

# Franchising in Russia: does an optimal franchise proportion exist?

Egor D. Nikulin

*Graduate School of Management, Saint Petersburg University, Russia*

Alexander I. Shatalov

*Graduate School of Management, Saint Petersburg University, Russia*

## Abstract

The focus of this study is on the problem of finding the optimal balance between the number of company-owned and franchised outlets. We start with the factors that determine a company's propensity to franchise in the emerging market of Russia. Data on 46 companies of different industrial affiliations for 2010 were examined. It is revealed that the proportion of franchised units is positively correlated with the number of cities a company operates in and is negatively correlated with a company's size. In line with these findings, we also reveal that the hypothesis of a nonlinear relationship between the proportion of franchised outlets and a company's return on assets is also supported in the sample of organizations considered. Therefore, an increase in the proportion of franchised outlets over a certain limit is not appropriate for a firm. This result can be explained in terms of two major risks inherent in the franchising strategy that come into play as the franchise proportion of a company grows: the risk of brand disruption and the risk of losing business.

**Keywords:** hybrid strategy, franchising, franchise proportion, Russia, franchised outlet, corporate performance.

## Introduction

The problem of selecting a company's growth strategy is discussed in a large number of research papers. There are several options for business expansion, such as vertical or horizontal integration, an organic growth of business or expansion involving the use of hybrid strategies (Peng, Heath, 1996; Peng, 1997). The organic growth strategy involves the creation of company-owned units, while the hybrid strategy enables a company to grow via divisions that are not under the full ownership and control of the company. Examples of the hybrid growth strategy include franchising (Norton, 1988; Sorenson, Sorensen, 2001; Michael, 2000), licensing (Sorenson, Sorensen, 2001), strategic alliances, partnerships, and joint ventures (Peng, Heath, 1996; Peng, 1997). These strategies are beneficial if they make it possible for a company to offer products and services with less risk and a relatively low capital investment (Chathoth, Olsen, 2007).

This paper focuses on the hybrid growth strategy of franchising. Franchising is defined as a method for the distribution of products and services that allows an independent entrepreneur (i.e., the franchisee) to acquire from the parent company (i.e., a franchisor that runs a network of outlets) the right to sell the products or services under its brand name and to use its business practices (Lafontaine, 1992; Combs, Michael, Castrogiovanni, 2004; Pruett, Winter, 2011). Although franchisors and franchisees are legally independent from each other, they share the same targets (Insa-Ciriza, 2003; Berbel-Pineda, Ramirez-Hurtado, 2012). The franchising strategy is usually applied in economic sectors that involve direct contact between a customer and a company (Ingram, Baum, 1997; Barthelemy, 2008). Its wide use started in 1940s and 1950s and nowadays franchising is one of the fastest developing types of business all over the world (Mendelsohn, 2005; Antonowicz, 2011; Ramirez-Hurtado, 2011). Franchising accounts for 40% of retail sales in the U.S., and, in some industries (e.g., restaurants, photocopying services, tax documentation preparation services), this percentage is even higher (Combs, Ketchen 2003; Michael, Combs, 2008; Sul, Khan, 2006; Gerhardt, Dudley, Hazen, 2012).

Franchising in Russia is mainly used in the following four economic sectors: catering, retail, services and petrol stations (Panyukova, 2005). It should be noted, however, that the quantitative data on the number of franchisors in Russia are contradictory (Ibadova, 2006). The estimates range between 100 and 200 companies. In general, it appears that although this growth strategy tends to be applied more frequently, it is still not widespread in Russia (Malkova, 2006). In particular, it is noted that the small businesses in the Russian Federation are inclined towards maximum autonomy and independence, whereas abroad, a considerable number of small firms operate under franchising contracts and subcontracts (Larichev, Strelkov, 2006).

For the last four decades a lot of attention in scientific research was given to the question why and under what conditions companies use franchising (Combs, Ketchen, Short, 2011; Diaz-Bernardo, 2012). Existing research on the aspects of franchising strategy can be divided into two large groups. One group of research papers (see (Roh, 2002)) investigates the factors that determine a company's propensity to franchise. Another group of papers (see (Koh, Lee, Boo, 2009)) is devoted to the analysis of the relationship between the proportion of franchised outlets and a company's financial performance.

To date, the majority of studies were devoted to the analysis of different aspects of the franchising strategy in the developed markets. At the same time, it seems that the implementation of the franchising strategy in emerging markets, like Russia, has its own distinct characteristics. In Russia in particular, the franchise operations are characterized by two key features. *First*, franchising is widely used in a fairly limited number of regions of the country (Panyukova, 2004a). This situation is caused by the intention of the parent company to retain control over the franchisees. *Second*, the use of franchising is often characteristic of large companies with high brand value. These companies adopt this strategy to ensure the required growth rate. These features are not typical for developed markets.

In light of these peculiarities, we investigate in our paper whether the factors that determine a company's propensity to franchise in developed markets are the same for emerging markets. Among these factors, we consider the size of the firm and the geographic range of its outlets. Then we analyze if there is an optimal proportion of franchised to company-owned outlets that maximizes a firm's financial performance and minimizes the risks of the franchising

strategy. This paper also specifies the risks of adopting the franchising strategy in Russia, as exemplified by several companies.

The paper consists of 4 parts. It starts with the literature review and research hypotheses. Next, research methodology is described. In the next section the empirical results of the study are presented and discussed. The next section concludes.

## Literature review and hypotheses

One of the main goals of our paper is to identify the determinants of a company's propensity to franchise in the emerging market of Russia. We believe that there are factors that persuade firms to use franchising and those that dissuade them from using this strategy. That's why, on balance, the company has to find the optimal franchise proportion that, from the one hand, maximizes its financial performance and, from the other hand, minimizes the risks of franchising for this particular company (Figure 1).

