one year.

[3] Researchers from other perspectives have made different arguments and a meta-analysis found little support for this relationship (Combs and Ketchen, 2003).

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this control variable, the estimations we provide demonstrate the effects of the length of franchising experience after removing the linear effects of experience of running company-owned outlets. We also control for potential *bandwagon effects* with a measure of the population average of the proportion of outlets franchised at time $t-1$, and *industry trade association* effects with a variable assigned a value of 1 when a franchisor is a member of the International Franchise Association and a value of 0 when the franchisor is not.

Statistical methods

Firm effects

To test our hypotheses, we use fixed effects regression, which controls for individual characteristics associated with each franchise system by calculating the effect of the *annual change* from the mean of the independent variables on the *annual change* from the mean of the proportion of outlets franchised. Fixed effects regression controls for unobservable firm dimensions, such as system quality or management-team expertise, that influence organizational governance form (Kogut and Zander, 1992). Failure to control for such effects can bias regression estimates (Heckman, 1981).

Selection correction

Because the proportion of outlets franchised may influence the survival of franchise systems (Shane, 2001), we include a selection correction control in our empirical analysis to mitigate biases that may result if unobserved factors influence both the choice of governance mechanism and the termination of franchise operations (Greene, 2000).[4]

[4] To control for selection effects, we use Lee's (1983) generalization of the Heckman selection model. In this correction, probabilities for franchise system termination are used in a Cox regression model to generate a sample correction variable *lambda* (Lee, 1983). The selection correction lambda is then included as a control in models predicting the proportion franchised. We model the hazard of termination as a function of the average franchisee cash investment, state requirements for registration, ownership restrictions for the franchisee (passive or full-time manager), numbers of employees at the corporate headquarters, the size of outlets, and the complexity of the franchise system.

RESULTS

Table 1 provides the descriptive statistics and the correlations of the variables. Although some of the variables in the model are highly correlated, the variance inflation factor for the full model is 1.77, well below the commonly used threshold of 10.0 (Chatterjee and Price, 1991).

Table 2 provides results of seven regression models that predict the proportion of outlets franchised. In each column the standard errors are reported in parentheses below the coefficient. Models 1 and 2 follow analytical schemes typically used in previous research and estimate the dependent variable with cross-sectional ordinary least squares (OLS) tests. Model 1 pools all observations in the datasets, whereas Model 2 uses the restricted sample of franchise systems in operation in 1991. As found in previous research, all six variables testing the efficient contracting theories are significant in the predicted direction.

Model 3 introduces variables that capture the momentum arguments in a fixed effects model. In this model, except for total investment, none of the efficient contracting variables was significant, whereas the momentum variables were significant in the predicted directions. Consistent with Hypothesis 1, firms with more franchising experience have a greater proportion of franchised outlets. Consistent with Hypothesis 2, firms with greater recent use of franchising have a greater proportion of franchised outlets, whereas those with greater recent use of company-owned outlets have a lesser proportion.

The disappearance of the effects of the efficient contracting variables in the fixed effects regressions shown in Model 3 suggests that the cross-sectional regressions shown in Models 1 and 2 suffer from omitted-variable bias. The absence of controls for firm effects leads the efficient contracting variables to proxy some of the effects of firm differences, thereby overstating their effects. Consistent with this argument, in Model 3 we observe that the estimates of σ_u—the firm-specific variance component—is $r = 0.23$, which is significant at the $p < 0.001$ level. In addition, a χ^2 test for $\sigma_u = 0$ was rejected, indicating that unobserved firm characteristics influence their organizational governance forms. Similarly, the selection correction *lambda* is significant in Model 3 ($p < 0.05$), suggesting that the results shown in Models 1 and 2 are likely affected by selection bias.

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Table 1. Descriptive statistics and correlations

		Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1	Proportion of franchised outlets	0.82	0.25	1															
2	Length of franchising experience^{L}	2.41	0.68	0.23	1														
3	Recent franchising experience	17.33	169.21	0.04	0.05	1													
4	Recent company-owned outlet experience	0.72	51.88	−0.06	0.03	0.12	1												
5	Training	77.95	119.13	−0.11	0.11	0.05	0.05	1											
6	Total investment^{L}	4.59	1.26	−0.17	0.17	0.00	0.03	0.26	1										
7	Franchise fee^{L}	2.85	0.77	−0.05	0.00	0.02	0.01	0.15	0.49	1									
8	Royalty rate^{L}	1.73	0.56	−0.01	0.00	0.03	0.01	0.02	−0.04	0.13	1								
9	Contract term	11.63	9.64	0.01	0.16	0.04	0.01	0.10	0.16	0.05	−0.03	1							
10	Geographic dispersion	16.92	15.87	0.28	0.43	0.15	0.04	0.01	0.03	0.02	0.01	0.08	1						
11	Number of franchised outlets^{L}	3.68	1.79	0.46	0.63	0.15	0.02	0.07	0.09	0.03	0.02	0.11	0.76	1					
12	Number of corporate-owned outlets^{L}	1.48	1.53	−0.45	0.24	0.12	−0.03	0.22	0.37	0.15	0.03	0.09	0.21	0.26	1				
13	Organizational age^{L}	2.83	0.65	−0.01	0.73	0.05	−0.01	0.11	0.20	0.03	−0.02	0.12	0.31	0.43	0.33	1			
14	Bandwagon effects	0.78	0.01	0.02	0.01	0.02	0.00	−0.23	0.02	0.01	−0.01	−0.06	0.01	0.02	0.01	0.02	1		
15	Industry trade association	0.41	0.49	0.09	0.21	0.09	−0.01	0.05	0.15	0.14	0.06	0.05	0.42	0.40	0.20	0.22	0.00	1	
16	Lambda	0.85	0.59	−0.17	−0.32	−0.11	−0.03	−0.14	−0.45	−0.32	−0.04	−0.11	−0.57	−0.58	−0.27	−0.27	−0.01	−0.42	1

