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# **Performance in Franchise Systems: The Franchisee Perspective**

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Cover :

Picture shows a schematic view of a franchise system .

Back:

The bird is a metaphor for a franchise system. The wings represent a franchisor, while each feather symbolizes the individual franchisee.

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Performance in franchise systems: The Franchisee Perspective

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*To my wife and daughters*



## Abstract:

During the last decades, franchising as an organizational form has received a lot of attention from researchers and practitioners alike. While many studies have examined various aspects of franchising from the franchisor's perspective, little research has taken the franchisee's perspective. Therefore, given the importance of franchisees in a franchise system, the lack of research about consequences from the franchisee's perspective, and that many of the previous studies have taken a top-bottom view, this research concentrated on the franchisee's performance. This study focused on business format franchising in the restaurant industry in two countries, Iran and Sweden.

In this study, the three perspectives of entrepreneurship, strategic management, and marketing were used to study the franchisee's performance. Moreover, the resource-based view, relational view, and relational exchange theory have been used to find the influential factors in a franchisee's performance. Therefore, by considering franchising as a mutual relationship and examining the influential factors in a franchisee's performance, the related factors of both the franchisor and franchisee, as well as the relationship between them, were examined.

According to the franchisee's related factors, the franchisor's related factors, and the relationship and environmental factors, 12 main hypotheses and 9 sub-hypotheses were developed. In total, 191 usable questionnaires from Sweden and Iran, comprising a response rate of 22 percent, were returned from the franchisees. In this study, confirmatory factor analysis was used to test the construct measurement; to test the hypothesis, hierarchical multiple regression analysis was performed. Moreover, the Chow test was conducted to integrate the data from these two countries.

A primary contribution of this study is taking a bottom-top view in franchising research. This study also provided a detailed and holistic view about the consequences of franchising for franchisees. Moreover, this study, offers important contributions toward understanding entrepreneurial activities, as a controversial issue, in franchising outlets.

The results provide interesting insights into the franchisee's performance. While the franchisees' related factors of absorptive capacity, Kirznerian entrepreneurial orientation, and social capital positively affected their performance, Schumpeterian entrepreneurial orientation and human capital did not affect their performance. Moreover, the franchisor's related factors of system profitability, brand reputation, advertisement and providing raw material had a positive influence on the performance. However, training did not cause a difference in the franchisee's performance. All relationship factors also positively affected the performance, and conflict and satisfaction mediated the relationship between trust and performance. Finally, the implications of this study and suggestions for further contributions in this stream of research are discussed.

## Sammanfattning:

Under de senaste decennierna har franchising som organisationsform fått en hel del uppmärksamhet från både forskare och praktiker. Många studier har undersökt olika aspekter på franchising från franchisegivarens perspektiv, men endast ett begränsat antal har tagit franchisetagarens perspektiv. Med bakgrund av franchisetagarens betydelse i franchisingssystemet, bristen på forskning om konsekvenserna från franchisetagarens perspektiv, samt att många av de tidigare studierna har ett top-down-perspektiv, så har denna forskning koncentrerat sig på faktorer som påverkar franchisetagarens resultat. Studien fokuserade på affärsmodellen franchising i restaurangbranschen i två länder, Iran och Sverige.

I denna studie användes de tre perspektiven entreprenörskap, strategisk styrning och marknadsföring för att undersöka franchisetagarens ekonomiska resultat. Dessutom har Resource Based View, Relational View och Relational Exchange View använts för att identifiera de viktigaste faktorerna för franchisetagarens resultat. Genom att betrakta franchising som en ömsesidig relation och undersöka de viktigaste faktorerna studerades resultatpåverkande faktorer för både franchisegivare och franchisetagare, liksom faktorer som påverkar förhållande mellan dem.

Med utgångspunkt i franchisetagarens och franchisegivarens resultatpåverkande faktorer, samt relations- och miljömässiga faktorer, utvecklades 12 huvudhypoteser och 9 underhypoteser. Sammanlagt samlades 191 kompletta enkäter in från urvalet av franchisetagare (motsvarande en svarsfrekvens på 22 procent). I studien användes metoden Confirmatory Factor Analysis (McFadden et al.) för att testa begreppens validitet och reliabilitet; för hypotestestning utfördes hierarkisk multipel regressionsanalys. Även Chow-test genomfördes för att integrera data från de två länderna.

Studiens huvudsakliga bidrag är att ta ett bottom-up-perspektiv i forskning om franchising. Studien bidrar även med både ett detalj- samt ett helhetsperspektiv på konsekvenserna av franchising för franchisetagarna. Dessutom utgör studien ett viktigt bidrag till ökad förståelse för entreprenöriella aktiviteter i franchisetagares verksamhet, vars förekomst är en omdiskuterad fråga.

Resultatet ger intressanta inblickar i faktorer bakom franchisetagarens ekonomiska resultat. De relaterade faktorerna upptagningsförmåga (absorptive capacity), kirzneriansk **entreprenöriell orientering** och socialt kapital hade en positiv påverkan på franchisetagarnas resultat, medan faktorerna schumpeteriansk **entreprenöriell orientering** och humankapital inte påverkade resultatet. Dessutom hade de relaterade faktorerna lönsamhet i franchisesystemet, varumärkets anseende, reklam, och tillhandahållande av råvaror en positiv inverkan på resultatet. Utbildning ingen påverkan på franchisetagarens resultat. Samtliga relationsmässiga faktorer hade en positiv påverkan på resultatet, och konflikt mellan franchisetagare och franchisegivare var en medierande faktor för förhållandet mellan tillit och resultat. Som avslutning diskuteras konsekvenserna av studien och förslag på ytterligare bidrag i denna forskningsinriktning.

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Table of contents:

- 1 Chapter 1 ..... 1
  - 1.1 Introduction ..... 1
  - 1.2 Research on franchising..... 3
  - 1.3 Importance of research on the franchisee's point of view..... 5
  - 1.4 Problem statement and importance of research ..... 5
  - 1.5 Research perspectives on franchisees’ performance in franchising: ..... 7
  - 1.6 Research questions: ..... 9
  - 1.7 Theoretical contribution: ..... 12
  - 1.8 Research boundary: ..... 13
  - 1.9 Organization of the dissertation:..... 14
- 2 Chapter 2: Theoretical background and literature review ..... 17
  - 2.1 Theories ..... 17
    - 2.1.1 Resource-based theory ..... 19
    - 2.1.2 Relational View ..... 22
    - 2.1.3 Relational exchange theory: ..... 26
    - 2.1.4 Contingency theory: ..... 28
    - 2.1.5 Summary of the theories: ..... 30
  - 2.2 Literature review and hypotheses ..... 32
    - Franchisee-related factors in franchisee’s performance:..... 32
      - 2.2.1 Absorptive capacity..... 32
      - 2.2.2 Entrepreneurial orientation..... 37
      - 2.2.3 Social capital: ..... 55
      - 2.2.4 Human capital: ..... 59
    - Franchisor- related factors in franchisee’s performance: ..... 65
      - 2.2.5 System profitability ..... 68
      - 2.2.6 Training ..... 69
      - 2.2.7 Providing the raw material ..... 72
      - 2.2.8 Advertising ..... 73
      - 2.2.9 Brand ..... 75
    - Relationship factors in franchisee’s performance: ..... 77
      - 2.2.10 Trust ..... 79
      - 2.2.11 Satisfaction ..... 82
      - 2.2.12 Conflict..... 85
  - 2.3 Holistic view:..... 86



3	Chapter 3: Research Methodology .....	91
3.1	Research design .....	91
3.2	Hypotheses:.....	92
3.3	Population data and sampling:.....	94
3.4	Data Gathering.....	95
3.5	Sampling of location:.....	96
3.6	Variables and measurements: .....	96
3.6.1	Measurement of franchisor-related variables (independent variables):.....	97
3.6.2	Franchisee-related factors (Independent) .....	99
3.6.3	Factors associated with the relationship between the franchisor and the franchise independent variables) .....	103
3.7	Performance (Dependent variables).....	104
3.8	Control variables:.....	105
3.9	Moderator variables: .....	106
3.9.1	Environmental dynamism:.....	106
3.9.2	Environmental competitiveness.....	107
3.10	Franchisees' perception: .....	107
3.11	Non-response bias.....	107
3.12	Common method bias: .....	108
3.13	Statistical Analysis.....	109
3.13.1	Construct measurement .....	109
3.13.2	Reliability .....	109
3.13.3	Construct validity: .....	110
3.13.4	Measurements invariance: .....	111
3.13.5	Poolability test.....	112
3.13.6	Hypothesis testing: .....	112
4	Chapter 4: Analysis and result.....	115
4.1	Descriptive analysis .....	115
4.2	Construct measurement.....	116
4.2.1	Reliability .....	117
4.2.2	Cronbach's Alpha Coefficient in Iranian sample .....	117
4.2.3	Construct validity: .....	118
4.2.4	Convergent Validity: .....	118
4.3	Discriminate Validity.....	121
4.3.1	Discriminant validity test for franchisee related factors.....	122
4.3.2	Discriminant validity test for franchisor related factors: .....	123

4.3.3	Discriminant validity test for Relationship factors:.....	123
4.4	Measurements invariance: .....	124
4.5	Poolability test .....	125
4.6	Construct measurements in combined data: .....	126
4.6.1	Convergent validity for combined data: .....	126
4.6.2	Discriminant validity test for combined data: .....	128
4.7	Testing the Hypotheses:.....	129
4.7.1	Hypotheses related to the franchisee-related factors .....	129
4.7.2	Hypotheses related to the franchisor related factors.....	141
4.7.3	Hypotheses related to the relationship between the franchisor and the franchisee .....	144
5	Chapter 5: Discussion .....	149
5.1	Franchisee-related factors in franchisee's performance: .....	149
5.1.1	Absorptive capacity:.....	150
5.1.2	Entrepreneurial Orientation.....	153
5.1.3	Social capital: .....	160
5.1.4	Human capital: .....	161
5.2	Franchisor-related factors in franchisee's performance: .....	163
5.2.1	System profitability: .....	163
5.2.2	Raw material: .....	164
5.2.3	Training: .....	165
5.2.4	Advertising:.....	166
5.2.5	Brand .....	167
5.3	Relationship factors in franchisee's performance:.....	168
5.3.1	Trust: .....	168
5.3.2	Satisfaction:.....	169
5.3.3	Conflict:.....	170
5.3.4	Post hoc analysis: .....	170
6	Chapter 6: Conclusion and implication.....	173
6.1	Introduction: .....	173
6.2	Franchisee-related factors in franchisee's performance: .....	175
6.3	Franchisor-related factors in franchisee's performance: .....	180
6.4	Relationship factors in franchisee's performance:.....	182
6.5	Implication:.....	186
6.6	Limitation and future research:.....	189

## List of tables

Table 2-1: Services Provided by franchisor in a franchise system .....	66
Table 4-1: Franchise systems and number of respondents in Iran .....	115
Table 4-2: Franchise systems and number of respondents in Sweden .....	115
Table 4-3 Cronbach's alpha coefficient reliability for Iranian sample.....	117
Table 4-4 Cronbach's alpha coefficient reliability for Swedish sample .....	118
Table 4-5 Average Variance Extracted and individual loading factor for franchisee-related factors in Iran .....	119
Table 4-6 Average Variance Extracted and individual loading factor for franchisee-related factors in Sweden .....	119
Table 4-7: Average Variance Extracted and individual loading factor for franchisor-related factors in Iran .....	120
Table 4-8: Average Variance Extracted and individual loading factor for franchisor-related factors in Sweden .....	120
Table 4-9: Average Variance Extracted and individual loading factor of relationship between the franchisor and franchisee in Iranian sample .....	121
Table 4-10: Average Variance Extracted and individual loading factor of relationship between the franchisor and franchisee in Swedish sample .....	121
Table 4-11: Discriminant validity test for franchisee-related factors in Iran (Composite reliability, Average Variance Extracted and correlation between the constructs).....	122
Table 4-12: Discriminant validity test for franchisee-related factors in Sweden (Composite reliability , Average Variance Extracted and correlation between the constructs) .....	122
Table 4-13: Discriminant validity test for franchisor-related factors in Iran (Composite reliability, Average Variance Extracted and correlation between the constructs).....	123
Table 4-14: Discriminant validity test for franchisor-related factors in Sweden (Composite reliability, Average Variance Extracted and Correlation between the constructs) .....	123
Table 4-15: Discriminant validity test for the relationship between the franchisor and franchisee in the Iranian sample (Composite reliability , Average Variance Extracted and correlation between the constructs)....	124
Table 4-16: Discriminant validity test for the relationship between the franchisor and franchisee in the Swedish sample (Composite reliability, Average Variance Extracted and correlation between the constructs) .....	124
Table 4-17: Cronbach's alpha coefficient reliability in the combined data. ....	126
Table 4-18: Average Variance Extracted and individual loading factor for franchisee-related factors for the combined data.....	127
Table 4-19: Average Variance Extracted and individual loading factor for franchisor-related factors for the combined data.....	127
Table 4-20: Average Variance Extracted and individual loading factor for the relationship between the franchisor and franchisee in the combined data.....	128
Table 4-21: Discriminant validity test for franchisee-related factor for the combined data (Composite reliability, Average Variance Extracted and Correlation between the constructs) .....	128
Table 4-22: Discriminant validity test for franchisor-related factors for the combined data (Composite reliability , Average Variance Extracted and correlation between the constructs) .....	128
Table 4-23: Discriminant validity test for the relationship between the franchisor and franchisee for the combined data .....	129
Table 4-24: Scale properties, descriptive statistics, and correlation matrix of franchisee-related factors in overall.....	131
Table 4-25: Regression analyses of franchisee-related factors on franchisee's performance .....	133
Table 4-26: Post hoc regression analyses of franchisee-related with Schumpeterian EO .....	140
Table 4-27: Scale properties, descriptive statistics, and correlation matrix of franchisor-related factors .	141
Table 4-28: Regression analyses of franchisor-related factors on the franchisee's performance in the total sample .....	142
Table 4-29: Scale properties, descriptive statistics, and correlation matrix of relationship factors.....	144

Table 4-30 Regression analyses of relationship factors on the franchisee's performance .....	145
Table 5-1: Distinction between core and peripheral elements of the business format in a restaurant. ....	155

List of figures:

Figure 2-1: Theoretical framework .....	18
Figure 2-2: Research model .....	88
Figure 4-1 . Relationship between the franchisee’s ACAP and performance.....	135
in low and high levels of environmental dynamism	
Figure 4-2. Relationship between the franchisee’s ACAP and performance.....	136
in low and high levels of environmental competitiveness	
Figure 4-3. Relationship between the franchisee’s Kirznerian EO and performance.....	137
in low and high levels of environmental dynamism	
Figure 4-4. Relationship between the franchisee’s Kirznerian EO and performance.....	138
in low and high levels of environmental competitiveness	
Figure 4-5: Indirect effect of trust on performance through conflict and satisfaction.....	147
Figure 6-1: Holistic view of franchisee’s performance.....	185





# Chapter 1

## 1.1 Introduction

In the last few decades, franchising has turned into one of the most popular means to be involved in a business in a variety of activities (Ramírez-Hurtado et al., 2011). It also has been considered to be an important strategy for those firms that would like to expand their business (Rajagopal, 2007). Franchising as an organizational form is used in many industries (Felicio et al., 2014b, Michael and Combs, 2008), especially in retail and service chains (Gillis et al., 2014, Gorovaia and Windsperger, 2013), where due to the nature of the product or service, it is difficult to separate production from consumption. Such firms are required to spread out their outlets geographically to be near their customers (Combs et al., 2004b).

The franchising strategy began with the Singer Company for the first time during the nineteenth century in the USA, to distribute sewing machines. Since the 1950s, other companies such as McDonald's, Burger King, Coca-Cola, Pizza Hut and Holiday, have used this strategy to expand their operations (Eser, 2012). Today, although many businesses in different industries are utilizing franchising, restaurants, miscellaneous services, and non-food retailing in particular are the major industries that apply this strategy (Hoffman and Preble, 2003).

In recent years, franchising has received considerable attention from a variety of academic fields and practitioners (Madanoglu et al., 2011, Hsu and Jang, 2009). Due to creating job opportunities and economic and local development (Pizanti and Lerner, 2003a), franchising continues to increase in importance in many countries such as the US, France, Germany, Spain and other countries; as there are approximately 265,943 franchised outlets in Europe (Bordonaba-Juste and Polo-Redondo, 2008). Franchising is used in many different industries (Combs et al., 2011a); and a major portion of sales in industries such as restaurants, tax preparation, specialty food retailing, printing and copying, and lodging are a result of franchising (Combs et al., 2004c). Through

franchising, companies are able to take advantage of the expertise, and responsiveness of small-scale entrepreneurs to adopt with the local market (Cochet et al., 2008a). It also helps firms to expand their business overseas and enter into unfamiliar foreign markets (Combs et al., 2011a).

There have been many debates on franchising definition, and several research disciplines are needed to define it (Stanworth et al., 2004). A widely accepted definition of franchising refers to it as " 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" (Stanworth et al., 2004). In a franchising agreement, the franchisees, because they pay an initial fee and royalty, are granted the right to use the franchisor's system of trademark. Although in a franchising system as a partnership, two entities are closely linked to one another, they remain distinctly separate (Bordonaba-Juste and Polo-Redondo, 2008).

In addition to the general form of franchising, there are three variants of franchising:

1- A trade names strategy, is a relationship between a supplier (franchisor) and a dealer (franchisee), in which the dealer agrees to acquire some of the supplier's identity in order to become the preferred source of the supplier's goods under the franchisor's trade mark (Elango and Fried, 1997, Hoffman and Preble, 2003). In this case, the franchisee is in fact the distributor for the product manufactured by the franchisor, as is the case for Coca Cola (Lafontaine and Shaw, 1998).

2- A business format strategy, is where a franchisor supports the franchisee with a product/ service, trademark, methods of operation, and ongoing guidance. This type of franchising is prevalent in the restaurant industry (Hoffman and Preble, 2003). In return, the franchisee pays an initial fee and ongoing royalties to the franchisor (Barthelemy, 2008). Franchisees in this strategy do the business in the franchisor's manner. The franchisor also has control over the franchisee's activities including products sold, price, hours of operation, conditions of the plant, inventory, insurance, personnel, and accounting



and auditing. However, the franchisor's control over the franchisee, according to antitrust rules and the signed agreement, will be different in each case (Rubin, 1978).

3- A conversion strategy, is where someone with a successful small business is offered to join the franchise system and do business under the franchise trade mark. The conversion strategy has been presented as a means to compensate for poor recruitment, a lack of expertise, and market saturation (Hodge et al., 2013). In this strategy, after joining the franchise system, the independent business is known by the franchised brand. A changing environment has made this strategy more prevalent in lodging and real estate (Hoffman and Preble, 2003).

As mentioned earlier, the service industry is one of the great driving forces behind the growth of franchising in many countries (Ramírez-Hurtado et al., 2011). Among the different types of franchising, business format franchising is prevalent in the restaurant industry (Hoffman and Preble, 2003). Thus, this study focuses on business format franchising in the restaurant industry, in which a relatively complete business system is replicated across local units in a franchising system (Castrogiovanni and Kidwell, 2010).

## 1.2 Research on franchising

Research in franchising is classified into four main themes, namely antecedents to franchising, the consequence of franchising, potential moderators of franchising relationships, and franchising evolving in different national contexts (Combs et al., 2011a).

In the first theme, antecedents of franchising, researchers look to know why people become franchisees, or seek to know the potential franchisee's reason for prioritizing the franchisors. For example, Peterson and Dant (1990), studied why individuals select franchising over starting an independent business. Guilloux et al. (2004) demonstrated that the franchisor's support and providing of services, as well as the franchisor's brand name recognition, are used by the potential franchisee's to select the franchisor. The franchising scholars on this theme, use resource scarcity, agency theory, institutional theory, property rights theory, and individual learning to study a franchising system (Combs et al., 2011a).

In research that focuses on the consequences of franchising, studies concentrate on survival, growth, financial performance, the franchisee's satisfaction, system size, and a propensity toward free riding. Resource-based theory, agency theory, property rights

theory, and relational governance are dominant theories in examining the consequences of franchising. Studies about the consequences of franchising can also be categorized according to the outcomes for franchisees or franchisors (Combs et al., 2011a). From the franchisor point of view, prior research on the consequences of franchising focused on franchising growth, probability of survival, and using multi-outlet franchisees. Current studies pay more attention to the variety of consequences, including free-riding behavior, union bargaining, relational governance, and financial performance (Combs et al., 2011a). Although research on the consequences of franchising for the franchisee mostly concentrated on profitability for franchisees, in recent years, research on this theme has shifted toward other important outcomes such, as the franchisee's exit and failure or sale of the business, or economic and legal implications (Combs et al., 2011a).

Research on potential moderators of franchising relationships, implies that franchising outcome can be enhanced only under certain conditions. Agency costs, chain strategy, local competition, and contract design are the most common moderators that have been studied as the moderator in studying the franchisors. Most of the studies on this theme have taken the franchisor's perspective to study the franchising–consequences link (Combs et al., 2011a). Indeed, Yin and Zajac's (2004) study is the only recent research that focused on the franchisee's view based on contingency theory, and investigated how governance structure moderates the relationship between strategy and the franchisee's performance .

The final theme in franchising studies is the focus on developing the franchise system across countries. Several articles, such as (Doherty, 2009) and Combs et al. (2011a) investigated international franchise systems.

In addition to the classification of research in franchising studies by Combs et al. (2011a), Díez, Ronda'n, & Navarro (2004) divided the research about franchising into four groups: (1) social reasons for franchising, (2) research on the franchisor, (3) research on the franchisee, and (4) franchisor–franchisee relationships (as cited in Rondan-Cataluna et al., 2012). In franchising research, the second-mentioned research group is studied more prominently in the literature on franchising by treating diverse research scopes, such as reasons for franchising, own versus franchised units, reasons for the internationalization

of franchising, and selection of franchisees. In spite of the existence of many studies on franchisor activities, research on franchisees has received little attention.

Given these two major categories in franchising research, and to fill the gap in studies, this study focuses on the consequences of franchising. Moreover, to answer the call to investigate franchising from the franchisee's point of view (Dant et al., 2011), this work is centered on research on the franchisee. Given the contingency theory (Raymond and Croteau, 2009), environmental factors also will be studied as a potential moderator in the franchising relationship.

### 1.3 Importance of research on the franchisee's point of view

There are several reasons for the necessity of studying the franchisee's perspective in a franchise system. Franchising research in recent years has been focused more on franchisors than on franchisees in the literature (Combs et al., 2011a). In a franchise agreement as an inter-firm relationship, the franchisee's performance will affect the franchisor's performance, and franchise systems do not succeed if the franchisees do not succeed (Mellewigt et al., 2011).

Although the franchisee as an intelligent player has an important role in this system, studies have tended to view the franchising system as a top-down relationship (Elango and Fried, 1997). In spite of the importance of franchising as a way of running a business by entrepreneurs, the influence of franchising for small businesses is relatively less researched and understood (Lafontaine and Shaw, 1998). While many studies have examined various aspects of franchising from the franchisor's perspective, little research has taken the franchisee's perspective. Thus, this lack of research from the franchisee's perspective, has led to the limited understanding of the motivators, behaviors and consequences of franchising for the franchisees (Croonen and Brand, 2013).

### 1.4 Problem statement and importance of research

During the past decades, examining the influential factors on business performance has been the subject of many articles in management and business studies. Many potential entrepreneurs prefer to run a franchised outlet rather than an independent business. In this way, they are able to take advantage of both large and small business under the protection

of a well-established brand and with less risk of failure (Michael and Moore, 1995) . In fact, they choose the franchise strategy to improve their ability to compete (Combs et al., 2004c). Therefore, paying attention to the performance, failure and survival is of great interest in franchising studies (Barthelemy, 2008).

While the literature indicates high success and growth rates in franchising, there is now a critical mass of academic literature to demonstrate that failure rates in franchising are in fact very high (Stanworth et al., 2004). Since different franchisees in a franchise system may show different behaviors and performance (Marnburg et al., 2004), understanding of the influential factors in franchisee's performance will enhance the probability of survival among the franchisees (Michael and Combs, 2008). Furthermore, although small business performance has been the subject of many articles, there are limited studies which pay attention to the franchisee performance (Frazer and Winzar, 2005). Research on the consequences of franchising for franchisees has also been rare (Combs et al., 2004c), and just a few important efforts have concentrated on the franchisees' performance (Bates, 1998), or focused on why individuals select franchising over independent entrepreneurship (Michael and Combs, 2008).

Given the role of franchising in the economy, the lack of research establishing the franchising – performance relationship, seems to present a gap in the literature (Combs et al., 2004b). Moreover, considering the franchisees as an essential party in successful franchise chains, the lack of understanding about factors affecting franchisee performance also represents an important gap in the literature. Even the few previous studies in franchisee-focused consequences, have largely used franchisor's survey data (Holmberg and Morgan, 2003). Knowledge about the influential factors in franchisee performance could help the franchisors, in addition to the franchisees, to enhance performance of their systems and adopt more supportive policies (Combs et al., 2004c). Moreover, prior research calls for more reliable studies on the controversial subject of franchisee's consequences (Frazer and Winzar, 2005). They believe it is an important area that merits further study and analysis (Holmberg and Morgan, 2003).

In summary, to fill the gap in the literature, as well as the need for more reliable studies on franchisee consequences (Holmberg and Morgan, 2003), this research will concentrate on the franchisee's performance from the franchisee's point of view. Therefore,

the purpose of this study is to examine the factors that affect the performance of restaurant franchisees from the perspective of the franchisee.

### 1.5 Research perspectives on franchisees' performance in franchising:

The rapid growth of franchising has piqued the interest of researchers from a variety of academic fields (Lee et al., 2015). A significant amount of research on franchising has been devoted to disciplines including economics, law, entrepreneurship, marketing, and strategic management (Combs et al., 2004c); most ideas about it, however, originated in strategic management, entrepreneurship, and marketing (Combs et al., 2011a). From the strategic management perspective, franchising is viewed as an important organizational form (Combs and Ketchen, 1999b). In the entrepreneurship perspective, franchising is a way for potential entrepreneurs to be involved in business ownership. It is also considered an entrepreneurial strategy for franchisors to develop their business (Shane and Hoy, 1996). Franchising has been considered as a distribution channel from the perspective of marketing; and is also studied to understand the structure of contracts, in the perspective of economics (Combs et al., 2004c).

There is no doubt that entrepreneurship is a natural home for franchising research (Combs et al., 2011b), and the franchisees as the potential entrepreneur risk their money and run a new business (Shane and Hoy, 1996). In a franchising system as an entrepreneurial activity (Shane and Hoy, 1996), franchisees are the main source of innovation and local adaptation (Combs et al., 2004a). Although franchising has been considered as an important strategy in service firms, it has been part of some research in entrepreneurship (Dada and Watson, 2013, Shane and Hoy, 1996, Dada et al., 2012, Combs et al., 2011b, Dant and Kaufmann, 1998) and there is still a lack of research on entrepreneurship within the franchising (Shane and Hoy, 1996). Therefore, franchising constitutes a unique form of entrepreneurial activity in which entrepreneurially-minded firms and individual entrepreneurs come together (Combs et al., 2011a). However, the entrepreneurship perspective remains under researched within the area of franchising (Hoy and Shane, 1998). Moreover, understanding the causes of business success and failure is a cornerstone of entrepreneurship research (Michael and Combs, 2008), and studying franchising as a cooperative entrepreneurial endeavor requires the integration of the

entrepreneurial role for both franchisor and franchisee (Davies et al., 2011). Therefore, according to the importance of entrepreneurship, it is the first perspective in this study.

Studying the performance and competitive advantage of a firm is a widely-used research subject in strategic management (Singh et al., 2010). Much empirical research from the strategic management perspective (Schroeder et al., 2002, Felício et al., 2014b, Aaker, 1989, Barney, 1991, Barney, 2001a, Anderson and Eshima, 2013, Eisenhardt and Martin, 2000) has been conducted to show how business performance can be derived from a strategic management approach. Many authors also refer to the importance of organizational performance or success in the strategic management perspective (Nag et al., 2007).

Studying small business survival and success, and understanding what factors can affect the firm's performance is the important topic in the strategic perspective (Combs et al., 2004b). From the perspective of strategic management, franchising is an inter-firm cooperation in which the franchisor and the franchisee strive to achieve shared goals and objectives (Alur and Schoormans, 2011). This perspective has been used in many studies on franchising such as (Peris-Ortiz et al., 2012, Combs and Ketchen, 1999b, Chien, 2014, Felício et al., 2014b, Holmberg and Morgan, 2004a). Similar to entrepreneurship, understanding the determinants of firm performance is of great interest to strategic management research in a franchising context (Nag et al., 2007), and a comprehensive strategic management approach is needed to identify and manage franchisee failure (Holmberg and Morgan, 2004a). Therefore, the strategic management perspective is embedded in the franchise failure and success model (Holmberg and Morgan, 2004a), and this study aims to use it as the second perspective.

The third view in this study relates to the marketing perspective in which the franchise is seen as a distribution channel. In recent years, although much conceptual and empirical research has paid attention to franchising, franchising as a distribution channel has received less attention. However, few franchise channel topics have gained more interest over the years (Holmberg and Morgan, 2004a), and some studies have focused on franchising to determine the key drivers of a franchisee's performance from a marketing perspective (Chiou et al., 2004b, Watson and Johnson, 2010, Bordonaba-Juste and Polo-Redondo, 2008)

From the marketing perspective, the relationship between the franchisor and its network of franchisees is central to the success of the organization (Watson and Johnson, 2010, Kidwell et al., 2007). Like other topics in franchising, most of the studies in the marketing perspective have been conducted from the franchisor's point of view (Doherty and Alexander, 2004), and only a few has taken the franchisees' perspective (Bordonaba-Juste and Polo-Redondo, 2004). In recent years, however, due to the significant role of franchisees, it has received considerable attention, and several researchers such as (Davies et al., 2011, Croonen and Brand, 2013, Rodríguez et al., 2006) have studied the franchising from the franchisee's perspective. Following these articles, and the need for more empirical evidence (Rodríguez et al., 2006), this part of research aims to examine the effect of relationship factors on the franchisee's performance from the marketing perspective.

#### 1.6 Research questions:

Although many factors have been put forward in the literature to explain the success of small businesses, performance in franchising has received limited attention (Barthelemy, 2008). As discussed earlier, study about the franchisee's consequences has been limited to just a few studies that examine the franchisee's satisfaction and exit. Since franchisees commit significant wealth to their outlets, they expect to perform better than those who run their own businesses (Sorenson and Sorensen, 2001). Franchisees always strive to maximize their performance (Combs et al., 2011a). They get into the franchising to improve their capabilities to compete; thus, it should positively affect their performance (Combs et al., 2004c).

Entering into a franchise system and activity under a well-established brand does not guarantee the franchisee's success (Eser, 2012). Therefore, understanding the factors that affect the firm's survival and growth is one of the most important things for franchisees who commit their resources in a venture (Cooper et al., 1994).

Previous research into franchising has focused on the consequences of franchising from one dimension, including the franchisor's related factors, the franchisee's related factors, or the relationship between them. However, the consequences of franchising entail almost all dimensions at the same time. Therefore, this study has taken a holistic approach and proposed that the consequences of franchising from the franchisee's perspective no

longer depend on one dimension. In fact, three dimensions are linked within a holistic view of the franchisee performance. Thus, given the importance of a bottom-up view in franchising research, the main research question guiding this study is as follows:

*Main research question: What are the major factors that affect the franchisee's performance?*

The features of a franchised outlet as the primary factor affect the consequences for the franchisee (Rajagopal, 2007). Many studies have pointed out the crucial role of the franchised outlet in its performance and the success of its network (Watson and Johnson, 2010). Moreover, in entrepreneurial small firms, success and failure depend on the owner manager's skill, ability, and intuition (Watson and Johnson, 2010). According to Emmerling et al. (2012), factors such as education, industry experience, managerial experience, and entrepreneurial capabilities are influential factors in performance. Therefore, the ideal franchisee's characteristics combined with the business characteristics (Ramírez-Hurtado et al., 2011) make major contributions to the success of their firms and their franchise systems (Jambulingam and Nevin, 1999). Thus, regarding the importance of outlet features and the franchisees' profile, the next research questions guiding this study are as follows:

*Research question 1: What are the franchisee's related factors that affect the franchisee's performance?*

*Research question 2: What is the relationship between the franchisee's related factors and the franchisee's performance?*

In a franchising, as a mutual relationship between the franchisor and the franchisee, (Clarkin, 2008, Jambulingam and Nevin, 1999), participants are dependent on one another's objectives and performance to achieve their goals (Bordonaba-Juste et al., 2008). Therefore, when studying and examining the influential factors in a franchisee's performance, one needs to investigate the related factors of both the franchisors and franchisee, as well as the relation between them (Bordonaba-Juste and Polo-Redondo, 2008).

The franchisor is responsible for providing a wide range of services to the franchisees, including training, providing the raw material, advertisement and managerial



support and so on (Watson and Johnson, 2010). Several studies have implied the importance of the franchisor's offers on the franchisee's consequences (Chaudey and Fadaïro, 2008). They believe that the success of a franchisee's outlet is significantly dependent on the services provided by the franchisor (Chaudey and Fadaïro, 2008). According to Frazer and Winzar (2005), initial and ongoing support from the franchisor has a significant effect on the potential franchisee's decision to enter into a franchise system. The greater the assistance provided to franchisees, the higher the likelihood they will be successful (Watson and Johnson, 2010).

Because of the critical role of franchisor services, franchisees are also encouraged to seek proper franchisors with more efficient and effective services to follow their recommendations (Michael and Combs, 2008). In the traditional view, more offered services would lead the franchisee to less dissatisfaction, and additional support from the franchisor would have the better impact on performance (Grunhagen et al., 2008). According to Grünhagen et al. (2008), however, only offering the effective services to the franchisee and eliminating the nonproductive ones will have a positive impact on the franchising system. Therefore, regarding the importance of franchisor services in franchising performance the next research questions would be:

*Research question 3: What are the franchisor's related factors that affect the franchisee's performance?*

*Research question 4: What is the relationship between the franchisor's related factors and the franchisee's performance?*

Cooperation between partners has a significant role in the prospering of a franchise system (Jambulingam and Nevin, 1999). Considering franchising as a form of relational exchange (Michael and Moore, 1995), the relationship between the partners is central to the success of the organization (Michael and Moore, 1995), and a close partnership can enhance their performance (Bordonaba-Juste and Polo-Redondo, 2008). Finding from studies in the franchising literature demonstrates that much attention has been paid to franchisor-franchisee relationships (Watson and Johnson, 2010). As a mutual relationship, performance should be improved by the relationship between the franchisor and the

franchisee (Clarkin, 2008), and unproblematic cooperation and coordination between them strongly affect it (Davies et al., 2011) . Thus, it seems that the success of a franchising system relies on the strength of the franchising relationship (Merrilees and Frazer, 2006).

In a franchise agreement, the number of elements has an effect on the relationship between the involved parties, and poses a critical challenge for franchise performance (Michael and Moore, 1995). While there are many interests in examining the relationship from the franchisor's perspective (Doherty and Alexander, 2004), few studies have taken the franchisees' perspective (Bordonaba-Juste and Polo-Redondo, 2008). Therefore, in this study, to examine the relationship of the franchisee's performance the next questions would be

*Research question 5: What are the relationship factors that affect the franchisee's performance?*

*Research question 6: What is the relationship between relationship factors and the franchisee's performance?*

### 1.7 Theoretical contribution:

This study aims to make theoretical contributions. Although studying franchising has received a lot of attention in many countries from both academia and practitioners (Clarkin and Swavely, 2006), most of the studies had a top-bottom view and examined franchising from the franchisor's perspective. Nevertheless, regarding the importance of the franchisee, and to fill the gap, this study has considered the franchisee's view. Therefore, taking a bottom-top view in franchising research would be the first contribution of this study.

While there are many studies in the franchising literature about the antecedent of franchising, the consequence of franchising is little known. Potential franchisees with the aim of enhancing their performance and minimizing their risk of failure, get into a franchise system. By doing business under a well-proven brand they expect to perform better than other individual small businesses. However, just entering into a franchise system does not guarantee their success. Therefore, as a mutual relationship, the franchisee's performance would no longer just rely upon one factor, and a holistic view is

needed to examine influential factors in the franchisee's performance. In most of the research, franchising has been studied from one side, and almost no research has examined franchisor-related, franchisee-related and relationship factors, simultaneously. Therefore, this study will provide a detailed and comprehensive view about the consequences of franchising for the franchisee and its causes, effects, and the factors that shape its performance.

In a franchise system, on the one hand, franchisors should spread standardization all through a system; on the other hand, they need to apply an adoptive strategy to take advantage of local market opportunity. This dual strategy makes a unique context for an entrepreneurial activity. To have a more detailed view about the entrepreneurial activities in a franchised outlet, this study will have a more detailed view about the role of the franchisee's entrepreneurial orientation in its performance. Therefore, this study will offer important contributions toward understanding how entrepreneurial activities in a franchised outlet shape performance.

#### 1.8 Research boundary:

Since in a business format franchising a franchisor provides a wide range of services to the franchisee; and since this strategy is more common in industries, this research examines just those businesses that use business format franchising. Moreover, considering the restaurant industry as the largest industry that uses business-format franchising, this research is conducted in the restaurant industry.

Moreover, given the importance of franchisees in a franchise system, and lack of research about consequences from franchisee's perspective in literature, this study has considered the franchisee's view to study a system.

As previously discussed, franchising has been the subject of many studies, including in the area of law, economics, marketing, strategic management, and entrepreneurship. By considering franchising as an entrepreneurial activity and the franchisee as potential entrepreneur, entrepreneurship perspective is the first view that to be used in this study. Moreover, given the importance of variation of performance as a key subject of strategic management, this perspective is also used in this study. By considering

franchising as a distribution channel, the marketing perspective is the third point of view in this study.

Dant (2008) called for researchers to look beyond United States-based contexts for data, where most franchising research has been focused. According to Elango (2007), franchising activities in different markets are particularly relevant in the franchising literature. Even some academics have examined franchising systems across different countries (Perrigot et al., 2013, Dant et al., 2008). To follow these studies and Dant's (2008) recommendation, this research will be conducted in two countries, Iran and Sweden. A reason for choosing Sweden and Iran relates to the dynamic conditions of franchising activities in these two countries. While there were 9,000 franchised outlets in Sweden in 2002, this has increased to 29000 outlets in 2012, with more than 110000 employees working in these franchise systems. The franchising strategy has also been increasingly used in Iran, especially in the restaurant industry. Therefore, this dissertation focuses on Iran as a first field of study. Sweden, as a nearly mature sector in franchising, is the second country that this study is carried on.

## 1.9 Organization of the dissertation:

Chapter 1 is comprised of an introduction to franchising, the importance of the franchisee's perspective in franchising research, a description of the research problem, and a discussion of the factors affecting the franchisee's performance. Chapter 2 contains a review of the relevant literature and theories and the extent of the findings with regard to the research questions addressed in the first chapter. Moreover, after reviewing the empirical research in this chapter, regarding the applicable theories, the research hypotheses are developed. Chapter 3, first describes the empirical research methodology, and then gives a description of constructs measurement. In chapter 4, a confirmatory factor analysis is used first to evaluate the measurements' reliability and validity. Chapter 4 also contains the tests of the hypotheses in three sections: hypotheses about the franchisor's related factors, the franchisee's related factors, and relationship between them. In chapter 5, the results of the study are discussed. Finally, in chapter 6, conclusions are drawn, implications of the research are summarized, and suggestions are provided for further research.





## Chapter 2: Theoretical background and literature review

*As discussed in Chapter 1, in this research, the three perspectives of entrepreneurship, strategic management, and marketing, are used to study the franchisee's performance. Therefore, this chapter first explains the theories that are used in the literature to explain business performance, and then, regarding theories and after reviewing the literature and identifying the potential affecting variables, in each part it will present the hypotheses.*

### 2.1 Theories

In spite the importance of franchising as an organizational activity, literature on franchising continues to be vague and incomplete (Altinay and Wang, 2006). Instead, most of the studies have relied upon prior findings in other contexts, interviews or common wisdom (Combs et al., 2011a). While there are just a few studies that have examined the franchisee's consequences, the lack of well-specified theory to explain the relationships and selection of variables has led to difficulties in studies (Combs et al., 2011a). Therefore, as first step in this study, there is a need to build a theoretical foundation for explaining franchisees' consequences.

The question of whether any single theory, on its own, can explain the franchisee's performance is not settled. Therefore, Combs et al. (2004c) suggest to study the franchising through multiple lenses and thus gain a richer understanding. To identify the influential factors in the franchisees' performance, this research has focused on the three different perspectives of strategic management, entrepreneurship, and marketing. Then, given the holistic view, this research will identify the factors and characteristics that are most likely related to the franchisee's performance.

Given the holistic view in the study, three major groups of factors are going to be studied to identify the influential factors in franchising performance, namely the franchisee's related factors, the franchisor's related factors, and the relationship between them. This will be done by examining the factors related to the performance and four leading explanations (theories) for the franchisee's performance.

The variation of the firm's performance has drawn many researchers' attention, and several theories in management and business literature have been used to understand the reasons for this variation. By considering the firms as autonomous entities, some researchers have attempted to focus on the firms' internal resources and capabilities and use the resource-based theory to examine the firm performance (Wernerfelt, 1984, Barney, 1991). More recently, involving in an interfirm relationship has also lead the researchers to go beyond the firms' internal resources and take a relational view that supplements the resource based view (Dyer and Singh, 1998). Relational view explains that such competitiveness arises not from firm, but form interfirm sources of advantage (Dyer and Singh, 1998, Lavie, 2006, Mesquita et al., 2008). Moreover, some studies on the inter-firm relationship have paid attention to the quality of transaction between the involved firms and relational exchange theory to explain the variation of performance (Harmon and Griffiths, 2008). Many researchers also look toward contingency theory and focus on the environmental or organizational context to examine the firm's outcome (Watson and Johnson, 2010). According to Rouse and Daellenbach (1999), contingency theory is in the range of factors important to performance. Therefore, given the holistic view and three perspectives in this study, four main theories - the resource-based view, the relational view, the relational exchange theory, and contingency theory - will be discussed to identify the influential factors in the franchisee’s performance.

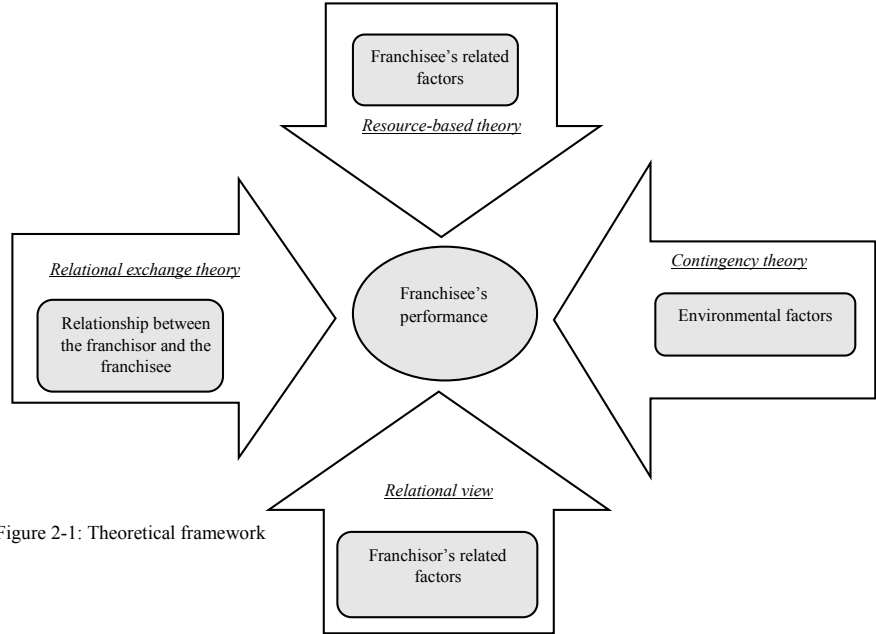


Figure 2-1: Theoretical framework



### 2.1.1 Resource-based theory

The strategic management literature attempts to explain the variation of firm performance by proposing a broad set of organizational resources and capabilities (Rouse and Daellenbach, 1999). During the past decades, a significant number of studies have concentrated on the firm's resources to describe the firm's consequences and the effect of the resources on performance (Combs and Ketchen, 1999b). Edith Penrose (1959) was one of the first scholars that implied the role of resources in a firm's competitive position. In her view, a firm's growth, both internally and then externally through merger, acquisition, and diversification, is accounted by the way in which the firm's resources are employed. She believed that firms, through exploiting the valuable resource, may reach a competitive position (As cited in Newbert, 2007).

