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Mika Tuunanen

Essays on Franchising in Finland

Empirical Findings on Franchisors
and Franchisees, and Their Relationships



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ABSTRACT

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The present study focused on business format franchising. The purpose was to fill an obvious knowledge gap in this field in Finland by generating novel and generalizable empirical results. As a whole, the research consisted of five separate but integrated studies. The target phenomenon was approached from the point of view of entrepreneurship. Analytical examination was conducted in accordance with the three-level, holistic and integrative model of Stanworth and Curran (1999). On the level of society, and particularly of economy, the research task was to explore the scope of franchising in Finland. On the organization level, i.e. the franchisor, the rationales why the company initially launched franchising as well as the contents of a typical franchise contract were investigated. On the individual level, i.e. the franchisee, the business advantages and disadvantages experienced and the entrepreneurial orientations were examined especially from the viewpoints of franchisees' prior entrepreneurial background and the duration of the franchise relationship. Franchisee satisfaction, intentions and franchise contract were analyzed as part of the franchise relationship. The nature of the study was nomothetical, and the knowledge interest theoretical. The research strategy applied was structured and quantitative. One of the main outcomes of the study was compilation of Finnish franchising statistics for 1999-2003. Furthermore, the primary reason for companies to initiate franchising was strive to attain rapid growth, market penetration and geographical dispersion. The results strengthened the view that franchisees' underlying motives are dynamic, and that their prior entrepreneurial background has an effect on the motives. Franchisees had diverse entrepreneurial orientations towards the franchise relationship. The business advantages experienced by franchisees (stimuli and support, internal and external rewards, ease of start-up) increased their satisfaction and acted as cooperative motives. Disadvantages (decreased independence and responsibility, franchise fees, contract and cooperation-related friction) gave rise to franchisee dissatisfaction. Components explaining franchisee satisfaction were finance, franchisor's ongoing support, market performance of the franchise system and work as a franchisee. Dissatisfaction caused negative intention to continue franchise relationship. However, franchisees were relatively satisfied with and committed to their businesses. The franchise contract seemed to have a key role in collaboration, and it had strategic significance for both parties. Finally, implications concerning franchising research, education and training, management and small business policy were produced.

Keywords: Business format franchising, franchisor, franchisee, franchise contract, franchise relationship, franchisee satisfaction, transaction cost theory, agency theory, resource-based theory, property rights theory, Finland

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When I commenced academic studies in 1991 I had no way of knowing or even imagining, where they would eventually take me. Now, fourteen years, sixty articles and two dozen international conferences later, I can state with immense satisfaction that my studies have reached a conclusion – if not an absolutely final one, at least a formal one.

Four years ago I was able to transform my theoretical studies into real-life entrepreneurship. I can now argue to know something from my own experience that I assert to know through my studies and research. Working for the largest franchisor in the world, first as an employee and then as a business advisor, and a partnership in a franchisee company have also deepened my understanding of the phenomenon of entrepreneurship.

This journey, which well deserves to be called a time of mental growth, has been one worth taking and experiencing. I would be lying if I did not admit that the journey was at times a long one – in my opinion and certainly of those watching my progress. Making this journey has called for sacrifice in many areas of life. If I had known all this in advance, I might not have chosen to take the journey at all. However, getting under way and staying in motion have been of primary importance. The journey itself has undoubtedly been a larger thing than finally getting there, which was the objective despite the uncertainty of ever reaching the goal. The first studies reported in my thesis were launched in spring 1996. Perseverance and tenacity have thus been needed companions along the way.

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The manuscript of my thesis was reviewed by “the father of franchising”, professor, Robert T. Justis, PhD, from the Louisiana State University in Baton Rouge (LA), the USA, and professor Jukka Vesalainen, PhD (Econ. & Bus. Adm.), vice rector of Vaasa University, Finland. Professor Justis has been an outstanding inspiration for my research. Bob, it has been a real pleasure and honor to get to know you and to be able to work with you. You are a real hero! Professor Vesalainen will act as the opponent when I publicly defend my dissertation. My sincere thanks are due to both for their helpful and constructive criticism and for their contribution towards my thesis.

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In Jyväskylä, January 2005

Mika Tuunanen

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PART I

1 INTRODUCTION

1.1 Background of the study

This study focuses on franchising. Franchising is approached from the viewpoint of entrepreneurship, in which case franchising is understood as a form of starting and conducting entrepreneurship and business.¹ The approach utilized in the study is not traditional; it is relatively new and little applied. The research tradition of franchising, like that of entrepreneurship, is fairly short, its foundation is multidisciplinary and its theories are rather undeveloped.² In business studies, franchising has largely been looked at from the point of view of marketing, i.e. as a retail distribution channel solution and a form of international business, as well as from a management point of view, i.e. as a form of organization, strategy and cooperation between enterprises. Earlier franchising studies have to a large extent been isolated, insufficiently integrated and relying too much on the viewpoint of one party, the franchisor (see e.g. Elango & Fried 1997; Stanworth & Curran 1999; Hoy & Stanworth 2003a; 2003b). In the present study, franchising is approached in a more holistic manner, from the viewpoint of both the franchisors and franchisees. The study

¹ In *New Venture Strategies* from 1980, considered a classic, Karl Vesper saw franchising as one of the main strategic forms of competitive advantage, the so-called "entry wedge", with the aid of which a new enterprise can be founded, thus giving rise to new entrepreneurship in existing competition in the market without special innovation (Vesper 1990, 192-194, 217-224). Vesper's view is in line with that of Baumol (1986). According to the idea presented by Baumol, entrepreneurs can be divided into two groups on the basis of the nature of the business idea of the enterprise founded: initiative, i.e. innovative, and imitative entrepreneurs. In franchising, the franchisor could therefore be seen as being initiative and franchisees as imitative entrepreneurs. In franchising, business concept and operation that is already working and possibly successful is reproduced in a new market area. This way franchising contributes to efficient dissemination of innovations.

² E.g. Bygrave (1989, 7-13) described the multidisciplinary background of entrepreneurship, timing the actual development of the entrepreneurship paradigm to the beginning of the 1960s, when systematic empirical entrepreneurship research began. (see also Grant & Perren 2002)

is empirical and descriptive, and it provides new knowledge on franchising-type entrepreneurship in Finland.

The research theme is examined on three levels:

- 1) On the level of economy, the focus is on the extent of franchising and its manifestations in the Finnish economy,
- 2) Organizationally, on franchisor level, the focus is primarily on the motives for launching franchising and the ways the franchise contracts are drafted, and
- 3) On franchisee level, the key questions are the business advantages and disadvantages experienced by the franchisee, the nature of entrepreneurship as well as the co-operational and contractual relationship with the franchisor.

There were several factors contributing to the initiation of this study in 1996, the most important being the obvious gap in franchising-related knowledge observed in Finland. By the mid-1990s, virtually no advanced academic research had been carried out on the subject in Finland.³ However, the knowledge gap did not only concern academic research data; merely no textbooks on franchising had been written for the general public in Finnish at that time. Franchising was either not mentioned at all in basic textbooks on entrepreneurship available in Finnish, or if it was, the perspective was more than likely to be something other than entrepreneurship.

In his basic textbook on entrepreneurship, for example, Koironen (1993, 115) only described establishment of new start-up enterprise, continuation of family firm through a generation transfer and various types of business acquisitions as forms of launching external, i.e. owner-based, entrepreneurship. According to his view, franchising was a special form of networking economy, i.e. *custopreneurship* (see Koironen 1993, 139-149). The concept of *custopreneurship* was created by professor Jarmo R. Lehtinen in his book *Custopreneur: A Profitable Business Resource* (Lehtinen 1988). In very simplified terms, the concept can be seen as covering the combination of customer relationship marketing and entrepreneurship, so that the customer (cf. agent or franchisee) of the main enterprise (cf. principal or franchisor) is integrated as a business resource of the aforementioned operations. *Custopreneurship* was later developed further by Koironen and Tuunanen (1996).

Franchising as a form of inter-business cooperation, networking and *custopreneurship* has also been studied by Vesalainen (1996). According to his view, franchising is a form of cooperation between parties characterized by high intensity of business operation, in which uniform business is carried out. Specialization occurs regionally in enterprises that are highly similar, and

³ As far as it is known, no doctoral dissertations on franchising have been published in Finland prior to the present study. There are, however, three doctoral dissertations on merchant-driven retail distribution channels by Mannermaa (1989), Hyvönen (1990) and Mitronen (2002). Several studies on franchising have been conducted at Finnish universities as master theses.

division of labor is implemented between franchisor and franchisees. The formality of the cooperation is characterized by a written contract and hierarchical decision-making (see Vesalainen 1996). However, in Finnish research, franchising was only later seen clearly as a germ for the birth of new business and new enterprises. Laukkanen (1999, 54-57, 178-179) for example, regarded franchising as an example of guided establishment of new enterprises based on transfer of business operation models, where new business operation is based on another, already operating enterprise, or branches off of one (cf. spin-off). The related advantages include rapid and less risky start-ups. Laukkanen (1999) linked franchising strongly with entrepreneurship, stating that franchising is also a potential form of serial or portfolio entrepreneurship (see Ronstad 1988; Scott & Rosa 1997). Pihkala and Vesalainen (1999, 50) mentioned that globally dispersed franchising is an interesting example of operational innovation that creates something new. This view is consistent with e.g. that of Price (1997, 506), who regarded franchising in itself as a form of innovation.

The root of modern business format franchising can be traced to the latter part of the 1950s in the United States (see e.g. Dicke 1992). It is therefore understandable that franchising research and literature has the longest tradition there, dating back nearly 35 years, to the beginning of the 1970s. In Europe, mainly in Great Britain, franchising research has a history of nearly twenty years. Compared to this background, the Finnish franchising culture seemed to be very young and considerably less developed (Tuunanen & Koironen 1998). The national franchising association was founded in 1988 in Finland, and many franchising systems were established as late as the late '80s and early '90s.

In addition to the knowledge gap regarding franchising, another important reason for carrying out this study was the aggressive spread and growth of franchising in an increasingly service-oriented and globalized economy (see e.g. Welch 1989; Hoffman & Preble 1993; Swartz 1995; EFF 1997; Hoffman & Preble 2001). Chan and Justis (1992), for example, mentioned franchising as the fastest-growing form of business, not only in the United States, but also in the whole world. Bradach (1998, 1) mentioned franchise chains as one of the most dominant forms of organization in the markets of our time. It was predicted in the early 1990s that by the end of the millennium more than 40% of the total annual value of retail trade in the United States would be channeled through franchising systems.

In the United States, tensed competition and a saturating domestic market drove franchising systems to international markets from the 1980s on, especially to Europe, Japan, Australia and Asia.⁴ With European integration, Europe became a primary target for American franchise systems. Chan and Justis (1992) identified Europe as the most suitable target area for franchising, as economic, legal, fiscal, technical and physical trade barriers could be lessened by integration and harmonization, which would speed up international trade and

⁴ In 1990, about 8,000 franchised outlets of US origin were operating in Europe. That was one third of all franchise outlets of US origin, when outlets in Canada and Mexico as well as the Caribbean are excluded. (see Zimmerer & Scarborough 1996, 500-504).

therefore also franchising.⁵ According to their view, the considerably lower penetration of franchising in Europe compared to the United States meant that there was a shortage of at least 1,300 franchisors and 375,000 outlets. Generally taken, it seemed likely that the effects of this development trend would increasingly be experienced in Finland as well.

As far as is known, University of Jyväskylä was the first to launch academic research and teaching on franchising in Finland. This took place in 1996 as part of entrepreneurship studies. That is when the present study was initiated as well. The principal notion underpinning the research was to provide new knowledge on franchising in Finland and to fill the knowledge gap in this field. There was also a strong belief that franchising as a form of entrepreneurship would grow strongly in Finland in the future, and that information concerning it would be topical and needed, in addition to being essential and useful for interest groups of entrepreneurship. (see also Koironen & Hyrsky 1996; Koironen & Tuunanen 1996; Tuunanen & Koironen 1998)

1.1.1 Focal definitions of the study

The key concepts used in this study are as follows:

Franchising. Franchising is an organizational form in which a company grants another company *the right* to do business in a prescribed manner over a certain period of time in a specified place in return for royalties or the payment of other fees. (Elango & Fried 1997, 68-69)

Franchising is typically divided into two main types, product-and-trade-name franchising and business format franchising. The first one is a supplier-dealer relationship, where the franchisee acts under its principal's brand and as a distributor of its products. In the latter, cooperation between the parties is closer and more extensive, and it covers the transfer of the entire business operation concept to be utilized by the franchisee, i.e. not just licensing part of the business operation. In the cooperation, the franchisor offers the franchisee continuous support services, commercial and technical assistance and training. Examples of product-and-trade-name franchising include many merchant-driven distribution channels such as car dealerships, fuel distribution chains and soft-drink bottlers (for a more detailed account, see e.g. Elango & Fried 1997, 69; Justis & Judd 1998, 1-4...1-7)⁶

⁵ The accelerating effect of European integration on the spread of franchise systems is hardly over yet. In 1992, the European Union consisted of twelve member states. After that, thirteen new states have joined in. If the present Union with 25 member states is expanded by an additional three countries – Bulgaria, Romania and Turkey – the union will form a market area of about 500 million people, the largest after China and India. A study conducted by the European Franchise Federation in 2004 showed that there were more than 5,500 franchise systems operating in Europe with over 250,000 outlets. The number had risen by 50% from the year 1998. (see Chopra 2004)

⁶ The number of product-and-trade-name franchising outlets has been declining for a long time. The volume of sales channeled through them is however very significant, due to high volumes (e.g. fuel) or the high unit price of commodities (e.g. new cars). Many product-and-trade-name franchising systems have converted into business

According to European views and sets of norms, product-and-trade-name franchising is not regarded franchising, and that is why the term *franchising* in this study always refers to business format franchising, unless expressly otherwise indicated.

Franchising is often misleadingly discussed and referred in everyday context as a single business industry. Franchising is however utilized as a form of business operation in many domains and business industries. In the United States, franchising has been identified in at least 75 business industries (National Economic Consulting Practice of PriceWaterhouseCoopers 2004). Later in this report, a more precise definition of franchising is created and presented. A set of franchising criteria is also set up, operationalizing the concept.

Franchisor. The company granting *the right* to another company is called franchisor (Elango & Fried 1997, 69). The definition focuses on ownership and governance of right (cf. property rights theory). The franchisor has often also launched, conducted and developed the business concept and operation that is the target of the right in question.

Franchisee. The company receiving the granted *right* is termed franchisee (Elango & Fried 1997, 69). A synonym for the word franchisee is *franchise owner*. *Multi-unit franchisee*, on the other hand, refers to a franchisee owning and running several units in its name. In such cases, each of them has been agreed on with a separate contract.⁷

It should be noted that the franchisee is in actual fact an enterprise, a unit that is legally and economically independent of the franchisor. In many instances the word franchisee is used synonymously with entrepreneur (or small business owner or self-employed), in which case franchisee is thought of as a person. On the one hand it is true that most franchisees are founders and owner-managers of their companies and therefore individual small and medium-sized entrepreneurs. On the other hand, franchisees are sometimes companies that are even larger in size than their franchisor.

Franchise. *The right* that is granted is called franchise (see Elango & Fried 1997, 69). The right is granted in a franchise contract, which is often very detailed and comprehensive, written, and from the franchisee point of view, a standard document.⁸ By definition, franchising is established through a franchise contract, where the contracting parties agree on governance and use of the right (cf. property rights). The term franchise refers thus to the right, but also to the contract and the franchise organization. The etymology of the word can be traced to the old French word *franc*, meaning *free*. Semantically, the word

format franchising systems. The franchise contracts made today comply primarily with the business format model. (Justis & Judd 1998)

⁷ *Master franchisee*, on the other hand, is a form of international franchising, in which one franchisee is given the right to spread franchising operation within a given area, often an individual state, by making sub-franchise contracts. In practice, so-called *area development agreement* comes close to this. In area development agreement, an individual franchisee is entitled and obliged to expand franchising regionally within a given period of time in a manner agreed on in advance.

⁸ In essence franchising is very analogical to licensing where licensor license a right to licensee. Many times also license (verb) seems to be used as a synonym for franchise.

denotes a prerogative or privilege, as well as some given power or right or authorization. Spinelli, Rosenberg & Birley (2004, xv) consider the term franchise as being perhaps one of the most misunderstood and misused words in today's business life.⁹

Company-owned unit. Units that are owned and operated by the franchisor company are called company-owned units (see Elango & Fried 1997, 69). The word *unit* generally refers to a store or outlet. It should be noted that in some cases the unit could be a mobile or a home-based operational establishment (cf. Preble & Hoffman 1994, 6).

Franchised unit. Units that are owned and where franchising based business is operated by the franchisees are called franchised units (see Elango & Fried 1997, 69).

Franchise system. The entity covering both the company-owned and franchised units is referred to as franchise system or franchising system (see and compare Elango & Fried 1997, 69). In most cases, also the franchisor owns and manages units. All units are only very rarely governed by the individual franchisees. When the franchisor owns units, in addition to the franchisees, the organizational structure is referred to as *plural form* or *dual structure*.¹⁰ Besides the term franchise system, the more everyday expression *chain* or *network* is sometimes used.

1.1.2 Structure of the research report

The doctoral thesis at hand consists of five separate research articles that have been subjected to double blind review by expert referees and published on international academic forums. The articles are linked to the research themes mentioned previously and their levels of examination. The theoretical framework connecting the articles as well as the research design, the results with their implications and discussion are presented in the first part of the report. The original articles are presented in the second part of the report in their original form, i.e. exactly as they appeared when first published. The original articles will appear in chronological order, i.e. their initial publishing order except one article dealing with franchising statistics 2003.

In the next part of this chapter, earlier franchising studies and literature are examined. After this, the present study is positioned within the field of entrepreneurship studies. Key theoretical starting points utilized in this research describing the birth, growth and survival of franchising are depicted

⁹ In 1987 in Finland, an attempt was made to replace the term *franchise*, which had previously been used as borrowed quotation, with the word *luoake*. As the word did not catch on, the term *franchising* was officially accepted into Finnish as an established foreign term (Eronen 2000, 8). According to the author's observations, there are still a lot of difficulties in Finland with regard to understanding, semantically correct using as well as spelling of the word. This is probably a reflection of our young franchising culture.

¹⁰ The parallel structure of franchise organizations or dual distribution is one of the most widely studied and interesting special issues, because for a organization it goes back to the problem of "make or buy", i.e. "own or franchise".

next. The framework of the study is formulated in this chapter (1.5). Summaries of each article and presentation of their findings and discussions in a concise form follow after presentation of the methodology and research design. The summaries are followed by main conclusions and implications of this study. A list of references that only include sources used in the introductory chapter concludes the first part of the report.¹¹

1.2 Previous franchising research – a literature review

Franchising research has a fairly short history. The oldest known and frequently cited studies were published in the late 1960s. The *Journal of Retailing*, an academic journal focusing on marketing channels, edited a special issue dedicated to franchising in the winter of 1968.¹² The issue included several articles that can be regarded as the first pioneering efforts in the field of franchising research. Research on the contents of prior franchising studies was not launched until the late 1990s. For example Kaufmann (1996) brought forward franchising-specific fields of study of interest of the industry in his overview concerning the state of franchising research. These included the following: motivation to become a franchisee, franchisee failure rates and industry growth.

Subsequently Elango and Fried (1997) analyzed extensively previously published franchising studies. As far as is known, this was the first study of its kind. Their research material consisted of 99 known and widely cited studies, all of which were first summarized, after which their content was analyzed. They divided the studies into three more comprehensive streams: franchising and society, creation of the franchising relationship, and operation of a franchising system. The classification was based on their observations of different orientations, perspectives and research questions of the studies. The first category is politically oriented, and its viewpoint is that of the societal impact of franchising. The latter two are management-oriented. The second focuses on the organizational efficiency and economic profitability of franchising. The third orientation uses the existing franchising relationship and its operative issues as its starting point.

Table (1) has been drawn up based on the analysis of Elango and Fried (1997). It shows, by research stream, the orientation, perspective and the disciplines of research in which studies have been conducted, as well as the fundamental research questions and most commonly studied individual issues in each category.

¹¹ A joint list of references is given at the end of the second part of the report after the research articles, including sources used in the entire report, i.e. the introductory chapter and the original articles.

¹² The special issue was published in the 43rd volume of the journal.

TABLE 1 Previous franchising studies elaborated (applied from Elango & Fried 1997)

| Main stream of franchising study | Orientation, perspective and disciplines of study | Fundamental research questions | Issues |
|---|---|---|--|
| <p style="text-align: center;">I</p> <p style="text-align: center;">Franchising and society</p> | <p style="text-align: center;">Public-policy Utility to society</p> <ul style="list-style-type: none"> • Law • Economics | <p style="text-align: center;"><i>"Should we allow franchising?"</i></p> <p style="text-align: center;"><i>"How much the franchisor might abuse the relationship to the detriment of the franchisee?"</i></p> | <p>Economic efficiency vs. antitrust concern</p> <ul style="list-style-type: none"> -pricing -exclusive territories and dealings -contract clauses -disclosure |
| <p style="text-align: center;">II</p> <p style="text-align: center;">Creation of the franchising relationship</p> | <p style="text-align: center;">Managerial Performance and profit maximization</p> <ul style="list-style-type: none"> • Management • Management science • Economics, econometrics | <p style="text-align: center;"><i>"Should we conduct business operations separately or in collaboration with others through a franchising system?"</i></p> | <p>Franchising as a form of organization</p> <ul style="list-style-type: none"> -reasons to franchise -rent sharing -units to own or franchise -international franchising |
| <p style="text-align: center;">III</p> <p style="text-align: center;">Operation of a franchising system</p> | <p style="text-align: center;">Managerial Franchisees existing to operationalize the goals of the franchisor</p> <ul style="list-style-type: none"> • Marketing • Retailing | <p style="text-align: center;"><i>"What is the best way to operate the franchising system?"</i></p> | <p>Franchising as a type of marketing channel</p> <ul style="list-style-type: none"> -control, power, autonomy -co-operation -trust, commitment, satisfaction -conflicts -dependence-interdependence-independence |

In addition to semantic taxonomy of earlier studies, Elango and Fried (1997) made several recommendations, particularly concerning improvement of fragmented research. Firstly, they recommended that franchising theories be extended into resource-based theory, because according to them, franchising is ultimately about pooling franchisees' and franchisor's different resources. According their view, also the franchisor should be considered an agent, because

franchisees must monitor the operation of the franchisor.¹³ In their view, the agent theory had been applied in a limited manner. All in all, they perceived that franchisees should be looked at as an intelligent party of the franchise relationship, not only as the implementer of the franchisor's objectives, which seemed to be the dominant view applied by earlier studies. Franchisees inevitably make their own important contribution towards the success of the relationship. The franchise relationship had been looked at in a static manner. According to Elango and Fried, it has thus so far been impossible to study the changing and dynamic relationship. They feel that the fundamental question of the relationship and the ultimate advantage of franchising, the relationship between decision-making authority and division of residual claim rights, deserves further research attention. They also pointed out the need for franchising examinations in individual business industries. (Elango & Fried 1997)

In their analysis of the methods used in franchising research, Elango and Fried (1997) found several factors that had restricted the studies. Firstly, empirical studies had been exclusively based on quantitative methods, which give a limited amount of information about a large number of cases. Results aiming at generalization tend to mask variation, and the complexity which is evident in practice and which qualitative case studies are able to reveal, is often lost. According to Elango and Fried, data had often been gathered by postal questionnaires, but the amount of secondary data was also considerably high. In empirical studies on franchisees, all subjects in a sample often came from a single franchise chain, whereas in studies on franchisors various franchise listings were used for sampling. The authors also observed a significant deficiency in the variables used for measuring performance. According to them, turnover or the number of outlets were merely too simplified as measures of performance. The main problem was from whose point of view performance should be measured – that of the franchisor, the franchisees or the system as a whole. Instead of descriptive studies that currently dominate the scene, the focus should be on prescriptive studies.

Subsequent the franchise literature classification by Elango and Fried (1997), more limited classifications have been proposed in other instances. As they were developing an integrative and comprehensive explanatory model for franchising, Stanworth and Curran (1999) analyzed previous literature and listed the most frequent subjects of franchise research. They were as follows: franchisor's motives for the adoption and retention of the franchise format, franchise contracts, the franchisor-franchisee relationship, locational and pricing decisions, trends in ownership redirection, and international franchising and globalization issues. Later, Hoy, Stanworth and Purdy (2000) came up with a partly similar classification. They identified six issues that had dominated franchising research: distribution channels, contract issues, international

¹³ The moral hazard problem is two-sided in franchising since franchisees need to monitor the franchisor. This causes a collective action problem for franchisees. (Lafontaine 1992)

expansion and the benefits of internationalization, growth models and degrees of survival and failure.

Meanwhile, Young, McIntyre and Green (2000) published a content analysis of 285 research papers presented at thirteen *International Society of Franchising* (ISoF)¹⁴ conferences held in 1986 and 1988-1999. This provided an applicable means of inspecting earlier franchising research, because the community comprises many prolific frontline researchers and scholars, and many of the studies presented at the conferences are later published in academic journals in the field. The most popular subjects of the studies analyzed were as follows: international franchising (18%), franchise management (17%), franchise relationship issues (16%), performance and growth (13%), juridical and political issues (11%), marketing (9%), nature and scope of franchising (9%), economics (3%), entrepreneurship (3%) and methodology and modeling (2%). The results of Young et al. (2000) can thus be regarded as being mostly in line with those of Elango and Fried (1997), although the studies published within the ISoF have included a relatively large number of themes related to franchising implementation, which were called for by Elango and Fried.

A total of 154 or slightly over half (54%) of the studies analyzed by Young et al. (2000) were empirical studies. Secondary data was utilized in a good third (37%) of the studies. Interviews had been used as the primary method of gathering data in one out of seven (14%) studies, while postal surveys were the most widely used method, in 50% of the studies. The least frequently used method was case study, which was only used in ten studies. On this point the observation and criticism of Elango and Fried (1997) regarding the scant utilization of case studies is in line with the results of Young et al. (2000). There is a risk that studies relying strongly on quantitative methods produce descriptive results that are of relatively little use from the viewpoint of practical business management.¹⁵

The subjects of study of empirical research were fairly equally distributed. The most commonly studied group was franchisees (39%), followed by franchisors (34%) and other interest groups (27%). The observation of Young et al. (2000) is surprising on this point, because the franchisor's perspective has generally been the dominant one. The majority of empirical studies were fairly exclusively limited to the hospitality sector, i.e. hotel and restaurant industries.

¹⁴ Founded in 1986 and operating in the US, the International Society of Franchising is an international community of academic franchising scholars. The society did not meet in 1987, but after that a conference has been arranged every year jointly with the annual convention of the International Franchise Association (IFA). Nearly 30 research articles are published each year in Conference Proceedings. The latest conference arranged in March 2004 was the 18th. The number of franchising studies published so far exceeds 400. Until 1999 the Society was known as the Society of Franchising, but the name was changed due to the increasing number of international participants. At present, the Society has 148 academic members from 17 countries.