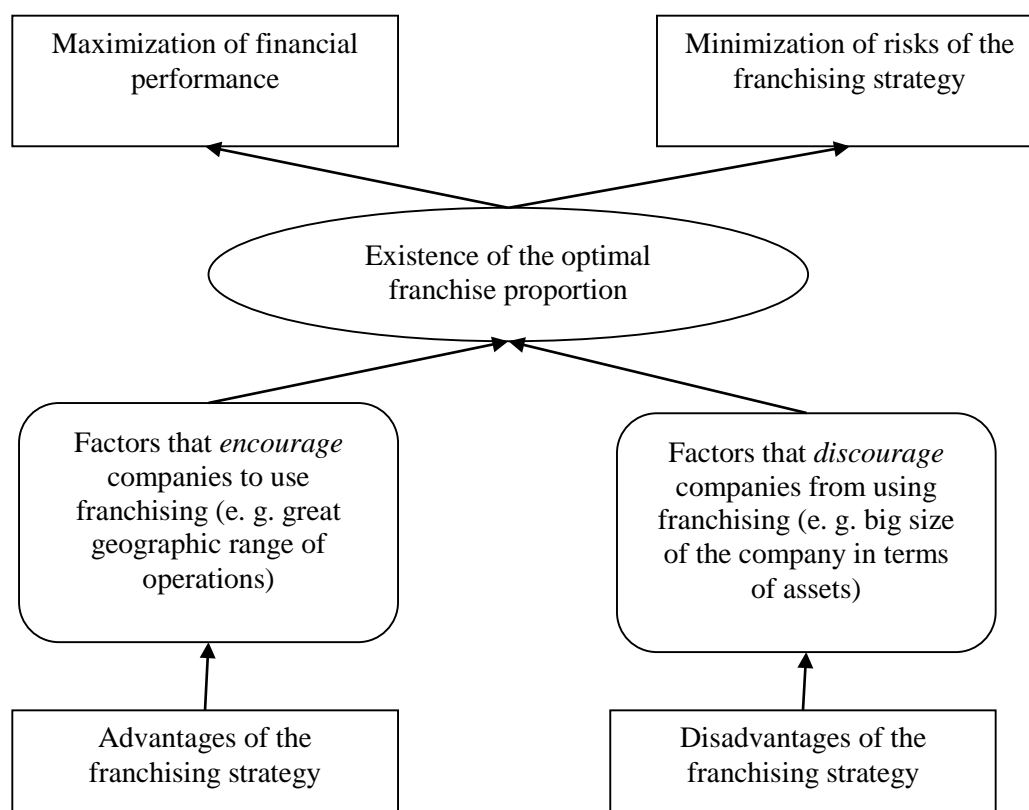


Figure 1: The theoretical model of research

One of the main factors that stimulates companies to use franchising is a firm's strategy for geographic expansion. At least two theories back up this argument.

Firstly, the agency theory suggests that the choice between a company-owned and a franchised outlet depends on the amount of agency costs (Brickley, Dark, 1987; Caves, Murphy, 1976; Fama, Jensen, 1983; Jensen, Meckling, 1976; Lafontaine, 1992). Because the compensation schemes of franchisees' managers are usually tied to their outlet's performance, they have less incentive to avoid doing their duties in contrast to the managers

of company-owned outlets, who often receive a fixed salary plus a possible small additional bonus. As a result, the companies adopt a franchising strategy to lower the costs of monitoring outlet managers. Evidently, difficulties of controlling managers of company-owned outlets become more acute as the geographic range of operations of a company increases.

Secondly, the active use of franchising in geographically dispersed companies can also be explained by the resource dependence theory (Brickley, Dark, 1987; Carney, Gedajlovic, 1991; Combs, Ketchen, 1999; Lafontaine, Kaufmann, 1994; Norton, 1988; Sen, 1998; Oxenfeldt, Kelly, 1969; Hsu, Jang, 2009). According to this theory, a firm adopts the franchising strategy when it lacks the financial, human and/or information resources that are necessary for growth (Dant, Paswan, Kaufmann, 1996; Kaufmann, Dant, 1996; Oxenfeldt, Kelly, 1969; Hsu, Jang, 2009; Roh, 2002). In general, franchising is regarded as a strategy for small and young companies that do not have sufficient capital for rapid expansion (Oxenfeldt, Thompson, 1968; Oxenfeldt, Kelly, 1969; Hunt, 1973; Caves, Murphy, 1976; Martin, 1988; Manolis, Dahlstrom, Nygaard, 1995; Dant, Kaufmann, Robicheaux, 1998). In other words, franchising provides an opportunity for a company to acquire low-cost resources, which allow it to increase its market share (Laurie, 1995) without incurring a significant amount of debt or equity financing (Roh, 2002).

The aforementioned theoretical underpinnings of the role of franchising in the regional expansion of a company allow us to stipulate the first hypothesis of this study:

*H1: There is a positive relationship between the geographic range of a company's operations and its proportion of franchised units.*

As the organization grows, it can revise its strategy, which means that, at some point, it may renounce the use of franchising. This decision may be influenced by the potential issues that the adoption of the franchising strategy could cause for the company. The most prominent of these issues include the following: 1) legal complexity (i.e., difficulties in ensuring compliance with the contract terms on the part of a franchisee); 2) loss in operating income because the franchisor does not own the franchised divisions and can thus claim only a share in the income generated by these divisions; 3) potential conflicts with franchisees on maintaining the required quality standards; and 4) difficulties in maintaining confidentiality and trade secrets (Panyukova, 2004b; Andrew, Damitio, Schmidgall, 2007; Koh, Lee, Boo, 2009; McCuddy, Eser, Pinar, 2011; Kashyap, Antia, Frazier, 2012). Therefore, we can assume that large companies (in terms of assets or revenues) that possess substantial resources tend to avoid using the franchising strategy to reduce their risks. This allows us to formulate the second hypothesis of the study:

*H2: There is a negative relationship between a firm's size and the proportion of franchised units.*

Given that the franchising strategy has both advantages and disadvantages, companies have to make the decision about the proportion of company-owned to franchised units. This decision plays an important role in the implementation of the franchising strategy because the franchise proportion may influence a company's financial performance (Sorenson, Sorensen, 2001). The issue of finding an optimal proportion of company-owned to franchised units can be addressed from different perspectives.

