

School of Management

**Critical Success Factors of International Franchising:
Case Studies of Foreign Franchisors in Asia**

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**This thesis is presented as part of the requirements for
the award of the Degree of Master of Commerce
of the Curtin University of Technology**

December 2001

Abstracts

A multiple case study of four foreign franchisors was conducted in 2000 to study the critical success factors of international franchising in East Asia. The four franchisors were chosen because they possess different international franchising capabilities and are at varying levels of internationalisation. This study provides a useful insight into how a foreign franchisor should approach and compete successfully in East Asia. Firstly, the research provides a conceptual model, which displays the six key categories and success factors for international franchising in East Asia. The study has made a significant contribution in identifying two new categories that have mostly been neglected by researchers in international franchising. Secondly, the study reveals a unique form of master franchising that is being practiced in East Asia. Thirdly, the effective management of Asian partners is found to begin with recruiting the right partners with the desired characteristics and subsequently developing a long-term mutually beneficial working relationship with the partners. Finally, successful franchisors were found to believe strongly in the power of branding and niche marketing in East Asia.

Acknowledgements

I would like to express my heartfelt appreciation and gratitude to my supervisors Dr. Tim Mazzarol and Professor Lawson Savery for their wisdom, encouragement, and invaluable direction throughout the year. I am particularly appreciative of their fine effort in meticulously and painstakingly going through my thesis with a “fine tooth-comb.” My special thanks must go to Dr. Mazzarol for his continuing mentoring, support and guidance over the past several years.

This research would not have been possible without the open access to the four studied organizations. I wish to thank all of the respondents who willingly gave their time to share their knowledge and stories with me. In particular, I would like to acknowledge the significant contributions Messrs Phil May and Shaik Aziz of Dome Coffees have made to this study. They have been incredibly generous in their support, of which I am most appreciative.

My deepest gratitude and love, however, is reserved for my wife Tina. Her tireless effort in preparing those delicious sandwiches for my lunches and unconditional support has made the undertaking of this thesis possible. This thesis is, therefore, dedicated to my beautiful wife, partner and friend.

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1 INTRODUCTION

As a business model, franchising has experienced a significant increase in popularity throughout the world over the past three decades. Commencing from the 1970s, franchising has grown to represent nearly one-third of United States (U.S.) domestic sales (Boe, Ginalski and Henward III, 1987). In 1990 it totaled approximately US\$700 billion of sales (Hogan, 1990; Steinberg, 1991). The majority of this growth has been attributed to “business format franchising” (Chan and Soon, 1992; Felstead, 1994). Business format franchising requires the franchisee replicate, in different locations, the entire franchisor’s business concept other than the right to use its trademark. This type of franchising accounts for 74 per cent of all franchise arrangements in the U.S., where it contributes some 14 per cent of total retail sales (Mendelsohn, 1995).

Franchising is not just a U.S. phenomenon but has proven to be highly popular elsewhere. Franchising is common in Europe, parts of Asia, Australia and New Zealand (Chan and Justis, 1990; Durden, 1994; Preble, 1995). With respect to Asia, Japan was the first country in the region to be targeted by U.S. franchisors in the 1970s (TDB and Arthur Andersen, 1997; Love, 1995). As of March 1995, Japan had 158,000 franchise outlets, which ranked the country as having the third largest number of franchise outlets in the world after U.S. and Canada.

The popularity of international franchising in Asia grew exponentially in the 1980s when local companies set out to acquire the country rights of foreign franchises in fast food (e.g. McDonald’s, Kentucky Fried Chicken, Pizza Hut), service (e.g. Avis, Hilton, Mister Minit), and general retail (e.g. 7-eleven, Body Shop, Benetton) (TDB and Arthur Andersen, 1997). The overwhelming success enjoyed by these firms

pioneered further interest among other international franchisors to create their presence in Asia.

Foreign franchisors were attracted to Asia because it had a soaring middle class, with high disposable income, and more than half of the world's population lives in the region. China alone comprises nearly one-quarter of the world's population and is considered the most under-retailed country in the world (Swartz, 1997). Further, governments in Singapore and Malaysia have recognised franchising as a vital key to stimulate growth in entrepreneurial activities and small businesses (TDB and Arthur Andersen, 1997). The two governments have introduced laws and established organizations and development programs to stimulate franchising in their countries.

1.1 Problem Statement

Despite this widespread growth in franchising as an international business model, research on this form of business remains sparse, perhaps in part, because of its rapid emergence. Most studies of international franchising were conducted in the 1990s and there remains a scarcity of empirical and conceptual research on the topic (Ackerman, Bush and Justis, 1994; Fladmoe-Lindquist, 1996; Shane, 1996a; Fladmoe-Lindquist and Jacque, 1995; Huszagh, Huszagh and McIntyre, 1992). Fladmoe-Lindquist (1996) suggests that international franchising research has been limited to problems, motivating factors, constraining factors, and managerial attitudes.

However, research in international business and franchising has recently begun to identify several distinct categories of capabilities needed to franchise internationally (Shane, 1996b; Huszagh, Huszagh, and McIntyre, 1992; Kedia, Ackerman, Bush and Justis, 1994). Despite this trend there remains a lack of research on determining the critical factors, other than capabilities, that lead to improving the performance of

franchising in foreign markets, especially in Asia. An examination of organisational characteristics and international strategies of franchisors, other than capabilities, would be helpful in determining the critical success factors of international franchising. Therefore, the following three questions are studied, analysed and answered to address this

1. How do foreign franchisors expand into East Asia?
2. How do foreign franchisors manage their overseas partners in East Asia?
3. Why are some foreign franchisors in East Asia more successful than others?

1.2 Purpose of the Study

The purpose of this study is to explore the factors critical to the success of international franchising in relation to four foreign franchisors operating in East Asia. This study aims to provide a detailed, fully documented and valid theoretical foundations of how international franchising operates in East Asia. It is hoped that these findings can be studied and utilized by franchisors proposing to expand into East Asian markets.

1.3 Contributions of the Study

International franchising, as a business model, appears set to increase in popularity within East Asia. Over the past 10 years the level of competition has intensified significantly for foreign franchisors as many local East Asian-based franchises have entered the sector and learned to compete with and even surpass their more famous Western counterparts (Prystay and Kumar, 1997). Without a systematic exploration of the strategic aspects of international franchising within East Asia there will be no guidance as to how best to compete within the region.

This study has made several contributions. Firstly, this study will add to the existing knowledge on international franchising, since published empirical research in this area is very limited (Fladmoe-Lindquist, 1996; Shane, 1996a). Furthermore, it not only provides linkages of theoretical and empirical constructs, but also synthesizes theoretical concepts of success factors of international franchising, postulated by various researchers.

Secondly, this study provides a model of the critical success factors that an international franchisor needs to develop or acquire in order to gain a competitive edge in East Asia. The model serves as a useful framework for other franchisors desiring to enter into other emerging regions of the world (i.e. Eastern Europe, Middle East, or South America). This model could be adapted to apply for any retail concept.

Finally, this study uncovers the master franchisee characteristics that are associated with successful international franchising in East Asia. The desired master franchisee characteristics are financial strength, entrepreneurial and like-mindedness. Selecting the appropriate overseas partner is a critical factor for franchisors entering East Asia as master franchising is the most popular business mode used by foreign franchisors in the region (Chan and Justis, 1992). However, there appears to be a lack of empirical research conducted in determining the characteristics of a master franchisee that will increase the likelihood of success in East Asia.

1.4 Definition of Terms

For the purpose of this study the following terms, arranged in alphabetical order, have been given special definitions:

- Asia – The entire geographical area which encompasses East Asia, India, Pakistan, Vietnam, and Cambodia.

- Business Format – The entire franchisor’s business concept, including the marketing strategy and plan, the operating manuals and standards, and quality control.
- Critical Success Factors – Those capabilities and key areas of activity, which must be possessed and performed particularly well in order for the franchise firm to outperform its competitors.
- East Asia – The geographical region which encompasses China and her Special Administrative Region of Hong Kong, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan and Thailand.
- International Franchising – A foreign market entry mode that involves a relationship between the entrant (the franchisor) and a host country entity, in which the former transfers, under contract, a business package (or format), which it has developed, and owned, to the latter.
- Master franchising – A contractual relationship between the franchisor and an independently owned sub-franchisor to develop a specified number of franchises in a given area in exchange for exclusive right to use the business format for a specified length of time.

2 LITERATURE REVIEW

The literature review has eight major sections. Section 1 provides a definition of international franchising, which has often been inappropriately equated to licensing, exporting and foreign direct investment. Section 2 provides an overview of the phenomenal growth of international franchising over the past 20 years. Section 3 discusses the various modes of international franchising. Section 4 reviews the literature on international franchising. Section 5 discusses the capabilities required in international franchising and provides a typology for understanding international franchise types. Section 6 overviews the international expansion of U.S. franchisors. Section 7 discusses the market entry modes used by international franchisors and the adaptation of the franchise systems in East Asia. Section 8 overviews the trend of changing consumers in East Asia over the last four decades and identifies the various customer segments in the region.

2.1 Definitions of International Franchising

Previous studies have treated franchising as a generic mode of entry into international markets, requiring no equity investment or control (Boddewyn, Halbrich and Perry, 1986; Fladmoe-Lindquist and Jacque, 1995). A more realistic view would see international franchising to be a continuum of different modes of market entry, which vary in the amount of risk and control they embody.

Incomplete definition and conceptualisation of international franchising can lead to the development of misleading theories, the wrong choice of data collection, inappropriate selection of analytical techniques and erroneous conclusions (Alon, 1999). International franchising has been equated to licensing, exporting and foreign

direct investment. However, international franchising is a unique method of doing business that captures several modes of market entry.

International franchising has been traditionally treated as a type of licensing (Ackerman, Bush and Justis, 1994; Root, 1987; Boddewyn, Halbrich, and Perry, 1986). For example, Root (1987) proposed that franchising was a form of licensing in which a company (franchisor) made available its intangible assets (i.e. patents, trade secrets, know-how, trademarks, and company name) to an independent company or person (franchisee) in return for royalties and/or other forms of payment. Studies utilising this conceptualisation have concluded that the franchisor is less affected by risk of failure because ownership is often assumed by the franchisee (Aydin and Kacker, 1990).

Unlike licensing, franchising may provide tangible as well as intangible assets. The franchisor often provides an input into the production of the franchisee product or service. Furthermore, a study of U.S. based international franchisors conducted by Arthur Andersen (1996) found that the average investment in international franchising was about US\$680,000. An example of this was McDonald's which invested over US\$50 million in its Russian venture before even opening its first store (Love, 1995). Therefore, the traditional view of international franchising as licensing is erroneously rooted in the assumption that international franchising is a non-equity and non-direct mode of entry (Burton and Cross, 1995).

Ackerman, Bush and Justis (1994) equated international franchising to exporting because both are means of entering global markets with little investment and limited risk. The experience of many franchisors reveals that entering a foreign market involves at least some investment by the international franchisor (Love, 1995; Arthur Andersen, 1996). Furthermore, unlike exporting, international franchising requires

close attention to tracking down equipment, securing local raw materials that meet the franchisor's quality specifications, and protecting trademark and trade secrets (Steinberg, 1992). Therefore, equating international franchising to exporting is erroneous.

Finally, international franchising is often distinct from direct investment. This view was espoused by Boddewyn, Halbrich, and Perry (1986) who stated that franchising in its purest form does not involve equity investment by the franchisor. Therefore it cannot be considered a form of direct investment.

However, international franchising is probably best defined by Burton and Cross (1995, p. 36), as "...a foreign market entry mode that involves a relationship between the entrant (the franchisor) and a host country entity, in which the former transfers, under contract, a business package (or format), which it has developed and owned, to the latter." The host country entity can be either a domestic franchisee, a foreign franchisee, a master franchisee, or an entity that is partly owned by the franchisor itself. This definition encompasses multiple forms of international franchising, including international master franchising, direct international franchising, international joint ventures and sole ventures.

2.2 International Franchising Phenomenon

Over the past 30 years, franchising has spread rapidly throughout the world. In 1971, approximately 150 U.S. firms were involved in international franchising. By 1986, this number had doubled to 300 with well over 15,000 foreign franchise units (US Department of Commerce, 1988). The prospects for franchising to continue growing on a global basis seem substantial. Franchising is being increasingly understood as a useful formula for business growth and success. It simultaneously harnesses the

energies of individual entrepreneurs, takes advantage of local knowledge, and expertise, spreads financial risk among all members of the franchise network, and relies on a proven successful package and set of procedures at each new location.

Franchisors are classified either as “product-tradename” or “business format” franchising (Arthur Andersen & Co., 1992). Product-tradename franchising, which is prevalent in automotive sales, retail gasoline, and soft-drink distribution, uses franchisees to distribute a product under a franchisor’s trademark. Business format franchising is designed to have the franchisee replicate, in different locations, the entire franchisor’s business concept including the marketing strategy and plan, the operating manuals and standards, and quality control. Fast food, fast printing, cleaning, hygiene, rental, employment and health services are heavy users of this “package” concept. Business format franchisees are typically small- and medium-sized enterprises (SMEs) (Stanworth, Price, Porter, Swabe and Gold, 1995).

According to Hoffman and Preble (1993), business format franchising is predicted to be the dominant form of franchising internationally in the twenty-first century. Business format franchising experienced rapid growth in the U.S. during the 1950s. However, the 1980s were a period of rapid international expansion during which some 400 U.S. franchisors increased their overseas units by more than 70 per cent, to almost 39,000 (Preble, 1995). The majority of these overseas units were located in Canada, Japan, Europe, and Australia. Business format franchising has experienced faster growth than product name franchising in the domestic market (Kostecka, 1969-1988) and was the source of most of the successful international franchising ventures (Burton and Cross, 1995).

Although much attention has been focused on understanding the motivations which cause firms to begin exporting, relatively little attention has been directed to the

forces which influence franchise firms to internationalise their operations (Kedia, et al., 1994). Classical trade theories focus on explaining mechanisms by which firms chose to remain in domestic markets, export to foreign markets or invest in in-country facilities to serve those foreign markets. While these theories may provide explanatory power for decisions regarding traditional export, licensing and foreign direct investment strategies, they may not be useful for newer entry strategies such as franchising and international joint ventures.

Franchising became a significant force in the post World War II United States in the form of gasoline franchises (Hogan, 1990). Since the 1970s, the growth in franchise arrangements has been large, representing nearly one-third of domestic retail sales (Boe, Ginalski and Henward III, 1989; Hogan, 1990) and totalling approximately US\$716.7 billion of sales in 1990 (Hogan, 1990; Steinberg, 1991).

Interest in international franchising has experienced a similar growth rate, with household names such as McDonald's becoming well known throughout the world. Interest in franchising operations has expanded from the U.S. to other countries, with companies based in countries such as the UK, Australia, and Canada, entering the United States as a foreign market (Welch, 1989b).

The internationalisation of franchising began initially by firms establishing a presence across overseas markets within industrialised nations with developed economies and language/cultural proximity and affinity to the home market (Hogan, 1990). As markets began to become saturated in America, and as the export potential of franchising became more evident, the growth rate accelerated and the global net has broadened.

The recent growth in international franchising is fuelled by both push factors, such as saturation, competition, and diminishing profits in the domestic market, and pull

factors, such as the liberalisation of the Eastern block countries, the formation of regional trading blocks and the emergence of some newly industrialised countries in the international market place (Alon and McKee, 1999).

2.3 Modes of International Franchising

Six modes of international franchising can be identified. They are (1) master franchising, (2) area development franchising, (3) joint ventures, (4) direct franchising, (5) direct franchising with a subsidiary, (6) sole venture and (7) conversion franchising. In the following sections these modes are discussed:

2.3.1 Master Franchising

Hackett (1976) was one of the earliest observers of the use of master franchising in a global setting. According to his study, 21 per cent of the firms surveyed were using this mode of market entry. Twenty years later, Arthur Andersen (1996) found that 81 per cent of the reporting firms used master franchising, up from 59 per cent in 1989. This research also suggests that master franchising was the most popular franchising mode of entry. One possible factor responsible for this marked rise is the use of franchising is the increase in U.S. franchisors' entry into distant and culturally dissimilar countries such as Asia, Mexico, the Caribbean and the Middle East (Arthur Andersen, 1996).

Master franchising refers to the contractual agreement between the franchisor and an independently owned sub-franchisor to develop a specified number of franchises in a given area in exchange for exclusive right to use the business format for a specified length of time (Justis and Judd, 1986). The master franchisee is an intermediary party between the franchisor and franchisee that has the responsibility to sell the franchises,

qualify franchisees, collect part of the royalties and majority of the franchisee fee, and train the franchisees.

The major advantages of using master franchising as a foreign market entry mode are: (1) increased speed of business/market development, (2) relatively little capital outlay, and (3) enhanced knowledge of local markets (Justis and Judd, 1986). The master pays a fee for the territory based on the perceived strength of the area, often measured by the level of population. The franchisor assumes very little political risks since it receives the initial fees up front and a small percentage of sales over time. Franchisors often seek masters who are familiar with local culture, financially stable and like-minded.

Master franchising is a mode of entry that is low in risk and control (Burton and Cross, 1995). It involves an arm's length transaction with a host country independent entity in which the franchisor makes no financial and management commitment. Political and market risks are negligible. The franchisor delegates most of the responsibilities of monitoring and control to the master, who in turn keeps a portion of the franchise royalties.

With the selection of master franchise partners, U.S. franchisors generally require proven management expertise, ability to compile a business plan, the financial resources to support growth, understanding of the local market and U.S. business practices, access to real estate, and the right goals (Steinberg, 1994).

Despite the widespread use of master franchising, research by Ryans Jr., Lotz and Krampf (1999) has found several criticisms of this entry mode expressed by 39 leading international franchisors. The results suggest that most master franchisees often fail to communicate effectively with the franchisees, follow home office directives or follow the fundamental concepts of the franchise.

James Kramer, vice president of international franchising for McDonald's cautions any franchisor considering using international master franchising (Ryans, Lotz and Krampf, 1999, p. 33) saying:

All you have, if the agreement goes sour, is your contract. Yes, you have the right to terminate, but it can be a long, onerous, expensive task and in the end you may not get the outcome you desire. McDonald's prefers to make investments with our partners or franchisees because it changes the basic relationship and gives us greater control either as a shareholder of the operating companies or owner/lessors where our restaurants are located.

2.3.2 Area Development Franchising

An increasing popular version of master franchising has been the use of area development agreements. Research by Arthur Andersen (1996) found that 112 per cent more franchisors have used this mode since 1989. The study also revealed that area development was the second most popular franchising mode of entry.

In an area development agreement, the area developer is permitted only to establish and operate its own units (Burton, Cross and Rhodes, 2000). These units are run by employee managers of the area developer. This franchise agreement does not permit the area developer to sell the franchise on to independent sub-franchisees.

Area development franchising is at times preferred by franchisors to master franchising. The prolonged nature of the franchising contract (usually 10 to 20 years) exposes the franchisor to problems associated with choosing the wrong master, such as ensuring quality, and the likelihood of being sued by the franchisees for not meeting the expectations (Justis and Judd, 1986). In case of a dispute between the franchisor and master, the master may keep the franchisees since they are used to working with the master and are reluctant to deal with the franchisor (Burton and

Cross, 1995). Therefore, some franchisors have been found to be “hedging their bets” with area development franchising before committing themselves into a long-term and extensive relationship (Steinberg, 1994).

For example, Gloria Jean, the gourmet coffee chain, first signed an area development agreement in Mexico with an individual to open three stores in three years. Three months later after sales at the first store outperformed U.S. stores by 42 per cent and the foreign individual proved he could manage the business, Gloria Jean converted the area development agreement into a master franchise contract.

2.3.3 Joint Ventures

Some 35 per cent of franchisors reported entering foreign markets via joint ventures (Arthur Andersen, 1996). This mode of entry is used when it is required by law and when a local partner is necessary in securing resources and local market knowledge. The advantages of this mode are: (1) the political and economic contacts it can provide, (2) local market knowledge, and (3) existing distribution networks and labour that may be available via the partner (Burton and Cross, 1995).

Ownership in a joint venture can vary from minority to majority share holdings. International joint ventures tend to reduce the possibility of legal or economic impediments to the growth of the franchise system in a host country, but their success depends on key economic and competitive environment factors (Falbe and Dandridge, 1992). For example, a joint venture agreement with the City of Moscow allowed McDonald’s to secure real estate and production inputs in addition to smoothing out political impediments (Love, 1995).

The disadvantages of this market entry mode are that (1) profits need to be shared, (2) disputes with the joint venture partner may arise, and (3) administrative costs may be high (Falbe and Dandridge, 1992). Cross-cultural negotiations and

communications with the joint venture partner add another dimension of difficulty because of the broader scope for disagreement on operational issues (Alon, 1999). Furthermore, divestiture is more difficult than in the case of a master agreement (Amos, 1993).

2.3.4 Direct Franchising

Direct franchising is found to be used by around 67 per cent of foreign franchises (Arthur Andersen, 1996). Direct franchising is an extension of domestic franchising arrangements. It involves a direct contractual agreement between the franchisor and foreign franchisee in a similar manner as it is used in the domestic market. This contractual relationship is often used by U.S. franchisors in Canada where the cultural and physical distance is small (Kostecka, 1988). This method is, however, not suitable to countries, which are distant and have linguistic and cultural differences.

Distance makes effective monitoring of the franchisee's behaviours and business conduct, including quality control and customer service, very difficult to achieve. Cultural differences make arrangement at arm's length difficult due to different perceptions and expectations of both parties (Burton and Cross, 1995). The advantages of using direct franchising are: (1) contracts can be standardised and (2) profits on fees and royalties do not have to be shared with another party. Therefore, the franchisor uses the franchisees for managerial, labour and financial resources.

2.3.5 Direct Franchising with a Subsidiary

It is estimated in 1995 approximately 18 per cent of franchisors used a foreign subsidiary, up from 10 per cent in 1989 (Arthur Andersen, 1996). This mode of market entry is similar to direct franchising except the franchisor locates in the host country and enters into franchising agreements from there. The advantages enjoyed by the franchisor when using this mode include (1) the ability to monitor franchisees

closely and reduce service costs, (2) a capability to develop empathy with the local culture thus improve relations with their franchisees and (3) the ability to take advantage of various governmental incentives, such as tax advantages, preferential loans, and government subsidies (Burton and Cross, 1995).