Note 1: N = 4130 Note 2: L indicates that the natural log was used in the analysis. Note 3: All coefficients greater than 0.11 in magnitude are significant at the 5 percent level

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Table 2. Results of regression analyses

	1: OLS (pooled)	2: OLS (Exist 1991)	3: Fixed effect	4: Random effect	5: GEE (AR1)	6: GLS (PSAR1)	7: GLS (AR1)
Training	−1.41E-04***	−1.36E-04***	3.66E-06	−4.87E-06	−8.54E-06	−1.86E-05	−8.82E-06
	(3.47E-05)	(3.49E-05)	(1.58E-05)	(1.62E-05)	(1.45E-05)	(1.28E-05)	(1.75E-05)
Total investment[L]	−0.04***	−0.04***	−0.01*	−0.02***	−0.02***	−4.56E-03**	−0.02***
	(3.16E-03)	(3.82E-03)	(4.29E-03)	(3.19E-03)	(3.40E-03)	(1.50E-03)	(3.23E-03)
Franchise fee[L]	0.01*	0.03***	−3.17E-03	3.71E-03	0.01*	0.01***	0.01*
	(0.01)	(0.01)	(4.99E-03)	(4.28E-03)	(4.63E-03)	(2.48E-03)	(4.39E-03)
Royalty rate[L]	−0.02**	−0.02*	9.93E-04	−3.48E-03	−2.16E-03	−3.03E-03	−2.22E-03
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(3.00E-03)	(0.01)
Contract term	9.90E-04**	1.16E-03**	−2.01E-04	−1.21E-04	−2.03E-04	−9.39E-05	−2.02E-04
	(3.91E-04)	(4.50E-04)	(2.21E-04)	(2.20E-04)	(1.46E-04)	(1.62E-04)	(2.22E-04)
Geographic dispersion	0.01***	3.68E-03***	1.52E-04	−5.45E-04	−7.18E-05	0.09***	−1.11E-04
	(2.21E-04)	(2.47E-04)	(3.32E-04)	(2.86E-04)	(4.02E-04)	(1.46E-03)	(2.85E-04)
Number of franchised outlets[L]			0.02***	0.07***	0.06***	−0.09***	0.06***
			(4.24E-03)	(3.06E-03)	(0.01)	(1.13E-03)	(3.09E-03)
Number of corporate-owned outlets[L]			−0.02***	−0.06***	−0.07***	−0.07***	−0.07***
			(3.41E-03)	(2.48E-03)	(4.09E-03)	(3.37E-03)	(2.46E-03)
Organizational age[L]			0.02	−0.06***	−0.07***	−1.46E-03***	−0.07***
			(0.01)	(0.01)	(0.01)	(1.43E-04)	(0.01)
Bandwagon effects			0.15	0.11	0.33	0.20	0.33
			(0.19)	(0.19)	(0.21)	(0.13)	(0.21)
Industry trade association			−6.48E-04	−0.01	−0.01	−4.04E-03	−0.01
			(0.01)	(0.01)	(0.01)	(2.96E-03)	(0.01)
Lambda			−0.02*	−0.02**	−0.02**	1.92E-03	−0.02***
			(0.01)	(0.01)	(0.01)	(3.85E-03)	(0.01)
Length of franchising experience[L]			0.04***	0.06***	0.07***	0.03***	0.07***
			(0.01)	(0.01)	(0.01)	(3.70E-03)	(0.01)
Recent franchising experience			4.65E-05***	6.22E-05***	5.58E-05*	4.87E-05***	5.60E-05***
			(9.80E-06)	(1.01E-05)	(2.62E-05)	(7.34E-06)	(9.49E-06)
Recent company-owned outlet experience			−3.41E-04***	−4.05E-04***	−3.76E-04***	−3.12E-04***	−3.77E-04***
			(3.15E-05)	(3.24E-05)	(8.96E-05)	(2.47E-05)	(3.22E-05)

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Table 2. (*Continued*)

