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Market orientation and business performance: Evidence from franchising industry

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ABSTRACT

This paper examines the relationships between top management factors, franchisor market orientation, competitive strategy, and business performance within the context of Korean franchisor companies. 156 food-service franchise firms provide the basis for this empirical investigation. Findings show that top management factors such as management emphasis and risk aversion can lead to market orientation. Franchisor market orientation was found to lead differentiation and cost strategies, which, in turn, increase financial and non-financial business performance. Also, market orientation directly increases financial and non-financial business performance. The context of the franchise industry differs from other industries, and this paper discusses the implications of these findings for researchers and managers in the franchise industry.

1. Introduction

In the last few decades, franchising has become a part of everyday life in developed countries. In particular, due to recent globalization efforts by firms looking to branch out of a saturated primary market, entry into developing countries has become a viable means of business growth. However, the global financial crisis of 2008 led to a rapid contraction of business credit, as economic uncertainties and decreased consumer spending led to an unstable economic environment. Recently, as the world's economy starts to recover, both entrepreneurs and multi-national enterprises alike have again looked toward business expansion in developing countries, albeit with a cautious optimism. As a result, many firms in a variety of industries have adopted franchising as a key business strategy since markets have become highly competitive and turbulent and are constantly changing (Hsu and Jang, 2009). Environmental uncertainty is a major obstacle to decision making for the franchise industry (Boyle, 1999). Franchisees in particular, which are often small business owners, face uncertainties in terms of business model, competitors, customers, marketing efforts, and overall viability. Since small businesses are crucial to the financial well being of an economy, franchising has become a popular business model because it alleviates pressures and uncertainty in starting a business via the transmission of best practices and marketing assistance (Chiou et al., 2004).

The rapid growth of franchising has attracted the interest of researchers from a variety of academic fields (Elango and Fried, 1997; Hsu and Jang, 2009). The recent growth of the franchise industry in Korea needs systematic and strategic research to be successful in a competitive environment. Existing literature, however, has yet to address how market orientation and competitive strategy together influence business performance in the franchise industry, especially in Korea. Therefore, the significance of focusing on a key function of market orientation in the context of a dynamic environment to obtain a better understanding of competitive advantage and business performance is meaningful on both conceptual and strategic venues.

The value of this research is twofold. First, despite abundant research on its theoretical construct – the role of market orientation on business performance – further investigation is needed as to whether specific top management factors facilitates or causes the relationship between market orientation and business performance in the franchise industry. Although much research suggests that market orientation plays a critical role in increasing a firm's

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business performance, the issue of whether specific antecedents to market orientation, like risk aversion and management emphasis, influence the market orientation–business performance relationship has yet to be addressed explicitly in the franchise field. Namely, this study examines the contingent relationship between franchise businesses, market orientation, and competitive strategy to align franchise firms both internally and externally.

Second, though the importance of market orientation on firm performance is widely known, the findings on the nature of the competitive strategy–business performance relationship is somewhat limited in strategic value for franchise managers. Accordingly, if the inclusion of the competitive strategy construct can contribute to identifying empirical regularities or reconciling irregularities in the competitive strategy–performance relationship, the level of confidence in competitive strategy would be advanced from a strategic standpoint. Our findings also can make a significant contribution to understanding how to enhance franchise performance through competitive strategy.

The authors of this study identify Korea as an appropriate business context to conduct this research due to rapid growth and constant change in its business environment. Relevant to this study, the franchise industry in Korea has been growing significantly over the past 10 years. The trend was jumpstarted by fast food restaurants, which was followed by family restaurants, clothing chains, cleaning services, educational institutions and discount stores. In 2002, the number of franchise businesses in Korea was approximately 1600, overseeing 120,000 outlets. In just ten years, this number has more than doubled, with the number of franchise businesses and operating outlets increasing to 3500 and 488,000 outlets, respectively (KB Daily Knowledge Vitamin, 2012). In 2010, according to the Ministry of Knowledge Economy's distribution and logistics division, the franchise industry in Korea was worth an estimated $70.2 billion. From this number, franchises for food services, including fast food chains and family restaurants, account for around 52 percent, or $36.5 billion; the retail sector, including convenience stores and consumer goods, account for 36.2 percent, or $25.4 billion; and the remaining sectors, including education, real estate, cleaning, and mailing services, account for 11.8 percent, or $8.2 billion.