However, international franchising using a subsidiary involves more investment and risk than is typical with direct franchising, as the franchisor has to establish a subsidiary in the host country. Since the subsidiary is often associated with the foreign market, it may be subject to nationalistic ideologies and adverse governmental actions within its own country (Alon, 1999). For example, Kentucky Fried Chicken (KFC) in Syria was forced to rename itself as the “Kuwaiti Fried Chicken” (KFC) because governmental officials were not satisfied with the American cultural imperialism the name symbolised (*The Road from Damascus*, 1998). The result was that KFC has lost its distinctive marketing appeal, leading to the deterioration of its competitive advantage.

2.3.6 Sole Ventures

Sole ventures in international franchising are similar to foreign direct investments in the sense that full control as well as market and political risks are assumed by the franchisor (Alon, 1999). The primary advantage of using a sole venture is that the franchisor retains full authority over the operations of the foreign units and, therefore keeps the entire proceeds of the profits. The disadvantages of this mode of entry are a lack of cultural sensitivity and greater market and political risks (Falbe and Dandridge, 1992).

This mode of entry is prevalent in developed countries with similar linguistic characteristics. For example, McDonald’s used sole ventures in Australia, Canada and England (Alon, 1999). Sole ventures abroad can be either purchased or built.

Blockbuster, for instant, first built 15 stores when it entered the United Kingdom and then purchased Cityvision, the largest video chain store.

2.3.7 Conversion Franchising

Conversion franchising refers to the development of a franchising system primarily through the conversion of independent, going concerns into members of a franchise system (Hoffman and Preble, 1991). Independent firms facing mature and intense competition are attracted to the franchise's internationally known brand name, access to customers, and cost savings through mass purchasing power or improve operations (Feltes and Digman, 1986). For example, Century 21, a U.S. based real estate company, has catapulted to 6,181 units worldwide almost exclusively by converting real estate brokers to Century 21 franchisees (Steinberg, 1993).

2.4 Research on International Franchising

To understand the internationalisation of franchise operations, two general streams of literature must be examined: (1) the literature that specifically investigates the decision to internationalise operations via franchising; and (2) for the purpose of comparison international expansion through exporting.

Hackett (1976) found that the desire to exploit potential markets was the most important force in franchisors' decisions to internationalise their operations. Trankhiem (1979) found the most common reasons given by franchisors for having international markets were increased sales and profits, market expansion, and a desire to be known as an international firm.

Aydin and Kacker's (1990) findings suggest that firm size is a significant variable in understanding the decision to internationalise operations. Companies with large

numbers of franchisee units have a greater likelihood of entering international operations than their smaller counterparts.

A study of 142 U.S. franchising firms undertaken by Kedia et al. (1994) suggested that franchisors are more significantly motivated by managerial attitudes, particularly the desire to expand, and the desire to increase profits, than by firm characteristics such as size.

Subsequent research has also examined franchisors' reasons for not entering international markets. For example, Aydin and Kacker (1990) investigated U.S.-based franchisors' international expansion intentions. They concluded that the primary reasons firms remained domestic were adequacy of opportunities in the U.S. and lack of international knowledge and competencies.

Perlmutter (1969) noted that the attitudes of top management played a significant role in determining the extent to which a given firm will engage in international activities. There appears to be a common thread between some of the literature on franchising and that on exporting (Welch, 1992). Given these commonalities, one would expect some similarities in the general patterns of internationalisation between exporting and franchising. Since the literature regarding exporting is much larger in volume than that of franchising, certain key studies can provide insights into the internationalisation of franchising activities.

Franchisors grow by expanding the size of their franchise systems. This expansion can take place in two ways: through the establishment of additional company-owned outlets or through the establishment of franchise outlets. Franchisors appear to prefer to expand by franchising in geographically distant locations (Brickley and Dark, 1987; Norton, 1988; Martin, 1988; Brickley, Dark and Weisbach, 1991). This preference has been explained as a function of relative agency and governance costs.

The more remote the location of an outlet, the higher the costs of monitoring employees and the greater the preference for franchising (Brickley and Dark, 1987; Martin, 1988).

Research studies undertaken during the 1960s and 1970s into franchising dealt mostly with domestic operations and concentrated on the industry's legal problems (Hunt, 1976; Hunt and Nevin, 1978). In the field of international franchising, two research studies stand out: Etzel and Walker (1973) and Hackett (1976). Both examined the international expansion of U.S.-based franchisors and their future plans.

As a structural form and mode of operation, franchising has a number of important advantages for franchisors in comparison with wholly-owned branches or subsidiaries (see Ayal and Izraeli, 1990). The same advantages apply in varying degrees to international joint ventures. Some of the advantages include adaptability to local conditions, enhanced market communications, local ownership giving stronger motivation for success and reduced operating expenses.

Firms that are operating successfully and innovatively in their domestic market are frequently motivated to set up franchise system by the perceived competitive advantages that it can offer (Preble, 1992). In order to perfect the franchisor's management and operating systems, (Welch, 1989a) has posited that most firms would be expected to get significant domestic experience before going abroad. Although a fair degree of variability existed as to the timing of franchisors making the initial expansion outside the U.S., Walker (1989) reported that the majority (60 per cent) of his respondents had at least 5 years of franchising experience and/or at least 100 units operating domestically (56 per cent) before going international. In the fast food sector, McDonald's took more than a decade before making its first international entry into Canada in 1967 (Love, 1995).

Empirical research studies investigating the motivations for franchisors to internationalise have identified several key considerations (Hackett, 1976; Walker, 1989; Walker and Etzer, 1973). One factor cited by a high proportion of respondents in all three studies was “Companies receiving inquiries or proposals from prospective or existing franchisees.” It seems, therefore, that many franchisors may enter foreign markets in response to approaches from these markets. Two of the three studies also identified foreign market potential as a key reason for international expansion (Walker, 1989; Walker and Etzel, 1973). A further consideration was geographic proximity and/or cultural similarity of markets.

2.4.1 The Evolution of International Franchising

Research on the use of franchising within international operations has tended to concentrate on companies that have built franchising activities first within their domestic market before utilising that experience and the tried franchising system in the international arena (Walker and Etzel, 1973; Hackett, 1976; Walker, 1989; McCosker and Walker, 1992; McIntyre and Huszagh, 1995).

Walker (1989) found that the majority of U.S. franchising companies had engaged in minimal changes to the marketing mix (eg. product, price, promotion, placement) components of their franchising packages in international operations. Clearly there are significant benefits in being able to experiment, modify and develop a franchising system within a local market first – learning how to operate the system and to manage a franchise network.

If the resulting system and associated learning can be transferred to a foreign location with limited alteration, the transfer process becomes easier and cheaper. Nevertheless, research in the U.S. has stressed the additional demands on firm capabilities as a franchisor moves from domestic to international franchising, as a

result of having to adapt to differences in the franchising and cultural environment (Fladmoe-Lindquist, 1996).

While there appears to be a dominant path of domestic to international franchising, there is conceptually no reason why there should not be other patterns of adoption of franchising as a form of international operations. Welch (1990) in a small scale study of Australian firms engaged in international franchising found a diverse range of forms and paths to franchising used in international operations. These companies entered their initial overseas markets using non-franchise strategies, but gradually adopted franchising as an internationalisation growth strategy.

Several authors (Oxenfeldt and Kelly, 1968; Hackett, 1976; Welch, 1989a; McIntyre and Huszagh, 1995; Fladmoe-Lindquist, 1996) have proposed the “theory of franchising life cycle.” According to this theory, franchising goes through several stages of internationalisation. Oxenfeldt and Kelly (1968-9) have proposed that the most successful franchise systems will end up as almost wholly-owned chains. This hypothesis has been tested in the 1980s and 1990s using U.S. data with ambiguous results, partly relating to differences between industry sectors (Dant, Paswan and Stanworth, 1996). The reason could be due to the use of company-owned outlets being used initially as a basis for testing the franchising package within the target market before rolling out on a franchising basis. Companies concerned about control over their market are likely to follow this model (Welch, 1990). McDonald’s typically employs this approach, and has in some cases extended the company-owned path for some time, as in the case of the U.K. (Love, 1995).

Over time, as the franchisor develops experience and confidence with international markets, it increases its involvement, selecting entry modes that provide more control over the foreign franchise system (Alon, 1999). The franchisor may begin by the use

of international master franchising and subsequently may wish to participate more directly in what emerges as a high growth market (Law, 1999).

2.5 International Franchising Capabilities

Two distinct categories of capabilities needed to franchise internationally have been identified (Shane, 1996a, Huszagh, Huszagh, and McIntyre, 1992; Kedia, et al., 1994). The first category is the level of the administrative efficiency of the international franchise relationship. The second concerns the ability of the international franchisor to operate in a foreign context and directly relates to their level of risk management.

2.5.1 Administrative Efficiency

The level of administrative efficiency inherent in franchising as an internationalisation strategy is concerned with how contractual arrangements facilitate the alignment of preferences between franchisor and franchisee (Brickley and Dark, 1987; Carney and Gedajlovic, 1991; Combs and Castrogiovanni, 1994; Lafontaine, 1992). The problem of franchisee evaluation arises when monitoring is difficult or expensive and is exacerbated by a lack of goal congruence and asymmetry of risk preferences between the principal (franchisor) and agent (franchisee) (Jensen and Meckling, 1976). The ability of a franchisor to monitor its foreign franchisees has been empirically identified as an important capability that distinguishes domestic from international franchisors (Shane, 1996a). The effects of distance (Heskett, 1986) and culture (Bergen, Dutta and Walker, 1992) combine to further complicate franchisee-agent monitoring, control over service delivery and contract conditions. As a consequence, the ability to manage over distance via systems and the level of cultural adaptability

of the franchisor are key international capabilities that need to be developed by successful franchisors.

2.5.1.1 Distance Management

Many franchise services are location dependent, thus creating a network of service outlets that are physically distant from the franchisor. For the franchisor, the problem of incomplete information regarding their franchisee-agent's behaviour is aggravated by this decentralised service delivery system whose geographical scope extends beyond national boundaries (Norton, 1988). These problems of geographic distance and franchisee-agent monitoring intensify the problems facing the franchisors' entrepreneurial capability, where both time and distance can raise the level of uncertainty and widen the information gap (Norton, 1988).

Despite technological improvements that may facilitate the transmission of information, it is still difficult and costly to gather and receive complete and timely knowledge about foreign operations. Furthermore, the management of geographic distant locations may involve as much "art" as "science" which is often gained through experience (Aharoni, 1966). The ability of a franchisor to monitor its franchisee-agents over long distances involves a complex set of skills that may not be commonly possessed by the entrepreneurs or managers operating franchise firms and does not necessarily substitute for experience (Huszagh, Huszagh and McIntyre, 1992). These abilities, which include supervisory skills, have been shown to be important for international expansion (Shane, 1996a).

By carefully observing franchisee behaviour, franchisors can control opportunistic behaviour (Norton, 1988). If people are carefully observed, they perceive a greater likelihood of being caught and so reduce their opportunism. Franchisors can monitor against opportunism by inspecting franchisee facilities, examining their records, and

by specifying and verifying equipment usage or minimum standards. Therefore, monitoring is a capability that franchisors develop.

The development of this capability can be enhanced by increasing the size of the franchising system, the allocation of resources towards its development, and through learning over time (Norton, 1988). The first source of monitoring capability comes from firm size. In franchising, monitoring frequently requires the direct observation of the activities of franchisees (Carney and Gedajlovic, 1991). This implies an administrative cost on franchisors who need to have sufficient supervisory capability to undertake this observation (Combs and Castrogiovanni, 1994).

A second important aspect of distance management is the structure of the international franchising contract, which is a central aspect of the franchisor-franchisee relationship (Rubin, 1978; Lafontaine and Kaufmann, 1994). Within the franchisor's domestic market, most contracts between the franchisor and franchisee are standardised (LaFontaine and Kaufmann, 1994), thus simplifying general contract management. Contract details such as fees, royalties, advertising contributions and length of agreement vary little from franchisee to franchisee within the domestic context. However, within the international market, franchising contracts can vary substantially (Abell, 1990).

Given the greater potential for opportunism in the international arena, franchisors who intend to expand overseas need to create incentives for franchisees not to act opportunistically. One way to control opportunism is through the use of ex-ante bonding (Norton, 1988). If a franchisee has to pay a bond that is forfeited if he or she acts opportunistically, the franchisee has a financial incentive to avoid opportunistic behaviour. Typically, franchisees pay franchisors the use of their franchise system in two ways – through an up-front fee and through ongoing royalties and advertising

fees as a percentage of sales revenues. The franchisor controls the relative balance between the two payment mechanisms and can establish any given ratio, holding constant the total size of the payment made for the system. Franchisors can develop a bonding mechanism through the creation of a pricing structure that requires high up-front payments relative to the size of payments over time.

A high franchise fee relative to the size of ongoing royalty and advertising payments appears to be an effective bond (Norton, 1988). Franchise fees are usually a significant sum relative to the size of the franchisee's investment in the ownership of the outlet. Therefore a franchisee incurs a substantial risk of forfeit if this ratio is high.

Moreover, according to standard franchise agreements, the franchisor has the right to revoke the franchise agreement without return of the franchise fee if the franchisee does not adhere to his or her contractual obligations. The higher the franchise fee relative to the size of the royalty and advertising payment, the greater the cost to the franchisee of agreement termination, and the more the franchisee needs to adhere to the franchise system (Carney and Gedajlovic, 1991; Norton, 1988; Combs and Castrogiovanni, 1994). This bond is a particular effective tool, as the franchisee usually invests a large percentage of his or her personal net worth in the purchase of the outlets (Combs and Castrogiovanni, 1994). Under these circumstances, termination of the franchise agreement often results in great financial hardship for the franchisee.

An important part of the franchising agreement is permission to use the franchisor's business system in return for a share of the franchisee's profits (Matthewson and Winter, 1985; Klein, 1980; Klein and Leffler, 1981; Norton, 1988). The franchisor's business system is the product that it sells to franchisees and includes such things as

store layout, product mix, operating procedures, and the location selection heuristic. Hymer (1976) argues that firms expand overseas because they possess a proprietary advantage that makes them able to out-compete local entrepreneurs.

According to Shane (1996a), international franchisors may need to modify contracts to include the initial terms of their franchise agreements, the ratio of their franchise fees, and provisions concerning cooperative advertising and store opening support. Such variations with an international contract may be due to the size of a franchisee, host country restrictions, local business practices, and the opportunistic behaviour of particular franchisees. It is important that franchisors have the ability to negotiate contract modifications (Root, 1987) and handle contract enforcement in order to achieve successful international development (Hood and Young, 1979).

2.5.1.2 Cultural Adaptability

The differing cultural environments found in foreign markets add further complexity to international franchising (Huszagh, Huszagh, and McIntyre, 1992). A cultural environment that is significantly different from the franchisor's home country may affect not only the contract negotiation process (Weiss, 1996), but also issues such as recruitment and selection of personnel, and the franchise format (Justis and Judd, 1989). The very strength of the franchise format, its standardisation, makes its successful replication in foreign markets difficult (Aydin and Kacker, 1990). Frequently, modifications may be needed. This may require not just in such things as the recipes and menu selections, but in the operations as well (Sadi, 1994). Embedded in the operational routines and processes are assumptions about how work should be done. Variations in cultural norms such as "power distance," Confucian dynamism, and individualism can affect local implementation (Hofstede, 1980; Hofstede and Bond, 1988).

2.5.2 Host Country Risk Management

The second set of capabilities to succeed in international franchising involves the ability to deal with uncertainty within the overseas host country. Risk management is an important consideration in international business research (Ghoshal, 1987). Issues such as government policies, regulations and macroeconomic variations make conducting business internationally more uncertain than domestically (Miller, 1992). Hackett (1976) indicated that such issues were important to franchisors. The franchisors in his survey were primarily concerned with government regulations within the foreign market that affect both the conduct of the service and monetary uncertainty, rather than the complexities of format modification. Therefore, host country policy evaluation and foreign exchange management are fundamental capabilities that are important for international franchisors to develop.

2.5.2.1 Host Country Policy Evaluations

The primary problems that international franchisors encounter in relation to foreign government policy are restrictions on the ownership and control of corporate assets and intellectual property, as well as repatriation of profits, interest, royalties, and principal repayments (Aydin and Kacker, 1990; Lafili and Van Ranst, 1990). It is important that international franchisors have the ability to evaluate these aspects of foreign government policy. Unfortunately, this set of management skills may be the hardest to develop because of the complexity of foreign regulations and the time and resources required to develop such expertise. Advice on such issues is available from many franchise consultants and small business agencies, but may be too expensive for some smaller franchisors (Fladmoe-Lindquist, 1996).

As many franchise businesses have a service-base, it may be easy for competitors to imitate the firm's business model. As such the protection of intellectual property

becomes a fundamental concern for many franchisors (Lafili and Van Ranst, 1990). Franchisors need the ability to monitor the franchisees' use of their brand name and trademarks, including the specific details of management systems, designs, or processes that constitute core elements of the system (Justis and Judd, 1989). However, the protection of brand name, trademarks and reputation is not easily managed in countries where intellectual property laws vary or are not enforced.

A franchisor's business system can be considered an example of a proprietary advantage, because the business system is unique to the franchisor (Calvet, 1981). Caves (1971) demonstrated that companies with a proprietary advantage have an incentive to expand overseas, because they can use that advantage in foreign markets at little or no cost over the cost of initial developing the advantage in the domestic market. Because foreign competitors would have to incur the total cost of developing that proprietary advantage, the firm has a cost advantage over competitors (Caves, 1982).

Understanding host country policies concerning the transfer and repatriation of dividends, fees and royalties is also an important capability for the international franchisor. In the United States, franchise contracts generally standardise initial fees and royalty rates (LaFontaine and Kaufmann, 1994). These are usually only negotiated when groups of franchisees form a bargaining bloc to change the conditions of the agreement. In the international environment, fees and royalties are subject to national laws and regulations (Justis and Judd, 1989).

2.5.2.2 Exchange Risk Management

The need to manage the effects of exchange rate movements arises from the impact of fluctuating home and host country exchange rates on franchise contracts (Huszagh, Huszagh, and McIntyre, 1992). Large and frequent swings in foreign exchange rates

demand particular capabilities and expertise. For example, many franchisors require that some inputs into the franchise operation be imported from the home country. Therefore, any major change in the exchange rate can increase the franchisor's economic exposure as well as impacting negatively on the market. Many of the potential problems of fluctuating exchange rates may be proactively managed by the use of periodic rate adjustment and payment terms expressed in percentages (Meroni, 1990). However, this requires specialist skills not commonly found in most domestic franchisors.

2.5.3 A Typology of International Franchisor Types

The above discussion of international franchisor capabilities describes the important internal elements needed for international franchising. However, what is important is how those elements or capabilities are combined (Penros, 1959). Not all international franchisors possess these capabilities to the same degree.

Some franchisors' international experience are limited to their neighbouring country whereas a few may be in more than 20 countries. A franchisor, with a limited scope of international capabilities, will be less likely to seek new foreign opportunities, whereas a franchisor with a well-developed set of international capabilities should have the competencies needed to deal with the uncertainty of foreign agent monitoring and host country variability (Fladmoe-Lindquist, 1996).

Fladmoe-Lindquist (1996) presents a two-dimensional framework of international franchisor development that uses the existing set of international franchising capabilities and the capacity for developing international capabilities as the two dimensions (see Table 1). She identifies four types of international franchisors: constrained franchisors, integrating franchisors, conventional franchisors and worldwide franchisors.

The typology utilises resource-based theory (Barney, 1991; Conner, 1991), which stipulates that know-how based resources (Buckley, 1988), or routines for operating (Nelson and Winter, 1982), are essential in providing competitive advantage to individual firms. In addition, some companies are simply better than others at generating ideas and new ways to doing things (Penrose, 1959). Resource-based theory also emphasizes the importance of not just possessing resources, but of continual organisational learning (Kogut and Zander, 1993).

TABLE 2:1
International Franchising Capabilities and Capacity for Development

Capacity for Developing International Capabilities	Existing International Franchising Capabilities	
	LOW	HIGH
HIGH	INTEGRATING FRANCHISORS <ul style="list-style-type: none"> • Pursuit of cautious growth • Use multiple forms of franchising • Proactive evaluation 	WORLDWIDE FRANCHISORS <ul style="list-style-type: none"> • Focus on global markets • Use multiple forms of franchising • Both proactive and reactive
LOW	CONSTRAINED FRANCHISORS <ul style="list-style-type: none"> • Locally international • Limited involvement in international markets • Reactive evaluation 	CONVENTIONAL FRANCHISORS <ul style="list-style-type: none"> • Focus on several foreign markets • Use fewer forms of franchising • Often reactive with some proactive efforts

Source: Fladmoe-Linquist, K. (1996), "International Franchising: Capabilities and Development," *Journal of Business Venturing*, Vol. 11 (2), p. 428.

2.6 Internationalisation of U.S. Franchisors

The growth of U.S. franchisors in international markets has been phenomenal. In 1986, 354 U.S. franchisors operated over 31,000 outlets globally, which is a 786 per cent increase in outlets since 1971 (Kostecka, 1988). In 1988, 17 per cent of U.S. franchisors had more than 35,000 outlets in international markets (Falbe and Dandridge, 1992). Aydin and Kacker (1990) estimated that foreign outlets of international franchisors have increased at a rate of 17 per cent per year. This trend of growth is expected to continue (Shane, 1996a; Fladmoe-Lindquist, 1996).

The initial internationalisation efforts of U.S. based franchisors were directed toward Canada, Britain and Australia, countries that are culturally, politically and economically similar to the U.S. As franchising systems matured in these countries, profit potential decreased because of increasing domestic and international competition (Welch, 1992). Therefore, U.S. based franchisors had to seek growth avenues in less developed or culturally dissimilar or politically unstable countries. These environments presented a new set of challenges that often required changes in the product/service mix, contractual arrangements or methods of operation.