According to the agency theory, franchising is an effective way of running a business in situations where the marginal costs of monitoring managers of a company-owned unit are higher than the costs of implementing a franchise agreement (Rubin, 1978; Brickley, Dark, 1987; Brickley, Dark, Welsbach, 1991). In this case, franchising agreements make it possible to shift a significant share of the administrative and monitoring costs onto the franchisee, thereby reducing the costs of the franchisor (Shane, 1996). We can also assume that when the costs of implementing a franchise agreement start to exceed the marginal costs of monitoring the managers of company-owned units, the management will tend to oppose the use of franchising.

At the same time, franchising can be seen as a way to diversify a firm's operations. Franchising represents a separate type of operation that demands specific competencies from an organization. A parallel launch of company-owned and franchised units makes it possible to reduce a company's risk and cost of capital, which ultimately leads to an increase in its value (Koh, Lee, Boo, 2009). In general, some authors have come to the conclusion that there is an inverse U-shaped relationship between a company's proportion of franchised units and its sales volume, which is explained in terms of under- or over-diversification, i.e., insufficient use of franchising or an excessive proportion of franchised units, respectively (Sorenson, Sorensen, 2001). In this regard, we can assume that there is an optimal proportion of company-owned to franchised outlets that can maximize a company's value.

The necessity of maintaining a trade-off between the number of company-owned and franchised outlets is also supported by the resource-based theory of the firm. This theory addresses the unique and difficult-to-imitate resources that enable companies to improve their performance. In the case of franchising, such resources include a valuable brand and tacit (i.e., difficult to copy) business practices (Barthelemy, 2008; Solis-Rodriguez, Gonsalez-Diaz, 2011). On the one hand, both groups of resources provide organizations with a competitive advantage. On the other hand, they add complexity to franchise operations. For example, if a franchisor owns a valuable brand, its franchisees may not be inclined to devote much attention to the quality of service they provide because a popular brand can ensure the necessary flow of customers even when the service is of lower quality. However, such an approach can obviously damage both the franchisor and its franchisees in the long run. Tacit business practices, in turn, can also impede franchise operations because it then becomes difficult to transfer knowledge from a franchisor to its franchisees (Barthelemy, 2008). Thus, it is necessary to find a trade-off between the number of company-owned and franchised businesses that ensures the most efficient use of a company's resources.

In general, regardless of the approach (e.g., the agency theory, the diversification approach, the resource-based theory of the firm) that is used to justify the existence of an optimal proportion of franchised outlets for a firm, we can state that, at a certain point, the shortcomings of the franchising strategy can begin to outweigh its advantages. Hence, an increase in the proportion of franchised outlets beyond a certain limit is inappropriate for a company. In this regard, we put forth the following hypothesis:

*H3: There is a non-linear relationship between the proportion of franchised units and a firm's financial performance.*

## Methodology

The main method used in this research is a regression analysis. We tested our regression models on a sample of companies that adopt the franchising strategy in the Russian market. Both Russian and non-Russian companies were considered. The data on the firms' franchise operations were taken from the official websites of the Russian Franchising Association (Russian Franchising Association, 2010), the company Beboss.ru (Beboss.ru. Official site, 2010) and the franchisors themselves. The financial reports were collected from the SPARK database (SPARK database, 2011).

The main criteria for selecting companies were the following: 1) the availability of financial reporting for 2010; 2) the availability of data on the proportion of franchised to company-owned outlets for 2010; and 3) the availability of data on the number of Russian cities the company operates in (via company-owned outlets, franchised outlets or both) for 2010. On the basis of these criteria, data on 46 companies representing different industrial affiliations were collected.

To test the first and second hypotheses, we used the following regression model:

$$FR = \delta_0 + \delta_1 NumbTowns + \delta_2 \ln TA + \delta_3 ROA + e, \quad (1)$$

where  $FR$  is the proportion of franchised outlets to the total number of a company's outlets;  $NumbTowns$  is the number of cities the company operates in;  $\ln TA$  is the natural logarithm of firm's total assets;  $ROA$  is return on total assets;  $\delta_0, \delta_1, \delta_2, \delta_3$  are unknown parameters of the model and  $e$  is an error term.

To test the third hypothesis, we used the following regression model:

$$ROA = \beta_0 + \beta_1 FR + \beta_2 FR^2 + \varepsilon, \quad (2)$$

where  $ROA$  is the return on total assets;  $FR$  is the proportion of franchised outlets to total number of company's outlets;  $\beta_0, \beta_1, \beta_2$  are unknown parameters of the model and  $\varepsilon$  is an error term.

We used the OLS estimation procedure. Additionally, for each model considered, we calculated robust standard errors of coefficients. Table I presents the descriptive statistics for the variables of the regression models.

**Table I: Descriptive statistics for the variables in the regression models**

Variable	Mean value	Standard deviation	Minimum value	Maximum value
ROA	4.9	25.8	-75.09	74.9
FR	63.2	29	10	100
$\ln TA$	17.6	2.5	13.03	22.3
NumbTowns	24.2	28	1	115

**Note:** ROA is return on assets; FR is the proportion of franchised outlets to the total number of a company's outlets;  $\ln TA$  is the natural logarithm of firm's total assets;  $NumbTowns$  is the number of cities the company operates in. ROA and FR variables are measured in percentage points; NumbTowns is measured in units.

