# NAFTA AND FRANCHISING: A COMPARISON OF FRANCHISOR PERCEPTIONS OF CHARACTERISTICS ASSOCIATED WITH FRANCHISEE SUCCESS AND FAILURE IN CANADA, MEXICO, AND THE UNITED STATES

By: CECILIA M. FALBE and DIANNE H. B. WELSH*

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## Abstract:

Business-format franchising, which includes the product or service, the brand name or trademark, and the operating system developed by a franchisor, has experienced significant growth over the past few decades. International franchising also is growing at a rapid pace, in part, because of market opportunities that include new trade agreements. The debate over North American Free Trade Agreement (NAFTA) increased the focus on North American franchising. In spite of this attention, there are few, if any, comparative studies of franchising in Canada, Mexico, and the U.S. At the same time that international franchising growth is extolled, there is an argument over the extent to which franchising increases business success. A number of studies support the success thesis, however, recently critics claim that franchising does not significantly increase survival rates of franchisee- owned units.

The objectives of this study are, first, to extend 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, and second, to examine differences among the executives' perceptions of these characteristics based on the location of the franchisor—Canada, Mexico, or the United States. We also analyze the effects of franchise strategy, type of franchise business, and size of the franchise on executive perceptions of the characteristics associated with franchisee success and failure.

Franchisor executives rated the relative importance of 39 statements, taken from previous research, that are associated with perceptions of success. Results from a factor analysis indicate that 30 of the variables load on 5 significant factors. Examination of the content of the factors indicates that the first factor (system quality), and the second factor (brand name) consist of variables that directly relate to the core of business-format franchising, the quality of the operating system and the brand name of the franchise. The third factor (local environment) consists of statements that represent general characteristics of the local franchise environment. The fourth factor (communication) consists of variables that link the franchisee with the franchisor and other franchisees. The fifth factor (franchise activities) consists of variables that

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represent idiosyncratic characteristics or activities of a franchisee. Franchise executives also rated the relative importance of 16 statements associated with franchisee failure. Of these, 6 statements, associated with franchisor activities, are combined to form a scale of franchisor failure, and 10 statements, associated with franchisee activities, are combined to form a scale of franchisee failure.

The findings indicate that there are significant differences in most of the scales of success and failure among franchisor executives' perceptions based on country location. In addition, there is also a significant effect of franchise strategy on perceptions. There are no significant differences by type of franchise business or size of the franchisor.

This research contributes to two important areas of research in franchising; the study of perceptions of the characteristics associated with franchisee success and failure, and international franchising research. The study also has practical applications. Knowledge about country differences in perceived characteristics of success and failure will help franchisors to identify aspects of the business system that require increased monitoring and investment. Awareness of country differences will also influence the selection of relevant training and development. Finally, knowledge of differences in perceptions may assist franchisors in adapting systems and policies that are likely to increase the success of their international sites.

**Article:**

## INTRODUCTION

The research reported in this paper addresses two key issues in franchising. The first is the study of perceptions of franchise success and failure. This topic is the subject of extensive discussion by regulators, business people and academicians. The second is the absence of comparative survey research on issues relevant to franchising in Canada, Mexico, and the United States. The lack of studies is surprising as North American franchising has expanded rapidly during the last three decades and significant attention to business between the three countries was generated by the debate over the North American Free Trade Agreement (NAFTA).

The objectives of this study are, first, to extend 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, and second, to examine differences among the executives' perceptions of these characteristics based on location

of the franchisor—Canada, Mexico, or the United States. Additionally, we analyze the effects of franchise strategy, type of business, and size of the franchise on executive perceptions of the characteristics associated with franchisee success and failure. The paper is organized around the study of executive perceptions, and differences in perceptions based on country differences and franchise characteristics.

## RECENT DEVELOPMENTS IN FRANCHISING

Franchising has received a great deal of attention over the past few years. The *Wall Street Journal* recently ran a front page article on powerful franchisees (May 21, 1996) and followed it up with an article on money available for franchisees through institutional investors (May 23, 1996). A *Business Week* cover story focused on the 100 best small corporations. *Inc.* published a special issue on small business discussing "why small business is cool now." *Success* wrote about the hottest new franchises of 1996.

The academic literature also published special issues on franchising including, the *Journal of Business Venturing* (1996), the *Journal of Small Business Management* (1995), and selections from two issues of the *Journal of Marketing Channels* were published in book form (Kaufmann and Dant 1995). A new journal devoted exclusively to franchising and reflecting global perspectives, *Franchising Research: An International Journal,* also emerged in 1996.

There is substantial reason for all of this attention. In 1981, total franchise sales for the United States and Canada were estimated to be about $376 billion, and totaled almost one-third of all retail sales *(Franchise Annual* 1982). By 1984, they were estimated to be about $432 billion *(Franchise Annual 1985).* By the early 1990s, total franchise sales for the two countries amounted to $845 billion, about 35% of all retail sales (Sherman 1993).

There is heightened interest in the globalization of business and the expansion of franchising is a key part of this globalization effort. Recent events (such as, the end of the Cold War with new business sites in Russia and Eastern Europe, accelerated development of Pacific Rim countries, and the beginning of NAFTA), opened up new market opportunities. Studies indicate that by the year 2000, 60% of all U.S. franchisors will have outlets overseas (Hoffman and Preble 1993).

