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Deposited in *Repositório ISCTE-IUL*:

2023-03-03

Deposited version:

Accepted Version

Peer-review status of attached file:

Peer-reviewed

Citation for published item:

Pedro, M. I., Filipe, J. A. & Coelho, M. F. (2008). Franchising: A study about the intention of the Iberian companies to internationalize. In 2008 4th IEEE International Conference on Management of Innovation and Technology. (pp. 734-739). Bangkok: IEEE.

Further information on publisher's website:

10.1109/ICMIT.2008.4654456

Publisher's copyright statement:

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# Franchising –A study about the intention of the Iberian Companies to Internationalize

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**Abstract** - A study has been made for the internationalization of the franchising Iberian companies. Our aim was to analyze the most important variables for the internationalization. We studied it using several statistical methods applied to the answers given by companies to a questionnaire. We have concluded that are some relevant variables to be considered in the internationalization such as age, dimension, bond, dispersion, structure of the network and some variable connected with environment and motivational factors.

**Keywords** - Franchising, Internationalization, Organizational theory, Entrepreneurship

## I. INTRODUCTION

Franchising is a concept which importance has grown in the economic level and as an investigation subject. However the existing theoretical references in literature are incomplete when it tries to extend the analysis to the process of internationalization of the franchising companies which currently represent a much publicized form of entrance in external markets.

Another aspect to have in consideration when we analyse the literature is connected with the multidisciplinary nature of franchising. The theoretical contributions are dispersed among such different areas such as economy, marketing, sociology, psychology or law. In each one of these areas, the existing models befall mainly in specific aspects and show how these aspects contribute to the franchising as a form of business (Business Format Franchising).

The term franchising reflects a great variety of relationships in businesses and it is often wrongly used as an alternative to the word licensing. However, the main distinction of a business under the form of franchising comparing to one under licensing is that the first of them has a network structure that requires a bigger relationship between the implicated parts.

As business format, franchising has become to be used more and more as an alternative method of distribution and expansion of business, since years 40.

It is possible to identify three stages in the development of franchising. We can consider the first one beginning in middle of the 19<sup>th</sup> century in U.S.A. when the Singer Sewing Machine Company introduced a combination licensing/franchising. The second one can be consider in the years of 1920 to 1930 when was been

developed relations of licensing/franchising for the fuel companies and some wholesale and retail companies. The third generation of franchising is called of “Business Format Franchising” and it was initiated in U.S.A. in 1940/50 years. According [23] this format of business was stabilized in 140 countries, however it was in different levels of development depended of the economic resources and the cultural and legislative environment.

About international empirical analysis, despite franchising as business form (Business Format Franchising) to have become in a mature concept in U.S.A. and to have established in varied other countries, it becomes difficult to measure with precision its effect in one specific country or to make comparisons between countries from the available data. It is understood that there are several inaccuracy and imprecision, due to the difficulties in defining exactly the concept of franchising and there are also limitations in the methods of collect data [13], [27].

Briefly we can say that the franchising literature is subdivided in three main boarding and each one contributes for a conceptual vision of franchising:

1. Franchising as a functional alteration of the activities connected with an already existing business and that it can be studied through the application of models and theories to those functions.

2. Franchising as a unique phenomenon but where its peculiarities can be explained through the already existing theoretical models.

3. Franchising, as a unique phenomenon, that only can be completely understood through the development or the adjustment of models and theories that are applied specifically to its practice.

The first boarding enhances the marketing function, what means that franchising is seen as a specific process for retail or wholesale and it is described as one of the many types of activity of marketing [9]. In this boarding franchising is seen as a form to communicate to the customers a trademark that is already known and ignoring the factors that can affect the standardization process.

In the second boarding franchising is appreciated in accordance with the different theories of the company. Example of that is the theory of the agency [24], theory of the resource [5], theory of the life cycle [32] and many theories of behaviour entrepreneurial [17]. These models have an enormous explicatory capacity and its value is great because we are talking about models already tested.

However, they are all partial models; each one approaches franchising under its optics.

