GLOBAL FRANCHISING IN EMERGING AND TRANSITIONING ECONOMIES

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INTRODUCTION

Franchising has experienced phenomenal growth both in the US and abroad in recent years. Figures vary, but it is estimated that U.S. franchising generates $800 billion worth of business in gross sales and represents 40 percent of the retail trade (Swartz, 2001). While in the US, Canada and parts of Western Europe franchising has reached domestic market saturation, emerging markets remain relatively untapped. Emerging markets, accounting for 80% of the world's population and 60% of the world's natural resources, present the most dynamic potential for long-term growth to businesses, in general, and to franchisors, in specific. The U.S. Department of Commerce estimated that over 75% of the expected growth in world trade over the next two decades will come from emerging countries, particularly Big Emerging Countries, which account for over half the world's population but only 25% of its GDP.

Emerging markets are among the fastest growing markets for international franchisors. Several surveys conducted by Arthur Andersen showed that more and more franchisors are seeking opportunities in emerging markets. A recent article in *Franchising World* (Amies, 1999) stated: "Franchises are springing up in the most unlikely, and for many of us unheard-of, places...Those franchisors who can establish a beach-head on these wilder shores could do very well, but the risks are great." This article is a step in the direction of educating its target markets about international franchising opportunities and threats in emerging economies.

WHAT IS AN EMERGING MARKET?

While there is no consensus definition of the term "emerging market," Czinkota & Ronkainen (1997) identified three characteristics associated with an emerging economy:

- Level of Economic Development
- Economic Growth
- Market Governance

Level of Economic Development

The level of economic development is typically measured in terms of GDP per capita. GDP per capita is a useful measure of economic development because it is related to the

population's wealth, extent of middle class, and level of industrial and service sector development (Alon & McKee, 1999).

Level of Economic Development

The usage of the level of economic development as a demarcation criteria for distinguishing emerging markets equates with the anachronisms of the World Bank and the United Nations, which include terms such as Less Developed Countries (LDCs), Third World Countries, and Developing Countries. The World Bank divides countries on the basis of GDP per capita into four classes. Three of the Big Emerging Countries (India, China and Vietnam) fall into the lowest income class. According to the United Nations only about 15% of the world's population reside in developed market economy countries (Czinkota & Ronkainen, 1997).

When dealing with emerging markets it is important to adjust GDP per capita to purchasing power parity in order to gauge income in relation to the "real" cost of living (Arnold & Quelch, 1998).

Economic Growth

Economic growth is usually measured in terms of the country's GDP growth rate. The usage of economic growth is consistent with the concept of "emerging." Most of the countries referred to as emerging markets have enjoyed GDP growth rates exceeding 5 percent from 1990 to 1997, with some markets, particularly in East Asia, displaying double-digit growth rates (Czinkota & Ronkainen, 1997). In 1997, 1998, and 1999, East Asia, Brazil and Russia encountered financial crises that set back their economies growth. Such crises demonstrate that the often-touted high growth rates of emerging markets may not be sustainable over a long period of time.

The level of economic growth is among the most important consideration for international franchising expansion (Alon & McKee, 1999). When examining an emerging market's GDP growth, one must contrast it to the growth in the population. If population growth rates exceed GDP growth rates than the standard of living in those countries will actually drop over time. One useful measure that captures both growth rates is GDP per capita growth rate.

Market Governance

The third criteria for judging emerging markets is the country's market governance. Market governance includes the extent of free market, government control of key resources, stability of the market system and the regulatory environment. Countries that are liberalizing their economic institutions and democratizing their political structures are often referred to as Transitional Economies/Countries. These transitions have been welcomed by the western economies and regarded as opportunities for international franchising expansion.

Among the most important of the elements of transition with respect to international investors are the political and economic risks that are introduced by the reorganization of economic and political units in the emerging marketplace (Czinkota & Ronkainen, 1997). Western institutions such as the Economist Intelligence Unit, Institutional Investor, and ICRG systematically evaluate such risks.