	1: OLS (pooled)	2: OLS (Exist 1991)	3: Fixed effect	4: Random effect	5: GEE (AR1)	6: GLS (PSAR1)	7: GLS (AR1)
Constant	0.86***	0.86***	0.59***	0.71***	0.55***	0.59***	0.55***
	(0.02)	(0.02)	(0.15)	(0.15)	(0.16)	(0.10)	(0.17)
sigma_u			0.23	0.15			
sigma_e			0.08	0.08			
Rho			0.88	0.76			
R-square within			0.09	0.07			
R-square between			0.41	0.60			
R-square overall	0.12	0.13	0.39	0.57			
F	76.10***	39.71***	16.72***				
F test that all u_i = 0			8.37***				
Wald x2				1909.92***	771.41***	25973.24***	18973.48***
N of observations	6445	3127	4130	4130	3635	3635	3635
N of firms			1510	1510	1015	1015	1015

Standard errors are in parentheses. + = $p < 0.10$; * = $p < 0.05$; ** = $p < 0.01$; *** = $p < 0.001$ (two-tailed tests). L indicates that the natural log was used in the analysis. In Models 1 and 2, year-dummy variables are not reported to conserve space. Model 1 and 2 treat the data as a series of cross-sectional data and analyze them by year.

As robustness checks, we estimated the full model with random-effects and generalized estimating equations with autocorrelation-one structures in Models 4 and 5. These two models replicate findings in Model 3. In addition, in Models 6 and 7 we show generalized least squares models controlling for two types of autocorrelation, panel-specific autocorrelation-one structures and general autocorrelation-one structures, which reproduced our findings.

DISCUSSION

We argued that static explanations of organizational form are unlikely to fully account for why firms use particular types of governance structures, because organizational structure is path dependent, with early experiences and actions sending organizations down a path that is difficult to change. Our results demonstrate that this momentum perspective is a robust and important explanation of organizational governance form, whereas typical measures of efficient contracting are not, after we control for momentum, firm, and selection effects.

This article builds on extant theory in two ways. First, our results contribute to research on franchising by demonstrating the importance of momentum in explaining why firms are more or less likely to franchise. As a result, it offers the kind of 'fresh theoretical perspectives' (Combs and Ketchen, 2003: 462) called for by some authors to complement the efficient contracting arguments that dominate the discussion (Combs, Ketchen, and Hoover, 2004).

Second, our results suggest that firm-specific characteristics account for much of the variance in organizational governance form, whereas commonly used measures of efficient contracting are not significant. Because the failure to measure unobserved firm attributes often results in an overstatement of measured effects (Heckman, 1981), we believe that the literature has overemphasized the importance of efficient contracting in explaining organizational governance form, at the expense of organizational expertise, resources, strategies, and evolutionary processes. These findings challenge the optimal-design assumptions of efficient contracting theories (Lafontaine, 1992), and suggest that research on governance forms account for dynamic evolutionary processes.

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This article has several implications for managers. First, history matters! Organizational strategies, once institutionalized, become very sticky. Managers are inclined to confront new situations using those strategies and tools that they are most comfortable with. This suggests that managers need to consider their options very carefully before initiating strategic actions. Second, managers should take into consideration the consequences of building different types of organizational capabilities, because the capabilities that a firm selects affect its organizational structure, which, over the long term, shapes firm strategy and performance (Sine, Mitsuhashi, and Kirsch, 2006). Third, managers need to be cautious when drawing normative conclusions from academic studies. Our findings show that the efficient contracting explanations for the structure of franchised systems do not hold in analyses that control for unobserved heterogeneity and historical processes. More research is definitely needed before managers can trust, without any doubt, the normative conclusions that have been drawn from those studies.

Limitations

Our study is limited in several ways. First, our analysis indicates that much variance in organizational governance forms still remains unexplained. Future research might follow the recommendations of Combs and Ketchen (2003) to explore other theoretical frameworks to account for the choice of governance form. Second, we argued that two mechanisms—managerial decision making and learning processes—account for organizational momentum. Unfortunately, we lack the data necessary to examine the specific mechanisms that underlie this effect. Therefore, we can conclude that momentum plays a key role in decisions about a firm's organizational governance form, but can only speculate about the mechanisms behind momentum effects. Finally, while we show the effect of momentum on governance form in the context of franchise systems, future research would need to show similar effects in other settings in which efficient contracting researchers have amassed a substantial body of empirical evidence, such as make-or-buy decisions (Masten, Meehan, and Snyder, 1989), in order to demonstrate that these results are generalizable.

CONCLUSION

In this article we examine firms' choice of organizational governance form. We argue that past research that uses cross-sectional analysis to show that efficient contracting explains the choice of organizational governance form is not robust to the year of investigation, firm effects, or selection effects. We propose, instead, that organizational governance form is shaped by dynamic historical processes such as organizational momentum. We find that organizational momentum is a robust predictor of organizational governance form, suggesting the evolutionary character of organizational structures and strategies.

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