Despite its short franchise history of only 30 years, the Korean franchise industry has grown to make up 10% of the GDP in Korea due to its outstanding technologies, systems, capital capabilities, brand powers, etc. (KB Daily Knowledge Vitamin, 2012). Experts believe the potential for the franchise industry in Korea is bright because this segment has already been tried and tested with huge success. For example, the U.S. government website *Export.gov* indicates that Korean franchisees seek out and prefer to do business with U.S. franchisors that can offer established brand names to Korean consumers, and value the transfer of American management skills provided by U.S. headquarters (Export.gov, 2013). In addition, Tom Portesy, CEO of MFV Expositions (Global Franchise Corporation that organizes international franchise expos in NY, Houston, Anaheim, Mexico and UK) stated that Korean franchises have a very competitive edge in the US market thanks to effective systems, operations and services. Furthermore, the Korean government has consistent plans to assist franchise business to drive growth of international franchisors and entrepreneurs, creating new opportunities where otherwise growth becomes increasingly difficult in terms of local market saturation and increasing regulations.

Despite the recent growth of the franchise industry in Korea, several challenges remain. For example, franchise business in Korea has only operated for an average of 5.4 years. More specifically, over 60% of franchisors have less than 5 years of business life expectancy and over 16% with less than one year of operation (KB Daily Knowledge Vitamin, 2012). Despite this challenging fact, more and more franchise systems are expanding into Korea. There is little doubt that many of the major opportunities for franchising lie in the Korea market of the Asia-Pacific region. While Europe and North America remain affected by the consequences of the global financial crisis, most of the Asian Economies are growing strongly. The demand for goods and services from increasingly affluent middle classes will fuel strong economic growth in the upcoming decades. Due to Korean franchisee's preferences to do business with United States franchisors and the relative infancy of the Korean franchise industry, it is important for franchisors in all industries to accumulate relevant market information in order to become competitive in Korea's fast-paced business environment. Although this study takes place in Korea, the authors purport that due diligence and competitiveness by a franchising firm is relevant in most business environments across the world. The objective of this study is, therefore, to identify how market orientation and competitive strategy affect firm performance. To this end, we explore whether top management factors enhance market orientation and further study the extent of the consequences on the level of business performance. Also, we take competitive strategy into account to identify the contingencies for the framework. In summary, we present a model that synthesizes the knowledge in market orientation and competitive strategy to understand the path to firm performance from the franchisor perspective, rather than from the franchisee viewpoint.

2. Theoretical foundations

2.1. Market orientation

Market orientation is a marketing management concept that facilitates a firm's ability to deliver superior products and services to both internal and external customers. This is especially important in today's dynamic market environment where competition and uncertainty is intensifying. According to Kohli and Jaworski (1990), market orientation refers to company-wide acquisition of market intelligence, company-wide circulation of the material across departments, and company-wide reaction to it. In other words, this means that the company must first identify the various needs of such market participants as competitors, consumers, and suppliers, learn how to effectively respond to the changes in the market, and diligently work to create products and services that will provide a competitive advantage (Kohli & Jaworski, 1990). As such, Narver and Slater (1990) argue that profitability is the ultimate goal of a firm, and it results from successful market orientation. By definition, market orientation seeks to understand and capitalize upon exogenous factors surrounding a firm. In doing so, a firm is able to identify and respond to their customers' needs and provide products and services that fit those needs, thus making market orientation a primary instrument in developing a sustainable competitive advantage (Jaworski and Kohli, 1993; Narver and Slater, 1990; Kumar et al., 2011).

For the concept of top management emphasis, it is widely thought that top organizational leaders within a firm set the tone for the rest of the organization. Many studies have indicated that the actions of top management within an organization directly reflect the corporate culture and business ideologies of a firm (Senge, 1990; Hambrick and Mason, 1984; Slater and Narver, 1995). According to Slater and Narver (1995), a dynamic environment facilitates the need for a dynamic style of leadership from a visionary leader. Such leaders can educate cohorts, clients, and suppliers, as well as promote awareness toward relevant issues, ideas, and emerging trends. Additionally, these upper level managers can encourage an environment where innovation and non-conformation with the status quo is expected (Senge, 1990). In