¹⁵ According to Hoy (1997), the problem of the results produced by entrepreneurial studies in general is their lack of practical relevance. Hoy & Stanworth (2003a, 6) do not regard the problem to be equally serious in franchising studies.

One fourth of the studies analyzed had been conducted outside the United States. In addition to the US, research findings had been published from a total of 21 countries.¹⁶

1.3 Positioning of franchising in entrepreneurship research

Franchising-related research has been carried out for some 35 years. The research has been multidisciplinary in nature. Economics, marketing, entrepreneurial research, law, sociology and psychology are some examples of sciences and disciplines in which franchising-related studies have been published. The articles have mainly been of North American origin, but increasingly from other parts of the world as well. From the 1980s onwards, active research has been carried out in this field in Europe, particularly in Great Britain, as well as in Australia. The number of studies in the field has thus grown considerably since the 1990s. Despite the tradition of franchising research and the increasing economic importance of franchising, it has often been called to question whether franchising should be accepted as a legitimate field of study in its own right, or whether it should merely be thought of as a fairly peripheral type of inquiry within some branch of science. Although poorly understood at the moment, franchising is without a doubt a phenomenon worthy of study (see Hoy & Stanworth 2003a, 1-5)

Published franchising literature can be roughly classified into three schools of thought. The differences between them are based on their diverse approaches to franchising (see Hoy & Stanworth 2003b, 9-10). The first school sees franchising as functional activity of existing business, which is why it should be studied by applying the models and theories regarding those functions. Examples of this are marketing and distribution channel studies conducted within marketing research, or management and related strategic or contract-based cooperation between firms. The second school sees franchising as an original phenomenon whose characteristics can however be explained through existing theories. Examples of the approach of this second school are general business theories such as agency theory and transaction cost theory as well as life cycle theory.

The third and most recent school approaches franchising as a unique phenomenon that can only be understood by developing or applying models or theories that are particularly suited for the purpose. Franchising is thus seen as a separate, individual phenomenon. Such early attempts have been put forth by Kaufmann (1996), Stanworth and Curran (1999) as well as Hoy, Stanworth and Purdy (2000). Kaufmann took up issues of research that were explicitly franchising-specific. Stanworth and Curran developed a sociological franchising

¹⁶ Sixteen studies had been published on Europe, three of them on Scandinavia. Eleven studies focused on the Soviet Union or Russia, ten on Asia, eight on Australia, two on Central and South America, while there was one study each on Africa and India.

model, while Hoy et al. identified six themes that had dominated franchising studies.

In this study, franchising is understood as a form of entrepreneurship and as part of entrepreneurship research. The conceptual starting point of the study is the uniqueness of franchising, which can be described and explained both by applying existing theories from other fields of science and by developing them in a franchising context (cf. 2nd & 3rd schools). Franchising is defined in the same way as Curran & Stanworth (1983, 11) ended up defining it as they studied the evolution of the franchising concept in earlier studies:

"A business form essentially consisting of an organization (the franchisor) with a market-tested business package centered on a product or service, entering into a continuing contractual relationship with franchisees, typically self-financed and independently owner-managed small firms, operating under the franchisor's trade name to produce and/or market goods or services according to a format specified by the franchisor."¹⁷

Franchising is properly suited as a field of entrepreneurship research. As a discipline, entrepreneurship comes close to and overlaps many subjects in the field of business economy, such as marketing, management and accounting, while having a multidisciplinary background. The interrelation between entrepreneurship and franchising can be justified e.g. by the fact that franchising research is about entrepreneurial cooperation between two different types of entrepreneurs, franchisor and franchisees (Shane & Hoy 1996). Spinelli, Rosenberg and Birley (2004, xvi) agree with the prior view, as they perceive franchisors and franchisees as entrepreneurs (see also Stanworth 1995). In addition, franchising can be defined as a type of entrepreneurial organization. The operation of the franchisor, i.e. setting up the franchise system, and the operation of the franchisee, i.e. implementation of entrepreneurship within the franchise chain, are undoubtedly entrepreneurial activities (Hoy & Shane 1998). Vesper (1980) defines franchising as one form of entering the market upon which a new business and entrepreneurship can be based on.

The above views of Hoy and Shane have later received support from the study of Kaufmann and Dant (1999). It should however be taken into account that the view of franchising as entrepreneurship is strongly contradictory to the previously widely held belief according to which franchising was even seen as the antithesis of entrepreneurship. According to this view, franchising is

¹⁷ The definition is of European origin, and it describes most accurately Business Format Franchising as opposed to Product Distribution and Trade Name Franchising. The definition has several deficiencies, e.g. in relation to market testing, financing and size of franchisee, as the authors later became aware of as well (see Stanworth & Curran 1999). In spite of this, the definition cannot be said to be in contradiction with the general definition developed later in this study, which does not have the shortcomings mentioned. The criteria drawn up to support the definition, i.e. specific franchising characteristics, made it rather exclusive (see Tuunanen 2003).

multiplication of successful business operation that does not call for creativity, which is a typical feature of entrepreneurship (Kaufmann & Dant 1999, 6).¹⁸

Hoy and Shane (1998) identified significant overlapping between entrepreneurship and franchising in the seven main approaches prevalent in entrepreneurship research. By entrepreneurship research they referred to studies where the only unit of analysis was venture, i.e. not individual nor environment, all three of which are included simultaneously in the analysis of the process view of entrepreneurship. The venture as part of entrepreneurship research forms an entity of its own, with characteristics that distinguish it from the traditional firm or organization view (cf. Davidsson & Wiklund 2001). The subject of study is value creation through venture establishment or acquisition, albeit so that entrepreneurial actions prior to and subsequent start-up are included in the examination. Approaches to entrepreneurship research (Hoy 1995) and their links to franchising are as follows:

*Incubator Organizations.*¹⁹ Franchise systems act as incubators of new ventures and franchise operations.

Business Plans. The franchisor requires that the franchisees have a business plan, which are therefore much more common in franchising than in independent business. In the United States, franchisors are obliged by authorities to draw up a public "business plan", a document entitled Uniform Franchise Offering Circular, in order to ensure access to information of potential franchisees.

Investment criteria. Franchising is a source of capital needed for growth when other sources of financing are not necessarily available to the franchisor. Venture capitalists have played an increasing role as financiers of franchise systems.

Success factors. Studies on franchisors' and franchisees' failure and survival are a subject of constant study. The aim here is to compare the results obtained to the failure and survival of stand-alone firms.

Corridor Principle. Franchisors recruit potential franchisees among active entrepreneurs. In addition, franchisors have often worked as entrepreneurs or business managers prior to launching franchising.

Corporate Culture. In franchising, the franchisor must be able to establish and maintain circumstance where new franchisees are recruited and where they own and manage units independently (i.e. franchised units) or along with the franchisor (i.e. company-owned units; dual distribution).

Life Cycle Models. In franchising, the key issue is to understand the birth of the business organization and its later evolution into a franchise system.

Kaufmann and Dant (1999) combined research focusing on franchising, franchisors and franchisees into a separate, essential field of entrepreneurship research. They based this on an extensive analysis where definitions of entrepreneurship were first divided into three semantic groups, after which the

¹⁸ For example Rubin (1978) and Anderson, Condon and Dunkelberg (1992) have not kept franchisees as entrepreneurs.

¹⁹ In this connection, incubator refers to the organization the entrepreneur comes from prior to establishment of the venture, i.e. not incubator in the traditional sense of the word.

applicability of franchising was compared to their contents. The three groups of concept were personal traits perspective, process perspective, and activities perspective.²⁰ As a result of the comparisons carried out, franchising was observed to be almost fully compatible with the concepts of entrepreneurship. According to the authors, the notions of entrepreneurship research are closely associated to manufacturing-type business, which on the other hand is alien to the commonly prevailing retail-type franchising.

In addition, Kaufmann and Dant (1999) pointed out four special franchising-related research themes that have relevance to entrepreneurship research. They were the following:

Franchisor as Retail Entrepreneur. In retail franchising, often relying on narrow niche segments, the scale of economically profitable business is significantly smaller compared to manufacturing. Franchising often involves development of a unique and efficient operative system where service provision is industrialized and transferable to franchisees. Identification, utilization and distribution of such concepts are well suited as a subject of study in entrepreneurship.

Entrepreneurial Partnership of Franchising. Franchising is based on an entrepreneurial partnership, where the concept innovated by the franchisor is distributed to the market through a network of outlets owned and managed locally by franchisees. There are unique risks and challenges involved in the local markets and outlet locations, even though the multiplied concept is the same.

Franchisee entrepreneur. For the franchisor, franchising is a means of acquiring capital and of solving the agency problem. The franchisor's risk is linked to development of the brand, while that of franchisees is linked to development of the local markets. All environments restrict entrepreneurship, but in franchising there are clear restrictions related to changing the concept. On the other hand, the franchisee is given a relatively large amount of freedom with respect to operating in the local market. The decision-making process where a new entrepreneur chooses franchising instead of setting up a stand-alone business deserves more investigation.

Multi-unit franchisee. Multi-unit franchisees are an increasingly common phenomenon in franchising. Multi-unit franchisee is most commonly the result of expansion of individual franchise owners as they open new outlets, or a result of an area development contract. Multi-unit franchisees change the balance of power and risks in the franchisee-franchisor relationship. It is still unclear how franchisors choose franchisees as collaborative partners in different circumstances.

Kaufmann and Dant (1999) mentioned the importance of franchising for the national economy, both in terms of domestic and foreign trade, as an additional

²⁰ The authors were aware of the deficiencies regarding the concepts of entrepreneurship as well as the lack of consensus concerning a universal concept of entrepreneurship (e.g. Low & MacMillan 1988; Amit, Glosten & Muller 1993). Therefore they concluded to define entrepreneurship as a personal quality that is manifested by an individual engaged in entrepreneurial activity, which in turn is defined as the activities of a unique individual called an entrepreneur (Kaufmann & Dant 1999, 9). Moreover, they applied view presented by Venkataraman (1998). According that view entrepreneurship as a scholarly field should seek to understand *how* opportunities for profit are discovered and exploited, *by whom*, and with what *consequences*. The view was in line with three perspectives given to classify various definitions of entrepreneurship: *how (action)*, *by whom (traits)*, and *consequences (process)* (see also Shane & Venkataraman 2000).

motivation for defining franchising as a separate area of research (cf. also Kaufmann 1996; Lafontaine 1996).

Stanworth and Curran (1999) regard franchising undoubtedly as a manifestation of modern economic individualism, where key cultural values typical of a competitive capitalistic system such as autonomy, independence, material rewards and even creativity are emphasized. These values have previously been linked too exclusively to traditional forms of entrepreneurship.

1.4 Theories explaining franchising

In the following, the key theoretical starting points explaining the birth, growth and success of franchising are presented, which have partly been made use of in this study. In general, the number of theories linked to franchising has been showing a slow but steady growth, while the scope of research methods used has widened. The theoretical underpinnings have been linked particularly strongly to economics and management. The existence of franchising as an institutional structure has been explained from two perspectives: as a combination of vertical integration and the outlets owned by the franchisor and the franchisees, as well as from the point of view of the franchise contract structure. (see Hendrikse & Windsperger 2004, 3-4)

The most widely used and accepted franchising theories are based on the logic of economic efficiency. However, due to their multidisciplinary nature, earlier studies in the field have been very fragmentary (Elango & Fried 1997; Stanworth & Curran 1999; Hoy & Stanworth 2003a; 2003b). Individual theoretical explanations have often been shown to be insufficient, and there has been increasing pressure to come up with richer integrated theories with better explanatory capacity. One tendency has based its views on the notion that franchising should be explained as an independent phenomenon in its own right. Therefore theories and models ought to be developed for it separately (Hoy & Stanworth 2003b). It is therefore extremely likely that franchising research will undergo major theoretical reforms (cf. Hendrikse & Windsperger 2004).

Key theories applied to franchising and studies related to the franchising context are presented in the following table (see Table 2).²¹

²¹ More recent theories that have been applied less to franchising include signaling theory and (Gallini & Lutz 1992) search cost theory (Minkler 1992) and incomplete contract theory (Lutz 1995; Maness 1996). Among many other scholars, Kaufmann (1996, 4) sees agency theory and transaction cost theory completely mingled in franchising context, thus it is difficult to identify any pure examples of each.

TABLE 2 Theoretical perspectives to franchising

| Theory | Focal studies and applications to franchising |
|--------------------------------|---|
| <i>Transaction cost theory</i> | Williamson 1985; 1991 Rubin 1978; 1990 Klein 1980; 1995 Klein & Saft 1985 Klein & Murphy 1988 Minkler & Park 1994 Spinelli, Rosenberg & Birley 2004 |
| <i>Agency theory</i> | Alchian & Demsetz 1972 Fama & Jensen 1983 Jensen & Meckling 1976 Mathewson & Winter 1985 Brickley & Dark 1987 Eisenhard 1989 Thomas, O'Hara & Musgrave 1990 Brickley, Dark & Weisbach 1991 Lafontaine 1992 Dahlstrom & Nygaard 1994 Combs & Gastergiovanni 1994 Bhattacharyya & Lafontaine 1995 Spinelli, Rosenberg & Birley 2004 |
| <i>Resource-based theory</i> | Oxenfeldt & Kelly 1968-1969 Oxenfeldt & Thompson 1968-1969 Ozanne & Hunt 1971 Hunt 1973 Caves & Murphy 1976 Anderson 1984 Norton 1988 Minkler 1990 Thompson 1992; 1994 Shane 1996 Hoffman & Preble 2003 Stanworth, Stanworth, Watson, Purdy & Healeas 2003 |
| <i>Property rights theory</i> | Barzel 1997 Hart 1995 Brynjolfsson 1994 Windsperger 2002; 2004 |

1.4.1 Transaction cost theory

Adam Smith's pioneering work "An Inquiry into the Nature and Causes of The Wealth of Nations", put prices and price mechanisms into the focus of economic theory, while the nature and effects of transaction costs were first presented by Coase (1973). He saw markets and organizations as alternative mechanisms for transaction implementation. The actual theory of the role on

transaction costs and prices in market was to a large extent developed by Oliver Williamson.

According to Williamson (1985; 1991), market transactions or exchanges are at the core of transaction cost theory, while the firm is seen as a system of contracts between its interest groups. That means that internal structure of the firm; factors influencing efficiency as well as incentives are in the focus of study. The frequency of transactions, the uncertainty related to them as well as the specificity of resources, are the key elements of transaction. If transaction is predictable, it is possible to aim at scale benefits. Utilization of scale is a crucial element in franchising.²² Transaction also involves possible opportunistic behavior of the parties involved. They must guard against potential consequences of opportunism, which gives rise to costs. Transaction takes place in circumstances characterized by uncertainty, and contracts remain incomplete, because the information between the parties is asymmetrical and it is impossible to fully predict the future. Being prepared for uncertainty causes a problem of adaptation, and being prepared for that also gives rise to costs. Establishment of transaction calls for resources, material and immaterial investments, which are always specific and therefore bounded in nature. The greater the specificity of resources, the threat of opportunism and uncertainty, the more likely it is that transaction takes place internally, i.e. the control system is in that case hierarchy.

Transaction theory has been criticized from various points of view. Because the theory focuses on cost minimization and economic relations, the psychological and social aspects of the relations receive no attention. In addition, the firm's interest groups are largely ignored, because the owner's perspective concerning profit maximization is the dominant one. Looking at costs also ignores the value creation perspective and the innovations that result from relationship interaction and learning. In addition, the focus is only on two extremes, markets and hierarchies, even though these two do not even occur in their pure forms. An intermediate form, i.e. hybrid organizations, is ignored. (see Mitronen 2002, 40-41)

In a hybrid organization, the best mechanisms of different forms of organization or control system are combined, while avoiding their weaknesses. As an intermediate form between markets and hierarchies, hybrids have more effective incentives and better capability to adapt as well as stronger control and coordination mechanisms than markets. According to Powell (1990), accumulation and utilization of competence, speed of change and flexibility as well as trust are the most important characteristics of hybrids. Bradach (1997) emphasizes the capacity for uniform, albeit independent operation within a hybrid.

Franchising is a typical hybrid organization (Powell 1990; Shane 1996; Price 1997; Bradach 1997). When comparing it to hierarchy and markets, Price (1997, 107) characterizes it as follows:

²² Kaufmann (1996, 5) stated that franchising could take advantage of both economies of small scale (solving incentive issues) and economies of large scale (by combining and leveraging system-wide resources) at the same time.

“In hybrid (or network) relational forms, individuals exist in relation to other units. The affiliations take considerable time and effort to establish and sustain and, as such, constrain both participants’ latitude to behave individually; they are characterized by sequential transactions within a general pattern of interaction where the parties are perceived to be interdependent.”

In the taxonomy of hybrid organizations developed by Price (1997, 110), business format franchising is positioned between joint venture and voluntary chain cooperation. It is thus a highly fixed form where there are no ownership bonds between the parties. In this positioning, the franchise relationship is a type of organization involving a higher than average degree of risk/control and share of income, the establishment of which calls for a sizable investment (i.e. cost of entry) and a fairly high degree of conformance to standards.

Price (1997) states that network forms such as franchising may appear at any point during the lifecycle of a business industry. They have increased competition in the markets, reduced variation within business industries and consolidated fragmented industries. According to Powell (1987), hybrids also raise the threshold for entering the field. The choice of franchising as a type of organization may in Price’s view be either intentional or evolving (Price 1997, 108).

The principal hybrid benefits of franchising are aptly summarized by Bronson, Faircloth and Chacko (1999). According to them, franchising makes it possible to pool different resources of the parties and enables external specialization, but not at the expense of internal cost efficiency. To this should be added adaptation to markets, which occurs locally and efficiently, as well as strong incentives for the parties. Hybrids also have disadvantages. Their development takes time and resources. There is also the threat of opportunistic behavior or attempts to dominate on the part of one party, trying to reap all the benefits at the other’s expense (see Powell 1987).²³

1.4.2 Agency theory

The starting point of agency theory is the contractual relationship between principal and agent, where power and responsibilities should be divided so that the relationship is as efficient as possible. The parties have selfish interests and objectives, which may therefore conflict. The operation of the parties is rational only to a bounded degree, and there are risks involved with alternative arrangements of the relationship. The principal has the right as well as a strong interest to monitor the actions of the agent. Monitoring and measurement of outputs and accomplishments are however difficult tasks that involve expenses. (e.g. Jensen & Meckling 1976; Eisenhardt 1989)

²³ In the case study of *Kesko* (the leading retailer in Finland), Mitronen (2002) concluded that there were two management challenges threatening hybrids: inefficiency trap and governance deficit. Inefficiency trap may result from slow adaptation as environmental uncertainty factors increase. Governance deficit threatens the control and coordination of the whole. Mitronen emphasized the importance of trust as well as a management relationship based on mutual values and norms to prevent these threats. (see also Bradach 1998)

From the principal's point of view, the key question is choosing the most effective form of organization. There are two fundamental alternatives for the production and distribution of goods and services: making it yourself (i.e. company-owned organization) or buying (i.e. franchise organization). Comparison of the costs and risks of these alternatives should lead to the best possible decision.

Transaction cost theory, agency theory as well as studies on self-enforcing agreements, which are in this classification included in transaction cost theory, are all closely linked. The key contents of the theories are very similar. The hazards involved in alternative forms of organization are inspected and compared. The forms of organization have their own particular incentives, and the hazards are linked to these incentives. (see e.g. Bercovitz 2004)

A basic hazard related to salary-based organization is shirking on the part of employees, in this case particularly on the part of store managers, due to lack of incentives or due to their weak effect, while in the case of franchise organizations the key risk is related to franchisees' free riding of the brand. Shirking and free riding are forms of opportunistic behavior, which when implemented give rise to indirect costs and cause harm to the principal, while the agent him-/herself is spared. Avoiding shirking in a salary-based organization calls for setting up and implementing a monitoring and control system on the part of the principal that can be used for measuring the input of employees (cf. Ouchi 1979; Anderson & Oliver 1987). Setting up the system and using it cause expenses. Because franchising often involves a network of outlets covering a geographically widespread area, the costs of setting up a monitoring system may be considerable high.

The alternative is to choose franchising as organization form, thus creating a strong incentive for the owner-operators, i.e. franchisees.²⁴ In that case, the motivation is based on residual claimant rights, used to measure performance (cf. Ouchi 1979; Anderson & Oliver 1987). Due to residual claims, the shirking tendency that is typical among employees does not concern franchisees. Franchisees have the possibility to act opportunistically, saving on investments focusing on level of service, quality and maintenance of corporate brand image, i.e. they can free ride off of the investments of others. This is naturally damaging to the principal, i.e. the franchisor. In order to avoid this hazard, the principal must set up and start using a monitoring and control system, with the aid of which damage can be managed. The system gives rise to expenses.²⁵

²⁴ According to Michael (1996) to solve the agency problem the franchisor will need to pay rents to the franchisee an amount greater than the franchisee's best alternative employment. Therefore rents establish a crucial link between franchisor strategy and the solution to agency. If this holds true, then the franchise system must earn a return superior to that of independent business.

²⁵ The franchisee's aim is to maximize the economic profit of his enterprise by optimizing costs, i.e. input. The franchisor on the other hand aims to maximize turnover, because his/her profit is largely based on the royalties tied to turnover, and paid by franchisees. This leads to conflicting goals, which is undoubtedly a dilemma. Mitronen (2002, 26-27) illustrates the problems within the organization of Kesko: an outlet owner may say that his/her retail store is in good shape when generating higher profits than the average, but the situation may be viewed

The choice of organization form is thus based on attempts to choose the alternative that is most cost-effective to governance. Franchising should be chosen when the costs of shirking on the part of employees (store managers) in a salary-based organization exceed the costs due to free riding on the part of franchisees in a franchise organization. Conversely, a salary-based organization is regarded as the better alternative when the costs due to free riding in a franchise organization exceed the shirking costs in a salary-based organization. (Bercovitz 2004, 39)

1.4.3 Resource-based theory

The view of franchising relying on resource-based theory emphasizes franchising as a means of acquiring tangible and intangible capital, which the franchisor can use for expansion. Franchising is the franchisor's means of capital acquisition, because franchisees pay a franchise fee as they join the system. In addition to this, they also invest in their outlets. From the franchisor's point of view, this external source of capital can be very attractive thanks to its low cost and low risk. Franchising also provides a solution to the problem of outlet management faced by the franchisor. The franchisee may have information, skills, experience and knowledge of the local market. The franchisor has usually worked out a profile of the franchise owners being sought for, in terms of personality traits, personal characteristics, education, work experience, background and economic resources. Immaterial resources are also scarce and play an important role as far as the success of the franchise system is concerned.

The effect of the scarcity of the management resource and limitations as factors slowing down the growth of the organization has also attracted considerable interest (Shane 1996). Opening new outlets is an expensive and time-consuming task involving complex operations (Bradach 1998). The franchisor's organization's internal management capacity is however limited. If the franchisor were to open a new outlet owned by the chain, a store manager would have to be recruited for the job. Recruitment involves a significant risk of adverse selection, because it is hard to assess the candidates objectively and they have an opportunistic tendency to overestimate their own capability in order to secure a job and an income. The cost of recruitment, evaluation of candidates and the costs due to possible recruitment failures, such as extra training, are high. Franchising is an efficient solution to avoid such problems and costs (Norton 1988). Franchisees enter the franchise relationship on a self-selective basis. Because franchisees are faced with the threat of losing a sizable investment they have made, it is unlikely that they would behave opportunistically during recruitment. The selection is based on the contract with strong, built-in incentives. (cf. Bercovitz 2004)

differently by the chain management in light of outlet type concept and quality indicators.

The capital acquisition criterion is the aspect that resource-based franchising theory has been most criticized for. On the one hand, not all franchisors are faced with capital limitations, and on the other, it would be less risky for franchisees to invest money in the franchisor's stocks than in individual outlets (see Rubin 1978; Lafontaine & Kaufmann 1994). Despite the criticism, the capital acquisition hypothesis has received empirical support (Lafontaine 1992; Dant 1995; Combs & Ketchen 1999). The idea that the franchisor will buy back the franchisees' outlets when it is no longer facing a capital shortage after having expanded is also an integral part of the resource-based theory of franchising (e.g. Oxenfelt & Kelly 1968-1969; Hunt 1973; Caves & Murphy 1976; Anderson 1984; Thompson 1992). This much-studied hypothesis has however not received uncontested empirical support, and buying back belief cannot be regarded as a universal truth or trend (Dant, Paswan & Kaufmann 1996).

1.4.4 Property rights theory

According to Bercovitz (2004), property rights theory complements the agency theory and transaction cost theory, which look at ownership rights in relation to the disadvantages involved. Property rights theory focuses on resource allocation and power sharing with respect to residual claims. The immaterial investment of the franchisor is franchise system specific. The value culminates in the chain's brand name (see Spinelli 1994). The experience and know-how of the franchisor are also types of immaterial investment in the relationship, while the franchisee's immaterial input is outlet specific. Competence in the local market, other types of know-how and characteristics generating success are the immaterial investments the franchisee brings into the relationship. To put it simply, according to the theory, property rights, based on which ownership rights are defined and residual income rights divided, must be proportioned in accordance with the immaterial investments of the parties, so that the investment and the party with the greater impact on success receives a larger share of the rights. The franchisor's residual income rights concern fees in the franchise relationship, franchise fees and royalties as well as the franchisor's own outlets, while those of the franchisee are related to revenues and profit from the outlet. The division of rights is mainly defined in the franchise contract. When the division is efficient, both parties have a strong incentive to invest in the relationship in order to generate as big incomes as possible. (see Windsperger 2002; 2004)

In summary, it could be stated that the problem of the theories presented above is the fact that they have such clearly defined limits and are somewhat narrow in scope. The theories are limited to the choice of organizational form and efficient arrangement of transaction, which is why it has not been possible to use them comprehensively to explain franchising, a phenomenon with many forms and dimensions. There are phenomena within franchising which has not been possible to fully explain with these theories. An example of such a phenomenon is dual distribution or dual/plural structure, i.e. simultaneous existence of

franchisor- and franchisee-owned outlets. There have been attempts to explain the dual structure e.g. from the point of view of innovation production and through strategic synergic cooperation, in which case value is created by the fact that the parties have different roles and complement each other (see e.g. Bradach 1997; Bai & Tao 2000; Cliquet 2000; Sorenson & Sorenson 2001).