In recent years, the resource-based view (RBV) has been one of the most widely accepted theoretical perspectives in strategic management (Rouse and Daellenbach, 1999) that has received considerable attention in academic research (Newbert, 2007). The RBV has made an important contribution to strategic management (Barney, 2001a, Andersén et al., 2015, Barney et al., 2011, Armstrong and Shimizu, 2007). It refers to the way that the deployment of unique and idiosyncratic organizational resources and capabilities can result in superior performance (Rouse and Daellenbach, 1999). The RBV helps to explain the conditions under which a firm's resources will provide it with a competitive advantage (Barney, 1991). Wernerfelt (1984), published an article entitled "A Resource-Based View of the Firm" in the Strategic Management Journal that looks at the resources as important antecedents to products and, ultimately, firm performance. In other words, the firm's resources directly affect the production, and indirectly and eventually are related to the firm's performance. In this way, identifying and acquiring strategic resources can help the firm to earn above-normal returns (Newbert, 2007).

The RBV concept can be summarized in two key elements, resources heterogeneity and immobility (Barney, 2001b). In this perspective, firm heterogeneity in acquiring and deploying resources and capabilities enables firms to apply a value-creating strategy and results in economic rents (Oliver, 1997). Also, due to the immobility of these resources, the firms can take advantage of it for a longer period of time and achieve sustained performance (Andersén et al., 2015).

The RBV attempts to explain the performance differences among firms in the same industry (Zott, 2003). In the resource-based view, a firm is defined as a set of resource, skill and capabilities that create organizational capabilities (Wu, 2010), and the variation of the firm performance stems from the firm's resources. According to the RBV, firms with rare, valuable, and non-substitutable resources, that are difficult for duplication, would be able to implement new value-creating strategies and perform better than competitors (Wu, 2010, Wernerfelt, 1984). Through capturing the valuable, rare, inimitable and non-substitutable (VRIN) resources, firms can attain a sustainable competitive advantage and enjoy improved performance in the long term (Newbert, 2007). Given the RBV, “valuable” resource is one that enables a firm to apply strategies that improve its efficiency and effectiveness. However, the value of a resource is context dependent and is determined in relation to such conditions as organizational strategy and external environments (Barney, 2001b). A “rare” resources means competitors do not have the same resource. Valuable resources which are not rare only provide competitive parity (Barney, 2001a). “Imperfectly imitable” implies the difficulty for other companies to buy or imitate the resources. Unique historical conditions, causally ambiguity relationships between the resources and resulting competitive advantage, and social complexity make a resource imperfectly imitable (Armstrong and Shimizu, 2007). Finally, a resource is “non-substitutable” when there are strategically no equivalent resources for it (Barney, 1991). The resource’s ability to meet these criteria depends on industry features that affect a resource’s value (Amit and Schoemaker, 1993).

Barney (1991), divided the firms’ resources into three main categories: physical capital resources, human capital resources, and organizational capital resources. It is noteworthy that just possessing a VRIN resources is not enough to attain better performance, and firms require competence to exploit these resources (Newbert, 2007). In this view, combinations of resources and capabilities are the basis of a firm's "distinctive competence" (McGrath and MacMillan, 1995).

As discussed earlier, resources can be defined as “those assets that are tied semi-permanently to the firm” (Wernerfelt, 1984). Resources and capabilities are conceptually different (Zou et al., 2010): capabilities refer to skills based on human competencies, while resources refer to all other assets. Nevertheless, methodologically it is difficult to separate the concepts of resource and capability (Chandler and Hanks, 1994, Newbert, 2007).

Therefore, in this study, resource-based capabilities are used as a mix of resources and capabilities that are critical in a franchised outlet performance.

To expand the business in different local markets, a franchisor needs resources and local market knowledge. Thus, a potential franchisor, in order to access to resources such as financial resources and knowledge about the local market to expand its business, uses a franchising strategy (Combs et al., 2004c). In fact, taking advantage of potential franchisees resources would have significant influence on outlets outcome and franchise systems.

In many articles, the performance of the franchised outlet is attributed to the franchisees' characteristics and capabilities (Watson and Johnson, 2010). Lower performance in a franchise system is not only because of the franchisor, but also is caused by attributes of the franchised outlets (Minguella-Rata et al., 2012). In fact, abilities and capabilities in franchised outlets are the primary factors that affects the consequences of the franchisee (Rajagopal, 2007). In a franchise system, although the franchisor, in order to increase productivity, attempts to develop standardization throughout a system, franchisees are doing business in different local markets (Michael and Combs, 2008). Therefore, with the aim of taking advantage of environmental opportunity and increasing sale, the franchisee's resources and capabilities have a significant role in a franchised outlet performance (Gorovaia and Windsperger, 2013). Thus, regarding the RBV, the franchisee's tangible and intangible resources, such as a firm's management skills, its organizational processes and routines, and the information and knowledge under its control (Armstrong and Shimizu, 2007), are the most important factors that contribute to the performance of a franchised outlet (Gorovaia and Windsperger, 2013). However, despite the importance of the RBV in studying firm performance in academic research (Newbert, 2007), it has received less attention in previous studies in a franchising context (Gorovaia and Windsperger, 2013).

In applying Bacharach's (1989) framework, and following Barney (2001b) and Rouse and Daellenbach (1999), the RBV in this study explains and predicts the relationships between the particular resources of a franchisees' related factors (as independent variables) and performance (as dependent variable) (Armstrong and Shimizu, 2007).

### 2.1.2 Relational View

Today, in a hyper-competitive environment, it is especially difficult for a single small firm to possess all the necessary resources to survive and grow (Harrison et al., 2001, Dyer and Singh, 1998). Thus, due to the lack of resources in small firms, many of them attempt to enter into a relationship with other organizations and leverage their relational resources (Yli-Renko et al., 2001). In fact, the firm's relationship may offer a resource that is a source of valuable information for it (Dyer and Hatch, 2006), and allow it to strengthen its ability to survive and grow (Yli-Renko et al., 2001).

In studying the a firm's performance, the resource-based view focused on resources and capabilities that are housed within the firm (Dyer and Hatch, 2006), and how firm-level resources affect the firm's performance. In fact, RBV is usually used to study the firm rather than cooperative organizational forms such as franchising (Michael and Combs, 2008). Instead, as an extension of the resource-based view, the relational view focuses on resources and capabilities embedded in dyadic and network relationships, and considers them as the crucial sources of the firm's competitive advantage and superior performance (Dyer and Singh, 1998, Lane and Lubatkin, 1998, Ireland et al., 2002). In the relational view, focus is on behavioral phenomena, such as inter-organizational factors, as the drivers of firm performance (Paulraj et al., 2008).

In the relational view, a firm's competitiveness not only comes from internal resources, but also depends on inter-firm sources of advantage (Albino et al., 2012) and firms attempt to share their resources and capabilities to reach competitive advantage. According to this view, firms try to improve their competitive position and performance by sharing resources in a partnership with other firms in a cooperative arrangement (Dyer and Singh, 1998, Lane and Lubatkin, 1998, Ireland et al., 2002).

The proposition that relational competencies lead firms to superior performance has become of interest to both scholars and managers (e.g., Dyer and Singh, 1998, Gulati et al., 2000, Zollo et al., 2002). It has been emphasized in the literature that investments in relation-specific assets positively affect firm performance (Ireland et al., 2002).

According to a relational view, the advantage is jointly generated and owned by collaborating firms. Combination, exchange, and codevelopment of idiosyncratic resources (Lavie, 2006) between the partners lead firms to a supernormal profit.

Establishing a continuous relationship between partners creates value that cannot be created by either firm individually. As proposed by Dyer (1996), deeper and more carefully coordinated relationships will result in superior performance, and tightly integrated interorganizational networks outperform those that are loosely organized (Goerzen, 2007). In a partnership, relational rent can stem from only those shared resources that have been committed by the partners, and value of these resources determines the relational rent (Lavie, 2006).

#### 2.1.2.1 Mechanisms of relational rent

Dyer and Singh (1998) believe in the existence of some mechanism through which inter-firm cooperation will create relational rents and enable the firm to perform better than others. In their view, investing in relational-specific assets, developing knowledge-sharing routines, combining of complementary but scarce resources or capabilities, and efficient governance will help the firm in an inter-firm relationship to create relational rent.

##### Relational-specific assets:

According to Williamson (1985) three types of relational asset specificity can make a relational rent: site specificity, in which partners can significantly reduce inventory and transportation costs (Dyer, 1996); physical asset specificity in which product integrity facilitates the partners in product differentiation and improve the quality of their products; and human asset specificity, which allows the firms, through efficient and effective communication, reduce communication errors and consequently improve quality and speed to market (Dyer, 1996).

According to Dyer and Singh (1998), involvement in a franchise system can lead to relation-specific investments for the potential franchisee and conduct them to superior performance (Liu et al., 2014). In a franchising relationship, a franchisor provides important resources for the franchisee such as knowledge, financial, technological, physical and managerial (Das and Teng, 1998). The franchisor also, as a result of the relationship with the supplier and other firms, brings the advantage of social capital for the franchisee (Ireland et al., 2002). For example, in a franchise system, a franchisor's marketing capabilities and franchisees' local market knowledge create a relationship-specific investment (Garg et al., 2011, Dyer and Singh, 1998).

### Inter firm knowledge sharing routine:

Developing knowledge sharing routines is the second source of relational rent. Many articles have emphasized the importance of learning from other organizations through collaborating. Dyer and Singh (1998) believe that the most important idea and information come from the firm's alliance partners. Regarding the importance of knowledge and learning, through developing knowledge-sharing routines in a relationship, firms will be able to enhance effective interorganizational learning (Stuart, 2000, Dyer and Singh, 1998, Lane and Lubatkin, 1998).

In a franchise system, the franchisor supports the franchisee by initial and ongoing training. Relationship-specific knowledge from frequent interaction leads them to a relational capability that can improve the transactional outcome and performance in a franchised outlet (Zollo et al., 2002). Therefore, facilitation of knowledge exchanges between a franchisor and a franchisee in a system brings relational rent for both.

### Complementarity:

Sometimes firms are able to utilize their resources in conjunction with the complementary resources of another firm. In a relationship, resource complementarity can lead to more synergistic benefits from resource combinations than can resource similarity (Harrison et al., 2001). Dyer and Singh (1998) define complementary resource endowments as "distinctive resources of alliance partners that collectively generate greater rents than the sum of those obtained from the individual endowments of each partner." Complementary resources can generate rent only when none of the firms can purchase the relevant resources in a secondary market (Dyer and Singh, 1998).

The partner's resource profile has a crucial role in involvement in a franchise system, as it allows the franchisor and the franchisee to access each other's resources (Harrison et al., 2001). Entering into an interfirm relationship helps the firm to reach the complementary assets by of different firms (Combs et al., 2011a). In a franchise system, resource complementarity can create synergy and lead partners to greater performance (Harrison et al., 2001). In fact, while according to the resource-based view, the franchisee's resources allow a firm to have superior performance (Barney, 2001b), in the relational view, complementary resources of the franchisor and a franchise system help the firms to

achieve better performance (Dyer and Singh, 1998, Ireland et al., 2002). In a franchise system, on one hand the franchisor provides complementary resources such as advertising, raw material and leveraging the scope economy for the franchisee; on the other hand, the franchisees have knowledge of and are familiar with the local market. Having knowledge about the local market can help the franchisor to adapt product and advertising with local market features (Bradach, 1997). According to Oliver (1997), before entering into a franchise system brand reputation is not available for potential franchisees, but franchisor brand reputation allows the franchisee to take advantage of resource complementarity and procure the franchisor's intangible assets.

### Governance:

Establishing an effective governance routine is the last source of relational rent in the relational view. Effective governance by minimization of the transaction cost and improving efficiency creates the rent (Williamson, 1985). Although in a franchise system a legal contract creates a safeguard, the franchisor usually governs the franchisee through self-enforcing agreements (Dyer and Singh, 1998). In self-enforcing agreements, informal mechanism such as trust or embeddedness and reputation prevent the undesirable action. As Dyer and Singh (1998) propose, in a franchise system informal mechanisms are more effective than formal one. Using informal mechanisms for governance, through lowering the cost of contracting, monitoring, adaptation, and reconstructing, increases the probability of relational rent. Utilizing informal mechanisms also, make it difficult for others to imitate, and create a superior incentive for value-creation initiatives.

In summary, franchising is a long-term relationship in which the combination of franchisee and franchisor efforts can generate profits that they could not acquire individually (Dyer and Singh, 1998, Castrogiovanni et al., 2006). Inter-organizational cooperation in franchising improves the available resources for both parties and can bring them competitive advantage and entrepreneurial value (Dyer and Singh, 1998, Liu et al., 2014). Franchisors in a franchise system make relation-specific investments that enhance franchisee competitiveness (Combs et al., 2004c), and the franchisor's strategically valuable resources affect the franchises performance (Michael and Combs, 2008). According to the relational view, scale economies, the effective management of risk, cost-efficient market entries and learning from the other actors (Combs et al., 2011a), create the

value for the franchisee in a franchise system. Through entering into a franchise system, the franchisee is able to minimize transaction costs, cope with uncertain environments, reduce its dependence on resources outside of its control (Ireland et al., 2002) and consequently improve its performance.

### 2.1.3 Relational exchange theory:

Interfirm exchanges are spread on two sides of a continuum, from a discrete transaction to relational exchanges (Fontenot and Wilson, 1997). In a discrete transaction, there is no interaction, and only price guides the exchange. The discrete transaction is manifested by money and easily measured commodities (Baker 2001). A discrete transaction is a short-term transaction and is characterized by limited communication and narrow content. All events in this exchange are independent, and firms in an interfirm relationship always strive to get the best economic position for achieving their own goals (Fontenot and Wilson, 1997).

During the past decades, to achieve better performance companies have been inclined toward more relational exchanges. By moving toward relational exchange in the continuum, firms involvement and communication increase (Fontenot and Wilson, 1997). In relational exchange, in addition to the actual exchange of a product or service for financial compensation (Fontenot and Wilson, 1997), firms are expected to derive complex, personal, non-economic satisfactions and engage in social exchange (Baker 2001). Dyer and Wensley (1983) indicate that a relational exchange through help with product differentiation and creating a barrier to switch, provides the competitive advantage for partners (Baker 2001).

From a marketing perspective, it is important to differentiate the short-term transactions and long-term relational exchanges (Victoria Bordonaba-Juste and Polo-Redondo, 2008). The most important fact is that relational exchange is a long-term transaction and happens over time (Baker 2001). During the past decades, attention in relationship marketing has been focused on long-term relationships (Victoria Bordonaba-Juste and Polo-Redondo, 2008). Depending on the firm's goals and objective, different types of exchange can be used in interfirm relationships (Spinelli and Birley, 1996).



Norms that govern commercial exchange behavior in discrete transaction are completely different from those in relational exchange theory which involve a long-term transaction (Spinelli and Birley, 1996). In the interfirm relational exchange, the governance mechanism is based on minimizing the motivation of partner firms to pursue only their interest and maximizing the cooperation (Aulakh et al., 1996). According to relation exchange theory, firms' outcome can be maximized in relationships through cooperative behaviors that serve the best interests of the partnership (Davies et al., 2011).

Relational exchange theory refers to acceptance of social norms in interpersonal interactions and is defined by the expectations of the firms in an interfirm relationship about each other's behavior (Harmon and Griffiths, 2008). In sum, relational exchange theory refers to long-term, continuous, and complex relationships that are built on commitment, trust, common goals, communication, reciprocity and mutual cooperation (Morgan & Hunt, 1994), and which lead the partners to mutually beneficial economic and/or non-economic outcomes (Harmon and Griffiths, 2008).

In a franchising system, interaction between the franchisee and franchisor establishes a mutually beneficial relationship in which both parties, to achieve fair outcome and adopt to each other. Exchange theory suggests, regarding what the firms will receive in an inter-relationship, that they positively or negatively behave in the same way as other firms (Harmon and Griffiths, 2008). Since in a franchising, reciprocity is very important in creating relationship value, relation exchange can be utilized to examine the quality of the relationship between the partners (Harmon and Griffiths, 2008).

Combs et al. (2011a), through reviewing the recent articles in the franchising literature identified the need for studying the franchising from the relational exchange theory to explain franchisors' actions toward franchisees and the consequences on the franchisee and franchisor. Kaufmann and Stern (1988) refer to franchising as the prototype relational exchange wherein, parties' attitude and the transaction between entities are important in the firms' outcome (Spinelli and Birley, 1996). Although in a franchise agreement, there is a formal contract to govern the relationship between a franchisor and a franchisee, the informal relationship has a significant role in a franchise system (Rodríguez et al., 2006, Gassenheimer et al., 1996). Since in business format franchising, parties attempt to achieve sustainable profitability, relational exchange bounded by

informal agreement plays a critical role in this interdependent relationship (Harmon and Griffiths, 2008).

Exchange theory enables us to measure the strength and stability of the relationship in a franchise system. In fact, in a relationship in a franchising system, the franchisees' perception of the franchisor's characteristics affects the satisfaction and behavior (Spinelli and Birley, 1996). Since the participants have their own objectives (Rodríguez et al., 2006), the franchisor's behavior in the long term, and unexpected contingencies in daily relationships of exchange make some special situation. Franchisee's perception of the relationship could be destructive or constructive and affect the franchisee's behavior and performance outcome (Şengün and Wasti, 2011). Thus, by considering franchising as a long-term, continuous, and complex relationship (Huang et al., 2007), it is necessary to understand the franchisee's perception of relationship value and implications on both behavioral and objective franchisee performance (Harmon and Griffiths, 2008, Davies et al., 2011).

#### 2.1.4 Contingency theory:

In many studies in management and business, it has been indicated that there is no unique strategy or best way to manage an organization and achieve to a superior performance. According to Lawrence et al. (1967), adoptability between the industry condition and organizational features is necessary to achieve an optimal performance, and alignment between the internal and external factor can improve the performance (Rauch et al., 2009). However, most of the researchers who have studied the rent-generating resources and capabilities as described in the RBV, have not examined the environmental factors that may interact with the organizational factors (Rouse and Daellenbach, 1999).

Research in strategic management about the variation of performance has changed from simply investigating the performance relationship to examine the co-alignment between the firm's attributes, environment and performance (Singh et al., 2010). According to the contingency theory, the environmental or organizational context plays a crucial role in a firm's outcome (Raymond and Croteau, 2009). Contingency theory holds

that to achieve an optimal outcome, a firm should consider the alignment between its strategy and environmental contingency for organizing resources (Raymond and Croteau, 2009). In this perspective, an appropriate alignment between strategic orientation and environmental characteristics enhances the firm's performance over competitors (Aragón-Correa et al., 2008).

In addition to resource restrictions, a small firm deals with turbulent environments as well as increasing competitiveness and innovativeness. Therefore, investigating the environmental factors play a crucial role in examining the small firm performance and growth (Covin and Slevin, 1989). Many research studies mention the importance of certain conditions to enhance franchising outcomes (Combs et al., 2011a). Combs et al (2010) highlight the need for identifying and examining the moderators in franchising and performance relationships in future studies, especially from the franchisees perspective. According to Combs, et al.'s (2004), some contingent factors mediate the relationship between franchising and performance. Since franchisees are doing business in different geographical areas (Kaufmann and Eroglu, 1999), attributes of local markets might also moderate the relationship between the use of franchising and performance (Combs et al., 2011a).

The restaurant industry would appear to be relatively hostile and environmental factors significantly affect its outcome (Michael, 2003). Given the contingency theory, Yin and Zajac (2004) studied how flexible and decentralized structures moderate the relationship between franchising and performance. Vroom and Gimeno (2007) examined the local competition as a moderator in franchised outlets, and found that both franchised and company-owned outlets benefit from having few competitors, but company-owned outlets benefit more.

In summary, because of its concern with performance implications, the contingency theory has been fundamental to furthering the development of the management sciences (Rauch et al., 2009). Building on contingency theory, some moderator variables shape the link between franchising and performance (Combs et al., 2011a). Therefore, to understand the discrepancies in findings across different local markets, this research aims to investigate potential moderators in studying the franchisee's performance.

### 2.1.5 Summary of the theories:

Although franchising has been the topic of much academic research in recent years, literature on franchising continues to be vague and incomplete (Altinay and Wang, 2006), and most of the studies have relied upon prior findings in other contexts, interviews or common wisdom (Combs et al., 2011a). According to Combs et al. (2011a), the lack of well-specified theory to explain the relationships and selection of variables has proven problematic in studies (Combs et al., 2011a). Moreover, it seems any single theory, on its own, cannot explain the franchisee's performance. Therefore, regarding the three major perspectives in this study, i.e. strategic management, entrepreneurship, and marketing, and applying the holistic view to examine the different influential factors in the franchisee's performance, four theoretical bases were found useful in reviewing the literature from the franchisee's point of view.

A variation of the firm's performance has drawn many researchers' attention, and several theories in management and business literature are used to understand the reason for this variation. By considering the firms as autonomous entities, some researchers have attempted to focus on the firm's internal resources and capabilities and use the resource-based view to examine firm performance (Wernerfelt, 1984, Barney, 1991). Performance differences in a franchise system are not only because of the franchisor, but are also caused by the franchisees (Minguela-Rata et al., 2012). Therefore, the franchisee's abilities and capabilities are the primary factors that affect the consequences of the franchisee (Rajagopal, 2007). Thus, through applying the resource-based view in franchising context, this research concludes that the franchisees' heterogeneous and immobile resources that are VRIN can account for their performance differences.

More recently, involvement in an interfirm relationship has also led researchers to go beyond the firm's internal resources and take a relational view (Dyer and Singh, 1998) that supplements the resource-based view. According to the relational view, firms try to improve their competitive position and performance by sharing resources in a partnership with other firms in a cooperative arrangement (Ireland et al., 2002, Dyer and Hatch, 2006). Given the relational view, in a franchising system, a franchisee's competitiveness not only comes from internal resources, but also depends on franchisor's sources of advantage (Albino et al., 2012). In this view, a franchisee will be able to take advantage of

complementary resources and capabilities, which are shared by the franchisor. Moreover, knowledge sharing and relational-specific asset in the relationship with the franchisor may be enablers for the franchisee to achieve better performance.

In a franchising system, interaction between the franchisee and franchisor establishes a mutually beneficial relationship in which both parties, to achieve fair outcome, need to adopt to each other. In this study, the relational exchange theory is used to examine the relationship factors in the franchisee's performance. According to this theory, what the franchisees will receive in a franchising relationship, depends on their perception of the quality of the relationship; and their perception positively or negatively affect their performance (Harmon and Griffiths, 2008). Since reciprocity is very important in creating a relationship value in franchising, relation exchange theory is utilized to examine the quality of the relationship between the partners (Harmon and Griffiths, 2008).

The last theory that has been used in this study, relates to the contingency theory. According to the contingency theory, environmental context (Raymond and Croteau, 2009) plays a crucial role in the firm's outcome. To achieve an optimal outcome, a firm should consider the alignment between the firm's strategy and environmental contingency for organizing resources (Raymond and Croteau, 2009). Since the franchisees are doing business in different geographical areas (Kaufmann and Eroglu, 1999), attributes of local markets might also affect the relationship between the use of franchising and performance (Combs et al., 2011a). Therefore, this research uses the contingency theory to find how alignment between the franchisee's resources environmental context affect its performance.

## 2.2 Literature review and hypotheses

In this section, given the prior research in the small business, interfirm relationship, and franchising literature, the affecting factors in the franchisee's performance are reviewed. To examine the important factors in the franchisee's performance, all independent variables are discussed and the hypotheses are proposed for each part. Given that franchising is mutual relationship, features of the franchisor, the franchisee, and the relationship between them will be discussed to draw the hypotheses.

### **Franchisee-related factors in franchisee's performance:**

Lower performance of a franchisee can be caused by both franchisor and franchisee (Minguela-Rata et al., 2012). Although in a franchise system, the franchisor sets the standard and policy, the performance of a franchisee is also explained by referring to the franchisees characteristics (Michael and Combs, 2008, Marnburg et al., 2004). A significant amount of value of the firms is associated with the firm's resources and capabilities (Perdreau et al., 2015) and franchisors strive to select the best potential franchisee to enhance the network performance. Therefore, by taking the strategic management and entrepreneurship perspectives, as well as resource-based view, important factors in the franchisee's performance will be discussed and hypotheses proposed in each section.

#### 2.2.1 Absorptive capacity

During the past decades, identification and development of knowledge by firms has been explained as one of the key mechanisms through which a firm succeeds (Johnson et al., 2004). In interfirm relationships, relational rents are possible when a partner can exchange and apply resources such as knowledge in the firm. However, some firms learn how to develop and manage relationships better than others (Dyer, 1996, Kale et al., 2002). Firms' abilities in identifying and applying the knowledge are associated with their capabilities or competences (e.g. Johnson et al., 2004, Eisenhardt and Martin, 2000). When firms engage in an interfirm relationship to learn new knowledge and acquire external rent-generating resources, relative capabilities such as absorptive capacity have assumed an important role (Lavie, 2006).

Cohen and Levinthal (1990) introduced the concept of absorptive capacity as a firm's ability in identifying, assimilating, and exploiting external knowledge (Flatten et al., 2011). Research on interfirm relationships is one the area in which absorptive capacity plays a significant role (Flatten et al., 2011, Johnson et al., 2004). According to Cohen and Levinthal, (1990), absorptive capacity includes the ability to identify the value of new information, assimilate that information, and utilize it to commercial ends. Zahra and George (2002) divide absorptive capabilities into potential and realized absorptive capacities. Potential capacity focuses on knowledge acquisition and assimilation capabilities, while realized capacity centers on knowledge transformation and exploitation (Zahra and George, 2002). Acquisition refers to a firm's capability in recognizing and absorbing external new knowledge that is critical to its operations; and the firm's routines and processes through which companies analyze, process, interpret, and understand the information acquired new knowledge, is referred as assimilation capabilities. Transformation refers to a firm's capability in refining the routine to facilitate combining existing knowledge and the newly obtained knowledge, while exploitation reflects a firm's ability to exploit and apply the new knowledge into commercial ends (Zahra and George, 2002). While paying attention to potential absorptive capacity leads a firm to a short-term benefit, organizations should effectively react to environmental change through developing their realized absorptive capacity (Jansen et al., 2005).

The importance of ACAP has been a subject of the strategic management field (Zahra and George, 2002, Lane and Lubatkin, 1998, Nahapiet and Ghoshal, 1998). Although absorptive capacity has been examined through different theories, including learning, innovation, managerial cognition, knowledge-based view, dynamic capabilities, co-evolution (Volberda et al., 2010) and the resource-based view (Lane and Lubatkin, 1998), this study considers it as a firm's capability and studies it through the resource-based view.

Firms' capability in developing and managing knowledge is a major reason for their variation in performance (Zahra and George, 2002). Much research has studied the role of absorptive capacity in business performance (Flatten et al., 2011). Absorptive capacity helps the firm's learning, and consequently contributes to firm performance (Lavie, 2006). Zahra and George, (2002) believe ACAP in the firms helps them to reconfigure their resources and positively affect their performance.

According to Liao et al (2003), a firm's absorptive capacity is comprised of two major components: external knowledge acquisition and intra-firm knowledge dissemination. Firms should not only monitor the external environment for pursuing and acquiring new knowledge; they should also efficiently disseminate the knowledge within an organization, for example through interdepartmental meetings and interdepartmental cooperation (Liao et al., 2003). Prior related knowledge and diversity of knowledge have a crucial role in the acquisition of knowledge. Prior related knowledge in organizations through making a relation with new knowledge will help the firms to enhance their absorptive capacity (Cohen and Levinthal, 1990). Moreover, communication structure, the shared code, language, and symbols resulting from the relevant knowledge increase the affectivity of the communication and dissemination of the knowledge. Through an active social network, an organization's individual will be able to enhance their awareness of each other's capabilities (Cohen and Levinthal, 1990).

Despite the considerable attention given to absorptive capacity during the past decades, not much research that have examined ACAP in the context of small and medium-sized enterprises (SMEs) (Liao et al., 2003), and only a few studies have been conducted in franchising context. Knowledge as an intangible resources significantly contributes to firm performance in the franchising context (Paswan et al., 2014). Knowledge transfer between the franchisor and franchisee is one the components in business format franchising (Brookes, 2014). Partners in a system also have the opportunity to learn from other units (Huber, 1991, Tsai, 2001). In franchising, knowledge is transferred to the franchisees and offers them the opportunity to gain access to skills that would not have been acquired if the franchisee had not been joined (Harrison et al., 2001). However, the firms' abilities in the assimilation and exploitation of received external knowledge are different (Tsai, 2001), and not all franchisees may be able to exploit it. They all need internal capacity to learn from each other and apply it in their commercial ends (Tsai, 2001). Darr et al. (1995), by studying the US pizza franchisees of one franchise network, found acquisition of transferred knowledge by the franchisor depends on the franchisee's firm-specific learning capabilities. Brookes (2014) examined the knowledge transfer in international master franchise agreements and identified three antecedents to knowledge transfer: shared identity, absorptive capacity and casual ambiguity (Brookes, 2014).



In summation, a small business typically owns scarce internal resources and entering into a partnership can help it to access complementary resources such as knowledge (Flatten et al., 2011). A Firm with a low developed ACAP would not be able handle external knowledge successfully, and it would not be likely to enhance its performance by engaging in a partnership. Applying this concept to franchise systems, the franchisee should be able to absorb all knowledge transmitted by the franchisor, and apply it in the outlet (Minguela-Rata et al., 2012). According to Paswan et al. (2014), principal actors' absorptive capacity impacts the flow and sharing of knowledge in the value creation process of a franchising system. High absorptive capacity in the franchisees enables them to apply new information to business operations and commercial ends, generate significant benefits (Jansen et al., 2005) and eventually enhance their performance (Bergh and Lim, 2008). Influence of learning in franchised outlet also affects the cost (Darr et al., 1995), and acquisition and exploitation of external knowledge enhance the firm's innovation efforts (Segarra-Ciprés et al., 2014). Absorptive capacity also affects the firm's other organizational competencies, provides the franchisee with multiple sources of competitive advantage, and eventually improves its economic performance (Zahra and George, 2002). Therefore, this research study proposes:

Hypothesis1: The franchisee's absorptive capacity positively affects its performance.

#### 2.2.1.1 Environmental factors in absorptive capacity

According to the contingency theory, environmental or organizational context (Raymond and Croteau, 2009) plays a crucial role in the firm's outcome. According to strategy literature, uncertainty of environmental change is considered as one of the major sources of opportunities and threats (Liao et al., 2003). Doing business in turbulent environments requires the development of an organizational process for external knowledge management (Lev et al., 2009). Adoptability between the environmental condition and organizational features is necessary for getting optimal performance, and alignment between the internal and external factors can improve performance (Rauch et al., 2009).

Duncan (1972) indicated that environmental dynamism plays a critical role in firms' adaptation, and firms need to change their behavior to adopt with changing

environments (As cited in Liao et al., 2003). Differences in firms' histories and resources, particularly knowledge, lead each of them to develop a unique set of capabilities to take advantage of environmental opportunity (Lane and Lubatkin, 1998). To survive in environmental turbulence, identification, assimilation and applying new knowledge toward commercial ends is necessary (Jansen et al., 2005). Absorptive capacity enables firms to change to match the dynamics of the market (Lev et al., 2009, Zahra and George, 2002, Cohen and Levinthal, 1990). The firms that manage both potential and realized ACAP, achieve better performance in a turbulent environment. In their study, Jansen et al. (2005) found that environmental dynamism affects the relationship between the absorptive capacity and performance. Absorptive capacity enables the firm to have flexibility in the reconfiguration of resources to take advantage of environmental dynamism, effectively manage new knowledge and lead the firm to superior performance (Zahra and George, 2002). Since the restaurant industry would appear to be relatively dynamic (Michael, 2003), and franchisees are doing business in different geographical areas (Dant and Kaufmann, 1998), franchised outlets will also need to actively search for new knowledge, absorb it and apply it in their business (Liao et al., 2003). Given the above, this research proposes:

Hypothesis1<sub>1</sub>: The greater the environmental dynamism, the greater the impact of ACAP on franchisee performance.

Another environmental factor refers to environmental competitiveness. With environmental competitiveness, firms need to change, reconfigure, and enhance their resources to stay competitive (Jambulingam and Nevin, 1999). Environmental competitiveness refers to the extent to which the external environment has intense competition (Jansen et al., 2006). The competitive pressure of the marketplace affects firm performance as well (Mesquita et al., 2008). Vroom and Gimeno (2007) examined the local competition as a moderator in franchised outlets and found both franchised and company-owned outlets benefit from having fewer competitors.

Knowledge as an intangible resource plays an important role in firms' strategy and leads to superior performance (Grant, 1996). Gaining access to knowledge as a critical resource improves the firms' competitiveness and enhances organizational competitiveness (Brookes, 2014, Mesquita et al., 2008). According to the resource-based

view, creating competitive knowledge is one of the major strategies for firms dealing with increasing competitive pressures (Amit and Schoemaker, 1993, Lev et al., 2009, Jansen et al., 2006). Intense competition in the local market and a highly competitive market forces the franchisees to acquire the new information about the client and market, and apply it in the business. Therefore, potential ACAP helps the firms, through identifying and assimilating, to create new competitive knowledge. Realized ACAP can also help the firm to exploit new competitive knowledge and lead them to competitive advantage (Lev et al., 2009). Therefore, since the franchisees are doing business in different local markets with different local competitors, absorptive capacity enable the franchisee to achieve greater performance in a competitive environment. Thus, this research proposes:

Hypothesis1<sub>2</sub>: The greater the environmental competitiveness, the greater the impact of ACAP on a franchisee's performance.

### 2.2.2 Entrepreneurial orientation

Entrepreneurship is considered to be a significant factor when facing with the changing environment. Regardless of the firm's size or its industry, entrepreneurial behaviors are becoming significantly important to a firm's success (O'Shea et al., 2005). Entrepreneurial behavior firms triggers the flexibility and adoptability to deal with a rapidly changing environment (Kraus, 2013) and survive in it (Lyon et al., 2000).

Given the RBV, entrepreneurship may lead the firm to competitive advantages and to superior performance (Hult and Ketchen, 2001, Alvarez and Busenitz, 2007, Dess et al., 2003, Kollmann and Stöckmann, 2014). Alvarez and Busenitz (2007) refer to entrepreneurship as the process of combining and organizing resources as a resource in the resource-based view. They analyzed different aspects of entrepreneurship as unique resources that can lead the firm to the superior performance. According to Dess et al. (2003), from the resource-based perspective, entrepreneurship is a key means of accumulating, converting, and leveraging resources for competitive purposes.

Firms for displaying the entrepreneurial activity needs to promote the entrepreneurial behaviors in organizational process and individuals (Boso et al., 2013). Companies with a leadership position in the market always create the strong motivation to innovate, take risks, and aggressively pursue new venture opportunities. These ideas are captured by the concept known as “entrepreneurial orientation (EO)” (Li et al., 2008). In entrepreneurship studies, entrepreneurial behaviors are usually measured through the concept of EO and its corresponding scales (O'Shea et al., 2005). EO describes how entrepreneurial action is undertaken (Arshad et al., 2014) and refers to the strategy- making processes that, by capturing the entrepreneurial aspects of decision-making, provide a basis for entrepreneurial action in an organization (e.g., Lumpkin and Dess, 1996a, Wiklund and Shepherd, 2003, Covin and Slevin, 1989). According to Wiklund and Shepherd (2003), entrepreneurial orientation is a capability by which a firm utilizes the resources to discover and exploit the opportunities. Kollmann and Stöckmann (2014) refer to EO as a capability that may bind other resources together, enabling a company to deploy them advantageously. Therefore, in this study following Hult and Ketchen (2001), Alvarez and Busenitz (2007), Dess et al. (2003), Kollmann and Stöckmann (2014), EO has been considered as a resource in the resource-based view that may lead the firms to superior performance.

Franchise systems as a form of entrepreneurial ventures play a critical role in economic development in many countries (Holmberg and Morgan, 2003), and it has provided the unique context for entrepreneurship researches (Kaufmann and Dant, 1999). There is no doubt that entrepreneurship is a natural home for franchising research (Combs et al., 2011b). Franchisors as an entrepreneur consider the franchising as an entrepreneurial strategy to expand their business; and the franchisees as the potential entrepreneur risk their money and run a new business (Shane and Hoy, 1996). Hence, despite the importance of franchising as strategy in service firm, it has been part of the some research in entrepreneurship (e.g. Dant and Kaufmann, 1998, Hoy and Shane, 1998, Combs et al., 2011b) and there is still a lack of research on entrepreneurship within the franchising (Shane and Hoy, 1996).

In a franchise system, at first, when a franchisor wants to develop the business, standardization plays a critical role in the success of that system (Cox and Mason, 2007). Through standardization, the franchisor strives to take advantage of economies of scale,

pursuit of quality control, and cost minimization across the franchising system. After initial creation, each new franchised outlet deals with unique challenges and opportunities (Kaufmann and Eroglu, 1999). In this condition, learning from the local market and taking advantage of local market opportunities plays a crucial role in the system competitiveness. Moreover, the franchisee is familiar with the local market, and ignoring the franchisee's knowledge can infuse serious inertia into the system (Kaufmann and Eroglu, 1999). Further, dealing with too heterogeneous market conditions may also destroy the system's ability to function in a changing environment (Kaufmann and Eroglu, 1999). According to Bates (1998), entrepreneurs became franchisees to enhance their chances of survival during the turbulent early years of business start-up and operation. Moreover, when a system matures, experienced franchisees become more familiar about the local market and resist against the high level of standardization (Kaufmann and Eroglu, 1999), and standardization across the system will frequently conflict with the different local market conditions (Sorenson and Sorensen, 2001). Therefore, to take advantage of market opportunities the franchise system needs to carry out the adoptive strategy (Kaufmann and Eroglu, 1999) and display entrepreneurial behaviors (Covin and Slevin, 1989).

Entrepreneurship has been considered as one of the main perspectives in understanding the causes of business success and failure (Michael and Combs, 2008). Examining the relationship between EO and performance is one of the most interesting subjects in entrepreneurship (Arshad et al., 2014). Entrepreneurial orientation is believed to play a significant role in the survival and performance of firms (Miller and Friesen, 1983, Lumpkin and Dess, 2001, Wiklund and Shepherd, 2005, Wiklund and Shepherd, 2003, Zahra and Covin, 1995, Zahra and Garvis, 2000, Avlonitis and Salavou, 2007, Saeed et al., 2014). Several studies have indicated that greater EO in firms leads to greater performance growth (e.g. Hughes and Morgan, 2007, Wiklund and Shepherd, 2003, Wiklund and Shepherd, 2005). While entrepreneurial orientation due to important roles in a firm's success (Wang, 2008) has received much attention in an organizational setting such as in small and medium-sized enterprises, only a few studies have explored EO in franchised firms (e.g. Falbe et al., 1999, Grewal et al., 2011, Maritz and Nieman, 2006, Maritz, 2006, Ketchen et al., 2011, Dada et al., 2012, Dada and Watson, 2013). While some authors believe the role of EO in franchised outlets is still is un-clear (Grewal et al.,

2011, Maritz and Nieman, 2006), but others believe that the franchisee's EO can improve performance (Chien, 2014).

An entrepreneurial orientation can improve the exploitative capabilities of an organization, which in turn can help it to achieve superior business performance metrics (e.g., product, customer and financial performance) (Shane and Hoy, 1996). A high level of EO enables firms to constantly scan the environment and identify opportunities and threats, properly respond to these challenges (Keh et al., 2007), and eventually grow in a competitive and uncertain environment (Lumpkin and Dess, 1996a, Shane and Venkataraman, 2000). Dada and Watson (2013) indicate that EO is positively related to the performance outcomes of franchise systems. According to Chien (2014), EO positively affects the performance of a franchised outlet, and those franchisees who have EO will gain greater competitive advantage and higher franchisee performance. EO and alertness to opportunities foster franchisees' activities and significantly contributes to their overall performance over time (Zahra et al., 2009). Franchisees with high EO will be able to recognize local market needs and exploit opportunities (Windsperger, 2004). Entrepreneurial franchisees may show superior marketing and management systems in a given system (Merrilees and Frazer, 2006).

#### 2.2.2.1 Dimensions of EO

Although much research has emphasized the importance of entrepreneurial orientation in business success, scholars are not yet able to recommend to management which kinds of entrepreneurial behaviors are the best and under what conditions those activities are most beneficial (Sundqvist et al., 2012). These conditions are magnified in a franchising context in which on the one hand, franchisors try to standardize the activities in the system, and on the other, ignoring the local market condition and avoiding the adaptation strategy may hurt the system's profitability. As a result, it is necessary for the partners in a franchising system to invest in the right kinds of entrepreneurial strategies in order to achieve sustainable competitive advantage.

Moreover, several studies have emphasized the importance of an organizational context in the entrepreneurship - performance relationship (Walter et al., 2006). The

relationship between EO and performance is complex and context-specific (Lumpkin and Dess, 1996a, Combs and Ketchen, 2003). In the context of franchising, franchisees do their business in different local markets, and franchise territories and market areas undoubtedly play a crucial role in the franchisee's performance and even the survival of a system (Cox and Mason, 2009). As relationships evolve, franchisees learn the franchisor's operational methods and strategies and they will find their strengths and weaknesses (Davies et al., 2011). Moreover, given its local knowledge, the franchisee strives to adopt to the local market, develop new market offerings, and transform existing ones (Kaufmann and Eroglu, 1999). Consequently, franchisees in a system strive to adopt to the local environment, exercise entrepreneurial initiative, and apply their own experiences instead of executing the franchisor standard (Baucus and Baucus, 1996). Therefore, given the importance of context in studying entrepreneurial behaviors and to find the right kinds of entrepreneurial strategies in franchising systems, it is first necessary to have a more detailed view about the EO construct and its dimensions in the franchising context.

The concept of entrepreneurial orientation emanated from the work of the Aston Group in the 1960s and ended in 1983 with the research of Danny Miller. These researchers greatly contributed to the development of the EO concept. Miller provided a measurement scale for tapping into firm-level entrepreneurship. In fact, Miller developed the dimension of proactiveness to innovativeness and risk-taking for measuring firm-level entrepreneurship (Edmond and Wiklund 2010). Innovativeness indicates the tendency to engage in new ideas, novelty and experimentation through the introduction of new products/services and creative processes (Lumpkin and Dess, 1996b); it also refers to the search for novel, unusual, or creative solutions to challenges facing a firm (Dada and Watson, 2013). Risk taking is associated with a willingness to take action in an unknown situation and commit more resources to projects with high rate of failure (Wiklund and Shepherd, 2005). Proactiveness is an opportunity-seeking, forward-looking perspective characterized by the introduction of new products and services ahead of the competition and acting on future wants (Lumpkin and Dess, 1996b). Lumpkin and Dess (1996) conceptualized competitive aggressiveness and autonomy as two additional dimensions of a coherent EO. Competitive aggressiveness indicates the firm's intensity to directly challenge competitors, to retain and improve its position in the market. Autonomy refers

to a firm's ability and willingness to undertake an independent entrepreneurial action in the pursuit of market opportunities (Zhou, 2007, Lumpkin and Dess, 2001).

While Miller (1983) and Covin & Slevin (1989) view the EO a unidimensional construct, Lumpkin and Dess (1996) suggest that EO is a multidimensional one. In the first view, different dimensions of EO should relate to performance in similar ways. In the multi-dimensional view, however, all dimensions of EO tend to vary independently, and their effect on performance is different (Lumpkin and Dess, 2001, Rauch et al., 2009). In fact, each dimension represents a different and independent aspect of the multidimensional concept of EO (Rauch et al., 2009). Regarding Miller's conceptualization, three dimensions of EO namely innovativeness, risk taking, and proactiveness, have been extracted and widely used in the entrepreneurship literature (e.g. Dada and Watson, 2013, Rauch et al., 2009, Keh et al., 2007, Wang, 2008); and few studies have examined Lumpkin and Dess' (1996) five-dimension framework of EO (Lumpkin and Dess, 2001, Li et al., 2009a, Hughes and Morgan, 2007).