In the third boarding we can mention, for example, [14] who identify six dominant subjects: delivery channels, contractual characteristics, international expansion, growth of the network, benefits of the internationalization and ratios of survival/failure. From these dominant subjects he schematizes a classification of influences in franchising identifying variables in accordance with communitarian, organizational and individual factors.

Traditionally, the studies about franchising investigated characteristics such as: the ownership and relationship [15], [8], efficiency [25], [19], control [4] coordination [20], and failures of the franchise systems [31], all in a perspective of domestic market.

Regarding research, franchising in the global market has had a less important attention. However there are some published studies about internationalization of franchising like [33], [3] that had examined the diffusion of the system of franchise from the USA. [16] [18] mention that the systems of franchising have differences between the way to act in the domestic market and internationally. The critical factors of the internationalization of the systems of franchise are enhanced by [10], [22], [30], [12]. [26], [27] talk about problems of control in franchising international. [2] suggests a model that identifies explicatory variables of the internationalization of the USA companies of franchising. [7] develops a general model whose pretend to clarify the internationalization of the companies where franchising can be enclosed.

Most of these models does not have in consideration the set of the internal factors to the company (organizational factors), the external factors to the company (factors of the environment way) and the motivation factors (factors connected with the perspectives and the objectives' manager) to explain the internationalization of the franchising companies.

In this boarding the international business format franchising is considered as an organizational structure in network that admits multiples ways of entrance(like: own subsidiary, joint ventures with a partner of the destination market or master franchising) in the international markets through different contractual relations that influence the level of control of the franchisees units.

[2] refers that a great part of the franchisors with wide international experience, recognized trademarks, sophisticated know-how and with a highly standardized format use normally own subsidiary without franchisees units for its entrance in the foreign countries. On the other hand the small franchisors, with unknown trademarks, with little experience in international markets and with know-how that can easily be transferred they delegate its entrance to a master local who is more familiar to the destination market and it allow to reduce the risk of the internationalization process.

[28] suggests that national and international entity and not profitable organizations of franchisors have

recently played an important role in the internationalization of smaller dimension franchising companies. And, he still add that the internationalization of these companies is more reactive, what means that they are more receptive to the reactions coming from the outside. According to the International Association of Franchising - IAF some recent companies of franchising with a small number of units and with 5 years or less had already initiated the internationalization process or intend to make it in a near future. [1] concluded that in the services segment the age was negatively connected with the decision of franchising companies to internationalize and suggests that the youngest companies are eager for exploring the international markets due to the saturation of the domestic markets.

Based on the internal, external and behavioural factors, we aim to identify the determinative variables in the internationalization of the Iberian franchising companies and to develop an explicatory model, presented in Fig. 1. This model partially adopts the model proposed by [7]. That is, we widen the model of [7] to incorporate other theoretical variables connected with the agency theory and resources theory. According Daniel's model the principal objectives of companies' internationalization was to expand sales, to get resources and to reduce the risk. In our proposal model, first of all the companies must define that the internationalization is one of the objectives of its strategy of expansion and after we have analysed in what form some organizational, environmental and motivational factors are correlated with the intention of the franchisor's companies to internationalize.