## FRANCHISE VERSUS INDEPENDENT BUSINESS SUCCESS

One aspect of the focus on franchising is the debate over whether franchise units are more successful than independent businesses. A number of empirical and theoretical works examine the situational factors associated with success in small business (Aldrich 1990; Low and MacMillan 1988). These studies examine a number of factors that affect both franchise and non-franchise firms. Although they provide a useful starting point for research, there are other factors associated with success that are unique to franchising that should be considered. These include the operating system, and the relationships between the franchisor and franchisee. Franchisors argue that these unique factors can make the difference between success and failure in small businesses. The importance of these differences warrants separate research on the elements that affect franchise success.

A number of studies provide support for the assumption of greater franchise success (for example, Castrogiovanni, Justis, and Julian 1993; Justis, Castrogiovanni, and Chan 1992). However, other recent studies are critical of this position and argue that franchises exhibit higher rates of firm discontinuance and lower mean profitability than independent businesses (Bates 1995). To date the evidence is mixed. More studies on rates of success and the factors associated with success and failure factors are needed. The most important previous empirical studies of franchise systems have been conducted using archival data. The survey research reported here adds a much needed and complementary approach to the archival studies.

## FRANCHISE EXECUTIVES' PERCEPTIONS OF SUCCESS AND FAILURE

"Human behavior is affected by only that portion of the environment that is actually perceived; our views of the world and the people in it are formed from a highly filtered set of impressions and our images are strongly affected by the information we receive through our filters" (Gould and White 1986, p. 28). The study of managerial perceptions is a major issue of theoretical and empirical concern in organizational analysis, studies of strategic management, and the measurement of performance. In the study of organizational environment, Scott (1993, p. 141) notes that there is a long-standing controversy in the literature concerning the relative merits of subjective, perceptual measures versus objective measures of dimensions of the environment. One theoretical argument is that perceptual measures are more appropriate since only perceived factors enter into decision-making and influence subsequent actions (Dill 1958; Lawrence and Lorsch 1967; Duncan 1972). Recent work in organizational studies has rekindled interest in the importance of managers' perceptions, interpretations, and their effect on strategic decision-making (Gould and White 1986; Huff 1990; Reger and Huff 1993; Senge 1990). Managers deal with a myriad of events, and must interpret or make sense of these events and sort them into patterns that influence future actions (Daft and Weick 1984; Weick 1995). Research findings indicate that executive perceptions affect actions, choices, and organization performance (Hambrick and Mason 1984; Starbuck and Milliken 1988; Thomas, Clark, and Gioia 1993; Waller, Huber, and Glick 1995; Walsh 1988). Empirical studies show that measures of perceived organizational performance are positively associated with objective measures of firm performance (Delaney and Huselid 1996; Dollinger and Golden 1992; Powell 1992).

In this study, we measured franchisors' perceptions of the factors associated with franchisee success and failure. Based on prior research in the organization and franchise literature (Bracker and Clouse 1994), we assumed that executives' perception of the factors that make a franchise succeed or fail were important because these factors would influence franchisor decisions in a number of areas. These include investment, policies, incentives, and training and development. Using previously developed items, we measured franchise executives' perceptions of the importance of 39 items concerning franchise success (Bracker and Clouse 1994). Using the data reduction and scaling techniques described below, we found five factors associated with success: system quality, brand name, local environment, communication, and franchisee activities. We asked franchise executives their perceptions of the importance of 16 statements associated with franchise failure; 10 of the 16 statements described franchisee conditions and the remaining 6 statements described franchisor conditions (Bracker and Clouse 1994). An additive scale representing franchisee failure and one representing franchisor failure were developed.

Examination of the content of the factors indicated that the first factor (system quality) consisted of variables associated with the quality of the business system developed by the franchisor and operated by the franchisee. Examples are franchisor training and support, high quality standards, and efficiency of the operating system. The second factor (brand name) consisted of variables directly related to the brand name of the franchise, for example, extensive national advertising and positive name recognition. The first two of the five factors represent the core of the franchising business. The third factor (local environment) consisted of statements that represent general characteristics of the local franchise environment. For example, this would include good local location and extensive local advertising. The fourth factor (communication) consisted of variables that link the franchisee with the franchisor and other franchisees. The fifth factor consisted of variables that represented idiosyncratic characteristics or activities of the franchisee, for instance, leadership qualities and the ability to handle stressful situations.

There were also 16 statements associated with franchisee failure. Of these, 6 statements consisted of variables that were associated with franchisor activities and 10 that were associated with franchisee activities. The franchisor variables were combined into the first scale of franchise failure; the franchisee-related variables were combined into a second scale of franchisee failure.

## DIMENSIONS AFFECTING DIFFERENCES IN FRANCHISOR PERCEPTIONS

### *Country Differences*

Throughout the years, beginning with Fayol in 1949, there has been a prevailing assumption that management theories and techniques have universal applicability. Cross-cultural researchers including Hofstede (1980) and Adler (1983) questioned this assumption and found that this universalistic perspective was wrong. Since then there has been a plethora of comparative management studies and theory building in non-franchise firms (for example, Black, Mendenhall, and Oddou 1991; Doktor, Tung, and Von Glinow 1991; Hitt, Tyler, and Park 1990; Welsh, Luthans, and Sommer 1993; Withane 1991) and franchise firms (Falbe and Dandridge 1992; Hoy and Echegaray 1994; Knight 1984, 1986; Shane 1994, 1995). From this research has come the realization that although there are some similarities, significant differences do exist across cultures. In addition to cultural differences among nations, country characteristics also include differences in resources, infrastructure, history and traditions, political organization, economic conditions, and legal and tax structures among others (Preble and Hoffman 1995; Sethi and Elango 1995).