Using the single aggregate measure in EO makes the research more straight forward that may lead to loss of accuracy (Sundqvist et al., 2012). While the unidimensional measure of EO may provide important information about the consequences of entrepreneurial activity at a more abstract level, a multidimensional measure of EO dimensions is most likely to provide useful insights (e.g. Hughes and Morgan, 2007, Lumpkin and Dess, 1996a). Although all five dimensions of EO may be beneficial (Hughes and Morgan, 2007 & Kreiser, Marino and Weaver, 2002), not all entrepreneurial efforts will enhance firm performance (Arshad et al., 2014) and only a sub dimension of EO may be valuable for a firm (Hughes and Morgan, 2007, Kreiser et al., 2002). Therefore, for small business with restricted resources, it is very important to understand which of the five EO dimensions are most valuable to securing improved performance (Hughes and Morgan, 2007). Lumpkin and Dess (1996) imply that the value of each EO dimension may depend on firm context. According to Kreiser, Marino and Weaver (2002), given the context, different configurations of sub-set of EO dimensions will improve firm performance. For example, Hughes and Morgan (2007) examined the independent impact of all EO dimensions including risk taking, innovativeness, proactiveness, competitive aggressiveness, and autonomy on the performance of young



high-technology firms. They found only proactiveness and innovativeness positively affect business performance, and that risk taking has a negative relationship. They also could not find any relationship between competitive aggressiveness and autonomy, and business performance (Hughes and Morgan, 2007).

Sundqvist et al. (2012), following the dominant strand in the entrepreneurship literature, introduced two kinds of entrepreneurial-orientated behavior (EOB), Kirznerian and Schumpeterian. Under the Kirznerian view, opportunity is limited to access of information, which already exists, and is which available in the market (Kirzner, 1997). In the Schumpeterian view, existence of opportunities requires the production of new information (Shane, 2003). In the Kirznerian view, an entrepreneur responds to the market by engaging in market-driven behavior and discovers those possibilities unforeseen by competitors (Sundqvist et al., 2012). In the Schumpeterian view, entrepreneurs, by “creative destruction” (Schumpeter, 1934), create the new combinations that disequilibrate the market balance.

Kirznerian entrepreneurial processes occur in new or within the boundaries of existing markets, in which new opportunities arise from the firm’s efforts to take advantage of the competitive landscape it operates in (Sundqvist et al., 2012). According to Sundqvist et al. (2012), a company’s entrepreneurial behaviors in Kirznerian view entails competing in an current market, aggressively striking the competition, and realizing the present demand. In fact, in this view competitive strategies are the central element of entrepreneurial behaviors. Entrepreneurial activities in the Schumpeterian view start from “creative disruption” and instead of a competitive-focused activity, concentrate on creating new market opportunities and opening up new markets (Sundqvist et al., 2012). In this view firm needs to be innovative, free to act autonomously in order to identify the opportunity, and willing to take risks (Sundqvist et al., 2012, Kumar et al., 2000).

Therefore, given the unique context of franchising for entrepreneurial behaviors, and considering that the Kirznerian and Schumpeterian EOBs may have differential performance outcomes, following Sundqvist et al. (2012), this study considers aggregating EOBs along Kirznerian and Schumpeterian behavioral characteristics.

#### 2.2.2.2 The Schumpeterian view of the entrepreneurial orientation:

In the Schumpeterian view, the firm's focus is on the ability to launch a new product, extend the activities to the new market, and find a new way of organizing. Therefore, innovativeness is the key dimension of EO in this view. Schumpeter (1934) emphasizes the role of innovations as a core disequilibrating factor. Engaging in the innovative process and creating a new combination, in the Schumpeterian view, requires the willingness to take the risk of action in uncertain conditions. Franchisees also need to be autonomous enough to create new markets and be able to put their visions into the practice.

##### Innovativeness:

Schumpeter (1934) introduced innovation as the basic element of entrepreneurship, and Stevenson and Gumpert (1985), called innovation the " heart of entrepreneurship" (as cited in Covin and Miles, 1999). According to Miller (1983), engaging in innovation is one of the main characteristics of an entrepreneurial firm. The innovativeness dimension of EO refers to a top manager's willingness to embrace new ideas and novelty, to experiment to face challenges, and to foster creativity through the introduction of new or improved products, services, and processes (Merrilees and Frazer, 2006, van Riel et al., 2011, Lumpkin and Dess, 1996a). This is a reflection of the firm in facing new opportunities (Harrison et al., 2001) and emphasizes a firm's capabilities to explore new possibilities (Hughes and Morgan, 2007, Harrison et al., 2001). Innovations come in several forms, and they can be viewed along two ends of a continuum (Bordonaba-Juste and Polo-Redondo, 2008). Innovativeness in its simplest forms can be revealed e.g. in a firm's tendency to try a new product line or experiment with new advertising, and can also be shown in introducing the latest new products or technological advances (Arshad et al., 2014).

Innovation is viewed as one of the most important factors in a firm's growth. Innovative competences are rooted in the context and cannot be easily imitated in company, and hence, are viewed as a source of competitive advantage (Li et al., 2009a). Innovation also increases the possibility of securing a first-mover advantages (Wiklund, 2006).

Although innovation in a franchise system is primarily under the control of the franchisor (Maritz, 2006), all franchisees having knowledge about their local markets, are doing business on this network. A franchisor's over emphasis on standardization and maintain system uniformity can deprive the system from franchisee creativity and innovation, which have the potential for idea generation (Cox and Mason, 2007). Scanning the environment and recognition of the needs and demands of external play, have a critical role in innovation (Miller and Friesen, 1982), and access to and development of new information and knowledge is the core objective of innovation (Combs et al., 2011a). Therefore, since the franchisee has access to local knowledge, many ideas generated by franchisees are an important source of innovation (Combs and Ketchen, 2003, Kaufmann and Eroglu, 1999).

#### Risk taking:

The second dimension of EO under the Schumpeterian view refers to risk taking. Studies on entrepreneurship discuss how the propensity to take some degree of risk is associated with entrepreneurial activities (Miller and Friesen, 1983, Miller and Friesen, 1982, Stevenson and Jarillo, 1990). Risk taking denotes the firm's willingness to engage resources in activities, strategies and projects, where the unexpected outcome and the cost of failure may be high (Walter et al., 2006, Wiklund and Shepherd, 2005). It also reflects managers' preferences to take action in an uncertain situation (Hughes and Morgan, 2007) to achieve organizational objectives (Jambulingam et al., 2005). By committing resources to an uncertain project, a firm deals with the risk of failing and the risk of missing out on an opportunity (Hughes and Morgan, 2007).

Although doing business under a franchise system reduces risk, it never completely eliminate the risk for franchisees (Ketchen et al., 2011). It seems, all endeavors beyond the franchise routine and standardized activities involve some degree of risk, and even there is no activity with "absolutely no risk." (Lumpkin and Dess, 1996a). Therefore, risk-taking behavior in franchising can viewed as a continuum from —"safe" risks to highly risky actions (Lumpkin and Dess, 1996a). Since in franchising, the franchisee's risk taking not only affects their business, the franchisees' propensity to take a risk plays more of a critical

role than that of an individual business owner. The system brand name and the whole system will be affected by the franchisee's actions as well (Kaufmann and Dant, 1999).

After running a new outlet, every franchise outlet is dealt with unique challenges that create unique risk for them. Franchisees expand the system and are in charge of outlet performance, and have the risk of finding new demand and activities. In fact, franchisees devote their resources to the development of local markets that are uncertain (Kaufmann and Dant, 1999). Even so, the franchisor, due to the franchisees' local expertise and information, usually asks them to develop marketing programs (Kaufmann and Dant, 1999).

According to prior studies (e.g. Li et al., 2009a, Lumpkin and Dess, 1996a), a risk-taking tendency may positively affect the firms' success. The willingness to take a risk provoked the franchisees to be active and challenged the inertia (Busenitz and Barney, 1997), and being risk averse disordered the performance in a changing environment. Although committing resources in an uncertain project may fail in some cases and succeed in others, the franchisees' desire to tolerate the risk in taking advantage of entrepreneurial activities, generates high returns during longer time horizons (Dada et al., 2012, Lumpkin and Dess, 1996a)

### Autonomy

Autonomy is the third dimension of EO in the Schumpeterian view. To take advantage of opportunities, key employees must be granted autonomy and take part in making key decisions. According to Miller (1983), this is one of the main characteristic of the entrepreneurial firms. The autonomy dimension of EO is defined as a firm ability and willingness to undertake an independent entrepreneurial action in the pursuit of market opportunities (Rauch et al., 2009, Lumpkin and Dess, 2001). This implies a firm makes quick and self-reliant decisions in dealing with challenge (Li et al., 2009a).

Dependency and autonomy are the key challenges in a franchisee-franchisor relationship (Dant and Gundlach, 1999). Franchise relationships are ones of delicate balance, wherein on one side franchisor strives to expand standardization throughout the system and all decisions are made centrally; and on the other, the franchisee as an

independent small business owner often tries to achieve a certain degree of autonomy and carry out its own decisions (Combs and Ketchen, 1999b).

Organizational context, such as management style, ownership, organizational factors such as resource availability, actions by competitive rivals, or internal organizational considerations, plays an important role in provoking or preventing an individual to carry out an entrepreneurial activity (Lumpkin and Dess, 1996a). Although franchisees must do their business under the policy and rules set by the franchisor, in a franchise system, as entrepreneurs the franchisees still have a quest for autonomy (Dant and Gundlach, 1999). Franchisees with prior self-employment experience enter into a system and desire to be their own bosses and apply their experience and knowledge in their outlets (Dant and Gundlach, 1999, El Akremi et al., 2011).

As entrepreneur, franchisees enjoy autonomy more than managers; franchisees differed from company managers and displayed entrepreneurial attributes (Gassenheimer et al., 1996). Autonomy in a franchise system can be viewed as the extent to which the franchisee is unconstrained, independently makes decisions, and takes action (Cochet et al., 2008a, Felstead, 1991, Strutton et al., 1995). Cochet et al. (2008a) suggest the franchisor needs to grant autonomy to franchisees and involve them more in relational governance, such as efforts to resolve conflict, build cooperation, and create trust (Combs et al., 2011a). Franchisees as product champions should be autonomous to move beyond the usual organizational lines of authority and carry out new ideas (Lumpkin and Dess, 1996a & Dess and Lumpkin, 1996). They need to have open communication, unrestricted access to information and apply their decisions and ideas in the outlet (Hughes and Morgan, 2007). Constrained franchisees most likely will fail in undertaking the needed action when the environmental problem happened or when the firm needed to respond quickly to environmental change. Franchisees as the owner are responsible for the outlet performance, and autonomy enables them to engage in entrepreneurial activities and perform effectively (Hughes and Morgan, 2007).

In summary, franchisees' Schumpeterian EO are characterized by innovation, a willingness to take the risk and being autonomous to create the new innovation (Sundqvist et al., 2012). The franchisees act as entrepreneurs and always seek to improve their performance and grow (Baucus and Baucus, 1996). Further, the franchisees'

innovativeness helps them to apply market information and find a creative solution to business problems and challenges that lead them to better performance (Hult et al., 2004). Their tendency to provide innovative products or processes enables franchisees to renew their operations in the marketplace and improve their profitability (Li et al., 2009a, Zahra and Garvis, 2000). It also helps the franchisees to creatively combine market knowledge with system information, and by offering product market innovation such as product design, market research, advertising and promotion (Lumpkin and Dess, 1996a), take advantage of local market opportunity (Walter et al., 2006) and improve performance. When a firm takes a risk it also affects its strategic decisions and improves its performance. Furthermore, it makes it easier for the franchisee to overtake others in introducing innovations and respond to environmental change (Hughes and Morgan, 2007). Eventually, it helps the firm to enthusiastically identify the profitable opportunity, obtain higher returns, and improve performance (Arshad et al., 2014, Hughes and Morgan, 2007). Moreover, flexibility is a result of autonomy, and facilitates an active and reactive response to change (Hughes and Morgan, 2007). An autonomous franchisee would be able to respond to local market change and its rivals more effectively and quickly. Therefore, autonomy in a franchised outlet improves the franchisees' outcomes (Combs et al., 2011a, Bordonaba-Juste et al., 2008). It also fosters system-wide adaptability and outlet owners' satisfaction (Cochet et al., 2008a). Consequently, innovativeness, risk taking and autonomy are three dimensions of Schumpeterian EO that help franchisees to outperform rivals and potential imitators. Thus, this research proposes that:

Hypothesis2<sub>1</sub>: The franchisee's Schumpeterian EO positively affects its business performance.

### 2.2.2.3 The Kirznerian view of the entrepreneurial orientation:

In the Kirznerian view, franchisees are involved in entrepreneurial behavior through the process of opportunity discovery and exploitation (Kirzner, 1997). They need to be proactive and identify the market opportunity ahead of rivals, and afterwards must rapidly and aggressively seize that opportunity and exploit it.

### Proactiveness

Proactiveness is the first dimension of Kirznerian EO. It refers to the firm's opportunity recognition as well as predicting the market's future needs sooner than its competitors (Rauch et al., 2009). According to Lumpkin and Dess (2001), proactiveness is defined as "an opportunity-seeking, forward-looking perspective involving introducing new products or services ahead of the competition and acting in anticipation of future demand". Proactive firms scan and monitor the trend, and by focusing on current problems and anticipating future change, strive to effectively identify opportunities (Dess and Lumpkin, 2005). A forward-looking perspective enables the firms to explore opportunities, be a leader in the market (Wiklund and Shepherd, 2005) and achieve first-mover advantage (Lumpkin and Dess, 2001). In doing so, proactiveness keeps a firm a step ahead of less responsive competitors (Hughes and Morgan, 2007).

Several researchers have studied the role of proactiveness in improving firm performance (Dess and Lumpkin, 2005 & Chen and Hambrick 1995 & Lado, 1995). Since proactive firms identify the opportunity ahead of others, competitors cannot drive prices down (Dess and Lumpkin, 2005). It also brings brand recognition and enhances a firm's market share. However, sometimes customers are reluctant to try new things, and first movers are not always successful. Moreover, a forward-looking perspective also will also help the firm to change the nature of the competition in the industry (Dess and Lumpkin, 2005) and shape the direction of the market environment in the long term (Hughes and Morgan, 2007).

Falbe et al. (1999) studied entrepreneurial strategies in franchising and found that proactiveness has a significant positive association with growth. Doing business in local markets provides franchisees information about changes in the local market environment as well as customer preferences. Being knowledgeable about current and future customer preferences enables firms to proactively identify the opportunity and initiate acting against competitors (Venkatraman, 1989). In fact, franchisees' proactiveness increases their receptiveness to market signals and awareness of customers' needs (Hughes and Morgan, 2007). Taking initiative by anticipating and pursuing new business opportunities is rewarded by marketplace positions of competitive advantage such as unusual returns (Lumpkin and Dess, 1996a, Wiklund and Shepherd, 2005). Therefore, franchisees that

initiate the action ahead of competitors in the market (Dess and Lumpkin, 2005), will lead the market (Lumpkin and Dess, 2001) and create first-mover advantage (Wiklund and Shepherd, 2005, Lyon et al., 2000, Zahra and Covin, 1995). They will also be able to target premium market segments, charge high prices, (Arshad et al., 2014, Wiklund and Shepherd, 2005, Lyon et al., 2000), improve their competitive position, and eventually enhance their performance (Dess and Lumpkin, 2005).

### Competitive aggressiveness

Entrepreneurs, who run a small business, due to increasing the probability of survival and success, need to intensively compete and establish power relative to competitors (Lumpkin and Dess, 1996a). Competitive aggressiveness as a dimension of EO refers to the intensity with which a firm directly challenges competitors to outperform rivals and improve its position (Hughes and Morgan, 2007, Lumpkin and Dess, 2001). It establishes the ability of the firm to take a strong combative position or aggressively respond to competitive threats (Rauch et al., 2009, Jambulingam et al., 2005, Lumpkin and Dess, 2001). For instance, a firm dealing with a competitor in the market lowers prices to competitively challenge it (Lumpkin and Dess, 1996a). However, it can take the form of deliberate action along with reactive action (Hughes and Morgan, 2007).

Competitive aggressiveness in a firm may take several forms. Sometimes a firm aggressively enters a market that a rival has identified. Firms with competitive aggressive orientation might also spend more on marketing, product service and quality, or manufacturing capacity, to respond to competitive threats (Lumpkin and Dess, 1996a). When a new product emerges in the market, a firm with competitive aggressiveness also strives to quickly respond to it and take a "fast-followers" approach (Lumpkin and Dess, 1996a).

Aggressive firms do not hesitate to develop their market share and the number, size, and types of their customers, as well as the breadth of their product line (Lumpkin and Dess, 1996a). Competitor assessment plays a crucial role in competitive aggressiveness, and firms' emphasis on taking advantage of opportunities stems from their strengths and their competitors' weaknesses. They see competitors as enemies and aim to weaken them by creating an advantage through continuous offensive actions (Hughes and Morgan, 2007).



An aggressive position of a firm results in strong performance (Paik and Choi, 2007). A franchisee with competitive aggressiveness, given its competitors' weaknesses and its strengths, will constantly exploit market information, and use unconventional surprise tactics to improve its performance (Hughes and Morgan, 2007). Competitive aggressiveness not only makes it hard for competitors to predict the firm's future actions; it also undermines the competitors (Hughes and Morgan, 2007). A strong competitively aggressive stance gives a franchisee the ability to be a decisive player in a field of rivals and act forcefully to secure or improve its position (Lumpkin and Dess, 1996a).

Hence, franchisees' Kirznerian EOBs are characterized by proactive market-driven and competitive aggressive behavior (Sundqvist et al., 2012). Therefore, proactiveness and competitive aggressiveness are two dimensions of Kirznerian EO that help the franchisees to outperform rivals and potential imitators. Proactiveness in the franchised outlet enable the franchisee to target premium market segments, charge high prices (Arshad et al., 2014, Wiklund and Shepherd, 2005, Lyon et al., 2000), improve its competitive position, and finally enhance its performance (Dess and Lumpkin, 2005). Competitive aggressiveness will also enable the firm to acquire market share and outperform rivals through its ability to redefine the service and product (Lumpkin and Dess, 1996a), revise the rules of competition, and improve its position in the marketplace (Li et al., 2009a, Zahra and Covin, 1995, Lumpkin and Dess, 2001). Thus, this research proposes that:

Hypothesis 2<sub>2</sub>. The franchisee's Kirznerian EO positively affects its business performance.

#### 2.2.2.4 Environmental factors in entrepreneurial orientation:

In strategic management, the environment has been considered as one of the critical contingencies (Lumpkin and Dess, 2001). The contingency theory suggests that performance depends on the extent to which a firm's behavior fits with the external environment (Robertson and Chetty, 2000). Although some capabilities in firms can enhance the performance within certain environments, the same capabilities may lower the performance in other environments (Zahra and Bogner, 2000).

According to the entrepreneurship literature, the entrepreneurial approach is not suitable for all environmental contexts (Robertson and Chetty, 2000) and an entrepreneurial orientation is not necessarily desirable in all situations (Covin and Slevin, 1989). Given the contingency theory, environmental factors might affect the perspective relationship between EO and performance (Kraus et al., 2012). Many studies in the entrepreneurship literature have proposed that environmental factors moderate the relationship between the EO and performance. (e.g., Zahra and Covin, 1995, Covin and Slevin, 1989, Rauch et al., 2009, Wiklund and Shepherd, 2005). They believe the EO should be understood in terms of contingency approaches in relation to the environment (Aloulou and Fayolle, 2005, Lumpkin and Dess, 2001, Lumpkin and Dess, 1996a, Miller, 1983), and environmental factors affect the way that an entrepreneurial orientation will lead to high performance (Lumpkin and Dess, 1996a).

As discussed earlier, franchised outlets are geographically distributed in different local market with different environmental conditions. In this study regarding the previous studies in entrepreneurship and by considering the franchising context, two environmental constructs, environmental dynamism and environmental competitiveness, are used as potential moderators in the franchisee's performance.

#### Environmental dynamism

Change in the environment always provides opportunities and threats for firms. In a highly changing environment, firms' products and services are no longer used as before and they need to come up with new ideas to fit with the environmental dynamism (Jansen et al., 2005). Environmental dynamism indicates the degree of uncertainty a firm is faced with. It refers to the rate of unpredictable change in a business' environment (Lumpkin and Dess, 2001). In a dynamic environment where competitor behavior changes quickly, existing opportunities and resources can quickly become redundant. Consequently, firms need to have strategic decision-making by which to explore and exploit opportunities and outperform their rivals (Rosenbusch et al., 2013). Environmental dynamism makes current products and services quickly useless (Sørensen and Stuart, 2000), and firms will need to rapidly respond customers' new preferences (Burgers et al., 2009). However, these environmental changes can create opportunities in the market (Ruiz-Ortega et al., 2013).

Several studies have identified the environmental dynamism as a potential moderator between EO and performance (Rauch et al., 2009). According to Miller and Friesen (1982), environmental dynamism is positively associated with a firm's entrepreneurial activities. Zahra (1993) found the firm's ability to leverage its entrepreneurial orientation (EO) into successful performance depends on environmental dynamism (as cited in Kraus et al., 2012). Kreiser et al. (2002) found that environmental factors affect the interaction between all sub-dimensions of EO and business performance. Covin and Slevin (1989) and Zahra and Covin (1995) discovered that EO has a larger positive effect on performance in dynamic than stable environments (Wiklund and Shepherd, 2005).

EO helps firms to adapt to a changing environment and even constantly predict change, adapt (Huang and Wang, 2013) and attain sustainable competitive superiority in time (Ruiz-Ortega et al., 2013). In a dynamic environment, higher innovativeness and risk taking leads firms to stronger performance (Casillas et al., 2010). Firms will be able to change and improve their resources, focus on more innovative strategies (Rosenbusch et al., 2013) and take more risks. This is because activity in a dynamic environment involves taking actions that are more likely to fail (Zahra, 1991). Therefore, higher environmental dynamism accelerates the implementation of EO in the identification and exploitation of emerging opportunities (Rauch et al., 2009).

A high degree of EO would also help the firm to explore new opportunities and minimize the threat of obsolescence (Lawrence and Lorsch 1967; Miller and Friesen 1983), as well as exploit it. Taking advantage of environmental change leads the firm to above-normal returns by targeting premium market segments and creating new niches (Lumpkin and Dess, 2001, Jansen et al., 2006).

In stable environments, franchisees that just follow the routine will have less variance and show stronger performance. They will tend to keep the competitive position of the outlet, or to improve it slightly (Casillas et al., 2010). Doing business in a dynamic environment, however, means franchisees are required to quickly respond to the environment (Burgers et al., 2009), and the franchisee with higher levels of EO will be able to take advantage of opportunities and entrepreneurial rewards in dealing with a dynamic environment (Zhao et al., 2011). It seems that when doing business in different

local markets with different customer preferences, the franchisees' EO enables them to make a quick decisions as a result of more informal decision-making processes and thus improve their performance (Casillas et al., 2010).

Hypothesis2<sub>3</sub>: Environmental dynamism will moderate the relationship between the franchisee's Kiznerian EO and performance. The franchisee with higher Kiznerian EO performs better in a more dynamic environment.

Hypothesis2<sub>4</sub>: Environmental dynamism will moderate the relationship between the franchisee's Shumpeterian EO and performance. The franchisee with higher Schumpeterian EO performs better in a more dynamic environment.

#### Environmental competitiveness

Environmental competitiveness indicates the extent to which a competition is intense in an environment (Jansen et al., 2006, Zahra and Bogner, 2000). In a highly competitive environment, customers have no specific preference to select a special firm within the market (Burgers et al., 2009) and a firm should always work to improve its efficiency (Matusik and Hill, 1998). Several studies have demonstrated the moderating role of environmental competitiveness between the EO dimensions and performance (Miller and Friesen, 1982, Rauch et al., 2009, Lumpkin and Dess, 1996a, Wiklund and Shepherd, 2005, Lumpkin and Dess, 2001). Regardless of the firm size, entrepreneurial behavior is vital to take advantage of competitive environments (Covin and Slevin, 1989, Lumpkin and Dess, 1996a, Miller, 1983, Zahra, 1993). In a competitive environment, the intensity of competition exerts more pressure on the firm and entrepreneurial firms can take advantage of the more entrepreneurial activities (Casillas et al., 2010).

In the franchising context, the external environment also has a crucial role in entrepreneurial strategy from the perspective of the franchisees (Sul and Khan, 2006). For those franchisees that are in different local markets, environment competitiveness increases the need for entrepreneurial activities (Dada and Watson, 2013, Falbe and Welsh, 1998). Although strong and high innovativeness may be hazardous for the franchisee in a highly competitive environment (Jansen et al., 2006, Zahra and Bogner, 2000), competitive aggressiveness can help them to react to competitive trends and demands that already exist in the marketplace (Lumpkin and Dess, 2001). In fact, through incremental

and minimal refinements to existing resources, franchisees can overcome the intense competitive threat. Competing successfully in competitive environments can be consistent with a posture of competitive aggressiveness in a firm. A firm with higher competitive aggressiveness can increase its efficiency by taking bold action, such as cutting prices and sacrificing short-term profitability. The risk-averse franchisee also will be attacked by its more aggressive competitors to achieve better performance (Casillas et al., 2010). To compete with a rival in a competitive environment the franchisee should also invest more in marketing, product service and quality, or production capacity (Lumpkin and Dess, 2001). Therefore, with a certain level of EO, franchisees can enhance their performance in such an environment (Burgers et al., 2009).

H2<sub>4</sub>: Environmental competitiveness moderates the relationship between the franchisee's Shumpeterian EO and performance. The franchisee with a higher Shumpeterian EO performs better in a more competitive environment.

H2<sub>5</sub>: Environmental competitiveness moderates the relationship between the franchisee's Kirznerian EO and performance. Franchisee with a higher Kirznerian EO performs better in a more competitive environment.

### 2.2.3 Social capital:

Examining the social capital known as external links (Lee et al., 2001), personal networks (Ostgaard and Birley, 1994), or networking relationship (Zou et al., 2010) has received much attention in strategic management and entrepreneurship studies. Social capital indicates the firm's ability to take advantage of its social structures, networks and memberships (Davidsson and Honig, 2003). It concerns every relationship with the environment that affects the value of a firm (Hormiga et al., 2011). Given the social network theory, the social context in which a firm is embedded affects its strategic action (Gulati, 1999) and performance (Prajapati and Biswas, 2011).

It is widely accepted that social capital has assumed an important role in the performance of small firms (Stam et al., 2014, Li and Atuahene-Gima, 2001, Pirolo and Presutti, 2010). Prior studies in entrepreneurship (e.g. Shane and Venkataraman, 2000)

and strategic literature (Falbe et al., 1999) put emphasis on the role of industry structure and business environment on small business performance. Stam et al. (2014), after a meta-analysis of entrepreneurs' social capital and performance through an analysis of 61 independent samples, found that there was a significant and positive relationship between them. Davidsson and Honig (2003) found social capital has a significant positive relation influence on performance. Hormiga et al. (2011) studied social capital in 130 firms from mixed industries and found that relationships with customers and suppliers, and informal network positively affects performance. Given this view, social capital embodied in the development of managerial social networks and ties with external entities, affects a firm's competitive advantage and performance (Acquaah, 2007).

Although social capital has been variously defined and applied across many disciplines (Patel and Terjesen, 2011, Nahapiet and Ghoshal, 1998), this study follows Nahapiet and Ghoshal (1998). They defined social capital as "the sum of actual and potential resources embedded within, available through, and derived from the network of relationships possessed by an individual or social unit" (Nahapiet and Ghoshal, 1998: 243).

Social capital is used for different purposes. It entails the wide range of benefits, from financial support from family to access to intangible resources such as information about the location of a new potential client (Davidsson and Honig, 2003). Relationships with external stakeholders are critical for entrepreneurs and help them to gain access to potential customers (Baron and Markman, 2000, Zou et al., 2010). It also helps them to enter new market segments or gain access to new customers (Acquaah, 2007). Although in a franchising context the franchisor provides almost all of the resources and sets the policy about the franchisee's relationship with other actors, the franchisee plays an important role in establishing and developing the external relationship with its personal network (Hormiga et al., 2011) to gain access to new customers (Acquaah, 2007).

Social capital involves the relational and structural resources attained by individuals/firms through a network of social relationships (Li and Atuahene-Gima, 2001). The structural dimension of social capital concerns the overall pattern of connections between actors (Pirolo and Presutti, 2010). In the structural dimension, network configuration and the presence or absence of network ties between actors (Liao and Welsch, 2003) are the most important aspects. The relational dimension refers to the

different types of personal relationships that small business owners develop in a network (Granovetter, 1992), and affects their actions and results (Liao and Welsch, 2003). The relational dimension concerns the content in relationships, strength of ties and relational trust in a network (Claro and Laban Neto, 2009). Relational capital matters for performance (Patel and Terjesen, 2011), and through exchanging information, recognizing business opportunities provides a beneficial and productive resource for entrepreneurs (Liao and Welsch, 2003).

A main aspect of the relational dimension refers to a bridge between internal operations and the external environment (Mort and Weerawardena, 2006) including strong ties and weak ties (Davidsson and Honig, 2003). Weak ties represent distant and loose relationships between the franchisee and its customers, friends and relatives that may not be reciprocal. Strong ties, in contrast, involve frequent interaction, substantial past interaction, intimacy, reciprocity, and openness in exchanges (Batjargal, 2003). In strong ties, such as a two-way tie between the franchisee and the franchisor, information is perceived to be more trustworthy (Granovetter, 1992).

Strong or weak ties of social capital are believed to play a significant role in firm performance. All relationships with the related actors in a business environment can equally provide important sources of influence for the owner (Hormiga et al., 2011). According to Granovetter (1992), weak ties are an effective means of accessing to information sources and new knowledge exploration, while strong ties are more effective in the transmission of tacit, complex knowledge for experiential learning (Pirolo and Presutti, 2010). Following Davidsson and Honig (2003), this research uses social capital in terms of ties, to study its effects on performance. In a franchising system, friendship and family are strong ties and the customer is a weak tie in relation to the relational aspect (Batjargal, 2003).

A relationship with other actors in a business environment with, e.g., customers, suppliers, competitors, and government agencies, assumes an important role for the firm's economic outcomes. Social capital assists franchisees to more effectively perform, such as persuading customers to carry out tasks (Baron and Markman, 2000), provide access to resources and information (Liao and Welsch, 2003), and improve their performance (Baron and Markman, 2000). It plays an important role in gaining a competitive advantage

over rivals (Zou et al., 2010) through obtaining access to distribution channels, customers and resources. From the RBV, social capital is an intangible asset (Hormiga et al., 2011) embedded in the relationships of the franchisee and its customers, friends and other franchisees. It is considered a valuable and distinctive capability and is difficult for competitors to duplicate (Barney, 1991, Yli-Renko et al., 2001).

The relationship with the customer is believed to be an important factor in association with a firm's success (Hormiga et al., 2011). In this view, a customer provides access to a broader set of new useful contacts. As do Yli-Renko et al. (2001), this study considers social capital as a multidimensional asset inside the business relationships implemented by the franchisees with their main customers (Pirolo and Presutti, 2010), friends and acquaintances. This research applied customer social capital as the sum of obtained and used resources embedded in relationships between the franchisee and its customers. Yli-Renko et al. (2001) discuss customer network ties as "the extent to which the key customer provides the focal firm access or introductions to a broader set of customers" (2001, p. 590).

Establishing and developing a relationship with customers, friends, and acquaintances enables the franchisee to access key strategic information for the business (Hormiga et al., 2011). Impersonal and infrequent relationships between a franchisee and customers, friends and relatives link the franchisee to a broad marketplace (Pirolo and Presutti, 2010). Moreover, ties in a network enable the franchisee to be connected to other new and profitable contacts, to get new information, to identify opportunities (Patel and Terjesen, 2011) and to have access to new customers (Pirolo and Presutti, 2010, Hormiga et al., 2011). Consequently, these ties more likely enhance instrumental returns as well as increase efficiency and effectiveness (Baron and Markman, 2000, Gronum et al., 2012). The relationship with a customer can develop both customer and brand loyalties, as well as enhance sales (Acquaah, 2007). It can also bring value for the franchisee and lead it to success (Hormiga et al., 2011). For these reasons, this research offers the following hypothesis:

Hypothesis3: The franchisee's level of social capital positively affects its performance.



#### 2.2.4 Human capital:

During the past decades, many researchers in strategic management have highlighted the importance of human capital in leading the firm to outperform rivals in the resource-based view (Barney et al., 2011, Crook et al., 2011, Hatch and Dyer, 2004). The idea that human capital in a firm is a promising source of competitive advantage has long been acknowledged in the literature (Carmeli and Tishler, 2004). Human capital in a firm refers to the knowledge, skills, and abilities embodied in people (Coff, 2002)

Gaining access to specific and critical resources, such as human capital, is one the main reasons that explains the choice of franchising strategy (Dant and Kaufmann, 2003). Franchisors, because of resource scarcity and to compensate for the lack of human capital in local markets, use franchisees (Cox and Mason, 2009). Therefore, human capital in a franchised outlet, especially in local markets, seems to play a significant role in a franchisee's performance. A franchisee's superior human resources can also reduce the franchisor's uncertainty (Florin et al., 2003).

Research about human capital has received increasing attention in academic work. Most of the firm's value today is attributed to intangible assets, including human capital such as knowledge and employees' experience (Florin et al., 2003). The interest in human capital continues, and the positive impact of human capital on performance is widely accepted in much of the research (Chandler and Lyon, 2009, Deeds and Decarolis, 1999, Hitt et al., 2006, Hitt et al., 2001, Lee et al., 2001, Manev et al., 2005, Shrader and Siegel, 2007). Human capital plays a significant role in the firm's ability to survive and grow (Florin et al., 2003); it also enhances entrepreneurial performance (Pennings et al., 1998, Van Praag and Cramer, 2001). Although many studies have concluded that human capital is related to success, the magnitude of this relationship has remained unknown (Unger et al., 2011). For example, Davidsson and Honig (2003) believe that although human capital is influential for a new venture's outcome, it alone is not enough to ensure success. Human resources can easily move between firms and be expropriated by rivals (Hatch and Dyer, 2004). However, firm-specific human capital is a valuable and inimitable resource (Hitt et al., 2001). In fact, generating sustained rent from human capital depends on the degree of the firm's specificity and adjustment cost to work for the other firm. If the human capital is specific to the originating firm and adjustment costs in a new environment prevent

immediate expropriation by rivals, it can lead the firm to superior performance (Hatch and Dyer, 2004).

Knowledge and experience in the firm are viewed as two relevant characteristics of human capital (Felicio et al., 2014a) that can enhance firm performance; they are also the most frequently used selection criteria that a franchisor uses to evaluate and select potential franchisees (Unger et al., 2011). According to the RBV, knowledge embedded in human capital is among the most universal of resources that meet VRIN criteria for leading the firm to superior performance (Grant, 1991, Crook et al., 2011, Coff, 2002). Knowledge in human capital has been considered as one of the most valuable and imperfectly imitable resources that can enable the firm to improve its performance (Crook et al., 2011, Grant, 1991). Knowledge is defined as tacit or explicit. Explicit (theoretical) knowledge refers to "know-what", which is related to the processes, formal written documents, and educational institutions. Practical and experienced-based knowledge (tacit knowledge) refers to "know-how", which is often non-codified components of activity, and comes from experience and internalized information (Davidsson and Honig, 2003). While tacit knowledge concerns well-practiced skills and routines, explicit knowledge concerns the development of facts and propositions in the firm (Nahapiet and Ghoshal, 1998).

Human capital attributes has also found to be critical resources for success in entrepreneurial firms (e.g. Unger et al., 2011). In this study, following Becker (1964), human capital is defined as the skills and knowledge that a franchisee acquires through formal and non-formal education, as well as other types of experience, such as work in a franchise system or work in the same industry before joining the franchise system.

Education as an entrepreneurial variable has been studied extensively. Studies in examining the relation between the education, performance and success, has led the literature to existence of nonlinear effects (Davidsson and Honig, 2003). Through affecting the knowledge, skills, problem-solving ability, motivation, and self-confidence, education plays an important role in organizational outcomes (Cooper et al., 1994). Cooper and Gimeno-Gascon (1994) reported that 10 of 17 earlier studies had found positive relationships between prior level of education and performance, and proposed that educated owners have access to greater personal capital (Cooper et al., 1994).

The role of education level in a franchisee's performance is not clearly known. Some studies, such one by Tatham et al. (1972), imply a less important role of educational level in performance, while other researchers, such as Wattel (1969), indicate the importance of education level. Regarding the second view, the accumulation of knowledge through formal education will provide beneficial ability for the franchisees (Davidsson and Honig, 2003). The franchisee's education level plays an important role in better understanding the values in a business, the acceptance of policy rules in franchising and applying them to their businesses (Reuber and Fischer, 1997). It can help the franchisees to have better relationships in their businesses, including relationships with customers and franchisors in a system, and enhance their productivity (Van Der Sluis et al., 2008). It also reduces opportunistic behavior such and free riding against the franchisor (Jambulingam and Nevin, 1999). A higher education level also enables franchisees to tolerate ambiguity in a complex, uncertain situation. Although the influence depends on the type of academic education, it increases cognitive abilities and affects an individual's strategic decisions (Entrialgo, 2002).

In addition to education, experience and practical learning affect human capital as well (Davidsson and Honig, 2003). Cooper et al. (1994) proposed that experience is positively related to performance; it affects human capital and plays a significant role in the firm's growth (Wiklund and Shepherd, 2003). Previous experience increases the probability of a business surviving (Christopher Earley and Gibson, 1998), growing and being profitable (Ortiz-Walters and Gius, 2012), and significantly affects entrepreneurial activity (Davidsson and Honig, 2003). Like education, little is known about the influence of prior experience on a franchisee's outcome (Jambulingam and Nevin, 1999). Consistent with Olm et al. (1988), Jambulingam and Nevin (1999) proposed that prior experience helps franchisees to know what they need to do to enhance their success in a franchise system. An experienced franchisee as a strategic resource is able to monitor the market and benefit from sophisticated systems (Macpherson and Holt, 2007). It enables the franchisees, especially those who have experience with the local market, to build and maintain consistent service standards, manage costs and attain long-term success (Combs and Ketchen, 1999b). Moreover, experienced franchisees more likely perceive the relationship with the franchisor as cooperative.

Although prior work experience in the same industry of the firm is more positively associated with growth than years of prior work experience in other industries, Colombo and Grilli (2005) proposed that more experienced individuals should show superior growth. Industry-specific work experience affects the firm's growth. It helps the franchisee to monitor diverse functions in a business and also enables it to develop contacts with potential customers and improve its relations with current customers (Cooper et al., 1994).

In summary, human capital plays a promising role in a service sector business (Hatch and Dyer, 2004). Given the RBV, human capital resources across firms, due to employee mobility (Campbell et al., 2012) and being heterogeneous (Coff and Kryscynski, 2011), are considered to be an influential factor in a firm's superior performance (Cooper et al., 1994, Barney, 1991, Wright et al., 2001). Human capital in a business improves a firm's productivity and efficiency through increasing cognitive skill (Felicio et al., 2014a). It can also affect the firm's dynamic capabilities, improve them, and lead the franchisee to high performance (Perdreau et al., 2015, Florin et al., 2003). According to previous studies, there is a relation between human capital and success (e.g., Bosma et al., 2004, Van der Sluis et al., 2005). The high level of human capital in a franchised outlet, the result of knowledge and skill, creates a distinctive capability in the franchisees (Felicio et al., 2014a). New opportunity would more likely be seized by individuals with more or higher human capital (Davidsson and Honig, 2003). Explicit knowledge of franchisees acquired in educational institutions and implicit knowledge acquired through experience help them in identifying new opportunities (Davidsson and Honig, 2003) and affect the outlet's performance (Felicio et al., 2014a, Hatch and Dyer, 2004, Booth and Katic, 2011). Human capital also affects a franchisee's managerial and technical skill for leading the outlet, and identifying potential customers and serving new market segments (Wright et al., 1997). Therefore, the resource-based view predicts superior human capital, including experiences and education, which have consistently been viewed as central drivers for strategy and performance (Crook et al., 2011) can create competitive advantage and improve performance (Hatch and Dyer, 2004). Thus, this research proposes:

Hypothesis 4<sub>1</sub>: The franchisee's human capital, representing tacit and explicit knowledge, positively affects the performance.

Along with access to resources, the performance of a small business depends on the owner's managerial capabilities (Chandler and Hanks, 1994, Grant, 1991). Deficient managerial capabilities have been considered as a predominant cause of SME failure (Pizanti and Lerner, 2003b). Given the RBV, it has been established that a superior top management team most likely generates higher rent for its firm (Carmeli and Tishler, 2004). A management team's superiority depends on its managerial capabilities (Carmeli and Tishler, 2004), because "the attributes of the management team may satisfy the conditions for achieving and maintaining competitive advantage" (Mahoney, 1995).

Managerial capabilities, because of their important role in a firm's success or failure, have received a lot of attention in the small business literature (e.g. Merrilees and Frazer, 2013). Man et al. (2002) refer to entrepreneurs' managerial skill as one of the most important factors in small business performance. Chandler and Jansen (1992) have shown that managerial competencies are correlated with the performance of small firms. Chandler and Hanks (1994) also refer to managerial capabilities as a significant factor in small business performance.

Managerial expertise is one of the scarce capabilities that drive a franchisor to turn into the franchisee than managers (Combs et al., 2004a). It is the main criteria for the franchisor in selecting a proper franchisee (Combs et al., 2011a, Jambulingam and Nevin, 1999), and is one of the key resources that franchisees bring to the franchise system (Oxenfeldt, 1968). Since franchisees in a franchised outlet must develop programs, execute strategies, and evaluate the performance, they need to possess the managerial capabilities and act in a managerial role in an outlet (Chandler and Hanks, 1994).

Several studies highlight the importance of the franchisee's management and its relation to performance (Combs et al., 2006, Shane and Hoy, 1996). A study by Merrilees and Frazer (2006) showed that there were significant differences between the franchisee with a high level of performance and a low level of performance according to differences in managerial capabilities. Peris-Ortiz et al. (2012) examined performance in franchising, and found that the management of franchises significantly affects the growth and profit of a firm. According to Combs and Ketchen (1999a), managerial actions are strongly related to the franchisee's performance.

Due to taking advantage of investing in a franchised outlet, those franchisees who have managerial capacity are likely to purchase a franchised outlet (Shane and Hoy, 1996). They do their business in different places and must be able to effectively manage and coordinate the outlet to enhance performance (Fenwick and Strombom, 1998). They have to allocate resources (Torugsa et al., 2012), delegate and manage employees (Chandler and Hanks, 1994) to perform better. The franchisee's managerial capabilities also help it to understand and motivate other staff in the outlet (Hofer, 1987).

Administration of an outlet and business functions are important factors in outlet performance, and depend on the franchisee's managerial capabilities (Chandler and Hanks, 1994). Managerial capabilities are unevenly distributed among firms and, at least with respect to superior managers, are often in short supply (Crook et al., 2011). The managers' role in planning, motivating, and coordinating the staff has been demonstrated as an influential factor in firm performance in many studies (Pizanti and Lerner, 2003b). In a franchise system, franchisees are responsible for outlet performance and must be able to coordinate all activities of the outlet (Chandler and Hanks, 1994), and monitor the day-to-day activities of the outlet. In dealing with a challenge, their decision-making ability given local knowledge affects performance (Macpherson and Holt, 2007).

In the RBV, managerial capabilities provide an outlet specific human capital which positively affects the firm's outcome and profitability (Ortiz-Walters and Gius, 2012). Managerial capabilities also affect the firm's strategies and consequently enhance its performance. The franchisee's managerial expertise accelerates growth to reach minimum efficient scale and also builds brand name capital for the system (Hsu and Jang, 2009). Therefore, having managerial capabilities helps the franchisee to effectively and efficiently lead the firm to better performance (Merrilees and Frazer, 2006, Jambulingam and Nevin, 1999). Thus, this research proposes:

Hypothesis 4<sub>2</sub>: The franchisee's human capital, representing managerial capabilities positively affects the outlet's performance.