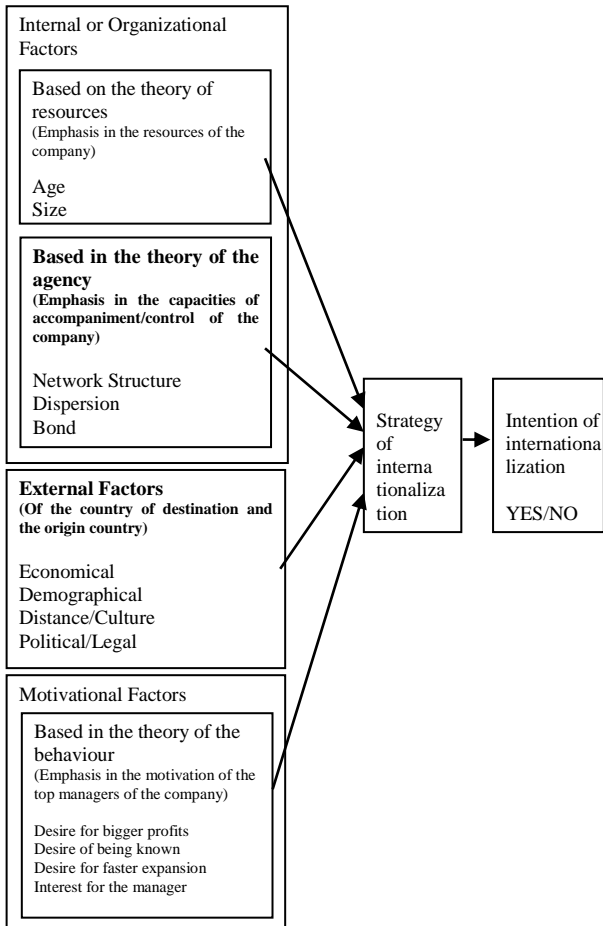


Fig. 1. Model of the Intention in the Internationalization of Franchising Systems

## II. INTERNAL OR ORGANIZATIONAL FACTORS INDUCTIVE OF THE INTERNATIONALIZATION: hypothesis of research

In the study we pose some research hypothesis that will be tested after the statistical study that resulted from the analysis of the questionnaires, which were sent to all Iberian companies of franchising.

We consider the following internal factors of internationalization: the company's age, the size (number of units), the network structure, the dispersion and the bond.

### AGE

In accordance with the theory of resources, the companies choose franchising to increase their scarce or insufficient resources. Although the majority of the inquiries give emphasis to the attainment of capital/financing, the companies are also capable to get labour, managerial talent, intellectual capital, local knowledge and capacity of long-distance management through the use of franchising [29].

It's a difficult task to measure the resources of a company since it involves many variables, both quantitative and qualitative. So, in order to skirt this difficulty we assume

that the company gets some of the resources from the experience that it manages to store throughout its existence [21].

**Hypothesis 1:** "Exists a positive relationship between the number of years that a company is in the market and its intention to internationalize, since it will have acquired bigger resources (particularly: financial, monitoring, control, or management resources, especially of long-distance)."

### SIZE

Another way for a franchising company to obtain resources it needs (capacity to follow, to control and to standardize the procedures) is to have some units that function in accordance with the specifications of the franchisor. For such, the franchisor company will have to possess the means and resources such as personal with proper formation, monetary means, local knowledge and legislative knowledge. These resources are obtained by the franchisor through the results and the exchange of information that it obtains from the franchisees or own units. Therefore it is assumed that:

**Hypothesis 2:** "A positive relationship exists between the number of units owned by the franchisor and the intention of internationalizing."

### NETWORK STRUCTURE

To internationalize, a franchising must have uniformity in its network and, for this, it should develop specific and clear norms that franchisees should fulfil as well as define objectives that they should reach. It's also necessary that the company knows how to innovate inside this uniformity as well as adapt itself to the requirements of the market. When the franchisor owns a wide-ranging network in the origin country (constituted of own units and franchised units) it may have additional advantages when it initiates the internationalization process because the own units allow to test the necessary innovations and adaptations for the continuity of the network before spreading them out next to the franchised ones. This way, it's assumed that:

**Hypothesis 3:** "A positive relationship exists between the fact that the franchising company possesses own units and franchised units in the origin country and the intention of internationalizing."

### DISPERSION

If the company has in the domestic market a geographically dispersed network it will be able to organize the company in order to obtain economies of scale, correct information asymmetries, gain advantages with standardization, reach effective control of all the units, and to get advantages on marketing and personalized service. This means that the entrance in the international market functions as a maintenance of what it already has in the domestic market. So, it is assumed therefore that:

**Hypothesis 4:** "A positive relationship exists between the degree of geographic dispersion of a franchising network in the domestic market and the intention of that company to proceed to internationalization."

## BOND

We will analyze in this study the bond just as a financial co-participation. The bond is, in this perspective, a way to attenuate the moral risk and opportunism of the franchisee in the existing relationship between the franchisor and the franchisee. Besides, another way of reduce this risk is through the assignment of a contract where are the rights and penalizations about the use of a trademark/image or know-how. This second way is not studied in this work.