The theories applied to franchising have been shown to be explanatory, both individually and taken together. Because the theories complement each other, they have been integrated, as was done e.g. by Carney & Gedajlovic (1991) when they combined the agency theory and resource-based theory.²⁶ A notable feature is also that the theories are exclusively franchisor-based. A franchise organization cannot however be established without franchisees, who have their own motives for entering the relationship, and this should be taken better into account when developing theories. It has even been suggested that customer markets should be incorporated into theories explaining franchising (see e.g. Stanworth & Curran 1999). Due to the limitations of the theories described above they are not used as the sole starting point of this study.

1.5 Research framework

In the context of present study is the extensive and universal sociological model of franchising created by Stanworth and Curran (1999) (see Figure 1).²⁷ The approach chosen thus corresponds to the definition by Hoy and Stanworth (2003b) of a school that sees franchising as its own separate area and subject of study, as a form of venture, and attempts to describe and explain its uniqueness by using models adapted and developed expressly for that purpose. The conceptual model of Stanworth and Curran (1999) explores franchising and its impact on three different levels: macro, organizational and individual level. The division into levels does not mean that they are independent of each other. They are partly overlapping and they naturally interact with each other. For example, economic issues are crucial at every level of the model.

The model is neither complete nor perfect. It includes fifteen propositions that can be tested empirically by quantitative or qualitative studies. As research based knowledge accumulate, these propositions can later lead to a universal theory of franchising. Used in this manner, the model can increase both theoretical and applied knowledge of the phenomenon. It is suggested by the authors that in further studies, more propositions should be developed at each

²⁶ In distribution channel studies in the field of marketing, Carman & Klein (1986) integrated power, property rights and conflict studies within a franchising context.

²⁷ The model is based on authors' large body of franchising research over a long period of time. The seminal version of the model was presented in their article published in 1983. According Stanworth and Curran it was possible to create a more comprehensive theory through sociology, because "sociology as discipline arguably has the conceptual suppleness and ability to link the strategies and behavioral patterns of individual actors to organizational structures and characteristics, and to set these in the context of the wider economy and society."

level of the model, but they should also be made more detailed. The continuous, dynamic development of franchising does however pose a challenge as far as this objective is concerned. (see Stanworth & Curran 1999)

The model presents the variables influencing the birth, growth and survival of franchise systems. There was a clear need for a uniform model, because earlier franchising studies were fragmented, focusing on narrow specialized issues. Previous studies did not fit seamlessly under any single discipline. In the following, the major aspects of the model of Stanworth and Curran are presented from the viewpoint of the study at hand.

| |
|--|
| <p><i>Franchising at the macro or societal level</i></p> <p>Cultural Economic Political</p> |
| <p><i>Franchising at the organizational level</i></p> <p>Rapid market penetration Divergent economies of scale Format permanence Relationship management Franchise failure rates</p> |
| <p><i>Franchising at the individual level</i></p> <p>Route into self-employment Unemployment push Prior self-employment Complexity of franchisee motivation Intrinsic/extrinsic goals System innovation Contemporary views of autonomy</p> |

FIGURE 1 Factors influencing the development of franchising: a model (Stanworth & Curran 1999)

There are three elements on the highest, i.e. macro or societal level of the model: culture, economy and politics. From a cultural viewpoint, economic individualism, channeled as appreciation and promotion of entrepreneurship, creates a favorable setting for franchising. On the level of economy, the increasing share of tertiary operations, i.e. services and competence-intensive business influences the likelihood of franchising. These features are fundamental factors in the new post-industrial and post-Fordian economy (Curran & Blackburn 1991). Franchising is linked to decentralization, sub-contracting and flexible specialization as well as geographical business expansion. Network organizations, of which franchising is one example, have a significant role in the re-organization of the global economy, which promotes both large and small

companies at the same time (Goffee & Scase 1995). In a political context, promoting small business ownership and maintaining it as a useful part of the activity of the market economy and employment also supports the establishment and success of franchising. According to Stanworth and Curran (1999), the topmost level of the model is the least studied phenomenon in franchising.

As a contrast, a lot of franchising studies have been carried out on the second or middle, i.e. organizational level of the model, although the studies have been fragmentary and poorly integrated. There are also some sharp contradictions in the earlier studies. An example of this is the question that has proved complex of the risk of franchise companies, franchisors and franchisees compared to traditional independent business. The degree of survival of franchise companies has been considered to be significantly better than that of independent companies. On the other hand, opposite results have been obtained, particularly when studying mature markets and individual business industries (see Bates 1995).

From an organizational point of view, franchising can be defined as an independent form of organization, i.e. hybrid organization, as a form of cooperation between organizations or as a marketing strategy. According to the last view, franchising is an answer to logistical problems, or a method aimed at entering the market swiftly and efficiently by making use of the franchisees' capital. Franchising as an organizational choice is also a result of divergent scales at different stages of manufacturing or service provision. Retail is most efficiently carried out at small local outlets, while centralization of manufacturing is generally the most efficient alternative. In addition, franchising represents a form of organization that has emerged as a result of minimization of transaction costs (cf. transaction cost theory). Contracting, monitoring and controlling transactions within and between organizations inevitably gives rise to costs, and an attempt is made to minimize them in order to maximize efficiency.

The fundamental question in looking at franchising from the organizational viewpoint has however been whether franchising is a relatively stable and permanent form of organization, or whether it is a transient phase as the organization evolves. The temporary nature of the organization is in such case caused by the franchisor's possible attempt to take over all the franchisee-owned outlets (cf. resource-based theory). In that event, the organization would change from a network, hybrid or federation organization into one that is hierarchical and fully vertically integrated.²⁸

Attempts on the part of organizations to concentrate on their core competence and to downsize through layoffs and increased subcontracting have on the one hand created possibilities for the birth of new small businesses, but on the other hand they have increased the numbers of unemployed persons looking for new potential entrepreneurial career paths. Changes in the

²⁸ Research findings have been conflicting on this issue, although the most recent findings support the view that franchising is not a temporary but a fairly permanent form of organization. The assumption that franchisors generally want to buy back franchisees' outlets after overcoming the resource constraints is therefore incorrect. (Dant, Paswan & Stanworth 1996)

economical structure and in the job market have thus created a favorable setting for franchising.

In elaborating the model on organizational level, the factors explaining the birth of franchising are according to Stanworth and Curran (1999) associated to the following situations. When an interlinked manufacturing and marketing process of goods or services includes divergent scales, the formation of a franchise arrangement is likely (cf. also Kauffman & Dant 1999). Or when a small organization is seeking rapid market penetration by expanding over a geographically widespread area with a number of outlets and sees franchisees as the most advantageous alternative, or as the only source of capital to finance expansion, franchising is an obvious choice. This view can however be criticized by saying that this is not true in the case of so-called converts. Converts are firms that change the mature fully company-owned organization (i.e. hierarchy; fully vertically integrated) into a franchisee-driven channel of distribution. In addition, there are no cases on the organizational level of the model where franchising is started through gradually concentrated cooperation of a voluntary chain or through consolidation within the business industry.

The cooperation relationship between two organizations, i.e. franchisor and franchisee, is typical of franchising, and characterized by harmony and conflicts, consensus and disagreements. Potential conflicts may be caused by e.g. economic results, payments and contractual obligations (cf. e.g. Hoy 1994). The franchisor's management is crucial for the collaborative capability of the parties. The success and survival of franchise systems is ultimately a complex phenomenon, and the variations can be explained by factors such as different business industries, the age of the system, the segment as well as the background and prior experience of the franchisee (see e.g. Shane 1996; Lafontaine & Shaw 1998). There are specific problems related to the development and growth of the franchise system at different stages of the system's lifecycle (Floyd & Fenwick 1999). However, franchising should primarily be regarded as a genuine and relatively stable organizational form, although in individual cases it is possible that the franchisor takes over franchisee-owned outlets at a later stage during the system's lifecycle. (see Stanworth & Curran 1999)

The last and bottom level in the model of Stanworth and Curran (1999) concerns franchising as a phenomenon on the level of the individual. According to the model, franchising as a form of business is most successful in societies where there are individuals available who are positively committed to economic individualism and entrepreneurship and where it is promoted by political and legal structures. Compared to other types of self-employment, franchising offers a relatively easy route to entrepreneurship. The franchisee does not have to develop a business idea; s-/he gets the business idea and blueprint he can utilize and which may already have been pre-tested from the franchisor. In addition, the franchisor provides the franchisee initial and continuing training that enables independent business management, as well as support services, such as centralized marketing, purchasing and accounting. It

is possible that compared to an independent businessperson it may be easier for a fledgling franchisee to get financing for initial business investments (cf. Stern & Stanworth 1994). However, the single most significant advantage to the franchisee is a well-known brand name. The factors mentioned above lower the entrepreneurial risk and make it easier to enter the market.

Franchising may also be an attractive alternative to those who do not necessarily possess all the competence, knowledge and skills as well as experience required for setting up and managing an independent business, or to those who are at risk of becoming excluded from the job market. However, a significant proportion of franchisees have earlier worked as independent small business owners, and thus it cannot be claimed that those choosing to become franchisees are risk adverse compared to others who employ themselves.

Franchisees' motivation, commitment and investments as well as knowledge of the local market are an integral part of the transaction within the franchise relationship and the franchise arrangement. Franchisees' motivation is a considerably richer and more complex phenomenon than what is suggested e.g. by the profit maximization assumption of the agency theory. Autonomy and independence are motivating factors of persons with no prior self-employment experience, while those with prior experience are motivated by greater security and better economic profit. Franchisees' internal motivation factors play a major role in their motivation. Franchisees also have a key role in the sustaining and reforming the viability of the franchise system through product, service and process innovations and local business adaptations. The older and larger the franchise system gets, the more formal the production of innovations becomes.

As criticism towards the model of Stanworth & Curran, it should be stated that the model is in many ways lacking and incomplete, as it leaves open many phenomena explaining the birth, growth and survival of franchising. For example, the model takes no stand as to potential differences between business industries. Co-branding or dual-branding (see Justis & Judd 1998, 1-7), i.e. cooperation between franchise organizations, which is increasingly common in highly competitive and saturating markets, does not receive any support from the model either. Neither is the simultaneous existence in the franchisor's organization of franchisor- and franchisee-owned outlets, i.e. dual distribution or plural form, or the existence of multi-unit franchisees explained by the model (see e.g. Kaufmann & Dant 1996; Ehrmann & Spranger 2004). It is obvious that the relationships between franchisor and franchisees need more study. How groups with different backgrounds are selected to franchising instead of traditional forms of self-employment is so far poorly understood. The recruitment practices of franchisors are also largely unstudied. According to Stanworth and Curran (1999), one poorly understood aspect left outside the scope of the model is linking end-user markets and customer preferences to franchising theory.

1.6 Methodological issues and research design

The present study belongs to the field of entrepreneurship. Entrepreneurship can be categorized as part of business science, and thus economics and further, social sciences. Entrepreneurship as well as franchising research, has a multidisciplinary background and a very young research tradition. The paradigm of entrepreneurship is therefore relatively undeveloped (see e.g. Bygrave 1989; Grant & Perren 2002). The phenomenon in the focus of the study, franchising, is seen as a form of initiating and conducting entrepreneurship and business (Vesper 1980). Franchising has previously received very little research attention from the point of view of entrepreneurship. In earlier studies marketing and management have been much more common and dominating approaches to franchising. This may on the one hand be due to the fact that in earlier studies, franchisors, not franchisees, have been quite exclusively the subject of study, and on the other hand, to the fact that marketing and management are considerably older disciplines than entrepreneurship. In addition to franchisors, franchisees and franchising as a whole are in the focus of interest of the present study, which is why the approach is more holistic. The inclusion of franchisees in the exploration particularly links the phenomenon strongly to entrepreneurship.

The study is empirical and descriptive in nature and therefore the approach is markedly *nomothetical* (see Neilimo & Näsi 1980; Näsi 1980, 34; Näsi 1981, 27-40). The scientific ideal of nomothetical research is based on natural sciences: it is "Galilean" and "causal", i.e. looking for conformity and regularities (cf. Burrell & Morgan 1989, 6-7; Alasuutari 1994, 128; Alkula, Pöntinen & Ylöstalo 1995; Metsämuuronen 2003). The results obtained can be characterized as being generalizable and rather superficial. A typical formulation of research questions is often *how is* and *why is*, and the form of the clauses sought for is descriptive, comparative, analytical and explanatory. The inventory of methods in this kind of study is extensive and standardized. Moreover, the research strategy can be characterized as being highly structured. The presence of empirical data in the study is comprehensive. Total studies or samples are typically large in size. The empirical data can be described as being hard and solid. The reliability can be evaluated in a controlled manner. The relationship between researcher and the subject of study remains distant –research is as objective as possible. (e.g. Hirsjärvi, Remes & Sajavaara 1997, 131)

The research paradigm described above has a *positivistic* background. To put it more precisely, it is so-called *logical positivism*. Despite the background, it should be observed that the stand of research to the nature of reality (ontological argument: *realistic ontology*²⁹) is not necessarily clearly or sharply demarcated,

²⁹ According to the paradigm, in realistic ontology reality consists of objectively observable facts. Furthermore, according to logical positivism, all information is founded on direct sensory perception as well as logical deduction on the basis of these perceptions. (see Hirsjärvi, Remes & Sajavaara 1997, 137).

and in many cases it is at least hidden. Methodological pluralism prevails in the studies. Reality may be socially constructed, and it is presentable mathematically and in a quantified manner (epistemological argument and choice). Hence, it is a question of the structural characteristics of the subject under investigation, i.e. whether the characteristics of the subject can be described with the aid of quantitative measures and variables. It is therefore primarily a question of methodological choice, not ontological commitment (see Niiniluoto 1984, 188-191; Riggs 1992, 138; Anttila 2000, 42-48; Kyrö 2003, 100-101).

Research of this kind has previously been common in both entrepreneurship and franchising (cf. Grant & Perren 2002).³⁰ Seen against this background, the current study is rather conventional and traditional. The research strategy chosen is the prevailing one in social sciences. Arbnor and Bjerke (1994, 49-50), for example, consider this approach, which they call analytical, as being the most common and oldest in business science. Studies in business science are often applied research and hence normative in their nature. At this juncture, one should mention the background assumption that the results of this study, the new information it yields, also have an instrumental value. By applying and utilizing the new information, normative recommendations can be, and are being issued in a variety of application domains (cf. *cognitivist view on science*) (Uusitalo 1995, 64-77).

Franchising here refers exclusively to business format franchising, unless expressly otherwise indicated. Merchant-driven distribution channels that represent some other form of channel co-operation, such as trade name and product distribution franchising, voluntary chains, etc. are left outside the scope of this study. Moreover, the analysis on franchise systems does not focus particularly on business industries, different stages of the lifecycle of franchise systems, or the organizationally dissimilar forms of franchise systems (i.e. dual structure or plural form issues). Neither are the forms of international franchising in the core on this research.

In the studies presented in this report a cross-sectional research setting is used, with the exception of the franchising statistics collected from 1999 to 2003. Due to the nature of the research task, they are follow-up studies rather than purely longitudinal examinations. The studies in the report are also based on samplings, even though studying the population of franchise systems (i.e. total study) is the aim when gathering franchising statistics. In addition to the time frame, the geographical limitation of the study is of essential importance. With the exception of one, study no. 5, all studies are based entirely on empirical data gathered from Finland. The results of the cross-national study are not generalizable in the USA, but in Finland they are.

In the following table (3), the nature and approach (see first and second column) of the studies, their empirical data, and data collection and analysis

³⁰ According to a taxonomy by Grant & Perren (2002), the present study is *functionalist*. Thus having realistic ontology, positivist epistemology, nomothetic methodology, and determinism as perspective to human nature and regulation as perspective to society. (see also Burrell & Morgan 1979)

methods (see third column) are shown in concise form. The fourth column indicates the research tasks of each study.

TABLE 3 Research settings of the studies

| S T U D Y | Perspective and nature | Data and methods | Research tasks |
|---|--|---|---|
| 1 st | <i>Franchisee</i> - quantitative - sample study - descriptive - hypothetical- deductive | Primary data: mail survey 686 franchisees from 16 franchise systems (n=211; 31%/N) -descriptives, principal axis factor analysis, alphas, T-tests, | -to explore franchisees' entrepreneurial characteristics and advantages and disadvantages they encounter in operating business -to examine two propositions related to franchisee background and its effect to his/her perceptions |
| 2 nd | <i>Franchisee</i> - quantitative - sample study - (hypothetical-) deductive | Primary data: mail survey and phone interviews 815 franchisees from 36 franchise systems (n=339+143; 59%/N) -descriptives, correlations, cross- tabs, component analysis, alphas, discriminant analysis, T-tests, U- tests, binominal tests, ANOVA, | -to test a created franchisee satisfaction model consisting factors for overall satisfaction, components for particular satisfaction, and post-engagement continuance intention -to test the influence of perception of conflict, opportunistic propensity, pessimism, imperfect pre- sale disclosure information, improper assessment process, and disposition not to grow business to franchise owners satisfaction -to test franchisee satisfaction model in explaining franchisees' willingness to give up his/her franchise |
| 3 rd & 4 th | <i>Franchisor</i> - quantitative - total study - follow-up study - descriptive | Primary data for framework development: 6 in-depth interviews of franchise experts Secondary data for tracing franchises: 1079 franchising related press articles from May '94 to March '99 Primary data at screening phase: mail survey and phone interviews 130 potential franchisors (n=130; 100%/N) | Year 1999 study: -to create a framework for identifying Business Format Franchises -to analyze the volume and state of Finnish franchising by compiling 1999 franchising statistics -to describe firms' franchise rationales |

| | | | |
|-----------------|---|--|---|
| | | Primary data: mail survey 106 qualified franchisors (n=106; 100%/N) | Year 2003 study: to analyze the volume and state of Finnish franchising by compiling 2003 franchising statistics |
| 5 th | <i>Franchisor (& Franchisee)</i> - quantitative - sample study - descriptive - comparative and cross-national | Primary Finnish data: mail survey & Secondary U.S. data: UFOCs Finland: (n=30; 67%/N) USA: (n=114; 23%/N) -descriptives, T-tests, U-tests, binominal tests | -to describe and compare franchise contract provisions and pre-sale disclosures to prospective franchisees in Finland and the USA |

When comparing and evaluating this study to previous franchising studies, some pertinent characteristics of the research design may be pointed out that have an impact on the contribution aimed at in the study:

- Extensive national franchising studies or total studies and wider research programmes whose results are genuinely generalizable are scant.
- Longitudinal or follow-up studies are also relatively rare in franchising.
- Cross-national franchising studies are also rather scarce.
- Only few franchising studies have been conducted earlier where both franchisors and franchisees are taken into account.

The aim of the study is to provide new knowledge on franchising in Finland. The objective is to fill an obvious and observed knowledge gap with regard to the phenomenon in question. The purpose is to obtain findings that can be generalized on Finnish level. The use of quantitative methodology, data gathering and data analysis methods is largely dictated by this choice. Qualitative methods are used only sparsely and carefully (e.g. expert interviews, open questions).

The interest for knowledge of the study is theoretical (Niiniluoto 1984). In such case, the task is to explain facts and regularities related to reality without predicting or controlling objective. The motive is man's intellectual need to analyze the world in which he lives and to obtain factual information concerning it by using scientific theories as tools. Arguments suitable for this type of information interest are typically deductive (cf. *formal logic*) and hypothetical-deductive, as in the present study. (see Kyrö 2003, 63, 77-78). In such cases, research is confirmatory rather than giving rise to a new theory. In general terms, the information orientation of the research further development and application of the prior results of basic research.

As previously mentioned, the phenomenon under scrutiny is looked at from the viewpoint of both parties involved, i.e. franchisors and franchisees. In accordance with the theoretical framework of the study, the target phenomenon is investigated on three levels (see Figure 1).

The uppermost level is the level of society or macro level. The study aims to chart the extent and manifestation forms of franchising in the Finnish economy. The research task can be formulated as follows:

- How widespread is franchising in Finland?

The research question as a whole is analyzed further as follows:

- How many franchise systems operate in Finland?
- How many outlets do the franchise systems have, and how is their ownership divided between franchisees and franchisors?
- In what industry sectors and business industries do the franchise systems operate?
- Where do the franchise systems originate from?
- What is their lifecycle stage; what is their growth target in Finland for the near future, and what are the factors that may potentially prevent or curb their growth?
- Do the franchise systems have internationalization aspirations?
- How many people do the franchise systems employ, and what is their annual turnover?

The second or mid-level, is the level of organization, i.e. that of the franchisor. The task is to find out franchisors' strategic motives for starting franchising and the ways the franchise contracts are drafted. The research task can be presented as the following questions:

- Why did the company launch franchising in the first place?
- What is the content of a typical franchise contract?

The third level is the level of an individual, i.e. that of the franchisee. The aim of the study is to chart the business advantages and disadvantages, the nature of entrepreneurship experienced by franchisees, and their co-operational and contractual relationship with their franchisors. The research task can be expressed as follows:

- What kind of business advantages and disadvantages do franchisees experience? What kind of impact do the franchisee's previous entrepreneurial experience and the length of their franchise relationship have on how they perceive the business advantages and disadvantages? What kind of entrepreneurial orientation do they possess?
 - What does franchisees' satisfaction consist of? What factors are crucial in explaining franchisee (dis-)satisfaction, and how do some special given factors affect satisfaction? Does dissatisfaction on the part of the franchisee predict giving up the franchise relationship and operation?
 - What contractual clauses are typically included in a franchise contract, and what kind of information does the franchisor give out before the franchise contract is signed?

The research questions are analysed further as follows:

- How is franchisee satisfaction affected by the conflict in the franchise relationship, by a recruitment process they feel to be insufficient and by the information provided during franchise negotiations they perceive as incomplete, by their opportunistic tendencies, pessimism and unwillingness to expand their business operations?
- What is a typical franchise owner like, and what is a typical franchised enterprise like?
- How do US and Finnish franchise contract provisions and characteristics possibly differ from each other?

2 SUMMARIES OF THE RESEARCH ARTICLES

2.1 Summary on Article 1

*“Entrepreneurial Paradoxes in Business Format Franchising:
An Empirical Survey of Finnish Franchisees”*

2.1.1 Background

*When we risk no contradiction, it prompts the tongue to deal in fiction.
[John Gay: “Fables I The Elephant and the Bookseller”]*

Franchising has grown worldwide and its importance as a form of business and as a distribution channel solution has increased significantly. Despite this, many fundamental questions concerning franchising have been given almost no research attention whatsoever. The majority of research in this area has focused on the franchisor’s point of view (Stanworth & Kaufmann 1996). This is surprising, because it is the capability of franchisees to successfully manage an independent business that is the most important factor in the cooperation between franchisor and franchisee. The contradictions and the versatility in the relationship between franchisor and franchisee have not been given the attention they deserve in previous franchising studies. The starting point of the present study is the relationship between franchisor and franchisee, its background and dynamics. Many of the dimensions of this relationship are paradoxical in nature.³¹

This study produces new information and helps to understand the reality of franchisees by describing their entrepreneurial orientation and the benefits, advantages, disadvantages and limitations they experience in their business activity. The study also adds to the body of knowledge about factors affecting

³¹ A paradox is an apparently impossible, contradictory and irrational or statement, which may however be valid, true and correct in the real world.

establishing, developing and sustaining productive and amicable co-operative relationship between franchisees and franchisor. A relationship has an indirect effect on the success and ultimately the survival of the parties in a highly competitive market.

The advantages and benefits of franchising experienced by franchisees have been studied more than the corresponding disadvantages and limitations. It has been observed that the advantages are linked to franchisees' decision to become franchise owners, which means that they are motivation factors (e.g. Storholm 1992; Justis, Olsen & Chan 1993). Business advantages affect franchisee satisfaction and commitment to the franchise system and relationship (Hing 1995), whereas business disadvantages and limitations as well as entrepreneurial endeavors on the part of the franchisee are linked to possible conflicts within the relationship (e.g. Hoy 1994). Advantages and disadvantages are linked to the daily operation of the franchisees, and they also affect their behavior within the franchising relationship. In distribution channel management studies, the description of franchise relationship has previously concentrated on the forms, quantity and use of power of the franchisor (Elango & Fried 1997).

In the present study, two propositions were tested. According to the first proposition, the motivational foundation of franchisees is dynamic, and linked to the length of their experience as franchisees within the franchise system. According to this proposition, persons with shorter versus longer experience as franchisees value different matters and are motivated by different factors in the business relationship. Less experienced franchisees, i.e. those with shorter experience value the advantages of the business relationship and their significance more often than their more experienced colleagues. According to the second proposition, franchisees differ significantly from each another with respect to whether they have prior entrepreneurial experience when they join the franchise system. According to the proposition, persons with self-employment experience assess factors within a franchise relationship differently from those with no such experience. Franchisees with no previous entrepreneurial experience value nearly all business advantages more than those with entrepreneurial experience (see Peterson & Dant 1990).

The results of studies focusing on the personality traits of franchisees have been highly conflicting. On the one hand, franchisees have been regarded as a combination of an employee and small business owner, i.e. not as a genuine entrepreneur, but not as a mere employee either. On the other hand, franchisees have been seen as entrepreneurs, characterized by risk taking, need for achievement as well as a strong internal locus of control and innovativeness (English & Hoy 1995). From a legal point of view, franchisees are autonomous entrepreneurs who are independently responsible for their legal and economic commitments. It is obvious that franchising is a problematic phenomenon from the viewpoint of conventional and traditional definitions of entrepreneurship (Brannen 1986). Franchising is more about multiplication and distribution of innovations than about innovations as such. Traditionally, innovation has been

seen as a personality trait of entrepreneurs and as a typical activity of the entrepreneurial process, where e.g. a new viable and potentially successful organization, product, service or production method is created (Tuunanen & Hyrsky 1997). It should be observed that due to the special nature of the franchising relationship, even other personality traits than those fitting the classic entrepreneur profile are significant to franchisees. These traits include e.g. the ability to cooperate, flexibility, and adaptability.

The cross-national study of Stanworth, Kaufmann and Purdy (1995) showed that franchisees see themselves as independent entrepreneurs, albeit with some limitations in their business activity (cf. also Baron & Schmidt 1991). According to Stanworth, Kaufmann and Purdy (1995), those franchisees that had no prior entrepreneurial experience saw themselves as being more dependent on the franchisor than those with prior self-employment experience. The motives for becoming a franchisee differed between the groups. Those with no prior entrepreneurial experience upon becoming franchisees regarded independence and "being your own boss" as the main reason behind their decision to become a franchise owner. Those with entrepreneurial experience, on the other hand, saw a well-known brand and a tested business concept as their main motivation.

Franchisees' motivation factors are dynamic (Stanworth & Kaufmann 1996), meaning that they change over time as experience grows. They also depend on the background of the person in question and particularly on whether he or she has prior entrepreneurial experience upon becoming a franchisee. The motives of franchisees have not been sufficiently studied, despite their importance (Guilloux, Gauzente, Kalika & Dubost 2004). Previous research has indicated that the selection process behind becoming a franchisee does not necessarily differ significantly from that of becoming an independent entrepreneur (cf. Kaufmann 1999). The decision-making process of a person considering the possibility of becoming an entrepreneur begins with the selection of a suitable business industry or sector. After that they face the question of whether the business to be established should be independent or belong to a franchise system. The decision focuses next on the franchisor, and only then is a decision taken concerning business form of one's own business. According to the findings of Williams (1999), the risk level of the industry, personal economic resources and level of education as well as the length of prior entrepreneurial experience affect the choice between a stand-alone business and a franchise.