### **Franchisor- related factors in franchisee's performance:**

In a partnership, a firm usually chooses another firm with specialized resources that are not available from others (Ireland et al., 2002). Access to complementary resources makes it possible for a firm in a partnership to gain economies of scope, create synergies, and develop new resources and subsequent skills (Ireland et al., 2002). Consequently, a partnership develops new competitive advantages for firms and create more value for them (Ireland et al., 2002).

Because of their unique responsibilities and the decision right between the franchisor and the franchisee, this kind of interfirm cooperation is different than that found in joint ventures, coalitions and so on (Combs et al., 2004c). The franchisor is usually responsible for setting the standards, selecting the franchisees, approving the outlet locations, and managing the trademark. A franchisor also coordinates activities such as purchasing, where scale economies are available (Caves and Murphy, 1976). The franchisees, on the other hand, are responsible for establishing the local outlets, setting the local policy such as pricing, hours, and staffing, and managing daily operations (Combs et al., 2004c). Table 2-1 illustrates the services provided by franchisor as found in the literature.

Franchisor's and franchisee's performance are interdependent (Davies et al., 2011). The franchisor in a franchise system should provide initial and ongoing support for the franchisee (Minguella-Rata et al., 2012). Services and support provided by the franchisor have a significant role in a franchisee's success and performance (Michael and Combs, 2008, Chaudey and Fadaïro, 2008), and a franchisor with well-developed start-up support services is more likely have a successful franchised outlet (Frazer, 2001). Given the importance of context for entrepreneurs, the franchisor is considered as a key dimension of the context for a franchisee (Falbe et al., 1999), and the greatest impact on franchisee performance relates to the ongoing support services provided by the franchisor (Brookes, 2014, Minguella-Rata et al., 2010).

A franchisor's support in a franchise system entails a wide range of services. Morrison (1996b) has referred to promotion and advertising, training, technical and day-to-day support, and work hours expected as the franchisor's functions in the franchising

system. According to Hollensen (2007), the franchisor offers services that contain trademarks/trade names, copyright, designs, patents, trade secrets, business know-how, geographic exclusivity, design of the store, market research in the area, and location selection. As reported by Grunhagen et al. (2008), the franchisor's responsibility in this relationship includes a variety of functions such as franchisee training, field visits, internet services, staff training, newsletters, software ordering, telephone assistance, national conferences, market analysis, franchise councils, point of service, insurance offers, and centralized booking.

Table 2-1: Services provided by franchisor in a franchise system

Authors	Provided services
Caves and Murphy (1976)	Set standards, helping in outlet locations, manage trade marks , and coordinates activities such as purchasing
Brickley and Dark (1987)	Monitor quality, provide concentrated national advertising and present training and managerial services to franchisees
Hollensen (2007).	Trademarks/trade names, copyright, designs, patents, trade secrets, business know-how, geographic exclusivity, design of the store, market research for the area, and location selection
Kaufmann and Stanworth (1995)	Promotion of the product and trademark, set the quality standards
Combs and Ketchen (2003)	Promotion of the product and trade mark , set the quality standards
Olsen and Roper (1998)	Enhance the value of the chain
Morrison (1996a)	Promotion and advertising, training, technical and day-to-day support, and work hours are expected as the franchisors' functions in a franchising system
Grunhagen et al. (2008)	Franchisee training, field visits, internet services, staff training, newsletter, software ordering, telephone assistance, national conference, market analysis, franchise council, point of service, insurance offers, and centralized booking
Hing (1995)	Initial support services and ongoing support services Initial services include initial training and help with site selection, facility design, purchasing necessary equipment, and raising business finance. Ongoing services include help with the operations manual, ongoing training, purchasing supplies, national marketing, local marketing, accounting, employee training, advice, consultation and field visits, management services at the head office, performance monitoring, and access to the franchisee advisory council.
Roh and Yoon (2009)	Pre-opening stage and ongoing support stage Pre-opening services include meeting with the franchisee and explaining the cooperation conditions, to include financial issues, renewal, termination, and dispute resolutions. Also includes learning the basic skills and management training and providing information about daily operations in another successful outlet Ongoing services include central purchasing as well as congeniality (communication) for improving strategies, problem solving and promoting the innovation, and reducing conflicts. Also includes business assistance such as for improving the brand, offering the new marketing analysis, target market analysis, sales forecast and analysis, new product development, and product improvement.

Hing (1995 and 1996) divide the franchisor’s services into two main parts, initial support services, and ongoing support services. The initial support in this categorization includes the initial training, help with site selection, help with facility design, help with purchasing necessary equipment, and help with raising business finance. Ongoing support services include the operations manual; ongoing training; help with purchasing supplies; help with national marketing; help with local marketing; help with accounting; help with



employee training; advice, consultation and field visits; management services at the head office; performance monitoring; and access to the franchisee advisory council.

Like Hing (1995), Roh and Yoon (2009) mention two stages for providing services for the franchisee, the pre-opening stage and the ongoing support stage. Pre-opening services include meeting with the franchisee and explaining the rights and responsibilities of both sides in the franchising system. They also include financial obligations, renewals, and termination and dispute resolutions. Moreover, franchisees in this stage learn the basic skills and management training. They will learn daily operations at other successful outlets.

Moreover, from a franchisee's view, there are some franchisor-related factors that affect the decision to engage in a franchise system, as well affect the franchisee's performance (Sivakumar and Schoormans, 2011). Several studies put emphasis on the importance of franchisor services in a franchisee's outcome (Chiou et al., 2004b, Combs et al., 2004b, Monroy and Aizola, 2005, Watson and Johnson, 2010). Michael and Combs (2008) examined why franchisees fail, and found that adopting the policies of the franchisor and investing in strategic resources increased the franchisee's chance of survival. Huang et al. (2007) also found that more support and assistance from franchisors lead the franchisee to better performance. Falbe and Welsh (1998) examined the franchisee's success by analyzing franchisee executives' perception system characteristics, and found the five factors of system quality, brand name, local environment, communication, and franchisee activities as influential in a franchisee's performance. Franchisor support, including training, efficiency of the operating system and brand name, are among the characteristics that affect the franchisee's performance (Ruiz-Ortega et al., 2013).

According to Tatham et al. (1972), a franchisor's demonstrated profitability, reputation, and progressiveness all have crucial roles in a franchisee's performance. Moreover, a franchisor's training program and recognized demand for the franchisor's product are other important criteria in the franchisee's performance. Morrison (1996b) studied 307 franchisees in the US in four industries (restaurant, business aid and service, automotive product and services, and non-food retailing) to develop a model for

franchisees' job satisfaction related to franchisor services. They found four major categories as the most beneficial elements in the franchisor package:

- 1- Name recognition, national awareness, and trademark
- 2- Technical support, training, and original start up assistance
- 3- Marketing support, good product, and advertising and market research
- 4- Purchasing discount, specific methods of operation, and preferential supplier treatment (Morrison, 1996b).

Brookes and Altinay (2011) believe that a franchising is a two-way communication between the franchisor and the franchisee. According to these authors, franchisees consider the following criteria as influential factor in their performance :

- 1- Franchisor ability to retain control of the portfolio
- 2- Franchisor ability to retain identity
- 3- Perception of mutual value/risk ,
- 4- Chemistry between individuals,
- 5- Similarity of organizational values and culture,
- 6- Providing resources to achieve objectives
- 7- Franchising reputation, and
- 8- Perception of a fair deal in partnership

In summary, in a franchise relationships, providing strategic resources by franchisor help the franchisees to improve their performance (Michael and Combs, 2008). Given the importance of the franchisor's services in the franchisee's performance, and after reviewing the literature, in this study franchising system profitability (Tatham et al., 1972), training (Falbe and Welsh, 1998), providing the raw material (Morrison, 1996b), advertising, and reputation (Morrison, 1996b, Huang et al., 2007) have been considered as most cited and important factors in a franchisee's performance for further examination.

#### 2.2.5 System profitability

As previously discussed, when engaging in a franchising system as a partnership, attention to the franchisor and franchise system characteristics is one factor that a franchisee should consider. However, since providing support services is costly for the franchisor, only profitable franchisors would be able to supply them to the franchisees

(Chaudey and Fadaïro, 2008). The franchisors' demonstrated profitability is one the most important criteria that affect the franchisee's performance, and the franchisee should pay attention to this (Tatham et al., 1972). Guilloux et al. (2004) found potential profitability along with franchisor support services as the most important criteria when selecting a franchisor.

Making relation-specific investments in a franchising system as an inter-firm relationship generates competitive advantage for the franchisee. Therefore, the franchise system profitability creates a relation-specific advantage for the franchisee and increases the probability of a franchisee surviving in the market (Liu et al., 2014) and consequently leads it to superior performance (Dyer and Singh, 1998). However, according to Lavie (2006), internal rent derived by the franchisee in a system depends on positive and negative complementarities with the shared and nonshared resources of a franchisor.

A franchise system with superior profitability will more likely be successful and positively affect the franchisee's performance. Therefore, regarding the interdependency of franchisor and franchisee performance (Davies et al., 2011), and considering the positive influence of franchisor performance on franchisee survival and performance (Michael and Combs, 2008), this research proposes the following hypothesis:

Hypothesis 5: Profitability of a franchise system affects the franchisee's performance.

#### 2.2.6 Training

Training is a significant feature of the services provided by a franchisor in a franchise system (Davey-Rafer, 1998). The franchisor's production system, marketing resources, organizational culture, and business management techniques are transferred to the franchisee through training (Dicke, 1992). The franchisee in a system receives continuous guidance and training (Marnburg et al., 2004, Davey-Rafer, 1998). While a lack of knowledge and experience can prohibit starting a new business, provided services and training make market entry possible for a potential franchisee (Frazer, 2001). The franchise system offers a relatively safe business model with significant embedded knowledge (delivered through training and information) for the franchisee as a small

business (Paswan et al., 2014). A franchisee is thus able to receive much-needed training that is not available when starting an independent business (Combs et al., 2011a, Bennett et al., 2010)

A franchisee is trained and taught to learn the technical expertise for doing business (Choo and Bowley, 2007). Although training is considered as one of the key elements in franchising, little is known about this area (Justis et al., 1991). While, inadequate training in a franchise system can cause deviation from the desired objective (Marnburg et al., 2004), the franchisor's investments in training improve the franchisees' chances for survival (Michael and Combs, 2008).

There are two major types of knowledge in a franchising system, tacit and explicit. Explicit (theoretical) knowledge refers to the know-what, which is related to the processes, formal written documents, and educational institutions about the franchising system. Practical and experienced-based knowledge (tacit knowledge) refers to the know-how, which is often non-codified components of activity, and comes from experience and internalized information (Davidsson and Honig, 2003). While tacit knowledge concerns well-practiced skills and routines, explicit knowledge is related to the development of facts and propositions (Nahapiet and Ghoshal, 1998). Tacit knowledge is different from explicit knowledge in three main areas: codifiability and transferring mechanism; method of acquisition and accumulation; and potential for aggregation and mode of appropriation. While explicit knowledge can be easily codified, stored, communicated and understood, tacit knowledge is action-oriented and difficult to formalize and communicate. Transfer of tacit knowledge needs close interaction to create a shared understanding. Explicit knowledge can be gained by formal and informal education, but tacit knowledge can be learned just through practical experience in a real context. Finally, while explicit knowledge can be aggregated in a single location, tacit knowledge is contextual, personal, and difficult to aggregate. Tacit knowledge requires close involvement and cooperation with a knowing subject (Lam, 2000).

Given the nature of knowledge, different training tools are used to transfer it (Subramaniam and Venkatraman, 2001). The explicit knowledge of a firm can be easily imitated, and a franchisor can use operations manuals to transfer explicit knowledge to the franchisee (Barthelemy, 2008). Therefore, explicit knowledge can hardly be considered as

a source of competitive advantage (Luthans and Youssef, 2004). On the other hand, a franchisor can use face-to-face training to transfer tacit knowledge (Barthelemy, 2008). Tacit knowledge is valuable, and because of being difficult to formalize and transfer, procedural knowledge can be considered as a rare and inimitable resource. Tacit knowledge as an intangible resource is embedded in an organization, and it is very difficult for competitors to transfer or duplicate it (Luthans and Youssef, 2004). The intangibility of system-specific resources will reduce the risk of imitation and positively affect the franchisee's performance (Gorovaia and Windsperger, 2013).

A franchisor will be able to exert control over the franchisee through training. Training also helps to transfer the franchisor's culture to the franchisee and affect the franchisee's performance as well as profitability (Paik and Choi, 2007). Training increases the franchisee's skill-sets, motivation, productivity and knowledge transfer (Choo and Bowley, 2007). Further, a well-trained franchisee positively affects the whole system's performance (Choo and Bowley, 2007). In a service industry such as restaurants, training is necessary for: facilitating the transfer of specific knowledge (Combs and Ketchen, 1999b); transferring experience and confidence through training over time; and increasing productivity and improving the franchisee's performance (Merrilees and Frazer, 2006, Clarkin and Swavely, 2006).

Franchisors have tacit and explicit knowledge (Paswan et al., 2014). Training helps the franchisor to transfer its know-how about operations, managing the store and marketing and advertising, as an intangible resources, to a franchisee (Gorovaia and Windsperger, 2013). Learning the system's valuable knowledge and routines helps the franchisee to develop firm-specific human capital (Michael and Combs, 2008). Moreover, training impacts the franchisee's productivity, and through creating customer and employee satisfaction, enhances performance (Choo and Bowley, 2007). Thus, according to the relational view, the franchisor in a system, through training programs and by creating the franchisees' firm-specific human capital, affects the franchisee's performance (Michael and Combs, 2008). Therefore, this research proposes:

Hypothesis 6: The training program in a franchise system positively affects the franchisee's performance.

### 2.2.7 Providing the raw material

A franchisor in a franchise system provides a wide range of resources for the franchisee, including physical resources such as raw material and equipment. Raw material, because of its major role in cost and quality, is becoming strategically important in the fast-food industry (Ryder and Fearne, 2003). Indeed, supplying services for franchisees creates value for them (Baucus et al., 1993). In a franchise system, during the providing of raw material, franchisors provide value to franchisees by offering a consistent product or service (Baucus et al., 1993).

Engaging in a franchise system can help the potential franchisee to overcome resource scarcity and gain access to critical resources (Combs et al., 2004b). As stated in Cecil and Goldstein (1990), a strategy that improves the scale advantage will lead firms to superior performance, "for example, a centralized purchasing system that minimizes raw materials costs". According to the literature, the prices of the product and services as well as economies of scale are very important for a firm's competitive advantage. The franchisee in a system would be able to capitalize on advantages such as economies of scale in purchasing (Hmieleski et al., 2012). Economies of scale makes operations efficient for the franchisee (Hsu and Jang, 2009). It also provides cost minimization for franchisees (Paik and Choi, 2007), and helps them to compete effectively against more established firms (Merrilees and Frazer, 2006, Combs et al., 2011a). According to Michael and Combs (2008), economies of scale also reduces the probability of a franchisee's failure. In fact, offering economies of scale improves performance (Combs et al., 2004b), and consequently affects the profitability and success of the franchisee (Huang et al., 2007, Dant and Nasr, 1998).

Providing raw material through franchising can save time and increase speed, as well as add value for the franchisee (Preble and Hoffman, 1998). In Ryder's (2003) view, speed, cost, and services are competitive advantages for food sector firms. Moreover, according to Preble and Hoffman (1998), speed is one of the influential factors that, by creating added value, leads a firm to competitive advantage.

The franchisor exerts control over suppliers and develops consistency over the end products throughout the system (Paik and Choi, 2007). It provides value to the franchisees

by offering consistent raw materials and/or service (Baucus et al., 1993). Consistency in the quality of services has been considered an important criterion for consumers to trust a firm. Regarding the literature, consistency as well as quality in products and services in the food industry has an important role in leading a firm to competitive advantage (Aaker, 1989, Wu, 2010, Mamalis, 2009, Moonkyu and Francis, 1997). According to the literature, maintaining and improving quality in products and services by decreasing cost and price sensitivity leads firms to superior performance (Morgan and Piercy, 1996). Eventually, according to the franchisees in these systems, franchisors providing raw materials and equipment provide consistency in the quality of products and offered services, and help the franchisees to achieve competitive advantage. The franchisor providing raw material also reduces supply uncertainty (Watson and Stanworth, 2006). Therefore, by supplying the raw material, the franchisor, through increasing the speed in the franchisee's business, creating economies of scale, and providing consistency in product quality, affects the franchisee's performance. Consequently, this research proposes:

Hypothesis7: The franchisor, by providing the raw material, affects the franchisee's performance.

#### 2.2.8 Advertising

In a franchising system, customer demand in a market depends on the promotional activities of the franchisor and franchisees (Hempelmann, 2006). Entering into a franchise system brings several advantages for a franchisee, including cooperative advertising programs offered by a franchisor (Herrington, 2005). While a franchisee is responsible for advertising in the local market, the franchisor is responsible for the national advertising (Hempelmann, 2006). However, a franchisor sometimes charges an advertising fee to cover the national advertising expenses (Desai, 1997). Advertising in the national media is very important in the services and retail trade industries. While a national advertising charge is a huge cost for franchisees, entering into a franchise system allows them to have effective advertising in the national media (Michael, 2003).

The effect of advertising on a firm's performance has been studied extensively (Peterson and Jeong, 2010, Wang and Zhang, 2008). According to the literature, marketing-related activities can enhance firm performance (e.g., Krasnikov and Jayachandran, 2008, Srinivasan and Hanssens, 2009). In their study, Peterson and Jeong

(2010) found larger advertising expenditures were related to larger firm-level financial performance. In a meta-analysis by Capon, Farley, and Hoenig (1990) (As cited in Madanoglu et al., 2011), advertising intensity was found to be a key variable that correlates to performance. Advertising can affect the firm's value in two ways: the effect on firm value (Joshi and Hanssens, 2010) and the effect on the firm sale (Wang and Zhang, 2008). It is also generally accepted that advertising improves the brand value (Li Li and Hean Tat, 2007).

In the franchising literature, research emphasizes the importance of advertising. According to Doherty and Quinn (1999) and Hodge et al. (2013), advertising in a franchise system is strongly related to the franchisee's success. Srinivasan (2006) found advertising as one of the important factors that significantly affects performance in the franchising system. Franchisees also associate advertising with their own individual success (Doherty, 2007, Hodge et al., 2013).

Priority in the criteria for selecting the franchisor has shifted to advertising (Guilloux et al., 2004), and the importance of it in creating value (Lee et al., 2015) in the restaurant industry has increased advertising expenditures (Andrejeva et al., 2011). Promotional activities are one of the important tools for enhancing sales and service recognition in a market (Lee et al., 2015), especially in a restaurant (Hsu and Jang, 2008). According to previous studies, the effects of advertising on performance are industry specific (Sorenson and Sorensen, 2001). Although advertising in some industries has a positive short-term effect on sales growth, in restaurant firms that use franchising it has long-term positive effects (Lee et al., 2015). Therefore, advertising costs in restaurant franchising should be considered as an investment (Lee et al., 2015). Since the restaurant industry is relatively hostile, it can play an important role in a franchisee's activities (Michael, 2003).

According to Hempelmann (2006), advertising by both the franchisee and franchisor is necessary to achieve any sale, and the franchisees can achieve even higher margins than the franchisor. Michael and Combs (2008) believe that the franchisor's investment in advertising in restaurant chains improves the franchisees' chances for survival. For the franchisee as a small business, achieving economies of scale is necessary to perform successfully (Vazquez, 2009) and compete effectively against more established



firms (Combs et al., 2004c). Franchisors provide effective materials for advertising and promotional materials, and bring the advantage of economies of scale to the franchisee. Economies of scale in national advertising can reduce the franchisee's cost and improve its performance (Combs et al., 2004b, Combs et al., 2011a).

Given the franchisors' experience in the business, they know the most effective advertising strategies, and are able to coordinate promotional activities and develop a more consistent brand image throughout the system (Bradach, 1997). According to Herrington (2005), advertising effects in restaurant chains are passed on to all outlets. The franchisee is also able to use this promotional material in the local media with lower cost than the national advertisers (Herrington, 2005). Therefore, advertising in a franchise system can lower the cost of sales, create price premiums, generate competitive barriers, and consequently increase a firm's cash flows and intangible value (Hsu and Jang, 2009). It also positively affects the franchisee's attitude toward the franchisor (Merrilees and Frazer, 2013), reduces its uncertainty and motivates it to perform better (Sorenson and Sorensen, 2001). Brand-based advertising can also create a comparative advantage for a franchisee and help it to differentiate its product (Li Li and Hean Tat, 2007). Advertising as well can create an intangible market-based asset for the franchisee and enhance its performance (Peterson and Jeong, 2010). Accordingly, this research proposes:

Hypothesis8: Advertising in a franchise system positively affects the franchisee's performance.

#### 2.2.9 Brand

According to the literature, in business format franchising, the franchise package essentially contains a brand name (Barthelemy, 2008). Entering into a franchise system and doing business with a well-known brand name (Herrington, 2005) is the most significant advantage for a potential franchisee (Merrilees and Frazer, 2013). In a franchising system, a franchisor promoting the brand name provides brand recognition for potential unknown franchisees. Positive effects of investments by the franchisor in the brand are passed on to all franchisees in a system (Michael and Combs, 2008).

Although branding plays an important role in franchising, the literature rarely discusses it (Merrilees and Frazer, 2013). The restaurant industry is one of the most

competitive (Vukasovič, 2012), and one in which brand reputation is significantly important for a firm's competitiveness (Perrigot et al., 2012). In the restaurant as an experiential service industry (Nayyar, 1990), brand reputation has a very important influence on the buyer's first-time purchasing (Combs and Ketchen, 1999a). Moreover, in the restaurant industry, because of mobility of customers among geographic areas (Combs and Ketchen, 1999a), the brand name serves as a signal and reduces the costs of searching unfamiliar retail markets for customers (Baucus et al., 1993, Felício et al., 2014b). According to Rajagopal (2007), performance of the franchisee in the restaurant industry depends on the outlets' brand, and brand reputation affects market share and financial performance (Felício et al., 2014b). The brand is a valuable resource that affects long-term success in the restaurant industry (Combs and Ketchen, 1999b). It also shapes the franchisee's perception and behavior (Guilloux et al., 2004).

It is widely accepted that brand reputation plays an important role in a firm's profitability and success (Veloutsou and Moutinho, 2009). Brand name as an intangible resource for value creation is a predictor of ROA (Aaker and Jacobson, 2001), and significantly contributes to firm performance (Felício et al., 2014b, Combs and Ketchen, 1999b). Brand reputation in a franchise system is a key element of competence (Davies et al., 2011). It reduces uncertainty for the customer, thus making it costly for competitors to attract them (Combs and Ketchen, 1999b). While market awareness is one of the biggest obstacles for starting a small business (Herrington, 2005), joining a franchise system with a well-established brand name, brings the advantage of a competitive franchise system for the potential franchisee (Chiou et al., 2004a). Indeed, the franchisor brand name is a complementary resource for the franchisee. From a strategic perspective (Amit and Schoemaker, 1993), brand reputation is difficult to imitate, creates loyalty and makes barriers to entry for others; consequently, it positively impacts sales growth (Felício et al., 2014b) and leads the franchisee to superior performance (Li Li and Hean Tat, 2007, Barthelemy, 2008, Gorovaia and Windsperger, 2013). It also can be considered as a factor for differentiation of the franchised outlet (Felício et al., 2014b, Zachary et al., 2011). Therefore, this research proposes the following hypothesis

Hypothesis9: The franchisor's brand reputation positively affects the franchisee's performance.

### **Relationship factors in franchisee's performance:**

Franchising is viewed as a form of relational exchange (Watson and Johnson, 2010). Complexity and "continual metamorphosis" in a franchise system increase the need for studying the relationships in that system (Davies et al., 2011). The quality of the relationship between the franchisor and the franchisee (Baucus and Baucus, 1996) affects the franchisee's performance in a franchise network as a model of interorganizational cooperation (Victoria Bordonaba-Juste and Polo-Redondo, 2008). Moreover, a strong relationship in a franchise system plays a crucial role in operations (Dant et al., 2013), survival and achieving better performance than a rival. Therefore, franchisors and franchisees need to cooperate and work closely together (Pizanti and Lerner, 2003b) to achieve long-term, profitable relationships (Victoria Bordonaba-Juste and Polo-Redondo, 2008).

Examining the link between performance and relationship has been extensively studied in earlier works in franchising (Huang et al., 2007). According to Holmlund (2008), interfirm relationships and their elements have a crucial role in the outcome of a business. As reported by Hunt et al. (2006), developing an efficient and effective relationship is one of the key factors that enables the parties to achieve superior performance, and both parties should look for a long-term relationship (Saraogi, 2009). The success of franchising systems depends on the strength of the franchising relationship, and it is considered as central to success in franchising (Watson and Johnson, 2010). According to Davies et al. (2011), unproblematic coordination and cooperation in franchising play a crucial role in a franchise's performance. Moreover, a disciplined relationship will maximize brand value and ensure consistency in product and service output (Davies et al., 2011).

Although in business format franchising the partners' relationship should be based on contractual requirements (Kidwell et al., 2007, Pizanti and Lerner, 2003a), the franchisee's perceived relationship value directly affects the behavioral outcomes (Chen, 2011). Franchisee behavior in a system is rather based on actual interactions than contractual requirements (King et al., 2013). If a franchisee perceives the value of the relationship imbalanced and is dissatisfied, it leads to conflict and poor performance

(Chen, 2011). In fact, by preventing conflicts and improving cooperation, the franchisee's perception of the relationship will positively affect the performance outcomes (Chen, 2011, Huang et al., 2007).

In summary, the quality of relationships, in franchising as a form of relational exchange (Watson and Johnson, 2010), affects the overall franchise performance (Liu et al., 2014). Facilitating a harmonious relationship between the franchisors and franchisees can enhance cooperation and positively affect performance (Falbe and Dandridge, 1992). Given the lack of research from the franchisees' point of view (Bordonaba-Juste and Polo-Redondo, 2008, Chiou et al., 2004a), and the role of the franchisee's perceptions of the relationship on franchise performance (Falbe et al., 1999, Kaufmann and Stanworth, 1995, Morrison, 1997, Spinelli and Birley, 1996), this research will examine the franchisee's perception of relationship and its effect on performance.

#### Relationship dimensions:

Previous studies suggest that the franchise relationship is impacted by several factors (Watson and Johnson, 2010). In most interfirm relationships, the quality of a relationship in a franchise system depends on the development of trust and satisfaction, as well as avoiding conflict (Yli-Renko et al., 2001, Davies et al., 2011, Dyer and Singh, 1998). Thus, this research adopts the well-accepted three-dimensional view of relational quality within the franchising context, namely trust, relationship satisfaction, and conflict (Dant et al., 2013, Moorman et al., 1992, Palmatier, 2008).

Given the relational exchange theory, franchisee trust in the franchisor's integrity significantly impacts a franchisee's behavior (Davies et al., 2011). Trust has been identified as a key factor in successful relational exchanges in a number of studies (Watson and Johnson, 2010). The franchisee's satisfaction in a relationship is another influential factor in behavioral attitude (Hing, 1995, Michael, 2003). The franchisee's satisfaction is a promising success factor for franchise systems (Saraogi, 2009). Satisfaction influences the performance of the franchised outlet (Hing, 1995) and can lead it to superior economic performance (Jambulingam and Nevin, 1999, Mellewigt et al., 2011). In addition to trust and satisfaction, several franchising studies have focused on conflict between franchisors

and franchisees as an influential factor in success (Huang et al., 2007). Therefore, conflict has been identified as the third factor that affects behavioral attitudes in franchising.

#### 2.2.10 Trust

Although a franchising contract governs the relationship between the franchisor and the franchisee, it is not sufficient to align the interests of the two. In fact, through a formal contract it is not possible for the partners to completely anticipate each other's undesirable behavior, and some relational forms of governance are needed (Cochet and Garg, 2008). Therefore, in addition to formal contracts, relational forms of governance can fulfill the governance of the relationship between the franchisor and franchisee (Davies et al., 2011).

Trust is one of the main dimensions of relationship quality in a franchising context (Dant et al., 2013). In a franchise system as an interfirm relationship, mutual trust between the franchisor and franchisee is important for them in performing their own tasks (Victoria Bordonaba-Juste and Polo-Redondo, 2008). Trust is an important factor in the franchising relationship (Merrilees and Frazer, 2006, Watson and Johnson, 2010), and encourages both parties to maintain and develop the relationship (Victoria Bordonaba-Juste and Polo-Redondo, 2008), work successfully (Eser, 2012) and achieve mutual profitability (Davies et al., 2011, Altinay and Brookes, 2012).

The issue of trust in an interfirm relationship has been widely studied in academic research in recent years (Eser, 2012, Croonen, 2010, Pinto et al., 2009). Trust in a relationship not only affects the interaction and coordination between parties; it also works as a precondition for superior performance and competitive success (Eser, 2012). It leads to cooperative behaviors, reduces uncertainty (Merrilees and Frazer, 2006), and helps the partners to enhance cooperation in a relationship (Ireland et al., 2002) and achieve competitive advantage (Barney and Hansen, 1994). Given the relational exchange literature, the lack of trust can be problematic to manage in the relationship between a franchisor and franchisee, and it can deteriorate their relationship (Eser, 2012). Therefore, both parties in a relationship have an interest to preserve or improve trust (Davies et al., 2011).

In the context of relational exchange, trust refers to “confidence in an exchange partner’s reliability and integrity” (Morgan and Hunt, 1994) and is a central determinant of co-operation. Moorman et al. (1993) define trust as "a willingness to rely on an exchange partner in whom one has confidence." Anderson and Narus (1990) define it as a "firm's belief that another company will perform actions that will result in positive outcomes for the firm as well as not take unexpected actions that result in negative outcomes." Mayer et al. (1995) define trust as “the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party” (p. 712).

Trust in a relationship can be distinguished between inter-personal and interorganizational levels of trust (e.g. Searle et al., 2011, Zaheer et al., 1998). Inter-personal trust depends on the direct interaction between the specific individuals, while interorganizational trust is based on the other party's actions and decisions that affect the relationship and mutual benefit (Croonen and Brand, 2013). Researchers also make a distinction between the truster and the trustee (Croonen and Brand, 2013). Since in a franchising context, the franchisee's trust in the franchise system is more important than the franchisee's feeling about the franchisor, this study focuses on interorganizational trust from the franchisee's (as a truster that has a certain degree of trust in the franchisor) perspective.

Franchising as a unique form of entrepreneurship is based on intra-organizational trust. Intra-organizational trust reduces the uncertainty that normally exists between independent entrepreneurs, and ensures mutual gain for the franchisors and franchisees (Davies et al., 2011). However, asymmetrical relationships in franchising have made the relationship in a franchise more complex. More franchisor power can be problematic, making the franchisee vulnerable to opportunistic behaviors by the franchisor (Croonen and Brand, 2013).

Davies et al. (2011) defined franchisees' trust as their acceptance in taking the risk with the franchisor and adjusting with vulnerability in their relationships with their franchisors. Following Croonen and Brand (2013), this research defines the franchisee trust as "the willingness of a franchisee to be vulnerable to the actions of its franchisor

based on the expectation that the franchisor will perform particular actions important to the franchisee, irrespective of the franchisee's ability to monitor or control the franchisor".

Several studies have focused on the importance of trust in performance, and suggested trust as a determinant of performance (e.g., Croonen and Brand, 2013, Bordonaba-Juste and Polo-Redondo, 2004). Zaheer et al. (1998) investigated 107 interfirm relationships to study the role of trust in interfirm exchange, and its effects on performance. Their results indicate that interorganizational trust has a link with performance. Bordonaba-Juste and Polo-Redondo (2004) studied 107 franchisors and 102 franchisees operating in the retail and the service sectors in the Spanish franchised distribution system. Their results showed that the partners' trust is the key variable for performance. Poe (1990) identified franchisee trust in the franchisor as an important attribute for a successful franchisee. Eser (2012), also found that a high level of trust in a relationship affects the franchisee's commitment. Lack of trust in a relationship, however, can cause a failure in the interfirm relationship (Ireland et al., 2002).

Mutual trust would lead the partners to cooperative behavior (Mayer et al., 1995), and a franchisee without trust in its franchisor may view all of the franchisor's actions as against their interests. This leads the franchisee to disagreement with the franchisor, and negatively affects their attitude and efforts to enhance the value in the outlet (Davies et al., 2011). Lack of trust also makes the franchisee more concerned about opportunistic behaviors with the franchisor, and increases the needs for safeguards against the franchisor (Corsten and Kumar, 2005). Consequently, it increases the probability of the franchisee's deviation from operational policies, free riding against the franchise system and even leaving the system (Davies et al., 2011).

The existence of trust causes partners to sacrifice short-term alternatives in favor of long-term benefits (Watson and Johnson, 2010). It affects the franchisees' attitude toward work provided by the franchisor (Chiou et al., 2004a) and improves cooperation between the franchisor and franchisee. Eventually, it prevents opportunistic behaviors (Gulati et al., 2000) and helps the partners to achieve long-term benefits. Davies et al. (2011) believe that a franchisee's trust in the franchisor affects the franchisee's compliance, and consequently the franchise's performance (Davies et al., 2011 ). Lack of trust weakens the attractiveness of reputation and jeopardizes the system's survival (Pizanti and Lerner,

2003b). It can also decrease sales, create problems in franchisee recruitment and eventually decrease the franchise's profitability (Croonen and Brand, 2013).

The greater the trust between partners, the more easily both parties will be able to reach their mutual objectives. Greater franchisee trust increases the relational rent and results in lower adaptation costs, lower re-contracting costs, and superior incentives for value-creation initiatives (Dyer and Singh, 1998). When franchisees trust in a the franchisor, they believe that the franchisor will not perform actions that will result in negative outcomes for the outlet, and it reduces the risk of opportunistic action by the franchisee (Cochet et al., 2008a). Avoiding opportunistic action (Cochet et al., 2008a), reducing the cost of monitoring and allowing the partners to integrate their "tacit resources and capabilities" affects the market performance (Gulati et al., 2000). Therefore, it is accepted that franchisee's trust has a positive influence on a market performance (e.g., Aulakh et al., 1996, Gulati et al., 2000, Davies et al., 2011, Robicheaux and Coleman, 1994). Given the above, this research proposes:

Hypothesis 10: Franchisees' trust in their franchisor positively affects with their performance.

#### 2.2.11 Satisfaction

It is vital for partners to develop and maintain a long-term relationship (Wang et al., 2015, Geyskens and Steenkamp, 2000). Satisfaction, as a fundamental element in the exchange relationship between two partners (Hutchinson et al., 2011, Spiteri and Dion, 2004), has a significant role in determining a long-term relationship (Wang et al., 2015). Satisfaction has been considered as a major dimension of relationship quality in many studies ( e.g. Homburg and Rudolph, 2001, Rauyruen and Miller, 2007, Zhang et al., 2011, Dant et al., 2013, Chen, 2011).

The level of satisfaction stems from the inter-organizational relationship, and plays a crucial role in analyzing the quality of relationships (Rodríguez et al., 2006). It is based upon the partner evaluation of all the aspects of a working relationship, including economic satisfaction and social satisfaction with another partner (Rodríguez et al., 2006).



Economic satisfaction in a relationship indicates the partner's perception of economic outcome derived from the relationship with its partner from consideration such as sales volume, margins, and discounts (Geyskens and Steenkamp, 2000). According to Geyskens et al. (1999), “an economically satisfied channel member considers the relationship to be a success with respect to goal attainment. It is satisfied with the general effectiveness and productivity of the relationship with its partner, as well as with the resulting financial outcomes” (p. 224). Social satisfaction is defined as a partner's a positive and effective reaction to the psychosocial element of its relationship, in that interactions with the exchange partner are fulfilling, gratifying, easy, and facile (Geyskens and Steenkamp, 2000). Satisfaction with social outcomes of the relationship take place when a partner “appreciates the contacts with its partner, and, on a personal level, likes working with it, because it believes the partner is concerned, respectful, and willing to exchange ideas” (Geyskens et al., 1999).

Literature on the exchange relationship has identified satisfaction as a fundamental dimension of a partner's attitude and behavior (Rauyruen and Miller, 2007, Spiteri and Dion, 2004, Hutchinson et al., 2011). In a relationship, satisfaction affects the partner's attitude and behavior and encourages it to participate in collective activities (Geyskens et al., 1999). Through the perception of parties' satisfaction, it is possible to guide behavior during future interactions (Davies et al., 2011).

Despite the many studies conducted on the relationship subject, there is no agreement on the relationship between satisfaction and performance. While some studies have proposed a weak relationship between satisfaction and performance, others have found stronger and more consistent correlations between the two under certain circumstances (Morrison, 1997). While research about franchising increased in recent years, just limited research has studied the franchising relationship, particularly from the franchisee's point of view (Hing, 1995). However, in a franchising system, it is widely accepted that the franchisee's satisfaction is a crucial element in the quality of the relationship (Chiou et al., 2004b, Watson and Johnson, 2010, Bordonaba-Juste et al., 2008, Combs et al., 2011a). After conducting a study, Walker (1971) found that the franchisee's satisfaction positively affects the income and total sales volume, and satisfied franchisees are more likely to achieve higher annual income and sales (As cited in Morrison, 1997).

Like Walker (1971), Morrison (1997) also indicates that satisfied franchisees are likely to be more profitable than dissatisfied ones.

Several studies, such as Hing (1995), Connell (1997), Davies et al. (2011) and Eser (2012), found franchisees' satisfaction as an important factor in the franchise's outcome, and an antecedent of the franchisee's performance. Cooperation and satisfaction in a relationship affect the partner's behavioral attitudes, and will lead it to superior performance in the long term (Hing, 1995). In a franchise system, the franchisee's satisfaction relies on its perceptions of factors that characterize the franchise system and directly concern the franchisees (Mellewigt et al., 2011). Following Dant et al. (2013), franchisee satisfaction, in this study, indicates the franchisee's positive affective response to cumulative assessments of prior interaction experiences with the franchisor. It can serve to create superior performance and thus a superior franchise system (Jambulingam and Nevin, 1999).

Satisfaction affects the franchisees' morale and behavioral attitudes, and motivates them to participate in collective activities (Geyskens et al., 1999). In fact, satisfaction in a franchise system enhances the franchisee's understanding of cooperation with the franchisor (Weaven et al., 2014) and leads them to achieve a long-term relationship (Mellewigt et al., 2011, Hing, 1995). Satisfaction also reduces the need for litigation and facilitates better relations (Weaven et al., 2014, Chiou et al., 2004a). Consequently, the franchisees have the potential to bring about certain benefits that can lead to sustained competitive advantage, increased customer satisfaction and market share, and greater profitability (Wang et al., 2015). Therefore, the satisfaction of the franchisee benefits the quality of the franchise relationship, and through positively affecting profitability and sales, enhances the performance of the franchised outlet (Harmon and Griffiths, 2008). Thus, this research proposes that:

Hypothesis 11: The franchisee's satisfaction in franchisor positively affects the franchisee's performance.

### 2.2.12 Conflict

Conflict between parties in a relationship has been extensively examined in previous studies in the relation exchange literature (e.g., Brickley and Dark, 1987, Combs and Ketchen, 1999a, Harmon and Griffiths, 2008, Dant et al., 2011). Since each party in a relationship has its own objectives and tries to maximize its goals, when a partner perceives the other partner's behaviors as against its effort to achieve its goal, a conflict appears (Rodríguez et al., 2006). In fact, conflict in a relationship will be manifested as a result of the divergence of goals and unpredictable contingencies in the relationships of exchange partners (Şengün and Wasti, 2011). Since conflict imposes social and economic costs (Weaven et al., 2014, Frazer et al., 2012), managing the conflict arising from a relationship has a crucial role in the parties' success (Davies et al., 2011). Disagreement affects each party's behavior (Spinelli and Birley, 1996) and damages the relationship. Therefore, conflict needs to be removed to lead the partners to a long-term relationship (Şengün and Wasti, 2011).

The partners' objectives rarely concur in franchising, and may lead to conflict (Cox and Mason, 2009). Like all commercial transactions between two firms, a franchising system is not immune to from conflict or disputation (Spinelli and Birley, 1996), and conflict often appears in the franchisor and franchisee relationship (Herrington, 2005). Despite paying attention to the detrimental effects of conflict in franchising performance in previous studies (e.g. Gassenheimer et al., 1996, Koza and Dant, 2007), there has only been limited investigation regarding the franchisee's perception of conflict in a system (Gassenheimer et al., 1996, Frazer et al., 2012) and the consequences of conflict (Weaven et al., 2014).

Conflict is inherent in franchising: on the one hand, the franchisor strives to add value to the system and benefit from royalties; on the other hand, franchisees are always looking for a way to increase the outlet's profit (Combs et al., 2004c). While the franchisor seeks to spread standardization in a system and look for a way to increase its control over the franchisee, franchisees strive to follow their entrepreneurial interests and personal objectives (Kidwell et al., 2007). Therefore, divergent goals of the partners in franchising may create a negative attitude in the relationship and give rise to conflict.

In summary, the franchisee's performance is affected by the degree of conflict in its relationship with the franchisor. According to (Morrison, 1997), conflict in a franchising system negatively affects performance, and positively affects the probability of negative franchisee exits (Frazer and Winzar, 2005). Conflict in a relationship likely increases the rising of "non-value-enhancing activities" and negatively affects performance (Zaheer et al., 1998). It intensifies destructive behaviors and jeopardizes the quality of the relationship in a franchising system (Frazer et al., 2012). It can also prevent collaborative activities among the partners and negatively affect the economic results (Rodríguez et al., 2006). Therefore, this research proposes that:

Hypothesis 12: The franchisee's perceptions of conflict in a franchise negatively affect its performance.

### 2.3 Holistic view:

Although research in franchising has been growing in recent years, most of them have adopted the franchisor's perspective, and there is a still lack of study on the franchisee's point of view. Franchisees play a crucial role in a franchising system and the consequences of franchising for the franchisee and studying the influential factors in its performance are important questions for the practitioner and scholars.

While in a franchising system three groups of the franchisor's related factors, the franchisee's related factors, and the relationship between the franchisee and franchisor might potentially affect the franchisee's performance, most of the studies have had an isolated approach. Motivated by filling this research gap, a holistic system approach has been used in this study to build a performance model and simultaneously examine those three factors in the franchisees' performance.

Combs et al. (2004c) state that researchers in a franchising context can benefit from greater theoretical diversity as it enables "researchers to view phenomena through multiple lenses and thus gain a richer understanding." Therefore, and following the main stream in the franchising literature, three perspectives - strategic management, entrepreneurship, and marketing - have been adopted to study the franchisee's performance.

After reviewing the theories concerning performance and the literature in the franchising context, four theoretical lenses - the RBV, the relational view, the relational exchange theory and the contingency theory - were introduced to integrate three major factors in the franchisee's performance. The resource-based view has drawn much attention from academics in strategic management to examine the performance differences in the firm. Therefore, the RBV has been used in this study to examine the role of franchisees' related factors in their performance. By considering franchising as an interfirm relationship, the relational view has been adopted to examine the role of the franchisor's related factors in the franchises' performance. In a franchising system, interaction between the franchisee and franchisor establishes a mutually beneficial relationship in which both parties, to achieve a fair outcome, adopt to each other. Therefore, the relational exchange theory has been introduced to find the role of the franchisees' perception of quality of relationship with the franchisor in their performance. Given the importance of the local market environment in the franchisees' performance, the contingency theory was introduced.

As is shown in Figure 2-1, given the strategic management and entrepreneurship perspective, as well as the resource-based view, four main variables, absorptive capacity, entrepreneurial orientation, social capital and human capital, have been extracted as the franchisees' related factors from the literature in a franchising context. Moreover, given the contingency theory, the two variables of environmental dynamism and environmental competitiveness have been introduced to examine the role of the local market environment in moderating the effect of absorptive capacity and entrepreneurial orientation on a franchisee's performance. Moreover, according to the relational view, five variables have been identified as franchisors' related factors: system profitability, training, providing the raw material by the franchisor, advertising, and brand reputation. From the marketing perspective, and considering the relational exchange theory, the three major factors of trust, satisfaction, and conflict between the franchisor and the franchisee have been found in the literature to help examine the role of perception of relationship in the franchisee's performance.

