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Towards a Strategic Model of Global Franchise Expansion

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Abstract

This paper develops the first global index of international franchise expansion that ranks countries according to their attractiveness to US-based franchise firms. A quantitative model combining insights from academic research and business practice generates a ranking of 143 potential expansion target countries according to their risk/opportunity profiles. The rankings suggest that countries with large markets and strong political and legal systems (large European countries, and Canada, Japan, and Australia) are the most attractive for US-based franchisors, while the small, unstable African countries are the least attractive. China (and the other BRIC countries—Brazil, Russia, India) though attractive from a market opportunity perspective, is nevertheless not highly ranked due to their significant risks and large cultural and geographic distances. This study reaffirms the importance of a strategic approach to international franchising decisions, underscores the importance of properly assessing the relative importance of key determinants in internationalization decisions, highlights the importance of a comprehensive and systematic assessment of the various risks in international franchising decisions, shows the usefulness of quantitative modeling in international franchising, and advocates the development of effective risk management methods in order to cope with rapid changes in the global marketplace.

Keywords: International expansion; Market opportunity; Market risks; Integrated model; Global index

Introduction

Recent changes in the US and global economies have had a significant impact on how US-based franchise firms do business. Over the past four decades, the reduction of trade barriers, saturation of domestic markets, advances in communication and transportation, improved foreign economic conditions, and enhanced currency convertibility have provided strong incentives for US-based franchise firms to consider expanding their businesses to foreign markets (Justis and Judd, 2003; Alon, 2006; Aliouche and Schlentrich, 2009). Internationalization is now considered an essential strategy for an increasing number of US franchise firms. From 1971 to 1985, US-based franchise firms expanded overseas units at a rate of 17 percent per year (Justis and Judd, 2003). According to a survey of members of the International Franchise Association, 52 percent of US-based franchise firms had units outside the United States in 2006, compared with 34 percent in 1989. In addition, 79 percent of the respondents intended to enter or expand into the European Union within 3 years, representing a 70 percent increase from 1989 (Schlentrich and Aliouche, 2006).

Recently, a number of theoretical and empirical studies have attempted to explain the internationalization process of franchise firms. Though these studies have greatly improved our understanding of international franchising and foreign market entry mode selection, important issues remain. The extant research has been largely descriptive. Though understanding why and how franchise firms expand internationally is important, it is of limited practical assistance to franchise executives faced with the daunting challenges of expanding their operations internationally.[2]

Most past studies have addressed one of two aspects of the international franchise expansion challenge—*why* expand (motivation to go international) or *how* to expand (selection of mode of entry), while *where* to expand (selection of target countries) is seldom fully addressed. A more comprehensive, strategic approach may be beneficial for both franchise scholars and practitioners. Aliouche and Schlentrich (2009) proposed a

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[2] In fact, the main motivation for the present study is the widespread sense of frustration expressed to the authors by numerous franchise executives over the lack of effective decision making tools to help them formulate their international franchise expansion strategies.

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prescriptive three-phase model of international franchise expansion that addressed the two strategic questions faced by a franchisor planning expansion into foreign markets[3]:

1. *Where* should we expand to? (determination of the optimal target countries).
2. *How* should we enter into these priority target countries? (determination of optimal entry mode).

Focusing initially on the first question (*where*), Aliouche and Schlentrich (2009) developed a methodology to operationalize the main determinants of international franchise expansion decisions and produced a ranking of the 25 European Union countries according to their attractiveness from a macro opportunity/risk perspective. The present study aims to extend this line of research with three important contributions.

Based on the results of academic research, the model proposed in Aliouche and Schlentrich (2009) lacked an explicit link to actual franchise practice. The present study addresses this limitation by integrating the real life experiences and opinions of franchise executives into the model. Opinions of franchise executives with extensive international experience were collected via an online survey that was complemented with face-to-face and phone conversations. These executives represented 104 franchise firms with a total of 165,559 units globally. The survey helped validate the selection of the key internationalization drivers and helped provide a way to gauge the relative importance of each driver. It allowed the linkage of theoretical analysis and actual franchise practice, a linkage that was missing in Aliouche and Schlentrich (2009) and other studies. The learning that comes with years of dealing first-hand with the opportunities, challenges, successes and failures of international expansion makes franchise executives' opinions invaluable. By including input from seasoned franchise executives, the present study improves the practical relevance of the original model.

Most previous studies, including Aliouche and Schlentrich (2009) implicitly assigned an equal importance to the key determinants of internationalization decisions. The current study explicitly illustrates that the various key factors in internationalization decisions have different relative influences, and that ignoring this fact (for example, by assigning equal weights to all factors, the practice of most past studies), may lead to a suboptimal selection of expansion markets. In an equally weighted model, small but relatively less risky countries (such as Switzerland and Denmark) would appear more attractive as expansion markets, while large but relatively more risky countries (such as China and India) would appear less attractive. This study goes a long way in addressing this shortcoming of previous studies by explicitly assigning relative weights to the various drivers.

Aliouche and Schlentrich (2009) focused on the EU countries only. The present study has a much wider scope. Though the EU is an important region of the world, other countries are also of interest to US franchisors. The present study creates a comprehensive international franchise expansion index that ranks all countries that have publicly available data (143 countries in 2009). This index is to our knowledge the first global index of international franchise expansion available in the academic literature and business practice. This index provides franchise practitioners a guide to where the optimal franchise expansion markets may be. Globally, the index identifies the United Kingdom, Canada, and Germany as the most attractive international expansion markets for US-based franchise firms, and the Central African Republic, Guinea Bissau, and Liberia as the least attractive countries.

The proposed international franchise expansion model is presented in the section "The international franchise expansion model". The methodology used to carry out this study is presented in the section "Methodology". Section "Results and discussion" reports and discusses the results of the global index of international franchise expansion. Section "Conclusions and implications") summarizes the results of the study and presents a number of managerial and theoretical implications.

The international franchise expansion model

Theoretical background

Three theoretical frameworks have had a marked influence on internationalization research: the Uppsala model (Johanson and Vahlne, 1977), the eclectic paradigm (Dunning, 1988), and the transaction cost analysis model (Anderson and Gatignon, 1986).

The Uppsala model of internationalization asserts that, because internationalization is inherently risky, firms tend to internationalize first to psychically close countries and then gradually move to more psychically distant ones. According to this model, firms will tend to favor low resource commitment modes of entry into foreign markets (such as exporting and licensing), and will only move to higher commitment modes as they gain experiential knowledge in the foreign markets.

According to Dunning's eclectic paradigm of internationalization, three sets of advantages determine firms' international expansion and foreign market entry mode decisions: ownership advantages (advantages specific to the owners); internalization advantages (advantages rising from the transfer of ownership advantages to the foreign markets); location advantages (advantages coming from the characteristics of specific locations) (Hill et al., 1990; Agarwal and Ramaswami, 1992). This model predicts that foreign direct investment will be the preferred mode of market entry when advantages in all three factors can be realized.

The transaction cost analysis model initially proposed by Anderson and Gatignon (1986) is derived from transaction cost economics (Williamson, 1975). This model asserts that firms deciding on international expansion and entry modes make trade-offs between control (benefits of integration) and cost of resource commitment (cost of integration). Wholly owned operations, for example, are characterized by the highest level of control. Higher control may reduce transaction costs but may

[3] It is assumed in this study that the franchise firm has already decided to expand internationally. The issue of why to internationalize has been extensively addressed in the literature.