Market governance influences a wide arrange country risk element such as government regulation and red tape, political stability, bribery, ownership restrictions, controls of capital flows, import restrictions, all of which are important to international franchisors' evaluations of foreign market potential (Alon & McKee, 1999).

CHARACTERISTICS OF EMERGING MARKETS

Among the general characteristics of emerging markets are:

- Low GNP per capita, but high potential growth
- Unequal distribution of income, but a growing middle class
- Technological and regional dualism with pockets of development along urban centers
- Agricultural (Less Developed) and industrial (Developing) economies
- High population concentrations and growth (2.4-4%)

The challenges include:

- Lack of managerial and entrepreneurial talent
- Lack of capital for international franchising expansion
- Political instability/risk, regulatory uncertainty, and corruption
- Undeveloped infrastructure

These challenges add to the cost of doing business (transaction and agency costs) and are important components of the uncontrollable environment of international franchising. Transportation and communication networks, supporting industries, and availability of supplies are often lacking in developing markets and require the franchisor to make an investment in the franchising system in order to ensure the success of its franchisees.

Misery Factors

- High unemployment and underemployment
- High misery index (inflation + unemployment rate)
- High rate of illiteracy and insufficient educational facilities
- Malnutrition, pollution and health problems
- Balance of Payment and Fiscal Deficits

Franchisors need to examine how they can contribute to the economic development and success of their partners in the overseas markets. Such examination can greatly enhance the long-term success of the franchisor, show the host market government and people concern for their interests (a great public relations tool), and lower the political risk exposure of their venture abroad. Specifically, franchisors should emphasize their employment, educational and environmental contributions; and attempt to use local sources for inputs.

Big Emerging Markets

The Big Emerging Markets (also known as BEMs) offer much future potential for international franchising growth because they constitute:

- Half the World's population
- 25 percent of GDP; by 2010 50%
- A growing share of the world's exports and imports

BEMs have become regional economic and political drivers of change in their respective areas because of their:

- Size – geographical and population
- Growth – potential for a significant market
- Transformation – privatization and economic reforms

In our two books, we covered the franchising conditions of eight out of the 10 BEMs. China, India, Mexico and Brazil were given multiple chapters due to their increasing importance in the international business arena.

EMERGING MARKETS VS. DEVELOPED MARKETS

Table 1 summarizes emerging markets (traditional) vs. developed markets (modern) dichotomies. It is dangerous to interpret the preconceived notions of national culture in international business because the cultural diversity within countries is often as great as between countries. An executive arriving in China may be surprise to find an individualistic, profit motivated, socially mobile, risk taking, cosmopolitan women as a potential business partner. In the same fashion, developed markets have pockets of traditionalism, where a foreigner may encounter people with patriarchal, family oriented, religious, and fatalistic views.

Table 1: Dichotomy Between Emerging Markets and Developed Markets

Environment	**Emerging Markets**	**Developed Markets**
Global Position	South and East	North and West
Marketing Orientation	Sales Orientation	Marketing Orientation
Marketing Dev.	Production Emphasis	Consumption Emphasis
Marketing Channels	Fragmented	Unified and Integrated
Economics	Centralized/Planned	Decentralized/Free
Competition	Low Competition	High Competition
Firms' Size	Small-scale	Large-scale
Firm Motives	Output Maximization	Profit Maximization

Culture and Society	Collectivist/Conformist	Individualistic
Elements	Traditional	Modern
Communications	Formal	Informal
Communications	Indirect Communication	Direct Communication
Co-requisites	Relationship-Based	Contract-based
Social Structures	High-Power Distance	Low-Power Distance
	People are born unequal; Hierarchical Structure	People are born equal; Status is earned
	High Uncertainty Avoidance	Low Uncertainty Avoidance
Context	High Context	Low Context
Promotion Basis	Who you know?	What you know?
Family	Extended Family	Nuclear Family
Acceptance of Others	Parochial	Universal
Time Orientation	Polychronic	Monochronic
	Elastic	Linear
Agreements	Mutual Understanding	Legal Understanding
	Written Expression Flexible	Written Expression Binding
	Disputes Settled by Negotiation	Disputes Settled Contractually
Politics	Autocratic	Egalitarian
Ideology	Nationalist/Fundamentalist	Internationalist/Pluralistic
	Promotes Internal Harmony and rewards conformity	Promotes Competitiveness and rewards success