In many cases there is in fact a financial contribution (entrance fee) that is charged to the franchisee, as well as upcoming financial contributions during the lifetime of the contract (royalties), beyond the contract. These contributions vary from a franchising to another, or even inside the same franchising, in function of the ratings given to the risk factor associated with the market of the destination country, the risk associated with the franchisee (opportunism and moral risk), the distance, the customs or cambial costs and the monitoring costs.

When the franchisor intends to go to markets that involve greater risk, or forecast the occurrence of opportunism or moral risk by the franchisees, or where the monitoring costs are higher, it can estimate an increased initial payment and/or royalties, as well as placing diverse contractual penalizations in case of violations to what was initially settled down. It's assumed that:

**Hypothesis 5:** "The higher the risk and costs associated with the destination country, higher will be the royalties, entrance-fees and costs of entrance. Consequently, the intention on the internationalization will be influenced."

Regardless of these payments the bond variable can become difficult to compare since the ways of internationalization of the franchising vary from country to country.

### III. EXTERNAL FACTORS OF INTERNATIONALIZATION: Hypothesis of Research

Differences between markets at the level of values, preferences and methods of work can create uncertainty and affect the transactions between franchisors-franchisees and the process of internationalization of franchising. The franchising that operates globally has to understand the differences of cultures with the purpose of specifying products, services, standards and adequate methods of work.

The physical/geographical distance in relation to the franchisor normally increases the control/monitoring costs. The costs of separation in space and time are high in the global market and despite the recent improvements in the transports and information technologies it continues to be a challenge to follow and control the performance of the diverse units, which many times is only possible with frequent direct visits. In the international market the costs of communication, coordination and supervision are normally high when the units are dispersed in several countries with different cultures. The monitoring is easier

when the units are concentrated in fewer places, with similar cultures. So, we have assumed that:

**Hypothesis 6:** "The intention of internationalization is inversely related with the cultural difference and distance of the destination country."

### IV. MOTIVATIONAL FACTORS INDUCTIVE OF INTERNATIONALIZATION: Hypothesis of Research

Some authors as [18], [10], [6], point out the motivation of managers as an important variable in the process of internationalization through the franchising. The objectives of the managers of any company are established through its motivations. In the short term, the motivations of the managers influence their evaluation on availability and desires at the level of opportunities of markets. In our model, we assume that:

**Hypothesis 7:** "A positive relationship exists between factors of motivation related with the manager of the company (particularly, the desire of attainment of bigger profits, of being known, of expansion and the interests of the manager) and the intention to internationalize."

### V. STATISTICAL TREATMENT OF THE DETERMINATIVE VARIABLES OF THE INTERNATIONALIZATION OF THE IBERIAN FRANCHISING COMPANIES

After formulating the hypothesis and identified the determinative variables for the international expansion of franchising companies, we proceed to the empirical analysis of data relatively to the franchising companies of Iberian origin. For the gathering of information, we have elaborated a questionnaire with closed questions, which was sent by mail, e-mail and fax to all franchising companies of Iberian origin listed in the *Guia Ibérico de Franchising de 2001* (2001 Iberian Guide of Franchising), which reach 866 companies of Spanish origin and 98 Portuguese companies. In 2002<sup>1</sup>, there were just 661 Spanish companies and 89 Portuguese in the active and we got complete answers to the questionnaire from 10% Spanish and 21% Portuguese companies. After analyzing the characteristics of the companies who had fully answered the questionnaire it was considered that the sample was representative.

To analyze the hypothesis were used several statistical methods: analysis of variance - ANOVA, the qui-square test, test of equality of means and the principal components analysis. For the statistics analysis the software SPSS-X was used.

### VI. CONCLUSIONS

The developed model is supported in eight hypothesis of research that intends to identify the main factors that the Iberian franchising companies consider

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<sup>1</sup> The study occurred between 2001 and 2002.

more important when they proceed to the internationalization. So the particular conclusions are as follows to each one of the hypothesis.