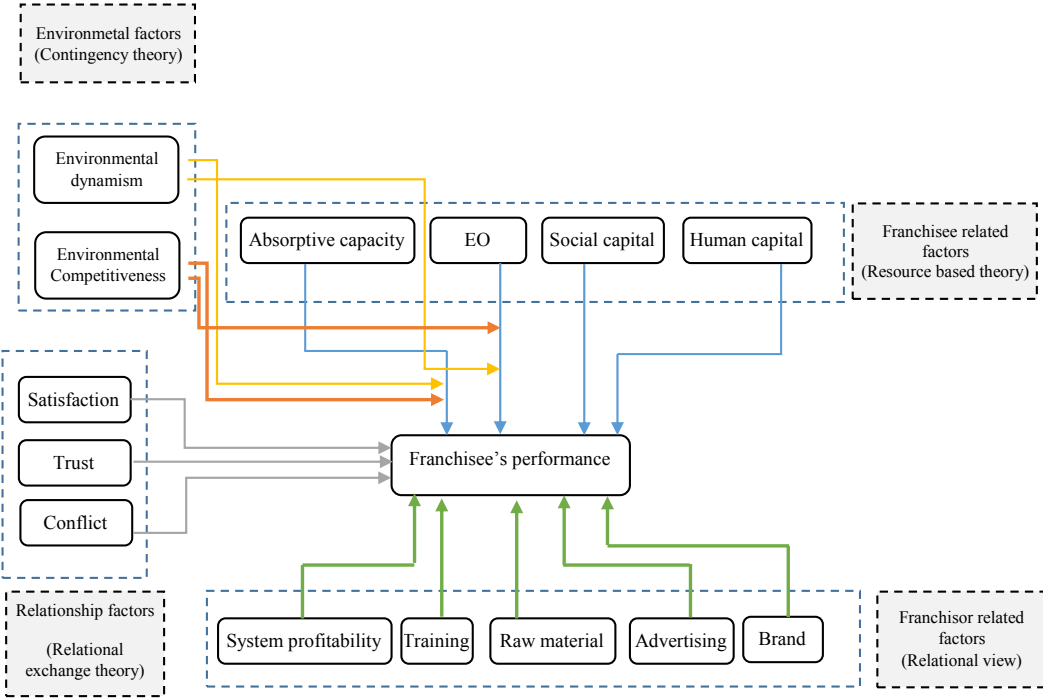


Figure 2-2: Research model







## Chapter 3: Research Methodology

*This chapter introduces the methodological consideration of the research, including research design, sample and data gathering, the measurements for all the constructs, and the analytical procedures used for reliability and validity. The first section of this chapter discusses the research design, including the strategy of inquiry and scientific paradigm. Next, the hypotheses are presented. Following that, each measurement of the independent, dependent, moderator and control variables are presented. Finally, non-response bias, common method bias, and statistical analysis are discussed.*

### 3.1 Research design

According to Creswell (2009), there are three major components involved in research: philosophical worldview (paradigm), strategy of inquiry, and research methods. Philosophical worldview is referred to "as a general orientation about the world and the nature of research that a researcher holds" (Creswell, 2009). It consists of post positivism, constructivism, pragmatism, and advocacy. Since this research has a deterministic philosophy in which causes probably determine the effects or outcomes, post positivism is the philosophical worldview. In this worldview, problems studied reflect the need to identify and assess the causes that influence outcomes.

Strategies of inquiry refer to the qualitative, quantitative, and mixed methods designs or models that provide specific direction for procedures in a research design. There are five strategies in social research, namely experiments, surveys, archival analysis, history, and case studies (Yin, 2008). Using each strategy in a research study depends on three conditions: forms of the research question, required role of behavioral events, and focus on contemporary or historical events. Since this study addresses the "what" questions, focuses on contemporary events and needs no control over behavioral events, a survey was used (Yin, 2008). Survey research is intended to provide a quantitative or

numeric description of trends, attitudes, or opinions of a population by studying a sample of that population (Creswell, 2008).

Although social research entails many purposes, exploration, description, and explanation are the most common (Babbie, 2001). Exploratory studies are extremely valuable in social research, and are used when a researcher's desire is to understand, to testify to the feasibility of a study, or to develop the methods for application in any study (Babbie, 2001). Since this study's problem calls for the identification of factors that affect an outcome, the quantitative approach is the most favorable (Creswell, 2008). As this study strives to explain the cause and effect relationship between variables, the quantitative approach is used to explain and interpret quantitative results.

There are two major research approaches, deductive and inductive (Parkhe, 1993). In deductive research, a hypothesis is drawn from existing theory and then data are collected to test the hypothesis (O'Reilly, 2009). With inductive research, the researcher begins with empirical data and then allows theory to emerge from the data (O'Reilly, 2009). In summary, the deductive approach involves reasoning from the general to the particular, while the inductive approach involves reasoning from the particular to the general (Nickerson, 2010). In this study, the theory, and literature on franchising, entrepreneurship and small businesses are first reviewed, and then, given the franchising context, the hypotheses are extracted. Therefore, in this study the deductive approach has been followed.

3.2 Hypotheses:

According to prior research on the franchising context and after reviewing the literature, the major influential factors in a franchisee's performance have been divided into three sections: the franchisor's related factors, the franchisee's related factors, and the quality of the relationship between them. Then, hypotheses in the research are drawn and tested in each section. All hypotheses are summarized in the following table (Table 3-1).

Table 3:1 Research hypotheses
<b>Hypotheses addressed in the franchisee-related factors:</b>
Hypothesis 1: Franchisee's absorptive capacity positively affects its performance.
Hypothesis 1 <sub>1</sub> : The greater the environmental dynamism, the greater the impact of ACAP on franchisee performance.
Hypothesis 1 <sub>2</sub> : The greater the environmental competitiveness, the greater the impact of ACAP on franchisee's performance.
Hypothesis 2 <sub>1</sub> : Franchisee's Schumpeterian EO positively affects its performance.
Hypothesis 2 <sub>2</sub> : Franchisee's Kirznerian EO positively affects its performance.
Hypothesis 2 <sub>3</sub> : Environmental dynamism will moderate the relationship between the franchisee's Kirznerian EO and performance. A franchisee with higher Kirznerian EO performs better in a more dynamic environment.
Hypothesis 2 <sub>4</sub> : Environmental dynamism will moderate the relationship between the franchisee's Shumpeterian EO and performance. A franchisee with higher Shumpeterian EO performs better in a more dynamic environment.
Hypothesis 2 <sub>5</sub> : Environmental competitiveness moderates the relationship between the franchisee's Shumpeterian EO and performance. The franchisee with higher Shumpeterian EO performs better in a more competitive environment.
Hypothesis 2 <sub>6</sub> : Environmental competitiveness moderates the relationship between the franchisee's Kirznerian EO and performance. A franchisee with higher Kirznerian EO performs better in more competitive environment.
Hypothesis 3: The franchisee's level of social capital positively affects its performance.
Hypothesis 4 <sub>1</sub> : The franchisee's human capital, representing tacit and explicit knowledge, positively affects the performance.
Hypothesis 4 <sub>2</sub> : The franchisee's human capital, representing managerial capabilities, positively affects the outlet performance.
<b>Hypotheses addressed in the franchisor-related factors:</b>
Hypothesis 5: Profitability of a franchise system, affects the franchisee's performance.
Hypothesis 6: The training program in a franchise system positively affect the franchisee's performance
Hypothesis 7: The franchisor, by providing the raw material positively affects the franchisee's performance.
Hypothesis 8: Advertising in a franchise system positively affects the franchisee's performance.
Hypothesis 9: franchisor brand reputation positively affects the franchisee's performance.
<b>Hypotheses addressed in the relationship between the franchisee and franchisor:</b>
Hypothesis 10: Franchisee's trust positively affects its performance.
Hypothesis 11: Franchisee's satisfaction with the franchisor positively affects the performance.
Hypothesis 12: The franchisee's perceptions of conflict in a franchise negatively affect its performance.

### 3.3 Population data and sampling:

Given the review of the theoretical background and of the literature, this study carries out empirical research to examine the research model in the fast-food industry in Iran and Sweden. Fast-food franchising systems have been frequently utilized for empirical studies within the franchising research (e.g. Paik and Choi, 2007, Pizanti and Lerner, 2003b, Dant and Kaufmann, 2003, Kamal and Wilcox, 2013, Eser, 2012, Ramírez-Hurtado et al., 2011, Merrilees and Frazer, 2006, Pizanti and Lerner, 2003a) .

The primary means of data collection in this study involves a mailed and emailed questionnaire of franchisees in Sweden and Iran, with a focus on franchisees in the fast-food service industry. Although focusing on a single industry limits the generalizability of the findings, it reduces the artifactual statistical heterogeneity associated with sampling from multiple populations (Dant and Kaufmann, 2003). Data were drawn from a single industry for two reasons. First, the restaurant industry is the largest industry that uses business-format franchising; in fact, franchise chains account for 47 percent of all sales of food (Michael, 1996). Second, confining the study to a single industry controls industry-specific factors that affect the firms' conditions (Michael and Combs, 2008). In the case of the present study, the cases were randomly selected. The sampling in this study consisted of the franchisees in business-format franchising. Business format franchising involves a complete business context rather than a single product or trademark (Hoffman and Preble, 2003).

Although the first fast food outlet was introduced in the 1960s in Iran, the first fast food franchising system was developed in the late 1990s. Since then, fast food franchising has grown rapidly in Iran, where today there are more than 11 fast food franchise systems. The first fast food franchise system in Sweden was developed by McDonald's in Stockholm. Today, there are several fast food franchising systems in Sweden, including McDonald's, Burger King, Subway, Pizza Hut, Max, Sibylla, and Frasses. More than 110,000 employees work in franchise systems in Sweden.

### 3.4 Data Gathering

In this study, a franchisee questionnaire was developed based on an extensive review of the literature. Previously established scales were utilized to measure the study constructs whenever possible. The survey, originally developed in English, was translated into Persian and Swedish and then back-translated into English to avoid translation errors and to make sure that the intended meanings of the questions were maintained. The questionnaire was pre-tested with several faculty members to assure the appropriateness and consistency of the scale items. Based on feedback offered by those who examined the questionnaire, there were no significant changes made to the scale items. In addition, the questionnaire was also pre-tested with 23 franchisees to be assured that the questions were clearly understandable and not confusing.

A survey population was selected from the websites of the five major fast food franchises in Sweden, namely McDonalds, Burger King, Subway, Sibylla, and Frasses, and 11 franchise systems in Iran. These franchise systems in two countries captured a significant number of the total franchisees in the region, equaling 849.

A targeted sample in Iran consisted of 140 franchised outlets, and trained interviewers performed the survey. A total of 473 questionnaires were distributed to the franchisees in Sweden. Included with each questionnaire was a cover letter explaining the importance of the research and written instructions for completion of the survey. Following two reminders, a total of 65 usable questionnaires, comprising a response rate of 13.7 percent were returned in Sweden. Interviewers in Iran collected questionnaires from around 90 percent of those targeted, amounting to 126 usable questionnaires. The total response rate, 22.2%, compares favorably with other surveys of the franchisee business such as Dickey et al. (2008), who reported a similar response rate, about 13%, Chien (2014), who reported a 14.3% response rate with 99 franchisees, and Huang et al. (2007), who reported 14.4%. In addition, Zahra and Covin (1995) had 108 firms, Falbe et al. (1998) had a sample size of 50 participants, Zahra and Garvis (2000) had 98 firms, Combs and Ketchen (1999b) had 94 firms, Guilloux et al. (2004) had 84 franchisees, and Marnburg et al. (2004) study 48 franchisees in their studied as a sample size. Moreover, following Muthén and Muthén (2002), the size of sample in this study was 191 cases, which is substantially more than 150.

Moreover, about 26 questionnaires were returned undelivered due to reasons such as addressee not found, addressee has gone away, and outlets were closed down. In this study, as owners of the franchised outlet, the franchisees were asked to answer the questions as the most appropriate key informants (Dada and Watson, 2013) to provide the required information about the franchised outlet.

### 3.5 Sampling of location:

Target locations in Iran consisted of 23 provinces in which fast food franchise systems are active. There are 11 fast food franchise systems with almost 360 active franchised outlets in Iran. Target locations in Sweden were in all provinces, where almost 473 fast food franchised outlets are doing business under the five franchise systems.

### 3.6 Variables and measurements:

A franchisee questionnaire was constructed following an extensive review of the literature. Consistent with many scholars of franchising and small businesses, this research employed previously validated measures wherever possible, and most were re-worded to fit the franchising context. All measures were adopted from prior research and with the exception of demographic questions; all of the constructs were assessed using a seven - point Likert-type scale, with the exception of the demographic characteristics and performance.

The questionnaire in this study was divided into general questions and six main sections. General questions involved the demographic questions. Section 1 was related to the franchisor-related factors. The second and third sections were designed to measure the franchisee's related factors. Relations between the franchisor and franchisees were asked in the fourth section. The fifth section associated the environmental questions, and finally last section was related to the performance as the dependent variables. General questions included questions about the demographic characteristics of the franchisees. Questions about the franchisees' human capital were also asked in this section. Sections 1 included franchisor-related factors to measure system profitability, training, raw material provided by franchisor, advertising, and brand reputation. Section 2 and 3 included four parts to measure the absorptive capacity, entrepreneurial orientation, social capital, managerial capability. Section 4 was designed to measure the quality of the relationship between the

franchisee and the franchisor. This section included three parts to measure the trust, satisfaction, and conflict. Section 5 included environmental dynamism, and environmental competitiveness. The last part includes the franchisee's performance.

### 3.6.1 Measurement of franchisor-related variables (independent variables):

#### 3.6.1.1 System profitability:

According to previous studies franchise system profitability has been considered as one the most important factors that potential franchisees consider when selecting a franchise system (Tatham et al., 1972). Moreover, a franchise system with superior profitability will more likely lead the franchisee to success (Holmberg and Morgan, 2004a). To examine system profitability in this study, the franchisees were asked about the extent that the franchisor's business was profitable compared to similar franchises and other businesses in the industry.

System profitability was measured on a 7-point Likert-type scale ranging from

(1) = Strongly low to (7) = Strongly high

#### 3.6.1.2 Brand Reputation:

Adopted from Veloutsou and Moutinho (2009), brand reputation was measured in this research by an index of five items on a seven-point Likert scale. This study used two constructs to measure the franchise system reputation. The first was brand reputation, consisting of three items and the second sustainable image, consisting of two items (Veloutsou and Moutinho, 2009).

The respondents were asked to provide a rating for each of the following statements.

##### Brand Reputation

- This brand is trustworthy
- This brand is reputable
- This brand makes honest claims

##### Sustainable Image (Veloutsou and Moutinho, 2009)

- This brand has a long lasting nature

- In the past, today and in the future, the values behind this brand will not change
- Brand reputation was measured on a 7-point Likert-type scale ranging from (1) = Strongly Disagree to (7) = Strongly Agree

#### 3.6.1.3 Training:

In a service industry such as restaurants, training facilitates the transfer of specific knowledge (Combs and Ketchen, 1999b). According to Choo and Bowley (2007), a well-trained franchisee positively affects the whole system's performance. Adopted from Hing (1995) and Chiou et al. (2004b), franchisor training in this study was computed as the average of all the scales for items relating to the usefulness of training in personnel management, providing customer services, the franchisor's ongoing training for store operation, and training in managing the outlet advertising and promotions. The four following statements were used to measure the training:

- To what extent is franchisor training in personnel management useful?(Chiou et al., 2004a)
- To what extent is franchisor training in store operation useful for your personnel?
- To what extent is franchisor training in customer services useful for your restaurant
- To what extent is franchisor ongoing training in managing a store and services useful?

Training was measured on a 7-point Likert-type scale ranging from (1) = Strongly Low to (7) = Strongly High

#### 3.6.1.4 Providing raw material:

Raw material, because of its major role in cost and quality, plays a crucial role in the fast-food industry (Ryder and Fearn, 2003). The franchisor, by supplying services, creates value for the franchisee (Baucus et al., 1993), and helps it to take advantage of economies of scale. According to Cecil and Goldstein (1990), a strategy that improves the



scale advantage will lead firms to superior performance, "for example, a centralized purchasing system that minimizes raw materials costs".

Provided services of the franchise system are operationalized by the extent through which providing the raw material increases the franchisee's quality and speed and brings it the advantage of economy of scale. Three questions address the raw material in a franchising system:

- To what extent raw material provided by the franchisor is cheaper than others can offer.
- To what extent raw material provided by the franchisor helps you to provide product with high quality rather than others.
- To what extent raw material provided by the franchisor increases the speed in your business.

Providing raw material was measured on a 7-point Likert-type scale ranging from (1) = Strongly Low to (7) = Strongly high

### 3.6.2 Franchisee-related factors (Independent)

#### 3.6.2.1 Entrepreneurial orientation (EO):

Following Sundqvist et al. (2012), entrepreneurial orientation in this study is considered as a multi-dimensional construct entailing two main types: Shumpeterian EO, which includes risk taking, innovativeness and autonomy; and Kirznerian EO, which includes proactiveness and competitive aggressiveness. Therefore, EO was captured with the average of those features of entrepreneurial orientation that have the primary effect of performance (Eggers et al., 2012). The measures of EO were adapted from Hughes and Morgan (2007), Eggers et al. (2012) and Lumpkin and Dess (2001). The following 15 statements were used to measure the entrepreneurial orientation in this study:

#### **Risk taking:**

- People in our outlet are encouraged to take calculated risks with new ideas
- We, in our outlet, would rather accept a risk to pursue an opportunity than miss it altogether

- When confronted with decision-making situations involving uncertainty, my firm typically adopts a cautious, “wait and see” posture in order to minimize the probability of making costly decisions (Reverse coded)

**Innovativeness:**

- We actively introduce improvements and innovations in our business
- When it comes to problem solving, we value creative new solutions more than solutions that rely on conventional wisdom
- Our outlet tries to find new ways of advertising, customer relations, distribution and so on.

**Autonomy:**

- Employees perform jobs that allow them to make and initiate changes in the way they perform their work tasks
- We are pursuing business opportunities and make decisions on our own without constantly referring to the franchisor.
- We are given authority and responsibility to act alone if we think it to be in the best interests of the business

**Proactiveness:**

- We always try to take the initiative in every situation (e.g., against competitors, in projects and when working with others)
- We excel at identifying opportunities
- We initiate actions to which other organizations respond

**Competitive aggressiveness**

- Our business is intensely competitive
- In general, our business takes a bold or aggressive approach when competing
- We try to undo and out-manuever the competition as best as we can rather than to avoid competitive clashes

Entrepreneurial Orientation was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

### 3.6.2.2 Absorptive capacity:

Franchisees' abilities in the assimilation and exploitation of received external knowledge are different (Tsai, 2001), and all franchisees may not be able to exploit it. They need the absorptive capacity to learn from each other and apply it in their commercial ends (Tsai, 2001). To examine absorptive capacity, this study used the potential and realized absorptive capacity's dimensions that have been previously defined (Zahra and George, 2002). Items were based in particular on existing items regarding absorptive capacity and adopted from Jansen et al)2005( . :

- We have frequent interactions with the franchisor and other franchisee to acquire new knowledge.
- We periodically organize special meetings with customers to acquire new knowledge.
- We quickly analyze and interpret changing market demands.
- Employees record and store newly acquired knowledge for future reference.
- Our unit quickly recognizes the usefulness of new knowledge to combine with existing knowledge.
- Employees share their practical experiences.
- We constantly consider how to better apply new information into the business.
- We have difficulty implementing new products and services.(Reverse coded)

Absorptive capacity was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

### 3.6.2.3 Human capital

Education and training are the most widely accepted measures of human capital (Coff, 2002). In a meta-analysis about the relationship between human capital and success, (Unger et al., 2011), after reviewing 495 studies on the human capital subject, found that the most frequently employed indicators of human capital were education (used 69 times), industry-specific experience (22 times), management experience (21 times), and work experience (12 times). Vazquez (2009) also used general business experience, specific

industry experience, and level of education as measurements of human capital. In this study, adopted from Liao and Welsch (2003), Vazquez (2009), and Davidsson and Honig (2003), the following items are used to measure human capital:

- Pre-work in the fast-food industry
- Prior experience (pre-work) in the franchise system
- Education level (years of education)

Franchisees in the study were asked to indicate their highest level of education-representing explicit knowledge. To examine tacit knowledge, the franchisees were also asked their total years of full-time paid work experience in the fast-food industry and in a franchising system.

Moreover, the franchisees conduct business in different places and must be able to effectively manage and coordinate the outlet to enhance its performance (Fenwick and Strombom, 1998). Administration of an outlet and business functions is an important factor in outlet performance that depends on the franchisee's managerial capabilities (Chandler and Hanks, 1994). To operationalize the managerial capabilities, Fenwick and Strombom (1998) used four statements to measure the managerial capabilities in a franchised outlet. These statements originated from Chandler and Hanks (1994). Therefore, this study adopts the statements of Fenwick and Strombom (1998), in measuring the franchisee's human capital representative of managerial capabilities. The four following statements were used to measure the managerial capabilities in a franchised outlet:

- One of my greatest strengths is achieving results by organizing and motivating people.
- One of my greatest strengths is organizing resources and coordinating tasks.
- One of my greatest strengths is my ability to supervise, influence, and lead people.
- One of my greatest strengths is my ability to delegate effectively.

Managerial capability was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

#### 3.6.2.4 Social capital:

Establishing and developing relationships with customers, friends and acquaintances enables the franchisee to access key strategic information for the business (Hormiga et al., 2011). Impersonal and frequent relationships between a franchisee and customers, friends and relatives link them to a broad marketplace (Pirolo and Presutti, 2010). Adopted from Yli-Renko et al. (2001) and Pirolo and Presutti (2010), this study measured strong and weak ties of social capital between the franchise outlet and its customers, friends and partners by selecting the three following items:

- We obtain new contacts (customers, suppliers and employees) through our customer
- Our customer provided us with new contacts useful for the development of sale.
- We use our key industry friends and partners extensively to help us develop and market our products and services.

Social capital was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

#### 3.6.3 Factors associated with the relationship between the franchisor and the franchisee (independent variables)

##### 3.6.3.1 Trust

The instrument was developed to measure the franchisee's trust toward the franchisor with respect to four constructs. The trust construct has been used before in several studies, for example by Zaheer et al. (1998). This study adapted the statements of Dant et al. (2013) to measure trust in the franchise setting:

- I can count on my franchisor to be honest in its dealings with me
- I can rely on my franchisor to keep the promises they make to me
- My franchisor is sincere in its dealings with me
- My franchisor can be counted on to do what is right
- My franchisor is a company that I have great confidence in

Trust was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

#### 3.6.3.2 Satisfaction:

The satisfaction construct was measured with a three-item scale, which was adopted from Dant et al. (2013) . The following statements were used to measure the satisfaction:

- Overall we consider our relationship with the franchisor to be: satisfying
- Overall we consider our relationship with the franchisor to be: friendly
- Overall we consider our relationship with the franchisor to be: fair

Satisfaction was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

#### 3.6.3.3 Conflict:

The conflict construct was indicated by three items adopted from Davies et al. (2011), based on the same extant measures from Kumar et al. (1992):

- My relationship with the franchisor can be best described as tense. (Revers coded)
- The franchisor and I have significant disagreements in our working relationship.
- The franchisor and I frequently agree on issues relating to how I should conduct my business. (Revers coded)

Conflict was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

### 3.7 Performance (Dependent variables)

One of the major challenges and problematic issues in the franchising research relates to the financial implications and knowing the franchisees' performance data (Combs et al., 2011a, Huang et al., 2007). The dimensions of performance in business studies include objective performance and subjective performance (e.g. Sorenson and

Sorensen, 2001, Combs et al., 2004a, Combs et al., 2011a, Kidwell et al., 2007). According to the previous literature, there is a strong correlation between objective and subjective performance indicators (Gorovaia and Windsperger, 2013). Consistent with Wiklund and Shepherd (2005, p. 80), this study assumed that "performance is multidimensional in nature, and it is therefore advantageous to integrate the different dimensions of performance in empirical studies". Thus, both financial and non-financial items of performance outcomes were designed to regarding the perception of the respondent (Dada and Watson, 2013) objectively measure the performance. In fact, performance was measured by the objective self-perception of performance as reported by the franchisees. Previous studies have supported the effectiveness and usefulness of using objective perceptual performance in franchising, entrepreneurship and strategic management (Yoo et al., 2012, Keh et al., 2007, Dada and Watson, 2013, Chien, 2014, Megicks and Warnaby, 2008, Kreiser et al., 2013, Simsek and Heavey, 2011, Li et al., 2009b, Wiklund and Shepherd, 2003, Lumpkin and Dess, 2001).

Therefore, performance was measured using items that asked respondents to compare their franchised outlet with competitors in four statements. Adopted from Keh et al. (2007) and Dada and Watson (2013), the following statements were presented to the franchisees to compare their results to those of their competitors:

- Net profit (i.e. sales minus operational costs)
- Development of sales (i.e. change or growth in the volume of sales)
- Cash flow (i.e. inflows vs. outflows of money)
- Growth of the company's value

Performance was measured on a 7-point Likert-type scale ranging from

(1) = Strongly worse to (7) = Strongly better

### 3.8 Control variables:

To examine the franchisee's performance and strengthen the empirical data, this study included a set of control variables for possible spurious effects. Age and the business sector of the chain may demonstrate different characteristics, which in turn may influence

the franchisee's performance (Mellewigt et al., 2011, Bradach, 1997, Dant and Nasr, 1998). According to Jambulingam and Nevin (1999), the length or age of a franchised outlet may have a significant effect on the outcomes of franchisees due to experience effects. This study was conducted in two different countries. Country characteristics, including political, economic, and institutional characteristics, are an important component in understanding firm performance (Goldszmidt et al., 2011). Therefore, in this study, and consistent with the previous franchising research (Yang and Li, 2011, Falbe and Welsh, 1998, Dada and Watson, 2013), the business sector, the franchisee's business age, and the country effect were controlled to make sure that the model was properly specified, and to allow for explanations of variations in the performance of the franchised outlets.

In the data gathering step, by focusing on the fast-food industry as a single industry, this study controlled the effect of industry technology and market demand (Michael, 2009) in a franchisee's performance. Moreover, business age and country effect are controlled in the analysis section by entering them into a multiple regression model.

### 3.9 Moderator variables:

#### 3.9.1 Environmental dynamism:

The scale for environmental dynamism is measured by the rate of change and the instability of the external environment. Adopted from Jansen et al. (2006), which was based on Dill (1958), Volberda and Van Bruggen (1997) (As cited in Jansen et al., 2006), the following statements were used to measure the environmental dynamism:

- Environmental changes in our local market are intense.
- Our clients regularly ask for new products and services.
- In a year, nothing has changed in our market.
- In our market, the volumes of products and services to be delivered change fast and often.

Environmental dynamism was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree



### 3.9.2 Environmental competitiveness

Environmental competitiveness is measured by the extent to which a unit's external environment is characterized by intense competition. Adopted from Jansen et al. (2006), which was based on Birkinshaw et al. (1998) and Jaworski and Kohli (1993) (As cited in Jansen et al., 2006), the following statements were used to measure the environmental competitiveness.

- Competition in our local market is intense.
- Our organizational unit has relatively strong competitors.
- Competition in our local market is extremely high.
- Price competition is a hallmark of our local market.

Environmental competitiveness was measured on a 7-point Likert-type scale ranging from

(1) = Strongly Disagree to (7) = Strongly Agree

### 3.10 Franchisees' perception:

As previously mentioned, despite the importance of the franchisee's point of view, most of the studies about franchising concentrate on the franchisors (Grunhagen and Dorsch, 2003, Peterson and Dant, 1990). Therefore, given the crucial role of franchisees in a franchise system, more knowledge about the perceptions of the franchisee is needed (Felicio et al., 2014b, Watson, 2008, Ribeiro and Akehurst, 2014, Burkle and Posselt, 2008, Harmon and Griffiths, 2008). Thus, franchisees, as the owners of the franchised outlet, are the most appropriate key informants to provide the required information. In line with previous studies (e.g. Watson, 2008, Felicio et al., 2014b), this study assumes that the franchisees' perception of the factors that make a franchised outlet succeed or fail are very important, and the study is based on the perceptions of the franchisee.

### 3.11 Non-response bias

According to Mentzer (2008), one of the main goals of research in a business study is to maximize the generalizability. To generalize the result of a study, researchers need to ensure that the samples correctly represent the population. Therefore, there is a need for

researchers to assess the possibility of non-response bias (Beuckelaer and Wagner, 2012, Clotey and Grawe, 2014).

As mentioned earlier, since samples were selected by simple random sampling and interviewers collected data from Iran, non-response bias is not an issue in interpreting the findings of the study. To assess the non-response bias in Sweden, the returned questionnaires were divided into two sections: the questionnaires received before the reminder and those received after it. A non-response analysis was conducted by comparing early versus late responses, with late respondents being assumed to be similar to non-respondents (Simsek et al., 2007). According to the test, there were no statistically significant differences in the mean responses for the constructs that were measured in the study (Simsek et al., 2007). Thus, it seems that a non-response bias is not an issue in interpreting the findings of the study.

### 3.12 Common method bias:

Reliance on the franchisees as single respondents may cause a common method bias in this study. Common method bias is “Variance that is attributable to the measurement method rather than to the constructs the measures represent” (Podsakoff et al., 2003, p 879).

Chang et al. (2010) recommend several remedies to avoid common method bias in surveys. As a remedy, the survey questionnaire should be carefully designed. Following Simsek et al., (2007), to minimize the biasing effects, all questionnaire items were carefully designed and pre-tested, and used valid multidimensional constructs. Using established multiple-item measures in this study has reduced the likelihood of respondents artificially inflating relationships among them (Simsek et al., 2007).

Moreover, as a “post hoc approach”, since in this research, several variables and moderator and mediator have been used, complex relationship between the independent and dependent variables reduce the common method bias (Chang et al., 2010). According to Podsakoff et al. (2003), as a procedural remedy to avoid common method bias, all respondents remained anonymous to reduce evaluation apprehension. In addition to the procedural remedy, a statistical remedy, Harman’s single-factor test, was used to control for common method biases. This test is one of the most widely-used techniques, and one

that has been used in many studies (Back et al., 2014, Joensuu et al., 2013, Jones and Jayawarna, 2010, Kenny and Fahy, 2011, Kibler, 2013, Kuckertz and Wagner, 2010, Avlonitis and Salavou, 2007) to address the issue of common method variance (Podsakoff et al., 2003). After conducting an Exploratory Factor Analysis (EFA) from all items of all constructs and performance, a single factor just explains less than 20% percent of the variance (Avlonitis and Salavou, 2007), and no single factors accounts for most of the variance in these variables (Dada and Watson, 2013).

Therefore, given the results, common method variance is not a major problem in this study, and it, provides support for the validity of the measures used in this study (Dada and Watson, 2013, Rhee et al., 2010).

### 3.13 Statistical Analysis

In this study, to test the construct measurement, the confirmatory factor analysis (CFM) was used. Following Barclay et al. (1995), Netemeyer et al. (2003), and Zhao et al. (2011), this study assessed the reliability and validity of the constructs.

#### 3.13.1 Construct measurement

Before proceeding with the hypothesis testing, the evaluation of the scales' properties and a preliminary examination of the data and constructs must be done (Bordonaba-Juste et al., 2008, Weaven et al., 2014). Thus, this study first conducted a confirmatory factor analysis using AMOS 22 software and assessed measurement reliability and validity (Flatten et al., 2011). Following Barclay et al. (1995), Netemeyer et al. (2003), and Zhao et al. (2011), this study assessed the reliability and validity of the constructs. Based on the categorization of influential factors in a franchisee's performance, validity and reliability of the construct are assessed in three sections.

#### 3.13.2 Reliability

Reliability of indicator refers to the internal consistency of the result when using an instrument, and it is regarded as the repeatability of the response (Berkowitz and Wren, 2013). It indicates to what extent the item response is consistent across the constructs (Creswell, 2009). Calculation of Cronbach's alpha coefficient relating to each of the scales

(Rodríguez et al., 2006) is one of the best-known techniques for assessing reliability (Berkowitz and Wren, 2013). In this thesis, since the data was collected from two countries, reliability was assessed in each country separately.

Moreover, in this study, after examining the construct validity, including convergent validity and discriminant validity, the composite reliability technique was used to assess the reliability in each construct.

### 3.13.3 Construct validity:

Validity refers to the extent that a variable measures what it is supposed to measure. This study employed confirmatory factor analysis (McFadden et al.) (McFadden et al., 2014) using AMOS 22 software to assess the construct validity. CFA provides a more conservative and objective basis for interpretation of validity (Gerbing and Anderson, 1988, as cited in Avlonitis and Salavou, 2007).

#### 3.13.3.1 Convergent Validity:

Convergent validity is “. . . the degree to which multiple attempts to measure the same concept by different methods are in agreement” (Phillips 1981, p. 399). It shows whether the measures of a construct that are thought to be theoretically related are in fact related or not. If they are related, it means that there is convergent validity. Convergent validity indicates that path coefficients from a latent construct to its corresponding items are statistically significant (Ramaseshan et al., 2006).

Following Jap and Ganesan (2000), Chiou et al. (2004b) and Bordonaba-Juste et al. (2008), this study employed confirmatory factor analyses to assess the constructs and their measurement validity by using the maximum likelihood estimation procedures. Following (Li et al., 2008), convergent validity in this study was assessed by examining individual item loadings and the average variance extracted (AVE). An AVE of 0.50 or greater (Fornell and Larcker, 1981) indicates that constructs capture the variance more than measurement error. Moreover, to assess the convergent validity, individual loading factors should be evaluated. Although some researchers believe that individual loading factors, which represent squared multiple correlations, should surpass 0.70 (Gefen et al., 2000), according to Ford and McCallum (1986), 0.4 will be the minimum level for item loadings on established scales (Li et al., 2008).

### 3.13.3.2 Discriminate Validity

Bagozzi (1993, p. 54) refers to discriminant validity as “the degree to which measures of different concepts are distinct. The notion is that if two or more concepts are unique, then valid measures of each should not correlate too highly”.

One way to test discriminate validity is by comparing the  $\chi^2$  when correlation between two constructs is constrained to one, with the correlation between two constructs when it is free to vary (Avlonitis and Salavou, 2007). A significantly lower  $\chi^2$  value for the unconstrained model provides support for discriminant validity (Zaheer et al., 1998, Avlonitis and Salavou, 2007). Moreover, to assess the discriminant validity, the AVE of each construct can be compared to the correlations among constructs in each section (Netemeyer et al., 2003). If the intercorrelation between the two constructs is less than the square of AVE estimates of the two constructs, the discriminant validity between them is not violated (Zhao et al., 2009).

### 3.13.4 Measurements invariance:

Since this study was conducted in two countries, to ensure that the measurements had an equivalent representation in Iran and Sweden and that the constructs were cross-nationally invariant (Steenkamp and Baumgartner, 1998a), this study used a multigroup confirmatory factor analysis. (Durvasula et al., 1993, Kumar et al., 1995, Deshpandé et al., 2013, Siu and Lo, 2013, Runyan et al., 2012, Laukkanen et al., 2013). Measurement invariance refers to “whether or not, under different conditions of observing and studying the phenomena, measurement operations yield measures of the same attribute” (Horn and McArdle 1992, p. 117). In fact, it indicates whether instruments designed to measure the constructs are cross- nationally invariant (Steenkamp and Baumgartner, 1998b).

Lacking a measure’s invariance leads the research to ambiguous results (Steenkamp and Baumgartner, 1998b), and the conclusions of a study will be weak (Horn and McArdle, 1992). Since this study was conducted in two countries, to ensure that the measurements had an equivalent representation in Iran and Sweden and that the constructs were cross-nationally invariant (Steenkamp and Baumgartner, 1998a), this study used a multigroup confirmatory factor analysis (Durvasula et al., 1993, Kumar et al., 1995, Deshpandé et al., 2013, Siu and Lo, 2013, Runyan et al., 2012, Laukkanen et al., 2013).

Therefore, in this study, before testing the hypothesis and doing the analysis, the measurement invariance test will be run to ensure that measurements are invariant.

### 3.13.5 Poolability test

After ensuring that the measurements had an equivalent representation in Iran and Sweden, and that there was no variance between the measurements, there was a need to ensure that data from the two countries was poolable. It was very important to show that there were no cultural issues, and that the franchisees in the two different countries had produced comparable data. Therefore, in this step the Chow test (Chow, 1960) was conducted to determine whether the coefficients in two linear regressions on different data sets were equal.

$$F = \frac{(RSS_c - (RSS_1 + RSS_2))/k}{(RSS_1 + RSS_2)/(n + m - 2k)}$$

$RSS_c$  = sum of squared residuals from the combined data

$RSS_1$  = sum of squared residuals from the first group (Iran)

$RSS_2$  = sum of squared residuals from the second group (Sweden)

$K$  = Total number of independent variables

$n$  = Number of the cases in the first group (Iran)

$m$  = Number of the cases in the second group (Sweden)

If the F statistic for the factors was smaller than the critical value  $F_\alpha = 0.05$  it is accepted that the estimate for the combined data, it is possible to estimate the relationship of the combined data set.

### 3.13.6 Hypothesis testing:

To test the hypothesis, hierarchical multiple regression analysis is performed to identify the significant factors in determining the franchisee's performance. In each regression model the relationship between the independent, moderation and dependent

variables was estimated. In each regression model, the coefficient of determination R square ( $R^2$ ) reported that represents the amount of variance in the dependent variable explained by the model, and the independent variables in a regression equation (Field, 2009). Moreover, the F value in a regression model is a criterion to assess the overall usefulness of the regression model in analyzing, predicting, or explaining the variation in the dependent variables (Field, 2009). The parameter estimates of betas and corresponding  $\rho$ -value also provides a useful interpretation of the relationship between each independent and dependent variable.





## Chapter 4: Analysis and result

*In this chapter, a description of the respondents and the results of the analyses are presented. In the first section, descriptive statistics and profiles of the franchisees are reported. In the second section, preliminary steps for the analysis, including constructs measurement, measurement invariance, and a poolability test, are taken. In the third and final section, the data are analyzed and the hypotheses are tested.*

### 4.1 Descriptive analysis

The survey was executed in two countries, Iran and Sweden. As mentioned in the methodology chapter, 11 fast-food franchise systems in Iran and 5 fast-food franchise systems in Sweden were selected to gather data. The businesss format franchise systems studied in Iran were Icepack, Shila, Salsal, Atavich, Nemat Ice cream, Haida, Keyhan Fc, Boof, Superstar, and Pedar-e-khoob. In Sweden, the franchises studied were Sibylla, Subway, Burger King, McDonald's and Frasses. Tables 4-1 and 4-2 show the number of respondents in Iran and Sweden.

Table 4-1: Franchise systems and number of respondents in Iran

Country	Franchise system	Number of respondents
Iran	Icepack	35
	Shila	6
	Salsal	3
	Atavich	8
	Nemat Ice cream	22
	Haida	13
	Keyhan Fc	4
	Boof	14
	Superstar	3
	Avachi	5
	Pedar e khoob	12
Subtotal	11	126

Table 4-2: Franchise systems and number of respondents in Sweden

Country	Franchise system	Number of respondents
Sweden	Sybilla	20
	Burger king	15
	Subway	17
	McDonald's	7
	Frases	6
Subtotal	5	65

To gather data from the Iranian franchisees, interviewers were trained to clarify every question that was not clear. Therefore, the data in the questionnaires were mostly complete. According to the returned questionnaires from the franchisees in Sweden, only one respondent skipped a page. This franchisee was contacted and it turned out that he had simply missed the page, and he was able to answer it later. In the returned questionnaires from Sweden, just a few questions were not answered. In these cases, missing data were replaced with the maximum likelihood method.

The average age of the franchisees in Iran was 35.5 years, while the average age in Sweden was 42 years. About 55 percent of respondents in Iran and 25 percent of those in Sweden had a university education. In Iran, 69 percent of the respondents were married, compared to 60 percent in Sweden. Regarding gender, 92 percent of the respondents in Iran were male, compared to 72 percent of the respondents in Sweden. 26 percent of the franchisees in Iran had experience working in a franchise system before getting into their current franchise system, with an average of 1.3 years of experience; in Sweden, those figures were 24.6 percent and 1.6 years. Moreover, about 80 percent of the franchised outlets in Iran and 84.6 percent of those in Sweden were managed by the franchisees.

## 4.2 Construct measurement

Before proceeding with the hypothesis testing, the evaluation of the scales' properties and a preliminary examination of the data and constructs must be done. Thus, this study first conducted a confirmatory factor analysis using AMOS 22 software and assessed measurement reliability and validity (Flatten et al., 2011). Based on the categorization of influential factors in a franchisee's performance, validity and reliability of the construct are assessed in three sections.

As previously mentioned, in this study, data is collected from two different countries; to combine the data into one set, an evaluation of the result of the F-statistic in the Chow test is needed. For assessing the F-statistic in the Chow test, the sum of squared residuals from each sample and combined data are needed. Therefore, this study will first conduct the regression for each country to find the sum of the squared residuals, and then assess the poolability of the data. Hence, construct measurements for each country are separately assessed first, and then construct measurements for the combined data are presented.

#### 4.2.1 Reliability

In this thesis, since the data was collected from two countries, reliability was assessed in each country separately. Moreover, in this study, after examining the construct validly, including convergent validity and discriminant validity, the composite reliability technique was used to assess the reliability in each construct.

#### 4.2.2 Cronbach's Alpha Coefficient in Iranian sample

Table 4-3 demonstrates Cronbach's alphas for all constructs in Iran. As shown, except for Schumpeterian EO and conflict, Cronbach's alpha is well above 0.70; thus, these scales were considered to be reliable and adequate for the research purposes (Nunnally, 1978). Therefore, removing the third item from risk taking increases the reliability of Schumpeterian EO. Cronbach's alpha is also improved for conflict construct after deleting item number two. Therefore, after modifying some constructs, all latent factors in the Iranian sample were viewed as substantially reliable for continuing the research analysis.

Table 4-3 Cronbach's alpha coefficient reliability for Iranian sample

Item-Total Statistics Sample number: 126			
	Number of item	Cronbach's alpha	If item deleted
Kirznerian EO	6	.894	
Schumpeterian EO	9	.65	.87 if Item 3 in risk taking is deleted
Absorptive capacity	8	.80	
Managerial capability	4	.874	
Social capital	3	.767	
Training	4	.949	
Advertisement	2	.833	
Raw material	3	.851	
Profitability	2	.748	
Brand reputation	5	.898	
Trust	3	.861	
Satisfaction	4	.936	
Conflict	3	-	.761 if Item 2 is deleted
Performance	4	.884	
Environmental dynamism	4	.775	
Environmental competitiveness	4	.883	

As seen in Table 4-4, except for Schumpeterian EO and conflict, Cronbach's alpha is well above 0.70 in Swedish sample and thus those scales were considered as reliable and adequate for the research purposes (Nunnally, 1978). Moreover, deleting Item 3 from risk taking increases the reliability of Schumpeterian EO. As shown in Table 4-3, reliability in conflict is substantially improved after removing one item. Consequently,

after modifying some constructs, all latent factors in the Swedish sample reached high reliability.

Table 4-4 Cronbach's alpha coefficient reliability for Swedish sample

Item-Total Statistics			
Sample number: 65			
	Number of item	Cronbach's alpha	If item deleted
Kirznerian EO	3	.90	
Schumpeterian EO	3	.69	.73if Item 3 is deleted
Absorptive capacity	8	.75	
Managerial capability	4	.874	
Social capital	3	.737	
Training	4	.829	
Advertisement	2	.738	
Raw material	3	.776	
Profitability	2	.74	
Brand reputation	5	.845	
Trust	3	.861	
Satisfaction	4	.913	
Conflict	3	.67	.813 if Item 2 is deleted
Performance	4	.926	
Environmental dynamism	4	.76	
Environmental competitiveness	4	.801	

#### 4.2.3 Construct validity:

Given the literature and the theories that are used in this study, the influencing factors in a franchisee's performance are broken down into three main sections: franchisor-related factors, franchisee-related factors, and the relationship between the two parties. Therefore, as explained in section 3-13-3, confirmatory factor analyses are used to assess the convergent and discriminant validity of the constructs in each section.