* Based partly on Hill (2000)

We suggest that managers study not only the national differences between the home and the host country, but also the cultural diversity within the nation-state that may influence business practices in emerging markets. Countries often possess development poles and pockets of underdevelopment and embody various levels of traditional and modern elements. Hill (2000) suggested a flexible stereotype model for understanding emerging markets. He claimed that developed countries exhibit more modern behaviors, but also contain traditional behavioral clusters, while emerging economies' behaviors are mostly traditional, containing poles of modern development.

The U.S., for example, has an agricultural based economy and show high level of family orientation, localism, fatalism, resistance to innovation, sex-role-differentiation, racism, authoritarianism, distrust of outsiders, religious fundamentalism, friendly and hospitable – all traditional elements – in certain parts of the south and mid-west despite having an overall highly developed economy and a large service sector. On the other hand, traditional societies in emerging economies will possess in their polar cities modern elements of social development, highly sophisticated consumers with greater purchasing power, and individualistic and competitive behaviors that resemble Western culture.

REVIEW OF THE LITERATURE

A number of authors, both industry analysts and academics, have identified emerging markets as a topic that needs further research for the franchise industry. In 1988, Kaufmann and Leibenstein wrote an article for the United Nations when franchising in developing countries was just beginning. In 1990, Welsh conducted the first survey on Russian soil on franchising, at a time when the word franchising had no meaning to the population except when it was coupled with McDonald's. That was the same year the franchise opened in Moscow to a tremendous welcoming by the Russian people and the press (Welsh & Swerdlow, 1991). Since that time, franchising in emerging markets has grown dramatically. For example, by 1995, there were 26 more franchisors in Brazil alone than there were in all of South America in 1985 (International Franchise Research Centre, 2000).

Academics and practitioners have answered the call for more research and evaluation of franchising in these new markets around the globe. Young, McIntyre, & Green (2000) examined the content of articles that had been published in the International Society of Franchising Proceedings, the premier academic conference in the franchising field. Out of almost 70 articles between 1987 and 1999, nine dealt with economies in transition and 14 others dealt with developing economies. Practitioners have also published articles on the topic. Leonard Swartz with Arthur Anderson examined the state of franchising in Asia-China, Indonesia, Singapore, and Malaysia, Eastern Europe-Russia, Poland, Hungary, and Greece, as well as the Middle East-United Arab Emirates, Israel, Saudi Arabia, Kuwait, Egypt, and South America-Chile, Uruguay, Brazil, Argentina, Columbia, and Peru.

Practice and Theory Development

Authors have also examined why franchising has had such an impact internationally and what forms franchising has taken in different parts of the world. Kaufmann (2001) looks at the issues of cultural and legal differences in the age of the Internet and the impact of franchising on host country development. Specifically, he examines the modes of entry, cultural differences and proven concepts, cultural differences and technology, legal differences, and host country development. Stanworth, Price, and Purdy (2001) examine franchising as a means of technology-transfer for developing economies. Their article explores the background to the internationalization of franchising, favorable factors to the growth of franchising, benefits to developing economies, other consequences to developing economies, advantages and risks to franchisors, as well as government action to encourage franchising. The authors give special insight into Indonesia, China, and Brazil.