With the increased diversity of countries in which franchisors sought potential outlets came the need to develop a systematic way to evaluate potential host countries (Welch, 1992). The standardised nature of franchising necessitates a high degree of cooperation and control by the franchisor, which is complicated in a multicultural context.

Walker (1989) examined reasons given by American companies to engage in internationalisation for the first time. A majority of them (44.0 per cent) had simply responded to a first/only contact from a foreign prospect. After that came 'proximity to the U.S.' (27.6 per cent), and 'similarities to the U.S./English language' with 18.0 per cent combined.

Although international franchising of services started in developed countries based on geographic proximity, language and culture similarity (Steinberg, 1991; Aydin and Kacker, 1989), it is now spreading rapidly into other emerging markets such as Indonesia, the Philippines, Thailand, and Mexico.

Approximately 15 per cent of U.S. owned franchise outlets are now located in lesser-developed countries (LDCs) (Aydin and Kacker, 1991). It appears that franchise companies will continue to move into developing countries when

opportunities arise, either on their own initiative or in response to approaches from the countries concerned.

In a survey of 386 U.S. franchisors in 1995 conducted by Arthur Andersen (1996) for International Franchise Association, respondents were asked to evaluate on 20 factors that might be significant in successfully establishing and operating franchises outside of the U.S (see Table 2). Caution must be exercised when interpreting the result in Table 2 for the following three reasons: (1) no distinction was made between the perceptions of international and non-international franchisors; and (2) almost half of the franchisors were operating in Canada, and (3) only 17 per cent of the respondents had operations in Asia.

TABLE 2:2
Success Factors in Establishing and Operating Foreign Units by U.S. Franchisors

(* Respondents were asked to rate each of the factors on a scale of one to four, with one being the least significant and four being most significant)

SUCCESS FACTORS FOR INTERNATIONAL FRANCHISING	Mean*	SUCCESS FACTORS FOR INTERNATIONAL FRANCHISING	Mean*
1. Maintaining adequate quality controls	3.4	11. Making product acceptable	3.0
2. Ability to support franchisees	3.3	12. Repatriating royalties	3.0
3. Recruiting qualified franchisees	3.3	13. Overcoming language/cultural barriers	2.9
4. Controlling franchisees outside U.S.	3.2	14. Securing sufficient financing	2.9
5. Dealing with trademark violations	3.2	15. Obtaining suitable locations	2.9
6. Committing sufficient human resources	3.1	16. Dealing with tax and import duties	2.9
7. Arranging supply channels	3.0	17. Adapting promotional approaches	2.7
8. Training franchisees	3.0	18. Coping with currency uncertainty	2.7
9. Satisfying government or legal restrictions	3.0	19. Redesigning the franchise package	2.6
10. Determining potential of markets	3.0	20. Beating competitors in host country	2.4

Source: Arthur Andersen (1996), International Expansion by U.S. Franchisors, Chicago, USA, p. 62.

In another survey conducted in 1996 of international U.S.-based restaurant operators by the National Restaurant Association (Masur, 1997), the findings revealed

that almost two-thirds of respondents indicated their companies franchise all of their international units.

The survey also found that a well-chosen foreign franchisee was more likely to be familiar with the local market, which partially explained why respondents reported franchise units showing a positive return earlier than fully owned establishments. Survey respondents reported that their companies' franchise establishments turned profitable in 16 months on average, compared with more than 25 months for company-owned units.

The 1996 Survey of International Restaurant Operators also revealed that many of the ingredients that contributed to success in the domestic marketplace were also important to success abroad. According to respondents, finding and retaining good managers was the most important element of success, followed closely by finding and retaining good hourly staff. Thirdly, marketing was regarded by respondents in ensuring success overseas. It was one of the elements more likely to be altered by operators when entering a new foreign market. Finally, respondents perceived distribution and supply issues as very important in international restaurant expansion.

The 1996 survey also indicated that 80 per cent of the respondents reported that they modified their menus in international markets. Taste differences were the most frequently cited reason for altering menus, followed by the local lack of specific food items. Higher food costs, religious considerations and government restrictions were also mentioned.

2.6.1 McDonald's International Expansion

When one thinks of fast food, the first name that comes to mind is likely to be McDonald's. With 28,707 restaurants located in 120 countries as at December 31, 2000, McDonald's is by far the largest food service organisation in the world

(<http://www.mcdonalds.com>). In many of its foreign markets such as Australia, Canada, Japan, U.K. and Hong Kong, McDonald's is the leading food service chain.

The company's strategy of offering a limited menu of consistently prepared food has fostered the chain's phenomenal growth. Although the brand is global and the core attributes of Q.S.C. & V. (i.e. Quality food, fast and friendly Service, restaurant Cleanliness, and a menu of Value) are fundamental, each market has its own way of delivering the promise.

Around the world, McDonald's offers the standard menu of hamburgers, chicken and fish sandwiches along with its world-famous french fries. Some markets, however, choose to offer one or two local items to appeal to customer preferences and to offer variety (Watson, 1997). Some examples include 'McHuevo' in Uruguay, a hamburger with a poached egg on top, 'McLaks' in Norway, a grilled salmon sandwich with dill sauce; beer in Germany, and the 'Samurai Pork Burger' in Thailand, a sausage patty in teriyaki sauce.

McDonald's has staged this phenomenal growth using a distinctive franchising system that concentrates on recruiting and training individuals with motivation and entrepreneurial talent to become active, on-premise owners and not just investors (*McDonald's: Hong Kong Individuals Before Investors*, 1997). It stresses personal commitment and a sharing of common goals, principles and ideals. The company has extended this system internationally to encompass not only its franchisees, but also the partners it chooses to set up joint venture operations with overseas.

Early successes in Canada and Japan made it clear to McDonald's that to succeed in retailing abroad, it needed a partnership that could give the company a home-grown flavour in each foreign market without deviating from the fundamentals that made McDonald's work in the U.S. (Love, 1995). Its success in operating in a completely

different culture in Japan gave McDonald's the *modus operandi* in entering overseas markets – dependence on a local entrepreneur with a substantial ownership position in a joint venture and even more autonomy than that of franchisees in the U.S.

Apart from their entrepreneurial flair, no two foreign partners shared similar backgrounds or even similar arrangements with McDonald's (see Love, 1995). Daniel Ng, the joint venture partner of the McDonald's 177 restaurants in Hong Kong, was a chemical engineer who did research for seven years at Chicago's noted Institute of Gas Technology before he returned to his native Hong Kong and became a venture capitalist. Robert Kwan, the joint venture partner with 52 stores in Singapore, had a small wholesale toy operation before taking an equity stake interest in McDonald's Singapore. Peter Rodenbeck, the partner in Rio de Janeiro, was an investment banker in Rio. Saul Kahan, one of McDonald's partners in Mexico, was a new car sales manager in Mexico City.

Despite their diverse backgrounds, one common element found among most of McDonald's foreign partners overseas was that they are all foreign by birth, non-traditionalists in their homeland, with an affinity for American business practices and American entrepreneurs, and had spent considerable time in the United States (Love, 1995).

2.7 International Franchising in East Asia

During the 1980s and 1990s, East Asia attracted foreign investors because its growing economies saw the emergence of a rising affluent middle class in a region with more than half of the world's population. China alone comprised nearly one-quarter of the world's population and was considered the most under-retailed country in the world (Swartz, 1997). Other governments notably in Singapore and Malaysia encouraged

franchising through the introduction of laws that established organisations and development programs to support the effort.

By the end of the 1990s, the ubiquitous presence of U.S. fast food chains in East Asia stood as testimony to the success of international franchising in this region. When western (predominantly U.S.-based) fast food chains first entered East Asian markets, many sceptics argued that Asians would never develop a taste for hamburgers and pizzas, and that their presence would only be a passing fad (Wee, 1997). Such arguments were not unfounded. The prices of these western fast foods were not cheaper than local fast food. Further, it would have been plausible to believe that Asians, who had grown up on rice and vegetables, would never fall for “junk” foods.

Despite these misgivings, the western fast food outlets like those of McDonald’s, Burger King, Kentucky Fried Chicken (KFC) and Pizza Hut became familiar sights in any major city such as Singapore, Hong Kong, Manila, and Kuala Lumpur. Average sales per store in Asia for KFC are US\$1.2 million, compared with US\$750,000 in the U.S. The difference occurs even though most Asian markets have much lower per capita income than the U.S. (Tanzer, 1993). In Hong Kong, with a population of around six million, was home to five of the world’s 10 busiest McDonald’s (Love, 1995).

Strong marketing positioning by the western fast food franchisors was identified as one of the key factors for their success (Love, 1995; Watson, 1997; Wee, 1997). In East Asia, there is a plethora of cheap and tasty foods that are easily available. It was unproductive for western fast food chains to compete head-on against these local operators on the basis of food. Instead, these franchisors have positioned themselves as a lifestyle phenomenon by offering other benefits such as courteous service, air-

conditioned comfort, hygienic and efficient food preparation, clean toilets, brightly lit dining areas, modern and attractive ambience, and constant but varied promotional offers.

According to Chan and Justis (1992), the proliferation of franchising in East Asia is due to several economic and demographic trends. Some of them include universal cultural trends, increased disposable income, increasing number of women in the workforce and demographic concentrations of people in urban areas.

Two western franchises that proved particularly successful in East Asia were Pizza Hut in Hong Kong and Kentucky Fried Chicken in Malaysia (Gatbonton, 1998). Pizza Hut Hong Kong is owned by the Jardine Pacific and a Marketing Management winner of the Asian Management Awards. Jardine Pacific is a leader in the Asia-Pacific region, with approximately 300 outlets and more than 8,500 employees. These operations include the world's largest international franchisee of Pizza Hut, as well as Taco Bell, Ruby Tuesday, and the "Nine to five" restaurants, plus the Oliver's Super Sandwiches chain (<http://www.jardine-matheson.com>).

In Malaysia, Kentucky Fried Chicken is owned by KFC Holdings (Malaysia) Berhad, which is a publicly-listed company on the Kuala Lumpur Stock Exchange. The company operates restaurants, a convenience food store chain, a poultry processing and poultry retail chain, breeder farms, hatchery, broiler farms and a feedmill. KFC Holdings' sales were reported as US\$232 million in 1999 and the company owned 274 KFC stores (KLSE, 2000). Effective marketing, vertical integration and strong, stable management were reportedly responsible to its astounding leadership position of 60 per cent share of Malaysia's fast food market (Astbury, 1992).

Although U.S. franchisors are perhaps among the best known, many Asian franchises have entered the sector and learnt to compete with and even beat their famous Western counterparts in their own game (Prystay and Kumar, 1997). One such company is Jollibee, a Philippine hamburger chain. With 302 outlets it is the clear market leader, making the Philippines one of only two countries in the world where McDonald's is not the market leader. Much of Jollibee's success at home and abroad is tied to the greater variety of foods found on its menu and the taste that is more suited to Filipinos (*Cash-Up Filipinos Feast on Fast Food*, 2000; Liddle, 1998).

2.7.1 Modes of International Franchising in East Asia

Several foreign market entry strategies have been used by franchisors in East Asia. At least four major types of market entry modes are used: (1) master franchising, (2) joint ventures, (3) establishing a franchising agreement with the local government as master franchisee and (4) regional franchising (TDB and Arthur Andersen, 1997; Chan and Justis, 1990).

2.7.1.1 Master Franchising

Master franchising has been the most popular market entry mode used by American firms to franchise into East Asian countries. McDonald's, Burger King and KFC have successfully used this strategy in their East Asian markets. The master franchisee may be an individual, business or conglomerate corporation that assumes the rights and obligations to establish franchises throughout a particular country or region (Chan and Justis, 1990). Master franchisees have the option to sub-franchise the units or open all units by themselves.

Although master franchising is an attractive option to many franchisors in East Asia, it suffers one major weakness: control (Steinberg, 1994). Franchisors have to give up much of the control over the sub-franchisees, who actually operate the units,

to the master franchisee. Although some measures can be put into place legally such as approving all system changes, site selection and sub-franchisees appointment, the distance between the franchisor and master franchisees often lessens the practicality of doing so.

2.7.1.2 Joint Ventures

Foreign investors appear to be driven by three major forces in selecting joint ventures in East Asia (Lasserre and Schutte, 1999). The first of these is political imperative (the will of local governments); the second is a competitive imperative (the need to acquire competences in order to compete more effectively); and the third is a risk-sharing imperative (to hedge against adverse conditions when the stakes in the investment are high).

With joint ventures, franchisors can access the local partner's capabilities in sales, local market know-how, and most important contacts with decision-makers and business networks (Lasserre and Schutte, 1999). Managerial and human resources are often the most critical resources that can be obtained from a local joint venture partner. Furthermore, the local partner can handle all language problems, cultural differences, and help develop local markets through appropriate means of advertising and promotion.

Finding the right person, who is the master franchisee, as an international joint venture partner became one of the keys to McDonald's success in East Asia (Law, 1999). In effect, the use of a master franchise is combined with an equity stake by McDonald's. Such active participation serves to both check on, and assist the partner, and reduces the risk of quality dilution and brand erosion.

The selection of a potential joint venture partner is the most crucial and difficult decision the foreign franchisor will make, and one that will have long-term

ramifications for its future in the target country (Lasserre and Schutte, 1999). Partner selection is crucial because the foreign franchisor's expansion and strategic success in a country will depend on the capabilities of the partner, the partner's willingness to cooperate, and the climate of mutual trust that must be developed between both parties.

One method often used by non-franchising companies willing to test a partner before embarking on a joint venture in East Asia is to establish some sort of 'pre-marital' arrangement, either in the form of a manufacturing contract, a limited distributorship or a licensing agreement (Lasserre and Schutte, 1999). This allows partners to experiment with their working relationship on a small scale. This method, while not entirely error-free, increases the chances of detecting eventual misfits.

For example, Starbucks Coffee International entered into a licensing agreement with Shinsegae Department Store in early 2000 to operate Starbucks cafes in South Korea (*Starbucks and Shinsegae Sign Joint Venture Agreement to Expand Growth in the Korean Market*, 2000). Six months later, the licensing relationship was converted to a joint partnership following the phenomenal success Starbucks enjoyed with the first store.

2.7.1.3 Partnering with Government

In China, foreign franchisors often partnered with the Chinese government (national or provincial) in operating the country's franchise operations (English and Xau, 1994). The Chinese government can be a master franchisee or an international joint venture partner, depending on the particular arrangement. The franchisor will contribute investment funds, the needed technology and provide some management expertise (particularly training). The Chinese partner will contribute investment funds, securing the necessary supplies, site-use rights, some of the management and

all of the non-management personnel. For example, KFC's operation in China is an international joint venture with KFC International that contributes 60 per cent of the investment, the remaining being shared between two Chinese government bodies (English and Xau, 1994).

There are several advantages in having the government as the local franchisee (Chan and Justis, 1992). First, the franchisor need not worry about full compliance with the law. Second, the host government is in a stronger financial position than a business or an individual, and may have little difficulty providing the necessary capital to run the franchisee. Third, general adherence to quality standards is more likely. Finally, payment of royalty fees is guaranteed unless otherwise stated in the franchise agreement.

On the other hand, there are also several disadvantages in having the government as the local franchisee. First, the government is generally less able to attract qualified managers and staff than a private business. Second, the restrictions imposed by the government on the franchisor may limit options and activities. For example, the government may require that the local unit be restricted to a certain area that may turn out to be a poor location.

2.7.1.4 Regional Franchising

Regional franchising involves granting of the franchise rights for a number of countries to an entity in a particular host country (TDB and Arthur Andersen, 1996). It is usually practiced in two forms. In the first form, the foreign franchisor appoints a regional master franchisee for a number of countries and the franchisee would then proceed to develop the franchises within these countries. This is achieved by opening franchise outlets either through the regional master franchisee, various country master franchisees or direct franchisees appointed by the regional master franchisee.

The second form of regional franchising is practised through the establishment of its own corporate entity by the master franchisee. This entity will then appoint direct franchisees or master franchisees within the region. Nearly 80 foreign franchisors have used Singapore as a platform or hub for regional franchising which included Hertz car-rental, Planet Hollywood and Tony Roma's Ribs Restaurant (Swartz, 1997). Singapore and Hong Kong have served as platforms for foreign companies for gathering intelligence and initiating contacts, which later become the hub for future regional coordination (Lasserre and Schutte, 1999).

2.7.2 Adaptation of Franchise Systems in East Asia

It is important to note that franchising, as a business model, requires a great deal of standardisation (Preble, 1992). In most cases, this does not mean 100 per cent uniformity but, instant international recognisability (Czinkota and Ronkainen, 1990). Additionally, there is a strong desire on the part of these franchisors to "roll-out" into new countries the proven franchise package, which has been responsible for their success in their home market. This partly helps to explain the pattern of geographical expansion and concentration that has emerged. Foreign countries with advanced economies and comparable cultural characteristics to the U.S. have been logical candidates for the transfer of franchise systems and consequently, a high degree of standardisation has been possible there (Welch, 1989).

Although Japan is culturally dissimilar to the U.S., there are numerous American fast food franchises found in that country. This can be attributed to three factors. Firstly, international master franchising has been extensively and successfully used by western companies to minimise being directly involved in development operations in a foreign culture such as Japan's (Grant, 1985). Secondly, Idea Link Japan Inc. has a large network designed to link up unique franchising concepts developed in the U.S.

with Japanese investors (Ashman, 1986). Thirdly, the enthusiastic assimilation of all things Western has allowed for relatively standardised packages to satisfy a wide variety of disparate consumer needs and wants in numerous countries with widely varying cultures (Daniels and Radebaugh, 1989).

Despite the fact that the conditions above suggest high levels of standardisation can be practised in all markets, some adjustments to the business format or package are required to be made on a country-by-country basis. These adaptations may be expected to increase as franchisors seek out more remote and culturally diverse locations. In order to appeal to differing taste preferences in foreign countries, franchisors have sometimes to tailor 'product' offerings (Preble, 1992). According to Chua (1999), the huge success of McDonald's in Singapore has been the ability of the brand to assimilate into the daily lives of Singaporeans. Otherwise, the product will always be in the realm of the consumption of the 'exotic', which is a singular and an occasional thing.

Examples of product adaptation by western fast food restaurants include Kentucky Fried Chicken, which offers a considerably spicier version of Hot Wings, a spicy chicken dish, and sweeter coleslaw in Thailand (Tanzer, 1993). In the highly competitive Japanese market, KFC has branched out into dishes like chicken curry. Variations on McDonald's original, American-style menu exist in many parts of East Asia (Watson, 1997): milk shakes that are flavoured with a fruit peculiar to Malaysia, Singapore and Thailand, mixed spaghetti in the Philippines, mutton burgers and vegetable dishes in India, and corn soup and teriyaki burgers in Japan. McDonald's restaurants in India are the only ones in the world where no beef is being served because of the large population of Hindus. One can purchase an all lamb version of the "Big Mac" called a "Maharaja Mac."

2.8 Changing Consumers in East Asia

Rapid industrialisation and urbanisation are changing the face of East Asia. With the importation of foreign capital, technology and personnel from the western world, it is inevitable that the people in East Asia are increasingly influenced by westernisation (Wee, 1997). This influence is further augmented by various western mass media like television programmes, cinema shows, magazines, and newspapers. They not only influence the attitude and behaviour of East Asian consumers, but have the capacity to alter their outlook and lifestyle as well.

Western companies may be tempted to believe that, given time, consumers in East Asia will become more like Western consumers (Schutte, 2001). Therefore, most companies apply marketing concepts in East Asia developed from a distinctively Western (and primarily U.S.) perspective. This thinking is very much in line with Levitt (1983) global marketing concept, which posits that the world's markets would be driven toward a converging commonality. However, consumer behaviour is strongly influenced by culture and East Asian culture is distinctively different from Western culture (Schutte and Ciarlante, 1998). Cultural bonds run deep and different tastes, habits, and customs prevent consumers from universally preferring the same product attributes, advertising messages, packaging and presentation.

2.8.1 Segmentation Across East Asia

Although East Asia is culturally heterogeneous, Schutte and Ciarlante (1998) have observed two segments in the region, which exhibit a great deal of similarity with each other but differ considerably in other segments. The first segment comprises the 'old' and 'new rich' individuals who are well educated and well travelled. Members of the 'old-rich' group are relatively conservative and still hold on to Asian traditions. However, those who belong to the 'new rich' group who have recently acquired

wealth are less attached to traditional values (Chua and Tan, 1999). They share similar preferences and attitudes with cosmopolitan consumers found in the Western countries.

The second segment includes the young, trendy, superficially westernised people who are well educated, often travel or study abroad and spend considerable time searching for new ideas and values. Asian youth have been the marketing targets of a growing number of corporations in light of the massive size of the population (Yasue and Gu, 2001). Population ratios of those under 30 years old in major Asian countries are 67 per cent in Indonesia, 65 per cent in Vietnam, 63 per cent in Malaysia, 58 per cent in China, 52 per cent in Taiwan, and 46 per cent in Singapore. It is extraordinary that on average close to 60 per cent of the Asian population are in their twenties or teens.

Two large-scale surveys were conducted in 1995 and 1997 with respondents between the ages of 15 and 54 years old in 12 Asian cities to study lifestyle attitudes and value of Asian consumers (Yasue and Gu, 2001). This survey is called Dentsu's Global Compass consumer research, initiated by Dentsu Inc., an advertising agency in Japan. The findings on Asian youth reveal the following:

- Asian youth in large cities have become affluent in terms of possession of durable goods.
- Consumption attitudes of these young people have become increasingly cautious and mature, somewhat similar to young consumers in developed countries. The financial crisis in Asia has accelerated the trend.
- The values of the Asian youth have been shifting from traditional group orientation to the Western individual orientation.

- Asian youth are progressing in the same direction and share similar lifestyle values and traits, regardless of the country of residence. However, the degrees of similarities vary between countries.

3 COUNTRY PROFILE: SINGAPORE

East Asia is a diverse region with countries having heterogeneous economic or political systems. National and business cultures vary significantly and macro-economic data show extreme differences (World Bank, 1994). In 1996, Indonesia had 197 million people with an income per capita of US\$1,080; neighbouring Singapore had a population of four million people with an average income of US\$30,550. Japan represents 17 per cent of the global economy, but has only 2.2 per cent of the world's population; China's population, on the other hand, makes up more than a fifth of the world's population but contributes only three per cent to the world's economy.