The latest research has shown also that the longer-term vision, goals and strategies of the franchisor act as motivation factors for potential franchisees (Guilloux, Gauzente, Kalika & Dubost 2004). This finding complements the view where one-time support services related to the start-up and early stages of the franchisee's business, ongoing services related to operative support of the franchisee's business, a well-known brand, a lower risk and a ready-made business concept have been found to be motivational factors, in addition to income- and earnings-related factors.

Within the framework of this study, several phenomena were found in literature that is paradoxical from the franchisee point of view. These include the following: independence/autonomy vs. dependence, interdependence; individualist vs. team builders, self-employment vs. low self-actualization; responsibility vs. limited decision-making authority; satisfaction vs. dissatisfaction; harmony vs. conflict, creativity vs. conformity; innovation vs. replication/adaptation; and initial/creative, initiative entrepreneurship vs. imitative entrepreneurship. The concept of paradox has to the authors' knowledge only been used once within a franchising context.³² In his comprehensive research on the nature of a franchisor-franchisee relationship, Felstead (1993) analyzed "who controls what, why and how". He aimed to address the question of whether the firms involved in a franchise relationship are relinquishing control over the actions of those on whom they rely for success or failure. Felstead (1993, xi) viewed the phenomenon as a paradox: "On the one hand, a franchised business looks and acts like a branch of a much larger corporation, while on the other hand, it retains a distinct legal persona."

2.1.2 Findings and discussion

Based on the observations concerning benefits and drawbacks experienced by franchisees, it was seen that the benefits to business were as a rule felt to be more significant than the drawbacks, and there was also a more widespread consensus concerning them. The advantages and benefits seemed to be more commonly linked to franchised businesses, whereas drawbacks and limitations were more often experienced as being linked to individual franchise systems. The most significant benefits to franchisees were the following; a well-known brand name, a proven business concept, economies of scale, ongoing franchisor support services and the possibility to provide family income. Among the drawbacks, the following were seen as being the most significant: regular franchise fees that are too high, the lack of national franchise legislation, an excessive work load, support services that are too expensive as well as limitations concerning contract transfer and termination.

In the study, factor analysis was utilized to extract the information. This enabled the grouping of items concerning benefits, drawbacks and entrepreneurial orientation into more comprehensive entities. According to the results, essential business benefits experienced by the franchisees were the following: internal and external rewards (e.g. independence, better job satisfaction, a reasonable income, scale benefits, self-improvement and professional skills, stimulating working environment), stimuli and support

³² The survey data of this study was compiled in the spring 1996. Later, also Price (1997) utilized the concept of paradox in his multi-disciplinary investigation on franchising. He defined the related paradox as the following question: "How can franchisors stress conformity, rather than innovation, and also simultaneously expect fewer failures than independent businesses?" Price came to the conclusion that franchising, in itself is an evident innovation, and the ability to realize further continuous innovation is substantial to survival. (Price 1997, 506)

provided by the franchisor (e.g. training provided by the franchisor, cooperation benefits, possibility to concentrate efficiently on one's own work, continuous franchisor support), and the ease of start-up (e.g. the possibly to earn family income, limited initial investment and lower risk, a proven business concept as well as franchisor control and management of operation).

The most significant disadvantages experienced by franchisees were as follows: decreased independence and responsibility (e.g. the limitations of entrepreneurial activity, limited scope for innovation, planning and implementation power by the franchisor, lack of challenge, excessive control on the part of the franchisor, limited risk-taking, inappropriate franchisor support), franchise fees (service fees that are too high, expensive support services, high initial franchise fee) as well as contract- and cooperation-related friction (another outlet belonging to the same chain located too near i.e. encroachment, difficulties related to contract transfer and termination, damage caused by errors made by others, lack of national franchise legislation).

The overall picture emerging from the study of benefit and drawback factors is paradoxical. It seemed that franchisees' willingness to pay franchisors for business operation benefits, such as a ready-made business concept, lower risk, easier entry into the field and continuous support services, was low. On the other hand, it is difficult to assess the value of these tailor-made business operation benefits. In the long term, support services provided by the franchisor cannot be incorrectly priced, because survival in the competitive market calls for success of both parties (cf. Grünhagen & Dorsch 2003). The input-output ratio must be balanced so as to satisfy both partners. Otherwise, asymmetry will lead to dissatisfaction, conflict as well as commitment and motivation problems.

When looking at the entrepreneurial orientations of franchisees, it was shown that they represent for the most part self-assured, i.e. "self-confident and self-directed actors" (the characteristics loaded to this factor were the following: sense of responsibility, service/customer orientation, inventiveness, strong self-confidence, diligence) as well as flexible persons who have a positive attitude towards cooperation who can adapt to concept, i.e. "conformist" (franchised business suits me best, franchising makes business run more systematically, franchising makes the work run easier). "opportunists" (I benefit more than my franchisor, my franchisor is not a trustworthy partner, I will open more outlets in the future) seeking their own advantage or those seeking alternatives, "lookers-around", open to alternative strategies (I might set up a franchise chain in the future, I have many other business opportunities, I'll try another type of franchise when I get the chance) did not emerge as strong orientations. The length of franchising experience or an entrepreneurial background did not seem to influence the appearance of orientations either.

The results of this study strengthen previous notions of the differences in the motivational basis among franchisees (cf. Peterson & Dant 1990; Kaufmann & Stanworth 1995). The assessments concerning the most significant business benefits and advantages of franchisees with prior entrepreneurial experience differed from those of franchisees with no personal entrepreneurial experience

at the time of signing the franchise contract. Support services provided by the franchisor as well as the low risk involved in franchised businesses were factors that persons with entrepreneurial experience valued in particular. On the other hand, they experienced more and stronger business-related disadvantages than those with no prior entrepreneurial experience. This is understandable, because upon joining the franchise system they had to give up some of the operational freedom of the stand-alone small business owner. Those with no prior entrepreneurial experience saw the advantages of franchised business somewhat differently. They valued in particular the proven business concept and the internal and external rewards they reaped from the operation. This gives some indication that in their case, franchising had lowered the threshold of becoming an entrepreneur and provided them with an opportunity to take up a career as an entrepreneur, for which they might not necessarily have had all the prerequisites otherwise (cf. Stanworth & Curran 1999). They saw the large amount of work, control on the part of the franchisor as well as a relatively high initial franchise fee as drawbacks of franchising.

The length of experience of franchisees also had an effect on perceptions concerning business advantages and disadvantages. Franchisees with shorter experience, in this case less than three years, valued the advantages of business operation more highly than those with longer experience. A more critical attitude towards the restrictions and disadvantages caused to them in their business operation was detectable in the assessments of franchisees with longer experience. The difference may be partly explained by the fact that franchisor support to fledgling franchisees is versatile and intensive until the operation of the new outlet stabilizes, at which point the franchisee is able to manage local operation in accordance with the concept in a more independent manner. This phase of the cooperation is the "honeymoon". The self-confidence of the franchisee increases, as does a critical attitude towards the franchisor when the franchisee gains more experience, learns more and may experience success. The franchisee begins to question the role and activities of the franchisor, and in particular the cooperation and royalties it must pay. This means that it is almost inevitable that gradually, the support services provided by the franchisor will start to lose their initial value in the eyes of the franchisee. From the point of view of the franchisor, behavior on the part of the franchisee that is too entrepreneurial in nature may be undesirable and may lead to a crisis in the relationship.

It should be observed that the present research finding is preliminary and suggestive, and the greatest limitation of the study is related to this very fact. The study was a cross-sectional, not a longitudinal study, on the basis of which it would be possible to verify the finding. It is regrettable that no longitudinal studies have been carried out on this subject. There are also significant limitations linked to quantitative research in studying this phenomenon. Qualitative methods, such as theme or in-depth interviews or group interviews, would yield more accurate and, in particular, more profound information on this phenomenon. Studies of this kind could be case studies on individual franchise systems. On the other hand, more detailed scrutiny of the motives and

goals of franchisees, as well as a more comprehensive definition of the subject and phenomenon under study are called for. This would make it possible to understand factors that clarify and explain descriptions that are opposing or contradictory or that appear anomalous.

A franchisor should be able to reform and upgrade its forms of support and differentiate them in accordance with franchisees' needs. What was a relevant advantage to the franchisee at the beginning of the relationship may be of lesser importance or even a source of discontent later on. Similarly, what is a significant benefit or drawback to one franchisee may not necessarily be the same thing to another. Understanding the different backgrounds and differing motivation factors of franchisees would help the franchisor to formulate its impact efforts. The finding that of internal and external incentives and rewards, it was internal rewards that were seen as being more important was also paradoxical. Franchisees on the other hand feel that internal incentives are a limitation in the franchise relationship.

The concept of paradox used in the study proved to be very applicable in describing the contradictions and multiple dimensions of the franchise relationship. At its best, paradox is a tool that stimulates new thinking characterized by multiple values, helps to understand issues and may provide substance for a framework. Some of the dimensions of the franchise relationship, which may still be very poorly understood, were presented as paradoxes. These descriptions may also serve as practical business management tools. Increased knowledge and understanding may provide means for cooperation relationship management and the recruitment of new franchisees. The knowledge provided by the findings may be applied e.g. when organizing franchisor support services and training. Improved practices in these areas increase the functionality and productivity of the cooperative relationship.

According to the view based on the results of the study, the management-related challenges met by the franchisor arise from understanding the background and situation of the franchisee. The franchise relationship is not static, despite the standard content of the franchise contract. It is in actual fact a unique, sensitive and dynamic relationship. The relationship is affected by the franchisee's background, motives and objectives. The requirements of the other party as well as those set by a changing market vary. Cooperation should be based on trust, norms and a strong culture. The role of the franchisee may in some operations and circumstances be one of "implementer or re-duplicator", and in others that of "actor or initiator". Dependence and autonomy may therefore co-exist (cf. Dant, Wortzel & Subramamiam 1992). At times, the franchisee's need for more independent and entrepreneurial operation may be apparent and well motivated in prevailing local competitive conditions. Not only the franchisor and the franchise system, but also each franchisee has their own life cycle with characteristic phases. These phases are: Introduction, Growth, Maturity, Decline or Development (see Justis & Judd 1998, 19-1).

From the franchisor's point of view, it is a question of regulating the autonomy of the franchisees. Anand and Stern (1985) and later Anand (1987)

established in their studies that franchisees are willing to relinquish decision control over operations when their own expectancy of success as independent of the franchisor was low and they attribute the success of the business to franchisor. Dant and Gundlach (1999) stated that balancing the competing forces of dependence and autonomy in the franchise relationship is a key management challenge for franchisors. Phan, Butler and Soo (1996) suggested that franchisors should give more entrepreneurial autonomy, i.e. self-directed strategy-making authority, to franchisees when a tense market competition situation prevails and when the goals of franchisor and franchisees are likely to conflict. This would be potentially the best way to try to secure single franchisees' profits.

Pizanti and Lerner (2003) on the other hand reached the conclusion that in the relationship between franchisor and franchisee, control and autonomy are not dichotomic but dialectal. The franchisor controls contract adherence and operation standards, thus decreasing the risk of opportunistic behavior and freeloading on the part of franchisees. Franchisees, on the other hand, aim at independence in order to guarantee sufficient local adaptation of their enterprise, which is necessary due to regional differences. Thus the issue is not a high degree of control on the part of the franchisor or great independence on the part of the franchisee, but a balance between the two. Extremes would often have a negative, undesired effect on the relationship. The authors compared the relationship to a pendulum between control and independence that sways according to the changes and nature of the relationship. According to them, differences in individual relationships between franchisor and franchisees depend on balancing control and occasional promotion of independence. The view of Pizanti and Lerner (2003) supports the recommendation of this study concerning a more individual approach in the management of franchise relationships.

2.2 Summary on Article 2

*“An Ounce of Prevention Is Worth a Pound of Cure:
Findings from National Franchisee (Dis-)Satisfaction Study”*

2.2.1 Background

Job satisfaction, its antecedents and outcomes have been a widely studied phenomenon in the field of organizational studies, whereas research efforts have seldom focused on analyzing satisfaction among entrepreneurs. This is surprising, since satisfaction has been ascertained to be a fundamental measure for entrepreneurs (Cooper & Artz 1993). The satisfaction of self-employed persons is usually higher than that of salaried employees (Bradley & Roberts 2004). In the process leading to the decision of becoming an entrepreneur, job

dissatisfaction can act as a so-called push factor motivating a person towards self-employment (see e.g. Cooper 1971; Shapero 1975; Brockhaus 1980a). According to Brockhaus (1980b), dissatisfaction not only affects the decision of setting up a business, but it may even indirectly affect the success of the new enterprise as well. Cooper and Artz (1993) stated that a causal relationship exists between business success and entrepreneurial satisfaction. In addition, they emphasized the impact of satisfaction on the efforts of continuing business and self-employment.

Various studies on the satisfaction of franchise owners have been conducted in the United States since the beginning of the 1970s. The satisfaction of franchisees has been shown to have a key role when it comes to understanding their conduct, and many studies have indeed been launched based on the point of view as well as need of distribution channel management (Robicheaux & El-Ansary 1975-1976). Among other things, satisfaction has been shown to increase commitment and coping and to bring about a more productive franchisor-franchisee relationship.

The large number and versatility of previous studies on the subject has created a substantial body of knowledge about the phenomenon. This made it possible to conduct a hypothetic-deductive study for the first time in a Finnish franchising environment. Based on previous literature, a total of eight hypotheses were developed for testing.

The hypotheses postulated were as follows:

- Hypothesis 1: The greater the satisfaction with particular satisfaction components and the franchisees' post-engagement continuance intention, the greater the overall satisfaction.
- Hypothesis 2: The lower the overall satisfaction,
- a) the greater the conflict in the franchise relationship.
 - b) the greater the opportunistic propensity.
 - c) the greater the pessimism concerning the future development of the business.
 - d) the greater the amount of imperfect (unreliable, irrelevant, inadequate) information that has been supplied to the franchisees by the franchisor during the initial franchise negotiations.
 - e) the greater the perception of improper franchisee assessment process.
 - f) the greater the disposition not to enlarge the business.
- Hypothesis 3: The greater the overall satisfaction, the satisfaction with particular satisfaction components, and the post-engagement continuance intention, the greater the likelihood to continue operation and remain in the franchise system (i.e., not to give up voluntarily their franchise).

The sample of the study consisted of 36 franchise chains' 815 franchisees from three industry sectors – retail, services and the restaurant sector. This corresponded to some 40% of all known franchise chains in Finland at that time, and to over half of all franchisees. An additional aim of the study was to create

a more precise picture of the Finnish franchisee and the typical features of their business. This was made possible by the extensive nationwide sample.

2.2.2 Findings and discussion

Typical characteristics of franchisees

The amount of female franchisees turned out to be surprisingly high, 47%. About a third of Finnish entrepreneurs are females – a top high figure by European standards (Hyrsky & Lipponen 2004). There are four potential reasons for the high number of females among all franchisees. Firstly, franchise systems operate mainly in industry sectors such as services and retail, where the number of female entrepreneurs is traditionally higher than average. Secondly, franchisees' businesses are small micro businesses, and small business size is a typical quality of female-owned businesses. This is also reflected in the typical risk-taking behavior of female entrepreneurs. Women tend to avoid risks and they take smaller risks than men (Koiranen, Hyrsky & Tuunanen 1997; Hyrsky & Tuunanen 1999). In franchising, the entrepreneurial risk is considerably lower compared to other types of business (Tuunanen & Koiranen 1998). It has been estimated that about nine out of ten franchisees continue operating after the first five years, when the corresponding survival rate among independent businesses is only a bit more than 50%.

The third factor accounting for the high number of woman franchisees could be the fact that franchising may lower one of the major obstacles to entrepreneurship among women, i.e. combining home and family life and entrepreneurship. Franchisees' businesses are often couple or family based. In such cases the problem can at least partly be overcome. Some franchisors even use it as a recruitment criterion for franchisees, and thus it may be to the franchisee's advantage if their spouse and/or other family members are able to support and take part in the business. In this sample, the number of franchisees who were either married or cohabiting was high, 86%. Fourthly, the support and help provided by the franchisor in setting up a business may be especially valuable and of critical importance to women in particular. Studies on female entrepreneurs have shown that it is more difficult for females than males to gain entry into the market because the sort of relationships that are useful in setting up a business, which males traditionally possess, are lacking in their social networks (see Dant, Brush & Iniesta 1996; Bates 2002).

The average age of franchisees was approximately 42 years, the youngest being 18 and the oldest 64 years old. The median age for Finnish entrepreneurs, about 45 years, is high compared to salaried employees (see Hyrsky & Lipponen 2004, 55). Franchisees may therefore be somewhat younger than other entrepreneurs. The average length of their franchising experience was four years and one month. The experience varied from one month to 20 years. This means that the average age of becoming a franchisee was 38. The short franchising experience is probably a reflection of the fact the Finnish franchising

culture is still in its infancy. Franchising is a relatively new form of entrepreneurship in Finland.

Around 40% of the franchisees studied had upper secondary school and/or matriculation examination as their basic education. The vocational education level of the franchisees also turned out to be relatively high – approximately six out of ten had completed vocational college education after basic education. A fifth had completed vocational education or had similar qualifications, while one in thirteen had completed college/polytechnic or university education. In recruiting, franchisors may prefer applicants with a high level of education.

Almost a third (31%) of all franchisees had previous entrepreneurial experience. Earlier international studies have shown that this number has remained relatively constant during the years (Stanworth & Curran 1999, 337). The franchisees studied here had nine to ten years of entrepreneurial experience. Roughly the same number of franchisees, about 9%, had previously been either unemployed or working in the public sector. The biggest group, nearly half (48%) of all franchisees, had previously been salaried employees in the private sector. The typical length of salaried employment was 11-12 years. The smallest group was persons with student status, accounting for less than 3%. All in all, 95% of all franchisees studied had previous work experience. Six respondents out of ten had work experience from a different field than that of their franchise. Therefore, becoming a franchisee does not seem to require work experience from the particular field, while work experience in general and education are prerequisites.

The average length of franchisees' workweek was 53 hours. The calculated total working week is thus almost two whole working days longer than that of the average salaried employee. The duration of work input was significantly dependent on the business hours of the franchised outlet. Franchisees viewed the future of their business as positive. Two franchisees out of three anticipated that their revenues would increase during the next two years. The estimated increase was on average 15%. However, only one in four thought that they would be hiring more staff within the same time span. Thirty per cent of franchisees also wanted to become multiple-unit owners by setting up new outlets. Over half (53%) of all franchisees studied gave economic profit and growth as their primary objective, while 47% gave their own income and family income as the main objective of their business. The observation is surprising, as earlier studies have shown the number of growth-oriented businesses among small and medium sized enterprises to be more or less 15%-25% (cf. Koskinen 1996; Tuunanen 1997). This is also a paradox of sorts, since it is the franchise contract and, ultimately, the franchisor that dictate whether the franchisee can expand by setting up new outlets. It is possible that franchisees identify themselves with a brand that operates in the market as a single large company.

Typical characteristics of franchisees' businesses

Franchisees' businesses are typically micro enterprises, i.e. with less than ten employees. On average, the businesses employed 4.7 full-time external employees. However, the employee structure was mainly based on part-time employees. The average number of part-time employees per business was 6.3. Part-time employees are a flexible resource, and they are undoubtedly needed to accommodate for the long business hours and irregular flow of customers. Six enterprises out of ten were open for business seven days a week, one quarter six days and the rest for five days per week. Businesses in the service and retail sectors were relatively equal in size, but larger businesses in the restaurant sector distorted the average numbers of employees. A more accurate picture of the distribution is obtained by stating that two businesses out of three employ no more than two full-time or part-time external employees. The number of franchisee businesses not employing any external employees is considerably higher – about one third – than among other businesses in Finland (see Hyrsky & Lipponen 2004). In the majority of the cases, it seems that the franchisees own personal commitment with an intense involvement and input in operative work of the business is imperative. In the firms studied, in addition to the entrepreneur an average 1.3 family members worked in the business as well. Three out of four franchisees considered their family's support and entrepreneurial work as being an essential factor for the success of the business.

The relatively small size of franchised businesses is also reflected in the turnover. It was on average €437,000. It is noteworthy that the larger units in the restaurant sector increased the average turnover. One fifth of the businesses had a turnover exceeding €757,000, while a good third had a turnover of less than €252,000. About one sixth (17%) of the franchise owners surveyed were multi-unit franchisees, i.e. say franchisees owning and managing more than one outlet. Multi-unit franchisees seem to be relatively rare in the Finnish markets. The majority of the franchisees' businesses were limited companies (60%). The number is remarkably high compared to the Finnish firms. This may be partly due to requirements in the franchise contract as well as fairly substantial financial investments. One sixth of the firms were partnerships, 4% general partnerships and 13 % limited partnerships. The rest, i.e. a little over one fifth of the ventures were sole proprietorships.

The most frequent length of franchisees' initial term was five years, the average being only six years and two months. The longest contract period was twenty years. In international comparison, the contracts were remarkably short, since e.g. in the United States the average contract period has been reported to be ten years and seven months (DeBolt 1999). One in five franchisees started their business at an outlet that had previously been run by another franchisee, while about one third started their operation at an outlet previously operated by the franchisor. The rest, i.e. almost half of the franchisees, started their operation at a completely new outlet and location.

The average start-up investment needed by the franchisees to set up business was €52,000. However, the median sum was only about half of that,

€25,000. One in five franchisees had put in an opening investment of over €67,000, while one third had managed with €17,000 or less. The investment sum included a one-time franchise fee averaging €9,000, leaving an average of €42,000 for material investments. The investment sums of franchisees in the retail and service sector were equal in size, €31,000, while the corresponding sum among businesses in the restaurant sector was more than fourfold. The majority, about 60%, of franchisees considered the opening investment and franchise fee as being reasonable or even inexpensive when assessed afterwards. Only about 40% considered the service fees and royalties reasonable or inexpensive in relation to the benefits and ongoing support they received from the franchisor. The amount of royalty payments varied between 4 and 10% of the turnover. Three franchise owners out of four paid a royalty of 8% or less. This supports the earlier conclusion that franchisees see the ongoing fees they have to pay as a considerable adverse factor in franchising (Tuunanen & Hyrsky 2001).

Franchisees' satisfaction and commitment

Franchisees' satisfaction with their business was measured in three complementary ways: as overall satisfaction, satisfaction with particular business domains, and as post-engagement continuance intention. Overall satisfaction was measured as the balance or congruence between franchisees' expectations about franchise ownership and their actual experiences. The theoretical approach applied was discrepancy theory (see Michalos 1986).

More than six franchisees out of ten (61%) felt that their experience had met their expectations. Two respondent groups equal in size, both somewhat one fifth of all franchisees surveyed, stated that their expectations had been exceeded either slightly or considerably (19%), or had fallen short either slightly or considerably (21%). The distribution indicating overall satisfaction was therefore nearly within normal distribution, albeit showing a distinct peak. The image provided by the results of franchisees' overall satisfaction rate was thus rather positive.

This conclusion was also supported by the franchisees' relatively positive evaluations of particular business domains. Previous research has shown that franchisees' satisfaction can be explained by certain specific factors related to the franchise relationship and business. This study produced a total of four relevant satisfaction components. These components were formulated based on 26 items that were compressed using component analysis. The components were "finance", (i.e. the profitability and financial development of the business, self-sufficiency or solvency, the personal income and own status of the franchisee); "ongoing Support", (i.e. the quantity and quality of support services, franchisor's performance, communication, franchise contract and the development of the business concept as well as the franchisee's influence possibilities); "market performance of the franchise system", (i.e. a well-known trademark/brand, market position and competitiveness, image, customer-orientation of the business concept); and "work as a franchisee", (i.e. the

franchisee's work load and tasks). The highest levels of satisfaction were attained in the component market performance, followed in order of satisfaction by the components work, ongoing support, and finance, which latter two were scored exactly the same by the franchisees. Individual items with levels indicating high satisfaction rates not included in the sum variables mentioned above included satisfaction with business location and satisfaction with the chain's other franchisees.

Franchisee's satisfaction has previously also been measured indirectly through their commitment. As it has been established, satisfaction leads to commitment, attempts have been made to depict satisfaction by analyzing post-engagement continuance intentions. The phenomenon has traditionally been measured by one factor: "Based on your experience, would you take up the franchise again if you were given the chance at this point?" Results show that 59% would rejoin the same franchise system. Every fourteenth franchisee (7%) would like to join another franchise system instead, while about 3% of respondents stated that they would no longer want to join any franchise system whatsoever. About one franchisee in twenty would not want to become a self-employed any longer, while more than every eighth would become an independent small business owner. The same number (13%) of respondents was uncertain of their possible decision.

There was a strong correlation between post-engagement continuance intention and overall satisfaction. About 93% of those with a positive intention toward their present franchise system had had their expectations regarding franchising either met or even exceeded. On the other hand, less than one fifth of dissatisfied franchisees would like to continue their franchised business and contract with their present franchisor.

A total of eight hypotheses were set in the study for empirical testing. According to the first hypothesis, the franchisees' overall satisfaction is explained by their satisfaction with particular business domains, i.e. satisfaction components, and franchisees' post-engagement continuance intention. According to linear regression analysis, the components of ongoing support, finance, market performance and work as well as post-engagement continuation intention strongly account for overall satisfaction. The model explained 44% of the total variance, which can be regarded quite good. In addition, the regression model showed that other factors than those connected to the franchisee's business operation, such as general entrepreneurial atmosphere, do not account for overall satisfaction (cf. Stern & Reve 1980; Schul, Little & Pride 1985). The statistical properties of the model were proper in other aspects as well. The first hypothesis was thus given indisputable empirical support.

The next six hypotheses set concerned the explanation of dissatisfaction. According to them, franchisees' dissatisfaction is related to conflicts within the franchise relationship, franchisees' opportunistic tendencies, franchisees' pessimistic views on the future development of business operation, the lack of adequate information received in the franchise contract negotiations (inadequate, irrelevant and unreliable information), inadequacies in the

recruitment process experienced (length, methods, depth, equality/fairness), and the franchisee's tendency to keep the size of their business unaltered (lack of growth-orientation, i.e. unwillingness to open new outlets). Five of the hypotheses received empirical support.

The hypothesis on the franchisee's opportunistic orientation did not receive enough empirical evidence, as the result remained statistically non-significant. However, the result was in line with the expected direction. It is possible that both dissatisfaction and satisfaction with business success may lead to the increase of opportunistic and alternative-seeking behavior. The dissatisfied franchisee may feel the need, while the satisfied franchisee may see the opportunity to act against the franchise contract and norms of cooperation and seek alternatives.