As shown in Table I, the minimum proportion of franchised units in the data sample considered is 10%, whereas the maximum proportion is 100%. The maximum number of cities the companies operate in is 115.

Table II presents the correlation matrix of the dependent and independent variables of the regression models:

**Table II: Pearson correlation coefficients and their significance**

	ROA	FR	lnTA	NumbTowns
ROA	1.00			
FR	-0.0272 (0.8592)	1.00		
lnTA	-0.0375 (0.8067)	-0.2650 (0.0785)	1.00	
NumbTowns	-0.0103 (0.9463)	0.4276 (0.0034)	0.2794 (0.0631)	1.00

**Note:** The p-values for the test of whether the correlation coefficient is statistically significant are in parentheses. ROA is return on assets; FR is the proportion of franchised outlets to the total number of a company's outlets; lnTA is the natural logarithm of firm's total assets; *NumbTowns* is the number of cities the company operates in.

The correlation results support the expected relationship between the proportion of franchised units and the two factors that determine a company's propensity to franchise — the size of the company and the extent of its geographic expansion. Table 2 shows that FR is negatively related to a company's size and positively related to the number of cities in which a company operates. Both of the correlation coefficients are statistically significant.

The sign of the correlation coefficient between  $FR^2$  and ROA is negative. This result implies the existence of an expected non-linear relationship between these variables, i.e., the existence of an optimal franchise proportion that maximizes a company's return on assets and, therefore, its value. However, this correlation coefficient is not statistically significant.

## Empirical results

The results of the regression analysis are shown in Table III.

**Table III: OLS estimates of the regression models**

<i>Independent variables</i>	<i>Model (1)</i>	<i>Model (2)</i>
Intercept	133.75 (0.000)	-24.64 (0.108)
ROA	-0.042 (0.786)	-
FR	-	1.55 (0.023)
FR <sup>2</sup>	-	-0.014 (0.022)
lnTA	-4.77 (0.001)	-
NumbTowns	0.56 (0.000)	-
R <sup>2</sup>	0.3445	0.1415
The significance of a model (F-criterion)	(0.0001)	(0.0703)

**Note:** The p-values for the tests of whether models and separate variables are statistically significant are in parentheses. ROA is return on assets; FR is the proportion of franchised outlets to the total number of a company's outlets; lnTA is the natural logarithm of firm's total assets; *NumbTowns* is the number of cities the company operates in.

As shown in Table III, both of the regression models used in our study are statistically significant. Model (1) is significant at the 0.1% level, while model (2) is significant at the 10% level.

In model (1), the NumbTowns variable is statistically significant at the 0.1% level, and the sign of the coefficient on this variable is positive. Thus, it can be inferred that, in the sample of companies examined, the proportion of franchised units increases when the extent of geographic expansion of a firm becomes greater. The lnTA variable in this model is also statistically significant ( $p < 0.01$ ), and the sign of the coefficient on this variable is negative. This result indicates that larger companies strive to avoid using the franchising strategy.

In model (2), the FR<sup>2</sup> variable is statistically significant at the 5% level, and it has a negative coefficient. Thus, the regression analysis supports a non-linear relationship between the proportion of franchised units and a firm's financial performance, which is measured by the return on total assets. In other words, there may be an optimal proportion of franchised units that maximizes a firm's return on its assets and its value (Hsu, Jang, 2009). According to these results, the optimal franchise proportion is 55.4%. When the proportion of franchised units starts to exceed the "optimal" value, the return on assets begins to decline.

## Discussion

The focus of the current paper is on the relationship between the proportion of franchised units and a company's financial performance.

The study confirmed that the *strategic goals of the organization regarding the extent of its geographic expansion* are important factors affecting the proportion of its franchised units. The results demonstrate that the proportion of franchised outlets tends to grow with the increase in the number of cities in which the company operates. This result is consistent with

the current theory regarding a company's geographic expansion. That is, the organizational intention to grow requires additional resources to penetrate new markets, which franchisees indirectly provide. Additionally, more geographically dispersed companies have difficulty controlling their own outlets. As a result, to minimize these costs and accelerate the expansion process, the companies usually resort to franchising.

The proportion of franchised outlets is also determined by *the size of the company*. We found a negative relationship between a firm's size and the number of franchised outlets in the data sample examined. This result has a theoretical rationale. The implementation of the franchising strategy does not require a significant investment in assets, so the company with a large amount of assets is likely to grow by launching company-owned, rather than franchised, units. Large companies do not rely heavily on franchising as the growth strategy for at least two reasons. *First*, these organizations usually have the resources required to finance their own growth, and *second*, even if they initially use franchising, these companies tend to eventually buy back the most financially successful franchised units to obtain the benefits that previously accrued to the franchisee (Combs, Castrogiovanni, 1994; Roh, 2002).

Another important finding of the current paper is a non-linear relationship between the proportion of franchised units and a firm's financial performance, as measured by the return on its total assets. According to the results, an increase in the proportion of franchised outlets initially leads to a rise in a company's return on assets. However, there is a certain optimal proportion of franchised units that maximizes a firm's return on assets. When this proportion is exceeded, a company's financial performance worsens. This result indicates that the benefits of the franchising strategy depend, to a certain extent, on the proportion of franchised outlets to the total number of the company's outlets. As this proportion grows, the shortcomings of the franchising strategy become more prominent and, at some point, begin to outweigh its advantages. This is why managers are usually inclined to limit the number of franchised outlets the company has.

Another reason to search for the optimal balance between company-owned and franchised outlets concerns the minimization of potential negative outcomes related to the franchising strategy (Figure 1). There are at least two risks associated with the franchising strategy: *the risk of brand disruption* and *the risk of losing business*.