Among all of East Asia's many markets, Singapore has proven highly attractive to many of the world's international franchisers. The country's rapid economic growth since the 1980s has been substantial, and it remained both stable and affluent in the face of the "Asian Economic Crisis" of 1997. In addition to its economic stability, the rapid spread of Western influence on the relatively young population in Singapore has resulted in an increased demand for western-oriented lifestyle and higher quality products and services. Singapore also has ready investors receptive to new business opportunities who have demonstrated strong interest in foreign franchise concepts. Finally, the Government of Singapore has established several programs to promote franchising as a business model. For these reasons Singapore has been selected as the country in which to undertake the case study that forms the basis of this analysis.

The country profile has four sections. Section 1 provides brief geographical and economical background information on Singapore. Section 2 identifies various segments made up of demographic and psychographic variables in Singapore's marketing environment. Section 3 overviews the Singaporean franchise industry in terms of its domestic franchising, governmental programs and international

franchising. Section 4 provides a summary of the country profile and identifies the key constructs critical to achieving success in franchising in Singapore.

3.1 Background Information

Singapore is a small city-state approximately 641 square kilometres in area, consisting of the main island of Singapore and some 60 islets within its territorial waters (Wirtz, 1998). Lying 137 kilometres north of the equator, it is linked to Peninsular Malaysia by a causeway across the Straits of Johore and separated from Indonesia to the south by the Straits of Singapore.

Singapore has a diversified economy. With a gross domestic product of only US\$84 billion in 1999, the Singapore economy is small by world's standards (Singapore Department of Statistics, 2000a). However, it is also one of the richest countries in the world. This affluence is largely due to the open nature of the economy.

The Singapore economy continues to enjoy strong fundamentals such as a high savings rate, strong reserves of about US\$77 billion in 1999 (Singapore Department of Statistics, 2000a), a pro-business legal framework, world-class sea, air and telecommunications infrastructure, and a strong support for technology, research and development (<http://www.contactsingapore.org.sg>). These factors have placed Singaporeans among the most potentially lucrative consumers in East Asia.

3.2 Marketing Environment

Three decades of rapid economic growth from 1997 to 2000 have spawned an expanding middle class within Singapore. Evidence of this is everywhere throughout the island-nation (Chua, 1998). Prestigious cars are not the only famous goods known to Singaporeans. Almost every international fashion house is represented within the

ubiquitous shopping complexes everywhere on the island. All fast food chains, but particularly those of American origin, are highly visible. They are found not only in leisure districts but also in the public housing estates that accommodate more than 90 per cent of the four million population.

In order to reach various targeted groups, it is critical for companies to segment consumer markets according to either geographic, demographic, socioeconomic, or psychographic factors as well as consumption patterns, attitudes and brand loyalty (Jain, 1997).

Market segmentation allows companies to gauge differences in buyer attitude, their motivations, values, patterns of usage, aesthetic preference and degree of susceptibility. For the Singapore market there would be no need to do a geographic segmentation, as the size of the tiny island does not justify it (Stravens, 1996). Furthermore, the population is largely urbanized and there is very little rural area left. The segmentation of the Singapore market will therefore be examined in terms of demographic and psychographic variables alone.

3.2.1 Demographic Variables

As of 30 June 2000 Singapore had a population of 4,017,833. This included 754,524 foreigners (Singapore Department of Statistics, 2000b). The growth of the total population during the last decade 1990 to 2000 was 2.8 per cent annually, which was the fastest in the post independence era. This was mainly due to inflows of permanent residents and foreign workers. The proportion of foreigners within Singapore's population increased from 10 per cent in 1990 to 19 per cent in 2000. It is likely that Singapore will continue to use foreigners for both specialized skills not available in the city-state and for unskilled work, such as work on construction sites and basic assembly work in electronics factories (Wirtz, 1998).

The ethnic composition of Singapore's population had remained relatively stable in 1990s. The population is predominantly ethnic Chinese; with just over 2.5 million people or 77 per cent of the total population in 2000 (Singapore Census of Population, 2000). The next largest group is ethnic Malays, constituting 453,633 or 14 per cent of the population, followed in turn by ethnic Indians with 257,791 people or 8 per cent of the population.

Singapore has a fairly youthful population. Approximately 71 per cent of Singapore residents are below 45 years of age (Singapore Census of Population, 2000). Just over 1 million people (35 per cent of the population) are below the age of 24 years.

Without the financial burdens of family concerns or a home mortgage, this 'youth' segment can freely spend on itself (Chua, 1998). This segment has been identified as being willing to indulge in unlimited consumption, constrained only by financial circumstances. The consumption practices of youth have also become increasingly Americanised or Westernised, a condition only aggravated by stints of living and studying in foreign lands in the case of returned students.

On the other hand, Singapore is one of the fastest aging countries in the world due to smaller families and low birth rates (*7000 Jobs Lost Last Year but 46 000 New Ones Created*, 1995). Between 1990 and 2000, the median age rose from 29 years in 1990 to 34 years in 2000. The number of people aged 45 to 54 years increased by seven per cent per annum (see Table 3).

TABLE 3:1
Proportion of Singaporeans by Age Group

AGE GROUP	NUMBER	PER CENT	AVE. ANNUAL GROWTH (%)
TOTAL	3,263,209	100.0	1.9
Below 15	700,798	21.5	1.1
15-24	423,929	13.0	-0.7
25-34	558,462	17.1	-0.3
35-44	636,112	19.5	3.4
45-54	469,708	14.4	6.7
55-64	236,574	7.2	2.6
65-74	157,183	4.8	4.1
75-84	62,969	1.9	2.4
85 & Over	17,474	0.5	6.1

Source: Singapore Census of Population 2000, Singapore Department of Statistics, Singapore.

Singaporeans are affluent when compared to other East Asian countries. The expanding economy has greatly improved the livelihood of working persons in the last decade, as reflected in the rising income from work. The median income among working persons doubled from S\$1,100 to S\$2,200 per month over the last ten years (Singapore Census of Population, 2000). Younger working persons aged 25 to 39 years experienced the fastest income growth, with median income rising from S\$1,200 to S\$2,600 per month during 1990 to 2000.

In line with the greater earning power of the workforce, the average Singapore household has become more affluent. The median household income from work grew from S\$2,300 in 1990 to S\$3,600 in 2000 per month (Singapore Census of Population, 2000). This amounted to an average increase of five per cent per annum over the ten-year period.

3.2.2 Psychographic Variables

Psychographic segmentation utilizes factors such as lifestyle and personality traits to segment the market (Jain, 1997). In Singapore, the ethnic Chinese and Malay populations can be clustered into 10 psychographic groups (see de Mooij and Keegan, 1998 for more details). All these 10 groups have very distinct differences and, therefore, marketers can, in fact, market products that will appeal to each group or a number of groups.

3.2.2.1 Lifestyle Studies

Singapore has a strong Oriental focus as well as having traces of Western values so that Singaporeans are characterised by different degrees of westernisation.

According to Tan and Farley (1987), Singapore's consumers presume that foreign-made products are of better quality than local brands. Western models were generally preferred in advertising and a strong "family orientation" – common throughout East Asian society - also appears to affect consumer evaluation of advertising.

Some Singaporeans adhere closely to the traditional values associated with older generations, while others may show strong Western beliefs and lifestyles. The "more Chinese" consumers are usually thrifty, quality minded, spend less on conspicuous items and shop more at stores that carry Chinese goods while those "more Westernised" Chinese consumers tend to be sophisticated, brand name conscious and have shopping habits more like their Western counterparts (Tai and Tam, 1996).

Further research by Kau and Yang (1991) found that Singaporeans between the ages of 15 to 40 generally enjoyed a rather secure and comfortable life, felt quite contented, and lived in a safe environment. Although they were somewhat cautious in their attitudes, their traditional values were undergoing transformation. A Delphi study, to determine the characteristics of future Singaporeans, was conducted by

(Kau, Yong and Richmond, 1993) with 150 participants. The authors concluded that future Singaporeans would be characterised by the traits of below:

- *Increasing individualism.* It is felt that increasing influence, and living in a highly urbanised society, will make consumers want to differentiate themselves from society in general.
- *Remaining very status conscious and materialistic.* This is reflected in the famous “5 Cs,” said to be aspired by all young professionals: career, cash, credit card, condominium, and a car.
- *More brand conscious.* Respondents believed that future consumers would be increasingly concerned with buying well-known brands across a wide range of product categories, from cosmetics and food to jewellery and cookware. It appears that brands associated with high income, status, and sophistication will show the highest growth.
- *More discerning consumers.* Consumers are expected to value more and more, and be more and more willing to pay for, higher quality products. They are also expected to want more and more detailed and accurate product information, and their appreciation of art and culture is expected to increase.
- *More health-conscious consumers.* As the population ages and influence grows, consumers are expected to pay more attention to their health. For example, this will show in an increased demand for fitness and health clubs, as well as health food with lower cholesterol, fat, salt and sugar content, but more vitamins, fibre, and natural ingredients.
- *More emphasis on leisure activities.* Pastimes such as watersports, golfing and cultural activities will become increasingly important.

- *More demand on time.* The recent increase in the labour participation rate of women will lead to more time pressure, particularly for working women. However, time pressure will not reach levels such as those in the West, as Singaporeans frequently live within an extended family, and maids, and other household helpers are readily available.

3.3 Franchise Industry

The development of Singapore's franchise industry dates back to the 1970s when major companies such as Shell, Esso, Singer and Bata operated under licensing systems which bore characteristics of present day franchise concepts (TDB and Arthur Andersen, 1997). In the 1980s, Singapore based companies began acquiring country rights of international franchises such as Kentucky Fried Chicken, McDonald's, Pizza Hut, Avis, Mister Minit, ServiceMaster, Body Shop, 7-Eleven, Benetton and Esprit. As at June 1996, there were close to 125 foreign franchises operating in Singapore (TDB and Arthur Andersen, 1997). At the same time, several local provision stores had also launched their local franchise programmes.

The size of the franchise industry in Singapore is difficult to quantify due to the limited data available on this highly diversified form of business activity. A recent report published in 1996 by TDB and Arthur Andersen stated that franchising represents 13 per cent of total retail sales in Singapore. Major contributors to this sales volume are the petrol station chains and hotels. Latest available data on total retail sales in Singapore showed \$7 billion for 1999 (Singapore Department of Statistics, 2000).

3.3.1 Domestic Franchising

Local franchising started in the 1980s (TDB and Arthur Andersen, 1996). One of the first sectors to venture into franchising was the convenience store company. Both Econ Minimart and Happy Family Minimart started the expansion of their franchise network through the conversion of traditional independent provision shops. Their success in expanding the group to a few hundred franchise outlets contributed significantly to the popularity of franchising and led to the recognition of franchising as an avenue for small business growth.

The number of homegrown companies that have developed franchise systems has also grown tremendously over the last decade (TDB and Arthur Andersen, 1996). At the end of 1995, there were 85 companies with developed franchise systems. This number grew to 140 at the end of 1998 (TDB, 2000).

A franchising survey was conducted jointly by Trade Development Board (TDB), Singapore Productivity and Standards Board (PSB) and Singapore International Franchise Association (SIFA) in March 1999 to assess the performance of the Singaporean franchisor's performance as well as to identify areas for improvement, development and growth. The survey findings were compiled from 83 franchisors who responded to the study.

The franchisors surveyed were mostly from the education, healthcare and other services sectors (40%), with high proportions from the food and beverage sector (36%) and retail sector (24%). The survey showed that the highest number of franchises being launched both locally and overseas was in the 1997-98 period, where 20 per cent increase occurred compared with the year before. This is a positive development despite the East Asian economic slowdown during the 1997-1998

period. It was found that most of the franchises set up within this period were from the retail and service sectors.

Almost all of the franchisors (90%) surveyed experienced an increase in average monthly sales since embarking on franchising. Similarly, almost all the franchisors (90%) agreed that franchising was a feasible option of business expansion compared to owning company outlets. The survey also showed that the majority of franchisors enjoyed better profits since franchising, with 74 per cent of them reaping net profits in the last financial year.

More than half (55%) of the franchisors had franchised their operations overseas to seek more business opportunities. Although Southeast Asia was still a popular region for expansion, 34 per cent of the respondents had already gone further to Latin America, Middle East, Africa, and Europe. 55 per cent of the respondents also felt that franchising was an effective strategy for overseas business expansion in the next 12 months. The five most attractive markets being China, Malaysia, Brunei, Indonesia and Taiwan.

The franchisors indicated that their success in franchising was caused by their strong track record, good financial background, a committed management team as well as proactive support from promotional agencies such as TDB and PSB.

In addition to the franchisor survey, PSB also conducted a survey on franchisees during the same period in 1999. Of the 154 respondents, which represented a response rate of 53 per cent who responded, close to 80 per cent of the franchisees experienced an improvement in sales since joining a franchise. Of these, seven out of 10 reported improved profitability since becoming a franchisee.

3.3.2 Governmental Programs

The Singaporean government has demonstrated considerable commitment to franchising as a means of small business development and expansion (PSB, 2000). The Singapore Trade Development Board (TDB) plans to make Singapore into a franchise hub (TDB, 2000). It aims to help successful local businesses to become homegrown international franchises, assist local companies to acquire master franchise rights for the region, and promote Singapore as the regional headquarters for foreign franchisors.

The TDB views franchising as an avenue for Singaporean companies to expand internationally with the offer of the Franchise Development Assistance Scheme (FRANDAS). With this scheme, successful local companies with a strong track record and firm foundation for franchising would receive assistance to develop their franchise systems and promote their franchises overseas. Franchise missions to locate suitable overseas franchises have been arranged to Hong Kong, Paris, China and South Africa, with others being considered, including Australia. Since its inception in 1990, some 40 Singaporean franchises have been assisted in international expansion. Examples include Kinderland (a child-care provider), Melandas Casa Mobili (a furniture manufacturer and retailer) and Bee Cheng Hiang (a retailer of barbecued meat products). It appears that the FRANDAS can assist foreign franchises if they are involved in conversion franchising, such as offering franchises to existing local firms, so improving their efficiency and survivability, or using Singapore as a base to expand into other areas of Asia.

TDB has also developed another assistance program to help both Singaporean and foreign companies to expand their franchise businesses using Singapore as their base (TDB, 2000). This program is called the International Franchise Enterprise Program

(IFEP). Foreign companies can access IFEP to expand their franchise businesses through partnerships with Singaporean companies. Singaporean firms could leap into the international area through IFEP by receiving assistance in franchise research and consultancy, trade mark registration, prototype shop design, franchise manuals and prospective development and international marketing.

In 1993, under the efforts of TDB to encourage industry representation, a group of franchise companies gathered together to form the Singapore International Franchise Association (TDB, 2000). Since its launch, it has actively worked with various governmental agencies to promote franchising and assist its members in their international expansion.

3.3.3 International Franchising in Singapore

The economic situation in Singapore has had a very positive effect on the demand for consumer-ready products. The buying power of Singaporeans for imported goods has increased, and interest in “Westernised” products is growing (Patterson and Kong, 1996). A strong “yuppie” culture exists in Singapore, where Singaporeans spend willingly on branded products. Still, consumers are generally very price conscious and want value for their money in their purchases.

It is often said that the two national pastimes of Singaporeans are shopping and eating. Over the past decade, Singapore’s consumers have almost doubled the amount they spend on food and beverages. They consumed US\$5 billion worth of foodstuffs and beverages in 1999, about half of which was spent eating out (Department of Statistics, 2000).

Eating habits are changing, which are caused by being increasingly exposed to Western media, travel, and education abroad. Fast food restaurants are particularly well liked by youngsters, who exert enormous influence over family decisions as to

where families eat out on weekends (Kong, 1997). Western franchises, such as McDonald's, Hard Rock Café, Planet Hollywood, Pizza Hut, Kenny Roger's Roasters, KFC and TGI Friday's are present on the local food scene. The number of Italian and other continental style restaurants has also doubled since the early 1990s.

For foreign franchises setting up in Singapore, acceptance of the franchise and brand name by the local population is vital, so skilful marketing is essential (Kong, 1997). Products and services may also need to be tailored to local preferences to get maximum response. Food franchisors are popular but very competitive, and some strong U.S. entrants have failed in Singapore such as Hardee's and Wendy's. Although it is not known why some fast food restaurants have not succeeded in Singapore, lessons could perhaps be drawn from the entry of KFC and McDonald's into Hong Kong.

Western food was first introduced to Hong Kong by KFC in 1973 (Lan and Khan, 1995). The first KFC unit was managed under a joint venture contract with a local Hong Kong partner. Business was brisk at the outset and KFC grew to 11 units within a year. KFC made several fatal errors including poor locations, inconsistent product quality and uncertain market positioning and pricing. In 1975, KFC closed down all 11 units and withdrew the concept from Hong Kong.

The same year that KFC left, McDonald's arrived, bringing with it an approach different from KFC's (Lan and Khan, 1995). First, McDonald's advertised aggressively to raise awareness of the fast food phenomenon among its target customers – children and teenagers. Second, new units were added carefully and gradually after intense market research. Third, a competitive pricing strategy positioned the restaurants well in the target market.

Those offerings that are very different have better possibilities, and franchises that emphasize foreign aspects are more likely to be popular (Kong, 1997). Others that concentrate on healthy foods would appeal as health-consciousness is high and few in the food industry have this approach. The foreign fast food and restaurants presently operating are dominated by U.S. franchises.

A franchising survey was conducted by TDB in June 1996 to provide key measures of the growth and profile of the franchising industry in Singapore (TDB and Arthur Andersen, 1996). The survey findings were compiled from 83 franchise companies that responded to the survey.

Almost half (42 %) of franchises were foreign concepts. They were made up of USA (66%), UK (16%), Switzerland (6%), Australia (6%), Italy (3%), and Hong Kong (3%). This is to be expected, as the U.S. is the largest and most established pool of franchise concepts in the world. This also indicates the generally high receptiveness of Singaporeans to U.S. brands, products and services.

A large majority (70%) of the franchises had established their franchise operations within the last five years. Firms with at least 10 years of franchising operations in Singapore made up about 15 per cent of the franchises.

Advertising and promotion (65%), and training (70%) were the main major activities undertaken by franchises. On the other end of the scale only 23 per cent of the respondents indicated that they carried out manufacturing activities in Singapore. This could be due to the comparatively higher labour and land costs in Singapore. Some local franchisors have shifted their manufacturing operations abroad to tap on cheaper production resources while maintaining their headquarter functions in Singapore. Master franchisees largely imported the products rather than manufactured them locally.

A third (35%) of the franchises indicated the initial term of agreement granted were between 10 and 15 years. This is followed by 20 per cent of the respondents having their franchise agreement between two and less than five years. When it comes to the number of years granted in an extension of the franchise agreement, the common period granted ranged from five to 15 years.

About 93 per cent of the respondents indicated that they provided initial training for their franchises. Out of this group, a quarter of them provided training that ranged from 14 to 21 days. This was followed by another group (20%) that provided training for less than seven days. As for on-going training, the survey indicated that 68 per cent of the respondents stated that the number of days of training provided per year fell within 21 days.

The survey found that 44 per cent of the franchise companies started with local franchise outlets prior to expansion overseas. However, 56 per cent indicated they did not have any franchising experience. Taking the small population size of Singapore (4 million) in consideration, it is perhaps not uncommon for companies to serve the entire domestic market with company owned stores rather than having any franchise outlets.

3.4 Implications for Foreign Franchises

Over the past 30 years international franchises have created a strong presence in Singapore. Renowned franchises such as McDonald's, Kentucky Fried Chicken (KFC), Pizza Hut, 7-Eleven, Hertz, and the Body Shop have achieved overwhelming success in Singapore, which subsequently have motivated other international franchises to expand into the country.

The strong growth of the franchising industry in Singapore is expected to continue over the foreseeable future. This is largely fuelled by the country's robust economic growth, excellent infrastructure, friendly business environment, political stability and Government's pro-active policies toward franchising. In addition, the rapid spread of Western influence on the relatively young population in Singapore has resulted in an increased demand for western-oriented lifestyle products.

For foreign franchises to succeed in Singapore, skilful marketing is essential to generate wide acceptance of its concept and brand name by the local population. The huge success of McDonald's in Singapore has been the ability of the brand to assimilate into the daily lives of Singaporeans. Although Singaporeans are largely cosmopolitan and westernised, there is still a need for foreign franchises to make adaptations to their concept to achieve maximum results.

Singapore has also found to have astute investors with the financial and administrative resources to take up and develop master franchises for the Asian region. In addition, foreign franchisors can access FRANDAS, which is a Government's development assistance financial scheme, when using Singapore as a base to expand into other parts of Asia. Singapore can offer two major advantages to potential foreign franchisors considering expanding into Asia. Firstly, Singapore's relatively large westernised population makes it highly suitable for foreign franchises to test-market and fine-tune its foreign franchise concept before introducing it into the Asian region. Secondly, foreign franchisors can take advantage of the Singaporean investor's extensive experience and strong local knowledge of the region.

4 RESEARCH METHODOLOGY

This research is designed as a multiple-case study comprising four purposely-selected foreign franchisors that have expanded into East Asia. The process of operating franchises in East Asia, including selection of franchisees, management and marketing is the focus of the study. The research into international franchising has been largely quantitative, which makes its complexities very difficult to be tracked and studied in detail. The decision of carrying out case studies was that they are valuable as preliminaries to major investigations as they generate rich data that may suggest themes for more intensive investigation (Burns, 1990).

Yin (1994, p. 13) defines a case study as “an empirical inquiry that investigates a contemporary phenomenon within its real life context; especially when the boundaries between phenomenon and context are not clearly evident.”

The case study method has been an essential form of research in the social sciences and management. It has been used in research involving business and organisational issues, education, child-development and youth policy, family studies, international affairs, evaluation, technology development and research on social problems (Yin, 1983).

Traditionally, case studies were considered appropriate for exploratory research only. Yin (1994) however, points out that some of the best and most famous case studies have been both descriptive, such as Whyte (1955)’s “Street Corner Society” and explanatory, such as Allison (1971)’s “Essence of Decision-Making: Explaining the Cuban Missile Crisis,” in 1971. Eisenhardt (1989) identifies other uses for the case study method to provide description (Kidder, 1981), test theory (Anderson, 1983; Pinfield, 1986), or generate theory (Harris and Sutton, 1986; Gersick, 1988).