The last hypothesis concerned the usability of satisfaction factors in predicting the continuity of the franchisee's business operation. According to the hypothesis, the greater the overall satisfaction, the satisfaction with particular satisfaction components, and the post-engagement continuance intention, the greater the likelihood to continue operation and remain in the franchise system, i.e. not to give up their franchise voluntarily. To test the hypothesis, discriminant analysis was used, by dividing respondents into two dichotomic groups: those indicating no intention of giving up their franchise, and those who intended to give it up during the following two years. The model worked well and as anticipated, with little deviation. Of the particular satisfaction components, the Market performance did not affect the predictability of the franchisees' intentions of giving up franchising. The cluster accuracy of the cases of the model was 81%, which can be considered very good. The strength of the model lay particularly in the fact that it was capable of picking out the few cases, i.e. those likely to give up, with nearly 90% accuracy. In conclusion, (dis-)satisfaction can be stated to be a significant explanatory factor in the case of giving up franchising. (Dis-)satisfaction with its various dimensions and aspects can be used to predict franchisee turnover. In addition to measuring and improving satisfaction levels, the knowledge gained can therefore also be used to control the problem of franchisee turnover, which is detrimental, expensive and time-consuming to the franchisor (cf. Macmillan 1996).

Dissatisfaction can cause motivational and commitment problems, which may also be reflected on the staff and thereby also on customer service. Unpredicted franchisee turnover hampers chain growth. Franchisee turnover is a severe problem, particularly since the major obstacle to growth or slowing factor is the lack of suitable franchisee candidates. When a franchisee suddenly gives up, finding a successor for the outlet is difficult, and often the franchisor may be forced to take over and run the business himself. These changes may also disturb customer service at the store location.

Short franchise contract terms may tend to reinforce the idea of franchise owning as something with an easy getaway, caused by the fixed-term nature of franchise arrangement. In international comparison, Finnish contract terms are short – maybe even too short. Contract terms that are too short may increase

franchisee turnover – franchisors should therefore expressly avoid drafting contracts that are too short-term. The length of the contract term should first and foremost be based on economical factors (e.g. pay back time of the investment), and secondarily on the present market situation (e.g. competitors' franchise contracts, supply of the potential franchise owners). The franchisor can also differentiate itself from other franchise systems by the qualities of its contract. This in turn is closely linked with the franchisor's recruitment policy and the profile of the entrepreneurs sought.

Franchisees' dissatisfaction may complicate the recruitment of new candidates considerably otherwise as well. In this study, franchisees evaluated franchisees already operating for the chain as their second most important source of information, right after the franchisor. A little less than 60% of the franchisees had contacted a franchise owner operating in the chain when looking for information on the franchise system and during contract negotiations. Operating franchisees were the third most common entrepreneurial inspiration for aspiring franchisees. Franchisees' dissatisfaction leads to a negative spiral, as they are unlikely to recommend franchise ownership in their franchise system to anyone. In addition to the fact that dissatisfaction and setbacks weaken the goodwill and brand image of the franchise, they also project a negative image of franchising in general, thus making it a less tempting career option.

Even though franchisee recruitment has been the subject of substantial research interest during the last 35 years, there is still evidence of the fact that franchisors have not understood the great importance of franchisees' satisfaction and their different backgrounds and motives. Dissatisfaction can easily lead to conflict-prone situations. The findings of the study also highlight the importance of franchisors' ongoing technical and commercial support services in achieving satisfaction (see Peterson & Dant 1990; Kaufmann & Stanworth 1995; Tuunanen & Hyrsky 2001).

Recruitment and the early stages of the franchising relationship are critical in creating an open, confidential and smoothly working co-operation. This was shown by the findings of the study in at least two different ways. Firstly, franchisors should make sure that they have given enough relevant and information for the aspiring franchisees. On the other hand, aspiring franchisees are also responsible for gathering information. About one fifth of the respondents reported defects in the quantity and quality of the information they had received. The same amount of franchisees reported afterwards that the information they had received had been insufficient. Secondly, franchisors should pay attention to aspects of their recruitment process – its duration, depth, equality, fairness and the use of proper methods. This way, recruitment of unsuitable candidates could be avoided, which could in turn improve the chain's competitive edge and decrease franchisee turnover. The prevention of franchisee dissatisfaction seems to be a key issue in franchise relationship management.

In the United States, federal legislation stipulates the information that franchisor must disclose in advance to anyone considering becoming a

franchisee. The aim of the legislation is to prevent misappropriations and to ensure the availability of essential information. The law protects the one in the weaker position, i.e. the aspiring franchisee, who would not otherwise have access to this information, or who would not necessarily have the competence to ask for all salient information. A uniform data disclosure format, Uniform Franchise Offering Circular, also ensures that aspiring franchisees are able to analyze and compare different franchise systems. In Finland, as well as in other European countries, the ethical codes of franchising associations steer towards this practice. However, ethical codes have only minor or no legal validity whatsoever, and there are no sanctions for breaking them. In light of these differences, it is possible that the aspiring franchisee in Finland is in a weaker position and that the circumstances here are more prone to failure in recruitment.

The study also revealed that the franchisees' entrepreneurial decision-making process had perhaps been based on information gathering that was too biased and inadequate, and maybe even on intuitive action. Owning and running a franchised business is a considerable investment and commitment, in terms of both money and time, and that is why it is important that the decision leading to it has been thoroughly considered. The survey conducted provides a useful framework for future franchisees' information gathering. They should concentrate on at least four central factors when comparing and analyzing franchise systems. These factors are: work, franchisor's support, franchise system's market performance and finance.

The results of the study are consistent and in line with a great number of earlier studies concerning franchisees' satisfaction. Due to the large sample size, results can be generalized nationally. The information produced is novel and instrumental, as it has never previously been available on the young Finnish franchising culture. Compared to previous studies, this analysis emphasized the importance of the early stages of the franchise relationship as well as recruitment in building a foundation for successful co-operation. In addition, the study showed that franchisees' satisfaction is connected with their level of optimism concerning the positive development of their business in terms of turnover and with their willingness to increase business by opening new outlets. Since increasing sales and a growing chain constitute the franchisor's earning logic, it is possible that franchisee satisfaction removes or at least alleviates conflicting objectives between the actors as well as resulting co-operational conflicts.

The study also included setting up a uniform and comprehensive model of essential factors explaining satisfaction in franchisees' business operation. In addition, an extensive synthesis of the negative and positive outcomes of the satisfaction factors of previous studies was carried out. Of the negative outcomes, franchisee turnover was emphasized in particular, as something explained by either dissatisfaction or so-called natural reasons (e.g. retirement, illness, death and so forth).

One of the main limitations of the study was its cross-sectional nature. That is why the study will continue as a follow-up study, in which those

franchisees that have given up franchising will be contacted about two years after the survey conducted here. The study will look at the following issues:

- when and how the franchisee gave up business, and whether it happened on voluntary basis,
- the reasons for and opinions on giving up,
- general perceptions on the success rate of franchised business,
- satisfaction with franchising and the intentions on recommending it to others,
- personal experiences of the economic profitability of franchised business,
- operation and vocational position after giving up franchise, satisfaction with the current position, and
- fate of the outlet after giving up ownership (closure, new franchise owner or company owned unit).

The results obtained will be compared to the results presented here, especially with reference to satisfaction as well as commitment and post-engagement continuance intentions. The results enable the verification of the discriminant analysis that has been set up, i.e. what is the actual role of dissatisfaction in the cases of giving up franchise.

The conclusions of the present study as to what constitutes franchisees' overall satisfaction, and how satisfaction affects their intentions to continue operating within the franchise system have subsequently gained support. Active and two-way communication with franchisees on the part of the franchisor helps build up trust and increase franchisees' satisfaction. Increased satisfaction and trust strengthen franchisees' intentions of continuing their operation (see Chiou, Hsieh & Yang 2004).

Furthermore, a later study conducted by Wadsworth, Tuunanen and Haines (2004) on the satisfaction of franchisees in the quick service restaurant industry in Finland and the United States showed that franchisees' satisfaction dimensions are generalizable in different cultures, at different times, and in studies of different industries. The study also showed that compared to their colleagues in the United States, Finnish franchisees were more dissatisfied with their franchise contract, communication within the franchise system, their own influence possibilities and their financial performance.

2.3 Summary on Article 3 & 4

*"Compilation of Finnish Franchising Statistics" &
"Finnish Franchising Statistics 2003"*

2.3.1 Background

Since franchising is not a single business industry, yet a form of entrepreneurship and business operation, reliable, systematic data gathered by authorities maintaining enterprise or other statistics have not been available in

our country. In Finland, as is mostly the case in other countries as well, franchisors are not obliged to register separately in order to franchise. Franchisor and franchisee companies thus blend into the general mass of companies in business industries and enterprise registers, making it impossible to recognize and separate them as well as to analyze them.³³

The franchising statistics available have thus been mostly maintained by national franchising associations or compiled separately by external service providers commissioned by franchising associations. The reliability of these statistics is however highly questionable due to insufficient and constantly changing statistical methodology and the poor coverage of statistical data. Earlier, e.g. in the US, franchising statistics were compiled occasionally by authorities, but this is no longer the case. In 2004, the comprehensive study on the extent of franchising and its economic impacts in the United States commissioned by the *International Franchise Association Educational Foundation* was completed (National Economic Consulting Practice of Pricewaterhouse Coopers 2004).

At times, even more extensive studies concerning the spread of franchising have been published. The *European Franchise Federation* carried out a statistical study on franchising in its twelve member states in 1997 (EFF 1997). Two years prior to that, the *World Franchise Council* in cooperation with national franchising associations in 31 countries, carried out a study on the extent of franchising (see Swartz 1995). The study comprised countries from all continents, even though the majority (n=14) was from Europe. The study was carried out by *Arthur Andersen* consulting firm. In addition to this, qualitative franchising analyses on different countries have been published. They have mostly been drawn up from the point of view of internationalization of franchising (see e.g. Mendelsohn 1992; Welsh & Alon 2001a; Welsh & Alon 2001b; Alon & Welsh 2002; Alon & Welsh 2003).

The *Finnish Franchising Association* was founded in the fall of 1988, and it has collected information concerning franchising in our country since 1991. At that time, there were thirty franchisors operating in Finland, and they had some 600 outlets. The average franchise experience of franchise systems was only two years and five months. Statistical data are presented in the association yearbook, which was at that time, and still is, the only printed, regularly published source of franchising information in the country. In January 1999 the association and the *University of Jyväskylä* agreed that a national franchising statistics study,

³³ The general industry category standard (TOL 1995) maintained by *Statistics Finland* does not include categories with reference to franchising. In January 2004, a search among basic data of some 500,000 companies and sole proprietorships or other legal persona yielded one "franchisor", one "franchisee" as well as 515 and 555 hits for the words "franchising" and "franchise", respectively. In addition, a word referring to the words "franchising" or "franchise" was found about 300 times, but incorrectly spelled. The registered business name of franchisor firms in the trade register is very often different from their market name, i.e. the brand name the chain uses in the market. Franchisees on the other hand are not entitled to use the chain's brand name upon registration, as the brand name is the franchisor's protected immaterial property.

"Franchising in Finland", would be carried out as an academic, independent and confidential study, supported by the association.

The aim of the first statistical study was firstly to develop a valid framework that would make it possible to recognize and screen business format franchises in the market. Secondly, the aim was to compile the official 1999 franchising statistics. In addition, the initial strategic motives of franchisors for starting to franchise were charted, because no Finnish research data on this subject were available. The ultimate objective of the study was to significantly improve the reliability and coverage of franchising statistics as well as to develop an appropriate procedure for statistical data collection, which could also be used for statistical purposes in the years to come.

A method to improve the coverage of statistics had to be developed that could be used to reach franchisors. There was awareness that the former statistics compiled by the association were deficient, and that a large number of potential franchisors would be operating outside the association. When the first study was carried out, 41 chains belonged to the association, while 48 franchise systems were known to exist outside the association. In tracing potential franchisors, so-called printed media monitoring service was utilized, which the association had been purchasing from a private media intelligence company for almost five years' time, from May 1994 to March 1999. The monitoring service covered in practice all known printed media publications appearing on a regular basis in Finland - at that time, a total of 1,369.

The printed media monitoring service gave the association access to original article cuttings every time the words "*franchising*" or "*franchise*" appeared in an article in one of the publications monitored. During the period mentioned, the total number of hits filed was nearly 1,100. Content analysis of the articles revealed that the majority, 82%, could be linked to a certain franchisor/-s. This means that the remainder, about one sixth of the articles, were general texts about franchising. A total of 140 franchisors were identified in the articles, of which 58 were previously known. The majority, 82, were thus "new" potential franchisors. Their contact information was searched for in different public and commercial databases, after which they were contacted for screening, to verify the potential fulfillment of business format franchising criteria.

Press monitoring proved to be an applicable and highly appropriate method for seeking out franchisors in the market. Fledgling and expanding franchisors are sorely in need of press coverage and free publicity in order to lure potential franchisees. Chains are also eager to publicize the opening of new outlets. This creates the impression of a growing and successful business, which again supports the chains' reputation and brand and thus help to attract new owner-operator candidates. The quantitative increase in the amount of franchising-related reporting gave an indirect indication that franchising is increasingly recognized among the general public. Improved coverage of franchising statistics as a result of press monitoring does not however mean

that the statistics are wholly comprehensive. The real extent of franchising in our country is thus wider than what is shown by the statistics.

In order to develop a screening framework an extensive analysis of literature was carried out, in which theories explaining the inception and growth of franchising were looked at. The key franchising theories were agency theory, resource scarcity theory, transaction cost theory and risk spreading theory (see e.g. Oxenfelt & Kelly 1968-1969; Rubin 1978; Carney & Gedajlovic, 1991; Combs & Castrogiovanni 1994; Dant 1995; Julian & Castrogiovanni 1995; Bronson & Morgan 1998). Practical and juridical definitions of franchising as well as franchising definitions included in franchising association regulations were also examined. A semi-structured interview was also carried out with three franchise lawyers and three franchise consultants to validate the framework.

A key task in improving the reliability of statistics was to make sure that only genuine business format franchises fulfilling all criteria were included in the statistics. It was thus necessary to be able to differentiate quite a large number of distribution channels of the product distribution and trade name franchising type as well as other types of distribution based on marketing cooperation from business format franchising. It should be pointed out that in the United States, the other two types of franchising are included in franchising statistics. There are thus considerable differences between the North American and the European definitions of franchising.

Castrogiovanni and Justis defined (1998) salient features of franchising. They were three characteristics that exist simultaneously: geographic dispersion of the outlets, product replication and joint ownership by the franchisor-franchisee. Meanwhile Kaufmann and Eroglu (1999) stated that (business format) franchising comprises four main concepts: product or service deliverable, benefit communicator, system identifier and format facilitator.

As a result of extensive concept analysis the following general definition of (business format) franchising was reached:

“Franchising is a relationship which involves a contractual and long-term collaboration between two independent firms, a franchisor and a franchisee, in which the franchisor grants for payment a right to the franchisee to make use of the franchisor’s business format in a pre-described and controlled manner at a certain location or area for a certain period of time.”

The definition was consistent with current EU legislation, as were the franchising screening criteria that were developed in the study (see Table 4).

TABLE 4 Legal definition of franchising

Commission Regulation No 4087/88 (EEC)

(a) 'franchise' means a package of industrial or intellectual property rights relating to trade marks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services to end users;

(b) 'franchise agreement' means an agreement whereby one undertaking, the franchisor, grants the other, the franchisee, in exchange for direct or indirect financial consideration, the right to exploit a franchise for the purposes of marketing specified types of goods and/or services; it includes at least obligations relating to:

- the use of a common name or shop sign and a uniform presentation of contract premises and/or means of transport,
 - the communication by the franchisor to the franchisee of know-how,
 - the continuing provision by the franchisor to the franchisee of commercial or technical assistance during the life of the agreement
-

The EU identifies three features of franchising: a common brand and uniform outfit of the premises, communication of know-how from franchisor to franchisee, and continuing provision of commercial or technical services by the franchisor to the franchisee, whereas in the U.S., legislation addresses three main factors for franchising: trade mark, control and payment. Interestingly, Coughlan, Anderson, Stern and El-Ansary (2001) stated that if franchising is conceived more broadly than the EU description, there is a risk that franchising and other forms of marketing channels will be blended. In product distribution and trade name franchising selling units are known as dealers, distributors, resellers and agents which can operate at the wholesale or retail level. These business modes include car and truck dealerships, soft drink bottlers and gasoline service stations. (see Norton 2004, 19)

The extent and intensity of cooperation between franchisor and franchisee is considerably more significant in business format franchising than in product distribution and trade name franchising (e.g. Stanworth & Curran 1999). The idea of business format franchising is a complete business operation model, "package", which the franchisor licenses to the franchisee. Based on the package and the know-how of the franchisor, a person with little experience of self-employment and of the specific industry may launch and independently manage an entire, often quite extensive business, not just a part of it. The difference compared to product distribution and trade name franchising is therefore quite considerable. In the latter two forms of franchising cooperation is almost entirely based on brand name utilization and product distribution.

The critical point of the EU regulation is the communication by the franchisor to the franchisee of *know-how*.

Know-how refers to a package of non-patented practical information, resulting from experience and testing by the franchisor, which is *secret*, *substantial* and *identified*. When the know-how, as a body or in the precise configuration and assembly of its components, is not generally known or easily accessible, it is considered to be secret. Moreover, when the know-how includes information which is of importance for the sale of goods or the provision of services to end users, and in particular for presentation of goods for sale, the processing of goods in connection with provision

of services, methods of dealing with customers, and administration and financial management; and when the know-how is useful for the franchisee by being capable, at the date of conclusion of the agreement, of improving the competitive position of the franchisee, in particular by improving the franchisee's performance or helping it to enter a new market, it is regarded as substantial. (Commission Regulation No 4087/88, EEC)

The last requirement, identified know-how, means that the know-how must be described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality. The description of the know-how can either be set out in the franchise agreement or in a separate document (i.e. operational manual).

The screening criteria developed are presented in table (see Table 5). The criteria of business format franchising are based on earlier franchising theories, legislation and business management practice. Screening was carried out by phone interviews and postal questionnaires. Managing directors, franchise or marketing directors of franchisors were used as informants.

TABLE 5 Screening criteria for business format franchises

- | | |
|----|--|
| 1 | There are outlets operated by the franchisee(s) - i.e. not totally company owned channel of distribution. |
| 2 | A written (standard) franchise contract exists between the parties. |
| 3 | The franchisee pays an initial franchise fee and/or s/he pays royalty on continuing basis to the franchisor. |
| 4 | The franchisees operate under the same brand/trade name and their outlets have a uniform outfit. |
| 5 | The franchisor provides relevant and classified know-how by training and/or other significant assistance to the franchisees. |
| 6 | The franchisor offers an operational manual(s) to guide franchisees' business operations. |
| 7 | The franchisor supplies technical and/or commercial support (i.e. ongoing services) to the franchisees. |
| 8 | The franchisor does not own (substantial) share of the franchisees' companies. |
| 9 | The franchisor acknowledges franchising as its operational form and/or searches for new franchisees. |
| 10 | An exclusive right for a territory may be granted to a franchisee in the franchise contract. |
| 11 | The franchisor controls and monitors franchisees' business operations on a continuing basis. |
| 12 | The franchisee may not sell, lend, transfer or grant the franchise or any related rights to a third party without franchisor's approval. |

Legal criteria: 2 to 7

Theoretical/practical criteria: 1, and 8 to 12

Minimum requisites for qualifying as a franchise in the screening: 1 to 4, and 5 or 6, and 7.

Analyzing and operationalization the concept of business format franchising was necessary in order for recognition of genuine franchise systems to be carried out reliably. The process also improved concept validity of the study. In this way, the obvious, recognized shortcomings of previous statistical attempts could be also avoided. Franchises that did not meet the criteria of business

format franchising were removed from the previous statistics. Correspondingly, new franchises that had been operating for a shorter or longer time and met the franchising criteria were added.

In connection with the screenings carried out, the fact was revealed, characteristic of the young Finnish franchising culture, that the concept of franchising was not well known. Some of the companies screened which had been recognized as franchisors had not realized before that they operated on this principle. In addition, some of the companies, which claimed to operate as franchisors proved upon a more detailed screening analysis to be operating in accordance to some other distribution format. It was observed that product distribution and trade name franchising channels are very common in the Finnish market as well.

The statistical study is presented in the following figure as a process description (see Figure 2).

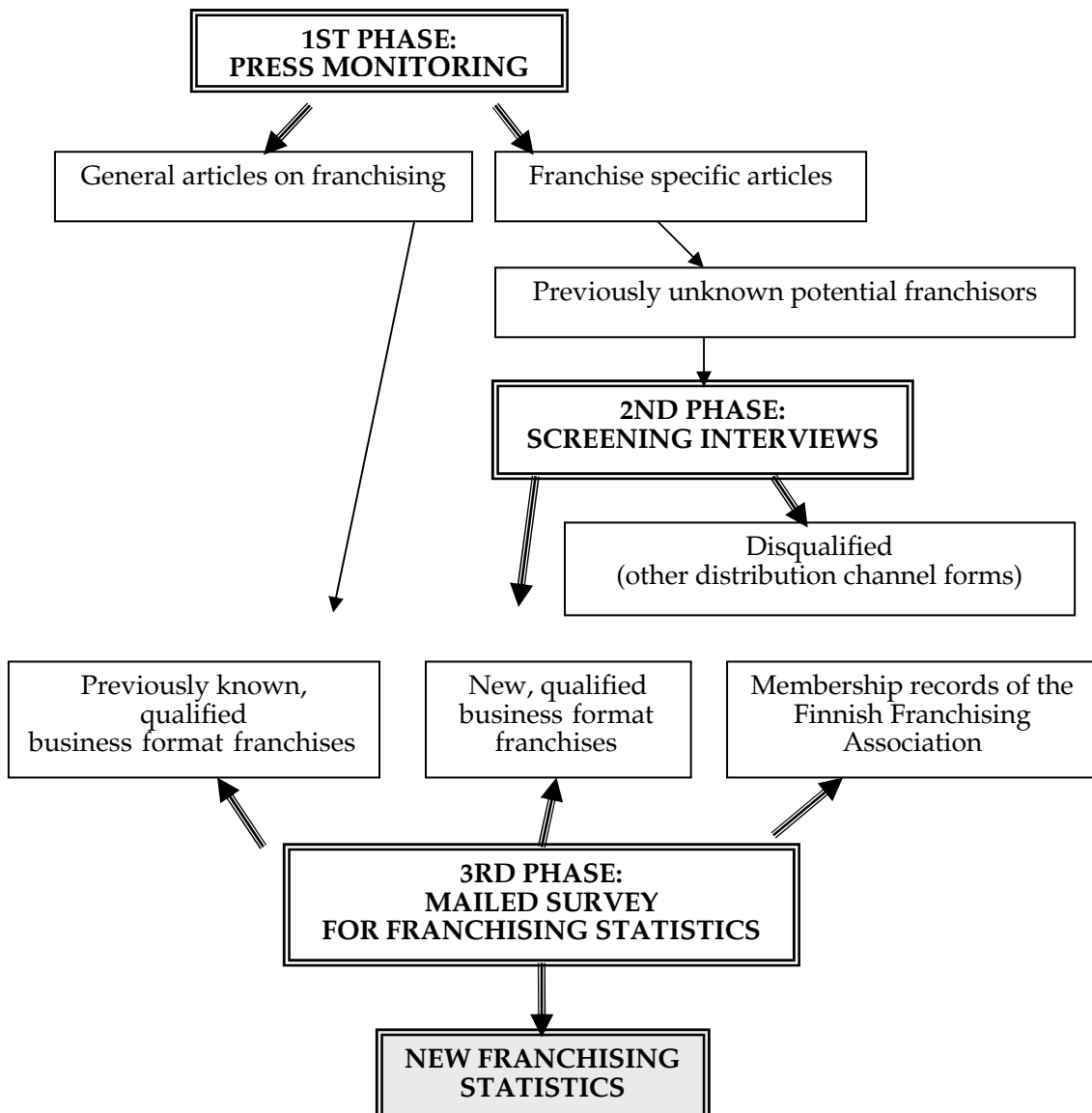


FIGURE 2 Statistical franchising study as a process.

The postal questionnaire drawn up for the compilation of statistical data included the following key data:

- name of franchisor, name and contact information of chain, time of founding the company, year of launching franchising, business industry, name of franchise manager or CEO,
- number of outlets (company owned and franchised), and the number of franchise owners,
- combined turnover and number of staff of the franchise system,
- growth target for the next year in term of new outlets, obstacles to growth as well as
- internationalization objectives and
- the lifecycle stage of the franchise system.

2.3.2 Findings and discussion

Results: Motivations to start franchise

The reasons for launching franchising were examined in connection with the first statistical survey in 1999 with the aid of an open question in the questionnaire. After qualitative contents analysis of the answers, a total of thirteen semantically arranged groups of responses were obtained (see Table 6). The contents of the groups were shown to be fragmentary in view of existing theoretical models concerning franchising. No single theory seemed to rise clearly above the others; in fact, the reasons of starting a franchise seemed to be a multiple combination of several franchising theories.

TABLE 6 Initial franchise rationales

| <i>Why was franchising started?</i> |
|--|
| 1. Rapid growth, Geographical spreading, Market coverage (14%) |
| 2. Solution to the principal-agent problem (12%) |
| 3. "Copycat Strategy" - method copied from abroad or competitors (7%) |
| 4. Economies of Scale, Benefits from Co-operation (7%) |
| 5. Control and organizational issues (7%) |
| 6. Cost management and efficiency (6%) |
| 7. Do not know / decline to answer (6%) |
| 8. Access to financial capital (5%) |
| 9. Access to human capital, Local market knowledge (5%) |
| 10. Pilot operations and R&D (3%) |
| 11. "Go with a flow", No specific reason (3%) |
| 12. Risk sharing (2%) |
| 13. Miscellaneous reasons (1%) |
| Note: Responses of qualified franchises (N=65) analyzed only. Multiple responses (N=124). |

Most commonly, franchising was seen as a strategy enabling rapid growth, with the aid of which comprehensive coverage of the targeted market and geographical spread of the concept could be efficiently achieved. The utilization

of franchisees' entrepreneurial motivation and incentives also emerged relatively strongly. By this is meant solving the agency problem of the relationship. Maybe somewhat surprisingly, overcoming resource limitations, i.e. raising capital and utilizing franchisees immaterial capital were not given a high priority as motives for starting franchising. On the other hand, the third most common group of answers was unexpected, in light of previous research. Franchising had been started primarily as a copycat strategy, either by copying a domestic competitor or by imitating the operation of foreign peer businesses. The observation may be an indication of the young Finnish franchising culture, the scarcity of franchising know-how and the general novelty of franchising as a phenomenon. Efficiency-, organization- and scale-related motives also received empirical support.