*The risk of brand disruption* addresses the possible deterioration of the consumers' perception of the franchisor's brand because its franchisees do not pay enough attention to the quality of the goods or services they provide. As a result, income from both franchised and company-owned units may decrease. In general, the value of a company's brand is one of the most important factors that influence the organizational intention to use franchising (Roh, 2002). The more valuable the company's brand is, the more significant the consequences are for an organization if a franchisee violates the contract. This is why the risks of the franchising strategy tend to increase with the growth of a company's brand value. This fact could encourage many large companies to limit their use of franchising.

The intention to avoid the risk of brand disruption can explain why many Russian companies are not willing to conduct franchise operations. A restaurant chain called "Dve palochki" serves as a good example in this regard. Its management refused to use franchising in spite of the general orientation of the company towards fast growth. The owners of the company attributed this to the high importance of maintaining quality standards for the company, which the franchisees may fail to achieve. Measures to reduce the risk of brand disruption

include the monitoring and training of the franchisees. We need to keep in mind, however, that the marginal costs of monitoring a franchisee's managers may be too high, which will make the whole franchise operation inefficient.

The second risk of the franchising strategy is the *risk of losing business*. This risk is especially pronounced in emerging markets, including that of Russia. The Russian legislation on franchise operations has some gaps (Malkova, 2006; Panyukova, 2004a; Rykov, 2001). For example, in Russia there is no separate federal law on franchising. This is why franchise operations in the country are conducted according to different contracts — license agreements, purchase and sale agreements, etc. In these circumstances, the risk of losing business can be significant<sup>1</sup>. For example, when implementing the franchising strategy, the chain of fast food restaurants “Kroshka-Kartoshka” has been unable to protect its brand and technology within the existing legislation. As a result, a rival organization with a similar product appeared on the market (Osadshaya, 2004).

In general, the risk of losing business contributes to the reasons why the management of many Russian companies often avoid using the franchising strategy or at least why they tend to launch company-owned units in parallel with the franchised units.

In general, these two risks of the franchising strategy can explain the existence of a non-linear relationship between the proportion of franchised units and a company's financial performance. Yet it seems that this functional relationship is not universal. Indeed, it may be specific to a particular company and be contingent on the nature of the business processes franchisees can perform under their contracts.

As mentioned earlier, franchise operations are hampered by tacit business practices, which are hard to convey to franchisees. From our point of view, the crucial issue here is the extent to which the business processes performed under the franchise agreement are core for the franchisor, i.e., the extent to which these business practices form the basis of the franchisor's core competencies.

The example of “Dve palochki” shows that when a company's core competencies form the scope of the franchise agreement (in this case, the capability to ensure the quality of food and create an appropriate atmosphere), franchising strategy results in some risks. If the franchise agreement provides for only a partial transfer of the core competencies of the company, these risks are not as great. For example, one might consider the company “Helix,” which conducts independent clinical analysis for private clients (“Helix”. Official site, 2012). Its franchise agreement covers only the process of collection of, for example, blood or urine samples. The clinical analyses that form the core competencies of the company are processed in the central laboratory. In this case, there is no transfer of the entire set of core competencies to the franchisees. This allows the company to alleviate the potential risks of the franchising strategy. All in all, we assume that the relationship between the proportion of franchised units

---

<sup>1</sup> It is not only franchisors that face legal issues in the process of implementation of franchise agreements. Franchisees have these issues as well. There is evidence that, in Russia, a large number of pseudo-franchises (i.e., franchises that authorize the use of brands that are not registered in accordance with the existing legislation) are being sold (Denisov, 2009). Moreover, these brand names are often very similar to the names of famous brands known worldwide, which is why they often mislead potential franchisees. If a pseudo-franchise is acquired, the franchisees will have little chance to plead their case if the original owner of the trademark takes steps to protect its intellectual property rights.

and the financial performance of “Helix” is not quadratic, but linear, i.e., the return on assets rises with an increase in the number of franchised units.

## **Conclusion**

The present paper focuses on the factors that determine a company’s propensity to franchise and the relationship between the proportion of franchised units and a firm’s financial performance. According to the results, an increase in the number of cities the company operates in leads to a rise in the proportion of franchised units, while an increase in a company’s size reduces this proportion. The regression analysis supports a non-linear relationship between the proportion of franchised units and a firm’s financial performance, as measured by the return on its total assets. In other words, there is an optimal proportion of franchised units that maximizes this indicator. These findings are consistent with the basic theoretical assumptions about different aspects of the implementation of the franchising strategy. Therefore, the empirical results let us infer that, despite features specific to emerging markets like Russia, the overall trends remain the same.

A more detailed analysis of the optimal proportion of the franchised outlets led to the conclusion that the risks of the franchising strategy influence a company’s financial performance substantially. These risks include risk of brand disruption and risk of losing business. Both can be mitigated either by contractual or organizational (managerial) methods. However, under the specific legal framework of emerging markets, it is not always possible to legally protect the franchise. Attention should therefore be shifted to organizational methods such as staff training, the provision of necessary support to the franchisees, etc. Organizational methods should also enable companies to maintain control over their core competencies.

We need to note the limitations of the current research. First, this study is restricted to only one time period — the year of 2010. Second, the results were obtained using a sample of companies with different industrial affiliations. The main explanation is that the panel data analysis on Russian companies in specific industries is significantly hampered by a lack of information. Above all, we lack data on the changes in the number of franchised units and the number of cities the companies operated in over several consecutive years. Nevertheless, we believe that investigating the optimal franchise proportion in specific industries is an important task and should be considered in further studies.

## **Practitioner’s summary. “Implications for Business Marketing Practice”**

The main practical implication of the current study is the following. The analysis conducted in the current paper enabled us to formulate the theoretical model which assesses the necessity to use franchising for a particular company.

The decision of the organization concerning the extent of franchising implementation is based on the answers to two questions, which involve determining the necessity for and identifying the opportunities from the use of franchising as a growth strategy, while also considering how to minimize the potential risks of this strategy. The decision-making process can be described as a scheme (Figure 2).

