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### Research Announcement

#### Franchisee's marketing activity and two royalty structures: margin-based royalty versus sales-based royalty

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#### Abstract

This paper studies the two royalty structures: Sales-based Royalty (=SBR) and Margin-based Royalty (=MBR). From the standpoint of a franchisor, if it is necessary for a franchisee to engage in a marketing activity, the SBR grants a more high-powered incentive scheme to the franchisee than the MBR does. On the other hand, the latter plays a role in alleviating the double marginalization problem. This paper analyzes how the optimal royalty structures will change according to market size. It is shown that when the market size is large, the franchisor should choose the SBR structure in order to provide its franchisee the high-powered incentive scheme. Consequently, if the market size is small, the franchisor should implement the MBR structure to alleviate the double marginalization problem. This study also shows that the franchisee's marketing activity level under the SBR is always larger than that under the MBR, regardless of the market size.

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