In some cases, no particular motivation was given for starting up franchising. Cases of this kind indicate a situation where franchising is formed over a longer period of time as one developmental stage, when previous loose marketing collaboration gradually intensifies and concentrates within a distribution chain. Risk sharing, pilot operation as well as research and development were mentioned relatively rarely. Miscellaneous reasons, "cannot say" and refusal to answer made up the remainder of the answers given. Compared to earlier research data, agency theory, resource scarcity theory and transaction theory received support, and the results were thus very much in line with earlier findings (cf. e.g. Dant 1995).

It could however be seen as a slight surprise that the possibility for internationalization or EU legislation (namely block exemption rule) were not put forward as franchising-related motives. To sum up, one might say that in light of the results, the decision to start a franchise does not seem to be a very clear and straightforward choice. Differences related to individual companies, their lifecycle stage and industry might complicate the rationale behind the decision to start franchise operations. It is also clear that retrospective study makes the reliability of the results somewhat questionable. The reasons for initiating franchising deserve more inquiry. However, in the exploration pertaining franchise rationales franchisees and even the behavior of customer markets should be taken into account simultaneously. It has been suggested that instead of the individual theoretical explanations used a more holistic and integrative approach is needed (e.g. Stanworth & Curran 1999). The application of several theories simultaneously has been attempted earlier (cf. Pizanti & Lerner 2003). The doctrine is undergoing a development phase in this respect (e.g. Hendrikse & Windsperger 2004).

Results: Present volume and state of franchising in Finland

The franchising statistics for 2003 were the fifth statistics compiled in a standardized manner in Finland. According to the statistics, there were a total of 177 retail, service and restaurant franchise systems operating in Finland.³⁴

³⁴ The restaurant category also covered fast food and café businesses.

The highest number of chains was found in retail (n=76) and services (n=71). One sixth of the chains (n=30) operated in the restaurant sector (see Figure 3). A little more than a quarter (28%) of the franchise systems operating in the Finnish market are members of the Finnish Franchising Association.³⁵

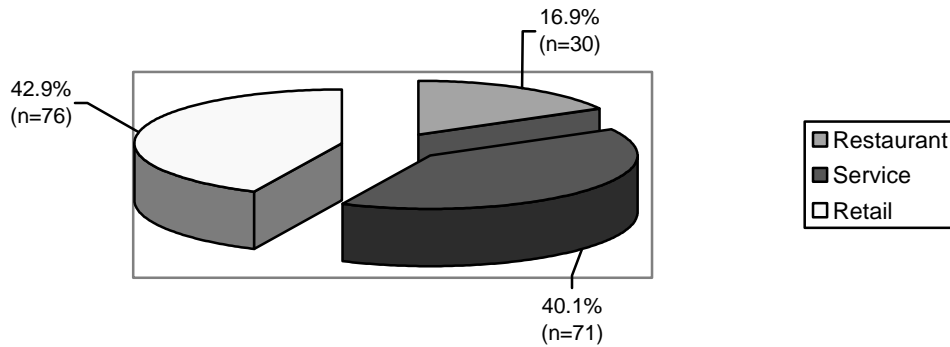


FIGURE 3 Franchise systems by industry sectors 2003

Compared to the level of the previous year, the net increase in the number of franchises was 8%, or thirteen chains. The increase was consistent with the trend in previous years, considering that there were only press hits from six months' time.³⁶ The trend in the four previous years had shown that the total amount of franchise systems increased by about 15% per year (see Figure 4). The increase would have been even greater, if systems had not been removed from the statistics at the same time. A total of ten franchise systems were removed because of ceased franchise operations. Only one case was due to bankruptcy, and one was due to merging of two systems. Ending a franchise operation only rarely means the end of business of the entire chain. In many cases, it involves reorganization of distribution channels and continuing operation using some other form of cooperation. This was also shown to be the case in 2003.

³⁵ The franchisor members of the association are bound to comply with the ethical code in conducting franchising.

³⁶ For the franchising statistics survey of 2003, press monitoring was only available for six months, as the Finnish Franchising Association discontinued the use of the service, which was considered very pricey. Because of this, the results of the statistics are not comparable to those of earlier years without some reservations. The results obtained are however indicative of a trend.

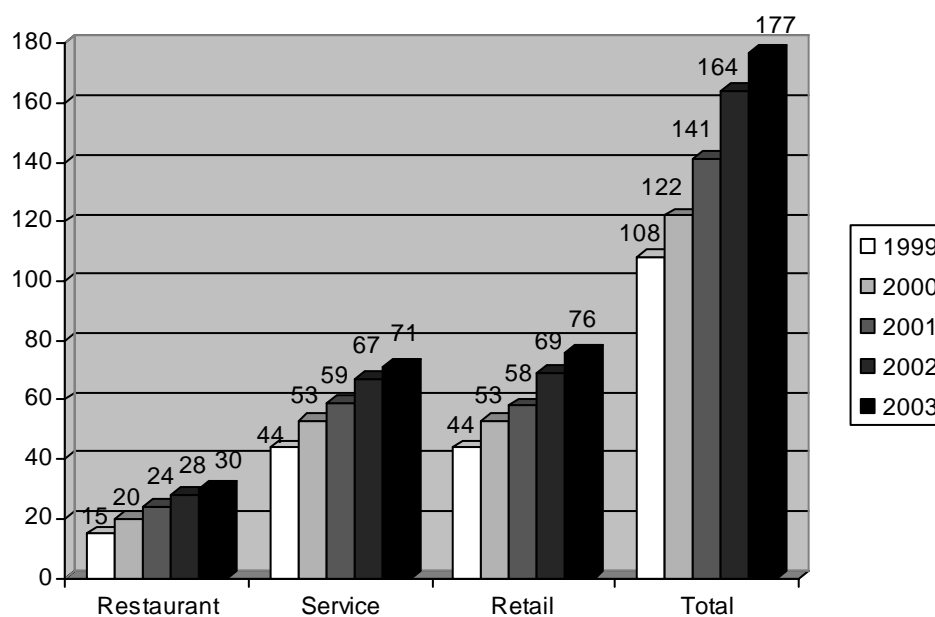


FIGURE 4 Franchises by industry sectors in Finland 1999-2003

Twenty-three new franchises were introduced in the statistics. The corresponding figure for the previous year was forty. There were also some multi-brand companies among the franchisors, i.e. franchisors owning and running with several separate franchise chains at a time. Such cases are however rare in Finland, and the chains managed by them were entered in the statistics as separate franchises. The total number of cases was three, and the number of franchise systems operating under their management was eight.

After compilation of previous statistics, the largest increase in the number of chains was seen in retail, both quantitatively (7 chains) and relatively (10%). The increase in the number of retail chains was probably an indication of the improved supply of business premises as well as increased purchasing power among consumers. The increase in the number of restaurant franchises (two chains) was relatively less (7%) than that of retail franchises. It is very likely that the growth of the restaurant sector will continue to be fairly stable, even unsurprising. A significant proportion of restaurant chains operate in saturated markets with excessive capacity and very tense competition. The restaurant sector is typically very dynamic. Enterprise turnover appears to be high, i.e. a lot of new businesses are set up, but business mortality is also relatively high. New franchises may emerge in the sector, but they are unlikely to reach very brisk growth. The increase in the number of chains in the service sector was four (6%). A significant increase is expected in the number of businesses providing e.g. well-being, personal as well as health, social and care services, both in the near future and in the longer run. The service sector also has the greatest growth potential measured in terms of outlets. When measuring scope and growth, one cannot only look at the number of chains; their size must also be measured in terms of outlets. The threshold of entering

the field is relatively lower in the service sector compared to the retail or restaurant business.

The Finnish Franchising Association has traditionally classified franchise systems into three broad industry sectors: retail, service and restaurant. In the survey "Franchising in Finland", business categories were inspected more closely by using the classification utilized in the United States (see Table 7). The four largest business categories are: retailing (43 franchises), food-related businesses (in total 37 franchises), business services (19 franchises) and automotive service and spare parts (16 franchises). Together these branches account for two thirds (65%) of all franchises in the markets.

TABLE 7 Franchises by business categories 2003

| Business Category | Frequency |
|--------------------------------------|------------|
| Automotive | 16 |
| Building Products & Services | 2 |
| Business Services | 19 |
| Children's Products & Services | 2 |
| Computer Businesses | 9 |
| Food/Quick Service | 29 |
| Food/Full-Service Restaurants | 2 |
| Food/Retail Sales | 6 |
| Health Care Businesses | 6 |
| Home-Improvement Products & Services | 8 |
| Maintenance Services | 2 |
| Personal Care Businesses | 10 |
| Pets | 1 |
| Photo-Video Businesses | 2 |
| Recreation | 5 |
| Retail | 43 |
| Service Businesses | 11 |
| Training Services | 4 |
| Total | <u>177</u> |

Three out of four of the franchise systems operating in the Finnish market were of Finnish origin while the remaining one fourth were thus of international ancestry (see Figure 5). The number is on average European level. In an analysis of domestic franchises carried out in twelve European countries by the European Franchise Federation, the share of domestic franchise systems varied from 54% to 87%, the median being 77.7% (EFF 1997). The majority of the 44 foreign franchises operating in our country were from Scandinavia (Sweden, Denmark, Norway) or Western Europe (England, France, Germany, Switzerland, Spain, The Netherlands, Belgium) and a little under one third were of North American origin (USA, Canada). The relative share of foreign franchise systems of European origin varied between 52 and 100% of all foreign franchises in the countries surveyed in the EFF franchise study, the median being 85.4% (EFF 1997). Thus it seems that there are relatively fewer chains of

European origin among the franchise systems of foreign origin operating in Finland.

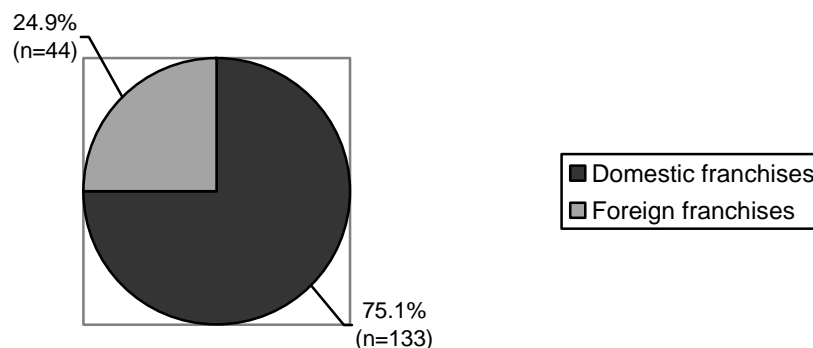


FIGURE 5 Origin of the franchises operating in Finland in 2003

One fifth (21%) of Finnish franchise chains had gone international, and one in twelve (8%) aimed at the international market later. The number of franchises that had spread their operation abroad was considerably high even by international comparison, as it would entitle Finland to a 7th place in the franchise survey of 31 countries published in 1995 (Swartz 1995). However the internationalization intentions of franchises had slightly diminished since 2002. This may reflected the overall instability of the economic trend in the Western economies. The target market of domestic chains intending to spread abroad was very much the same area from where franchises systems had come to Finland, i.e. Scandinavia and Western Europe. In addition, the Baltic countries (Estonia, Lithuania, Latvia) and Russia (especially the metropolises of St. Petersburg and Moscow) were also significant market areas for Finnish franchises.

According to the 2003 statistics, 177 franchises had a total of 6,608 outlets (see Figure 6). Compared to the year before, the total number of franchise outlets increased by 15.2% or 871 outlets. The largest quantitative increase, 581 (18.8 %) was experienced in retail, while in the restaurant sector the increase was 262 (22.5%) and in the service sector 28 (1.9%). The increase in the number of outlets exceeded the average 15% annual growth especially in 2001-2003.

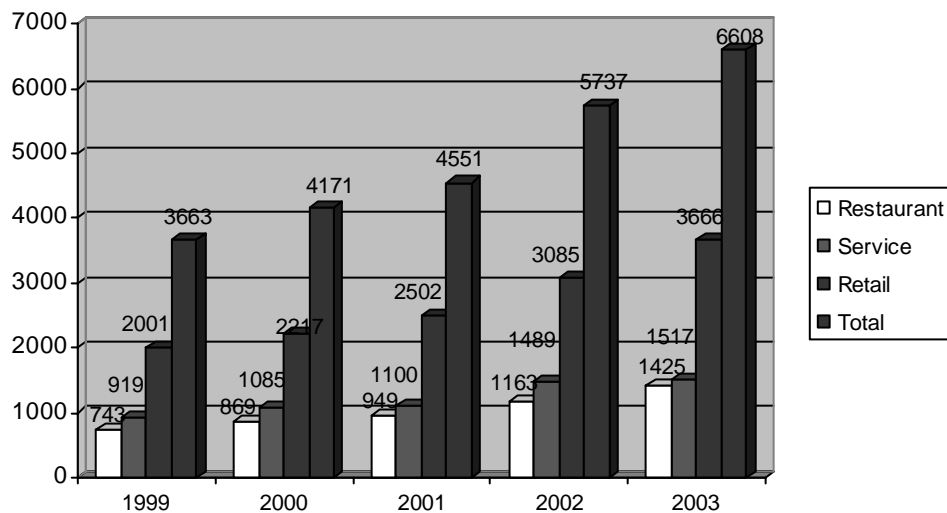


FIGURE 6 Distribution of outlets by industry sector 1999-2003

Two thirds (67%) of the outlets were owned and managed by local franchisees. The rest, i.e. one third, were company-owned. For the sake of comparison, in the United States the corresponding number of franchised outlets was 76% (National Economic Consulting Practice of PricewaterhouseCoopers 2004). The development between 1999 and 2003 showed that relative share of company-owned outlets of the total number of outlets has varied between 32 and 36% in Finland. It must however be remembered that there are considerable differences in ownership structure between industries and particularly between individual franchises. Franchised outlets were most common in the restaurant sector, where eight out of ten outlets were owned by franchisees. In the service sector, seven out of ten outlets were franchised, while retail had the lowest figure, six out of ten. There were some franchises with distribution channels that were wholly franchised, while the majority of franchises had both franchisee- and company-owned outlets, in varying proportions.

The number of franchisees, about 3,700, differed somewhat from the total number of franchised outlets, because almost 600 outlets were managed by multiunit franchisees. Multi-unit franchisees are however relatively rare in Finland. Generally taken, only some 1.7% of all the active businesses in our country seemed to operate on a franchise basis. However, their relative number will probably rise in the future, as it is estimated that 3-4% of all new businesses start-ups will be franchise-based. In the United States, about 5% of the country's eight million small enterprises operate on a franchise basis.

Franchisors aiming at growth within a one-year period, three fourths (75%) of all 159 that had indicated a target, had a total target of 718 new outlets. This observation underlines the significance of franchising as a growth strategy in particular. On the other hand, the observation also indicated the relatively short operation history and early lifecycle stage of franchise systems. Only one franchisor in twenty (5%) estimated that they would diminish in size, while one

in five (20%) estimated that the size would remain unchanged. Franchise chains had again a record number of positions open for new franchise owners. If the proportion between franchised and company-owned outlets remains unaltered, i.e. two out of three new outlets will be franchisee-owned. It should also be observed that the growth estimate did not include franchisee turnover within the franchise systems.

The targeted growth is however held back or slowed down by obstacles to growth experienced by franchisors, and the targets will not be fully met. This was also shown by earlier statistical studies. It is likely that about one third of the growth expectations will be realized. Significant obstacles to growth experienced by the chains included difficulties in recruiting proper franchisee candidates and the scarcity of suitable outlet site locations. Other growth-hampering factors included availability of capital and competitive situation, referring either to tense competition or market saturation.

Despite this, continued future growth can be also predicted based on franchise system lifecycle phases. Half of the chains (49%) were in the growth phase, and one fifth (21%) were only just entering the market. According to their own estimate, only one in four (26%) had reached maturity, and the rest, less than one in twenty, were in the declining and exit phase.

About 130 chains gave out their employee figures. The share of missing data (26%) was thus regrettably high, and that is why the number of those employed within franchise systems could not be given accurately for the year 2003. The total number of employees reported was 37,150. The real number was estimated to be one fourth higher, which means that about 46,000 people were employed within franchising. The number was less than 2% of the total Finnish workforce. Half of the franchising jobs were in retail, one third in the restaurant sector and the rest, one in six jobs, in the service sector. The employee figures included part- and full-time employees working within the franchisor organization as well as in franchisor- and franchisee-owned outlets, i.e. only the direct employment effect of franchising. The indirect employment effects were naturally also considerable. Franchise chains operate in labor-intensive fields, and the level of domestic purchases is mainly high. In the United States, the indirect effect of franchising in terms of jobs have been estimated to be 1.849 – fold, i.e. one job in franchising created almost an other job as an indirect effect. In the United States, franchising accounts for almost 7.4% of all jobs in the private sector (National Economic Consulting Practice of PricewaterhouseCooper 2004).

Seven chains out of ten (124 chains) reported their total turnover figures for 2002, and the combined turnover was €3.76 billion. Because turnover data were missing for 53 franchise systems, or 30% of the respondents, the total turnover generated by business could not be calculated accurately. The estimated total turnover of all chains was €4.88 billion. The figure included combined turnover of the franchisor and company-owned as well as franchised outlets. The turnover was around 3.4% of total gross domestic product (GDP) in Finland. The corresponding share in the United States was as high as one sixth.

While franchise-based retail and restaurant business account for a little over ten percent of the total annual value of their respective sectors, the corresponding share of services only amounts to about one per cent. This observation is another indirect indication of the growth potential of franchising in the service sector. To sum up, it could be stated that it is very likely that franchising will show fairly strong growth in Finland in the near future, and its role in the Finnish national economy will thus increase.

2.4 Summary on Article 5

“Exploring the Anatomy of Franchising: A Cross-National Examination of US and Finnish Franchise Contract Provisions”

2.4.1 Background

Franchise contracts and legislation have been the subject of fairly intensive study in the fields of law and economics (see e.g. Dnes 1992). The published studies have mainly been of North American origin. In their extensive analysis and taxonomy of previous franchising studies, Elango and Fried (1994) described the studies in this field as one of the tree main streams of franchising research, naming it “Franchising and society”. The public politically oriented perspective has concentrated on examining the social impact, advantages and disadvantages of franchising. The subjects of study have been to a large extent related to antitrust issues and the functionality of the market as well as to the asymmetry of power between franchisors and franchisees and possible misappropriations on the part of franchisors due to this power imbalance (see e.g. Brickley, Dark & Weisbach 1991; Castrogiovanni, Justis & Julian 1993; Hadfield 1990; Stadfeild 1992; Hüsichelrath 2004).

In Finland, public information about franchise contracts has been very scantily available. However, in 1988 a textbook focusing on franchising practices expressly from the contract point of view was published. It was written by two lawyers and it was said to be the first Finnish book on franchising (see Lautjärvi & Tommila 1988). Shortly after that, a survey report conducted by the Office of Free Competition, a Finnish competition authority (see Andersson-Tuominen & Porttikivi 1991) was published on the competitive effects of franchising. As part of the survey, a questionnaire was conducted to analyze e.g. the immaterial rights of the franchise contracts of 32 franchisors, various fees paid by franchisees and the monitoring activities implemented by franchisors.

In Finland, franchise contracts are typically confidential, which means that the contracting parties do not disclose information concerning the contract to outsiders. This being the case, potential franchisees cannot openly or at least not at a very early stage acquaint themselves with their contents. The franchise

contract is however the basis of the entire cooperative relation. The contract defines the status and role of the parties, the content of exchange and the nature and objective of the relationship. The responsibilities, rights and obligations of the parties are also defined in the contract. The nature of the contract is unavoidably strategic, as it indicates how the cooperation is supposed to operate in order to bring about a competitive advantage to the collaborating parties. The contract has a fundamental impact on how business and entrepreneurship are shaped for the individual franchisee. By scrutinizing franchise contracts the anatomy of the franchise arrangement, i.e. of the cooperative organism can be understood.³⁷

Franchise contracts are typically very extensive and detailed. It is not uncommon for the contract to be dozens of pages long. Despite this, contracts remain incomplete. Hendrikse (2003, 459) defines incomplete contracts as agreements that fail to specify actions under every course of events. Incomplete contracts lead to franchisor governance, which for its part gives rise to control and monitoring costs. On the other hand, smooth cooperation and particularly trust between the contracting parties tends to lower these costs and the mutual risk due to incomplete contracts.

A potential franchisee needs objective information about the franchise arrangement and the franchise contract for two reasons: first, in order to compare different franchise offerings and second, in order to make a weighed decision about becoming a franchisee. Because contract information is not readily available in Finland and franchisees are in a weaker position of the two contracting parties because they must operate on the basis of incomplete information, there is a danger that the decision is not based on sufficient, relevant and reliable information.³⁸ This may lead later to disappointment and discontent on the part of the franchisee, which may again endanger the relationship (Hing 1995; Tuunanen 2002b). Franchise legislation enacted in different countries has come about based on a need to protect the weaker contracting party. A significant part of existing regulation concerns the amount, quality, and form of presentation and distribution of information to franchisees before signing of the franchise contract. Self-regulation on the part of actors in the field, so-called ethical codes or guidelines, have taken on a role in promoting good business practice especially in cases where national franchise legislation is lacking.

As a member of the European Franchise Federation (EFF), the Finnish Franchising Association applies the European Code of Ethics for Franchising (EFF 2002). The Code of Ethics prohibits member franchisors from giving

³⁷ According to this view, an enterprise can be defined as a network or nexus of contracts, meaning that the concept in accordance with the neoclassic theory of an enterprise as a production unit can be discarded. The enterprise is thus not a whole working towards the attainment of a single goal by profit maximization (Henrikse 2003, 98-102).

³⁸ The Ministry of Trade and Industry (2002) recently published a report on forms of contract in business cooperation. The report dealt extensively with the key provisions of franchise contracts and aspects that potential franchisees should pay attention to before signing the contract.

misleading or subjective information to franchisees. Moreover, franchisors should give franchisees all possible written material concerning the franchise relationship well before signing the franchise contract. Franchisors should also choose and accept as franchisees only persons who have the skills, the education, personal traits and financial qualifications required in running a franchise outlet in that particular franchise. However, it is important to take into account that the law does not enforce the Code. In addition, in Finland it binds only the member franchises of the FFA and more than two thirds of the franchises do not belong to the FFA.

The franchise contract is always drawn up from the franchisor's viewpoint. The contract has at least two significant functions from the franchisor's point of view. First, the franchisor aims at efficient protection of the know-how and other immaterial capital included in the business concept or franchise package. According to the current view, the value of this capital culminates in the chain brand name (cf. Spinelli 1994). The contract aims at managing the risk posed by the possible opportunistic behavior of the franchisee and damage related to that.³⁹ Second, the contract also delineates the property rights, i.e. decision and ownership rights. Decision rights include the right to utilize the asset and the right to change its substance, whereas ownership rights cover the right to appropriate the returns from assets (residual income claim)⁴⁰.

According to Windsperger (2002, 25), the dependence of the decision rights on the knowledge assets can be postulated as follows: decision rights have to be allocated according to the distribution of knowledge assets between the franchisor (system specific, brand name capital) and the franchisee (outlet specific and local market know-how). The higher the portion of the franchisor's intangible knowledge assets relative to the franchisee, the more residual decision rights must be transferred to the franchisor. When the franchisor's incentive to invest in intangible knowledge assets is higher, the fees are higher and ownership surrogates compensate the more the diluted residual income rights. While the franchisee's incentive to invest in intangible knowledge assets is higher when the fees are lower and the more ownership surrogates (such as exclusive territory, exclusive customer clauses, alienation rights, option rights)

³⁹ A fact that is often overlooked is that the franchise contract protects not only the franchisor but also the franchisee against other franchisees that may behave opportunistically. Just one franchisee who disobeys the rules may damage the chain's reputation and corporate image, and thereby weaken the position of other franchisees. This is often illustrated by the saying: "A chain is only as strong as its weakest link."

⁴⁰ The ownership rights include residual income rights (franchisee's payments to the franchisor: initial fee, royalties, advertising fees, and other fees) and complementary ownership surrogates (e.g. tying arrangements, exclusive dealing clauses, resale price maintenance, lease control, option rights at the end of the contract period such as buy back arrangement, approval and termination rights). In the franchise channels strategic decision-making is virtually centralized to the franchisor while operative decisions (e.g. marketing: product, price, promotion, service, procurement and human resource decisions) are decentralized through co-ordination and delegation to the franchisees.

are included in the franchise contract. The co-location of knowledge assets and decision and ownership rights as well as the complementary relationship between decision and ownership rights are key drivers of an effective institutional structure. This means that both the franchisor and franchisees are motivated to utilize the knowledge assets to maximize the residual income stream because of ex post surplus (Windsperger 2002, 27).

The study was exploratory in nature, since no cross- or multinational studies had been undertaken on this subject before. From the Finnish point of view, the knowledge produced had an undeniable novelty value. The information was relevant from the viewpoint of future franchisees and franchisors alike. The differences related to legislation and contract practices are also pertinent from the viewpoint of internationalization of franchise chains. The tension in and the justification of the study were based on the differences between two totally different franchise market and cultures. Both Finland and the United States represent a modern, competitive, post-industrial Western market economy. However, there is a huge difference in size between the markets in the two countries, both in terms of population and geographical extent.

Differences between the countries are particularly marked when it comes to franchising. Modern franchising was born in the United States in the mid-1950s, whereas the oldest known franchise chain started operation in Finland in the 1970s, and franchising was only launched on a larger scale in the late 1980s and early 1990s. Unlike in Europe, in the US also Product Distribution and Trade Name Franchising are included in franchising.⁴¹ From the study's point of view, a significant difference may have been the different judicial systems of the two countries, common law and civil law. In addition, the United States represented a tightly regulated and Finland a loosely regulated franchising environment.

The aim of the study was to analyze possible differences and similarities between Finnish and American franchise contracts with respect to contract features, contract clauses and information disclosed to franchisees before signing of the contract. The data gathered in the study were defined based on the contents of the UFOC, Uniform Franchise Offering Circular document (see Table 8).

⁴¹ In the United States, Business Format Franchising accounts for 81% of all franchising outlets, 79% of the jobs, 61% of wages paid and 74% of annual production value of franchising. (National Economic Consulting Practice of PricewaterhouseCoopers 2004).