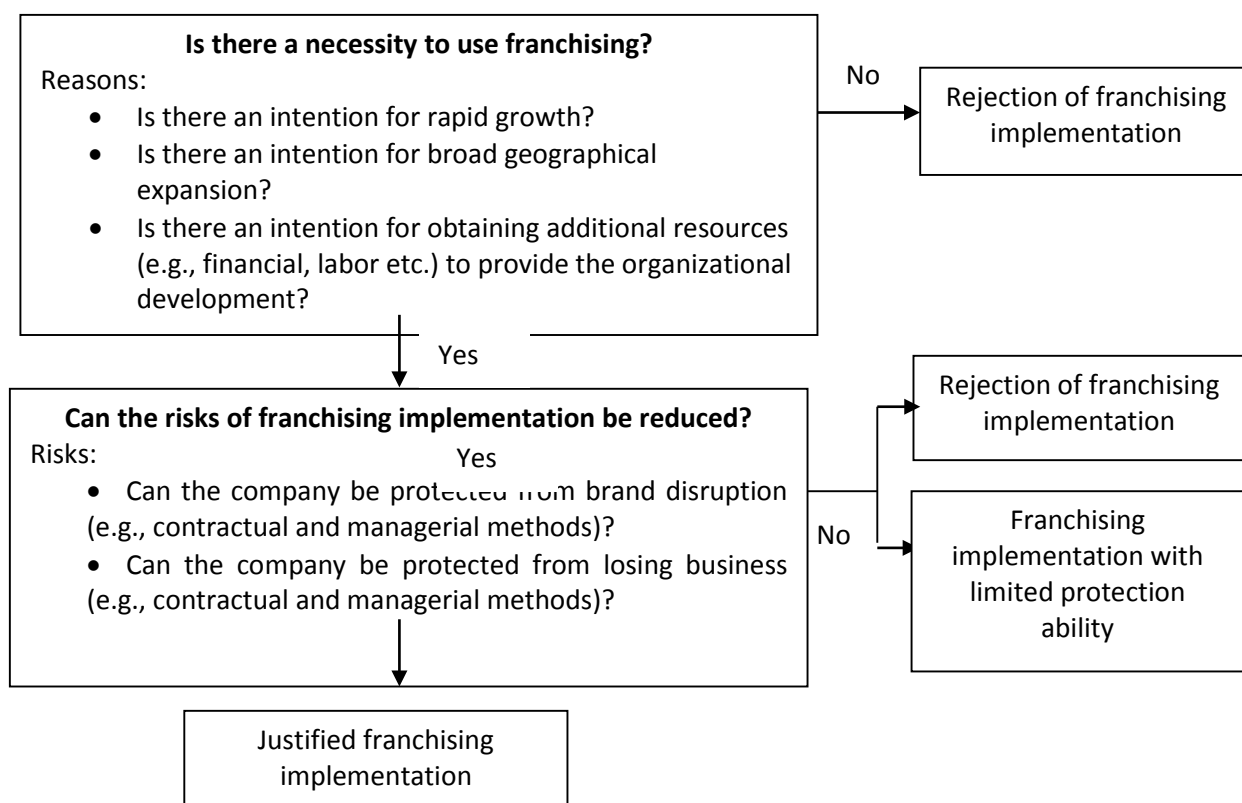


Figure 2. The decision-making process concerning franchising implementation

The decision of the company's management to use franchising starts with its awareness of the necessity to implement franchising as a growth strategy, the occurrence of which is usually driven by the need to achieve the target growth: the required rate of growth, the extent of geographical expansion and the acquisition of the necessary resources (which also include the managerial resources that the company attracts through the franchisees' involvement with its business processes and that help it solve the agency problem). When the necessity for franchising implementation is identified, it raises the question about the feasibility of using franchising for a particular business. The key problems with franchising implementation that were discovered in the survey are the risks associated with brand disruption and with losing business. Protection from these risks can be provided by contractual (legal) methods, which might not be able to ensure the safety of the firm in the institutional environment of emerging markets, and managerial methods, which should be focused on those transfers of business operations according to the franchising agreement that do not represent the core competencies of the firm. This approach provides the company with the opportunity to increase the scale of the business while maintaining the basic implicit business practices within the organization. If these methods can successfully be applied by the company's management to protect the business during the franchising implementation, the use of franchising is justified; the potential increase in the extent of franchising implementation in the organization is not limited and will have a positive impact on the performance of the firm. Otherwise, the company's management prefers either to reject the use of franchising or to limit the extent of its implementation to achieve a balance between the number of company-owned and franchised outlets.

On the grounds of this theoretical model companies may analyze their strategies and operations and determine to what extent it's feasible for them to use franchising.