This chapter is divided into two main sections. First, the case study method is examined in the principal areas of the common criticisms it is facing and verification of the evidence by the process of triangulation. Second, the application of the case study method to this research study is demonstrated. The key components of the research methodology including research questions, cases selection, data collection, and data analysis are discussed.

4.1 The Case Study Method

A case study is considered a more appropriate strategy for answering research questions which ask ‘how’ and ‘why’ and which do not require control over the events (Robson, 1993). This is because such questions deal with operational links that would need to be traced over time, rather than mere frequencies or incidence. Furthermore, because of its ability to test and generate theory, the case study approach will be more suitable than survey research to establish the validity of the content. By using the case study approach, the reasons why certain decisions were made, how they were implemented and what the results are can be identified.

Case studies can be classified by purpose, which is differentiated as descriptive, explanatory, evaluative or exploratory (Gall, Borg and Gall, 1966; Robson, 1993). When the purpose is *descriptive*, the researcher looks for constructs to organise data and relate them to other research findings and for themes that identify the salient features of a case. The purpose of descriptive research is to accurately portray an accurate profile of persons, events, or situations (Robson, 1993). This requires extensive knowledge of the research subject in order to identify appropriate aspects on which to gather information. However, Yin (1994) cautions that descriptive case

studies should not be used simply to describe everything but to focus on answering the purpose of the study.

In an *explanatory* case study, the operative dynamic is the identifying of patterns, in which one item of observed variation is systemically related to another (Gall, Borg and Gall, 1966). If causality is claimed, the pattern is termed causal; if not, it is termed relational. *Evaluative* case studies refer to those in which the researcher makes judgments (Gall, Borg, and Gall, 1966).

The *exploratory* case study seeks to find out what is happening, to seek new heights, to ask questions, and to assess phenomena in a new light (Robson, 1996). This is perhaps the most pure hypothesis or theory building form of case study. Consequently, an exploratory case study normally focuses on current events and concerns and seeks to answer questions of how and why. Yin (1994) favours exploratory case studies only when the available literature or existing knowledge base is poor. Once the uncertainty has been investigated and resolved, the exploratory phase is complete and the real study should be undertaken.

There are two fundamental approaches to using the case study method. Yin (1994) uses case studies to test theory while Eisenhardt (1989) uses case studies to develop theory. The latter, theory development from case study evidence, was used for the purpose of this study.

In the case of theory development, the existing knowledge base may be poor, and the available literature does not provide any conceptual framework or hypotheses. Therefore, such a knowledge base does not lend itself to the development of good theoretical statements, and any new empirical study is likely to assume the characteristic of being an exploratory study. However, Yin (1994) argues that it is

nonetheless essential for the theory development approach to develop theory at the outset.

4.1.1 Criticisms of the Case Study Method

Although the case study is a distinctive form of empirical inquiry, many research investigators have regarded it as a less desirable form of inquiry than either experiments or surveys (Yin, 1994). Perhaps the greatest concern has been over the lack of rigour of case study research. This has largely been attributed to the investigator allowing equivocal evidence or biased views to influence the direction of the findings and conclusions (Yin, 1994).

A common criticism of the case study method, however, is that it provides little basis for scientific generalisation. “How can you generalise from a single-case?” is a frequently heard question. This question has also been asked with the generalising ability of a single experiment. Yin (1994) points out that scientific facts are rarely based on single experiments; they are usually based on a multiple set of experiments, which have replicated the same phenomenon under different conditions. The same approach can be used with multiple-case approach but requires a different concept of the appropriate research designs. Yin (1994, p. 10) further asserts, “that case studies, like experiments, are generalisable to theoretical propositions and not to populations or universe.”

In this sense, the case study, like the experiment does not represent a sample, and the investigator’s goal is to expand and generalise theories (analytic generalisation) and not to enumerate frequencies (statistical generalisation). Understanding the distinction between two types of generalisation may be the most important challenge in undertaking case studies (Yin, 1994). In statistical generalisation, an inference is made about a population (or universe) on the basis of empirical data collected about a

sample. This method of generalising is commonly recognised because researchers have ready access to formulas for determining the confidence with which generalisations can be made, depending mostly on the size and internal variation within the universe and sample. Moreover, this is the most common way of generalising when doing surveys and experiments.

A flaw in doing case studies is to conceive of statistical generalisation as the method of generalising the results of the case (Yin, 1994). This is because cases are not 'sampling units' and should not be chosen for this reason. Instead, case studies are to be selected as a laboratory investigator selects the topic of a new experiment. This method of generalisation is known as analytic generalisation, in which a previously developed theory is used as a template to compare the empirical results of the case study. If two or more cases are shown to support the same theory, replication may be claimed.

4.1.2 Triangulation

A major strength of case study data collection is the opportunity to use many different sources of evidence. Further, the need to use multiple sources of evidence far exceeds that in other research strategies, such as experiments, surveys, or histories (Yin, 1994). Experiments, for instance, are largely limited to the measurement and recording of actual behaviour in the laboratory and generally do not include the systematic use of survey or verbal information. Surveys tend to be the opposite, emphasising the verbal information but not the measurement or recording of actual behaviour. Finally, histories are limited to events in the past and, therefore, seldom have any contemporary sources of evidence, such as direct observations of a phenomenon or interviews with key actors.

The use of multiple sources of evidence in case studies allows an investigator to address a broader range of historical, attitudinal and behavioural issues (Yin, 1994). However, the most important advantage presented by using multiple sources of evidence is the development of triangulation. This is a process of converging lines of inquiry, which results in supporting a finding by showing that independent measures of it agree with it, or at least, do not contradict it (Miles and Huberman, 1994). Thus any finding or conclusion in a case study is likely to be much more convincing and accurate if it is based on several different sources of information.

There are four types of triangulation that can be used (Patton, 1987). They include triangulation by data sources (data triangulation), among different evaluators (investigator triangulation), of perspectives on the same data set (theory triangulation) and of methods (methodological triangulation). The present study used data triangulation to verify the interview by collection information from multiple sources, which aimed to corroborate the same fact or phenomenon.

4.2 Application of the Case Study Method

For this study on critical success factors of international franchisors in East Asia, it was decided that the multiple-case approach would be suitable, as it allowed both theoretical and literal replication approaches to be used. According to Eisenhardt (1989) and Yin (1994), replication logic enables a researcher to identify the subtle similarities and differences within a group of cases as well as inter-group similarities and differences. Replication logic also encourages the researcher to go beyond initial impressions. These forced comparisons allow new categories and concepts to be identified. By using the multiple-case approach, a better understanding of an

international franchisor's decision-making process and critical success factors can be attained.

As this study consists of the 'how' and 'why' questions, which are more explanatory, the use of case studies has been considered by Yin (1994) to be a preferred research strategy. The key steps of the research methodology are discussed below.

4.2.1 Research Propositions

The main aim of this study is to explore the critical success factors (CSFs) of international franchising in East Asia. The concept of CSFs needs to be clearly explained.

Critical success factors (CSFs) are those key areas of activity, which must be, performed particularly well in order for the organisation to outperform its competitors (Vasconcellos e Sa, 1988). They represent those areas that management must carefully consider in order to bring about continued good performance. Hofer and Schendel (1978) asserted that CSFs are well known to the existing competitors in an industry, although they may not be as evident to potential new entrants. Managers' evaluations of relevant CSFs and the firm's position vis-à-vis these factors provide the foundation for a firm's competitive strategy (Porter, 1980).

Yin (1994, p. 103)'s preferred strategy of analysing case study's evidence is to "follow the theoretical propositions that led to the case study." The proposition helps the researcher to focus on examining only the relevant data. It also helps to organise the entire case study, which enables alternative explanations to be examined. Theoretical propositions about causal relationships – answers to "how" and "why" – can be especially useful in guiding case study analysis.

One of the problems faced by international franchisors, even with advances in telecommunications technology, is the gathering and receiving of complete and timely knowledge about foreign operations (Aharoni, 1996). The ability of a franchisor to monitor its franchisee-agents over long distances involves a complex set of skills that may not be commonly possessed by the entrepreneurs or managers operating franchise firms and does not necessarily substitute for experience (Huszagh, Huszagh and McIntyre, 1992). These abilities, which include supervisory skills, have been shown to be important for international expansion (Shane, 1996a). Therefore, it is expected that international franchisors should have capability in distance management in order to increase the likelihood of success in East Asia.

P₁: The success of international franchising in East Asia will be contingent on having a strong capability in distance management.

The structure of the international franchising contract is considered to be a central aspect of the franchisor-franchisee relationship (Rubin, 1978; Lafontaine and Kaufmann, 1994). Most franchising contracts within the franchisor's domestic market are standardised (LaFontaine and Kaufmann, 1994). However, within the international market, franchising contracts can vary substantially (Abell, 1990).

In most standard franchise agreements, the franchisor has the right to revoke the franchise agreement without return of the franchise fee if the franchisee does not adhere to his or her contractual obligations. The higher the franchise fee relative to the size of the royalty and advertising payment, the greater the cost to the franchisee of agreement termination, and the more the franchisee needs to adhere to the franchise system (Carney and Gedajlovic, 1991; Norton, 1988; Combs and Castrogiovanni, 1994). This bond is a particular effective tool, as the franchisee usually invests a large percentage of his or her personal net worth in the purchase of the outlets (Combs

and Castrogiovanni, 1994). Under these circumstances, termination of the franchise agreement often results in great financial hardship for the franchisee.

According to Shane (1996a), international franchisors may need to modify contracts to include the initial terms of their franchise agreements, the ratio of their franchise fees, and provisions concerning cooperative advertising and store opening support. Such variations with an international contract may be due to the size of a franchisee, host country restrictions, local business practices, and the opportunistic behaviour of particular franchisees. It is important that franchisors have the ability to negotiate contract modifications (Root, 1987) and handle contract enforcement in order to achieve successful international development (Hood and Young, 1979). Therefore, it is expected that international franchisors should have the capability to handle contract negotiations and enforcement in order to increase the likelihood of success in East Asia.

- P₂** The success of international franchising in East Asia will be contingent on having a strong capability in handling contractual negotiations and enforcement.

The different cultural environments found in foreign markets add further complexity to international franchising (Huszagh, Huszagh, and McIntyre, 1992). The very strength of the franchise format, its standardisation, makes its successful replication in foreign markets difficult (Aydin and Kacker, 1990). Frequently, modifications may be needed in various aspects of the franchise operation (Sadi, 1994). Variations in cultural norms such as “power distance,” Confucian dynamism, and individualism can affect local implementation, especially when conducting business in East Asia (Hofstede, 1980; Hofstede and Bond, 1988). Therefore, it is expected that international franchisors must be able to make adaptations to its operations if it desires to achieve success in East Asia.

- P₃** The success of international franchising in East Asia will be contingent on having a strong capability in cultural adaptability.

To succeed in international franchising, companies must have the ability to deal with uncertainty within the foreign country. Risk management is an important consideration in international business research (Ghoshal, 1987). Issues such as government policies, regulations and macroeconomic variations make conducting business internationally more uncertain than domestically (Miller, 1992). Hackett (1976) indicated that such issues were important to franchisors. The franchisors in his survey were primarily concerned with government regulations within the foreign market that affect both the conduct of the service and monetary uncertainty, rather than the complexities of format modification. Therefore, it is expected that international franchisors possess a capability in host country policy evaluation and foreign exchange management to achieve success in East Asia.

- P₄** The success of international franchising in East Asia will be contingent on having a strong capability in host country risk management, including host country policy evaluation and foreign exchange management.

4.2.2 Selection of Cases for the Study

Eisenhardt (1989) states that in the multiple-case approach there are no ideal number of cases, but suggests that a study of between four and 10 cases usually works well. With fewer than four cases, theory is difficult to generate, and with more than 10 cases, the volume of data is difficult to cope with. For this study, four foreign that have several years of experience operating in East Asia.

Small to medium-sized firms were chosen because of the feasibility of access to principal decision makers. However, a highly successful large international franchisor has also been included in the study. The reasons for this inclusion are three

fold: (1) the company was judged to fit the characteristics of a ‘worldwide franchisor’ according to the typology of Fladmoe-Linquist’s (1996) model, (2) the U.K.- based company has a regional head office in Singapore that can be accessed easily from Perth, and (3) the regional international manager, who has been involved with the company’s expansion into East Asia since 1983, was prepared to be interviewed.

Each case was selected because it either predicts similar results (literal replication) or predicts different results for expected reasons (theoretical replication) (Yin, 1994). The unit of analysis was the firm. This meant that questions had to be pertinent to this unit of analysis otherwise the data collected would be irrelevant. An important step in all of these replication procedures is the development of a rich, theoretical framework (Yin, 1994). The framework needs to state the conditions under which a particular phenomenon is likely to be found (a literal replication) as well as the conditions when it is not likely to be found (a theoretical replication). The theoretical framework later becomes the vehicle for generalising to new cases, similar to the role played in cross-experiment designs.

The four cases were selected because they have different characteristics from each other, as Eisenhardt (1989) recommends. They have different existing international franchising capabilities and capacity for developing international franchising capabilities and are at varying levels of internationalisation development according to each of the four cells in Fladmoe-Linquist’s (1996) model as mentioned in the Section 2.5.3 of this thesis. Since each firm was selected to fit into each category of Fladmoe-Linquist’s (1996) model it is predicted that the level of performance of each firm in East Asia would differ for specific reasons (see Table 6). The integrating franchisors, constrained franchisors, conventional franchisors and worldwide franchisors are

predicted to have varying levels of success for the reasons explained by Fladmoe-Lindquist (1996).

TABLE 4:1
Typology of International Franchisors

CAPACITY FOR DEVELOPING INTERNATIONAL CAPABILITIES	EXISTING INTERNATIONAL FRANCHISING CAPABILITIES	
	LOW	HIGH
HIGH	INTEGRATING FRANCHISOR Dome Coffees (Australia) <ul style="list-style-type: none"> • Pursues cautious growth • Uses joint venture and master franchising • Proactive evaluation 	WORLDWIDE FRANCHISOR The Body Shop (U.K.) <ul style="list-style-type: none"> • Focuses on global markets • Uses multiple forms of franchising • Both proactive and reactive
LOW	CONSTRAINED FRANCHISOR Royal Copenhagen Ice Cream (Australia) <ul style="list-style-type: none"> • Concentrates locally • Withdrew from international markets • Reactive evaluation 	CONVENTIONAL FRANCHISOR Coffee Bean and Tea Leaf (U.S.) <ul style="list-style-type: none"> • Focuses on several foreign markets • Converted from franchise to company-owned stores • Often reactive with some proactive efforts

Adapted from Fladmoe-Linquist, K. (1996), "International Franchising: Capabilities and Development," *Journal of Business Venturing*, Vol. 11 (2), p. 428.

Constrained franchisors have limited international management capabilities and capacity for learning. A company in this capacity is not likely to pursue significant international franchise development. Such franchisors will limit their international expansion to the country closest to them, geographically or culturally. The Australian franchisor Royal Copenhagen Ice Cream fits into this typology. The company opened its first store in 1985 but did not begin franchising overseas until 1991. Although it subsequently expanded into Thailand, Indonesia, Malaysia, Japan and the Philippines, it withdrew all its 23 stores from these markets in 1998.

Integrating franchisors have limited international franchising capabilities but considerable capacity for learning from experience and integrating experiences into operations. These firms are more likely to initiate international expansion early in their life cycle. The Australian franchisor Dome Coffees has been selected for this typology. Dome Coffees expanded into Singapore after the opening of its first store

in Perth. The company enters each market using an approach that reflects an awareness of different national tastes, regulations and franchise partners. Dome set up a joint-venture with a Singaporean company to expand into Indonesia, Malaysia, and Singapore. It entered the Philippines and Dubai by master franchising.

Conventional franchisors have some of the capabilities needed for international expansion but do not have a great ability to develop what is needed to succeed in a broader global setting. These franchisors are also likely to expand into international franchising through foreign solicitations by prospective franchisees. A businessman from Singapore approached a U.S. family-owned gourmet coffee store Coffee Bean and Tea Leaf about opening stores in Singapore, Malaysia and Taiwan. Three years later, the Singaporean master franchisee acquired a substantial stake in the franchisor. This move has effectively transformed the franchise stores in all its overseas markets to become company-owned stores. Presently, the company prefers unsolicited enquires rather than proactive franchisee recruitment as a means to determine genuine interest shown in its concept.

Worldwide franchisors are generally largely franchisors with a great amount of experience and greater capabilities in both administrative efficiency and host country risk management. These franchisors operate in many countries. They used a variety of ownership and franchise agreements configuration. They have operated internationally for a long period of time and gathered additional knowledge in variety of markets. The U.K. franchisor Body Shop would fit into this category. The Body Shop is a value-driven, high quality skin and hair care retailer operating in 49 countries with 1,730 outlets spanning 25 languages and 12 time zones in 2000. The company's entry into East Asia first began in Singapore in 1983. In Asia, the Body

Shop is a well-established business with 332 stores (Annual Report and Accounts, 2000). Of the 322 stores to date, 17 are company owned.

4.2.3 Data Collection

In this study data were collected primarily via two methods: in-depth interviewing and documents research.

In-depth interviewing (face-to-face) was a data collection method relied on quite extensively in this study. The interviews were conducted with key decision makers involved in the internationalisation of the firms. They included managing directors, founder, international franchise managers and overseas master franchisees. All the interviews were tape-recorded and then transcribed. The typical interview lasted two hours; the length varied from 90 minutes to three hours.

A guideline for interview questions was provided in Appendix A. It consisted of 31 open-ended questions. Each question, however, was only a point of reference. During the interviews, questions were neither repeated verbatim nor in a given order. The importance of this guideline was that it provided some directions for the interviews. Typically, the researcher began the interviews with questions similar to the questions suggested in the guideline, and then depending upon the responses received, he moved into probing questions. Probing questions were useful in gaining more insights and clarifying the answers from the respondents.

The researcher explored a few general topics regarding international franchising to help to uncover the respondents' meaning and perspective, but otherwise respected how the respondent framed and structured the responses. This was to ensure that the respondent's perspective on issues of international franchising unfolded as the respondent viewed it, not as the researcher viewed it.

In keeping with the case study method, document research or multiple sources of data collection were used to provide triangulation. Documents are good sources of evidence, because many documents are easily accessible, free and contain information that otherwise would take an investigator substantial time and resources to gather (Dexter, 1970). The data were collected from documents such as annual reports, minutes of meetings, letters, internal memoranda, court proceedings, newspaper clippings, magazine articles and books.

4.2.4 Data Analysis

Data analysis is the process of bringing order, structure and meaning to the collected data. Merriam (1988) and Marshall and Rossman (1989) contend that data collection and data analysis must be a simultaneous process in a qualitative research design. The method of qualitative analysis here draws on Yin (1994, p. 103)'s preferred strategy of relying on theoretical propositions that led to the case study. The propositions helped to organise the case study and to examine alternative explanations.

Both single case and cross-case analyses were included in this study, and the process of data analysis entailed three activities: data reduction, data display, and conclusion drawing and verification (Miles and Huberman, 1994, pp. 10-3). These activities proceeded concurrently during the research project, although one might take precedence over the others at various times.

Data reduction refers to the process of selection, focusing, simplifying, abstracting, and transforming the data that appear in written-up field notes or transcriptions (Miles and Huberman, 1994). The process of data reduction in this study began as soon as the important topics or themes were identified and continued throughout data collection and report writing.

The writings of Miles and Huberman (1994) were drawn on for techniques of data display. They suggest that data displays should be designed to assemble organised information in a compact form that is immediately accessible. One of their techniques, which was used in this study, was to arrange empirical evidence in tables in the forms of words, rather than numbers. By looking at these tables, themes that agree or disagree across cases would emerge.

Drawing conclusions and verifying them took place before, during and after data collection. Before data collection the researcher might have had vague and unformed hunches that could lead to conclusions. As analysis proceeded, however, these conclusions were tested and elaborated systematically for their soundness, the conclusions then became more explicit as they were verified by the data in increasingly grounded analyses.

In ensuring internal validity, several strategies were utilised (Merriam, 1988):

1. Triangulation of data. Data were collected from multiple sources to include interviews and document analysis.
2. Member checking. The researcher took data and interpretations back to the interviewee to check for accuracy. When accuracy was confirmed, the case evidence was deemed suitable for analysis.
3. Participatory mode of research. Interviewees of the four firms were involved in most phases of this study, from the design of the study to checking interpretations and conclusions.

The primary strategies that were utilised in this study to ensure validity included (a) providing the provision of rich, thick, and detailed description so that anyone

interested in transferability will have a base of information appropriate for comparison (Lincoln and Guba, 1985) and (b) by conducting a cross-case analysis.

To ensure reliability, three strategies were employed in this study: (a) the researcher provided a detailed account of the focus of the study, the researchers' role, the participant's position and basis for selection (Goetz and LeCompte, 1984); (b) multiple methods of data collection and analysis were to strengthen reliability as well as internal validity (Merriam, 1988); and (c) data collection and analysis process were reported in detail in order to provide a clear and accurate picture of the methods used in this study (Merriam, 1988).

Data reduction, data display, and drawing conclusions were activities of data analysis occurring interactively throughout the study. All the three activities were, therefore, combined to produce a comprehensive analysis of the study.

5 CASE STUDIES

In this chapter, three successful international franchisors operating in Asia and one failed international franchisor were carefully selected for conducting the case studies. They are Dome Coffees Australia Pty. Ltd., Coffee Bean and Tea Leaf, The Body Shop and Royal Copenhagen Ice Cream Cone Company. Several face-to-face interviews have been conducted with the respective franchisors and master franchisees of these companies in Perth, Sydney and Singapore.

5.1 Dome Coffees Australia Pty. Ltd.

Dome is a retailer of coffees in Australia, Southeast Asia and the Middle East. The company operates 48, mostly franchise, outlets around Australia, Malaysia, Singapore, The Philippines, Indonesia and the United Arab Emirates (See Table 7).