#### 4.2.4 Convergent Validity:

##### 4.2.4.1 Convergent validity for franchisee related factors in two samples:

In this section, the validity of franchisee-related factors is evaluated. Since in this research, entrepreneurial orientation has been considered as a multidimensional construct, a second-order factor confirmatory factors analysis was conducted to assess the convergent validity. As is shown in Table 4-5, a second-order confirmatory factors analysis was run to calculate the AVE and factor loading. As seen in Tables 4-5 and 4-6, in the AVE analysis of all constructs, except for autonomy in Schumpeterian EO and one item in absorptive capacity, factor loading in all items exceeded the threshold of .4 (Li et al., 2008). Therefore, these items were removed from the model. Running the CFA model after removing those cases shows the low fitness, and even in Schumpeterian EO, average variance extracted did not surpass the recommend threshold for the constructs. Moreover,

the existence of two items with factor loading of less than .6 violates the convergent validity in absorptive capacity. Therefore, this study used the CFA model after removing those items. Removing those items led the model to an accepted fitness with an accepted AVE and factor loading in two samples.

Table 4-5 Average Variance Extracted and individual loading factor for franchisee-related factors in Iran

Variables	AVE	Item	Loading Factor
Schumpeterian EO	.490	Autonomy	.29
		Risk taking	.78
		Innovativeness	.61
Kirznerian EO	.82	Proactiveness	.90
		Competitive aggressiveness	.81
ACAP	.551	Item 1	.60
		Item 2	.53
		Item 3	.79
		Item 4	.83
		Item 5	.83
		Item 6	.55
		Item 7	.78
		Item 8	.1
Managerial capability	0.64	Item 1	.77
		Item 2	.73
		Item 3	.85
		Item 4	.84
Social capital	0.54	Item 1	.77
		Item 2	.73
		Item 3	.69
Performance	0.68	Item 1	.77
		Item 2	.87
		Item 3	.86
		Item 4	.78

Table 4-6 Average Variance Extracted and individual loading factor for franchisee-related factors in Sweden

Variables	AVE	Item	Loading Factor
Schumpeterian	.486	Autonomy	.37
		Risk taking	.85
		Innovativeness	.50
Kirznerian EO	.78	Proactiveness	.96
		Competitive aggressiveness	.85
ACAP	.51	Item 1	.63
		Item 2	.50
		Item 3	.80
		Item 4	.80
		Item 5	.66
		Item 6	.21
		Item 7	.61
		Item 8	.20
Managerial capability	0.649	Item 1	.89
		Item 2	.82
		Item 3	.85
		Item 4	.63
Social capital	0.55	Item 1	.81
		Item 2	.73
		Item 3	.68
Performance	0.756	Item 1	.86
		Item 2	.89
		Item 3	.89
		Item 4	.83

#### 4.2.4.2 Convergent validity for franchisor related factors two samples:

The AVE analysis of all constructs in the franchisor-related factors in Iran and Sweden (Table 4-7 and 4-8) was higher than the recommended threshold for each construct, 0.5 (Li et al., 2008). Factor loadings were also higher than .5 and acceptable. Therefore, constructs of franchisor-related factors in both samples had convergent validity.

Table 4-7: Average Variance Extracted and individual loading factor for franchisor-related factors in Iran

Variables	AVE	Item	Loading Factor
Training	0.537	Item 1	.88
		Item 2	.89
		Item 3	.92
		Item 4	.75
Raw material	0.535	Item 1	.77
		Item 2	.84
		Item 3	.83
profitability	0.589	Item 1	.84
		Item 2	.71
Advertisement	0.605	Item 1	.91
		Item 2	.83
Reputation	0.709	Item 1	.77
		Item 2	.67
		Item 3	.90
		Item 4	.77
		Item 5	.80

Table 4-8: Average Variance Extracted and individual loading factor for franchisor-related factors in Sweden

Variables	AVE	Item	Loading Factor
Training	0.537	Item 1	.69
		Item 2	.68
		Item 3	.78
		Item 4	.77
Raw material	0.535	Item 1	.76
		Item 2	.73
		Item 3	.76
profitability	0.589	Item 1	.79
		Item 2	.75
Advertisement	0.605	Item 1	.70
		Item 2	.84
Reputation	0.709	Item 1	.82
		Item 2	.86
		Item 3	.86
		Item 4	.82
		Item 5	.68

#### 4.2.4.3 Convergent validity for relation between the franchisor and the franchisee two samples

The AVE analysis of all constructs in relationship factors in Iran and Sweden (Table 4,9- and 4-10) surpassed the recommended threshold for each construct, 0.5 (Li et al., 2008). Factor loadings, except for Item 2 in conflict, were higher than .5 and acceptable. Therefore, constructs of relationship factors in both samples had convergent validity.

Table 4-9: Average Variance Extracted and individual loading factor of relationship between the franchisor and franchisee in Iranian sample

Variables	AVE	Item	Loading Factor
Satisfaction	0.808	Item 1	.83
		Item 2	.85
		Item 3	.89
Conflict	0.654	Item 1	.81
		Item 2	.15
		Item 3	.81
Trust	0.793	Item 1	.76
		Item 2	.87
		Item 3	.89
		Item 4	.76
		Item 5	.83

Table 4-10: Average Variance Extracted and individual loading factor of relationship between the franchisor and franchisee in Swedish sample

Variables	AVE	Item	Loading Factor
Satisfaction	0.685	Item 1	.84
		Item 2	.82
		Item 3	.84
Conflict	0.762	Item 1	.81
		Item 2	.41
		Item 3	.85
Trust	0.762	Item 1	.89
		Item 2	.86
		Item 3	.83
		Item 4	.89
		Item 5	.89

### 4.3 Discriminate Validity

As explained earlier (see section 3.13.3) to assess the discriminant validity, the AVE of each construct can be compared to the correlations among constructs in each section (Netemeyer et al., 2003). If the intercorrelation between the two constructs is less than the square of AVE estimates of the two constructs, the discriminant validity between them is not violated (Zhao et al., 2009).

The AVE values and the intercorrelations among the constructs are reported in Tables 4-11 , 4-12, 4-13, 4-14, 4-15 , and 4-16, and clearly demonstrate discriminant validity. In this section, the composite reliability each construct is presented. Note that to be reliable for further analysis, constructs should surpass the threshold of .7 (Bagozzi and Yi, 1988).

4.3.1 Discriminant validity test for franchisee related factors

As is demonstrated in Tables 4-11 and 4-12, since the intercorrelations between the all pairs of constructs were less than the square root of AVE estimates of them, the discriminant validity between each of the two constructs was not violated. Composite reliability in Schumpeterian EO was also less than 0.7, and shows low reliability in this construct. Therefore, it was removed from the analysis.

Table 4-11: Discriminant validity test for franchisee-related factors in Iran (Composite reliability, Average Variance Extracted and correlation between the constructs)

	CR	AVE	Social network	Schumpeterian EO	Kirznerian EO	ACAP	Performance	Managerial capability
Social network	.803	.575	.76**					
Schumpeterian EO	.628	.489	.339	.70**				
Kirznerian EO	.903	.823	.276	.521	.90**			
ACAP	.879	.551	.489	.388	.475	.743**		
Performance	.896	.684	.431	.324	.501	.492	.827**	
Managerial capability	.873	.633	.460	.273	.376	.464	.422	.796**

\* Square root of Average Variance Extracted ( AVE)

Table 4-12: Discriminant validity test for franchisee-related factors in Sweden (Composite reliability , Average Variance Extracted and correlation between the constructs)

	CR	AVE	Social network	Schumpeterian EO	kirznerian EO	ACAP	Performance	Managerial capability
Social network	.784	.55	.741*					
Schumpeterian EO	.61	.49	.203	.7*				
Kirznerian EO	.898	.81	.457	.555	.90*			
ACAP	.835	.51	.478	.608	.690	.72*		
Performance	.925	.76	.519	.430	.673	.663	.87*	
Managerial capability	.879	.65	.278	.262	.483	.405	.423	.8*

\* Square root of Average Variance Extracted ( AVE)



#### 4.3.2 Discriminant validity test for franchisor related factors:

As seen in Tables 4-13 and 4-14, since the intercorrelations between all the pairs of constructs were less than the square root of AVE estimates of them, the discriminant validity between each of the two constructs was not violated. Composite reliability in these constructs was also well beyond the threshold of 0.7.

Table 4-13: Discriminant validity test for franchisor-related factors in Iran (Composite reliability, Average Variance Extracted and correlation between the constructs)

	CR	AVE	Raw Material	Training	Advertisement	Performance	System profitability	Reputation
Raw Material	0.857	0.667	0.817*					
Training	0.920	0.743	0.497	0.862*				
Advertisement	0.864	0.761	0.299	-.031	0.872*			
Performance	0.892	0.674	0.476	.268	.459	0.821*		
System profitability	0.752	0.605	0.417	.483	.218	.456	0.778*	
Reputation	0.897	0.635	0.527	.121	.725	.530	.317	0.797*

\* Square root of Average Variance Extracted ( AVE)

Table 4-14: Discriminant validity test for franchisor-related factors in Sweden (Composite reliability, Average Variance Extracted and Correlation between the constructs)

	CR	AVE	Raw Material	Training	Advertisement	Performance	System profitability	Reputation
Raw Material	0.775	0.535	0.731*					
Training	0.822	0.537	0.460	0.733*				
Advertisement	0.751	0.605	0.558	0.437	0.778*			
Performance	0.927	0.761	0.413	0.345	0.560	0.872*		
System profitability	0.742	0.589	0.325	0.147	0.414	0.466	0.768*	
Reputation	0.907	0.709	0.727	0.495	0.618	0.559	0.419	0.842*

\* Square root of Average Variance Extracted ( AVE)

#### 4.3.3 Discriminant validity test for Relationship factors:

As is demonstrated in Tables 4-15 and 4-16, since the intercorrelations between all the pairs of constructs were less than the square root of AVE estimates of them, the discriminant validity between each of the two constructs was not violated. Composite reliability in these constructs was also far beyond the threshold of 0.7.

Table 4-15: Discriminant validity test for the relationship between the franchisor and franchisee in the Iranian sample (Composite reliability , Average Variance Extracted and correlation between the constructs)

	CR	AVE	Trust	Satisfaction	Conflict	Performance
Trust	0.950	0.793	0.890*			
Satisfaction	0.927	0.808	0.767	0.899*		
Conflict	0.791	0.654	-0.731	-0.757	0.809*	
Performance	0.891	0.672	0.436	0.479	-0.469	0.820*

\* Square root of Average Variance Extracted ( AVE)

Table 4-16: Discriminant validity test for the relationship between the franchisor and franchisee in the Swedish sample (Composite reliability, Average Variance Extracted and correlation between the constructs)

	CR	AVE	Trust	Satisfaction	Conflict	Performance
Trust	0.941	0.762	0.873*			
Satisfaction	0.867	0.685	0.764	0.827*		
Conflict	0.814	0.686	-0.666	-0.751	0.828*	
Performance	0.927	0.760	0.567	0.561	-0.561	0.872*

\* Square root of Average Variance Extracted ( AVE)

#### 4.4 Measurements invariance:

Since this study was conducted in two countries, to ensure that the measurements had an equivalent representation in Iran and Sweden and that the constructs were cross-nationally invariant, as explained at section 3-13-5, this study used a multigroup confirmatory factor analysis (Durvasula et al., 1993, Kumar et al., 1995, Deshpandé et al., 2013, Siu and Lo, 2013, Runyan et al., 2012, Laukkanen et al., 2013).

According to section to test the measurement invariance in franchisee-related factors, franchisor-related factors and relationship factors, all factor loading and factor variance were constrained equally across the two countries of Iran and Sweden. Following Laukkanen et al. (2013), a goodness of fit related to this constrained model in franchisor-related factors demonstrates a good fit ( $\chi^2/df=1.73$ , CFI= .91, RMSEA= .064), indicating invariance between the two countries. The chi-square difference test was also non-significant in this section.

A goodness of fit related to this constrained model in the franchisee-related factors demonstrates a good fit ( $\chi^2/df=1.72$ , CFI= .90, RMSEA= .062), indicating invariance between the two countries. The chi-square difference test was also non-significant in this section.

A goodness of fit related to this constrained model in factors related to the relationship between the franchisor and franchisee demonstrates a good fit ( $\chi^2/df=1.7$ , CFI= .956, RMSEA= .061), indicating invariance between the two countries. The chi-square different test was also non-significant in this section.

#### 4.5 Poolability test

As presented in section 3-13-6, in this step the Chow test (Chow, 1960) was conducted to determine whether the coefficients in two linear regressions on different data sets were equal.

$$F = \frac{(RSS_c - (RSS_1 + RSS_2)) / k}{(RSS_1 + RSS_2) / (n + m - 2k)}$$

$RSS_c$  = sum of squared residuals from the combined data

$RSS_1$  = sum of squared residuals from the first group (Iran)

$RSS_2$  = sum of squared residuals from the second group (Sweden)

$K$  = Total number of independent variables

$n$  = Number of the cases in the first group (Iran)

$m$  = Number of the cases in the second group (Sweden)

The F statistic (.77) for the franchisee-related factors was smaller than the critical value  $F_{\alpha} = 0.05 = 1.938$ . Therefore, it was accepted that estimate for the combined data was stable. The F statistic (0.87) for the franchisor-related factors was smaller than the critical value  $F_{\alpha} = 0.05 = 2.21$ . Therefore, it was accepted that the estimate for the combined data was stable. The F statistic (1.74) for the relationship factors was smaller than the critical value  $F_{\alpha} = 0.05 = 2.37$ . Therefore, it was accepted that the estimate for

the combined data was stable. Since the poolability test was successful (as shown above), it was possible to estimate the relationship of the combined data set.

#### 4.6 Construct measurements in combined data:

After conducting a successive poolability test, construct measurements for combined data were evaluated.

Table 4-17 shows the Cronbach’s alphas for all the constructs. As shown in the table, except for conflict, Cronbach’s alpha is well above 0.70, and thus those scales were considered to be reliable and adequate for the research purposes (Nunnally, 1978). Cronbach’s alpha is also improved in conflict after deleting Item number two. Therefore, after modifying some of the constructs, all latent factors in the combined data were shown to be substantially reliable for continuing the research analysis.

Table 4-17: Cronbach’s alpha coefficient reliability in the combined data.

Item-Total Statistics Sample number: 191			
		Cronbach's	
	Number of item	alpha	If item deleted
Kirznerian EO	6	.89	
Absorptive capacity	5	.86	
Managerial capability	4	.88	
Social capital	3	.79	
Training	4	.89	
Advertisement	2	.79	
Raw material	3	.83	
Profitability	2	.74	
Brand reputation	5	.89	
Trust	3	.94	
Satisfaction	4	.90	
Conflict	3	.58	.804 if Item 2 is deleted
Performance	4	.90	
Environmental dynamism	4	.75	
Environmental competitiveness	4	.87	

##### 4.6.1 Convergent validity for combined data:

The AVE analysis of all the constructs in the franchisee-related factors in the combined data (Table 4-18, 4-19 and 4-20) surpassed the recommended threshold for each construct, 0.5 (Li et al., 2008). All factor loadings except one item in environmental dynamism were higher than .5 and acceptable. Therefore, after removing Item number two in dynamism, all constructs had convergent validity. The CFA model in franchisee-related

factors showed a good fit (CMIN/DF= 1.71, CFI = .948 , RMSEA= .061, SRMR= .053). Moreover, the CFA model in the franchisor-related factors had a good fit as well (CMIN/DF= 1.86 , CFI = .945, RMSEA= .068, SRMR= .059). The CFA model in relationship factors also demonstrated a good fit (CMIN/DF= 1.705 , CFI = .979 , RMSEA= .061 , SRMR= .0396).

Table 4-18: Average Variance Extracted and individual loading factor for franchisee-related factors for the combined data

Variables	AVE	Item	Loading Factor
Kirznerian EO	.831	Proactiveness	.95
		Competitive aggressiveness	.88
ACAP	.518	Item 1	.60
		Item 3	.81
		Item 4	.82
		Item 5	.81
		Item 7	.72
Managerial capability	.617	Item 1	.80
		Item 2	.77
		Item 3	.84
		Item 4	.73
Social capital	.567	Item 1	.77
		Item 2	.76
		Item 3	.73
Environmental dynamism	.554	Item 1	.70
		Item 3	.93
		Item 4	.55
Environmental Competitiveness	.657	Item 1	.77
		Item 2	.85
		Item 3	.69
Performance	.696	Item 4	.63
		Item 1	.82
		Item 2	.86
		Item 3	.88
		Item 4	.77

Table 4-19: Average Variance Extracted and individual loading factor for franchisor-related factors for the combined data

Variables	AVE	Item	Loading Factor
Training	.69	Item 1	.86
		Item 2	.87
		Item 3	.84
		Item 4	.73
Raw material	.63	Item 1	.78
		Item 2	.79
		Item 3	.81
profitability	.60	Item 1	.82
		Item 2	.72
Advertisement	.67	Item 1	.87
		Item 2	.76
Reputation	.64	Item 1	.78
		Item 2	.79
		Item 3	.85
		Item 4	.80
		Item 5	.76

Table 4-20: Average Variance Extracted and individual loading factor for the relationship between the franchisor and franchisee in the combined data

Variables	AVE	Item	Loading Factor
Satisfaction	.77	Item 1	.87
		Item 2	.87
		Item 3	.89
Conflict	.68	Item 1	.83
		Item 3	.81
Trust	.78	Item 1	.82
		Item 2	.89
		Item 3	.88
		Item 4	.92
		Item 5	.89

#### 4.6.2 Discriminant validity test for combined data:

As is demonstrated in Tables 4-21, 4-22 and 4-23, since the intercorrelations between the all pair of constructs were less than the square root of AVE estimates of them, the discriminant validity between each of the two constructs was not violated. Composite reliability in all the constructs was also well beyond the threshold of 0.7. Therefore, they were reliable for testing the hypotheses.

Table 4-21: Discriminant validity test for franchisee-related factor for the combined data (Composite reliability, Average Variance Extracted and Correlation between the constructs)

	CR	AVE	Social network	Kirznerian EO	ACAP	Managerial capability	Environmental competitiveness	Environmental dynamism	Performance
Social network	.797	.567	.753*						
Kirznerian EO	.908	.831	.316	.91*					
ACAP	.862	.518	.520	.546	.719*				
Managerial capability	.865	.617	.433	.399	.473	.785*			
Environmental competitiveness	.884	.660	.051	.301	.037	.108	.812*		
Environmental dynamism	.780	.554	.279	.263	.158	.249	.441	.743*	
Performance	.901	.696	.434	.560	.539	.410	.07	.227	.834*

\* Square root of Average Variance Extracted ( AVE)

Table 4-22: Discriminant validity test for franchisor-related factors for the combined data (Composite reliability , Average Variance Extracted and correlation between the constructs)

	CR	AVE	Raw Material	Training	Advertisement	Performance	System profitability	Reputation
Raw Material	.835	.63	.792*					
Training	.896	.69	.410	.83*				
Advertisement	.803	.67	.308	.015	.82*			
Performance	.905	.70	.466	.225	.522	.84*		
System profitability	.747	.60	.310	.239	.200	.498	.77*	
Reputation	.898	.64	.544	.124	.671	.550	.273	.8*

\* Square root of Average Variance Extracted ( AVE)

Table 4-23: Discriminant validity test for the relationship between the franchisor and franchisee for the combined data (Composite reliability , Average Variance Extracted and correlation between the constructs)

	CR	AVE	Trust	Satisfaction	Conflict	Performance
Trust	.943	.78	.883*			
Satisfaction	.904	.77	.746	.877*		
Conflict	.784	.68	-.687	.737	.824*	
Performance	.889	.67	.542	.581	-.586	.82*

\* Square root of Average Variance Extracted ( AVE)

## 4.7 Testing the Hypotheses:

After assessing the construct validity and removing those items that had no convergent validity, as well as those items in which discriminant validity was violated, in this section the data are analyzed to examine the hypotheses. Given the successive poolability test, in this section combined data will be analyzed to test the hypotheses.

### 4.7.1 Hypotheses related to the franchisee-related factors

To test the hypotheses, hierarchical multiple regression analysis was performed to identify the significant factors in determining the franchisee's performance. In each regression model the relationship between the independent, moderation and dependent variables was estimated. Further, in each regression model the coefficient of determination R square ( $R^2$ ) is reporting what represents the amount of variance in the dependent variable explained by the model and the independent variables in a regression equation (Field, 2009). Moreover, the F value in a regression model is a criterion to assess the overall usefulness of the regression model in analyzing, predicting, or explaining the variation in the dependent variables (Field, 2009). The parameter estimates of betas and corresponding p-value provides a useful interpretation of the relationship between each independent variable and dependent variable.

In each regression model in this study, control variables and dummy variables were first entered into the model, then the independent variables, and finally any interaction variables involving those independent variables, were entered.

Four major hypotheses and five sub-hypotheses were presented concerning the franchisee-related factors in this study. Human capital, social capital, absorptive capacity, managerial capability and Kirznerian entrepreneurial orientation encompassed the independent variables in this section, and environmental dynamism and environmental competitiveness were the moderator variables. The franchisee's performance also included the dependent variable in this study. Table 4-24 shows the descriptive statistics and correlation matrix of the franchisee-related factors.

As shown in Table 4-24, all independent variables are were correlated with the performance at the 0.01 level. Among the independent variables, ACAP had the highest correlation with performance (Schumpeterian EO also had the lowest correlation). However, a high correlation coefficient in all the variables showed the importance of all of them in the franchisee's performance. Table 4-24 shows the descriptive statistics and correlation matrix of the franchisee-related factors in the sample.



Table 4-24: Scale properties, descriptive statistics, and correlation matrix of franchisee-related factors in overall

	Mean	Std. Deviation	Social network	Kiriznerian EO	ACAP	Managerial capability	Environmental competitiveness	Environmental dynamism	Country	Business age	Pre-work in franchise	Pre-work in industry	Education level (years of education)	Performance
Social network	4.61	1.29	1											
Kiriznerian EO	4.95	1.18	.316**	1										
ACAP	5.07	1.13	.520**	.546**	1									
Managerial capability	5.71	.96	.433**	.399**	.473**	1								
Environmental competitiveness	5.42	1.3	.051	.301**	.037	.108	1							
Environmental dynamism	5.05	1.12	.279**	.263**	.158**	.249**	.441**	1						
Country	.340	.47	-.366**	.009	-.231**	-.243**	.242**	.09	1					
Business age	5.93	.345	-.242**	.038	-.129**	-.130*	.119*	.094	.447**	1				
Pre-work in franchise	.27	.44	.081	.149**	.109*	.132**	.170**	.052	-.034	-.067	1			
Pre-work in industry	.36	.48	-.005	.145**	.151**	.014	.142*	.09	-.089	.05	.293**	1		
Education level (years of education)	13.74	2.0	.234**	.008	.151**	.062	-.04	-.073	-.348**	-.198**	.054	.031	1	
Performance	4.77	1.22	.434**	.560**	.539**	.410**	.07	.227**	-.003	-.024	.144**	.135**	.119**	1

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).

Table 4-25 shows the regression analysis for the franchisee-related factors. First, a multiple regression analysis was conducted with only control variables (Model 1). The regression model of the franchisee-related factors had no statistically significant F-test scores when it only controlled the business age and country. This showed that the franchisee's performance did not vary with the business age and country. It also showed that there were no differences in performance with regard to franchised outlet age and country in which the franchisees were conducting their business. Second, two dummy variables of human capital (pre-work in the fast-food industry) and prior experience (pre-work in a franchise system) were added. Although the R square in Model 2 was significant at the 0.1 p value, the coefficient of these two variables was not significant and showed no impact on the performance. However, the correlation tables show that there was a positive relationship between the human capital measurements and performance, and that the franchisees with higher human capital displayed higher performance. In the third model, the resource-based variables of education, managerial capabilities, Kirznerian EO, absorptive capacity and social networking were added. Model 3 in the regression model was statistically significant, and independent variables in the franchisee-related factors accounted for around 41 percent of the variation in their performance. It is important to note that because of the lack of convergent validity in the CFA model, Schumpeterian EO was not entered into this multiple regression. However, due to the closeness of the AVE value in the Schumpeterian EO to the borderline (.5), the effect of the Schumpeterian EO on the franchisee's performance was examined in a post hoc analysis.

The moderator variables of environmental dynamism and competitiveness were added in later models. The results of the regression analysis are presented in Table 4-25. To avoid problems associated with multicollinearity, VIF was evaluated. VIF in these models was within tolerable limits, and there was no multicollinearity between the constructs in each model. Each model is further explained in examining each hypothesis.

Table 4-25 shows the regression analysis for the franchisee-related factors. First, a multiple regression analysis was conducted with only control variables (Model 1). The regression model of the franchisee-related factors had no statistically significant F-test scores when it only controlled the business age and country. This showed that the franchisee's performance did not vary with the business age and country. It also showed that there were no differences in performance with regard to franchised outlet age and country in which the franchisees were conducting their business. Second, two dummy variables of human capital (pre-work in the fast-food industry) and prior experience (pre-work in a franchise system) were added. Although the R square in Model 2 was significant at the 0.1 p value, the coefficient of these two variables was not significant and showed no impact on the performance. However, the correlation tables show that there was a positive relationship between the human capital measurements and performance, and that the franchisees with higher human capital displayed higher performance. In the third model, the resource-based variables of education, managerial capabilities, Kirznerian EO, absorptive capacity and social networking were added. Model 3 in the regression model was statistically significant, and independent variables in the franchisee-related factors accounted for around 41 percent of the variation in their performance. It is important to note that because of the lack of convergent validity in the CFA model, Schumpeterian EO was not entered into this multiple regression. However, due to the closeness of the AVE value in the Schumpeterian EO to the borderline (.5), the effect of the Schumpeterian EO on the franchisee's performance was examined in a post hoc analysis.

The moderator variables of environmental dynamism and competitiveness were added in later models. The results of the regression analysis are presented in Table 4-25. To avoid problems associated with multicollinearity, VIF was evaluated. VIF in these models was within tolerable limits, and there was no multicollinearity between the constructs in each model. Each model is further explained in examining each hypothesis.

*Hypothesis: The franchisee's absorptive capacity positively affects its performance.*

Model 3 in the regression model was statistically significant, and all independent variables in the franchisee-related factors accounted for about 41 percent of the variation in the franchisee's performance. As shown in Table 4-24, the franchisee's ACAP is correlated with its performance at the 0.01 confidence level. According to Table 4-25, the ACAP ( $\beta = .287$ ,  $p < .001$ ) significantly related to the franchisee's performance. Therefore, the hypothesis, which predicted a positive influence of ACAP on the franchisee's performance, is supported.

*Hypothesis: The greater the environmental dynamism, the greater the impact of ACAP on franchisee performance.*

In this hypothesis, it is proposed that environmental dynamism moderated the relationship between the franchisee's ACAP and performance. In studying the interaction effect (moderator), if the change in the amount of variance of the franchisee's performance explained by the interaction effect, is significantly greater than the amount of variance explained in the main effects model, the hypothesis is supported.

Model 7 in Table 4-25 explains the interaction effect of environmental dynamism on the relationship between the franchisee's ACAP and performance. As shown below, the interaction effect of environmental dynamism ( $\beta = .094$ ,  $p < .13$ ) and R square change is not significant at the level of  $\alpha = .1$ , and interaction does not significantly increase the performance. Figure 4-1 shows the relationship between the ACAP and performance in low and high levels of environmental dynamism. Figure 4-1 indicates that although dynamic environment affected the relationship between the franchisees with lower and higher ACAP, it is not statistically significant. This means that the performance of the franchisee in those franchisees with higher ACAP did not increase more in dynamic environments. Therefore, the hypothesis is not supported. However, running a simple regression and scatter plot shows a positive influence of interaction model.

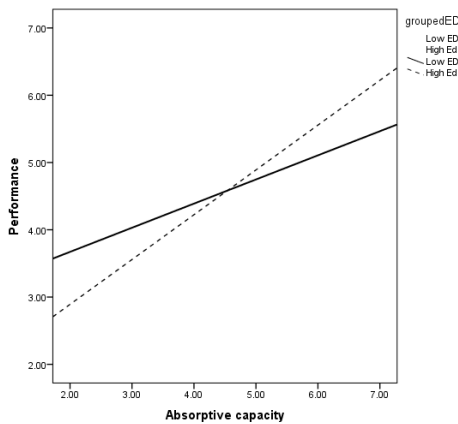


Figure 4-1 . Relationship between the franchisee's ACAP and performance in low and high levels of environmental dynamism

*Hypothesis: The greater the environmental competitiveness, the greater the impact of ACAP on the franchisee's performance.*

Model 5 in Table 4-25 explains the interaction effect of environmental competitiveness on the relationship between the franchisee's ACAP and performance. As shown below, the model is statistically significant, and the interaction effect of environmental competitiveness ( $\beta = .152$ ,  $p < .05$ ) and R square change is significant as well. This means that the interaction significantly increase the performance. Figure 4-2 shows the relationship between the ACAP and performance in low and high levels of environmental competitiveness.

Figure 4-2 indicates that in a competitive environment, greater ACAP leads the franchisee to greater performance, and that the effect of environmental competitiveness is significant. This means that when there is high environmental competitiveness, the impact of ACAP on the franchisee's performance was greater. Therefore, the hypothesis is supported.

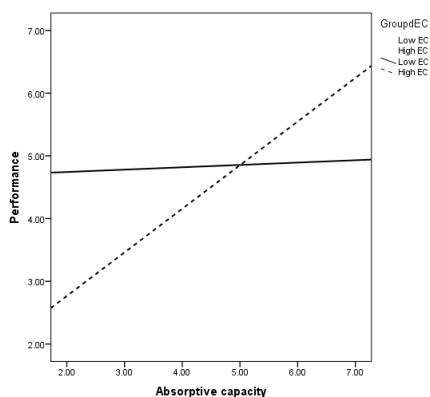


Figure 4-2. Relationship between the franchisee's ACAP and performance in low and high levels of environmental competitiveness

*Hypothesis: A franchisee's Kirznerian entrepreneurial orientation positively affects its performance.*

Model 3 in the regression model is statistically significant. As shown in Table 4-25, the franchisee's EO is correlated with the performance at the 0.01 confidence level. According to Tables 4-25, Kirznerian EO ( $\beta = .238, p < .001$ ) is significantly related to the franchisee's performance. Therefore, the hypothesis, which predicted a positive influence of the franchisee's EO on its performance, is supported.

*Hypothesis: Environmental dynamism will moderate the relationship between the franchisee's Kirznerian EO and its performance. The franchisee with higher Kirznerian EO will perform better in a more dynamic environment.*

In this hypothesis, it is proposed that environmental dynamism moderates the relationship between the franchisee's Kirznerian EO and performance. In studying the interaction effect (moderator), if the change in the amount of variance in the franchisee's performance is explained by the interaction effect, it is significantly greater than the amount of variance explained in the main effects model, and the hypothesis is supported.

Model 6 in Table 4-25 explains the interaction effect of environmental dynamism on the relationship between the franchisee's Kirznerian EO and performance. As shown

below, the model was statistically significant, the interaction effect of environmental dynamism ( $\beta = .668, p < .05$ ) and R square change is significant, and the interaction between the EO and environmental dynamism significantly increased the performance. Figure 4-3 shows the relationship between the EO and performance in low and high levels of environmental dynamism.

Figure 4-3 shows that in a dynamic environment, greater Kirznerian EO leads the franchisee to greater performance, and the effect of environmental dynamism is significant. This means in high environmental dynamism, the impact of Kirznerian EO on the franchisee's performance is greater. Therefore, the hypothesis is supported.

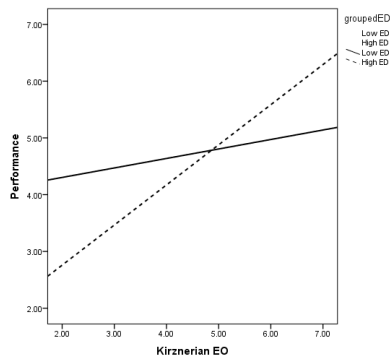


Figure 4-3. Relationship between the franchisee's Kirznerian EO and performance in low and high levels of environmental dynamism

*Hypothesis: Environmental competitiveness moderates the relationship between the franchisee's Kirznerian EO and its performance. The franchisee with higher Kirznerian EO will perform better in a more competitive environment .*

In this hypothesis, it is proposed that environmental competitiveness moderates the relationship between the franchisee's EO and performance. In studying the interaction effect (moderator), if the change in the amount of variance in the franchisee's performance is explained by the interaction effect, and is significantly greater than the amount of variance explained in the main effects model, the hypothesis is supported.

Model 4 in Table 4-25 explains the interaction effect of environmental competitiveness on the relationship between the franchisee's EO and performance. As

shown below, the model is statistically significant, the interaction effect of environmental competitiveness ( $\beta = .174, p < .05$ ) and R square change is significant and the interaction between the EO and environmental competitiveness significantly increased the performance. Figure 4-4 shows the relationship between the EO and performance in low and high levels of environmental competitiveness.

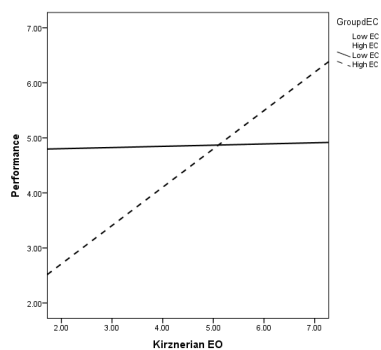


Figure 4-4. Relationship between the franchisee’s Kirznerian EO and performance in low and high levels of environmental competitiveness

Figure 4-4 shows that in a competitive environment, greater EO leads the franchisee to greater performance, and that the effect of environmental competitiveness is significant. This means that where there is high environmental competitiveness, the impact of EO on the franchisee's performance is greater. Therefore, the hypothesis was supported.

*Hypothesis: The franchisee's level of social capital positively affects its performance.*

Model 3 in the regression model is statistically significant. As shown in Table 4-24, the franchisee’s social capital is correlated with the performance at the 0.01 confidence level. According to Table 4-25, social capital ( $\beta = .162, p < .05$ ) significantly is related to the franchisee’s performance. Therefore, the hypothesis, which predicted a positive influence of franchisee’s social capital on its performance, is supported.



*Hypothesis: The franchisee's human capital, representing tacit and explicit knowledge, positively affects its performance.*

According to Table 4-25, Model 2, including human capital items entailing the franchisee's experience in a franchise system before joining the current system and the franchisee's experience in the fast-food industry, has no statistically significant F-score. However, positive correlation shows the importance of them in performance. Moreover, years of education does not significantly affect the performance. Therefore, it showed that the franchisee's human capital, representing tacit and explicit knowledge, has no influence on its performance. As a result, the hypothesis is not supported.

*Hypothesis: The franchisee's human capital, representing managerial capabilities, positively affects the outlet's performance.*

Model 3 in the regression model is statistically significant, and all independent variables in the franchisee-related factors account for about 36 percent of the variation in the franchisee's performance. As shown in Table 4-25, the franchisee's managerial capabilities are correlated with the performance at the 0.01 confidence level. According to Table 4-26, managerial capabilities ( $\beta = .137$ ,  $p < .059$ ) are significantly related to the franchisee's performance. Therefore, the hypothesis, which predicted a positive impact of franchisee's managerial capabilities on its performance, is supported.

#### 4.7.1.1 Post hoc analysis of franchisee related factors:

As previously mentioned, the closeness of the AVE value of the Schumpeterian EO to the borderline ( $AVE \geq .5$ ) leads to the examination of its effect on performance. Therefore, Schumpeterian EO was entered into the regression model. Entering the Schumpeterian EO in the multiple regression model does not change the R square, and the Schumpeterian EO ( $\beta = .012$ ,  $p \geq .869$ ) is not significantly related to the franchisee's performance (Table 4-26). Therefore, even in the presence of the Schumpeterian EO, the hypotheses concerning the effect of franchisee's Schumpeterian EO and environmental factors (as moderators) on franchisee's performance were not supported.

Table 4-26: Post hoc regression analyses of franchisee-related with Schumpeterian EO

variables	Model 1		Model 2		Model 3		Model 8	
	Beta	Sig	Beta	Sig	Beta	Sig	Beta	Sig
Constant		.000		.000		.806		.893
Country	.082	.327	.071	.395	.216	.003	.217	.004
Business age	-.011	.159	-.11	.180	-.05	.443	-.04	.485
Pre-work in franchising			.111	.156	.015	.815	.015	.815
Pre-work in fast food industry			.092	.243	.050	.429	.053	.402
Education level					.048	.460	.047	.476
Managerial capability					.137	.059	.142	.051
Kirznerian EO					.238	.001	.248	.001
ACAP					.287	.000	.269	.001
Social capital					.162	.029	.166	.026
Schumpeterian EO							.012	.869
$R^2$	0.12		.039		.408		.408	
Adjusted R Square	.001	.341	.017	.093	.377	.000	.373	.869
R square change							.000	
F-value	1.08		1.754		12.898		11.645	

#### 4.7.2 Hypotheses related to the franchisor related factors

In the second section of hypotheses in the study, those that concerned the franchisor-related factors were assessed. In this section, after reviewing the literature and based on the relational view, franchising system profitability, training in a franchise system, providing the raw material, advertising, and brand reputation have been considered as those factors that impact the franchisee's performance in a franchising system. Table 4-27 shows the descriptive statistics and correlation matrix of the franchisor-related factors.

As is shown in Table 4-27, all independent variables in the sample are correlated with the performance at the 0.01 level. Among the independent variables, franchising brand reputation has the highest correlation with the performance and training has the lowest correlation. However, the high correlation coefficient in all the variables shows the importance of all of them in the franchisee's performance.

Table 4-27: Scale properties, descriptive statistics, and correlation matrix of franchisor-related factors

	Mean	St. Deviation	Training	Advertising	System profitability	Brand reputation	Raw material	Performance
Training	5.53	.94	1					
Advertising	5.75	.87	.015	1				
System profitability	4.88	1.00	.239**	.200**	1			
Brand reputation	5.84	.87	.124	.671**	.273**	1		
Raw material	5.40	1.08	.410**	.308**	.310**	.544**	1	
Performance	4.83	1.16	.225**	.522**	.498**	.550**	.466**	1

\*\* Correlation is significant at the 0.01 level (2-tailed).

\* Correlation is significant at the 0.05 level (2-tailed).

The regression model of franchisor-related factors (Table 4-28) in the sample has no statistically significant F-test scores when it just controls the country in the first model. Model 1 in the regression only explains the less than 1% of variation in the franchisee's performance. The second model, with franchising system profitability, training in a franchise system, providing the raw material, advertising, and brand reputation as independent variables has statistically significant F-test scores, and it can be concluded that the models contain good explanatory power. The second model containing the variables accounts for more than 48% of the variation in the franchisee's performance. The VIF in this model was within tolerable limits, and there is no multicollinearity between the

constructs in each model. Each model is further explained in the explanation of each hypothesis.

Table 4-28: Regression analyses of franchisor-related factors on the franchisee's performance in the total sample

variables	Model 1		Model 2	
	Beta	Sig	Beta	Sig
Constant		.000		.022
Country	.024	.320	.059	.292
Training			.032	.615
Advertisement			.183	.018
System profitability			.368	.000
Brand reputation			.175	.040
Raw material			.213	.005
R <sup>2</sup>	.000		.487	
Adjusted R Square	-.006	.877	.47	.000
R square change	.001.		.487	
F-value	.102		27.268	

According to the third chapter, the following statements demonstrate the hypotheses in this section.

*Hypothesis: The profitability of a franchise system affects the franchisee's performance.*

Model 2 in the regression model is statistically significant, and all independent variables in the franchisee-related factors account for about 48 percent of the variation in the franchisee's performance. As shown in Table 4-27, the profitability of a franchise system is correlated with the performance at the 0.01 confidence level. According to Table 4-28, the profitability of a franchise system ( $\beta = .368, p < .001$ ) is significantly related to the franchisee's performance. This means that franchisees that are working in a franchising system with higher profitability than others are, have greater performance. Therefore, the hypothesis, which predicted a positive influence of profitability of a franchise system on the franchisee's performance, is supported.

*Hypothesis: The training program in a franchise system positively affects the franchisee's performance.*

As shown in Table 4-28, training in a franchise system, including initial and ongoing training, is not a significant variable in the franchisee's performance ( $\beta = .032, p < .615$ ). However, according to Table 4-27, training is significantly correlated to the franchisee's performance ( $r = .225, p < .01$ ). While according to the resource-based view, training leads the business to greater performance than other competitors, even performing

simple regression indicated that training in a franchise system does not increase the R square. Meanwhile, entering the other independent variables increase the R square by 48 percent.

*Hypothesis: The franchisor, by providing the raw material, positively affects the franchisee's performance.*

As shown in Table 4-27, providing the raw material is correlated with the performance at the 0.01 confidence level. According to Table 4-28, the franchisor's provision of raw material ( $\beta = .213$ ,  $p < .005$ ) is significantly related to the franchisee's performance. This means that the franchisor's provision of raw material in a system positively affects the franchisee's performance. Therefore, the hypothesis, which predicted a positive impact of providing raw material by the franchisor and on the franchisee's performance, is supported.

*Hypothesis: Advertising in a franchise system positively affects the franchisee's performance .*

As shown in Table 4-27, advertising in a franchise system is correlated with the performance at the 0.01 confidence level ( $r = .522$ ,  $p < .01$ ). According to Table 4-28, Model 2 indicates that advertising by the franchisor in a franchise system, and helping the franchisees in local advertising ( $\beta = .183$ ,  $p < .018$ ), is significantly related to the franchisee's performance. This means that franchisees working in a franchising system with more advertising and get help from the franchisor in developing local advertising, show greater performance. Therefore, the hypothesis, which predicted a positive effect of advertising in a franchise system on the franchisee's performance, is supported.

*Hypothesis: Franchisor brand reputation positively affects the franchisee's performance .*

As shown in Table 4-27, franchisor brand reputation has the highest correlation coefficient with performance at the 0.01 confidence level ( $r = .550$ ,  $p < .01$ ). According to Table 4-28, franchisor brand reputation ( $\beta = .175$ ,  $p < .05$ ) is significantly related to the franchisee's performance. This means that those franchisees working under a well-known brand will shows better performance than others. Hence, the hypothesis, which predicted

a positive influence of the franchisor’s brand reputation on the franchisee’s performance, is supported.

### 4.7.3 Hypotheses related to the relationship between the franchisor and the franchisee

The third section in hypothesis testing addressed the relationship between the franchisor and franchisee. The franchisee's perception of trust, satisfaction, and conflict with the franchisor's business are those factors that have been identified as influential in the franchisee's performance.

Table 4-29 shows the descriptive statistics and correlation matrix of relationship factors.

Table 4-29: Scale properties, descriptive statistics, and correlation matrix of relationship factors

	Mean	St. Deviation	Trust	Satisfaction	Conflict	Performance
Trust	5.248	1.15	1			
Satisfaction	5.30	1.31	.746**	1		
Conflict	2.83	1.14	-.687	.737**	1	
Performance	4.87	1.10	.542**	.581**	-.586**	1

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).

As is demonstrated in Table 4-29, all independent variables correlated with the performance at the 0.01 level. Among the independent variables, the franchisee’s conflict has the highest (negative) correlation with performance. However, all the variables' correlation coefficients with the performance are close to each other. A high correlation coefficient in all the variables shows the importance of all of them in the franchisee’s performance.

The regression model of the franchisor-related factors (Table 4-30) sample has no statistically significant F-test scores when it just control the business age and country in the first model. The second model, with the franchisee’s trust in the franchising system, the franchisee’s satisfaction with the franchising system, and trust and conflict between the franchisor and franchisee as independent variables, has statistically significant F-test

scores and explain 41% of the variation in the franchisee's performance. Therefore, it can be concluded that the models contain good explanatory power. The VIF in this model was within tolerable limits, and there is no multicollinearity between the constructs in each model. Each model is further explained in the explanation of each hypothesis.

