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Foreign ownership strategies of UK and US international franchisors: An exploratory application of Dunning's envelope paradigm

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Abstract

In industries dominated by franchising as the dominant mode of entry there is a tendency that franchisors pursue different ownership strategies. We test ownership strategies of international franchisors using Dunning's 'envelope' Ownership, Location and Internalization (OLI) paradigm. The ownership choices of international franchisors' foreign market entry based on the strategic intent of exploitation and exploration are well explained by Dunning's 'envelope' OLI paradigm. Our results show that the dynamic L advantages (perceiving foreign locations as a source of learning), the static O advantages (nationality of the firm) and static L advantages (the role of foreign applicants) have a significant influence on the selection of foreign entry strategy by international franchisors.

Keywords: International franchisors; OLI eclectic paradigm; Foreign market entry strategy

1. Introduction

The intrinsic nature of business format franchising enables a franchisor to take advantage of the resources, capabilities, and entrepreneurial spirit of a franchisee in setting

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up new outlets and allows, a franchisor to minimize the risk of running its foreign operations (Brickley, 1999). Consequently, the majority of international franchisors are known to use contractual modes of foreign market entry such as master franchising (U.S. Department of Commerce, 1988; Zietlow & Hennart, 1996).

However, there remain a number of international franchisors who prefer to own foreign outlets and invest their own financial and managerial resources (Justis & Judd, 1989; Preble, 1992; Teegen, 2000). Justis and Judd (1989, p. 557) reported based on an International Franchising Association survey that 12% and 6% of international franchisors formed international joint ventures (IJVs) and established subsidiaries, respectively. Preble (1992) presented the factors affecting franchisors establishing a fully owned subsidiary, and also explained why international franchisors form joint ventures. He offered examples of McDonald's early joint venture experiences, Kentucky Fried Chicken's 408 joint venture units operating worldwide, and Pizza Hut with 217. While Teegen (2000) studied Mexican buyers of US franchise systems (franchisees, master sub-franchisers and area developers), she also recognized the ownership options, such as company-owned outlets and equity joint ventures in addition to the conventional franchising option, that a franchisor has when it enters foreign markets. Petersen and Welch (2000, p. 480) also indicated that franchisors may enter foreign markets 'via a wide range of organizational types' that include wholly owned subsidiaries and joint ventures in addition to master franchising/area development and direct franchising. They acknowledged that 'franchised activities will often co-exist with company-owned operations' (Petersen & Welch, 2000, p. 481).

As the proportion of this group who engages in equity modes to the total number of international franchisors is normally small, they are often ignored in the literature. The key issue, however, raised in this paper is why these franchising firms should prefer investing in foreign operations and embrace a higher risk, instead of signing contracts with foreign local franchisees. If one assumes that the primary strategic motivation of the latter group of franchisors is to gain market access, then the underlying strategic rationale of the former group also needs to be identified.

The objective of this paper is to examine the foreign ownership choices of international franchisors. Our goal is to identify and test why a certain group of franchisors would like to own foreign outlets. We wish to test whether international franchisors expand into overseas markets primarily to gain additional revenue by exploiting their standardized product features, brand names, and oligopolistic power (Calvet, 1981; Teece, 1981) i.e., market-seeking franchising, or whether they are seeking access to new knowledge, learning capabilities, and adaptation techniques (Ghoshal, 1987; Kogut, 1985) i.e., asset-seeking franchising. We will show that international franchisors that enter foreign markets via an equity mode tend to have an exploration approach, while franchisors that are entering via franchising mode tend to have an exploitation intention. We shall focus on the dynamic interface between various strategic motives of international expansion and two ownership strategies commonly used in entering foreign markets. Our interest is more directed towards identifying the conditions under which franchisors might be expected to gain new knowledge in foreign locations via equity entry modes.

2. The major foreign market entry choice

McIntyre and Huszagh (1995) found that international franchisors in the 'committed involvement stage' are more likely to have company-owned units internationally compared