**H1: The age of the network and the intention to internationalize**

The results indicate that the youngest companies (1 year and less) are those where the intention of internationalization is more reiterated (the statistical result obtained in relation to this variable confirms the opposing hypothesis to the one initially posed). This situation could carry some dangers since the company could be internationalized itself with scarce resources in terms of financial capacity, ways of distribution or human resources, its product/service could not be tested enough and the franchisor could be focusing in fast profit and not in the franchisee.

**H2: The dimension of the network and the intention to internationalize**

The results show that the companies with a number of units between 21 and 59 are those that show more predispositions to advance with the internationalization. The explanation is that networks up to 21 units haven't reach resources that allow them to engage in an international network, while the networks with more than 60 units already obtained a comfortable number of units in domestic market. So they don't consider acceptable the inherent costs and risks of internationalization.

**H3: The structure of the network and the intention to internationalize**

It was verified that the companies with mixed structure have bigger certainty of franchising as desirable activity.

**H4: The dispersion of the network and the intention to internationalize**

The companies considered in the group<sup>2</sup> of "dispersion" and "high dispersion" are the ones that affirm to exist adequacy between the profit expectation and the real profit in the international franchising, as well as that international franchising isn't too complicated to worth the effort. This means that the franchisor companies can obtain economies of scale to reach ways of profiting and make sure that physical distance isn't inhibiting of processes of monitoring/control, before advancing to the international market.

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<sup>2</sup> Dispersion variable was obtained through the ratio between the number of provinces where each company has units and the total of existing provinces in the two countries. It varies between 0 and 1. It was not taken in consideration neither the dimension of the province nor the population density of each province. There are 19 Spanish provinces and 13 Portuguese provinces. The four steps that group the companies' dispersion had been obtained through the values of the dispersion variable quartiles. They were classified as: High concentration (values between 0 and 0,16); Concentration (values between 0,17 and 0,37); Dispersion (values between 0,37 and 0,63); High dispersion (bigger values than 0,63).

**H5: The bond of the network and the intention to internationalize**

The statistical results showed that:

The Iberian franchising companies that consider the risks and costs of internationalization higher, place higher entrance fees.

The Iberian franchising companies that consider the risks and costs of internationalization the same keep the entrance fees and royalties equivalent to those in the domestic market.

**H6: Factors related with the country of destination and the intention to internationalize**

We have concluded that if a company is planning to go abroad with the franchising, with a product or service that can be internationally franchised, and if it is considered that international franchising can contribute to the growth and profits of the company, it won't give importance to the cultural proximity of the destination country, the linguistic proximity nor to the fact that the country of destination has or has not high incomes per capita. However, if the company considers that the fact of initiating an international franchising involves high starting costs, then it will give importance to the physical proximity of the destination country, the political and economical stability, the advantages of the fiscal policy of the destination country, to the fact that there's a potential market for its product or service, and to the fact of having interested franchisees.

**H8: Factors of motivation and the intention to internationalize**

Relatively to the motivational factors it was only evidenced that the inquired companies that plan to expand international franchising do it because they intend to gain advantage in markets of big potential. Furthermore, if international franchising seems to be a desirable activity for the franchisor company as well as for its growth, the objective will not be sales increasing.

**VI. RECOMMENDING NOTES**

According to the conclusions, the Iberian franchisors that are interested in international expansion must have a financial and human resources structure that allows them to follow and control the international network. They should also own a sufficient number of units under the regimen of franchising, and have a high dispersion of the network in the internal market, so they can test the functioning of the network before starting the internationalization. Furthermore, it's important to define the profile of the international franchisees, as well as the capacity to control the meeting of the rules imposed by the franchising system (through the contract, the payment of the entrance fee or the royalties). It's verified that, preferentially, the franchisees should have a mixed structure.

The franchisors should know the legislation of the destination country, related with the business as with the regimen of franchising itself; they ought to understand in which ways the business corresponds to the expectations of the consumers of the destination country or in which

ways it can shape itself; they should analyze and evaluate on the economical and political stability and should analyse and evaluate the costs relative to internationalization.

In relation to the motivation, it should be known the real motives behind the internationalization of the business and analyze if effectively it's an internationalizable business and should evaluate its potential of success in the country of destination.

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