Table 4-30 Regression analyses of relationship factors on the franchisee's performance

Variables	Model 1		Model 2	
	Beta	Sig	Beta	Sig
Constant		.000		.000
Business age	-.06	.421	.051	.442
Country	.01	.903	.072	.272
Satisfaction			.229	.03
Conflict			-.310	.001
Trust			.182	.066
$R^2$	.004		.413	
R square	-.07	.694	.397	.000
R square change	.004		.409	
F-value	.365		24.795	

According to the third chapter, the following statements demonstrate the hypotheses in this section.

*Hypothesis: The franchisee's trust positively affects its performance.*

As shown in Table 4-29, the franchisee's trust in a franchise system has a high correlation coefficient with performance at the 0.01 confidence level ( $r = .542$ ,  $p < .01$ ). However, according to Table 4-30, franchisee trust in a franchise system ( $\beta = .182$ ,  $p < .1$ ) is significantly related to the franchisee's performance. It appears that a high intercorrelation between trust, conflict and satisfaction modifies the effect of the franchisee's trust in a franchise system on the franchisee's performance. Therefore, the hypothesis, which predicted a positive effect of franchisee's trust toward relationship, on its performance, is supported at the P value of 0.1.

*Hypothesis 12: The franchisee's satisfaction with franchisor, positively affects the franchisee's performance.*

As shown in Table 4-29, the franchisee's satisfaction with the franchise system has a high correlation coefficient with the performance at the 0.01 confidence level ( $r = .581$ ,  $p < .02$ ). According to Table 4-30, franchisee satisfaction in a franchise system ( $\beta = .229$ ,  $p < .05$ ) is significantly related to the franchisee's performance. Therefore, the hypothesis,

which predicted a positive influence of the franchisee's satisfaction toward the relationship with the franchise system, upon its performance, is supported.

*Hypothesis: The franchisee's perceptions of conflict in a franchise negatively affect its performance.*

As shown in Table 4-29, the franchisee's perceptions of conflict in a franchise has the highest correlation coefficient, but negative, with the performance at the 0.01 confidence level ( $r = -.586, p < .01$ ). According to Table 4-30, the franchisee's perceptions of conflict in a franchising system ( $\beta = -.310, p < .001$ ) is significantly related to the franchisee's performance. Therefore, the hypothesis, which predicted a negative effect of the franchisee's perceptions of conflict in a franchise on its performance, is supported.

#### Post hoc analysis of relationship factors in a franchisee's performance:

To further investigate the relationships between satisfaction, conflict, and performance, given the high intercorrelation between satisfaction, conflict and trust, and low-significance of trust ( $\beta = .182, p = .06$ ), the mediation effect of conflict between satisfaction and performance is evaluated.

A multiple regression analysis was conducted to assess each component of the proposed mediation model. After conducting a multiple mediation with trust as an independent variable, satisfaction and conflict as mediators, and country and business age as a covariate variables, it is found that trust was negatively associated with conflict ( $\beta = -.70, t = -13.4, p = .000$ ) (Effect of trust on conflict (a path)). It was also found that trust was positively related to performance ( $\beta = .55, t = 9.2, p = .000$ ) (c paths). Lastly, the result indicated that the mediator, conflict, was negatively associated with performance ( $\beta = -.28, t = -3.27, p = .000$ ) (Direct Effects of Mediators on DV (b paths)). Because both the a-path and b-path were significant, mediation analyses were tested using the bootstrapping method with bias corrected confidence estimation (Preacher and Hayes, 2004). In this study, the 95% confidence interval of the indirect effects was obtained with 5,000 bootstrap resamples (Preacher and Hayes, 2008). The result of the mediation analysis



confirmed the mediating role of negative conflict interactions in the relationship between trust and performance ( $\beta=.55$ ,  $CI= .18$  to  $.34$ ). In addition, the result indicated that the direct effect of trust on performance ( $\beta=.1753$ ,  $t= 1.86$ ,  $p=.064$ ) is less than the indirect one when controlling for negative conflict interaction, thus suggesting complete mediation.

Moreover, it is found that trust was positively associated with satisfaction ( $\beta= .85$ ,  $t= 14.90$ ,  $p=000$ ) (Effect of trust on satisfaction (a path)). It was also found that trust was positively related to performance ( $\beta=.54$ ,  $t= 9.105$ ,  $p=000$ ) (c paths). Lastly, the result indicated that the mediator, satisfaction, was positively associated with performance ( $\beta= .19$ ,  $t= 2.21$ ,  $p=.02$ ) (Direct Effects of Mediators on DV (b paths)). Because both the a-path and b-path were significant, mediation analyses were tested using the bootstrapping method with bias corrected confidence estimation (Preacher and Hayes, 2004). In this study, the 95% confidence interval of the indirect effects was obtained with 5,000 bootstrap resamples (Preacher and Hayes, 2008). The result of the mediation analysis confirmed the mediating role of positive interactions in the relationship between trust and performance ( $\beta=.55$ ,  $CI= .018$  to  $.34$ ). In addition, the result indicated that the direct effect of trust on performance is less than the indirect one ( $\beta=.1753$ ,  $t= 2.7$ ,  $p=.064$ ) when controlling for positive satisfaction interaction, thus suggesting complete mediation.

Therefore, the franchisee's perception of conflict and satisfaction mediated the relationship between trust and the franchisee's performance.

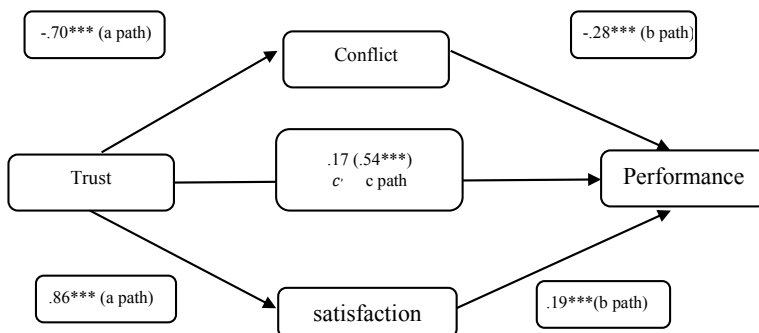


Figure 4-5: Indirect effect of trust on performance through conflict and satisfaction

- $P \leq .05$  \*\*  $p \leq .01$  \*\*\*  $P \leq .001$



## Chapter 5: Discussion

The purpose of this study was to examine the factors that affect the performance of franchisee from the perspective of franchisee. Accordingly, the relevant theories and literature were reviewed in chapter 2, and hypotheses were drawn in three different groups, including franchisee-related factors, franchisor-related factors, and relationship between the franchisee and franchisor, to meet the purpose.

Hypotheses 1, 2, 3, and 4 involve the relationship between franchisee-related factors and their performance. Furthermore, six sub-hypotheses also explain the interaction effect of environmental dynamism and environmental competitiveness on the linkage between the franchisee's absorptive capacity, entrepreneurial orientation, and performance. As presented in preceding chapter, the following section (5-1) discusses the result of franchisee-related factors.

According to the relational view and review of the literatures, 5 hypotheses were developed to study the franchisor-related factors in franchisee's performance. Therefore, given the analyses of empirical data in the fourth chapter, section 5.2 in this chapter discusses the hypotheses 5, 6, 7, 8 and 9, and examine the relationship between franchisor-related factors and the franchisee's performance.

Finally, section 5.3 examines the factors related to the relationship between the franchisee and the franchisor. This section entails the discussion of hypotheses 10, 11 and 12.

### 5.1 Franchisee-related factors in franchisee's performance:

As presented in chapter 4 (see Table 4-25), after performing multiple regression, it is found that Kirznerian EO, absorptive capacity, managerial capability, and social network positively affect the performance at a significant level. The result of each hypothesis will be discussed in the following sections.

### 5.1.1 Absorptive capacity:

The first hypotheses in this study relates to the role of franchisees' ACAP in their performance. As shown in the Model 3 of regression table (Tables 4-25), it confirmed that the franchisees' absorptive capacity positively affected their performance. The finding is on the line with Lev et al. (2009), Bergh and Lim (2008) and Segarra-Ciprés et al. (2014).

Franchisees perform their business in a network in which, in addition to the franchisor, they are connected with other franchisees in a franchise system. Each franchisee in a franchise system also has its own knowledge and experience about the business. Therefore, the exchange of resources such as knowledge and experience between these actors in a franchise system can create rent for the franchisees. In business format franchising, the franchisor attempts to convey tacit and explicit knowledge to the franchisees through initial training, ongoing training, and practical experience. Although almost all franchisees are taking advantage of the same resources in a system, they display different levels of performance. This shows that the firms' ability in identifying and applying the information and knowledge is associated with their capabilities or competences, and only the franchisees with high absorptive capacity can gain it and apply it in their businesses. Therefore, those who have more capability in acquisition and exploitation of information in a system will perform better than others.

Moreover, franchisees in different local markets need to collect information and knowledge about their marketplace. Franchisees that always strive to keep themselves updated, significantly display better performance. Absorptive capacity helps them to constantly search for new developments in the marketplace and adapt to them. As a result, they can appropriately react to the new information, and through transferring and exploiting business operations and commercial ends, improve their performance.

In a franchising context, the role of ACAP depends on the source of new knowledge and information. When the new information is distributed by the franchisor to apply in the outlets of a system, the franchisee's ACAP will help the franchisee to achieve greater performance. Otherwise, applying the new knowledge and information from external knowledge depends on the nature of the component in the business format franchising. If a franchisee obtains the some new information about the core elements of

components, they will not be able to apply it in their activities, and they first need to inform the franchisor. Applying the new knowledge and information in a peripheral element, such as knowledge about promotion and advertisement techniques or payment methods, would have no restriction. Of course, the degree of standardization in each system will also affect the flexibility between the core and peripheral elements in business format franchising.

As is shown in Table 4-25, this study found that the franchisee's absorptive capacity is positively related to performance. Consistently, Lev et al. (2009), Bergh and Lim (2008) and Segarra-Ciprés et al. (2014) reported a positive influence of ACAP on the performance. Despite the abundance of research on the subject of ACAP, little research has been conducted from a franchising context. In one of the rare studies on franchising, Minguela-Rata et al. (2012) studied the ACAP in franchising and found it does not affect uniformity. However, that author excludes knowledge recognition in the study. This study assumes that according to previous studies (Flatten et al., 2011), all dimensions of absorptive capacity must coexist and fulfill each other to lead franchisees to better performance. Moreover, Darr et al. (1995) studied the importance of potential ACAP on a franchisee's firm-specific learning capabilities, and found acquisition of transferred knowledge by the franchisor depends on the franchisee's firm-specific learning capabilities. Brookes (2014) also indicates the role of absorptive capacity in knowledge transfer in international master franchisees.

ACAP in franchised outlets enable franchisees to overcome the competence traps that prohibit them in appropriate responsiveness (Liao et al., 2003). Although the franchisee already has the franchisor and the other franchisee's experience and recommendations, ACAP helps the franchisee to, in addition to relying on their own experience and existing knowledge in the outlet, explore external information. Therefore, they can overcome the familiarity and maturity traps (Ahuja and Lampert, 2001) in the franchising context. Moreover, since the franchisees are members of a big network, probably with a highly well-known brand, it makes them to rely on their existing knowledge and avoid the major shifts in the external environment (Liao et al., 2003). Therefore, the franchisee's ACAP will help them to prevail over the propinquity (nearness) traps (Ahuja and Lampert, 2001).

Moreover, ACAP in different environmental conditions leads franchisees to different performance. As shown in the regression result, environmental competitiveness moderates the relationship between the franchisee's ACAP and performance (see Model 5 and 7 in Tables 4-25). As was shown through the interaction plot (Figure 4-2), the franchisee's ACAP leads it to higher performance in a more highly competitive environment. Moreover, according to the result of the multiple regression, ACAP does not significantly explain the difference in performance in a dynamic environment. However, conducting a scatter plot (Figure 4-1) between the ACAP and the franchisee's performance in low and high environmental dynamism shows a positive relationship between the ACAP and performance when the environment is dynamic. Moreover, although according to regression table (Model 7 at Table 4-25) interaction effect environmental dynamism and ACAP is not enough large, and hypothesis is not supported, result shows ( $\beta = .094$ ,  $p < .13$ ), its effect is not such small to ignore it. Running a simple linear regression without other independent variable in this section also showed a significant effect of interaction model.

Applying Jansen's (2005) recommendation to include the environmental competitiveness in ACAP, this study found that the effect of environmental competitiveness on the relationship between the ACAP and performance is supported. Given the contingency theory, a turbulent environment urges franchisees to establish a mechanism through which to gain a competitive knowledge. Franchisees in a competitive and dynamic environment, strive to gather information from different sources to adapt with competitive environment and appropriately respond. According to Lev et al. (2009), potential ACAP, influenced by competitive intensity, enables the franchisee to develop new competitive knowledge and realized ACAP enhances exploitation of existing knowledge with other resources to improve their performance, and to perform better than others. In fact, in a competitive environment, the franchisee's absorptive capacity enables it to better fit with the internal vision and external conditions, appropriately answer customers' and stakeholders' needs, and better incorporate experience and objectives.

As discussed before about the result of environmental dynamism interaction effect, consistent with Jansen et al. (2005) and Zahra and George (2002), it can be concluded that increasing the ACAP enables franchisees to improve their performance in dynamic environment. As discussed in chapter 2, the dynamic environment always

contains new information, and franchisees need a mechanism through which to grasp and apply it in their business (Jansen et al., 2005). In fact, franchisees with potential ACAP reconfigure their resources and spread knowledge at a lower cost, and the franchisees' realized ACAP in dynamic markets also helps them to, based upon their potential absorptive capacity, select and exploit certain aspects of newly acquired knowledge.

Earlier empirical research underlines the crucial role of recognizing the value of new external knowledge for the survival of firms in dynamic environments (Todorova and Durisin, 2007). ACAP in the dynamic environment empowers the business to acquire, assimilate, and exploit new information. Therefore, franchisees, who are performing their business in a dynamic environment, will need more capability in prediction and acquisition of change in the market. They will need to anticipate the trend in the market and estimate the effect of change in their business to suitably answer the external demands.

#### 5.1.2 Entrepreneurial Orientation

As demonstrated in the data analysis section (table 4-11, and 4-12), after conducting a confirmatory factors analysis there were no convergent measurements among autonomy, risk taking and innovativeness in forming the Schumpeterian EO. Therefore, this construct was removed from further analysis. However, regarding the closeness of the AVE value to the threshold of .5, a post hoc analysis was performed to find the effect of Schumpeterian EO on the franchisees' performance.

The second hypothesis in this study involves the relationship between the franchisee's Schumpeterian and Kirznerian EO and performance. Performing a multiple regression (Model 3 at Tables 4-25) showed that there is a positive relationship between Kirznerian EO and the franchisee's performance. Meanwhile, a post hoc analysis of the franchisee's related factors in the presence of Schumpeterian EO shows it did not significantly affect performance (Section 4-7-1-1). However, correlation analysis of the data indicates a positive relationship between Schumpeterian and Kirznerian EO and the franchisee's performance.

Regarding the importance of context in the influence of EO on performance, it is worthwhile to study the linkage between each individual dimension of an EO and the business performance in a franchising context. It also is important to know what kind of entrepreneurial behaviors are useful in a franchising context. Therefore, in this study, following the categorization of EO by Lumpkin and Dess (1996, 2006), Hughes and Morgan (2007), Lechner and Gudmundsson (2014) and Sundqvist et al. (2012), the desire was to determine which dimensions of the EO secure performance in a franchising context. Thus, this study considered EO as a multidimensional construct and distinguished five dimensions of entrepreneurial orientation in two major categories entailing Kirznerian EO and Schumpeterian EO. Schumpeterian EO includes innovativeness, risk taking, and autonomy, while Kirznerian EO includes proactiveness and competitive aggressiveness.

To clarify the entrepreneurial activities in a franchising context and explain the findings of this study, a more detailed view about standardization and adaptation is needed. In a franchise system, the franchisee is doing a business under the franchisor's control and is not allowed to deviate from its rule. In a franchise system, on the one hand the franchisor to takes advantage of a large business, develops standardization throughout the system; on the other hand, franchisees operate their outlets in different local markets, in different environmental conditions, and with different customer preferences (Dada et al., 2012). Although given the necessity of standardization, the franchisees' entrepreneurial activities can even jeopardize the system, ignoring the franchisees' capabilities and abilities in entrepreneurial activities may prevent a franchise system from taking advantage of environmental change and adapting to marketplace preferences (Ketchen et al., 2011). Therefore, although the franchisor sets standard rules and mechanisms to pursue quality control, cost minimization, and image uniformity (Kaufmann and Eroglu, 1999), differences in the nature of the local market will result in the franchisee's requests for adaptation in various aspects of the business. Thus, the franchisor needs to make a balance between the standardization and adaptation strategies.

The best option is to balance these two strategies associated with the business format components in a system. According to Kaufmann and Eroglu (1999), business format franchising is comprised of various elements with four distinct components: product/service deliverables, benefit communicators, system identifiers, and format



facilitators. All elements that encompass each of the four format components do not have the same importance, and the “core” and the “peripheral” elements of each format component are different (Kaufmann and Eroglu, 1999). Core elements in business format franchising are "those whose standardization must be enforced across all franchisees without exceptions since they are deemed indispensable for the system’s survival.” Moreover, peripheral elements are "those where the franchisor must balance the system-wide benefits of standardization against the benefits of adaptation to the idiosyncrasies of local demand" (Kaufmann and Eroglu, 1999). For example, in Table 5-1 we can find the distinction between core and peripheral elements of the business format in a restaurant.

Table 5-1: Distinction between core and peripheral elements of the business format in a restaurant.				
	Product/services deliverables	Benefit communication	System identifiers	Format facilitators
Core	Basic menu Accuracy of work	Clean uniforms/aprons Professional certification	System name Trademark, logo	Sales reporting procedure Operations manuals
Peripheral	Hours of operation Parking	Mint on pillow Display of certification	Color of scheme Decor of unit	POS equipment Local advertising

As a result, given the elements of the components in a franchising context, each Schumpeterian and Kirznerian EO can be discussed. As presented in Table 4-26, this research has shown that Schumpeterian EO, including innovativeness, risk taking and autonomy, does not affect the a franchisee’s performance . Innovations in a franchise system can be placed into two main categories, product-market innovation, and administrative innovativeness (Dess and Lumpkin, 2005). Product market innovation includes innovation in market research, product design, and innovations in advertising and promotion, while administrative innovativeness refers to novelty in management systems, control techniques, and organizational structure (Dess and Lumpkin, 2005). Innovation in a franchise system is primarily under the control of the franchisor (Maritz, 2006); the franchisee is only allowed to have innovation in the peripheral product in market innovation elements, and innovation in administration is beyond their authority. Therefore, franchisees’ innovation would be restricted to incremental innovations in market research, advertising, and promotion. Consequently, innovation in these dimensions cannot lead to a distinguished advantage for the franchisee that comes up with a new idea in peripheral elements. Eventually, this can be considered as an explanation for why innovativeness in a franchise system by the franchisee does not significantly affect the performance.

However, innovativeness is correlated with performance, and it means that the franchisees with higher innovativeness will show higher performance.

According to Lumpkin and Dess (1996), risk taking refers to the willingness to commit resources to implement projects, activities, and solutions that contain an inherently high level of uncertainty. Although in a franchise system, the franchisees risk their money at the outset, since their risk is limited to the peripheral element, it does not involve high uncertainty. When it comes to risk taking, an entrepreneur must tolerate one of two possible scenarios: risk of failing and the risk of missing an opportunity (Hughes and Morgan, 2007). In a franchising system, a franchisee takes advantage of the experience of the franchisor and the other franchisees in the system, and that can reduce the risk of an action as much as possible. Moreover, they never commit significant resources in a highly uncertain environment, because it might jeopardize the system's reputation. Therefore, it would make sense that risk taking does not make any difference in the franchisees' performance.

Autonomy is one of the most challenging issues in franchising. While in a franchise system, a franchisor desires to develop standardization and control throughout the system, a franchisee who has paid money for the business likes to apply its ideas to the business and be autonomous. This makes the franchisees more conservative in undertaking their own ideas. Autonomy in this study has the lowest mean value in the sub-dimensions of EO. While there is a correlation between autonomy and performance, it does not affect performance. This shows that the franchisee in a franchising context does not feel free to act, as it would like.

The autonomy of the businesses allows them to display entrepreneurial initiation without bureaucratic rigidity and being fearful to support or engage in new ideas. Nevertheless, in a franchising context within a highly standardized system, the franchisee must first consult with the franchisor, and then implement their idea. In fact, franchisees' autonomy in a franchise system is controlled by the franchisor, and since the franchisors set the rules for all franchisees, the franchisee's autonomy cannot account for variation of performance. In summary, Schumpeterian EO, including innovativeness, risk-taking, and autonomy would have no significant influence on the performance.

As is shown in the results (see Model 3 at Table 4-25), Kirznerian EO, including proactiveness and competitive aggressiveness, had a positive influence on performance, and was highly correlated with performance. Kirznerian EO had the highest influence on performance, and explains the high variation of performance in a franchised outlet. Proactiveness indicates the opportunity-seeking behaviors that keep the franchisee ahead of the competition by anticipating future demand (Rauch et al., 2009). Therefore, in proactiveness, being knowledgeable about current and future customer preferences and subsequently acting upon them plays an important role. In the fast-food industry, customers' preferences constantly change, and the franchisees with high proactiveness will be able to anticipate and identify new trends and take advantage of them sooner than others. Moreover, since the franchisees are spread out in different local markets, those with knowledge about the local market can proactively scan the environment to highlight opportunity areas. Therefore, as result showed, consistent with Falbe et al. (1999), proactiveness have a significant positive association with performance. According to previous studies, in a franchising context, the franchisee is able to promote or constrain proactiveness and follow the aspirations that exceed current resources (Falbe et al., 1999). Therefore, proactiveness in a franchising context is one of the major dimensions that demonstrate a positive effect on performance.

Competitive aggressiveness helps franchisees to monitor their competitors, and find a way to appropriately respond to trends and demands that exist in the marketplace. The restaurant industry is one of the most competitive (Vukasovič, 2012), and one in which firms strive to compete and surpass their competitors' actions. Therefore, franchisees with high competitive aggressiveness apply the techniques in reaction to a competitor's strategy. They are able to continuously assess competitors, exploit market information, and use unconventional tactics to compete with rivals in peripheral elements of business format franchising. Consequently, franchisees can compete more aggressively in the local marketplace to gain market share. Moreover, by monitoring competitors' behaviors in the marketplace, aggressive franchisees will target their rivals' weaknesses, and through undermining their competitors' abilities improve their performance (Hughes and Morgan, 2007). A strong, competitively aggressive stance also gives a franchisee the ability to be a decisive player in a field of rivals, and act forcefully to secure or improve its position (Walter et al., 2006, Lumpkin and Dess, 1996a). It will also enable the franchisee to

acquire market share and outperform its rivals through the ability to redefine the service and product, revise the rules of competition, and improve its marketplace position (Lumpkin and Dess, 2001, Zahra and Covin, 1995, Li et al., 2009b).

As is shown in Table 4-28 and consistent with previous studies (e.g. Hughes and Morgan, 2007, Kraus et al., 2012, Lumpkin and Dess, 2001), in the franchising context, components of EO have generated interesting findings. Following Lumpkin et al. (2006) and Hughes and Morgan (2007), it seems in a franchise context not all dimensions of EO can explain the relationship between EO and performance and Kirznerian EO, including proactiveness and competitive aggressiveness are the only subdimensions of EO that affect performance. Consistent with the result of this study, Lumpkin et al. (2006) indicate that new ventures' innovativeness and risk-taking behaviors become less strongly associated with their performance as they grow. Conversely, a venture's proactiveness and competitive aggressiveness were shown to develop stronger positive associations with new venture performance over time (Lumpkin et al., 2006). Hughes and Morgan (2007), by applying the five dimensions of EO in a study, found that only proactiveness and innovativeness were positively related to business performance. Their study also showed that risk taking had a negative relationship to business performance, and competitive aggressiveness and autonomy had no link with business performance value at this stage of firm growth.

#### Environmental discussion of EO:

Given the contingency theory, environmental factors may affect the relationship between EO and performance. This study examined the effect of two environmental constructs, dynamism, and competitiveness, in a franchising context.

The result of the moderation effect (see Model 4 and 6 in Table 4-25), showed that the relation between EO and performance is affected by environmental conditions. The result indicates that environmental dynamism positively affects performance. In a franchising context, a dynamic environment boosts this link, and the franchisee with a higher level of EO will more likely benefit from dynamism. In a highly dynamic environment with rapid change in customer preference, business activities that are based on entrepreneurial initiation will lead the franchisee to better performance. In the

restaurant industry, where customer preference is constantly changing, businesses are continually providing new products and services, and entrepreneurial activities enable the franchisee to achieve a greater level of firm performance. The prevalence of international food, changes the environment in the restaurant industry. Therefore, diversity of food in the marketplace, especially regarding international food, leads the customer to demand diversity in food. Thus, in this context, customers are constantly asking for diversity in products and services from the business, and the franchisees should meet their preferences.

As presented in Tables 4-25 and 4-26, along the lines of the entrepreneurship literature (Robertson and Chetty, 2000, Covin and Slevin, 1989), the entrepreneurial approach does not have the same effect on performance in all environmental contexts (Robertson and Chetty, 2000, Covin and Slevin, 1989), and in some situations it is not even suitable (Covin and Slevin, 1989). In a study by Zahra (1993) it was shown that there is a positive relationship between entrepreneurship and performance among firms in dynamic environments, and a negative affect between them in static environments. Miller (1988) also found that entrepreneurial activities in dynamic environments were associated with improved performance (Kraus et al., 2012). Unlike these studies, Wiklund and Shepherd (2005) found that the role of environmental dynamism is not significant in the relationship between EO and performance. In sum, in this study, and consistent with Covin and Slevin (1991), Zahra (1993a), Miller (1988) and Rauch et al. (2009), environmental dynamism in a franchising context moderates the effect of Kirznerian EO on performance.

Competitiveness is the second environmental condition under which a franchisee's EO exhibits a different outcome. As presented in Table 4-25, environmental competitiveness significantly moderates the relationship between the franchisee's EO and performance. Given the result, the regression model in the sub dimensions of EO can explain the different effects of environmental conditions. This means that in a competitive environment, the franchisee's Kirznerian EO leads it to higher performance. Environmental competitiveness indicates the extent to which competition is intense in an environment (Jansen et al., 2006, Zahra and Bogner, 2000). In a highly competitive environment, customers have no specific preference to select a special firm within the market (Burgers et al., 2009), and the firm should constantly improve its efficiency (Matusik and Hill, 1998). In a competitive environment, intensity of competition exerts

more pressure on franchisees, and entrepreneurial franchisees can take advantage of the more entrepreneurial activities (Casillas et al., 2010). In the franchising context, the external environment also has a crucial role in entrepreneurial strategy from the perspective of the franchisees (Sul and Khan, 2006). For those franchisees that are in different local markets, environmental competitiveness increases the need for entrepreneurial activities.

Although strong innovativeness may be hazardous for the franchisee in a highly competitive environment (Jansen et al., 2006, Zahra and Bogner, 2000), Kirznerian EO would help it to react to competitive trends and demands that already exist in the marketplace (Lumpkin and Dess, 2001). In fact, through incremental and minimal refinements to existing resources, franchisees can overcome intense competitive threats. Competing successfully in a competitive environment would be consistent with a posture of Kirznerian EO in a firm. Firms with higher EO would be able to increase their efficiency by taking bold action, such as sacrificing short-term profitability. The franchisee's proactiveness enables it to identify market opportunities ahead of its rivals. After finding an opportunity before others do through proactive behaviors, franchisees have to rapidly and aggressively seize that opportunity and exploit it for profit. To compete with a rival in a competitive environment, the franchisee also should invest more in marketing, product service and quality, or production capacity. Therefore, with a higher level of Kirznerian EO, the franchisees would be able to enhance their performance in such a competitive environment.

### 5.1.3 Social capital:

Given the contribution of the RBV, a networking relationship with both strong and weak ties in a franchised outlet was analyzed. According the result of analysis (see Model 3 at Table 4-25), this study found a positive and statistically significant effect of social capital including strong and weak ties, on the performance. It indicates that gaining access to a broader set of customers through family, acquaintances, current customers, and industry friends improves the franchisee's performance.

The findings of this study confirm that ties with the customer, acquaintances, family, and friends influence the franchisee's performance. For the franchisee as a small business owner, social capital provides a valuable social resource that is embedded within the network (Florin et al., 2003). Establishing a good network with customers, acquaintances, relatives, and friends will help the franchisee to access more customers and improve its performance. Although, doing business under a well-known brand has great impact on the franchisee's short-term success (Hormiga et al., 2011), after a while, loyal customers, who are prepared to recommend the firm and repeat their purchases, will play an important role in the success of the franchised outlet (Hormiga et al., 2011). Therefore, the franchisee's social capital, in order to find new customers, positively affects its performance. In a franchising context, distributed franchisees in different local markets would have their own personal networks that mostly can influence their access to customers. Social capital will enable the franchisees to enter into a new market segment with new customers (Acquaah, 2007). Moreover, it helps the franchisees to form many links with industry friends who have good experience within a network, and to find the customer needs. Therefore, consistent with prior research (e.g. Chien, 2014, Keh et al., 2007, O'Cass and Weerawardena, 2010), the social network of customer relationships leads franchisees to superior performance.

#### 5.1.4 Human capital:

In this study, tacit and explicit knowledge as well as managerial capabilities represent the human capital. According to the analysis, tacit and explicit knowledge, including the franchisee's education and its previous experience in franchising and the fast-food industry, does not significantly affect performance (see Model 3 at Table 4-25). However, there is a positive correlation between tacit and explicit knowledge, which indicates that franchisees with higher human capital perform better (Table 4-24).

Most of the previous research in management indicates the positive effect of education level and experience on performance (Van Praag and Cramer, 2001, Cooper et al., 1994, Bosma et al., 2004, Van der Sluis et al., 2005). Unexpected findings of this study show that neither education nor previous work in a franchise system affects performance. In spite of the importance of human capital in firm performance, Newbert (2007), by

examining the empirical studies on the resource-based view, found that only 33% of tests supported the relationship between human capital and performance. Moreover, the relationship between knowledge and experience was supported in only 20 to 30 percent of the tests in the previous studies.

Since in a fast-food franchise full training is provided (Jambulingam and Nevin, 1999), it seems potential franchisees are not required to have any experience, and even the franchisor prefers to start with the people new to the business who do not have preconceived ideas about the outlet. Furthermore, one of the most likely explanations for this unexpected result might be related to the partner selection step by the franchisors. In fact, franchisees who are working in a franchise system have already been vetted regarding their education level and experience. According to Jambulingam and Nevin (1999) and Clarkin and Swavely (2006), franchisees' education and experience are used by the franchisor as a key franchisee selection criterion. Therefore, it would be assumed that all franchisees in a system have enough education and experience to manage their own outlets. As a result, it cannot create a variation of performance between the franchisees. Moreover, in fast-food franchising, due to the existence of routines and high standardization, a minimum level of education and experience can lead the potential franchisee to expected performance.

Although firm-specific human capital is a valuable and inimitable resource (Hitt et al., 2001), human resources can easily move between firms and be expropriated by rivals (Hatch and Dyer, 2004). In fact, generating sustained rent through human capital depends on the degree of firm specificity and adjustment cost to work for the other firm (Hatch and Dyer, 2004). Since in fast-food franchising, human capital is not specific to the originating firm and adjustment costs in a new environment cannot prevent immediate expropriation by rivals, it cannot lead the firm to the superior performance.

Analysis of regression (Model 3 at table 4-25) also shows that, consistent with Chandler and Hanks (1994) and Fenwick and Strombom (1998), managerial capabilities in franchising outlets positively affect performance. Managerial capabilities in an outlet enable the franchisees to develop programs, execute strategies, and evaluate performance. Franchisees with managerial capabilities are able to effectively manage and coordinate the outlet's operations. When a problem comes up, they can figure it out and handle the



problem. Moreover, in most of the cases, the franchisees own many outlets and are not able to be in each outlet and directly manage the operations. Therefore, the best way of conducting operations in the outlets is by coaching the employees and delegating tasks to them. Moreover, they would be able to coordinate the activities in an outlet better. A franchisee's managerial capabilities also help them to understand and motivate the other staff in the outlet and empower them.

Therefore, and consistent with Felício et al. (2014a), this study found that human capital factors affect the organizational performance differently. This confirms that the relationship between human capital and success is commonly overemphasized (Baum and Silverman, 2004). However, consistent with Cooper et al. (1994) and Gimeno et al. (1997), in this study, human capital in terms of education as well as previous experience in franchising and the fast-food industry is correlated with the franchisee's performance. Meanwhile, in contrast to previous study (e.g. Dimov and Shepherd, 2005), they does not affect the performance. Moreover, the findings of this study show that there are significant differences between the franchisees with a high and low level of performance regarding differences in their managerial capabilities.

## 5.2 Franchisor-related factors in franchisee's performance:

The next section in the analysis concerns the franchisor-related factors in the franchisee's performance. System profitability, providing the raw material, training, advertising, and brand reputation are those services that examined as offered services to franchisees in a franchising system by the franchisors.

### 5.2.1 System profitability:

The findings of this study (Table 4-28) demonstrate that the profitability of a franchise system positively affects the franchisee's performance. This confirms the view of Holmberg and Morgan (2004b), that those franchisees that are working under a profitable system are more likely to be successful. In a franchise system, the franchisor and the franchisees' interests are dependent on each other (Davies et al., 2011). Therefore, regarding the interdependency of franchisor and franchisee performance, the franchisor's profitability positively affects the franchisees' survival and performance.

### 5.2.2 Raw material:

As presented in Table 4-28, the provision of raw material by the franchisor positively affects the franchisee's performance. Producing products with consistent quality in a franchised outlet depends on the consistency of quality in the raw material, and supplying consistent products in a franchised outlet and an entire system can add value. Therefore, and consistent with Baucus et al. (1993), the result of this study confirms that central purchasing of raw material by the franchisor by offering a product or service with consistent quality affects a franchisee's performance.

Moreover, franchisees in a system can have quick access to raw material, which affects the speed of supplying the final products. The franchisees can order and secure the raw material every time, and as a result can save their own time and workforce for doing business. Therefore, according to the franchisees, the provision of raw material by the franchisor can save time and increase speed in obtaining the raw material and equipment, and add value for the franchisees. According to Preble and Hoffman (1998), the speed of operation in fast-food franchising is an influential factor of performance. In Ryder's (2003) view, speed can create competitive advantages for food sector firms.

Although franchised outlets are considered to be small businesses, they can take advantage of the resources of a big company. The franchisors conduct central purchasing in these systems, and central and high-volume purchasing by the franchisor provides the raw material at a lower cost for the franchisees. In fact, although the franchisees are running a small business, they are still able to enjoy the advantages of a big company in terms of economies of scale. If the franchisee had to purchase the raw material, it would increase the cost of products and services for them. Moreover, the franchisees would have no bargaining power if they wanted to purchase the raw material themselves. Therefore, consistent with Pukelienė and Maksvytienė (2008), Harvey and Jones (1992), and Moonkyu and Francis (1997), this study found that economies of scale, in the result of provision of the raw material by franchisor, positively affects the franchised outlet's performance.

### 5.2.3 Training:

In a franchise system, transferring knowledge and business practices takes place through training, observation, demonstration, and work in successful franchisees. The result of this study (Table 4-28) demonstrates, unlike what was expected, that training conducted by a franchisor in a franchising system does not affect the franchisee's performance. Although training correlates with performance, the influence of training on performance is not statistically significant. Even after conducting the simple regression, training only accounted for less than 4 percent of the variation of the performance in both countries. However, a high correlation between training and performance shows that a higher level of training leads the franchisees to a higher level of performance.

The findings of this study, contrast with those of researchers (Ireland et al., 2002, Michael and Combs, 2008) who claim that training has a role in building firm-specific human capital in a franchisee's competitive advantage. However, consistent with them, in this study training was found to be correlated with performance. Consistent with Westhead and Storey (1996), the results of this study confirm that links between formal training and firm performance are less apparent.

According to Castrogiovanni and Kidwell (2010), there is a difference between a "training" program and a "development" program. While a training program focuses on the skills and abilities of an employee in a current job, a development program has a more long-term approach to prepare an employee for a future job. In a franchising system, training only focuses on standardized operating procedures, and teaching those who are unfamiliar with operations to perform them correctly. Therefore, training as a short-term approach cannot create a specific human capital for the franchisees. However, there is a need to protect the franchisee from unexpected results. Moreover, it seems, a development program in a system can be considered as an important element in training the manager for those outlets that are owned by the franchisors.

Another explanation relates to the specificity of the training. While specific relational assets can be a source of competitive advantage, training in the fast-food industry can be easily transferred to the competitors and cannot bring superior performance for the firms. Although training should increase the ability of workers to acquire and employ skills

and knowledge, it will not typically result in altered performance due to the similarity and training that are almost available to rivals.

#### 5.2.4 Advertising:

In a franchise system, the franchisor is responsible for advertising on a national level. The franchisor also helps the franchisees to promote their services and products in the local market. The result of this study (Table 4-28) shows that advertising by the franchisor in a franchising system, and the franchisor's assistance to the franchisee in local advertising, positively affects performance in a franchised outlet. Consistent with Doherty (2007), the franchisees in this study believed that advertising and marketing support positively effect their success. According to Sheinin and Biehal (1999), advertising has a "pass-through" effect on the brand, and the advertising effect on future operating and market performance is jointly determined by brand (Li Li and Hean Tat, 2007). While use of national advertising brings a huge cost to a business owner, entering into a franchise system allows franchisees to have effective advertising in the national media (Michael, 2003). Therefore, this study confirms, consistent with Lee et al. (2015), that advertising in restaurant industry firms positively affects the franchisee's long-term performance.

In the fast-food industry, there are many businesses with almost similar products and services. Therefore, in a highly competitive market, advertising helps the franchisees to differentiate themselves locally (Kamal and Wilcox, 2013). Moreover, advertising will affect consumer perceptions and shape consumption behavior. According to Dhar and Baylis (2011), confining the amount of fast-food advertising negatively affects consumption in the fast-food industry. In their study, Andreyeva et al. (2011) found that soft drink and fast-food television advertising was associated with increased consumption of soft drinks and fast food. Advertising also has a "durable" effect in the businesses (Assmus et al., 1984, Berkowitz et al., 2001), and its carryover effects last up to three years (Li Li and Hean Tat, 2007). Therefore, advertising in a franchising system, through influencing consumer attitudes and behavior, positively affects the franchisee's performance.

Moreover, the franchisor's advertising in a system creates the advantage of economies of scale, and enables the franchisee to compete effectively against established firms in the local market. The franchisee can also use other franchisee's experience in a

network for developing good local advertising. Moreover, providing effective materials for advertising and promotional materials in the local media and the franchisee's marketplace can lead them to better performance. Advertising in a franchise system also creates value for the franchisees as well as market barriers to prevent competitor entry.

#### 5.2.5 Brand

Given the findings of this study, reputation of a franchise system positively affects a franchisee's performance (see Table 4-28). Therefore, and consistent with Felício et al. (2014b), Barthélemy (2008), Gorovaia and Windsperger (2013) and Li Li and Hean Tat (2007), a franchisee's performance in this study was found to be strongly influenced by the brand reputation of the franchise system. Reputation is considered as an important factor in a firm's success in the restaurant industry. Because of the mobility of customers among geographic areas in the restaurant industry (Combs and Ketchen, 1999b), brand name serves as a signal and reduces the cost of searching unfamiliar retail markets for customers. Despite the importance of brand image in the fast-food industry, the franchisees would not be able to do their entire branding task individually. Creating brand equity requires a cumulative process over time, and franchisees can take advantage of this without spending time and money. Therefore, the franchisee in a franchise system will be able to get the benefit from the franchisor's investment in a brand. While market awareness is one of the biggest obstacles for starting a small business (Herrington, 2005), joining a franchise system with a well-established brand name brings the advantage of a competitive franchise system for the potential franchisee (Falbe and Welsh, 1998, Chiou et al., 2004a). Simply put, when customers know the brand, they will more likely buy the product.

Moreover, according to Grant (1991), franchisor reputation in a franchising system, as a complementary resource (Dyer and Singh, 1998), through creating a differentiation advantage leads the franchisee to superior performance. The positive effects of investments in brand names by the franchisor also extend to the franchisees (Michael and Combs, 2008). In a franchise system, doing business under a franchisor brand also reduces market uncertainty and cost of entrance into the new market. Moreover, compared to the non-franchised businesses, consumers do not deal with transaction anxiety by focusing on the franchisor's brand. Therefore, as a complementary resource, the brand

reputation of a franchise system can create relational rent (Dyer and Singh, 1998), and lead the franchisees to better performance in the local market. Franchisees with a successful brand will create more stability, in terms of performance, in the marketplace (Chien, 2014).

### 5.3 Relationship factors in franchisee's performance:

Factors related to the relationship between the franchisor and franchisee is subject of the third section in studying the franchisee's performance. Satisfaction, trust, and conflict are three major factors that have been examined in this part. Give the result (table 4-29), there is a high intercorrelation between these three factors in a franchising system. Therefore, in this section, in addition to examining the direct relationship between each independent variables of trust, satisfaction, conflict and performance, a multiple mediation procedure was conducted (Preacher and Hayes, 2008) to determine the interrelationship effect between them.

#### 5.3.1 Trust:

Given the findings of this study (Table 4-30), the franchisee's trust toward the franchise system positively affects the franchisee's performance. Although franchisees are legally independent business owners in a franchising system, they must follow the franchisor's rules, policies, and regulations. Therefore, since in a business format they take the risk of investing capital, the franchisees will assess the trustworthiness of their franchisor and franchise system. Moreover, they might consider stricter criteria to evaluate the trustworthiness in a franchise system (Croonen and Brand, 2013).

Consistent with Achrol et al. (1983), Dahlstrom and Nygaard (1995), Bordonaba-Juste and Polo-Redondo (2004) and Eser (2012), this study found that trust positively affects a franchisee's performance. The franchisee's trust toward the franchise system prevents opportunistic behavior by the franchisee and helps it to perform along with the franchisor's best interests and improve performance. The existence of trust between the partners in a franchise system also facilitates the solution of disputes and increases the commitment in the system and franchised outlet. Trust in a relationship also decreases the

franchisee's perceptions of goal incompatibility, disagreement, and unfairness (Geyskens et al., 1998). The presence of trust between the partners facilitates the sharing of tacit knowledge, and franchisees are better able to act cooperatively. The franchisee's trust in a franchising system enables the parties, through eliminating duplicate activities, to increase efficiency and shift the communication from verification to coordination, and through establishing a working relationship, facilitate performance (Dahlstrom and Nygaard, 1995).

Moreover, lack of trust will result in increasing compliance in a franchise system and negatively affect the relationship (Davies et al., 2011). When the franchisees feel they can no longer trust the franchisor, they may come to believe that their contractual obligations are against their own economic or entrepreneurial interests. These beliefs can lead to diminished efforts to follow the franchise regulations, or even acts of contractual defiance (Davies et al., 2011) and negatively affect the performance.

### 5.3.2 Satisfaction:

The franchisee's satisfaction with the franchise system correlates with its performance (see Table 4-29). Given the result in the table 4-30, satisfaction also positively affects the franchisee's performance. Consistent with Morrison (1997), this study found that satisfaction positively affects performance, and satisfied franchisees were more likely to achieve higher performance. In fact, satisfaction as a fundamental element in the exchange relationship between the franchisee and franchisor has a significant role in determining the long-term relationship. Satisfaction also affects the franchisees' attitudes and behaviors, and encourages them to participate in collective activities (Geyskens et al., 1999). By considering the parties' satisfaction, it is possible to guide behavior during future interactions. Moreover, satisfaction affects the franchisees' morale and behavioral attitudes, and motivates them to participate in collective activities (Geyskens et al., 1999). In fact, satisfaction in a franchise system enhances the franchisee's understanding of cooperation with the franchisor (Weaven et al., 2014), and leads them to achieve a long-term relationship and improved performance.