Cross-cultural research in entrepreneurship and franchising has primarily employed the work of Hofstede (1980) which examined four characteristics that are used to make meaningful comparisons about the ways that national differences among 40 countries including Canada, Mexico, and the U.S. May affect management styles. These characteristics are power distance, individualism, uncertainty avoidance, and masculinity and femininity (McGrath, MacMillan, and Scheinberg 1992; Moran and Abbott 1994; Shane 1994). The study included 116,000 survey responses from the employees of one multinational company in 40 countries. Although the research has been criticized on a variety of grounds, it has been commended for its parsimony and broad operationalism (McGrath, MacMillan, and Scheinberg 1992, p. 119). The wide application of the research makes it useful for the examination of possible differences in perceptions of franchisors located in the NAFTA countries.

Power distance is the extent to which members of a society accept that there is an unequal distribution of power in institutions and organizations. On this dimension, Mexico ranked 38 out of 40 countries, indicating a high tolerance for unequal power distribution. Canada and the U.S. ranked 14 and 15, respectively, indicating a much lower tolerance. Individualism/Collectivism measures the relationship between individuals and collectivities or groups. Mexico scored 12 out of 40 countries in the research, indicating a fairly strong leaning toward groups. Of the responses from 40 countries in the research, the U.S. scored 40, (that is, the most individualistic country), while Canada scored 36 out of 40. Uncertainty avoidance addresses future stance—the extent to which members of a society feel threatened by uncertain or ambiguous situations. Differences among responses from the countries in uncertainty avoidance indicated that responses from Canada and the U.S. tended toward weak uncertainty avoidance, ranks of 30 and 31, and those from Mexico, with a rank of 11th highest, tended toward strong uncertainty avoidance. Hofstede's concept, Masculinity, measures the extent to which the dominant values in society stress assertiveness, financial gain, and material goods. On this dimension, Mexico scored 6th highest, the U.S. 13th and Canada scored 21 out of 40. Thus, the Hofstede work shows differences in responses from managers in the three countries, with responses from Canada and the U.S. showing more similarities. This pattern of similarities and differences in culture among the three countries holds in a number of other studies as well (Moran and Abbott 1994).

We assumed that there would be strong differences in managerial responses, based on country characteristics (Preble and Hoffman 1995; Sethi and Elango 1995). We tested the following hypothesis:

> *Hypothesis I:* There are significant differences among franchisor perceptions of success and failure based on the franchise country of origin. Based on the patterns of differences reported in cross cultural studies (Hofstede 1980; Moran and Abbott 1994), we tested the following hypothesis:
> *Hypothesis 2:* Stronger differences in franchisor perceptions will occur between Mexico versus Canada and the U.S.

### *Type of Business*

The Department of Commerce divides franchising into two categories: product trade- name franchising and business-format franchising. Business-format franchising, according to the Department of Commerce,

> "is characterized by an ongoing business relationship between franchisor and franchisee that includes not only the product, service and trademark, but the entire business format itself—a marketing strategy and plan, operating manual and standards, quality control, and continuing two-way communications" (Kostecka 1986).

Types of businesses which fall under the definition of business-format franchising include restaurants, nonfood retailing, and personal and business services.

The service-producing industries have long been separated out by various analysts to fit the analysts' particular areas of interest. For example, a number of authors refer to transportation, public utilities, and communication as industrial services (Fuchs 1968).

Others segregate services into producer services or consumer services (Greenfield 1966). The annual survey of the Franchising 500 by *Entrepreneur*, employed in a number of studies, classifies franchises by 26 categories (Coombs and Castrogiovanni 1994; LaFontaine 1992).

The Bureau of Labor Statistics (BLS) designates non-goods producing industries as service-producing industries with the services as a catchall (Runyon 1985). Economists at the BLS clarify the definition by pointing out that the goods-producing industries include manufacturing, construction, mining and agriculture while their service- producing sector includes all other industries, including government. Specifically, they are food and lodging, personal and professional services, transportation and public utilities, wholesale trade, retail trade, finance, insurance, real estate, and government.

As business-format franchising continues to grow and is predicted to be the dominant form of franchising internationally in the 21st century (Hoffman and Preble 1993), there exists a need to aggregate these sectors for better data analysis. The categories in this study follow the general U.S. Department of Commerce categories of food, professional services, personal services, and retail. We divided the franchises in our sample into four business types food, business services, consumer services, and other retailing.

There is an extensive discussion in both the entrepreneurship and strategy literature on the relative effects of industry and firm capabilities on organization performance. Population ecology and strategic choice theories focus on environmental effects on performance (Aldrich 1990; Hannan and Freeman 1977; Pfeffer and Salancik 1978). In the strategy literature, the industry model posits that positioning the firm in a profitable industry and fitting firm capabilities to requirements of the industry will predict above average profits (Porter 1979). The resource-based model views firms as collections of unique resources and capabilities that provide the primary basis for profits rather than industry position (Hamel and Prahalad 1994).

Parallel arguments exist in franchising. Research indicates that there are significant differences among the franchise business types in capital investment, technology, labor intensity, franchise fees, royalties, value of brand name, amount of product purchased customer relationships, regulation and local environment which may affect franchisee performance (Dandridge, Falbe, and DePuis 1991; Kaufmann and Dant 1995; LaFontaine 1992). For example, brand name appears important in food franchising while local environment is important in retailing. However, other research indicates that firm effects may override the effects of franchise business type (LaFontaine and Shaw 1996). The latter findings lend support to the arguments of franchisors that the franchise operating system and brand name are more important to franchisee performance than industry differences. Given the centrality of the industry (business type) versus firm effects arguments in the organization, strategy, entrepreneurship, and franchising literature, we tested the hypothesis that the perceptions of importance of success and failure factors of franchise executives would differ significantly by franchise business type. Therefore, the following hypothesis was tested:

> *Hypothesis* 3: Franchisor perceptions of the importance of franchisee success and failure will differ significantly based on type of franchise business.