## References

- Andrew, W.D., Damitio, J.W. and Schmidgall, R.S. (2007), *Financial Management for the Hospitality Industry*, Pearson Prentice Hall, New Jersey.
- Antonowicz, A. (2011), "The dissemination of franchising all over the world: an attempt to assess the scale of the phenomenon", *Problems of Management in the 21<sup>st</sup> century*, vol. 2, pp. 8-18.
- Barthelemy, J. (2008), "Opportunism, knowledge, and the performance of franchise chains", *Strategic Management Journal*, vol. 29, pp. 1451-1463.
- Berbel-Pineda, J.M., Ramirez-Hurtado, J.M. (2012), "Issues about the internationalization strategy of hotel industry by mean of franchising", *International Journal of Business and Social Science*, vol. 3, no. 6, pp. 284-290.
- Brickley, J.A. and Dark, F.H. (1987), "The choice of organizational form: the case of franchising", *Journal of Financial Economics*, vol. 18, pp. 401-420.
- Brickley, J.A., Dark, F.H. and Welsbach, M.S. (1991), "An agency perspective on franchising", *Financial Management*, vol.20, no. 1, pp. 27-35.
- Carney, M. and Gedajlovic, C. (1991), "Vertical integration in franchise system: agency theory and resources explanations", *Strategic Management Journal*, vol. 12, no. 8, pp. 607- 629.
- Caves, R.E. and Murphy, W.F. (1976), "Franchising: Firms, Markets, and Intangible Assets", *Southern Economic Journal*, vol. 42, pp. 572-586.
- Chathoth, P. and Olsen, M. (2007), "Does corporate growth really matter in the restaurant industry?", *International Journal of Hospitality Management*, vol. 26, pp. 66-80.
- Cochet, O. and Garg, V.K. (2008), "How Do Franchise Contracts Evolve? A Study of Three German SMEs", *Journal of Small Business Management*, vol. 46, no. 1, pp. 134-151.
- Combs, J.G. and Castrogiovanni, G. (1994), "Franchisor strategy: a proposed model and empirical test of franchise versus company ownership", *Journal of Small Business Management*, vol. 32, pp. 37-47.
- Combs, J.G. and Ketchen, Jr.D. (1999), "Can capital scarcity help agency theory explain franchising? Revisiting the capital scarcity hypothesis", *Academy of Management Journal*, vol. 42, no. 2, pp. 196-207.
- Combs, J.G. and Ketchen, Jr.D. (2003), "Why Do Firms Use Franchising as an Entrepreneurial Strategy?: A Meta-Analysis", *Journal of Management*, vol. 29, no. 3, pp. 443-465.
- Combs, J.G., Ketchen, Jr.D. and Short, J.C. (2011), "Franchising research: major milestones, new directions, and its future within entrepreneurship", *Entrepreneurship: Theory and Practice*, May, pp. 413-425.

- Combs, J.G., Michael, S. and Castrogiovanni, G. (2004), "Franchising: a review and avenues to greater theoretical diversity", *Journal of Management*, vol. 30, pp. 907–931.
- Dant, R. and Berger, P. (1996), "Modeling cooperative advertising decisions in franchising", *Journal of Operational Research Society*, vol. 47, pp. 1120–1136.
- Dant, R., Kaufmann, P. and Robicheaux, R. (1998), *Change in mix of company-owned and franchised outlets: ownership redirection revisited*. Proceedings. 12th Annual Society of Franchising Conference. Las Vegas.
- Dant, R.P., Paswan, A.K. and Kaufmann, P.J. (1996), "What we know about ownership redirection in franchising: a meta-analysis", *Journal of Retailing*, vol. 72, pp. 429–444.
- Denisov, D. (2009), "Franchises with cockroaches" In Russian. *Business Journal*, vol. 8. Retrieved 12/05/2011, from <http://www.rdt-info.ru/20090915245/franshizy-s-tarakanami.html>
- Diaz-Bernardo, R. (2012), "An analysis of three confronting theories to explain franchising supply", *Journal of Business and Economics Research*, vol. 10, no. 3, pp. 167-170.
- Ellis, D.J. and Pekar, Jr.P.P. (1979), "Franchising: friend or foe?" *Strategy and leadership*, vol. 7, no. 1, pp. 11–35.
- Fama, E.F. and Jensen, M.C. (1983), "Separation of ownership and control", *Journal of Law and Economics*, vol. 26, pp. 301-325.
- Gerhardt, S., Dudley, D. and Hazen, S. (2012), "Franchising and the impact of McDonald's", *Journal of Management & Marketing Research*, vol. 10, pp. 1-10.
- Hsu, L.T.J. and Jang, S.C. (2009), "Effects of restaurant franchising: Does an optimal franchise proportion exist?", *International Journal of Hospitality Management*, vol. 28, no. 2, pp. 204-211.
- Hunt, S.D. (1973), "The trend toward company-operated units in franchise chains", *Journal of Retailing*, vol. 49, no. 2, pp. 3–12.
- Ibadova, L. (2006), *Financing a small business in Russia: legal issues*. In Russian. Walters Cluver, Moscow.
- Ingram, P. and Baum, J.A.C. (1997), "Chain affiliation and the failure of Manhattan hotels, 1898–1980", *Administrative Science Quarterly*, vol. 42, no. 1, pp. 68–102.
- Insa-Ciriza, R. (2003), "Franchising in Spain: The success of being your own boss", *European Regional Review*, no. 39, pp. 58-61.
- Jensen, M. and Meckling, W. (1976), "Theory of the firm: managerial behavior, agency costs, and ownership structure", *Journal of Financial Economics*, vol. 3, pp. 305–360.