### 5.3.3 Conflict:

According to the result of the multiple regression (Table 4-30) , this study found, consistent with Morrison (1997), Zaheer et al. (1998) and Frazer et al. (2012), that conflict between the franchisees and the franchisor negatively affects performance. The presence of conflict between the parties in a franchising system affects each party's behavior and damages the relationship. Therefore, conflict in a relationship is likely increase the frequency of "non-value-enhancing activities" (Zaheer et al., 1998), and by imposing social and economic costs, negatively affect the performance. Conflict also intensifies destructive behaviors and jeopardizes the quality of the relationship in a franchising system (Frazer et al., 2012). Rising conflict in a relationship hinders the development of cooperation (Rodríguez et al., 2006) and deteriorates the comparative relationship over time in the franchise (Combs et al., 2004c, Hoy and Shane, 1998). Consequently, it increases the opportunistic behaviors in a system, and in the long term negatively affects the performance.

### 5.3.4 Post hoc analysis:

Given the multiple mediation procedure (Figure 4-5), negative conflict mediates the relationship between the franchisee's trust in a franchising system and performance. The results of this study show that although trust has a positive effect on performance, the presence of conflict reduces the effect of trust on performance. Trust increases the franchisees' confidence to cooperate more with the franchisor and to be receptive about the policies and rules set by the franchisor (Davies et al., 2011). According to Davies et al. (2011), relational forms of governance such as trust negatively affect opportunistic behaviors in a relationship. Consequently, the franchisee with trust in a relationship is less likely to perceive the franchisor's behavior and attitudes as opportunistic and against its benefit. In controversial issues, when the franchisee's interest is not aligned with the franchisor's, trust in a franchise system will affect the franchisee's perception of the franchisor's behavior and will increase the conflict (Cochet et al., 2008b). A high level of trust in a relationship also affects the franchisees' attitude toward the franchise system, and increases their commitment to the relationship (Eser, 2012). Eventually, it reduces the scope, intensity, and frequency of conflict (Zaheer et al., 1998). Moreover, the mediation



analysis shows that satisfaction mediates the relationship between trust and performance. The results of this study show, consistent with Chiou et al. (2004a), that a franchisee's perceived trust toward a franchisor will positively affect its overall satisfaction toward the franchise system, and consequently increase performance.



## Chapter 6: Conclusion and implication

### 6.1 Introduction:

During recent years, the franchising has grown to be considered as one of the major strategies to develop a business by owner in many countries. Involvement in a franchise system has also created a great opportunity for many to run a business with low risk and a recognized brand. Accordingly, given the increasing importance of franchising for countries' economic success and growth, it has been applied in many industries, especially in the service industry, and it has also piqued academics' attention (Madanoglu et al., 2011, Elango and Fried, 1997, Hsu and Jang, 2009).

Despite the investigation of franchising in a large number of research studies, most of them have looked at franchising from the top, and the franchisee's perspective has received less attention. However, in a franchise system, there are many franchisees who are conducting their business, and no franchise system can succeed if the franchisees perform poorly. Therefore, as recommended by many researchers, to fill research gap, this research studied franchising from the franchisee's perspective.

From the franchisee's perspective as a small business, survival and performance are of great interest (Combs et al., 2004b). Unlike other studies in franchising, the study of franchisee performance has not been a popular subject (Madanoglu et al., 2011, Gorovaia and Windsperger, 2013). While in a franchise system, some franchisees succeed or show significant success in their outlets, other franchisees fail (Jambulingam and Nevin, 1999). Therefore, given the importance of consequence of franchising for franchisees, this study focused on the franchisee's performance and influential factors on it.

Given the importance of a bottom-up view in franchising research, the major research question in this study is associated with the influential factors in franchisee performance. Although franchising has been subject of several perspective and academic fields, this study concentrated on strategic management, entrepreneurship, and marketing perspective to find influential factors in franchisee's performance.

A variation of the firm's performance has drawn many researchers' attention, and several theories in management and business literature are used to understand the reason for this variation. By considering firms as autonomous entities, some researchers have attempted to focus on their internal resources and capabilities, and use resource based theory to study the performance (Wernerfelt, 1984, Barney, 1991). More recently, involvement in an interfirm relationship has also led researchers to go beyond the firms' internal resources and take a relational view (Dyer and Singh, 1998) that supplements the resource-based view. Studies on the interfirm relationship have also paid attention to the quality of transaction between the involved firms and apply the relational exchange theory to explain the variation of performance. Moreover, many researchers, in keeping with the contingency theory, have focused on the environmental or organizational context (Watson and Johnson, 2010) to examine the firm's outcome. Therefore, in this study four main theories - the resource-based view, the relational view, relational exchange theory, and contingency theory - were examined to find the influential factors in franchisee performance.

In franchising, as a mutual relationship between the franchisor and the franchisee (Clarkin, 2008, Jambulingam and Nevin, 1999), participants are interdependent on one another's objectives and performance to achieve their goals (Bordonaba-Juste and Polo-Redondo, 2008). Therefore, to study and examine the influential factors in a franchisee's performance, this study investigated both franchisor and franchisee-related factors and the relationship between the two parties. Consequently, in this study, a resource-based view was applied to find the franchisee-related factors, and the relational view was used to find the franchisor-related factors. Moreover, the relational exchange theory and contingency theory were used to study the relationship factors and environmental conditions that affect the franchisee's performance.

By taking the resource-based view, and by reviewing the literature in a franchising context, four major factors were selected to find the franchisee's related factors in its performance, i.e. absorptive capacity, entrepreneurial orientation, human capital and social capital. Given the relational view and after reviewing the literature, five factors - system profitability, brand reputation, training, providing raw material and advertising - were selected as major influential factors related to the franchisors and the franchising system. Moreover, trust, satisfaction, and conflict were studied from the relational exchange theory

as influential factors in the franchisee's performance. Environmental dynamism and competitiveness were also studied as two environmental factors under the contingency theory to study the franchisees' performance.

In summary, as discussed in chapter 2, according to the four theories, and after reviewing the influential factors related to the franchisee, the franchisor, and their relationship, 12 hypothesis were developed to study the franchisee's performance in a franchise system. According to the discussed procedure in chapter 3, to assess the empirical data, after measuring the construct with CFA and running a Chow test, collected data from Iran and Sweden is analyzed, and the findings of each hypothesis are presented in the following sections.

## 6.2 Franchisee-related factors in franchisee's performance:

The first and the second research question in this study, concern the franchisee-related factors. Given the strategic management and entrepreneurship perspectives and based upon the resource-based view, absorptive capacity, entrepreneurial orientation, human capital, and social capital have been examined to find their influence on a franchisee's performance. As shown in Table 4-25 and discussed in the section 5-1, the result showed, franchisee's ACAP, Kirznerian EO, social capital, and managerial capabilities positively affect the performance. However, no significant effect of franchisee's Schumpeterian EO, and explicit and tacit knowledge, on the performance is found. Moreover, the more detailed conclusion is presented in the following sections.

### Absorptive capacity:

This study showed that high absorptive capacity in the franchisees enables them to apply new information in business operations and commercial ends, and eventually enhance performance. In a competitive environment, franchisees need to develop knowledge to survive. Just developing internal knowledge; however, is not enough for franchisees; they need to constantly seek and acquire external knowledge as well.

In franchising, knowledge is transferred to the franchisees and offers them the opportunity to gain access to skills, that would not have been acquired if the franchise had

not been joined. However, all franchisees may not be able to exploit this knowledge, and they need internal capacity to learn from each other and apply it in their commercial ends. Knowledge as an intangible resource significantly contributes to the firm's performance in the franchising context, and franchisees need to manage their capability of acquisition, assimilation, and exploitation of new knowledge. Therefore, by focusing on new information and knowledge obtained through the franchisor and franchising system, the franchisees' ACAP will help them to not only renew their knowledge and information, but also to appropriately manage their outlet and improve their performance. Moreover, the franchisees who are working in different places, as "gatekeeper" (Cohen and Levinthal, 1990) in a franchise network, will be able to obtain new knowledge and information from external sources, adopt with marketplace and though increasing their learning capabilities and competencies, enhance their performance.

Environmental conditions also moderate the relationship between ACAP and performance. In a dynamic and competitive environment, the franchisee can no longer take advantage of existing knowledge; it needs to acquire, assimilate, and apply new information in its outlet as well. In competitive and dynamic environment, the franchisees with higher ACAP will be able to obtain new knowledge and information ahead of competitors, adopt with the environmental change, and quickly respond. Therefore, applying the new knowledge and information in such environment will lead those franchisees with higher ACAP to better performance.

### Entrepreneurial Orientation

By considering entrepreneurial orientation as a multidimensional construct, the results of this study showed that franchisees' Kirznerian EO, including proactiveness and competitive aggressiveness, is the primary feature of an EO responsible for improving business performance. In a franchising context, the franchisee's Kirznerian EO enables it to continually monitor competitors and find a way to appropriately respond to trends and demands that exist in the marketplace.

Franchising has created a specific context for entrepreneurial activities by the franchisor. In the context of franchising, franchisees conduct their business in different local markets, and the franchise territories and market areas play a crucial role in their performance and even the survival of the system. Since franchisees are working in a

different local market, local changes in customer preference force them to adapt to their needs. In fact, learning from the local market and taking advantage of local market opportunities play a crucial role in the system's competitiveness. Therefore, the franchisee's Kirznerian EO, including proactiveness and competitive aggressiveness, enables them to take advantage of market opportunities and improve their performance. However, Schumpeterian EO, entailing risk-taking, innovativeness, and autonomy, did not affect the franchisee's performance.

In the fast-food industry, customers' preferences constantly change, and the franchisees with high proactiveness are able to anticipate and identify the new trends, and take advantage of them sooner than others. However, regarding the special context of franchising, all entrepreneurial activities are limited to the peripheral element of products and services. The franchisees with high proactiveness are knowledgeable about current and future customer preferences, and subsequently act upon them. Moreover, franchisees with EO and knowledge about the local market, will have forward-looking perspective, and can proactively scan the environment to highlight opportunity areas. Furthermore, franchisees' competitiveness enables them to continuously assess competitors, exploit market information, and use unconventional tactics to compete with rivals. Consequently, franchisees can compete more aggressively in the local market to gain market share and improve their performance.

In summary, similar to the firms in other contexts, the franchisee is also likely to benefit from adaptation and entrepreneurial activities. However, not all dimensions of EO in a franchising context affect performance. The Kirznerian EO in a franchised outlet gives a franchisee the ability to future trends in market, and be a decisive player in a field of rivals and acts forcefully to secure or improve its position. Therefore, through redefining the service and product, revising the rules of competition, and improving the marketplace position, Kirznerian EO enables the franchisee to react market needs, acquire market share, and outperform rivals.

According to the contingency theory and the entrepreneurship literature, depending on the environmental context, entrepreneurial activities have different effects on performance, and EO in the franchisee is not even suitable in some situations. This study found that environmental dynamism and competitiveness in a franchising context

moderate the effect of Kirznerian EO on performance. In the restaurant industry, with its intense competition, customer preference is constantly changing and businesses are continually offering new products and services. Therefore, conducting entrepreneurial activities enables the franchisees to perceive market trend, offer new product and services sooner competitors, and achieve a greater level of firm performance. In a highly dynamic environment, franchisees must constantly seek out entrepreneurial opportunities and translate them into improved performance outputs. Environmental dynamism will lead the franchisees with higher Kirznerian EO to higher performance. In the fast-food industry, as a competitive industry, customers have no specific preference to select a special firm within the market, and a firm should continually improve its efficiency. Competing successfully in competitive environments would be consistent with a posture of Kirznerian EO in a franchised outlet. In a competitive environment, proactiveness and competitive aggressiveness enable the franchisees to take advantage of the more entrepreneurial activities. For the franchisees that are in different local markets, environmental competitiveness increases the need for entrepreneurial activities, and Kirznerian EO helps them to react better to competitive trends and demands that already exist in the marketplace. In fact, through incremental and minimal refinements to existing resources, procedures, product and services, franchisees can overcome the intense competitive threat. As a result, in the highly dynamic and competitive environment of the restaurant industry, Kirznerian EO enables franchisees to be open to change, predict local market change, and outrun their competition.

#### Social capital:

This study confirms that the franchisee's strong and weak ties with family, customers and key industry friends, through increasing their chance of access to the customers, positively affects their performance. Although franchised outlet are run under a known brand, loyal customers who are prepared to recommend the firm and repeat their purchases, play a crucial role in getting new customers, and in the success of the franchised outlet. In a franchising context, distributed franchisees in different local markets have their own personal networks that mostly affect their access to customers. Social capital enables the franchisees to enter into a new market segment with new customers. Therefore, the franchisee's social capital positively affects its performance. Moreover, the franchisee's



relationship with actors in the industry, customers, and friends, through recognizing the new customer, provides a beneficial and productive resource.

Social capital in a franchise system as a complement to other resources affects the franchisee's knowledge about the customer network, and influences its performance. In fact, in a franchise system, the franchisees would be able to focus on the development of valuable networks with external resource holders to succeed. Relationships with customers create tacit knowledge that is not easy to duplicate. Networks with customers benefit the franchisees as a small business and enable them to perform better. Moreover, to access to the potential customer, the franchisees' network relationship helps them to create and exploit the social capital as a source of competitive advantage. It also helps them in getting new information about the market and being aware of customer preferences.

#### Human capital:

The findings of this study show that human capital factors in franchising affect performance differently. While education level and experience do not affect the franchisee's performance, the franchisee's human capital in terms of managerial capabilities positively affect performance. However, there is a positive correlation between all human capital measurements and performance.

Education and previous experience as indicators of human capital can be easily moved among competitors, and similarly qualified human resources are readily available to rivals in fast-food industry. Therefore, human capital cannot create a difference in the performance of the franchisees. Moreover, franchisees working in a franchise system have already been vetted regarding their education level and experience before joining the system. This means that almost all franchisees have roughly the same characteristics required to join the system.

In a franchise system, franchisees also are responsible for outlet performance and they should be able to coordinate all activities in the outlet, as well as monitor the day-to-day activities. Managerial capabilities help the franchisee to understand and motivate the other staff in the outlet. A franchisee with managerial capabilities will be able to coach its employees and delegate tasks to them. They will also be able to understand the staff well, empower and motivate them and lead the outlet to better performance.

### 6.3 Franchisor-related factors in franchisee's performance:

The third and fourth questions in this study concerned the franchisor-related factors. Franchisors in the system develop policies and set the rules that affect the franchisees. The relational cost and benefit as result of these policies have a crucial role in the relationship value for a franchisee in a franchise system.

Advantages that franchisees gain as a result of joining a franchise system, are relationship benefits that affect the franchisee's performance and its decision to remain in a system. Relational value in a franchise system includes training, access to a reputable brand name, and advertising by a franchisor, providing raw material and system profitability. Franchisor support in the form of providing raw material, advertising, and initial opening support are not only important benefits for franchisees; they are also strongly related to success. However, training in this study had no influence on franchisees' performance. Therefore, given the relational view, in the following section, the effects of these factors on the franchisee's performance are presented.

#### System Profitability

This study also showed that the profitability of a franchise system positively affects the franchisee's performance, and those franchisees working under a profitable system are more likely to be successful. Given the interdependency of the franchisor's and the franchisees' interest in a franchise system, franchisees in a profitable system perform better, and the franchisor's profitability positively affects the franchisees' survival and performance.

#### Providing the raw material by the franchisor:

The results of this study demonstrate that the franchisor's provision of raw materials correlates with the franchisee's performance and positively affects it. Central purchasing of raw materials by the franchisor, by offering a product or service with consistent quality, affects the franchisee's performance. Providing the raw material by franchising can save time and increase speed in providing the raw material and equipment, and thus add value for the franchisees. Moreover, it enables the franchisees to take advantage of being part of a big company in terms of economies of scale. The results of this study showed that the franchisor's supplying raw material and equipment to the

franchisee, through creating consistency in quality, speed of services, and economies of scale, influences the outlets' efficiency and effectiveness and consequently leads the franchisee to better performance and successful operations.

#### Training:

This study showed, the training in a fast-food franchise system could not make a difference in the franchisees' performance. However, training correlates with the performance, and a lack of training in a franchise system can diminish the franchisee's performance. In a franchising system, training only focuses on standardized operating procedures and teaching those who are unfamiliar with operations to perform tasks the correct way. Therefore, it cannot create a specific relational rent for the franchisees to create a distinguished performance. In fact, while relational-specific assets can be a source of competitive advantage, training in the fast-food industry can be easily moved among competitors, and cannot bring superior performance for the franchisees. However, result of ACAP hypothesis showed, take advantage of training depends on franchisee's learning capabilities to make a difference in its performance.

#### Brand reputation:

As a complementary resource, brand reputation and brand strength had a positive influence on the profitability of the franchisee. The reputation of a franchise system also leads the franchisees to better performance in the local market; when compared to non-franchised businesses, consumers do not deal with transaction anxiety by focusing on the franchisor's brand.

Brand reputation plays an important role in consumption in a highly competitive market, in the fast-food industry. The quality of products and services is one the most important factors in the restaurant industry, and the reputation of a system, as the primary contributors to perceived quality of the products, plays an important role in a franchised outlet's performance. Franchisees in a system with a good reputation are more likely to attract customers and less likely to lose their positive reputation. Brand reputation is also difficult for rivals to copy, and it can be a barrier to imitation.

Developing a brand name in a market is very difficult for a small business owner, as it is costly and time consuming; joining a known brand system will help franchisees to

take advantage of the brand, as a relational rent, and improve their performance. Brand reputation also helps all the franchisees in a system to differentiate their product in the marketplace. Therefore, joining a franchise system with a well-established brand name brings the advantage of a competitive franchise system for the potential franchisee.

#### Advertising:

According to the result of this study, advertisement by the franchisor in a franchising system and helping the franchisee in local advertising, through affecting customer perception in the local market, affects the franchisee's performance. Although a franchisee as a small business cannot afford to advertise in the national media, it can take advantage of the franchisor's expenditures in national-level advertising. Advertising in a franchise system, due to its "durable effect" (Berkowitz et al., 2001), lasts a long time in the customer's mind, and through influencing the consumer's attitude and behavior, positively affects the franchisee's performance. Moreover, advertising influences value creation in a firm by acting as an appropriation mechanism to build brand names. It also creates market barriers to prevent competitors' entry in the local market. Therefore, advertising in a franchise system can lower the cost of sales, create price premiums, generate competitive barriers, and consequently improve the franchisee performance.

#### 6.4 Relationship factors in franchisee's performance:

The fifth and sixth questions in this study are associated with the relationship factors in franchisee's performance. Therefore, in the following section the effect of relationship factors on the franchisee's performance are presented.

Although in a franchising system, there is a formal contract between the franchisor and franchisee, trust in a relationship, as a non-formal relational governance, plays an important role in reducing the uncertainty, working cooperatively, and improving the parties' performance. Trust in a franchising system encourages the franchisee and franchisor to, through maintaining and enhancing the relationship, work successfully and achieve mutual profitability. Trust in a relationship sacrifices short-term alternatives in favor of long-term benefits. It also affects the franchisees' attitude toward work provided by the franchisor, and improves the cooperation between the franchisor and franchisee.

The creation of trust by the franchisor in a system reduces uncertainty and helps the partners to enhance cooperation in their relationship, and thus leads them to better performance. Moreover, a lack of trust can be problematic in managing the relationship between the franchisor and franchisee, and it can deteriorate the relationship. Consequently, trust increases the probability of the franchisee's deviation from operational policies, free riding against the franchise system, and leaving the system. As a result, greater franchisee's trust increases the relational rent with the result of lower adaptation costs, lower re-contracting costs, and superior incentives for value-creation initiatives. Eventually, it leads both parties to better performance.

Given the result of this study, satisfaction positively affects performance, and satisfied franchisees are more likely to achieve higher performance. In fact, satisfaction as a fundamental element in the exchange relationship between the franchisee and franchisor has a significant role in determining the long-term relationship. Satisfaction also affects the franchisees' attitudes and behaviors, and encourages them to participate in collective activities. Satisfaction affects the franchisees' morale and behavioral attitude, and provokes them to participate in collective activities. In fact, satisfaction in a franchise system improves the franchisee's understanding of cooperation with the franchisor, and leads the parties to achieve a long-term relationship.

Moreover, conflict between the franchisees and the franchisor negatively affects performance, and through affecting each party's behavior, damages the relationship. Therefore, conflict in a relationship increases the frequency of "non-value-enhancing activities" (Zaheer et al 1998), and by imposing social and economic costs, negatively affects the performance. It also intensifies destructive behaviors, jeopardizes the quality of the relationship in a franchising system, and by giving rise to opportunistic behaviors in a system, negatively affects performance.

In addition to the independent effect of trust on the franchisee's performance, conflict and satisfaction modifies its effect on performance. A franchisee with trust in a relationship will be satisfied, and less likely to perceive the franchisor's behavior and attitude as opportunistic and against its benefit. Trust in a franchise system will also affect the franchisee's perception of the franchisor's behavior, increase its satisfaction, and reduce conflict. A high level of trust in a relationship also affects the franchisees' attitude toward

the franchise system, and increases their commitment to the relationship. Eventually, it reduces the scope, intensity, and frequency of conflict, leads to a more cooperative relationship with the franchisor, and consequently positively affects performance.

In summary, to answer the main question of this study and get the purpose of it, a holistic systems approach was used to build a performance model, and simultaneously examined both the franchisor's and the franchisee's related factors, as well as the relationship factors in the franchisee's performance. Answering the call from Combs et al. (2004c), greater theoretical diversity was employed to view phenomena through multiple lenses and thus gain a richer understanding.

As is indicated in Figure 6-1, given the strategic management and entrepreneurship perspectives, and by applying the resource-based view, absorptive capacity, Kirznerian entrepreneurial orientation, social capital, and managerial capabilities in the franchisee-related factors positively affect the franchisee's performance. However, Schumpeterian EO had no influence on performance. In this part, the according to the contingency theory, environmental dynamism, and environmental competitiveness moderate the relationship between absorptive capacity, entrepreneurial orientation, and the franchisee's performance. As discussed before, although interaction effect of environmental dynamism and ACAP is not supported, high correlation and scatter plot indicated the importance of this interaction in franchisee's performance. Moreover, according to the relational view, the influence of the franchisor's related factors have been examined. This research showed that system profitability, the franchisor's provision of raw material, advertising, and brand reputation, all have significant and positive influence on the franchisee's performance. However, training had no effect on performance. From the marketing perspective, and considering the relational exchange theory, it is concluded that perception of relationship affects the franchisee's performance. While conflict has a negative effect on franchisee's performance, the franchisee satisfaction positively affects it. This study also showed that satisfaction and conflict mediate the relationship between trust and performance.

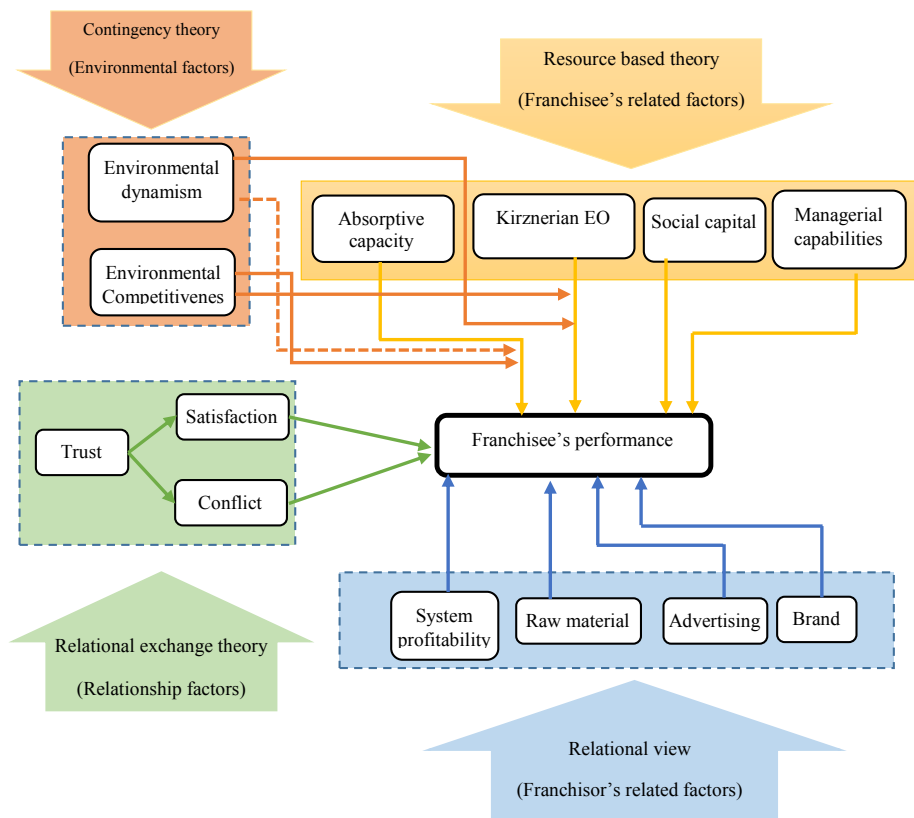


Figure 6-1: Holistic view of franchisee's performance

## 6.5 Implication:

The study's findings have important implications for the researchers, franchisees and franchisors. While most of the previous studies have used a single perspective and single theory in examining franchising, this study has applied a diversity of theories. The findings of this study present a holistic view about the franchisee's performance, and can help researchers, franchisor and franchisee to gain a deeper understanding of influential factors in performance. Given the special context of franchising for developing entrepreneurial behaviors in a system to take advantage of local market opportunity, this study sheds new lights on enhancing entrepreneurial activities in franchising. Categorizing the entrepreneurial orientation in the two major dimensions of Kirznerian and Schumpeterian EO shows that Kirznerian EO, including proactiveness and competitive aggressiveness, is a dominant dimension of EO that improves the franchisee's performance. In fact, this finding could serve as a starting point for a deeper view about the role of entrepreneurial orientation in a franchising context.

This study also shows that the human capital dimension has different effects on a franchisee's performance. While education and previous experience cannot change the franchisee's performance, the franchisee's managerial capabilities positively affect the performance. However, education and previous experience correlate with performance, and a lack of them can jeopardize business profitability.

While social capital is mainly exploited to reach resources, in a franchising system the franchisor is responsible for providing the resources. Therefore, the result of this study indicates that the franchisee's social capital should be more focused on accessing the new customer. Hence, franchising social capital with the aim of acquiring more customers, involves accessing the new knowledge of market trends and customer preferences.

The results of this study revealed that organizational mechanisms through which a franchisee would be able to identify, assimilate, and apply new information positively affect its performance. While always, franchisor concern the acquisition of new information and distribution of it in a system, a franchisee should has high absorptive capacity to apply the new information in the outlet. Moreover, since the franchisees are in different local markets, they are more familiar with the market, and are able to absorb the new information as a gatekeeper. This study also shows that in a more competitive



environment, a franchisee with higher absorptive capacity can display better performance than others.

Since the franchisor makes the policies in a franchise system and set the rules and standards, its decisions, support and routines affect the franchisee's performance. Although the RBV has been used in most of the articles to explain the performance difference, this study used the relational view to examine the effect of the franchisor's related factors on the franchisee's performance. While in traditional thought, more support by the franchisor would lead the franchisees to better performance, this study shows that not all services have the same importance. The findings of this study revealed that training in a franchise system cannot create a relational rent for the franchisee. However, training does correlate to performance.

This study provides empirical insight on the relationship in a franchising context. Research findings demonstrate that the franchisee's perception of quality of the relationship has an important role in both parties' performance. The franchisee's satisfaction toward the relationship and conflict affects the quality of the relationship. Although the franchisee's trust in the franchisor affects its performance, this relationship is mediated by satisfaction and conflict. In general, this study found that increased levels of the franchisee's trust in its franchisor improved overall levels of the franchisee's satisfaction and conflict, and consequently enhanced performance. Moreover, a lack of trust, through affecting satisfaction and increasing conflict, damages the relationship and in the long-term jeopardizes system sustainability and profitability.

#### Practical implication:

From a practical perspective, this study provides meaningful implications for franchisees and franchisors. Given the study, the franchisee should revisit their absorptive capacity to identify new information and appropriately apply in their business. Market trends and customer preferences are always changing and the environment is becoming more competitive. Therefore, higher absorptive capacity enables the franchisee to understand these changes and new information, and by assimilating the information perform better and outperform others. In addition, the franchisee needs continuous contact with the franchisor and other franchisees to get the new information. The franchisee can

benefit from external knowledge because, it encourages the growth of its own knowledge base. The franchisors can also through acquisition of new knowledge on its own or through other franchisees, and assimilate it among the franchisees, helps the franchisees.

Given the findings of this study, the key dimensions for franchisees to demonstrate entrepreneurial activities are proactiveness and competitive aggressiveness, which have a positive influence on performance. To adapt with local market changes and react to them ahead of others, the franchisee should be proactive. In the fast-food industry, customers' preferences constantly change, and the franchisees with high proactiveness will be able to anticipate and identify new trends and take advantage of them. Proactiveness and competitive aggressiveness also enable the franchisees to be open to change, predict the local market change, and outrun the competition. Given the result of this study, the franchisor should review its policies and procedures in favor of enhancing the franchisee's desire to display entrepreneurial behaviors. Franchisors also should consider that many of the new ideas come from the franchisees' side, and prohibiting them from generating new ideas will diminish the success of the franchise system in the long term. They can motivate and even train the franchisees to practice proactiveness and competitive aggressiveness to keep their competitiveness in the local market.

Since in the fast-food industry potential customers have no priority, by developing social capital through customers, friends, and acquaintances, the franchisee can have access to more customers. In addition to social capital, empowering managerial capabilities entails coordination, delegation, and organizational skill, and leads the franchisees to better performance, especially for multiple-outlet owners.

Given the findings of the second section, a franchisor's assistance has an important role in a franchisee's performance. Providing services has a twofold effect: not only it affects the franchisee's performance; it also enhances the system value as a whole. The potential franchisee should think about the system profitability before joining the system. Moreover, the franchisor must develop and promote the brand in a franchise system. Although the franchisees are independent, their long-term success depends on franchisor policy regarding advertising and brand reputation, which can affect consumer perceptions and shape consumption behavior. Therefore, the franchisee should be open to brand-developing expenditures, which would be shared among all the franchisees. Although

sometimes franchisees might think they could provide the material in lower cost, the franchisor's provision of raw material also helps the franchisee to provide a more consistent product that has a crucial role in repetition of purchasing by customers in the fast-food industry. The franchisor also needs to continually promote the brand and support the franchisee with efficient services.

A high level of trust and satisfaction, and a low level of conflict between the franchisor and franchisee, has important effects on the franchisee's performance. Given the result of relationship factors, franchisees and franchisors should improve their relationships by fostering strong and long-lasting relationships based on cooperation and communication strategies. Franchisors need to build trust among their franchisees, as this will lead to positive attitudes and behaviors that play an important role in their strategic decisions. The franchisor also should replace mandatory policies that cause dissatisfaction and conflict with the more cooperative strategies.

## 6.6 Limitation and future research:

Limitations of the present study provide several issues for further research. Although most of the studies in franchising have had a top-bottom view, this study was conducted from the franchisee's point of view, and data was collected from the franchisee. Therefore, future studies can be conducted having both the franchisor's and franchisee's perceptions about the franchisee's performance. Moreover, this study has used franchisees as key informants to answer the questionnaire. Although this study has taken several steps to control the common method bias, it cannot be totally removed.

Even though several analyses to evaluate the validity of the measures were performed in this study, it would be useful to further study to enhance these measurements in a franchising context and test it in other industries and countries. The data employed in this study to measure the performance was a perceived objective; therefore, in future studies, researchers may also try to measure dimensions of performance in a franchised outlet using archival objective measures.

The survey research was conducted in business format franchising in the fast-food industry only. Therefore, future studies may also incorporate this research in other types

of franchising, including trade name and conversion strategy. It would also be worthwhile to extend the study to other industries to examine the influential factors in a franchisee's performance. Moreover, given the cross-sectional nature of this study, further longitudinal design might be helpful to examine the hypotheses and clarify the findings.

Although this study was conducted in two different countries, further research in additional countries should be conducted to generalize the findings. Therefore, there is a need to be cautious in generalizing these findings to other countries and other industries. In addition, regarding the importance of cultural issues in a franchisee's perception, there may be merit in performing a cross-border study to examine the influence of personal traits and cultural traits that differ between people and countries.

In this study, the influential factors of franchisee's performance have been analyzed in three different sections. Accordingly, it would be helpful to examine the interaction effect of these variables from different sections in future studies, especially given the suggestion by a number of researchers that, the quality of franchisor services plays a crucial role in relational quality (Chiou et al., 2004a, Combs et al., 2004a, Monroy and Aizola, 2005). Moreover, since franchise system context have important influence in franchisee's performance, future studies may also conduct a multiple levels of analysis and investigate the franchising system-level variable.

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## Appendix 1 : Questionnaire

Dear Franchisee<sup>1</sup>,

This research project is conducted in Linköping University and you will be asked to complete a questionnaire. You are one of the small number of carefully chosen stores and your response is very important for us. Attached is a survey designed to improve the understanding of influential factors in success of restaurant franchisees. Your cooperation and participation are critically important for the results of this study.

There is no right or wrong answer in this survey. We just want to know your personal opinion. All data and measurements obtained from this research study will be stored confidentially. Only researcher will have access to view any data collected during this research.

Please read and answer all the questions as accurately as possible. That would be honored to send a copy of managerial implications of this research to you if you like. We greatly appreciate your prompt response!

Thank you for your time and cooperation.

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<sup>1</sup> This version of English questionnaire is translated to Swedish and Persian languages.

## General question

How old are you?

What is your gender? Female =0, Male =1.

What is your highest level of education?

Elementary school   high school   bachelor   master   PhD

Are you ? Unmarried 0, Married 1

When did you start this business

have you had any experience in any franchise system before buying this franchise? how long?

have you had any experience in similar business (but non franchise system) before buying this franchise ? how long?

Have you been self-employed before? No = 0, Yes =1.

Has your family been in any franchise outlet?

Has your family been any in fast food business?

How many outlet do you own?

## Section one

The statements below describe your franchising system. Using the scale below, please respond each following question by circling the number that most closely describes your opinion.

Strongly low	Moderately low	Slightly low	Neither low or high	Slightly high	Moderately high	Strongly high
1	2	3	4	5	6	7

1. How profitable is this franchising system compared to similar other franchise systems.
2. How profitable is this franchising system compared to non-franchise business in this industry
3. To what extent is your brand trustworthy?
4. To what extent is your brand reputable?
5. To what extent does your brand make honest claims?
6. To what extent does your brand have a long-lasting nature?
7. In the past, and today, to what extent the values behind this brand has not been changed
8. To what extent is franchisor training in personnel management useful?
9. To what extent is franchisor training in store operation useful for your personnel?

10. To what extent is franchisor training in customer services useful for your restaurant
11. To what extent is franchisor ongoing training and services useful?
12. To what extent is franchisor's assistance in advertising and promotion useful?
13. To what extent is franchisor's advertisement good for your outlet?
14. To what extent is raw material provided by the franchisor cheaper than others
15. To what extent raw material provided by the franchisor help you to provide product with high quality than others.
16. To what extent raw material provided by the franchisor increase the speed in your business

section 2 : The statements below describe your orientation in entrepreneurial actions, capabilities and networking. Using the scale below, please indicate how much you agree or disagree with the following statements by circling the number that most closely describes your opinion.

Strongly disagree	Moderately disagree	Slightly disagree	Neither disagree or agree	Slightly agree	Moderately agree	Strongly agree
1	2	3	4	5	6	7

1. People in our outlet are encouraged to take calculated risks with new ideas
2. We, in our outlet, would rather accept a risk to pursue an opportunity than miss it altogether
3. When confronted with decision-making situations involving uncertainty, my firm typically adopts a cautious, "wait and see" posture in order to minimize the probability of making costly decisions
4. We actively introduce improvements and innovations in our business
5. When it comes to problem solving, we value creative new solutions more than solutions that rely on conventional wisdom
6. Our outlet tries to find new ways of advertising, customer relations, distribution and so on.
7. Employees perform jobs that allow them to make and initiate changes in the way they perform their work tasks
8. We are pursuing business opportunities and make decisions on our own without constantly referring to the franchisor.
9. We are given authority and responsibility to act alone if we think it to be in the best interests of the business



10. We always try to take the initiative in every situation (e.g., against competitors, in projects and when working with others)
11. We excel at identifying opportunities
12. We initiate actions to which other organizations respond
13. Our business is intensely competitive
14. In general, our business takes a bold or aggressive approach when competing
15. We try to undo and out-maneuver the competition as best as we can rather than to avoid competitive clashes
16. We have frequent interactions with the franchisor and other franchisee to acquire new knowledge.
17. We periodically organize special meetings with customers to acquire new knowledge.
18. We quickly analyze and interpret changing market demands.
19. Employees record and store newly acquired knowledge for future reference.
20. Our unit quickly recognizes the usefulness of new knowledge to combine with existing knowledge.
21. Employees share their practical experiences.
22. We constantly consider how to better apply new information into the business.
23. We have difficulty implementing new products and services.
24. We obtain new contacts (customers, suppliers and employees) through our customer
25. Our customer provided us with new contacts useful for the development of sale.
26. We use our key industry friends and partners extensively to help us develop and market our products and services.

section 3 : The statements below describe you and your attitude toward your business. Using the scale below, please indicate how much you agree or disagree with the following statements by circling the number that most closely describes your opinion.

Strongly disagree	Moderately disagree	Slightly disagree	Neither disagree or agree	Slightly agree	Moderately agree	Strongly agree
1	2	3	4	5	6	7

27. One of my greatest strengths is achieving results by organizing and motivating people
28. One of my greatest strengths is my ability to supervise, influence, and lead people
29. One of my greatest strengths is organizing resources and coordinating tasks
30. One of my greatest strengths is my ability to delegate effectively

Section 4: The statements below describe your relationship with the franchisor. Using the scale below, please indicate how much you agree or disagree with the following statements by circling the number that most closely describes your opinion.

Strongly disagree	Moderately disagree	Slightly disagree	Neither disagree or agree	Slightly agree	Moderately agree	Strongly agree
1	2	3	4	5	6	7

- Overall we consider our relationship with the franchisor to be: satisfying
- Overall we consider our relationship with the franchisor to be: friendly
- Overall we consider our relationship with the franchisor to be: fair
- My relationship with the franchisor can be best described as tense.
- The franchisor and I have significant disagreements in our working relationship.
- The franchisor and I frequently agree on issues relating to how I should conduct my business.
- I can count on my franchisor to be honest in its dealings with me
- I can rely on my franchisor to keep the promises they make to me
- My franchisor is sincere in its dealings with me
- My franchisor can be counted on to do what is right
- My franchisor is a company that I have great confidence in

section 5 : The statements below describe your business environment . Using the scale below, please indicate how much you agree or disagree with the following statements by circling the number that most closely describes your opinion.

Strongly disagree	Moderately disagree	Slightly disagree	Neither disagree or agree	Slightly agree	Moderately agree	Strongly agree
1	2	3	4	5	6	7

- Environmental changes in our local market are intense.
- Our clients regularly ask for new products and services.
- In a year, nothing has changed in our market.
- In our market, the volumes of products and services to be delivered change fast and often.
- Competition in our local market is intense.

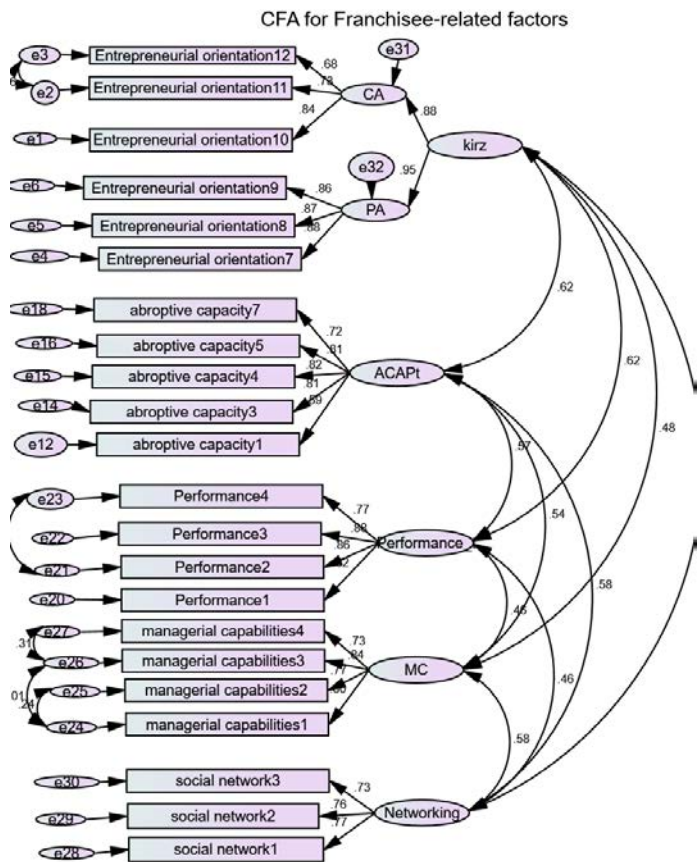
- 6. Our organizational unit has relatively strong competitors.
- 7. Competition in our local market is extremely high.
- 8. Price competition is a hallmark of our local market.

Section 6: For each of the following outcomes we would like to know how much your business’s result has been better, worse or equal to that of other companies in your industry.

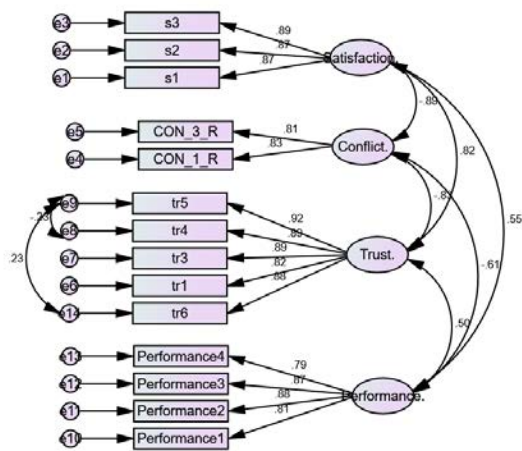
Strongly worse	Moderately worse	Slightly worse	Neutral	Slightly better	Moderately better	Strongly better
1	2	3	4	5	6	7

- 1. Net profit (i.e. sales minus operational costs)
- 2. Development of sales (i.e. change or growth in the volume of sales)
- 3. Cash flow (i.e. inflows vs. outflows of money)
- 4. Growth of the company’s value

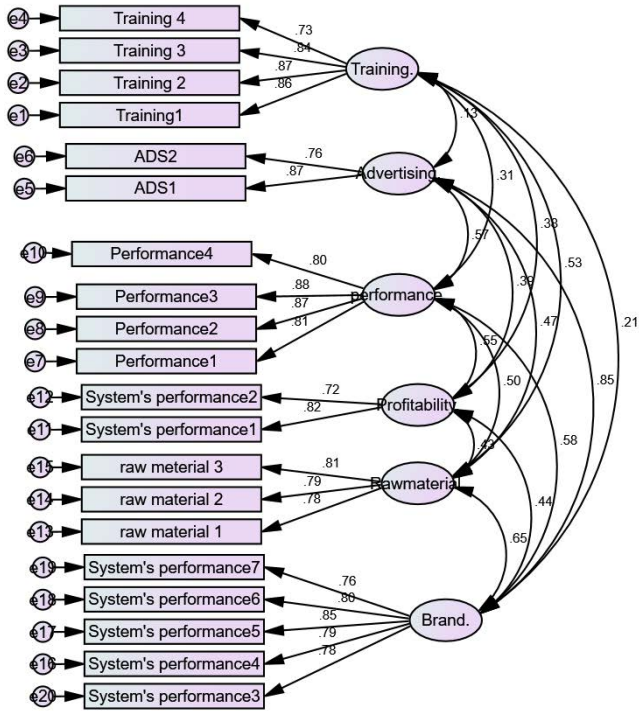
Appendix 2: Confirmatory factor analysis result:



Confirmatory factor analysis of relationship factors



# Confirmatory factor analysis for franchisor-related factors



Confirmatory factros analysis for Moderators