### *Franchise Strategy*

Franchise strategy refers to the outcome of the decision to operate and expand a business by franchising versus company ownership (Anderson 1984; Carney and Gedajilovic 1991; Combs and Castrogiovanni 1994). An extensive body of organization and economic literature discusses franchising as a hybrid organization form, noting that the franchise contract lies somewhere between conventional market exchange and the centralized firm (Brickley and Dark 1987; Mathewson and Winter 1985; Shane 1996; Williamson 1991). In fact, many franchise systems operate between the hybrid and the centralized firm, encompassing both franchisee-owned units and company-owned units.

A franchise contract generally is set for a specified time period. At the expiration of this period, the contract may be renewed, subject to agreed upon terms, or the unit(s) or territory may revert to company ownership. The percent of company-owned units in a franchise system may vary for several reasons. One franchise strategy is to operate a few stores as models of the system and as locations in which innovations can be tested. Other franchisors operate company stores reluctantly as a result of the repurchase of unsuccessful units in order to protect their brand name. However, the literature also discusses a strategy in which franchisors aggressively exercise repurchase agreements, particularly among high performing units, to increase the proportion of successful company owned stores (Caves and Murphy 1976; Hunt 1973).

Four major theoretical perspectives have been proposed to explain patterns of company-ownership versus franchisee-ownership: resource scarcity, agency theory, risk spreading, and life cycle (Anderson 1984; Carney and Gedajlovic 1991; Combs and Castrogiovanni 1994; Lafontaine and Kaufmann 1994). In the resource scarcity approach, franchising is viewed as a means of rapid market penetration. Franchisees provide scarce resources of capital, managerial expertise, and knowledge of local markets. As the need for these resources decreases, the firm is more likely to increase company ownership of sites. There is some empirical support for this theory (Anderson 1984; Combs and Castrogiovanni 1994; Hunt 1973). The theory also is criticized by economists on the basis that capital can be raised more efficiently in the market. In addition, it is argued that although franchising may lower risk for the franchisor, it increases risk for the franchisee (Rubin 1978).

The agency theory perspective discusses franchising as a means of efficiently controlling the problem of monitoring differences between the agent (employee) and the principal (owner) since the franchisee shares many of the same objectives and values held by the franchisor (Brickley and Dark 1987; Norton 1988a, 1988b). Franchising lowers the cost of monitoring under the same circumstances described in the resource scarcity approach. Managerial talent, local knowledge along with location and population density all are factors (Alchian and Demsetz 1972; Brickley and Dark 1987; Caves and Murphy 1976; Combs and Castrogiovanni 1994; Eisenhardt 1988; Jensen and Meckling 1976; Norton 1988a, 1988b). However, there are some situations in which the franchisee may be inclined to shirk by underinvesting and free riding. The situations include owning units with a high number of non-repeat customers, ownership of one franchise, and resisting promotions that benefit the entire system more than the individual unit. In such cases, the costs of monitoring increase and the franchisor is more likely to engage in aggressive buy backs.

Risk spreading discusses the risk-averse franchisor selling units to risk-neutral franchisees (Combs and Castrogiovanni 1994). Support for this approach lies with studies that show that units with the highest sales are either company-owned or buy backs. However, researchers argue that by selecting a franchise business, franchisees are following a route of lower risk (Combs and Castrogiovanni 1994; Martin 1988). It is widely reported in the literature that franchises appear to have a lower rate of failure than do independent businesses (Anderson 1984; Castrogiovanni, Justis, and Julian 1993).

The life cycle perspective suggests that as franchise systems mature and become more successful, they tend toward more company-owned stores. The life-cycle thesis is compatible with both the resource scarcity and agency theory perspectives. For example, in the resource scarcity model, constraints on capital and managerial expertise decline over time, franchisees contribute less value to the system, and companies will be more likely to buy back successful franchises. In the agency perspective, as company administrative efficiency increases over time franchisee monitoring costs increase and franchisors will be more likely to buy back successful franchises as noted above.

Previous studies have examined franchise strategy as a dependent variable and tested the resource scarcity, agency theory, and life-cycle explanations of patterns of ownership (Anderson 1984; Carney and Gedajlovic 1991; Combs and Castrogiovanni 1994; Shane 1996). Carney and Gedajlovic (1991) suggested that a typology of franchisor strategy was needed to explain ownership patterns. On the other hand, Combs and Castrogiovanni (1994) found that typology development was not necessary for their study and found significant results using number of franchise units as a percent of total units. In this study, we employed their measure of franchise strategy to examine the effects of two theories, agency and resource scarcity, on franchisors' perceptions.

Given the emphasis of agency theory on monitoring, we assume that the franchisor, in the case of franchisee ownership strategy, will perceive greater importance of the franchise system factor and the communication factor. We also assume in an agency theory model that franchisors will be more likely to associate franchisee failure with the franchisee failure scale. The following hypotheses were tested:

> *Hypothesis 4a:* The higher the percentage of franchisee-owned units, the more likely there will be a significant positive relationship with the system quality factor.
>
> *Hypothesis 4b:* The higher the percentage of franchisee-owned units, the more likely there will be a significant positive relationship with the communication factor.
>
> *Hypothesis 4c:* The higher the percentage of franchisee-owned units, the more likely there will be a significant positive relationship with the scale of perceived franchisee failure.