The company also has a coffee roasting business based in Perth, which roasts coffee from 16 different countries and sells to the Dome cafes and other outlets. Each week, it airfreights hundreds of kilograms of coffee to The Philippines and United Arab Emirates, with its Singapore factory roasting coffee for cafes in Singapore and Malaysia. Over the past 10 years, the company has grown from a single café in Napoleon Street in Cottesloe to an international AUD\$60 million-dollar international enterprise.

5.1.1 Company Founders

Dome was founded by Phil May and Patria Jafferries in 1990. May, who is the current Director of International Business, taught himself how to roast and prepare coffee, and still remains Dome's Master Roaster. Jafferries, currently the Managing Director, handles the marketing and presentation package of the franchise division, which has become the hallmark of Dome's appeal.

TABLE 5:1
International Locations of Dome Cafes

MARKET	OUTLETS
Australia	24
Indonesia	1
Malaysia	9
The Philippines	3
Singapore	8
United Arab Emirates	3
TOTAL	48

May was a national triple jump athlete for Australia, competing in the Olympics in 1976 and the Commonwealth games of 1970 (where he won a gold and silver medal) and 1974 (Buenas, 2000). He became involved in the business of coffee after working in a company, which sold espresso machines and catering equipment to restaurants. May decided to set up a business roasting coffee after witnessing the emergence in the 1980s of a chic café culture on America’s west coast. In 1983, he established Western Roast Coffee, a supplier of roasted coffees and the precursor to Dome Coffees.

Jafferries was born in 1952 in San Jose, California, with a mixture of Italian, Irish and Greek heritage. Her father ran his own telecommunications business that he had started in the 50s and Jafferries and her three sisters spent their childhood around the San Francisco Bay (Caccetta, 2000). It was while she was studying at university – a double major in graphic design and business – that Jafferries was first introduced to Western Australia (W.A.) by an Australian friend. She made her first trip to Australia in 1972 and returned regularly.

Jafferries began her working life as a rock promoter with Bill Graham Presents, an American company that represented such bands as the Rolling Stones and the Beatles. She then spent a year working for an aviation company in Paris, which began her love

of the cafe industry. She returned to the U.S. working in the hospitality industry when she was asked to come to Perth in 1986 for the America's Cup to work as a marketing manager and publicity officer for the Matilda Bay Brewing Company.

Jafferries stayed with Matilda Bay for three years, and was credited with the successful launch of the company's Redback beer label nationally. She was on maternity leave when the company was taken over by Carlton and United Brewery. "At that point I decided it was going from a family company to a corporate culture, and I didn't want to be doing it with a baby under my arm." (Laurie, 2000).

May first met Jafferries when he was supplying coffee to Matilda Bay. In 1989, May and Jafferries joined forces and the two have taken May's small business from production of 187 kg to 2.5 tonnes of coffee a week.

5.1.2 Company Background

Dome Coffees Australia Pty. Ltd. was established in 1990 with the firm objective to import and roast only the finest coffees from around the world. Dome created a range of distinctive individually styled coffees based on the traditional craft skills of hand roasting and blending. The company quickly found there was a burgeoning demand for its product from consumers who were in search of fresher, more flavourful alternatives to pre-packaged commercial blends.

Dome's success grew from its reputation for providing an outstanding range of fine coffees presented in stylish, high-quality packaging. It became necessary to develop the means to showcase the product, which brought about the original Dome Café concept. The design concept was to create the ambience of an Old-World style European café to serve as a 'shop window' for Dome products, specialising in the sale of freshly roasted coffees supported by a range of quality gourmet foods. Close attention was paid to every detail of the café in an effort to create the most inviting

atmosphere possible, surrounding patrons with the warmth of polished wood and soft brass. One unique aspect of the original design is the distinctive hand-painted domed ceiling map of the world.

The name Dome was chosen because May and Jafferries wanted an international sounding name, with a hint of Middle Eastern, French or Italian heritage, which everyone could remember and pronounce. The first café was opened in the affluent Perth seaside suburb of Cottesloe in November 1990.

“When we built the first store in Cottesloe, we built it to be repeatable and in the back of our minds, we wanted to build a franchise, something world class, something you could bring to any part of the world.” May says.

May and Jafferries took nine months in the development of a franchise system for the organisation in 1993. The first franchise store was opened in Subiaco, a trendy Perth suburb close to the city, in September 1994. Over the next 12 months, three stores were opened very quickly in Galleria Shopping Centre, Fremantle and Applecross. Today, Dome has 24 mostly franchise outlets around Australia.

“We are involved in the lifestyle business,” said May in an interview with Choo (1995). “It is an expression of Western Australian café lifestyle where particular types of coffees and foods are appreciated and enjoyed in Western Australia, it is where people can wear their fashionable clothes, be seen and enjoy their coffees under the sun.” This corporate philosophy has been faithfully followed by each of Dome’s cafes around the world in creating a mood and atmosphere that will enhance the enjoyment of its products.

Internationally, Dome’s concept involves the “creation of a friendly, comfortable and casual ambience for the appreciation and enjoyment of stylish contemporary gourmet food, its own blend of freshly roasted quality espresso coffee prepared in the

traditional Italian way, and good wine, all at affordable prices.” Its array of fresh food and drinks will cater to the discerning taste buds of its sophisticated customers throughout the day from breakfast, morning tea, lunch, afternoon tea to dinner.

5.1.3 Dome’s Internationalisation

In October 1992, a Singaporean named Ronald Lee approached May and Jafferries to discuss setting up Dome Cafes in the Republic. “My first impression of Ronald was he was personal enough,” says May. “I thought it was an interesting proposition.”

May and Jafferries flew to Singapore and spent five days in “walking the street” to get a feel of the café industry. “We went everywhere in the city, visited every shopping centre, I thought Singapore was terrific and a very immature market for coffees, and there was really no direct competition.” There was no formal market research conducted to supplement this preliminary investigation.

May was very excited and delighted with what he saw in Singapore. Intuitively, he felt that there were tremendously opportunities for Dome to introduce its European café concept, specialising in the sale of freshly roasted coffees and quality gourmet foods, into Singapore. Today’s popular Italian coffee drinks such as espresso, café latte or machiatto were unheard of in Singapore then.

The idea of setting up the second Dome outlet in Singapore became a highly attractive proposition to May and Jafferries. The idea of expansion had had been seriously desired after the huge success of its first café in Cottesloe. However, Australia was in a significant recession that caused business borrowing to be prohibitively difficult and expensive. On the other hand, Singapore was enjoying an economic boom of six per cent Gross Domestic Product (GDP) growth in 1992 (Singapore Department of Statistics, 1993).

“Australia has got a very small market, a very mature market, and a depressed market. Why do we want to expand to the eastern states?” said May (Choo, 1995). “Conversely, we look north. Singapore is on the same time zone. Hence, it’s easier to do business with Singapore than Sydney. The second thing is there is a denser population in Singapore. The people are retail oriented, they have higher disposable income, and the whole place is jumping and booming. It’s the trade gateway to the whole of Southeast Asia.”

In December 1992, May, Jafferries and two Singaporean investors named Ronald Lee and his cousin Sebastian Ong formed a joint-venture in Singapore. Lee was a 42 year old Singaporean tax lawyer who moved to Perth with his family in 1989 (Lim and Tong, 1996). When Lee failed to get himself admitted to the Bar in Perth, he decided to try his hand in business. It was in Dome’s Cottesloe café that Lee and his wife Grace decided that Dome would be the channel to introduce café culture into Singapore. Ong, a 45 year old entrepreneur, had had more than 15 years of experience in the food and beverage business in Singapore (Eng, 1999; Kerk, 2000a). Prior to joining Dome, Ong had owned and sold a range of eateries including several coffeehouses and specialty restaurants, a chain of seven-outlet Korean barbeque restaurants, and two 8,000 square foot Chinese restaurants.

The company was called Dome Café (Cecil Court) Pte. Ltd. The initial start-up capital was S\$800,000, which was contributed equally by all the four partners. Both May and Jafferries had so much confidence in Dome’s prospect in Singapore that they borrowed \$200,000 each from Development Bank of Singapore (DBS) using their residential homes as collaterals. The company’s primary objective was to operate a couple of cafes in Singapore initially as a showcase for establishing a franchise operation in the region. Dome’s mission statement was to bring the finest coffee to

Asia, serve it in the most stylist surroundings and support it with fresh, epicurean food (Jarrett, 1993). This was the beginning of Dome's path to international expansion.

5.1.4 Singapore

In March 1993, the Australia-Singapore joint-venture spent S\$500,000 to set up its first café in the heart of Singapore's financial district Cecil Court. It is located in the main financial district, which is surrounded by major banks and financial institutions. May and Jafferries, together with several staff, spent a month in Singapore personally overseeing the setting up of the store. The inaugural café in Singapore resembles the Cottesloe outlet in every detail, from the design and interiors right down to the chairs.

Dome baked its own breads, cakes, pastries and biscuits on the premises but flew in all its fresh vegetables, salads, milk, sun-dried tomatoes frozen dough, oils, vinegars, olives, chocolates, sweetmeats, jams, chutneys and preserves, Australian wines and cheeses, and Fremantle sardines and anchovies from Perth. The coffees were flown into Singapore twice a week. Upon receiving the coffee beans, they would be frozen immediately to maintain their moisture. Then they would grind and brew the coffee beans as and when the customers ordered their drinks (Jarrett, 1993).

Encouraged by the phenomenal success of its first store in Singapore, the company decided to locate its next outlet on Orchard Road, the main shopping and entertainment area, in order to achieve high brand visibility. In August 1993, Dome found such a site in the atrium foyer of the Promenade Shopping Centre, which has a retail mix of upmarket designer wear, jewellery and accessories. After some dissatisfaction with the design of the Cecil Court cafe, the Promenade outlet was built in Perth, dismantled and then rebuilt there (Gould, 1993). The first two stores were company-owned and ran by Australian managers. Dome Holdings recruited six

Australians including three award-winning chefs and three operational managers to maintain the “high quality of its food,” said Lee (Lum, 1995).

The success of Dome’s first two stores led to many enquiries from those who recognised a winning concept and were interested in opening a similar operation. Consequently, the seeds of franchising were sown.

In 1994, when May and Jafferries had spent nine months in developing the franchise system for its Australian’s operation, they decided that the best way to effectively manage and control the venture in Singapore was by master franchising. This led to the formation of a company by Lee and Ong, the Singaporean partners, called Dome Holdings (S) Pte. Ltd., which became the master franchisee in Singapore. Then, May and Jafferries sold the first two outlets to Dome Holdings (Singapore) Pte. Ltd. At the end of the restructuring exercise, 1,500,000 ordinary shares of Dome Holdings of S\$1.00 each were held by Lee, Grace (Lee’s wife) held 500,000 shares and Ong held the remaining 2,000,000 shares (Chan, 1998).

At the same time, Dome Coffees and Dome Holdings formed a 50:50 joint-venture called Dome Asia Pte. Ltd. All intellectual property interests subsisting in the Dome image and system are owned by Dome Asia. The new joint-venture company has the authority to sell master franchise of the Dome system in seven countries including China, Indonesia, Japan, Malaysia, Singapore, Taiwan and Thailand. The start-up seed capital was S\$600,000. The term of franchise rights held by Dome Asia on its territories is perpetual.

5.1.4.1 The Beginning of Conflict

In mid 1994, Dome Holdings sold to a Singaporean individual the franchise rights to open Dome’s third outlet in Wheelock Place (formerly known as Lane Crawford Place). However, the deal did not eventuate because the individual withdrew his

interest at the last minute. Faced with this predicament, Lee and Ong suggested to May and Jafferries that they should instead own and run this outlet. However, May and Jafferries declined the offer due to financial difficulties. In the end, Lee and Ong then decided to own and operate the outlet by themselves as a separate entity. Consequently, they both refused to pay royalties to Dome Asia, arguing successfully that this new brassiere concept was totally different to Dome's and that this was going to be a 'one-off affair.' However, against the wishes of May and Jafferries, Lee and Ong promoted the S\$1 million café-cum-brassiere as part of Dome by branding it Olio Dome. May and Jafferries were not at all pleased.

According to Shaik Aziz, the regional general manager of Dome Coffees Australia Pty. Ltd., the action taken by Lee and Ong is not uncommon among franchisees in Asia. "The problem with franchisees in Asia is that at one stage in their business, they think they know better than the franchisors with their local knowledge. When they get bolder, they will likely to hijack the brand."

Eight months after the opening of Olio Dome, much to the surprise of May and Jafferries, Lee and Ong set up another Olio Dome at Picture House. At this time, the trust level between the Singaporean partners and May and Jafferries was at its lowest. "What the Singaporeans were trying to do was to hijack our intellectual property, that was their plan or end game," says May. "We were very naive because we trusted them."

5.1.4.2 Localised Central Supply

In 1995, Dome Holdings decided to set up a \$2 million central factory and kitchen, and coffee roasting facility in Singapore that would supply roast coffee beans, cakes, pastries, breads and ice cream to all its Dome and Olio restaurants. Also in the pipeline were plans to establish a wholesale distribution company that would make

Dome's fresh roasted coffee blends available to restaurant and cafes all over Asia. In order to finance the purchase of the S\$2 million factory, Lee and Ong had to seek for an additional injection of capital. Subsequently on May 15 1996, about a year after the restructuring exercise, Dome Holdings admitted another shareholder with the issue of 2,000,000 shares of S\$1.00 each at the price of S\$1.30 per share to Samuel Wang. In the same month, Ong sold 1,000,000 shares to Ho Nai Yin also at the price of S\$1.30 per share.

The person recruited for setting up the central factory was a highly experienced, entrepreneurial and skilful manager in the Singaporean food industry named Shaik Aziz. He became both General manager of Dome Holdings and Dome Asia. The new central kitchen operation was called Dome Food Industries Pte. Ltd.

Aziz's close involvement with the Singaporean food industry started when he was the Operations Director of a catering company called Chrisvic Pte. Ltd. in 1980. "We were the leading caterer at that time as we were supplying to all the army camps, civil defence force, boys homes and 64 7-11 stores. We had two factories at Pandan Loop and hired 200 odd staff," says Aziz. However, the business was terminated in 1985 because of the loss of a major contract to the largest food supplier in Singapore called Singapore Food Industries Pte. Ltd, a government-linked company (GLC).

Subsequently, Aziz started the Halal Food catering company called Rasa Cinta Food Systems Pte. Ltd. and sold it after four years. Soon after, he became the General manager in a small food manufacturing and retailing company (with three outlets) called Café Al Fresco. The major shareholders were an Australian couple from Adelaide who had lived in Singapore for many years. "I decided to join Café Al Fresco as I said to myself to forget about local food," says Aziz. "I could see the cafés developing and western foods developing as well."

Upon joining Café Al Fresco, Aziz helped turn the company around and set up the central kitchen to manufacture European bakery products and gelato (an Italian water-based ice cream) and distribute to hotels, restaurants and cafes. Dome was one of the many customers Café Al Fresco supplied its products to. One and a half years later, Aziz helped to sell the business to a Hong Kong company called Grande Group as the Australian owners wanted to sell off the business and return to Adelaide. Following which Aziz joined Dome Holdings. He also took his German Chef De Patisserie Karl Gunter Ableitner from Café Al Fresco with him to Dome.

Aziz held two positions simultaneously – General manager of Dome Asia and General manager of Dome Holdings. He faced great difficulties at times to performing both roles satisfactorily because of the existence of a conflict of interest. “I had to maintain the integrity of the concept as GM of Dome Asia and at the same time as GM of Dome Holdings, I had to listen to my two Singaporean bosses.”

The roles of Dome Food Industries Pte. Ltd. are to (1) act as a head office, (2) centralise some of the food sourcing and preparation previously done separately in each outlet, (3) roast and distribute coffee within the region, and (4) provide a venue for administration and staff training. The overriding objectives are to reduce cost and labour and maintain consistent quality of its products.

Dome Food Industries also supplies a wide range of food products, which include cakes, pastries, specialty breads, savoury pies, soups, stews, salad dressings, roast meats, gelati, sherbets and semi-frozen deserts and cakes, to hotels and restaurants in Singapore. However, some of Dome’s signature products such as its focaccia bread are however supplied exclusively to Olio and Dome. Over the years, the menu has been transformed, with the assistance of chefs from Dome in Australia, to create a range of distinctive dishes that is a fusion of East meets West dishes with an Asian

orientation such as Afghan lamb curry and Thai-style roast chicken with sweet potatoes. Although 30 per cent of the menu has been allowed on foods to adapt to suit local taste, coffee remains a 'sacred cow' that is precluded from being altered. The coffee is being roasted by Dome Asia, which leases to Dome Food Industries for a space to roast coffee within its premises.

"The 12,000 square feet central kitchen has enable our customers to get a variety of pizzas, gourmet pies and pasta at all our Dome cafes in Singapore," says Aziz. "We'll do as much as we can from the factory. Unlike brassiere, you can't get everything in a café like catch of the day or steak of the day."

5.1.4.3 Withdrawal of Support

In August 1995, Dome occupied 2,500 square feet on the ground floor of Park Mall Home Furnishings Centre, which was also modelled after the café in Cottesloe. Two months later, Dome opened a 5,000 square feet café in the Singapore Arts Museum. The rapid expansion had led to reported complaints about poor service at Dome's. Lee admitted in an interview with (Kerk, 1995) that the labour shortage, which was a problem facing the whole service industry, had led to Dome's difficulty in retaining good staff.

"The first generation of workers were trained to give a high standard of service, to smile and know their product," Lee explained. "We also had Australian managers kneeling down to take orders, as practiced in Perth and Europe. But when staff leave, we have to tap them from a transitional workforce made up of students who do their work without any pride. To them, it's just a holiday job."

During this period, Dome Asia sold a master franchise in Malaysia to a high profile successful Malaysian businesswoman named Farah Khan. On 5th September 1996, May was at the opening of the first Dome outlet in one of Kuala Lumpur's prestigious

shopping mall Starhill. Unbeknown to May, Dome Holdings had sold two master franchise agreements to Khan; one for Dome at S\$175,000 and the other Olio Dome for \$75,000. May discovered this clandestine deal by accident when Khan requested him to look into certain clauses in Olio Dome's contract during the opening day.

“Our Singaporean partners took Dome's agreement and changed a few words, substituting Dome with Olio Dome,” says May. “It is an infringement of copy rights and they stole the intellectual property from us; their own partners.” May was extremely furious and decided that the partnership relationship was over. All the support staff from Australia were subsequently repatriated. Dome Holdings reciprocated by making no royalty payments to Dome Asia. When May found that Dome Holdings did not own the trademark rights to Olio Dome in Singapore and Malaysia, he made the applications and was successful.

The sales in Singapore suffered markedly following the withdrawal of support by Dome in Australia. A new outlet was opened in Orchard Point in February 1996. In March 1996, Lee and Ong visited May and Jafferries in Perth to apologise for their actions and attempt to repair the already strained working relationship between them. A month later, May returned to Singapore to rebuild the business by restoring the quality and taste of its coffee and food products. To achieve this, May had to spend a lot of time in Singapore and would often stay for a month per trip.

In June 1996, Lee was introduced to Robert Wang, the Managing Director and shareholder of Suntec Investment Pte. Ltd to explore the possibility of a joint-venture (Chan, 1998). The joint-venture was eventually formed.

Suntec Investment was already involved in the food and leisure industry through its subsidiary, Suntec Food and Leisure Pte. Ltd. As many of the outlets operated by

Suntec Food and Leisure were not operating successfully, it was hoped that they could be turned into successful operations under the management of Dome Holdings.

Suntec Investment was involved in a joint-venture with the Shaw Brothers Organisation of Hong Kong and there were plans to spend S\$50 million to develop 250,000 square feet on the third floor of Suntec City into a food, leisure and entertainment sport named Suntec Walk. If Dome Holdings came under the umbrella of Suntec Investment, there would be opportunities, advantages and privileges for Dome Holdings' expansion within Suntec City itself.

Suntec City had the financial resources and capabilities to back Dome Holdings' growth and expansion towards a listing on the Stock Exchange of Singapore within a few years.

On 25 July 1996, Lee, Ong and Wang entered into a written agreement with Suntec Food and Leisure and Dome Holdings whereby the former agreed to purchase 2,326,000 shares from the existing shareholders and subscribe for the 1,500,000 shares to be allotted to them at S\$1.30 per share, which totalled S\$4.97 million (Chan, 1998). This effectively led to Suntec Food and Leisure owning 51 per cent of the new joint-venture entity called Suntec Dome Holdings (S) Pte. :Ltd.

However on 14 April 1997, Wang sold all his 1,337,500 shares in Suntec Dome to Suntec Food and Leisure. Consequently, Suntec Food and Leisure's shareholding increased to 68 per cent. The staff of both companies merged under Suntec Dome, which managed the food and beverage outlets owned by Suntec Food and Leisure.

Suntec Investment is an investment vehicle for a group of 20 Hong Kong high profile business tycoons including Li Ka Shing, Frank Tsao and Run Run Shaw (Lam, 1996a). Currently, the company has three main active businesses in Singapore (Rashiwala, 1999):

- 51 per cent stake in property consultancy Chesterton International.
- 68 per cent share in Suntec Dome Holdings.
- 100 per cent stake in Suntec Food and Leisure, which runs the Fountain Food Terrace, a food court in the basement of Suntec City.

May was not at all pleased as Lee and Ong had breached the “First right of refusal” clause in the Shareholder’s Agreement of Dome Asia. The clause indicates that Dome Holdings may not sell any of its shares without the prior consent of May and Jafferries. The 51 per cent acquisition of Dome Holdings by Suntec Food and Leisure also made the latter an equal partner in Dome Asia as well. Therefore a meeting was held between May, Jafferries and key executives of the newly formed entity Suntec Dome in Singapore to discuss the matter. The meeting ended acrimoniously resulting in the withdrawal of support by the Australian franchisor to its master franchisee in Singapore for the second time.

“Suntec told us that they have bought two brands – Dome and Olio Dome. Olio Dome has got nothing to do with us. Ronald has invented the concept,” says May. “I say, ‘What about Dome’s agreement’ and they say, ‘Well, sue us then, take us to court.’ I say, ‘I am not going to take you to court but I am going to make sure your business suffers,’ then I said to Patria. ‘Let’s go.’ Patria said, ‘Let’s go to court’ but I say, ‘No, because Suntec is going to drag its feet and lots of time and money would have been wasted.’ ”

Suntec Investments made Lee the Managing Director of Suntec Dome Holdings. Although the franchisor had terminated its support to its master franchisee in Singapore, they continued to hold its obligation to supporting Farah Khan in Malaysia.