Models are beginning to be developed in international franchising. Thompson and Merrilees (2001) examine marketing through a modular approach to branding and operations for international retail franchising systems. Examples of Australian firms extending their franchise systems into Eastern Europe, Asia, and Latin America demonstrates the applicability of this approach to branding in their article. Other authors cite that new symbiotic relationships are created when franchising expands into developing countries. Franchising allows firms to achieve the expanded reach and efficiencies associated with internationalization more rapidly and effectively than the

firms could achieve on there own. Dana, Etemad, and Wright (2001) develop an Interdependence Paradigm to explain these franchise marketing networks using examples of firms in South Korea and the Philippines.

Research By Areas of the World Market

Central and Eastern Europe

Nitin Sanghavi's (2001) article, "The Use of Franchising as a Tool for SME Development in Developing Economies: A Case of Central European Economics," gives his personal perspective on the use of franchising as a economic development tool from his numerous experiences with those countries. He summarizes the current state of franchising as a tool for SME development in developing economies in general, and specifically in Central European Countries. Both the benefits and limitations are covered in this article.

Swerdlow, Roehl, and Welsh (2001), and Alon and Banai (2001) in their respective articles, "Hospitality Franchising in Russia for the 21st Century: Issues, Strategies, and Challenges," and " Franchising Opportunities and Threats in Russia," give us an historical review of franchise development in Russia as well as a current and future look at the prospects for franchise development in an area of the world that is barely realizing its full potential as a economic power. Both articles examine the post-communist economy with a focus on environmental factors associated with international franchise development and entry strategies that potential franchisors would find successful. The articles include some practical suggestions for those entering and maneuvering through this huge market.

Aneta Nedialkova (2001) specifically examines franchising opportunities in Bulgaria, with a focus on the macroeconomic factors of the Bulgarian economy associated with franchising. While international investors have been developing franchises in Bulgaria for over twenty-five years, the market has remained sluggish, given the government system and bureaucracy. However, the article describes a number of positive elements and success stories that give reasons to be optimistic concerning the future of franchise development in Bulgaria.

Ljiljana Viducic (2001) describes the two types of franchise arrangements that are prevelant in Croatia, using the examples of McDonald's and Diner's Club. Primarily, franchising has taken the form of several corporate facilities in operation, where local interaction with the store is limited to employment, not ownership, and the second form where an entrepreneur is taken on as a franchise holder with the understanding that his capital involvement will increase over time as well as his ownership interest as a full franchisee. Additionally, the article elaborates on the current state of Croatian franchise activity and other forms of market expansion that have been successful in Croatia.

Current conditions, features, and trends in Slovenian franchising is analyzed empirically in an article by Pavlin (2001). By the definition of franchising adopted by the European Franchise Federation, there are over forty operating franchise systems in Slovenia. The article includes results from a recent survey of prospective Slovenian franchisees

identifying their core attributes and offers a framework for profitable future development of the industry in Slovenia that might be useful for franchisors and franchisees.

Mexico and South America

Three articles focus on different aspects of Mexican franchising. Teegan (2001) examines foreign expansion and market entry from three different perspectives. The first perspective is that of the Mexican franchisee that might purchase the rights to a U.S. based franchise. The second perspective is that of the U.S. franchisor who might sell the rights to their business format. The third perspective is that of the host government, namely Mexico, in terms of the economic impact and development within their country. The author shares the results of a survey of over seventy Mexican franchisees of U.S. based franchise systems. Results showed that the commonly held beliefs within both the United States and Mexico concerning the desirability of franchising as a mode of market entry, and caution of the part of franchisees, franchisors, and the host governments is warranted. The article gives a realistic view of the risks and rewards of franchising and a bountiful amount of information for those contemplating franchising in Mexico.

Hadjimarcou and Barnes (2001) investigate the expansion process of a relatively new and small franchisor, Silver Streak Restaurant Corporation, into Mexico as a case study. The authors explain the cultural challenges of entering Mexico, the company's efforts to identify a suitable partner in the host country, the adaptation of the concept to address differences in the new market, and the multitude of crucial decisions that need to be made when going international. The authors discuss the recent changes in the law that favor franchising, as well as the role that strategic alliances play in the success of international franchise efforts. Implications for both research and practitioners are explicated.