In the resource scarcity approach, franchisees provide resources including local market knowledge and managerial skills. Therefore, in the case of a franchisee ownership strategy, franchisors will perceive greater importance of the local environment and franchisee activities. We tested these hypotheses:

> *Hypothesis 4d:* The higher the percentage of franchisee-owned units, the more likely there will be a significant positive relationship with the local environment factor.
>
> *Hypothesis 4e:* The higher the percentage of franchisee-owned units, the more likely there will be a significant positive relationship with the franchisee activity factor.

### *Franchise Size*

Franchise size was included in the analysis because of prior organization studies that show size to be a ubiquitous factor in predicting organization characteristics and outcomes (Scott 1992).

Because we had no specific assumptions concerning a relationship between size and perceptions of success and failure, no hypotheses were tested.

# METHODS

## *Survey Instrument*

The survey instrument employed in this study was adopted from the research developed in two stages by Bracker and Clouse (1994). In the first stage, the Franchise Policy Delphi Survey was administered in November of 1993 with responses requested by December 10, 1993. This questionnaire was designed to capture measures of franchise success and failure. Success and failure were not defined for the respondents. The instrument was administered to a sample of franchisors, franchisees and academics specializing in franchising research. Using the three groups provided broad coverage of the issues since the franchisors and franchisees have direct experience with franchise performance. The academics had the advantages of familiarity with multiple types of franchise businesses as well as a conceptual understanding of the items (Hambrick and Abrahamson 1995). A second survey, based on results from the first stage, was administered as a follow-up to the first survey. The results from the follow-up, entitled *Franchising in the Economy, 1992-1994,* were reported by Jeffrey Bracker at the International Franchise Association meeting (Bracker and Clouse 1994). The *Franchising in the Economy, 1992-1994* instrument was used in our research and adopted to survey samples of Canadian, Mexican, and U.S. franchisors.

Translation of the survey was performed using the back-translation method recommended by Earley (1989). The English version of the instrument was translated into Spanish and French, respectively, by faculty colleagues and then back into English by another set of faculty members as well as native Mexican and Quebec citizens who were foreign language graduate students. The retranslated English version was reviewed to verify whether it remained consistent with the original and any discrepancies were resolved.

## *Data Collection*

The survey was sent to all Mexico-based franchise members of the Mexican Franchise Association, Canada-based members of the Canadian Franchise Association, Quebec- based members of the Quebec Franchise Association, and a sample of U.S.-based members of the International Franchise Association. We focused on the country of origin of operations for the reasons noted earlier. Current mailing lists were obtained from the directors of each association in 1994 (Adolofo Crespo, Mexican Franchise Association, personal communication, September 1994; Sheila Alianak, Canadian Franchise Association, personal communication, September 1993 and June 1994; Michel Gagnon, Quebec Franchise Association, personal communication, June 1994). In addition, the Mexican Franchise Association list was cross-referenced with the January 1995 issue of *Entrepreneur* magazine's Mexican edition list of franchises. The international business reply service was used in Mexico and stamped self-addressed reply envelopes were used in Canada since they are not members of the international business reply system. We also gave firms the option of a fax reply. In gathering the data, we encountered numerous obstacles. For instance, there were major problems with the mail delivery service. Follow-up letters and calls revealed that many surveys were never delivered. Businesses in Mexico often did not have a fax at their disposal.

### *Analysis of Franchisor Perceptions*

The data for perceptions of success and failure were organized in the questionnaire in two distinct sections: characteristics of franchisee success, and characteristics of franchisee failure. In section one, for characteristics of franchisee success, respondents were asked: How important are the following statements to your definition of franchisee success? Importance refers to the impact the decision/concept/action may have on success. The 39 success items were measured by 5-point Likert scales (1 = very high, 5 = very low). We also allowed space for another category. Few responses were given; most often, this section was left blank by respondents.

The success items were factor analyzed using principal factor analysis with an oblique rotation. The solution yielded five factors that met the Kaiser criterion of eigenvalues greater than one. Thirty variables loaded at 0.5 or above on only one of the five factors. The results of the factor analysis are presented in Table 1.

The factor analysis provided the five scales of success. The first scale, *System Quality*, consisted of 12 variables that measured franchise system adaptation, maintenance and quality service. Franchisee and franchisor teamwork was also an important aspect of this scale. The System Quality scale had an alpha coefficient of 0.84. The second scale, *Brand Name*, was comprised of four variables that measured links to national franchise name and reputation including national advertising, reputation, promotions and clean premises. The brand name factor is tied to national reputation. It has been cited by theorists as an aspect in which some franchisees that do not have repeat business *(i.e.*, those located near national highways) may shirk and pass the cost of lost customer confidence along to other franchise units (Alchian and Demsetz 1972; Caves and Murphy 1976; Combs and Castrogiovanni 1994). The Brand Name scale had an alpha coefficient of the .67. The third scale, *Local Environment*, consisted of five variables that measured desirable general characteristics of the franchisee local environment, including visibility, commitment, location, local advertising, and local adaptability. The *Local Environment* scale had an alpha coefficient of 0.66. The fourth scale, *Communication*, was made up of three variables that measured franchisee communication and inclusion in the system and commitment. The *Communication* scale had an alpha coefficient of 0.60. The fifth scale, *Franchisee Activities*, was made up of six variables that measured unique activities of the franchisee, including leadership and handling stress. The *Franchisee Activities* scale was negatively correlated with the other four factors. The alpha coefficient for this scale was 0.70. The five scales were employed in the data analysis to examine franchisor perceptions of success.