- Kashyap, V., Antia, K.D., and Frazier, G.L. (2012), “Contracts, extracontractual incentives, and ex post behavior in franchise channel relationships”, *Journal of Marketing Research*, vol. XLIX, pp. 260-276.
- Kaufmann, P.J. and Dant, R.P. (1996), “Multi-unit franchising: growth and management issues”, *Journal of Business Venturing*, vol. 11, no. 5, pp. 343–358.
- Koh, Y., Lee, S. and Boo, S. (2009), “Does franchising help restaurant firm value?”, *International Journal of Hospitality Management*, vol. 28, pp. 289–296.
- Lafontaine, F. (1992), “Agency theory and franchising: some empirical results”, *RAND Journal of Economics*, vol. 23, pp. 263–283.
- Lafontaine, F. and Kaufmann, P.J. (1994), “The evolution of ownership patterns in franchise system”, *Journal of Retailing*, vol. 70, no. 2, pp. 97–113.
- Laricheva, Z. and Strelkova, L. (2006), “Small business: issues and prospects for development”. In Russian. *Management in Russia and abroad*, vol. 5, pp. 38-43.
- Laurie, C. (1995), “Multiplying your success”, *Franchising World*, vol. 27, no. 2, pp. 20–26.
- Lillis, C.M., Narayana, C. L. and Gilman, J.L. (1976), “Competitive advantage variation over the life-cycle of a franchise”, *Journal of Marketing*, vol. 40, no. 4, pp. 77–80.
- Malkova, I. (2006), “Franchising in the system of relations of the contemporary market economy”. In Russian. *Public management. Electronic herald*, vol. 9, pp. 1-6.
- Manolis, C., Dahlstrom, R. and Nygaard, A. (1995), “A preliminary investigation of ownership conversion in franchised distribution systems”, *Journal of Applied Business Research*, vol. 11, no. 2, pp. 1–8.
- Martin, R. (1988), “Franchising and risk management”, *American Economic Review*, vol. 78, no. 5, pp. 954–968.
- McCuddy, M.K., Eser, Z. and Pinar, M. (2011), “Exploring the connection between ethical issues in franchising business success and franchisees’ demographic characteristics”, *International Journal of Business Research*, vol. 11, no. 6, pp. 101-116.
- Mendelsohn, M. (2005), *The guide to franchising*, Bedford Row: Thomson Learning.
- Michael, S.C. (2000), “The effect of organizational form on quality: the case of franchising”, *Journal of Economic Behavior and Organization*, vol. 43, pp. 295-318.
- Michael, S.C. and Combs, J.G. (2008), “Entrepreneurial failure: the case of franchisees”, *Journal of Small Business Management*, vol. 46, no. 1, pp. 73-90.
- Norton, S. (1988), “The empirical look at franchising as an organizational form”, *Journal of Business*, vol. 61, no. 2, pp. 197-218.
- Official cite of the Beboss company. (2010), Retrieved 11/12/12, from: <http://www.beboss.ru>

- Official cite of the Helix company. (2012), Retrieved 14/03/12, from: <http://www.helix.ru/site/page/41>
- Osadshaya, O. (2004), "Potato riot in "Kroshka-kartoshka" In Russian. *Kommersant Secret of the firm*, vol. 39, no. 78 Retrieved 14/05/2011, from: <http://www.kommersant.ru/doc/860023/print>
- Oxenfeldt, A.R. and Kelly, A.O. (1969), "Will successful franchise systems ultimately become wholly-owned chains?", *Journal of Retailing*, vol. 44, pp. 69–83.
- Oxenfeldt, A.R. and Thompson D.N. (1968), "Franchising in perspective", *Journal of Retailing*, vol. 44, no. 4, pp. 3–20.
- Panyukova, V. (2004a), "The peculiarities of franchising in the Russian market". In Russian. *Marketing in Russia and abroad*, vol. 2, no. 40, pp. 64-69.
- Panyukova, V. (2004b), "Advantages and disadvantages of franchising for Russian companies". In Russian. *Marketing in Russia and abroad*, vol. 6, pp. 88-93.
- Panyukova, V. (2005), "The development of franchise operations in the Russian shoes market" In Russian. *Marketing in Russia and abroad*, vol. 5, no. 49, pp. 129-136.
- Peng, M.W. (1997), "Firm growth in transitional economies: three longitudinal cases from China, 1989-96", *Organizational Studies*, vol. 18, no. 3, pp. 385-413.
- Peng, M.W. and Heath, P.S. (1996), "The growth of the firm in planned economies in transition: Institutions, organizations, and strategic choice", *Academy of Management Review*, vol. 21, no. 2, pp. 492-528.
- Pruett, M. and Winter, G. (2011), "Why do entrepreneurs enter franchising and other share relationships?", *Journal of Small Business and Entrepreneurship*, vol. 24, no. 4, pp. 567-581.
- Ramírez-Hurtado, J.M., Rondán-Cataluña, F.J., Guerrero-Casas F.M. and Berbel-Pineda J.M. "Identifying the franchisee profiles franchisors prefer", *Journal of Business Economics and Management*, vol. 12, no. 4, pp. 567-588.
- Roh, Y. (2002), "Size, growth rate and risk sharing as the determinants of propensity to franchise in chain restaurants", *International Journal of Hospitality Management*, vol. 21, pp. 43-56.
- Rubin, P.H. (1978), "The theory of the firm and the structure of the franchise contract", *Journal of Law and Economics*, vol. 21, pp. 223–234.
- Russian Franchising Association (2010), Retrieved 16/12/10, from: <http://www.rarf.ru>
- Rykova, I. (2001), "Franchising in the activities of Russian companies" In Russian. *Marketing in Russia and abroad*, vol. 1, pp. 81-88.

- Sen, K.C. (1998), "The use of franchising as a growth strategy by US restaurant franchisors", *Journal of Consumer Marketing*, vol. 15, no. 4, pp. 397-407.
- Shane, S. (1996), "Hybrid organizational arrangements and their implications for firm growth and survival: a study of new franchisors", *The Academy of Management Journal*, vol. 39, no. 1, pp. 216–234.
- Shane, S. (2005), *From ice cream to the internet: using franchising to drive the growth and profits of your company*. Prentice Hall Professional Business, New Jersey.
- Solis-Rodriguez, V. and Gonzalez-Diaz, M. (2012), "How to design franchise contracts: the role of contractual hazards and experience", *Journal of Small Business Management*, vol. 50, no. 4, pp. 652-677.
- Sorenson, O. and Sorensen, J. (2001), "Finding the right mix: franchising, organizational learning, and chain performance", *Strategic Management Journal*, vol. 22, pp. 713–724.
- SPARK database (2011), Retrieved 15/06/2011, from: <http://www.spark.interfax.ru>.
- Sul, H.-K. and Khan, M.A. (2006), "Restaurant Franchisees' View of the Relationships Among the Determinants of Franchisors' Entrepreneurial Strategy Processes", *Journal of Hospitality & Tourism Research*, vol. 30, no. 4, pp. 427-451.