TABLE 8 Contents of the Uniform Franchise Offering Circular

| ITEM | TOPIC |
|------|--|
| 1 | The Franchisor, its Predecessors, and Affiliates |
| 2 | Business Experience |
| 3 | Litigation |
| 4 | Bankruptcy |
| 5 | Initial Franchise Fee |
| 6 | Other Fees |
| 7 | Initial Investment |
| 8 | Restrictions on Sources of Products and Services |
| 9 | Franchisee's Obligations |
| 10 | Financing |
| 11 | Franchisor's Obligations |
| 12 | Territory |
| 13 | Trademarks |
| 14 | Patents, Copyrights, and Proprietary Information |
| 15 | Obligations to Participate in the Actual Operation of the Franchise Business |
| 16 | Restrictions on What the Franchisee May Sell |
| 17 | Renewal, Termination, Transfer and Dispute Resolution |
| 18 | Public Figures |
| 19 | Earnings Claims |
| 20 | List of Outlets |
| 21 | Financial Statements |
| 22 | Contracts |
| 23 | Receipt |

2.4.2 Findings and discussion

Results: Franchisors' background

The collected data were grouped, analyzed and reported under four categories: "franchisors' background", "franchise contract governance", "obligations concerning franchisees' business operations", and "financial aspects of starting and running a franchised outlet".

Maybe somewhat surprisingly, franchisor companies were shown to be of about the same age in the two countries. However, a radical difference was seen between the countries when comparing the initiation of franchising to founding of the business. From the moment of start-up, American firms had initiated franchising more than four times faster compared to Finnish franchisors. When franchising in the US was in one out of two cases initiated within a year and a half at the most, and on average in the course of less than five years, it took Finnish enterprises on average more than twenty years, and in half of the cases ten years and six months. This means that businesses in the US sample had a franchise experience that was more than 2.5 longer compared to firms in the

Finnish sample. The difference was about twelve years, and it was statistically significant. The finding is probably indicative of the difference between franchising cultures in the two countries. It seemed that in the United States franchising was a recognized and natural choice for businesses, whereas in Finland businesses saw franchising more as a slowly evolving or adaptation strategy.

The differences in the length of franchising experience and the size of the market in the countries studied probably explain the difference in franchise system size observed. Finnish franchise systems were on average ten times smaller than the chains compared to measured in terms of number of outlets. Another significant difference between the franchise systems of the two samples was found in the relative share of franchised outlets. While eight out of ten outlets in the US (80%) were franchised, in Finland the corresponding share was less than six out of ten (57%). This may also be due to the difference in franchising culture between the two countries. On the one hand, Finnish franchisors have difficulties in finding enough franchisees, and on the other hand, franchising is still a form of entrepreneurship that is little known and poorly recognized (cf. Tuunanen 2003). The considerable differences in entrepreneurial activity between the countries may also play a role in this (cf. Reynolds, Hay & Camp 1999). Compared to earlier Finnish research data, the relative share of franchisees was fairly low in this study, 5–9 percent points (see Tuunanen 2003). In the case of relatively small samples, the observed differences in business industry distribution could also affect the reliability of the results.

There were other differences as well between the franchisors in the countries compared. The ownership of Finnish companies had changed significantly more often than that of American ones. This may have been related to the decision to initiate franchising. Changes of ownership of the franchisors may have a very significant impact on franchisees. US franchisors had been involved in legal disputes, either as plaintiffs or defendants, four times more often during the past seven years. Correspondingly, every fifth Finnish franchisor had been forced to go to court. It must be remembered that the greater size of the system and the longer franchising experience may increase the likelihood of lawsuits. This observation is made interesting by the fact that the number of lawsuits was considerably high in the US despite extensive franchising legislation. The differences in law systems and cultures may also affect this finding.

Franchise contract governance

The franchise contract term and the renewal term as well as the possibility to transfer and terminate the contract are typical factors related to contract governance. Franchise agreements are primarily fixed-term. There was significant variation in the length of the contract term between the two countries studied. In the Finnish sample, the majority of the contracts were for five years at the most, while the franchise contract terms in the US sample were

typically over ten years long. The average difference in contract term between the countries was almost eight years. A similar difference was also seen in the length of renewal term. The renewal term of US franchisors was more than twice as long as that of Finnish franchisors. The differences studied were statistically significant. Generally taken, the length of the contract term should have a strong correlation with the payback period of the initial investment required of the franchisee. Earlier observations also support the present finding (cf. Tuunanen 2002).

Significant differences were also found between contract termination conditions between the two countries. More than eight out of ten (83%) Finnish franchisors gave the franchisee the right to terminate the franchise relationship in the contract, while only little over half of US franchisors (54%) did so. Almost without exception, franchisors retained the option to terminate the contract in both countries. Significantly more terminations of contract initiated by the franchisor, 2.5 times more often, had been carried out in Finland compared to the US. The right of the franchisor to refuse to renew the fixed-term contract of the franchisee can in practice be regarded as having the same outcome as contract termination. Valid reasons are however required in such cases, and they proved to be extremely rare in both countries. Also rare were cases in which the franchisor took over the franchisee's business.

Cases of contract transfer may be related to resignation of the franchisee and transfer of business operation to a new franchisee. A succession from first-to-second generation of the franchisee's business also gives rise to contract transfer. Transfers are relatively rare, and franchisors' approval is always required. The franchisor may charge a fee from the franchisee to cover legal expenses and other indirect transfer costs. Charging fees appeared to be very rare in Finland, for the majority (70%) of franchisors had not mentioned them in the contract. In the US, however, charging fees was almost a rule, present in 90% of the cases.

Obligations concerning franchisees' business operations

One of the franchise contract clauses restricting free competition is the granting of exclusive territorial rights. This tends to reduce the franchisee's business risk, because according to the condition, the franchisor refrains from opening new company-owned outlets or outlets run by other franchisees in the area. Granting territorial rights seemed to be significantly more common among Finnish compared to US franchisors. This may be due to the fact that assumed violations of territorial rights are a common ground for litigation in the United States (see e.g. Zeller, Achabal & Brown 1980; Vincent 1998). When it comes to defining territorial rights, there are on the one hand many alternatives and on the other hand many complementary possibilities and their full spectrum seems to be widely in use. Territories can be defined e.g. on the basis of population base, address, as radius in miles or kilometers from the outlet or other spatial definitions, or a combination of the above. Spatial definition seemed to be the most common type in both countries, used particularly often in Finland, where

it accounted for 60% of the cases. Definition types commonly used in the US also included mile radius and an area with a certain population base.

An integral part of franchisor's strategy is to lump franchisees' purchases together and thus strengthen its negotiating power in relation to goods and service providers. Franchisors aim at discounts brought about by bulk purchases as well as other synergy and scale benefits (e.g. Dant 1995). So-called sole-source purchases are a form of tying that is well motivated and justified when the objective is to guarantee a certain level of quality, to support the brand and to achieve uniformity. Otherwise franchisees are usually guided by the contract to make purchases from approved suppliers. In Finland, three out of four franchisors (77%) used this clause, while the corresponding figure in the US was seven out of ten (71%). The difference between the samples was not statistically significant.

In addition to defining franchisees' purchase sources, franchisors naturally also limit the selection or assortment of products sold by the franchisee. This is essential in order to ensure uniformity of the concept. Franchisors generate the majority of their revenue from the income stream of goods franchisees sold, i.e. royalties. In Finland, all franchisors utilized this procedure, and in the US more than nine out of ten (93%) did so. In addition, franchisees are obliged to use certain brands and trademarks in their operation. In the United States, this seemed to be the rule that was applied in all cases. In the Finnish sample, there seemed to be more variation among franchisors, as 90% applied this practice.

In order to ensure franchisees' input and commitment to business, franchisors often restrict their possibility to engage in other lines of work or business ventures during the contract term. Investment-type franchise contracts, in which the franchisee only participates in the operation by an initial investment, are generally relatively rare. In Finland, 93% of franchisors demand that the franchisee must participate in actual business operation, and as many as 87% required that the participation must be full-time. The corresponding figures in the US were significantly lower, 62% and 19%. This phenomenon is probably related to the size of the franchisee's business. The smaller it is, the more important and more likely it is that the franchisee is expected to participate full-time for reasons of profitability.

Covenants not to compete are very common in franchise contracts. It is understandable that in handing over the know-how of the concept for a fixed time to be utilized by the franchisee in a certain market segment, including a certain residual profit expectation, the franchisor aims to protect its right, know-how and residual claim expectation in an efficient manner. If this were not the case, the opportunistic behavior of the franchisee could give rise to business competing with the franchisor and thus weaken its position. The covenant not to compete usually applies to the franchisee during the contract term and often also for a certain period of time afterwards. In Finland, all contracts included a covenant not to compete during the contract term, while 83% included a covenant not to compete after the contract term. There seems to be a bit more leeway in US contracts, as covenant not to compete during the

contract term and after termination of the contract was in force in 89% and 81% of the cases, respectively.

As part of the franchisee's investment and outlet equipment, the franchisee may also be required by the franchise contract to use e.g. certain types of proprietary software, hardware and data transfer connection. The contract may also require that a certain standard of equipment be maintained and upgraded on a regular basis. In this respect, Finnish franchisors seem to be technically more advanced, and they require these things significantly more often in their contracts than their US counterparts. In addition to being important means of communication, computers and data connections are today also used by franchisors for monitoring purposes (e.g. online cash register).

Financial aspects of starting and running a franchised outlet

Becoming a franchisee often requires a significant economic investment. In addition to the premises, machinery and equipment required for starting a local franchised store, the initial investment also includes possible initial stock inventory and working capital. Franchise fee is also included in the initial investment. Practices concerning the reporting of initial investment differed significantly from each other. While franchisors in Finland primarily (70%) reported the initial investment as a lump sum in euros, only about 2% of US franchisors gave a lump sum in dollars. The American practice was thus to report the initial investment as a certain average sum, which varied between a minimum and maximum. The size of the investment is naturally dependent on individual case and location, and it might therefore be better to estimate it as an average instead of an absolute sum.

The franchise fee is a one-time payment by the franchisee to the franchisor. It is often paid at the time of signing the contract and it is non-refundable. The fee is a compensation for the right to make use of the franchisor's business concept and the know-how and goodwill value it includes. In individual cases, the sign-up fee may also include expenses related to initial training and recruiting of the franchisee as well as costs related to looking for a suitable store site location and premises. While franchisors in Finland primarily (83%) reported the franchise fee as a lump sum, the opposite was true in the United States. Only 7% of franchisors gave the sign-up fee as an absolute sum. The differences between the samples were statistically very significant.

Franchisees' investments are typically not financed by the franchisor, because the franchisor does not want to carry the risk of the franchisees' performance (Martin 1988; Norton 1988). For the franchisor, franchising may be expressly a means of acquiring the capital needed for growth and expansion. However, franchisors with a solid resource base may offer financing for their franchisees. This may promote the recruitment of potential franchisees to the chain. A little over one fourth (27%) of Finnish franchisors offered partial financing for the franchisee's initial investment, while a little over one third (37%) of the US franchises did so. Assistance offered by franchisors to franchisees to raise money for the initial investment from a third party seemed

to be a special feature of the Finnish franchise scene: two out of three (67%) franchisors did this⁴², while the corresponding figure in the US was only about one in four (24%). The difference between the countries was statistically significant.

A franchisor collects ongoing fees and royalties of the franchisees' turnover. The level of the royalty payment is usually defined as a fixed percentage, e.g. of monthly turnover. In three out of four (72%) contracts of Finnish franchisors the royalty was defined as a fixed percentage, while in the US the practice was significantly more common: as many as 93% of franchise contracts included a fixed royalty percentage. Other practices observed used either royalties based on a varying percentage or on fixed payment. The average royalty payment was very similar in both countries at about 5.6%.

In addition to ongoing fees, advertising and marketing fees are collected from the franchisees. As the name indicates, the fees collected are used to finance national "umbrella" marketing costs of the franchise system. The average level of the fees in both countries was about two percent. The fee was in most cases defined as a fixed percentage. The advantage of a separately collected marketing fee is its transparency. Franchisees often participate in drawing up marketing plans. The marketing fees collected are used fully for marketing.

One of the most interesting pieces of information for future franchisee is potential earnings (Justis & Vincent 2003). Because financial information has a key role in the franchisee's decision-making, an evident risk is involved. If the information is later shown to be incorrect, the result is not only dissatisfaction on the part of the franchisee, but also possible contract disputes and litigation. This is why legislators in the United States have paid special attention to this issue (see Vincent & Kaufmann 1996). All information concerning projected earnings must therefore be documented, whether in oral, written or graphic form. Over half (55%) of the American franchisors refrained from providing earnings claims of any kind to potential franchisees, while in Finland all franchisors provided their potential franchisees with earnings claims. The difference was thus statistically significant.

The limitations of the study are related to the relatively small size of the sample in the United States. The sample included 114 franchisors, which was about 15% of the member franchisors of the *International Franchise Association*, while the Finnish sample included 67% of the members of the *Finnish Franchising Association*. The representability of the US sample could not be statistically tested, which limits the generalizability of the US results. No such restrictions applied to the Finnish sample. However, it was a key feature of the

⁴² Because the death rate of franchisees' firms is lower than that of other ventures, an external financier may offer a lower interest rate because of the lower risk. In franchise financing, the relative share of loan may have been higher than usual. It is common in Europe that commercial banks have their own departments for franchise and license financing (see Stern & Stanworth 1994). In Finland, *Finnvera* ltd. is the only actor specializing in franchise financing. Specialized franchise financing was launched in Finland in 1996 following a joint research and development project by *Kera* ltd. and University of Jyväskylä. (Tuunanen & Koiranen 1998)

sample that as the franchisors studied belonged to national franchising association, they were bound by an ethical code. Generalization of the results to franchisors outside associations must therefore be treated with caution and reservations.

Possible contract differences between franchisors of various ages, sizes or franchisors operating in different industries were not analyzed in the study. Neither were cultural differences between the countries looked into in more detail. What is more, this was a cross-sectional, not a longitudinal study, which would have been needed in order to reveal the dynamics of contracting. Contracts are not set for indefinite time period - they are altered, modified and updated upon a need or on regularly basis.

Extending the study to other countries was stated as a possible subject for further study. Multinational studies in this field are virtually non-existent, but from the point of view of internationalization of franchising, the information gained from such studies would be highly essential and pertinent. Franchise contracts must always be harmonized to comply with national legislation in the target country. The present results implied that there may be significant differences in franchising contracts e.g. between the EU and the US. On the whole, it could be said that the results clearly showed that there are more contract differences than similarities. Franchise regulation in the EU and the US has different starting points. EU legislation does not express any views regarding disclosure of pre-sales information or its amount, quality or form, whereas in US legislation pre-sales disclosure is the starting point. Franchise regulation in the EU is based on ensuring the functionality of the market and minimizing detrimental restrictions to free competition. Fundamental differences were also caused by different legal systems in the countries, because they affect how contracts are drafted.

It can also be assumed that the differences in franchising culture between the countries now studied had an effect on the results. In Finland, franchising is a relatively young, increasingly common, but still poorly known and recognized form of business, while in the US it has a long history and the national markets are becoming saturated.

The implications of the study were significant to contracting parties, franchisors and franchisees. The contract is the key element of the cooperation, and it is important for both parties that the contract is legally valid, equal and has a sound basis. Problems in contract interpretation or contracts that are otherwise insufficient tend to create conflicts between the parties. The importance of the contract must never be underestimated (Tuunanen & Hyrsky 2001). It protects the interests of both parties.

The lack of national franchise legislation in Finland and in many other countries as well means that the development of good practices in franchising is dependent on self-regulation on the part of actors in the field. The efficacy of self-regulation can, however, be called to question, because e.g. in Finland, it only affects a good fourth of all known franchisors. The UFOC form applied in this study could serve as a framework for information seeking for potential

franchisees. Finnish franchisors could also take the initiative to increase their use of the UFOC voluntarily, thus ensuring that those interested in becoming franchisees have access to pertinent, sufficient and correct information. The success of information seeking before signing of the franchise contract has a clear causal relationship with later franchisee satisfaction (Hing 1995; Tuunanen 2002). A decrease in the number of false decisions and failures as well as a diminished franchisee turnover would be a direct advantage of this, while an improvement of the cooperation between actors would be an indirect effect. Autonomically evolving self-regulation might diminish the need for legislation, which may involve costs and risks. That is why it might be a proper idea for the *Finnish Franchising Association* to promote self-regulation.

Franchise legislation planning is a topical and hotly debated issue in many countries worldwide (Terry 2003). Behind the planning process is the need to protect the weaker party, and in particular to regulate pre-sales disclosure of information to franchisees before closing the deal by signing the contract. If the present trend leads to a situation where legislation becomes necessary in Finland, the following aspects should be taken into consideration in the planning process. First, franchise legislation in different countries should be examined, searching for best practices. It is known even at present that ineffective laws e.g. in the US have given rise to negative experiences and problems, while there are examples of effective regulation in countries such as Australia. Second, legislation planning should be carried out in close cooperation with actors and stakeholders in the field, reserving a sufficiently long period of time for the parties to get ready for changes. A juridical and bureaucratic burden that causes expenses to businesses should be avoided.

3 SUMMARY AND MAIN CONCLUSIONS

This empirical and descriptive study focused on business format franchising. The study aimed to generate new information and to fill an obvious knowledge gap in this field in Finland. Franchising is a relatively recent form of entrepreneurship in Finland. It is still poorly known and recognized despite its growing importance in the global economy. The knowledge interest of the study was theoretical, and the research strategy structured and quantitative. The phenomenon under study was approached from the entrepreneurship point of view, which is less frequently applied to franchising in business science. The study was positioned particularly within entrepreneurship, although franchising has not been undisputedly regarded as a form of entrepreneurship. It was observed that franchising fulfills the characteristics and contains the subjects that are typical of entrepreneurship research (ch. Venkataraman 1998; Kauffman & Dant 1999). In order to gain a profound preunderstanding and to position the study within the doctrine, prior franchising research was reviewed.

Franchising was analyzed as a form of starting and conducting entrepreneurship from the viewpoint of both franchisors and franchisees, and within a wider economic context. The starting point of the analysis was the three-level, holistic and integrative model of Stanworth and Curran (1999). The levels of the model are that of the society, particularly of economy, that of the organization, i.e. the franchisor, and the level of the individual, i.e. the franchisee. The strength of the entrepreneurship perspective lies in its comprehensiveness and integrative nature. Entrepreneurship was an appropriate approach for analyzing the phenomenon under study on the different levels. According to the basic premise of the study, franchising is a form of entrepreneurship, and it cannot appear without entrepreneurship.

The relatively short and multidisciplinary research tradition on franchising and the multi-level study of the phenomenon has produced quite a large number of individual studies that are poorly linked to each other, with too much emphasis on the franchisor point of view (see e.g. Stanworth & Curran 1999; Hoy & Stanworth 2003). Franchising studies have also been limited by the

reigning paradigm (cf. Elango & Fried 1997). Franchising has been explained with the aid of common economic theories. The theories used have been separate, but complementary within a franchising context. A genuine, strong franchising theory has not yet been developed. The model of Stanworth and Curran (1999), which was utilized as a framework in the present study, has been a pioneering effort to come up with such a model.

Theories, especially the oldest and the most commonly used that explain franchising, namely transaction cost theory and agency theory, have limited explanatory power. Their viewpoint to franchising is very narrow: franchisor's choice of organization (i.e. management perspective), and profit maximization and economic efficiency (i.e. economics perspective). For instance, transaction cost theory does not recognize hybrid-form organizations between markets and hierarchies, of which franchising is one example. Many franchising-related phenomena have remained without satisfactory theoretical explanation. Because of this, the theories in question were only utilized in this study in the area they are best suited for that is in finding out why the company launched franchising.

Theories that are more applicable, more recent and hitherto less used in the franchising context include resource-based theory and property rights theory. The strength of resource-based theory lies in its capability to take into account both cooperating parties involved, and the complementary and synergistic nature of their immaterial and material resources in business initiation and implementation. Property rights theory, on the other hand, complements and deepens the resource-based theory, because it sees the cooperation as being resource-based. Strategic and operational decision rights and ownership rights (residual income rights) between the parties can be derived from resources. The division of rights is set down in the franchise contract, which is of strategic significance for both parties. Property rights theory is suited for examining both business parties, and in principle it can be utilized on all levels of Stanworth and Curran's (1999) model. In addition, it focuses on fundamental issues of franchising pointed out by Elango and Fried (1997), which should be given significantly more attention in future investigations. Putting it simply, a synthesis of resource-based theory and property rights theory takes us closer to a more comprehensive and flexible network theory. The network theory may be very applicable in explaining franchising as a form of inter-firm collaboration.

The acceptance of franchising as an independent and legitimate field of study will very likely strengthen its independent theoretical development in the future. It has been estimated that strong theoretical development is close, as pressure has increased to come up with better, i.e. holistic, integrative franchising theories that have greater explanatory power. Integrating customer markets into franchising theories remains one of the great challenges for the future.

Table 9 provides a synthesis where the main streams of earlier franchising research and theories applied on franchising are integrated into the framework

of the present study and key research questions. Issues left outside the scope of this study include other forms of distribution channels, industry related and lifecycle-specific analyses, the diverse organizational forms of franchise systems and international franchising.

TABLE 9 Prior franchising studies and applied theoretical perspectives relating to the present study

| Main stream of franchising research (Elango & Fried 1997) | Theoretical perspectives to franchising | Framework of the study (Stanworth & Curran 1999) | Focal research questions and issues of the study |
|---|---|---|---|
| I <i>Franchising and society</i> | - (property rights theory) | I <i>Franchising at the macro or societal level</i> - Economic | How widespread is franchising in Finland? |
| II <i>Creation of the franchising relationship</i> | - transaction cost theory - agency theory - resource-based theory - property rights theory | II <i>Franchising at the organizational level</i> - Rapid market penetration - Relationship management | Why did the company launch franchising in the first place? What is the content of a typical franchise contract? |
| III <i>Operation of a franchising system</i> | - (property rights theory) | III <i>Franchising at the individual level</i> - Route into self-employment - Unemployment push - Prior self-employment - Complexity of franchisee motivation - Intrinsic/extrinsic goals - Contemporary views of autonomy | - franchisees' (dis-) advantages and entrepreneurial orientations - impact of franchisees' prior entrepreneurial experience and the length of their franchise relationship - franchisees' (dis-) satisfaction and post-engagement continuance intention - content of a typical franchise contract and pre-contractual disclosure |

Next, the main findings of the study are presented in light of the study tasks set and the model of Stanworth and Curran (1999). It should be taken into consideration that the levels presented in the model as being separate have various interactions with each other. In the present study, the boundary between franchisors and franchisees is particularly emphasized. As such the boundary is artificial, because the aim of the study was to analyze the cooperation relationship, and not just the starting premises of the parties.

3.1 Franchising at societal level

According to Stanworth and Curran (1999), franchising has been studied least from a societal point of view - on cultural, political and economical level. Earlier franchising research with a societal approach used functionality of markets, competition law and the franchise contract terms as starting premises. However, in this study the dominant aim was to find out how widespread franchising is in Finland, and what forms it takes. The goal was to improve the reliability and comprehensiveness of franchising statistics. For this purpose, a concept analysis of business format franchising was carried out and specific criteria were created for it. Nevertheless, it must be observed that not even improved statistics provide full coverage. The actual franchising volume in Finland is greater than what the statistics indicate.

The franchising statistics for 2003 showed that there were a total of 177 franchise systems operating in Finland. Of these, 76 operated in retail, 71 in services and the remaining 30 in the restaurant sector. One fourth ($n=44$) of the franchise systems were of foreign origin and 75% were Finnish. As many as one in five (21%) of the Finnish franchise systems had gone international, and 8% intended to enter international markets in the future. The franchise chains had some 6,600 outlets, two thirds of which were owned and managed by franchisees. Franchise systems aiming at growth in the short term made up 75% of all franchise systems, and the targeted increase in the number of outlets was over 700. The high number may reflect the short tradition and early life-cycle stage of franchising in Finland, and the importance of franchising as a growth strategy. About half of the chains reported that they were in the growth phase of their life cycle, and one in five was just entering the market. Problems in recruiting suitable franchise candidates has for many years been the biggest obstacle to strong growth in the sector. As a result, targeted growth has not been achieved. The total number of franchisees was about 3,700, which corresponds to about 1.7% of active companies in Finland. The number of jobs created by franchise systems was estimated at about 46,000 (less than 2% of the Finnish workforce). Combined turnover of the franchise systems came to about €4.88 billion (about 3.4% of the Finnish GDP).

The findings of this study concerned the manifestations of franchising in the economy (i.e. *consequences*). Therefore, no exact conclusions can be drawn on

the existence of the cultural, political and economic forces (i.e. *reasons*) promoting franchising. These forces were pointed out by Stanworth and Curran (1999) in their model. However, the relatively brisk growth of franchising in Finland between 1999 and 2003 might reflect the existence and impact of forces promoting franchising. Entrepreneurship and economic individualism may be culturally more highly appreciated in Finland than before, and attempts are made to advance entrepreneurship in many ways, including political actions. The structure of our economy is increasingly dominated by services. In addition, the operation of businesses is characterized by high degree of inter-firm networking. There have been forces in the labor market encouraging entrepreneurship, such as threat of unemployment and relatively high unemployment rate. These factors may have contributed towards increasing the prevalence of franchising-based entrepreneurship in our country.

3.2 Franchising at the organizational level

On the franchisor level of Stanworth and Curran's (1999) model, this study is linked to the motives for launching franchising and to issues of franchisee relationship management. In this respect the results of the present study gave empirical support for the model. When analyzing the motives to initiate franchising, striving to attain rapid growth, geographical dispersion and market penetration emerged as the most important factors. Moreover, agency theory, transaction cost theory, resource-based theory, and property rights theory received empirical support. Nonetheless, no single theory stood out as being more applicable than others. The conclusion is in line with earlier franchising research and literature.

It seems that businesses had quite a few motives for launching franchising, but in some cases they were unable to provide any particular reason for it. The past research has not referred to so-called "Copy cat" strategy as a motive for commencing franchising. Therefore its appearance was unexpected. It was found that franchising as a form of operation was imitated either from a Finnish competitor or a foreign peer company. This may be an indication of the young franchising culture in Finland. It also came out that franchising is usually launched relatively slowly in Finland compared to US franchisors. This observation implies that in many cases, beginning franchising is not a rapid, conscious or straightforward strategic choice, rather it is a strategy that is evolving or adapted over a longer period of time.

According to the model of Stanworth and Curran (1999), franchise relationship is characterized by harmony and conflict, consensus and disagreement. Possible conflict causes within the relationship are e.g. economic performance, franchise fees and contractual obligations. The franchisor's ability to manage relationships emerges as a key factor. Factors influencing the success

of franchise systems include franchisees' prior background and experience. The results of the present study lend support to the above from various viewpoints.

From the franchisee's point of view, the franchise relationship contains many contradictory and paradoxical features. For instance, franchise fees that are high, or perceived as being high. Disadvantages experienced in business operation may give rise to dissatisfaction, which may lead to conflict with franchisor, and ultimately even to the voluntary turnover of franchisee. Uncontrolled turnover of franchisees stifles the growth of the franchise system and causes serious harm to the franchisor. On the other hand, franchise fees affect the economic performance, which is one of the key satisfaction factors among franchisees. A "bad" franchise contract may also cause dissatisfaction. Franchisee dissatisfaction poses a great challenge to the franchisor.