The second section was made up of 16 items that measured characteristics of franchisee failures. For characteristics of failure, respondents were asked: How important are the following statements to your definition of franchisee failure? Importance refers to the impact the decision/concept/action may have on failure. The 16 failure items were measured by 5-point Likert scales (1 = very high, 5 = very low). The survey questions on franchisor perceptions of failure clearly differentiated between activities in the domain of franchisors and those in the domain of franchisees. On this basis, two additive scales were constructed: *Franchisor Failure* and *Franchisee Failure.* The list of variables, means, and standard deviations of the two failure scales are presented in Table 2. Alpha coefficients of the failure scales were 0.87 and 0.79, respectively.

Thus, the variables measuring perceptions consisted of five scales related to success

**TABLE 1** Results of Factor Analysis of Perceived Success Variables

| Variables | Factor 1 System Quality | Factor 2 Brand Name | Factor 3 Local Environment | Factor 4 Communication | Factor 5 Franchise Activities |
|---|---|---|---|---|---|
| Good employee teamwork | 0.65 | | | | |
| Franchisor-Franchisee teamwork | 0.63 | | | | |
| Franchisor quality support | 0.62 | | | | |
| Fanchisee high quality standards | 0.59 | | | | |
| Franchisor training and support | 0.56 | | | | |
| Good employee selection | 0.56 | | | | |
| Prompt and courteous service | 0.56 | | | | |
| Franchisor adaptation to market | 0.56 | | | | |
| Operational system efficiency | 0.55 | | | | |
| Franchisor selective franchise sale | 0.53 | | | | |
| Franchisee exhibits ability to listen | 0.51 | | | | |
| Poor employees terminated quickly | 0.50 | | | | |
| Extensive national advertising | | 0.74 | | | |
| Positive public name recognition | | 0.67 | | | |
| Participation in promotions | | 0.57 | | | |
| Neat and clean premises | | 0.53 | | | |
| Good local market location | | | 0.61 | | |
| Visible franchisee | | | 0.60 | | |
| Full-time franchisee commitment | | | 0.55 | | |
| Extensive local advertising | | | 0.54 | | |
| Flexible adaptation to local market | | | 0.52 | | |
| Franchisee communication/network | | | | 0.69 | |
| Franchisee board representation | | | | 0.62 | |
| Franchisee has all on the line | | | | 0.50 | |
| Franchisee sufficient capital | | | | | −0.67 |
| Franchisee able to explain concepts | | | | | −0.66 |
| Franchisee shows leadership | | | | | −0.62 |
| Excellent product quality | | | | | −0.58 |
| Franchisee handles stress situation | | | | | −0.52 |
| Franchisee community involvement | | | | | −0.51 |
| Eigenvalue | 8.26 | 2.90 | 2.19 | 2.00 | 1.73 |
| Percentage of variance explained | 21.2 | 7.4 | 5.6 | 5.1 | 4.4 |
| Alpha Coefficient | 0.84 | 0.67 | 0.66 | 0.60 | 0.70 |

and two scales related to failure. These seven scales were used in the data analysis to examine the hypotheses.

### *Measurement of Predictor Variables*

Country of the franchise was the country which the franchisor considered the base of operations. The franchisors we surveyed identified their primary base of operations as either Canada, Mexico, or the U.S. A proportion of the respondents also had franchisees in one or two of the other NAFTA countries. For example, 19% of Canadian franchisors had franchises in Mexico or the U.S.; 16% of Mexican franchisors also operated in the U.S. Or Canada; and 39% of U.S. franchisors had operations in Canada or Mexico. As this was not a study of international franchise expansion, we focused on the respondents' country of origin.

The type of business operated by the franchise receives considerable attention in

**TABLE 2** Franchisor and Franchisee Perceived Failure Scales

| Franchisor Failure Variables | | Mean | Standard Deviation |
|---|---|---|---|
| Illegal or unethical conduct | | 1.98 | 1.34 |
| Misrepresentation or dishonesty | | 2.18 | 1.38 |
| Market saturation | | 2.53 | 1.14 |
| Faddish product appeal | | 2.61 | 1.33 |
| Over expansion | | 2.68 | 1.17 |
| Competition from company-owned units | | 3.34 | 1.39 |
| Franchisor Failure Scale | Alpha coefficient | 0.87 | |
| **Franchisee Failure Variables** | | | |
| Unwilling to follow system | | 1.39 | 0.66 |
| Unwilling to get involved in operations | | 1.47 | 0.82 |
| Misrepresentation or dishonesty | | 1.67 | 0.97 |
| Failure to pay vendors on time | | 2.07 | 0.98 |
| Inadequate facility maintenance | | 2.14 | 1.03 |
| Expanding too rapidly | | 2.22 | 1.32 |
| Poor local economic conditions | | 2.29 | 1.05 |
| Overstaffing of facility | | 2.30 | 1.02 |
| Inappropriate inventory levels | | 2.35 | 1.09 |
| Overcapitalization | | 3.57 | 1.32 |
| Franchisee Failure Scale | Alpha coefficient | 0.79 | |

the literature as we noted earlier. We divided the franchises into four categories determined by customer base and previous studies. The categories include food franchises of all types (31 %), business service franchises, (accounting, financial, and business printing services) (30%), consumer service franchises, (maid, yard, and decorating services) (25%), and other retail (14%). The latter category included a number of businesses that were based in retail stores, such as drug stores.

Franchisor strategy was measured by the number of franchisee-owned units as a percentage of total franchise units (franchisee-owned units plus company-operated units). The average was 79% with a standard deviation of 27. The minimum was 3% and the maximum was 100%. An examination of the data showed that franchises with a low percentage of franchisee-owned units consisted of franchises that were very small as well as large firms that were moving into franchising.