5.1.4.4 The Restoration of Faith

Following the acquisition, Suntec Dome Holdings immediately converted Suntec Investment's loss-making café called Suntec Terrace Café at Suntec City into the third Olio Dome.

In April 1997, Dome ventured out of the city to a growing Singaporean suburb called Bishan. The eighth outlet was located within the Bishan Community Club. The Café was close to Junction 8, which is among the first wave of suburban malls in Singapore (Wong, 1997). It serves a catchment of 700,000 people within a 4 kilometre radius and it is only 15 minutes away from the central business district.

“It took a while for our Bishan café to develop but it is now one of our best cash generating outlets,” says Ms Eng Foong Ho, director of Suntec Dome. “There are several advantages of operating from the suburbs. There are a large pool of part-times to draw upon, it is easy to get staff, people see it as their neighbourhood store and they like it and we are also able to target to other customers whom hitherto were frightened to try the outlet and will try us because they see it everyday.”

Since Lee assumed managing director of Suntec Dome in June 1996, sales in Singapore were experiencing a gradual decline. The reasons include the following:

Lee did not devote adequate time and energy in managing Dome effectively as he was spending two weeks in Singapore and two weeks in Perth.

The quality of coffee suffered as a result of a lack of support from the franchisor. Since the eventful meeting, May had stopped roasting coffee for Singapore. Instead, the people were using inferior coffee beans that were roasted by an inexperienced roaster.

Aziz resigned on March 25 1997 because he was unable to work with Lee. “I couldn’t get along with Ronald. He loves to interfere with the decisions I made and the hiring of staff.”

Ong, who had the experience and expertise in operating chain restaurants, sold his shares to Suntec Investments in 1998. Ong was also unable to work with Lee. Lee, who had none of the operation skills, was left to manage the business on his own.

When Aziz resigned in 1997, he was asked by May to become the regional general manager of Dome Coffees Australia Pty. Ltd. Aziz’s principal responsibility in this role is to expand Dome’s franchise concept into markets that fall outside Dome Asia’s territory. During the same year, Dome entered into The Philippines and the United Arab Emirates. This has caught the attention of Suntec Investments who increasingly was getting frustrated with Lee’s inability to expand Dome’s franchise concept into its territory of China, Japan, Taiwan and Thailand.

After 18 months of galloping losses and widespread dissatisfaction amongst Lee’s first line managers, Suntec Investments eventually sacked Lee in November 1997. Subsequently, Lee and his wife Grace took legal action against Suntec Investments for running the business in a manner oppressive to minority shareholders (*Founders of Dome Sue Two Companies*, 1998). As a result, the Lees wanted the defendants to buy out their 17.33 per cent stake, estimated to be worth S\$1 million. In February 1999, the Court of Appeal maintained the High Court decision in July 1998, which had ruled that their interests were not oppressed by majority shareholders Suntec Investment and its subsidiary Suntec Food and Leisure (*Dome Cafe Couple Lose Appeal Over Stake Buy-Out*, 1999).

In June 1998, Miss Eng Foong Ho (then joint managing director) of Suntec Investments had a meeting with May to discuss addressing the decline of sales in

Singapore. “Eng has woken up that Ronald Lee was not the genius he claimed to be,” says May. “I told them I could fix the problem within three months and Shaik Aziz was to be back at work at Dome.”

Since Lee’s removal from office, the relationship between Suntec Investment and Dome Coffees has been restored and strengthened. “Phil is a very adaptable man and he understands he has to give some freedom to the master franchisee of the country,” says Eng. “Phil is very happy and generous to share his experience with me, even for Olio Dome which is not his, and it is good.”

From July to August 1998, May set out to woo Dome’s previous customers back into its outlets. The first thing that May did was to restore the quality of its coffee. Every three to four weeks, he would return to Singapore to provide training to the staff. Soon after, Olio Dome Picturehouse was closed down as it was generating losses of some S\$70,000 per month, which was in excess of the profits that could be made by other locations.

The second thing May did was to get Suntec Investments to have Aziz returned to Dome in Singapore as general manager of Dome Asia. Therefore, his primary role is to expand Dome’s franchise concept within its territory. “I am a franchisor now. Therefore, I have become a custodian of Dome concepts and ideals, which causes no conflict of interest,” says Aziz. “I can audit all the outlets and say what is wrong.”

In his new job, Aziz is also responsible for bringing the benefits of past mistakes to current and future franchisees. This enables the franchisees to shorten their learning curve as their hands are being held during the early years of the franchising relationship.

In 1999, Dome closed down another of its outlet in Orchard Point. Soon after, it opened two outlets, one in UOB Plaza (situated in the heart of the financial and

banking district) and the other within the Singapore National Library city branch at Takashimaya Shopping Centre. Dome has also closed down its first outlet in Cecil Court in March 2000 due to poor sales performance.

5.1.4.5 Competition

There have always been the traditional ‘kopi tiam’ or the local coffee shops in the suburban neighbourhoods, which serve a thick brew made up margarine, corn, sugar and cereal and a dollop of sweetened condensed milk. Western-style coffee houses did not become popular until the first Coffee Club outlet opened in Holland Village in 1991. Hiang Kie, a Singapore-based coffee trading company established in 1936, set up the chain to offer a broad selection of special brews in modern, comfortable settings and attracted a loyal following from students to Yuppies.

Today, more than 100 cafes have followed suit, with the likes of Spinelli Coffee Company, Coffee Club, Dome, Starbucks. and Coffee Bean and Tea Leaf all competing for a piece of the estimated S\$50 million growing market (Teo, 1997). Table 3 shows some characteristics of the major specialty cafes in Singapore in December 2000.

The competition faced by Dome in Singapore has intensified significantly over the past seven years. This is evidenced by the aggressive expansion plans undertaken by Coffee Bean and Tea Leaf and Starbucks, which started their operations three years after Dome. In order to remain competitive, Dome believes it must never stray in constantly improving and maintaining its four fundamentals namely (1) ambience, (2) coffee, (3) food, and (4) full table service.

While café operators acknowledge that competition in the specialty coffee market is intense, they are also aggressively expanding to ensure they are the ones left standing when the worst of the battle is over (Kerk, 2000b). Physical growth also helps push

up overall sales. According to Ee (1996), unlike speciality restaurants, coffee is not something people seek out. Customers are not going to walk an extra block to a particular café, if there's one just next door. Product plays a part, but location and convenience are just as important.

While major players are expanding aggressively, Dome's growth has been unspectacular even though it was a pioneer in specialty coffee retailing. "Every outlet must make money and that is why we have not grown so rapidly like Coffee Bean and Tea Leaf," says Eng. "I think Dome is more complex than our competitors, say Coffee Bean and Tea Leaf. They are more prepared to pay more for site but as for us, we are more conservative."

In Singapore, one thing that most café operators acknowledged is that it is nearly impossible to survive just by selling coffee alone (Ee, 1999). Several local cafes such as Coffee Club and Coffee Connection, which started out with an emphasis on coffee, have been forced to include hot food on the menu. High rentals and Singaporeans' penchant for quality food to accompany their coffee are the main reasons as coffee sales alone are not sufficient to pay the bills. Spinelli, which has hitherto been reluctant to introduce food items for the fear of losing its identity, is reported to be expanding its bakery range to include savoury items and salads (Kerk, 2000).

According to Aziz, Dome positions itself at the top end of the gourmet coffee industry. It targets the market segment known as the PMEB (Professionals, Managers, Executives, and Businessmen) in Singapore. They are well educated, well travelled and wealthy who prefer a variety of foods when they meet at the outlet. Although they are willing to pay for quality, they also demand products that are value-for-money. Dome's major competitors such as Coffee Bean and Tea Leaf and Starbucks tend to attract the teenagers who are relatively more price-sensitive.

“Dome’s positioning is expensive and exclusive,” says Aziz. “We may lose some customers to our competitors but they will come back as they associate us with the good things in life. It is a place to see and be seen. They also see us as a treat and thanks to the hype created by the media and the café culture sweeping across Asia, we have a strong market positioning in Singapore.”

5.1.5 Malaysia

In 1995, a high profile successful Malaysian businesswoman Farah Tahira Khan approached May for the master franchise in Malaysia. Both she and her husband Akbar Khan were very well connected to the Malay elite and were said to be a close acquaintance with Finance Minister Daim Zainuddin and Prime Minister Mahathir Mohammed (Pillai, 1999). Khan became aware of Dome during her extensive business trips to Perth and Singapore.

Khan is currently president of a company called Melium Sdn. Bhd., which is in retailing, distribution and licensing of high-end fashion labels and accessories. The leading labels include Ermenegildo Zegna, Etienne Aigner, Hugo Boss, Liz Clairborne and Oshkosh B’Gosh. Melium is 51 per cent owned by Insas Berhad, which is a publicly listed diversified company with interests in property development, credit leasing, management services, construction, healthcare, stockbroking, and hotels.

5.1.5.1 Franchisor Support

In June 1996, Dome Asia entered into a 30-year master franchise agreement with Melium for Malaysia with a franchise fee of S\$175,000 (non-refundable) and royalty of 3.0 per cent of gross sales to be remitted monthly. In addition, Melium would be expected to commit 2.0 per cent of its annual gross sales on advertising and promotion. As part of the franchise agreement, Khan was given the four trademarked

operating manuals developed by Dome. They included (1) operations and procedures manual, (2) coffee and beverages project range manual, (3) kitchen product manual and (4) counter product range manual.

Dome regarded Khan to have the necessary prerequisites of becoming a master franchisee of Dome. “First, they must have the money, the second thing they need to have is the corporate structure,” said May (Choo, 1995). “Our master franchisee in Malaysia is a woman who already has got a substantial fashion empire. As she has got a corporate infrastructure in-placed, she has no major problems in engaging our expertise in the new division she has created.”

Following the negotiation of the franchise agreement, Aziz and his deputy general manager went to Kuala Lumpur twice for a week each to prepare the groundwork. According to May, there are “not many modifications being made in our international franchise agreement compared to our domestic one.” Aziz and his deputy general manager undertook the following market research in the areas of market opportunity, supplier network, transportation costs and corporate taxation.

Aziz also assisted in the recruitment of Dome Malaysia’s inaugural team of 12 key staff. They included one operations manager, four supervisors, one kitchen chef, four cooks, and two cashiers. The operations manager was sent to Singapore to be interviewed by Lee, Ong and Aziz. In the franchise agreement, Dome Asia must approve the hiring of the first Operations manager of all its master franchises. As it was impossible to recruit any individual who had had experience working in a chained western café operation, they finally selected an ex-TGIF (an American themed bar-restaurant) Manager named Kumar Manisekaran. Subsequently, he worked at Dome for seven years and rose to become the general manager. The current general manager is Rajendar Singh, who has had 15 years of experience

working at various fast food restaurants such as Delifrance, Pizza Hut, Shakeys and KFC.

The inaugural team of 12 staff was sent to Singapore for a month to be trained. All the relating expenses were borne by Melium. The training included a combination of the following:

- Company Orientation.
 - The team was provided with information on the franchisor's background, philosophy, culture and values.
- On-the-job training.
 - Job rotation was practiced to enable the team to acquire a broad understanding of Dome's business. Every individual was attached to a staff in Singapore whose responsibility was to ensure that the trainee fully understood the process.
- Competitor's analysis.
 - Aziz took the team to Dome's major competitors to try out the food and coffee to enhance product knowledge.

While the inaugural team was being trained in Singapore, the outlet at Starhill was being built. The outlet took eight weeks to build. The services of a local designer, provided by Melium, were obtained to configure one of Dome's design formats. Dome has three design formats ranging from a brassiere that offers a full menu with every meal prepared to order to a café that provides a limited menu in the evenings and a range of breakfast options to a kiosk that serves drinks with cakes and biscuits only. May and several key staff from Dome Perth visited Malaysia to conduct

training on coffee brewing for four months leading to the opening of the first outlet at Starhill.

In September 1996, Paul Roberts, food operations manager of Dome Australia was sent to Dome Starhill to undertake the following task:

- Developed the formats for the financial reporting system.
- Installed the computer software for the recipe management system.
- Developed with managers a new Starhill menu.
- Assessed training needs and make recommendations.
- Visited local suppliers and bakers to improve quality of products.
- Conducted an operational assessment of the café.

“I can open a café in three months,” says Aziz. “I’m called to visit the site, help negotiation. We work with key staffs, especially the café managers. If they are previously from hotels, we tell them to forget about that because they are big. Hotels are departmentalised; when you have a human resource problem, you would refer it to the human resource department. However, as a café manager, you’re everything – human resource manager, operations manager and finance manager as well.”

According to Aziz, one of the key attractions for master franchisees investing in Dome is the easy accessibility to a representative who has an intimate knowledge of the Asian culture. This is an important lesson for foreign franchisors when dealing with master franchisees in Asia. Due to cultural differences, the foreign franchisor is often regarded by the master franchisees never to fully understand the intricacies of the Asian culture. Therefore, most franchisor’s ideas, policies and suggestions are viewed as questionable in their application to the local market environment.

“After Phil and Patria have said their piece in a meeting, the master franchisees will never disagree for the fear of creating conflict or lose face. But they will meet me after and asked me whether they should do it. I have to Asianised the concept and put it in the Singaporean or Malaysian context. I think they looked at me for my opinion because I’m Asian, I’ve been in the food business and maybe I can see things these Westerners cannot see,” says Aziz.

May regards Aziz as critical in the management of the franchisor-franchisee relationship. Aziz acts as a conduit between the franchisor and master franchisees.

5.1.5.2 Cost Reduction

The first Malaysian Dome outlet at Starhill was officially opened on 5th September 1996. The response was overwhelming, as it became a trendy regular handout for the high society of Malaysia. According to Jafferries in her interview with Laurie (2000) in The Australian Magazine, Malaysia’s Prime Minister Mahathir Mohammed is regularly spotted on weekends drinking coffee with his grandchildren and daughter, whose best friend is Dome’s master franchisee in Malaysia.

Although the first outlet was an overwhelming success, it failed to achieve its profitability. The reasons were two fold. Firstly, the capital outlay was excessive, as the store had no infrastructure to support cooking on the premises. Therefore, additional expenses had to be incurred to reconfigure the space from retail to food and beverage. Secondly, it had the burden of carrying the entire cost of training, labour, and marketing. There were no opportunities to share the cost with other stores.

To improve the profitability of the franchise operation in Malaysia, Dome Asia implemented a two-pronged cost reduction strategy. The first was to open additional outlets (at least two more) quickly within the first 18 months to enjoy the benefits of economies of scale. The other was to develop a network of local supplier.

Soon after the Starhill store was opened, Aziz resigned from Suntec Dome on June 14 1996 as he had problems working with Lee. However, Aziz continued to be intimately involved with the Malaysian operation as a consultant hired by Melium. Over the next 18 months, Aziz assisted Melium in opening an additional four outlets. The return-on-investment (ROI) of Dome for Melium improved significantly with the ownership of four outlets. After four years, Dome Malaysia has grown to a total of nine cafes of which seven are in Kuala Lumpur, one in Johor Bahru and the most recent in Penang.

All of the food ingredients (e.g. breads, sundried tomatoes, grilled eggplant, fruit chutney, etc.) were not available in Malaysia during its early years. Therefore, the input cost was prohibitively high, as they had to be airfreighted in chilled containers from Singapore. From 1999 onwards, Dome Malaysia has become totally self-reliant as it is buying all of the ingredients from a network of local suppliers with the exception of coffee.

In December 2000, Dome Malaysia has set up a central kitchen. This is to enable the operation to be self-sufficient in food processing and not rely heavily on the supplier. “If you depend too much on your suppliers, they will increase the prices,” says Aziz. “You can’t discipline them with your service level. I’ve asked the franchisees to have more than one supplier for a food item to avoid being too dependent so that you can play one against the other.” An office will be available for staff training in the central kitchen in April 2001.

5.1.5.3 Control and Monitoring

After the initial training, Dome Asia conducted regular audits to monitor the progress and performance of the franchise operation in Malaysia. The audits were conducted

quarterly during the first year, bi-annually during the second year and annually for subsequent years. Each café outlet is being audited comprehensively

“I don’t audit them ostentatiously but informally over a cup of coffee,” says Aziz. “The objective is to do it with adding value in mind so that they will be open with you. After the audit, I produce a detailed report for the Operations Manager. I put it in a report with time frame and a checklist. I also c.c. a copy to the CEO of Melium Richard Curtis.”

The auditor would assess each outlet on 132 individual items on a rating scale of 1 to 3; where 1 is not meeting the standard, 2 is average and 3 is exceptional (See Table 8). Each café would be scored out of 1,000 points. The operational rating of the master franchisee’s café management is shown below.

65-75%	The café falls well below the acceptable standards, and indicates there are problems in the management of café operations. The operations manuals are not being adhered to.
76-85%	This café does not achieve an acceptable level of standards and requires attention.
85-95%	The café meets operational standards.
95-100%	The café exceeds operational standards minimum requirements.

Aziz monitors the café operation very closely by keeping a close watch on the current product and new product innovations. This is critical to maintain the integrity of Dome’s concept as foreign master franchisees are often tempted to introduce local fare to satisfy its customers.

TABLE 5:2
Operational Categories for Auditing Dome Cafes

CATEGORY	ITEM
<ul style="list-style-type: none"> • Staff & management personal presentation 	<ul style="list-style-type: none"> • Wearing the same style of Dome uniform • Aprons, name badges, head wear • Laundering & maintaining presentable uniform • Employees' appearance–Hair, cleanliness, personal habits, posture & personal jewelry.
<ul style="list-style-type: none"> • Dome ambience & design 	<ul style="list-style-type: none"> • Equipment, fixtures, fittings and signs • Finishes, trademarks, logos and lettering • Reading material, table layout, counter flower display, lights, Promotional pamphlets, music, ceiling fans, stationary and packaging, menus • Dry & live flower displays • External flower planters • Non-smoking areas
<ul style="list-style-type: none"> • Local advertising & promotions & signage 	<ul style="list-style-type: none"> • Artwork of advertisements and signs • Reproduction of trademarks and logos
<ul style="list-style-type: none"> • Product range displays 	<ul style="list-style-type: none"> • Food display stock, visual appeal • Cake display stock, visual appeal, portion control • Cake and biscuit counter displays • Bread, pastry & condiment displays • Merchandise displays and ticketing
<ul style="list-style-type: none"> • Customer service 	<ul style="list-style-type: none"> • Delivery of food orders (within 10 minutes) • Time of order notations • Initials on order notations • Accuracy of food orders • Length of time to acknowledge a customer, length of time the customer spends in the queue, handling queue delays greater than 5 minutes, queue service • Clearing tables, customer survey cards, answering the telephone • Customer relations
<ul style="list-style-type: none"> • Health & hygiene – storage of handling of products 	<ul style="list-style-type: none"> • Handling food – Hair cover, gloves • Dating stock, stock management – First in First out • Storage of equipment or supplies – Location • Storage of prepared foods & cut ingredients • Storage temperatures–display & under bench fridges, coolroom and freezer

TABLE 8 (Continued)

<ul style="list-style-type: none"> • Handling & hygiene – during operational hours 	<ul style="list-style-type: none"> • F & B spills in the kitchen & counter, on the café floor, on café tables & chairs • Storage of equipment – safety • Espresso machine, stainless steel milk jugs, serving trays • Merchandise displays • Toilets, car park , bin area
<ul style="list-style-type: none"> • Handling & hygiene – building, fixtures, fittings & equipment 	<ul style="list-style-type: none"> • Kitchen and counter floors, benches, shelving & wall tiles • Kitchen & café painted walls & ceiling, café & alfresco floor • Exhaust canopies & filters, ceiling exhaust filters – kitchen & toilets • Air conditioning vents, coolroom & freezer, display & under bench fridges • Oven & prover, gas burner, dishwasher, microwave, slicer, slam toaster, upright toaster, juicer, mixer, ice machine & filter, coffee hoppers
<ul style="list-style-type: none"> • Equipment maintenance – Espresso machine & grinders 	<ul style="list-style-type: none"> • Water supply pressure, group head water pressure, boiler pressure • Infusers & filter cups, group heads, steam wand • Water softener, water filters, boiler water • Deli & espresso grinder blades, espresso grinder dosing mechanism, deli grinder, coffee making utensil, grinder hoppers
<ul style="list-style-type: none"> • Coffee preparation & presentation 	<ul style="list-style-type: none"> • Frothing milk, infusing coffee • Freshness & coarseness of grind • Coffee crockery • Visual presentation & preparation of coffee • Coffees spilled in saucers, the espresso dose
<ul style="list-style-type: none"> • Food & beverage preparation & presentation 	<ul style="list-style-type: none"> • Visual presentation
<ul style="list-style-type: none"> • Authorised product range, suppliers & pricing 	<ul style="list-style-type: none"> • Freshness & quality of product & ingredients • Products being offered for sale • Products preparation & presentation • Purchase from suppliers, pricing
<ul style="list-style-type: none"> • Safety 	<ul style="list-style-type: none"> • Floors, broken glass, knives, handling baking trays, electrical equipment, • First aid kit, fire extinguisher, fire & emergency procedures
<ul style="list-style-type: none"> • Operational management 	<ul style="list-style-type: none"> • Operations manual & product range manuals • Opening hours & days of the café • Operations diary

“If the franchisee says he wants *rendang* (a popular Malaysian spicy coconut dish) on his menu, I would say no because customers are going to compare it with the local *rendang* which will be cheaper and better, says Aziz. “Customers don’t come to Dome to eat completely local food. However, we can domestify it. We’ll give it a Dome appearance. It must be colourful, sexy. The chef must jazz it up to give it a fusion theme. We must maintain our European presence.”

Dome believes that control and monitoring of foreign franchisees must be done in a manner that the franchisor is regarded by its franchisees as an asset. The franchisor must continuously provide value to the master franchisees so as to avoid being regarded as superfluous. The key to be perceived as an asset by the franchisees is the degree of knowledge, experience and expertise the franchisor can constantly bring to the relationship. The keyword to a successful long-term franchisor-franchisee relationship is interdependence.