In light of research results, franchisors can influence the success of the franchise system in various ways by their management. Recruitment of franchisees and awareness of their different, dynamic motives and satisfaction factors emerges as a key element. The motives of franchisees are affected by their background, especially whether they have prior entrepreneurial experience, and the length of their franchising experience. This should be taken into account in management, which should be clearly more individual in nature – i.e. based on franchisees' needs and the differences between them. In addition, it is likely that the management requirements of franchisor are diverse in different local operating environments and competitive situations and at various life-cycle stages. In franchisee recruitment, two aspects are emphasized: a well-balanced and thorough approach in the process on the one hand, and giving adequate, pertinent and reliable information to the franchisee on the other. This aims at securing two important things: avoiding misrecruitment and preventing later disappointment caused by insufficient precontractual disclosure. Only franchisee candidates that fulfill prerequisites and are believed to have the best qualifications to succeed in business should be recruited to the franchise system. Provision of information ensures that the expectations concerning business operation on the part of the candidates are as realistic as possible.

Franchise systems are not managed by the franchise contract. However, the functionality of the franchise contract is a vital issue for both the franchisor and the franchisees, and from the viewpoint of cooperation. The contract should be comprehensive, detailed and well-balanced, and it should create economic preconditions for the mutual success of both parties. For the franchisor, the contract is an instrument aimed at protecting immaterial capital and managing risks caused by the potential opportunistic behavior of the franchisee. In addition, property rights (i.e. decision rights and ownership rights) are allocated in the contract. The franchise contract thus defines transaction within the relationship and shows how the cooperation is aimed to work in order to provide competitive advantage in the market for both contracting parties. The franchisee needs objective information about the franchise contract before signing it to be able to compare different franchise

offers and to make an informed decision about whether to join a franchise system. For the franchisee, the contract contains many terms and limitations concerning business operation, as well as economic conditions for establishing and carrying out operation. In order to secure efficient contract governance and equality, a standard franchise contract is primarily used.

3.3 Franchising on the individual level

According to Stanworth and Curran (1999), franchising makes it in many ways easier to become self-employed. Franchising may also be an attractive alternative for those who do not necessarily possess all the qualifications required for independent entrepreneurship, or who are at risk of becoming excluded from the labor market. The following are significant factors that aid in the process of becoming an entrepreneur and entering the market: an existing business concept, initial and continuing training, support services, and the most important single factor, the franchise system's well-known brand. The results of the present study support the model of Stanworth and Curran (1999). On the level of franchisees, their background and characteristics and the typical features of their businesses were examined. In addition, the advantages and disadvantages experienced as well as their entrepreneurial orientations were studied. Franchisees' relationship to franchisors was analyzed through the franchise contract and through franchisee satisfaction and commitment.

Franchising may lower the threshold of becoming an entrepreneur. This is among other things due to the fact that people may become franchisees in industries of which they have no prior working experience. In this study, six out of ten cases were of this kind. Typical features of the franchisees were a somewhat lower age compared to stand-alone small business owners and a relatively good education level. Franchising also seemed to offer entrepreneurial career opportunities for women in particular. A typical franchisee business was a micro business.

The franchisor is committed to training franchisees so that they are able to run a local business independently and successfully. Other factors that speed up the start-up and make entrepreneurship operatively easier include a complete and pre-tested business concept, a well-known brand, continuous technical and commercial support services provided by the franchisor, financing arrangements for start-up investment for the franchisee, as well as a potentially lower business risk. It was found that a well-known brand was the single most important factor that brought advantages.

About every eleventh new franchisee had been unemployed before signing the franchise contract. This observation shows that becoming a franchisee is conceivable for unemployed persons. It is possible that in their case, unemployment has been a strong factor pushing them to entrepreneurship. The business advantages experienced by franchisees act as

strong motivating factors pulling them towards entrepreneurship. In the current study, those advantages were the following: internal and external rewards, stimuli and support provided by the franchisors, and ease of start-up. The disadvantages experienced in business operation were the following: decreased independence and responsibility, franchise fees as well as contract- and cooperation-related friction. The business advantages of franchising were felt to be greater than the disadvantages, and there was greater consensus concerning the advantages compared to the disadvantages.

The business advantages experienced by franchisees are factors that boost their satisfaction, while perceived disadvantages give rise to dissatisfaction. Franchisee dissatisfaction leads to poor commitment and negative continuance-intention on their part. This may ultimately lead to franchisee turnover within the franchise system. The key components explaining franchisee satisfaction were the following: finance, ongoing support, market performance of the franchise system and work as a franchisee. Franchisees were relatively satisfied with their businesses and committed to their franchises.

Conflicts within the franchise relationship experienced by franchisees, pessimism concerning future business development, unwillingness to grow the business, a recruitment process felt to be improper and information received during franchise negotiations perceived as being inadequate were factors linked to franchisee dissatisfaction. It is very important for persons aspiring to become franchisees to acquire sufficient, reliable and relevant information. It helps them make an informed and sound decision about becoming a franchise owner. Moreover, it prevents later disappointments caused by a hasty decision based on intuition. An improper recruitment process may indicate that the franchisor has low standards regarding future franchisees, and that the mode of operation is more prone to failure.

According to the model of Stanworth and Curran (1999), franchisee motivation and commitment are an integral part of transaction in the cooperation relationship. They stated that franchisee motivation is a considerably richer and more complex phenomenon than what earlier theories have portrayed. Those franchisees who do not have prior self-employment experience upon entering the franchise relationship are motivated by the independence and sense of autonomy. Those with prior entrepreneurial experience are primarily motivated by the security supplied by the tested business concept and the well-known brand as well as better earning potential. Franchisees' motives are likely to be dynamic and therefore change as they gain experience within the franchise relationship (cf. lifecycle).

The study strengthens the conception that franchisees' motives are diverse and dynamic in nature. Franchisor's support services and the lower risk involved seemed to motivate particularly people with prior self-employment experience. On the other hand business concept and internal and external rewards motivated those with no prior entrepreneurial experience. It appeared that persons with longer franchise experience have a more critical view of franchise relationship advantages compared to less experienced colleagues.

Franchisees' different backgrounds and the dynamic nature of their motives painted a paradoxical picture of franchise relationships. What was a significant business advantage for some was not like that for others. Correspondingly, the degrees of business disadvantages were perceived very differently by various franchisees. It is likely that dependence and autonomy, and independence and control exist simultaneously in a franchise relationship. People having past entrepreneurial experience act in a more autonomous manner, whereas those with no such experience, are more dependent by nature. The experience a franchisee gains may increase his/her willingness to act more independently.

The franchisor's management challenge is to differentiate the forms of support for franchisees and the style of management in a franchisee- and situation-dependent manner. Franchisees' entrepreneurial orientations reflect their different attitudes and approaches towards cooperation and the relationship. The dimensions found in this study were self-confident and self-directed orientation, conformist orientation, opportunism orientation, and "lookers-around" orientation.

4 IMPLICATIONS

The implications of the study are divided into four areas: research, education, managerial and policy implications.

4.1 Research implications

The studies carried out here were mostly descriptive and partly exploratory and explanatory in nature. The studies were the first of their kind conducted in Finland, and their aim was to produce new information with the aid of which an apparent knowledge gap with regard to franchising could be filled. The chosen research strategy was quantitative. As a result, a limited amount of information could be obtained from larger samples. Postal questionnaires were most often used as a method for gathering data. When planning sampling, the aim was to ensure that the results would be as generalizable as possible to the population, giving thus a comprehensive picture of franchising in Finland. Studies were carried out from the viewpoint of both franchisees and franchisors. The explorations on the scope of franchising were carried out as longitudinal study setting, more detailed follow-up studies. Otherwise the studies were cross-sectional. The current study was based on the general and multi-level framework of franchising created by Stanworth and Curran (1999), which integrated the individual studies to each other. The knowledge produced here forms a unified whole describing the state and extent of franchising in Finland from the pointviews of entity, franchisors and franchisees. Fragmentation and poor integration of studies has been a common problem of earlier franchising studies (Elango & Fried 1997; Stanworth & Curran 1999). The conscious choices made and the limitations of the study leave room for several apparent directions for future development and improvement measures. It must be taken into account that these suggestions are largely the same that have been given concerning earlier international franchising studies. They can be summarized as follows:

Research settings and methodological issues

By increasing the utilization of qualitative research, e.g. case studies and multiple case studies, a deep and rich understanding of a limited sample could be ensured. The nuances and variation of complex and multidimensional phenomena could thus be presented. For the business management, information of this kind would be normative, applicable, pragmatic, and prescriptive, focusing on essential, albeit precisely delineated franchising implementation issues. The studies conducted have been too descriptive.⁴³ (cf. Elango & Fried 1997)

An all too large a share of the empirical franchising studies carried out may have relied on secondary data. The sampling concerning franchisees has often been deficient, because sampling has only focused on a single franchise system. The results have however been presented so that they are generalized to apply to the entire franchisee population, forgetting potential franchise system specific effects. In franchisor studies, the sampling has all too often been based on a commercial and easily available and accessible franchise records. Thus the target group of the study has been a self-selective. Chains outside the record, e.g. those not belonging to franchise organizations, have been left outside the scope of studies. Again the results are often presented without any reservations or limitations, generalizing them to the entire franchisor population. The primary data gathering methods used in connection with franchising studies should be enriched instead of relying solely on postal questionnaires. The response rates of empirical studies are often alarmingly low, in the United States generally as low as under 20%. Analyzing the reasons for the low response rate and the non-respondents has only rarely received any attention. The deficiencies mentioned endanger not only research reliability but also validity. In the case of the studies carried out here, multiple attempts have been made to avoid the shortcomings mentioned above.

Research settings mentioned below may have been used too seldom or hardly ever in franchising research, even though they could more likely add to the existing body of knowledge: national studies (extensive, genuinely generalizable samples or whole studies), multinational studies (e.g. international franchising, economic areas like NAFTA, and EU, continents), longitudinal studies (e.g. utilization of lifecycle theories, growth and franchise system development issues, business industry specific studies, development of franchisor-franchisee relationships, franchisee's entrepreneurial career) and comparative studies (stand-alone vs. franchisor and franchisee firms).

⁴³ However, Kaufmann (1996, 7) sees also a great need for theory-based research on the field of franchising. According his view descriptive studies are useful in recognizing the phenomenon but to advance the understanding of franchising the necessary question to ask is *why*? Rather surprisingly, not only positivist, theory-testing research is to be valued. Inductive studies, that can serve as the logical predecessors of deductive theory, that observe and organize phenomena so as to develop theory are just as relevant.

Subjects of study. Internationally, there are many areas in franchising that have been little studied. For example the following areas deserve more research attention:

- *Franchisees:* selection of a person for franchising as opposed to independent small business owner, performance studies (comparative study design) and the multiple franchisee phenomenon.
- *The franchisor-franchisee relationship* (dynamic perspective).
- *Franchisors:* development and growth of the system as well as dual structure (strategy perspective) and business industry studies as well as co-branding (cooperation between franchisors) and multi-brand franchisors.
- *Interest groups:* franchising as consumers' choice.
- *Macro environment:* the effects of franchising on national and international economy. (cf. also Elango & Fried 1997; Stanworth & Curran 1999)

The implementation of more extensive research programs as well as basic research instead of applied studies could most probably promote the development of franchising theory and theories into a more comprehensive and integrated direction. The research efforts so far have unfortunately been isolated and therefore fragmentary and limited in nature.

4.2 Education and training

Entrepreneurship is learnable and teachable matter. This holds true at least in the case of franchising, where an essential part of operation is the efficient transfer of know-how necessary for business and entrepreneurship so that a person with no or limited previous entrepreneurial background and competence is able to run a business independently (Stanworth, Price, Porter, Swabe & Gold 1995, 4-6; Stanworth, Price, Purdy, Zafiris & Gandolfo 1996, 33-34; Stanworth & Curran 1999). While active and determined entrepreneurship education may create prerequisites for the creation of an entrepreneurial culture in country in the longer run, entrepreneurship training yields results significantly faster. A characteristic feature of our young franchising culture is the fact that franchising is poorly known. That is why determined action should be taken to make franchising more widely known at educational institutions, polytechnics and universities as one of the many manifestations of entrepreneurship, not just as a distribution channel solution or a form of export in the teaching of retail and international business. Franchising awareness should also be raised among business associations and organizations, among parties promoting and supporting entrepreneurship as well as among commercial banks and financial institutions.

Rapid and encouragingly promising results have however been obtained by arranging franchise entrepreneurship training programs for the unemployed by TE-centres (Torikka & Tuunanen 2003; Torikka 2004; Torikka & Tuunanen 2005). A further qualification for franchisees should be developed in addition to

the existing further qualification for entrepreneurs.⁴⁴ Strengthening the supply of franchisees is pertinent, bearing in mind that the factor limiting the growth of franchising most strongly at the moment is lack of appropriate candidates (Tuunanen 2002).

4.3 Managerial implications

The managerial recommendations of the study for franchisors and franchisees alike focus strongly on the early phase of the establishment of the franchise relationship. The view created by research is that the later success of the relation is strongly influenced by its initial phase. Franchisors should pay more attention than before on franchisee recruitment. Only such franchisees should be recruited into the system who will succeed in it, according to the best knowledge and judgment. The following measures suggested that are largely related to the improvement of the recruitment process affect the nature of the entire franchise relationship:

- The franchisee recruitment process must be sufficiently long, open as well as balanced, in addition to making use of versatile methods. This aims on the one hand at ensuring that the entrepreneurial decision on the part of the budding franchisee is as carefully considered and thorough as possible, while on the other hand aiming at preventing mis-recruitment and the costs resulting from it. It must be made sure in the recruitment process that the franchisee understands the requirements of the franchise contract and the nature of the cooperation. The franchisee must be given a sufficient amount of relevant and reliable information. This aims at promoting realistic expectations on the part of the franchisee, and thereby at creating a more stable foundation for the establishment of his or her later satisfaction and commitment. This may help prevent conflicts as well as franchisee turnover and the considerable harm caused by it.
- Franchisee recruitment requirements must be carefully considered. Franchisees' motives may well be dynamic⁴⁵, and franchisees with different backgrounds are motivated by different factors within the franchise relationship. Whether or not the franchisee has prior self-employment experience upon entering the franchise relationship has particular significance. The length of the franchisee tenure also has a fundamental effect on the franchisee's motives. A dynamic motive base calls for a more individual and differentiated managerial approach on the part of franchisors. The franchisor must also be able to constantly develop and improve the benefits and advantages provided for the franchisees, such as support services.
- The franchise contract occupies a strategic position in the franchise relationship as a means of ensuring effective transaction and competitiveness of mutual cooperation in the market. Drafting the contract is an aspect that should be focused on. If the contract has a poor starting point, its deficiencies may prevent the establishment of a successful relationship. A robust contract attempts to secure prerequisites for success for both parties, so that rewards are divided between the parties according to their contribution.

⁴⁴ Refers to "yrittäjän ammattitutkinto" (in Finnish).

⁴⁵ This should be interpreted with caution and reservations since there is so far no longitudinal empirical evidence showing that the franchisees' motivational background is dynamic, because no such studies have been undertaken.

The recommended measures concerning franchisees are related to their entrepreneurial decision. The franchise relationship is a significant investment and commitment. The fundamental nature of the entrepreneurial decision is emphasized in the case of the franchise relationship, because the freedom of the entrepreneur is limited by certain conditions. Key components of the franchise relationship concerning the franchisee include at least the nature and load of work, economical issues, franchisor's support and competitiveness of the franchise system. The franchisee should acquire sufficient information from different sources about franchise ownership in general, and particularly within the system he or she is about to join. Franchisees who are currently conducting business in the system or who have done so in the past are a source of information that is used far too seldom. The Uniform Franchise Offering Circular (UFOC), a document used in the United States also provides a list of issues that potential franchisees should find out about the franchise offer. If it is clear that one's own knowledge and skills are not sufficient for acquiring and evaluating the information, experts such as an accountant or lawyer should be consulted. These measures are aimed at preventing a rushed and hasty decision based on intuition to become a franchisee. Such a decision may often prove wrong and cause problems later, not only for the franchisee and his or her immediate family and friends, but also indirectly for the franchisor and possibly for other franchisees in the chain, and even for customers. A carefully considered entrepreneurial decision provides a more stable foundation for the pursuit of success.

Future development

On the basis of the studies presented here, conducted between 1996 and 2004, it has been possible to follow development of franchising in Finland extensively and on various levels. In light of the results obtained, a potential future vision of franchising can be drawn up (see also Tuunanen 2004). It could include the following aspects:

- Franchising becomes relatively rapidly more common as a form of entrepreneurship. The relative share made up of franchise-based ventures and franchisees of all enterprises and entrepreneurs will grow. Franchisors must compete over the best franchisee candidates, and growth speed will continue to be regulated by the scarcity of proper candidates. All in all, franchising will have an increasingly important role in the national economy.
- The number and the variety of business industries involved in franchising will increase. New franchise concepts may also be based on high technology innovations and high competence and knowledge. Of the business industries involved, the service sector will see the strongest growth in the near future, whereas businesses in which franchising first spread to our country will see market saturation. Examples of this are the fast food, hotels and car rental. Business format franchising will gain ground at the expense of product distribution and trade name franchising.
- Co-branding, i.e. cooperation between franchise systems, multi-brand franchisors, i.e. franchisors managing several franchise systems simultaneously, as well as multi-unit franchisees, i.e. franchisees running several outlets of their own will become increasingly more common in franchising.

- Franchising will become more generally known and franchising know-how will increase. There will be more interest towards franchising and it will receive more publicity. It is possible that independent surveys and various ratings will be published on franchise chains for the needs of interest groups and potential franchisees in particular. Reputation of the franchises, ethical conduct and self-regulation of franchising will increase their weight.
- Franchising will become a more conscious strategy alternative for firms. As a result, the use of franchising will occur significantly faster from the moment a firm is established. Franchising will also be actively used as an internationalization strategy; on the other hand, foreign franchise concepts will be imported and imitated.
- Besides quantitative growth, the development of the franchise culture will be seen as qualitative evolution in particular. Franchising infrastructure will develop as the number of interest groups heightens and their operation becomes more active and versatile (e.g. franchising lawyers and consultants, trainers, researchers, content providers, possible interest groups and organizations).

4.4 Business policy

At present there are more enterprises in Finland than ever before, a total of 230,400. The number of entrepreneurs, 213,000 (farming excluded) makes up 9% of the total workforce. The number is however significantly lower than in European countries with higher entrepreneurial activity (see Hyrsky & Lipponen 2004). The Finnish government has as its goal the creation of 100,000 new jobs. Reaching this objective requires the establishment of 30,000 new businesses. In the near future, more or less 60,000 Finnish firms are facing generation transfer, and the continuation of the firms is uncertain. The government has estimated that by the year 2010, a total of 90,000 entrepreneurs are needed. In Finland, entrepreneurship seems to be commonly held in high regard, and the atmosphere promoting entrepreneurship has developed in a positive manner. Despite this, there are too few of those who choose an entrepreneurial career. Culturally, we are still far from an entrepreneurial society (cf. Hyrsky 2001).

Measures aimed at promoting entrepreneurship in Finland have been set down in a special entrepreneurship policy program, the contents of which are in line with the strategic outlines of the report Green Paper: Entrepreneurship in Europe drawn up by the *European Commission* (Commission of the European Communities 2003). The general objectives of the policy program are included in the government agenda of Prime Minister Matti Vanhanen's cabinet entitled "Employment, entrepreneurship and common solidarity: the keys to an economic rebound". According to the government agenda, the aim of business policy is to promote economic growth and employment, to diversify production structure, to support stable regional development and to ensure the competitiveness of the Finnish economy. The aim of economic policy is to promote the establishment and growth of businesses, generation transfers and internationalization. The entrepreneurship policy program charts e.g. how entrepreneurship can be made more attractive as a career alternative, and how

the operation and expansion of SMEs during the initial and growth phase as well as woman entrepreneurship can be supported. In addition, legislation will be developed so that unnecessary bankruptcies of viable businesses can be avoided. (see Hallitusohjelma 2003)

The key to increased employment and generation of economic growth seems to be growth oriented entrepreneurship. It has been estimated that 3-5% of new businesses generate as many as three fourths of all new jobs created by new businesses. Sixty-one per cent of the fast growing businesses operate in the service sector, which is somewhat surprising. (Hyrsky & Lipponen 2004, 35, 73)

In an international perspective, maintaining Finland's current high economic competitiveness calls for expansion of the foundation of productivity growth, so that the standard of living of the welfare society can be raised. The GDP shares of business industries with poor productivity growth are quite significant, and the industries are overly dependent on domestic demand. Such service business categories include transportation, education, business services as well as health care and social services. Harmful labor market and goods regulation should be reduced in order to increase productivity growth and openness of the economy. The greatest opportunities are probably linked to setting up entrepreneur-driven well-being services. Compared to other OECD countries, there is more regulation and lack of competition in Finland. In addition, the public sector as well as the state-owned companies make up a large share of total production, while the share of foreign subsidiaries operating Finland is low. (see Lipponen & Viitamo 2003, 1, 9, 79-82)

Franchising does in fact have multiple linkages to today's Finnish business policy and promotion of entrepreneurship. Franchising is not presented here as a universal remedy, but rather as a mean among others for achieving goals. Franchising will continue to grow in Finland in the near future as well. By fostering and speeding up this growth a number of outcomes can be achieved that have been now set as objectives for business, economic and entrepreneurship policy. The following features that have come up in the course of this study conjoin franchising to the current business-policy debate:

- Striving for growth. Franchising is a growth strategy enabling fast regional expansion of business. Growth is the inherent characteristic of franchising and one of the prerequisites behind its success. Regionally, franchisee-owned units within franchise systems are often established peripherally, outside centers of growth as well. This may affect the supply and availability of goods and services in smaller towns and rural areas and therefore contribute towards a more balanced regional development. Growth firms, so called gazelles, are a rare phenomenon in Finland. An about one in 600 firm in Finland seems to be gazelle business characterized by fast and strong growth (Halttunen 2004, 297). Franchisors may be similar kind of growth oriented and growth intense businesses. It is necessary to state that perspectives and research of growth enterprises have been too limited in scope. Growth has traditionally been seen only as the organic growth of firms, as growth obtained through diversification or as growth through corporate acquisitions or mergers (cf. Halttunen 2004). The growth of franchising is multidimensional and occurs on various levels (see and cf. Tuunanen & Koiranen 1998). The growth of the franchisor through a franchise-form hybrid organization deserves more attention, as growth can be measured immediately as the start-ups of new ventures, not just in terms of turnover generated or jobs created.

- Franchising lowers the threshold to entrepreneurship. Earlier studies have shown that franchising creates entrepreneurial career opportunities for persons who do not necessarily pose the prerequisites required of self-employment and who would not become small business owners if franchising were not available as an option (see Stanworth & Curran 1999). The initial training provided by the franchisor and continuing support services, in addition to a pre-tested business concept that may be based on a well-known trade name lower significantly the threshold to become small business owners. Franchising increases entrepreneurial opportunities in society by increasing the number of potential self-employed.
- The birth of vital new firms. The growth aimed at by the franchisor occurs in cooperation with the franchisees. Growth gives rise to new ventures. The entrepreneurial risk of franchisee-owned enterprises that have been set up has been claimed to be considerably lower than that of other SMEs, because the survival rates of franchisees' ventures are higher. Franchising may thus lower mortality among new enterprises. According to statistics, 53% of enterprises established in Finland have ceased after the first five years of operation (Hyrsky & Lipponen 2004). It has been estimated that the corresponding figure for franchise ventures that have ceased their operation during that time is around 10%. Franchising gives rise to new enterprises, and they are based on a healthy foundation.
- Woman entrepreneurship. Studies show that franchising creates entrepreneurial opportunities for females in particular. Several reasons have been given for this: business industry explanation, risk-taking propensity, family or couple based entrepreneurship and the versatile support provided by the franchisor (Tuunanen 2002). If there is an aim to promote women's self-employment in particular, franchising offers one avenue. This is closely linked to entrepreneurial growth potential in the service sector.
- Internationalization. Besides being a growth strategy, franchising is also a form of internationalization. Internationalized Finnish franchise systems generate export income for our country. Studies show that Finnish franchisors have been active in their internationalization efforts, and the number of those who are planning to go international in the future is relatively high. According to statistics of tax authorities, only some 3.5% of all firms in Finland are export firms (see Hyrsky & Lipponen 2004, 71). Promoting franchising would thus also indirectly increase enterprises' internationalization. In terms of internationalization, increased attention should be focused on the markets close at hand, the Nordic countries, the Baltic area, Central and Western Europe. Russia is however the area that merits special attention. Compared to the domestic Finnish market, the metropolitan areas of St. Petersburg and Moscow make up a market that is more than three times larger, and its purchase power is increasing all the time. Finnish companies have a number of advantages when it comes to making use of the Russian market. (cf. Koironen & Tuunanen 1996; Tuunanen & Koironen 1998; Anttonen & Tuunanen 2004; Anttonen, Tuunanen & Alon 2005)⁴⁶
- Franchising creates efficiency and competition. The service sector offers the greatest potential for productivity growth as well as an increase in franchising. Deregulation and opening up public sector service provision for private companies and competition is crucial. Many well-being, social, healthcare, elderly and housekeeping services as well as personal services can be provided, and are already partly provided by the private sector. In the United States, for example, these services have in recent years been the fastest growing categories in franchising. There is no reason to doubt why this could not happen also in Finland and other Western countries that have experienced World War II and where the relative proportion of elderly people is constantly growing.
- Generating new franchise businesses. New innovative franchise concepts can be innovated in Finland, in addition to which they can be imported here by contract. Alternatively, they can be imitated and adapted to the domestic market. New concepts can also be based on the utilization of high technology and be information/competence-intensive in nature (e.g. people working in expert professions).

⁴⁶ The Ministry of Trade and Industry has focused attention on this issue and commissioned a study on it (see Laakso 1995).

- Our young franchising culture. The gap in the franchising knowledge and competence in our country has been a fact, although there has been some improvement as franchising has grown.⁴⁷ Increased awareness and strengthened competence promote the growth and success of franchising. Since franchising penetration in our country is lower than in the comparative countries, there seems to be unexploited potential. Lack of appropriate future franchisees is a factor that limits faster growth of franchising in our country in particular.

The special characteristics of franchising listed above are features that make franchising as a multifaceted form of entrepreneurship worthy of more attention in research, education and the business policy applied. These characteristics have undoubtedly inspired the author of the present study, as they have for their part created faith in the usefulness and applicability of the findings.

⁴⁷ The textbooks published recently on this subject (e.g. Mattila, Wathén, Tommila & Rinkinen 1998; Laakso 1998; Laakso 2001) are an example of this.

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