Size was measured by the total number of franchise units. The average was 313 units with a minimum of one and a maximum of several thousand.

## RESULTS

### *Effect of Country*

The first two hypotheses were tested with an analysis of variance. The mean scores for franchisor perceptions of success and failure by country are shown in Table 3. The effects of country on each of the dependent variables were evaluated with a univariate F test and the amount of variance in a dependent variable accounted for by country is indicated by the eta-squared values in Table 3. Pairwise differences between means were evaluated with Duncan's multiple range test.

**TABLE 3** Univariate Analysis of Success and Failure Scales

| Scale | Canada | U.S. | Mexico | F | p | $Eta^2$ |
|---|---|---|---|---|---|---|
| System Quality | $1.50_a$ | $1.56_a$ | $1.35_b$ | 3.22 | 0.04 | 0.05 |
| Brand Name | $1.78_a$ | $2.32_b$ | $1.58_a$ | 17.09 | 0.00 | 0.22 |
| Local Environment | $1.85_a$ | $2.07_b$ | $1.71_a$ | 3.96 | 0.02 | 0.06 |
| Communication | $2.47_a$ | $2.64_a$ | $2.02_b$ | 5.32 | 0.01 | 0.08 |
| Franchise Activities | 1.82 | 1.83 | 1.72 | 0.58 | ns | 0.01 |
| Franchisor Failure | $2.52_a$ | $2.74_a$ | $1.90_b$ | 6.22 | 0.00 | 0.10 |
| Franchisee Failure | $2.23_a$ | $2.38_a$ | $1.80_b$ | 9.62 | 0.00 | 0.14 |

Means with different subscripts differ significantly at the 0.05 level by Duncan's Multiple Range Test.

The results for the univariate F test indicate that four of the five measures of success and both of the measures of failure were affected by country of origin of the franchise. The results for the success and failure scales presented in the table show support for hypothesis one: there are significant differences among franchisor perceptions of success and failure based on the franchise country of origin. With the exception of franchisee activities, the success items differ significantly by country. Both of the failure scales also differ significantly by country. System quality is rated the most important, by all of the respondents, regardless of country. The results also showed that the mean scores for Mexico demonstrate a value of greater importance for all of the seven scales than do the scores for either Canada or the U.S.

Hypothesis two predicted that differences between Canada and the U.S. would be less than those with Mexico. In the case of success, only system quality and communication show similarities in the predicted direction. The mean scores for brand name and local environment for Canada are closer to the scores for Mexico than the U.S. There are no significant differences among the mean scores for franchisee activities. In summary, the results for success are mixed and provide little support for the second hypothesis. However, the two failure scales do provide support for hypothesis two since both scales show less difference between Canada and the U.S. than with the mean scores for Mexico. Further tests of the effects of country that include franchise strategy and franchise size are reported below.

### *Effects of Type of Business Franchise*

Hypothesis three was tested with an analysis of variance. Of the five success scales and two failure scales, there was only one significant result and that was for the brand name scale ($F = 2.90$, $p < 0.04$, eta-squared = 0.07). The results for the Duncan's multiple range test show a significant difference in brand between consumer services (mean score = 2.05) and the other three business types: food (mean score = 1.72), retail (mean score = 1.64), and business services (mean score = 1.95). Thus, the results provide no support for the hypothesis concerning differences among business types.

### *Effects of Franchise Strategy*

An analysis of covariance was performed to test the hypotheses related to franchise strategy and to examine the effects of strategy and country on franchisor perceptions of success and failure. The findings are presented in Table 4.

**TABLE 4** Analysis of Covariance: The Effects of Percentage of Franchisee-Owned Units and Country on Scales of Perceived Franchise Success and Failure

| Covariate: % of Franchise-Owned Units | beta | Standard Error | *t*-value | sig. |
|---|---|---|---|---|
| System Quality | 0.30 | 0.10 | 2.97 | 0.00 |
| Brand Name | 0.17 | 0.16 | 1.86 | 0.07 |
| Local Environment | 0.26 | 0.16 | 2.52 | 0.01 |
| Communication | 0.18 | 0.24 | 1.72 | 0.09 |
| Franchisee Activities | 0.24 | 0.14 | 2.26 | 0.03 |
| Franchisor Failure | 0.22 | 0.30 | 2.25 | 0.03 |
| Franchisee Failure | 0.19 | 0.17 | 1.94 | 0.06 |
| **Univariate F tests for Effect of Country** | **SS** | **MS** | **F** | **p** |
| System Quality | 0.04 | 0.02 | 0.19 | 0.83 |
| Brand Name | 7.49 | 3.75 | 14.93 | 0.00 |
| Local Environment | 0.93 | 0.46 | 1.97 | 0.15 |
| Communication | 2.26 | 1.13 | 2.18 | 0.12 |
| Franchisee Activities | 0.30 | 0.15 | 0.87 | 0.42 |
| Franchisor Failure | 6.69 | 3.35 | 4.06 | 0.02 |
| Franchisee Failure | 2.97 | 1.49 | 5.44 | 0.01 |

The tests yielded results that failed to reach significance with the Wilkes lambda test ($F = 1.77$, $p < 0.10$). However, the univariate F tests were significant for a number of the dependent variables for both franchise strategy and country. Results for tests of the agency model and the resource model are presented in Table 4. The findings indicate little support for the agency hypotheses; only hypothesis 4a (system quality) shows a significant positive association with percent of franchisee-owned units. On the other hand, the resource scarcity model hypotheses, hypothesis 4d (local environment) and hypothesis 4e (franchisee activities), are supported; both show a significant positive association with percent of franchisee-owned units. In addition, the franchisor failure scale, for which no hypothesis was tested, also demonstrates a significant association with percent of franchisee-owned units.