Welsh (2001) updates the study that was the first to examine the effect, if any, of the North American Free Trade Agreement (NAFTA) on franchisor perceptions of characteristics associated with franchisee success and failure in Canada, Mexico, and the United States (Falbe & Welsh, 1998). The original research addressed two key issues in franchising. The first was the extent the study of franchisee success and failure by analyzing franchise executives' perceptions of the importance of a number of characteristics associated with franchisee success and failure. Second was to examine differences among the executives' perceptions of these characteristics based on the location of the franchisor-Canada, Mexico, or the United States. Their study found that the respondents' perceptions of the importance of system quality, brand name, local environment and communication, and other scales of franchisor and franchisee activities differed by country of origin. Additionally, results of the study showed that neither business type nor franchise size had any effect on perceptions of success or failure. The authors examine the research that has been conducted since the study appeared in 1998 and what we know in 2001.

McIntyre (2001) gives us an update on the third largest franchising market in the world, Brazil. Only the United States and Canada have more franchises than Brazil. The author covers the history of franchising in Brazil, describes what is unique about Brazilian franchising, and gives her view of the country's prospects for the future franchise market.

McIntyre views Brazilian franchising is ripe for development, as evidenced by the size of the domestic franchise industry, demographics of the population, and current economic conditions.

REGIONAL ECONOMIC INTEGRATION

An important dimension of international franchising expansion is regional economic integration. The level of economic integration affects the selection of a region, the selection of a country within a region (i.e., the gateway country), and the entry strategy employed. We assume that international franchisors are proactive about seeking international markets.

We differentiate between two kinds of economic integration – *shallow integration* and *deep integration* – and focus on the latter. Shallow integration is economic integration "at the border" including the harmonization of tariffs, quotas, customs procedures and other border issues (Gerber, 1998). *Free Trade Areas* (FTA) – such as NAFTA (1994) and the U.S.-Israel FTA – and C*ustom Unions* – such as the Customs Union Between Kazakhstan, the Kyrgyz Republic, and Uzbekistan (1994) and the Custom Union Between Czech and Slovak Republics – fall into this category. Such trading arrangements between countries lower the transactions costs and ease the coordination of production, exports and imports among member nations.

Deep integration requires greater level of cooperation between signatory countries and includes both *Common Markets* and *Economic Unions*. Common markets allow not only the free mobility of goods and capital, but also the free mobility of labor. Professional labor, such as managers, accountants, lawyers, can move around with relative ease. Economic unions offer the benefits of common markets plus significant coordination of macroeconomic policies, a common currency, and the harmonization of laws. The latter means that the countries agree to a common standards relating to safety, technical, environmental, legal, and certification matters. The United States of America and the European Union are the most well know economic (and political) unions.

Deep economic integration means that countries need to synchronize national policies, environmental and product standards, labor rules, and competitive and industry policies. While these agreements are difficult to negotiate and expeditiously implement, the economic opportunities of a combined market can be substantial.

From the standpoint of international franchisors, these regional markets pose greater market opportunities than any one country alone can offer. Due to the higher level of economic integration, the level of inter-regional trade will grow and consumer tastes will tend to converge. Therefore, we recommend to view deeply integrated markets in the context of their regional economy. Table 2 lists some of the important common market and economic union agreements along with the year they were signed by region.