A second look at the effects of country, when franchise strategy is also taken into account, indicates that significant effects of country are limited to brand name and the two indicators of sources of failure, franchisor and franchisee. Finally, we tested for interaction effects between franchise strategy and country of origin. Of the five success scales, the interaction between franchise strategy and country was significant for brand name ($F = 12.09$, $p < 0.000$) and communication ($F = 3.07$, $p < 0.05$). In the case of sources of failure, the interaction was significant for both franchisor ($F = 6.17$, $p < 0.00$) and franchisee ($F$ 5.55, $p < 0.00$).

### *Effects of Franchise Size*

An analysis of covariance was performed to examine the effects of country and size on scales of success and failure. The test of size yielded results that failed to reach significance with the Wilkes lambda test ($F = 0.71$, $p < 0.67$). A logarithmic transformation of size also yielded results that failed to reach significance with the Wilkes lambda test ($F = 1.61$, $p < 0.14$). Thus, size failed to demonstrate significant relationships with any of the dependent variables. We did not propose any relationships between size and success and failure. We included the variable only because of its past prominence in the organizational literature.

## DISCUSSION

The research reported in this paper contributes to three important areas: the literature on perceptions of performance, comparative international research, and applications for franchisors and franchisees. Although the study was exploratory, the findings provide support for hypotheses on differences in perceptions of characteristics associated with franchisee success and failure among franchise executives in Canada, Mexico, and the U.S. Respondents' perceptions of the importance of four of the five success scales (system quality, brand name, local environment, and communication) and both the franchisor failure and franchisee failure scales differed by country of origin. We also found support for the importance of the effect of franchise strategy on perception of success and failure. Support for the resource scarcity strategy (local environment and franchisee activities) was stronger than for the agency model (system quality, communication, franchise failure scale). In contrast to some previous studies, we found that neither business type nor franchise size had any effect on the success and failure characteristics.

The present research adds an important dimension to the studies of perception of performance. The executives were able to identify the importance of the characteristics listed in the survey. They did not add a meaningful number of additional items. The items developed in the earlier Delphi study proved applicable in the present research. The cross-cultural assumptions of greater similarity between executives from Canada and the U.S. did not uniformly hold.

The study also contributes to the stream of research on franchise strategy. However, the present research adds a new dimension. Franchise strategy is employed as a predictor variable rather than as a dependent variable. It is certain that the variable measuring percent of franchisee-owned units and company-owned units is an important variable to include in franchise studies, including future international studies.

This research also contributes to the entrepreneurship survival studies by taking a different path. Rather than estimating numbers of surviving organizations, we provide data on characteristics that are likely to predict greater chances of survival. Furthermore, the study is linked to entrepreneurial research that is concerned with the effects of the environmental and organizational characteristics on organization performance (Lumpkin and Dess 1996).

A recent survey of international franchise associations discusses the need to study the international activities of non-U.S. Firms (Preble and Hoffman 1995). Given the rapid expansion of franchising and the prospect of greater growth internationally, the need for studies is great. In spite of this fact, the authors note that the international aspects of franchising have not received the needed academic or managerial attention. In particular, almost all studies have utilized archival data.

Our study differs from most of the international franchise studies that focused on reasons for franchising internationally (Fladmoe-Linquist and Jacques 1995), entry strategies (Hoy and Echegaray 1994), or characteristics of franchisors that expand internationally (Huszagh, Huszagh, and McIntyre 1992; Julian and Castrogiovanni 1995; Shane 1996). Instead, the research provides indicators of important success and failure characteristics in country of origin.

In their 25-year review of international business research, Wright and Ricks (1994) cited international entrepreneurship and the internationalization of small business as an emerging research direction. They determined that those engaged in international business will no longer be limited to large business and that research is evolving to reflect this. Franchising research will be a central part of this research trend.

A NAFTA-related study is particularly timely because of increased competitiveness and the expectation that NAFTA will promote new business opportunities. In fact, physical proximity is an important determinant of expansion patterns (Preble and Hoffman 1995). For example, Canada and Mexico report the U.S. as its leading international market and Mexico also lists Canada as an opportunity. Further expansion of the NAFTA pact to include countries in South America is under consideration. This research provides important initial information on the effects of the trade agreement. The data are also useful for other international comparisons.

We urge the usual cautions about generalizing from one study. The research was exploratory in nature and requires further elaboration and testing. There are also problems associated with conducting cross cultural/country research. The problem is particularly significant in countries such as Mexico where the communication infrastructure is not uniformly reliable. Mail delivery, according to many of our respondents, is problematical and the span of time to receive and respond to a survey is lengthy. In fact, a major private international surface delivery firm recently pulled out of Mexico. Fax transmission and e-mail are not as ubiquitous as they are in Canada or the U.S. Canada is not part of the international reply system. In spite of these difficulties, respondents were cooperative and interested in the study and the results.

The study also has a number of practical applications. Franchisors may be assisted in their development strategies by new knowledge of the characteristics that are perceived to affect franchisee success and failure in different countries. Other applications include guidance regarding the areas in which franchise units require additional investment, different types of training and development, changes in systems and policies, and the trade-off between standardization and adaptation (Hopkins 1996). Knowledge about country differences and their relationship to franchise strategies may prove important in increasing survival rates. Managers' perceptions and their perception of success should be an important aspect of the increased focus on international franchising studies.

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