Table 2: Deeper Economic Integration in Emerging Markets

Region	Agreement	Year	Objective

Africa	COMESA – Common Market for Eastern and Southern Africa	1993	Common Market
	ECCAS – Economic Community of Central African States	1992	Common Market
	ECOWAS – Economic Community of West African States	1975	Common Market
	UDEAC – Union Douaniere des Etats de l'Afrique Cnetrale	1966	Common Market
	Lagos Plan of Action	1980	Economic Union
	MRU – Manu River Union	1973	Economic Union
Europe	EEA – European Economic Area	1994	Common Market
	Belarus-Russia Economic Union	1994	Economic Union
	CIS (Commonwealth of Independent States) Economic Union	1993	Economic Union
Middle East	GCC – Gulf Cooperation Council	1981	Common Market
	AMU – Arab-Maghreb Union	1989	Economic Union
Western Hemisphere	ANCOM – Andean Common Market Pact	1969	Common Market
	Argentina-Brazil	1990	Common Market
	CARICOM – Caribbean Community	1973	Common Market
	LAIA – Latin America Integration Association	1960	Common Market
	Mercosur – Southern Cone Common Market	1991	Common Market

* Based on Harmsen and Leidy (1994)

With the exception of South Africa, the African continent has not been the focus of much international franchising activity, despite its effort toward deeper levels of economic integration. Poverty, hunger, ethnic strife, disease, and political instability have deterred most Western franchise systems from making a systematic attempt to penetrate the region.

In contrast, Asia -- with no common markets and economic unions -- is host to many multinational franchise systems. Asia does have free trade areas and economic cooperation agreements. Among them are two free trade areas:

- AFTA-ASEAN Free Trade Arrangement (1992)
- ANZCERTA-Australia-New Zealand Closer Economic Relations Trade Agreement (1983)

And four economic cooperative agreements including:

- APEC-Asia-Pacific Economic Cooperation (1989)
- Bangkok Agreement
- EAEC-East Asia Economic Caucus (1990)
- SAARC-South Asian Association for Regional Cooperation (1992)

In Asia, a large consumer market with growing disposables income living in highly urbanized areas has attracted the attention of franchisors.

Countries that are deeply integrated will tend to exhibit a greater market potential for franchisors, *ceteris paribus*. Entry into a deeply integrated country can be seen as a gateway into its regional economic partners.

CONCLUSION

We have attempted to answer the call for additional research in the area of emerging franchise markets worldwide. We accomplished this by first defining what is an emerging market, then summarizing the research both from a theoretical and practical development perspective as well as by specific franchise studies by region of the world. In doing so, we have hoped to raise the level of understanding among franchisors, franchisees, franchise associations, consultants, and academics concerning franchising around the globe. To our knowledge, this is the first attempt at summarizing the research on a global basis, from both a practitioner as well as an academic viewpoint. We hope this furthers the discussion of franchising in emerging markets and leads to a more comprehensive development of the international field of franchising.

MANAGERIAL IMPLICATIONS

The globalization of markets has opened new opportunities for international franchisors in overseas markets. Emerging markets, while offering great potential for future growth, are more difficult markets to penetrate given their cultural distance from the Western and developed World. Entry into emerging markets therefore is a strategic decision that requires a long-term planning horizon and a vision that not only helps the franchisor make money, but also contributes to the host market economic development.

Entry into emerging markets is especially recommended for those franchisors who:

- Have a successful domestic business
- Have some experience with international franchising
- Have top management personnel from the host market
- Have sufficient capitalization and resources to absorb short to medium term losses

In evaluating foreign market expansion, franchisors need to consider not only the specific host country factors and partner selection, which were addressed in several papers in our books, but also the external linkages between the host country and its regional environment. Such analysis may reveal that a country is more desirable because of its integration with other receptive markets, or that it is less desirable because it is in constant war with its neighbors.

A new economic landscape has emerged that exhibits cultural diversity and global interdependence both within and between countries. Franchisors should carefully

evaluate the specific market segments within each emerging market and pursue those segments that demand western consumer values.

FUTURE RESEARCH

The impact of economic integration on international franchising diffusion and expansion is relatively unexplored. The increase of international franchising activity in Mexico was partly fueled by the North American Free Trade Agreement. Such agreements create the basis for a common market and standardization of contractual items and operational standards.

Big emerging markets are important future markets for international franchisors and we encourage international business researchers to evaluate the market opportunities there as well.

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