The relationship between the franchisor and franchisees must not only be limited to top management but extended to the middle managers as well. Aziz ensures that he is known by all the key operational staffs in all the markets. Therefore he receives a telephone call from an outlet manager or a cook, and not only from the General manager, when a problem arises.

The franchisors must also exercise caution in its control of franchisees so that their imagination and creativity are not curtailed so as not to add value to the brand. This is highly essential for concepts that emanate outside of Asia, where some degree of adaptation will be required to suit the local tastes. Therefore, the franchisor must establish parameters and communicate clearly to the franchisees what the do’s and don’ts of the company are.

“Dome has very clear do’s in our branding, image, taste of coffee and marketing principles,” says Aziz. “However, we are quite flexible in our food offerings. That is not to say we give the master franchisees complete autonomy. If they asked me about doing something new or different, instead of saying no we asked them why they want to do that. If we allow one franchisee to have a new product, what will be the repercussions in another market? Dome will be different in different countries.”

Although Dome ensures that its set of policies and standards is adhered to by its master franchisees, it is also aware that it must be constantly reviewed to determine its relevance. “No matter how good your concept is, it must evolve in this dynamic, competition environment. Or else, you won’t survive the competition,” says Aziz.

5.1.5.4 Future Growth

Dome Malaysia has grown very quickly to nine cafes since it started four years ago in 1996. It has also expanded beyond Malaysia’s capital Kuala Lumpur to less populous states of Penang and Johor Bahru. Dome regards Malaysia as a highly attractive market that offers tremendous potential for growth. Both Dome and Melium plan to open an additional five cafe within the next 18 months. “I’ll talk to Melium C.E.O. on my next visit about expanding Dome into cities in East Malaysia such as Kuching and Kota Kinabaru,” says Aziz.

Dome has had much success with its recent concept of creating small elegant coffee bars/kiosks in high traffic shopping malls and commercial areas in Malaysia. Such kiosks are deliberately designed to have a small seating capacity of about 30 seats to focus on take away. A boutique coffee store is also incorporated for sale of coffee beans and related merchandise. Dome will be experimenting with sub-franchising when it expands beyond Kuala Lumpur in Malaysia. Melium will enter into a franchise agreement with individual franchisees on a 51:49 joint-venture. This equity

position allows Melium, the majority shareholder, the ability to exercise considerable control over the franchisees and achieve profitability by harnessing the entrepreneurial spirit of the owner-managers.

“Based on our previous experience for far away countries, it’s better to manage with an entrepreneurial manager in-charge with vested interest in the business for control and monitoring. It’s easier to achieve profitability over long distances,” says Aziz.

5.1.6 The Philippines

In 1997, Dome Coffees was having talks with two well-connected Filipinos Patricia and Leo Riigen about franchising in The Philippines. The Riigens had heard of Dome through Ashok Melwani who then was a minority shareholder of Dome franchise in Malaysia. Patricia is a Vice President of Asia Development Bank and Leo is the master franchisee of a computer training Singapore-based franchise called Informatics in The Philippines.

Patricia and Leo visited the Dome cafes in Singapore and liked what they saw. Consequently, the Riigens formed a company called ‘Dome Coffees of The Philippines’ that owns the master franchise rights to The Philippines for 30 years for A\$175,000. The Riigens currently own 75 per cent of the company and Melwani holds the remaining shares.

Dome Coffees granted the rights to the Riigens because firstly they had access to funds of A\$1 million. Secondly, they were passionate about coffee. Thirdly, they were politically well-connected with the Estrada and Ramos families and fourthly, Patricia promised to resign from the bank and concentrate on running the Dome franchise full-time. However, Patricia has reneged on her promise and continued to

work full-time at the bank, much to the disappointment of Dome Coffees. “It has left a sour taste in our mouths,” says Aziz.

Since Dome’s entry into the Philippines, it currently has three outlets in Manila. They are located in three of Manila’s busiest shopping malls, which are Adriatico Square, Greenbelt and Shangri-La Plaza. Although the Riigens have achieved their performance schedule of three outlets within 18 months, the growth plans for the Philippines have been halted due to a combination of political instability and complacency.

“When you have three outlets, you get very comfortable as you start to gain the benefits of cost sharing and economies of scale. Also, Pat can go around and check all the three outlets pretty comfortably,” says Aziz. “What we need are champions in the business. We have got people who would champion our brand in all the other markets but I can’t say that for the Philippines. Patricia is so busy with her full-time job at the bank and her three children. Also, we have had so many changes of the operations.”

According to Aziz, the Filipino café and restaurant industry is characterised by consumers exhibiting a “sheep mentality” who are early adopters of innovation and have very little brand loyalty. The Filipinos are very Americanised and highly likely to adopt any foreign concept. Therefore, Dome has to grow its brand rapidly so that it continues to remain competitive in the increasingly crowded marketplace.

5.1.7 Indonesia

Although Indonesia is the fourth most populous country in the world, the franchising industry did not begin to take off until McDonald’s started its first restaurant in 1991 (Hsieh and Sutanto, 1997). Foreign franchisors, including Dome, tended to avoid Indonesia over the past 10 years because of (1) lack of familiarity with the

marketplace due to a lack of publicity, (2) a lack of intellectual property protection, (3) the economic turmoil that commenced in July 1997 as the rupiah began to depreciate and (4) the political instability after the downfall of President Suharto in May 1998.

In 1995, an Indonesia woman approached May to make some inquiries about franchising Dome's concept in Indonesia. Soon after, unbeknown to May, she opened a café in Kuta Bali and called it Dome. Everything about the café, which includes the logo, menu and the interior, is a replicate of Dome. May and Jafferries are in the process of taking legal action against the woman for infringement of intellectual property rights.

Dome had received numerous enquiries from potential investors from Indonesia but most were found to be unsuitable. "International expansion depends on getting a good master franchisee, says Eng. "Every master franchisee has a learning curve and we have to hand held them. It took us a while to find our present Indonesian partner. I had to say no to a lot of them because they were buying for their wives or mistresses. I've to find someone who genuinely is interested, has connections, has no delusions that running cafes is damn hard business and prepared to follow Dome's dogma."

In June 2000, two ethnic Chinese Indonesian businessmen Felix and Anthonie Affandi whose children were studying in Singapore, approached Dome Asia for the rights to become Dome's master franchisee in Indonesia. The negotiations took two months and in August, Dome Asia entered into a 10-year master franchise agreement with PT Boga Rembilan.

There are four directors at PT Boga Rembilan. They are Felix Affandi (Chairman/CEO), Petras Lugito (Director), Andreas Wiharja (Director), Patrick Lim

(Director /Operations Director) and Anthonie Affandi (Director). These four directors own a A\$100 million wine and spirit distribution company called PT Tebet Indraya. Since 1996, the Indonesian government tightly regulated the import of alcoholic beverages (*Indonesia Agri-Food Export Market Assessment Report, 1997*). There are currently only two licensed importers of wine and spirit. PT Tebet Indraya is one of three distributors that is officially appointed to sell alcoholic beverages to various restaurants, hotels, bars and supermarkets in Indonesia.

The franchise fee for the master franchise rights in Indonesia differs to the previous Dome’s master franchises. The schedule for the franchise fee is provided in Table 9. According to Aziz, the reason for the change is that Dome has realised from previous experience that setting up the outlets and helping the master franchisee is a very costly exercise.

TABLE 5:3
Schedule of Franchise Fee for Indonesia

OUTLET	FRANCHISE FEE
1 st to 10 th outlet	S\$200,000 for all
11 th to 15 th outlet	S\$10,000 each
16 th to 20 th outlet	S\$5,000 each
21 st outlet onwards	No charge

On 8th September 2000, the first café in Indonesia was opened at Ratu Plaza in Jakarta. The second café was opened in March 2001 within the luxurious Grand Hyatt Jakarta.

5.1.8 The Future

Dome, which started in 1990 as a coffee roaster, has enjoyed a phenomena growth to an international retailer with 48 outlets in Australia, Singapore, Malaysia, the Philippines, Indonesia and the United Arab Emirates (see Table 10).

TABLE 5:4
Dome Coffees' International Activity

• October 1992	• Phil May and Patria Jafferries, founders of Dome Coffees Pty. Ltd., spent a week in Singapore to evaluate opening a company outlet in the city-state.
• December 1992	• May and Jafferries formed a joint venture with Ronald Lee and Sebastian Ong to open the first company outlet in Singapore.
• March 1993	• The first location was opened at Cecil Court, Singapore.
• 1994	<ul style="list-style-type: none"> • Lee and Ong formed Dome Holdings (S) Pte. Ltd. to hold the master franchise rights to Singapore. • Dome Coffees Pty. Ltd. formed a joint venture with Dome Holdings (S) Pte. Ltd. called Dome Asia Pte. Ltd., which holds the master franchise rights to China, Indonesia, Japan, Malaysia, Singapore, Taiwan and Thailand.
• June 1996	• Dome Asia entered into a 30-year master franchise agreement with Melium Shd. Bhd. for to open franchise outlets in Malaysia.
• September 1996	• The first location was opened at Starhill, Kuala Lumpur.
• 1997	<ul style="list-style-type: none"> • Dome Coffees entered into a 30-year master franchise agreement with Patricia and Leo Riigen to open franchise outlets in the Philippines. The first location was opened at the end of 1997. • Dome Coffees entered into a 30-year master franchise agreement with Al Ghurair LLC to open franchise outlets in Dubai. The first location was opened at the beginning of 1998.
• August 2000	• Dome Asia entered into a 30-year master franchise agreement with PT Boga Rembilan to open franchise outlets in Indonesia.
• September 2000	• The first location was opened at Ratu Plaza, Jakarta

Earlier last year Sydney based venture capitalist Grant Samuels Private Equity injected A\$10 million into Dome Coffees in return for a 50 per cent stake in the business (Caccetta, 2000). The company also has a A\$8.5 million debt facility with the National Bank of Australia. With a substantial fund of A\$18.5 million, Dome is undergoing a radical overhaul to handle its biggest expansion in its 10 year history as a retailer.

Dome's next phase of growth will be totally company-owned. In an interview with Treadgold (2000) of the Business Review Weekly, Jafferries said: "We tried franchising in our early days because we wanted to expand and didn't have our own capital. There is a role for franchising but we brought in an equity partner to help facilitate the growth of company-owned stores."

The first phase of Dome's expansion will be to focus on the Eastern Seaboard with 30 new outlets planned over the next three years. Dome would also like to develop a strong presence internationally with new outlets planned in India, Thailand, Taiwan and South Korea. May and Jafferries have plans to take Dome to an Initial Public Offer (IPO) over the next three to five years. By which time, they expect the company to have 100 shops in Australia and overseas.

5.2 Coffee Bean and Tea Leaf

Coffee Bean and Tea Leaf (CBTL) was started in 1963 by Herbert and Mona Hyman and it remains one of the oldest gourmet coffee stores in the United States (U.S.). Under the Hymans, CBTL opened 43 café outlets in Southern California from 1963 to 1999. The company has seven types of ice-blended coffee (i.e. a frozen coffee drink made with skim milk and fresh coffee extracts) and sells a variety of 20 types of exotic teas. Apparently, CBTL is the coffee of choice, especially with its trademarked original ice-blended, with many Hollywood's stars such as Tom Cruise and Sharon Stone.

In July 1999, the Hymans sold a substantial share of CBTL to its master franchisee, the Sassoon family, in Singapore. Currently, this privately owned family business is based in Los Angeles. CBTL's coffee roasting plant still remains in Los Angeles, which vacuum packs and distribute its coffee worldwide. The firm's proprietary ice-blended mix, which is considered to be a company's trade secret, is shipped to all its overseas operations. Since the acquisition, the business has aggressively grown the number of outlets to 136 worldwide over the past 18 months (see Table 11).

TABLE 5:7
International Locations of Coffee Bean and Tea Leaf

MARKET	OUTLETS
USA	71
Singapore	34
Malaysia	25
Taiwan	4
Israel	2
TOTAL	136

5.2.1 Company Background

Presently, CBTL is owned by the Sassoon family and an American partner, who has been a family friend for more than 20 years. The Sassoon family of Iraqi Jewish descent settled in Singapore in the 1930s. The family business owns Rubina Watch Company, which imports designer watches such as Tag Heuer, Cartier and Gucci in Indonesia, and the Sunvic group, which includes regional entertainment company Sunvic Productions and distributor Sunvic Co. Both Rubina and Sunvic had a group turnover exceeding S\$60 million in 1995 (Lam, 1996b).

Mr. Victor Sassoon, the managing director of Sunvic and chief executive officer of CBTL, runs the Asian leg of the business in Singapore. His wife, Michelle, is its chief operating officer. Victor's younger brother, Sunny, looks after the American market in Los Angeles with the chief operating officer there, Larry Edelman (Lim, 1999).

Victor's first foray into business was in his father's company, Rubina Watch (Lim, 1999). After completing his secondary studies in Singapore at 16, he moved to Indonesia to work in the family business. Six years later, he moved back to Singapore. At the age of 29 he inherited the business when his father died in 1986. Sunvic was formed in 1990. Victor and his wife Michelle also ran a chain of stores carrying a line of Disney baby merchandise until 1998.

Prior to November 1996 when the first CBTL opened in Singapore, Sunvic Productions – named after Victor and Sunny – was known to Singaporeans as the concert promoter who brought big names such as Phil Collins, Tina Turner, Michael Jackson, Metallica, Barry Manilow and Pearl Jam to Singapore (Lim, 1999). In the heyday of pop concerts in the early and mid nineties, ticket prices soared as high as S\$300 and audiences numbered tens of thousands. Sunvic also staged concerts in

Malaysia and Indonesia, and was a key player along with Lushington Entertainments. However, when the 1997 economic downturn hit Asia, such high cost large-scale shows became unprofitable. After staging 80 shows, Sunvic decided that it was time to diversify its business.

It came as no surprise that Victor chose coffee. “Coffee is a lifestyle business. It was a natural extension. We ourselves love to go out and drink coffee to unwind,” said Victor in his interview with Lim (1999) in *The Strait Times*.

5.2.2 Coffee Bean and Tea Leaf’s Internationalisation

Victor’s first encounter with CBTL was when he was on holiday in Los Angeles in 1995. While visiting Sunny his brother at his Beverly Hills office, he was persuaded to try the brew known as “the coffee of the stars” in Los Angeles.

“It was right next to my brother’s office, and I noticed that everyday, there was a long queue,” says Victor. “So, one day when I was queuing up, Paula Abdul was also in the queue. We chatted and she said, ‘This is the best coffee in the world. You gotta get this company!’ ” Paula Abdul, whom he had met when he staged her concert in Singapore in 1992, also told him that celebrities such as singer Janet Jackson and director Steven Spielberg were CBTL regulars. After Victor tried it for himself, he liked it, especially the ice-blended coffee, and he was determined to bring the brand to Singapore.

It took nine months of negotiation for Victor, before he could convince the founders Herbert and Mona Hyman, then in their 70’s, to give him the franchise. Victor believed that the top three factors that gave the Hymans confidence were sincerity, financial resources and the engagement of a food and beverage consultant.

“The Hymans was running a ‘mom-and-pop’ style cafes. They had 43 stores, were totally focused on the products and all were company-owned,” says Victor. “I think

they gave the franchise to us because they liked us, it is a personality thing. Singapore was the first overseas market and they had not even heard of Singapore.”

In August 1996, the Hymans awarded Sunvic the master franchise rights for Singapore, Malaysia, Taiwan and Australia for 20 years. The franchise agreement had a performance schedule to be observed by Sunvic of eight stores over the first 12 months. Over the next three months, a six-week training was provided in the U.S. to key managers in product knowledge such as coffee and tea but “nothing about management of stores.” As Sunvic had no prior expertise and experience in managing chain stores, it overcame this problem by hiring a management consultant to develop the operating system.

The Hymans came to Singapore for a couple of weeks to assist in the opening of the inaugural store. This was the first time they had ever set foot in Singapore. Victor recalled that early battles that were fought with the Hymans (franchisor) over changing menu and operational procedures. As Victor recalled: “I wanted to expand the menu to include sandwiches as Singaporeans need to have food with their coffees. I felt the drinks were too sweet for Asians, so I proposed some changes. The negotiations were not easy because to them it was like an insult – ‘You are a franchisee and you’re telling me what to do?’ ”

5.2.3 Singapore

In November 1996, the first CBTL opened at Scotts Shopping Centre. The outlet served 18 varieties of coffee, 20 blends of exotic teas, seven varieties of trademarked ice blended coffees, biscotti, sandwiches, cakes, some salads and pasta. Within three months of the opening of the first CBTL outlet, Singapore’s first Starbucks opened, less than half a kilometre away. There are now 21 Starbucks outlets in Singapore,

226 throughout the Asia-Pacific region, and plans for a total of 500 in the region by the end of 2003 (Arnold, 2000a).

Victor recounted that it was difficult trying to convince the landlord of Scotts Shopping Centre to lease the space for CBTL. However, Victor's reputation in the entertainment business eventually gave confidence to the landlord that the concept might work for the shopping centre. Although Victor admitted that he did not possess any real estate contacts, he sought the assistance of a professional who understood the commercial property and negotiated on Sunvic's behalf.

Encouraged by the resounding success of the first outlet, a second outlet was opened in Wisma Atria three months later. Victor commented that obtaining space at other major shopping centres for CBTL has become a lot easier following the success of the first two outlets.

Since the first store opened in November 1996, CBTL had expanded rapidly over the next 30 months. There were 28 outlets, which made CBTL the market leader among the specialty coffee cafes. Starbucks, its closest competitor, had 21 outlets. Sunvic had also 14 CBTL cafes in Malaysia. Sunvic opened its first outlet in Malaysia in June 1997. By the end of 1999, plans for an additional six outlets would be added in Malaysia and eight more in Singapore (Lim, 1999).

The beans continue to be roasted in California and shipped out in vacuum-sealed packs (Arnold, 2000). CBTL's baristas (Italian for coffee makers), mostly teenagers, are taught strict quality control, relying on a timer to make sure they pull every shot of espresso with just the right amount of *crema* (Italian for cream). They mix the coffee with milk in a glass so they can monitor the mixture by its colour.

The CBTL has proven to be very popular with the youth. Victor reasons that an Ice Blended coffee costs about S\$4.80 at CBTL, which is the next affordable thing to fast

food for the teens and working adults in their twenties. Besides, they also can obtain the comfort and ambience a café offers. Even the jazz music played at all the outlets are hand picked and recorded on CDs just for CBTL. The selection changes every three months.

CBTL has been most aggressive with its advertising and promotions. It has aligned itself with other major brand names targeting the youth market, such as Tower Records and Overseas Union Bank's Global Debit MasterCard (Lim, 1999). Victor cautions that although the Asian youth market is highly brand conscious, they are very perceptive when it comes to food. "Image will serve as the initial attraction for the youth to trial the product but it is not sufficient to promote brand loyalty," says Victor. "The ultimate test for repeated patronage is the quality and presentation of our food and beverage, which is why our sandwiches were created by renowned hotel chefs."

CBTL's outlets at Orchard Road attract yuppies, teenagers, students and tourists while the suburban outlets are popular with students and families (Chen, 1999). Victor admits that those CBTL outlets in suburbs of middle to high socio economic groups are performing financially better than those of low socio economic groups.

5.2.4 Franchisee Became the Franchisor

In July 1999, Sunvic acquired a substantial stake in the California-based International Coffee and Tea LLC, which owns the global franchise. This move has effectively transformed the former master franchisee to the franchisor. According to Victor, the move to buy over the business was a logical one (Koh, 2000). "I've watched many other businesses where the principals take back the franchisee after you've spent all your effort in building up the business. You're at their mercy, and as your contract gets closer to the expiry date, things will get harder for you," Victor said.

“With the success in Singapore and Malaysia, we realised there was a great potential in Asia. We knew we had to take it over,” said Victor in his interview with Jordon (1999). “It is quite rare for a franchise owner to sell the business to a franchisee that is why it took such a long time to negotiation. They liked us very much, we are a family business and they are a family business and we were able to build up a lot of trust. They liked the way we had set up our stores and they realised that we had been successful. We had 25 outlets after two and a half years and they had only 40 outlets in 30 years of business, so they were very surprised and they were very happy.”

5.2.5 The Future

Following the purchase, it was reported that CBTL had plans to have 32 outlets by the end of 1999 and would hope to generate more than S\$100 million worth of business from the Asian region (*Coffee Bean to Expand*, 1999). Plans would be set in place to develop wholly-owned shops in Hong Kong, Taiwan, Australia and all over the U.S. For the more “complex markets” such as Japan, the Philippines and the Middle East, CBTL would intend to seek for franchisees.

In September 1999, Victor was reported in *The Strait Times* (Lim, 1999) that he would like to grow the business, which was worth about US\$80 million to a US\$300 million company in four to five years’ time.

In April 2000, CBTL set up its first company-owned store in Taipei, Taiwan. Currently, it has five stores, which are managed by a Singaporean general manager. Victor acknowledges that Taipei is a very tough market because the Taiwanese shopping landscape is very different to Singapore and Malaysia. It is made up of mostly strip shopping rather than malls. Therefore, it does not provide a catchment

area, unlike the shopping malls, whereby the majority of the customers are in transient.

CBTL does not allow its master franchisees to sub-franchise any of their outlets in the Middle East and Asia. The reason is attributed largely to the limited size of the specialty coffee industry in these markets. CBTL is targeted at specific niche markets rather than the general public. Therefore, coupled with the high cost of rent, franchisees will not be able to be financially viable if the ownership is limited to one or two stores.

To be a master franchisee of CBTL, one must possess the following characteristics: (1) it must be a public company; (2) it must demonstrate that it has the fund and infrastructure to open between 30 to 40 outlets; and (3) it must be currently running a successful business. However, Victor maintains that the most important ingredient he looks for in a master franchisee is the “passion for coffee.” Sassoon prefers unsolicited enquiry rather than active soliciting when it comes to locating potential franchisees. Sassoon believes that when a potential franchisee has taken the initiative in making the first approach, he would have liked the concept.

The Sassoons have very ambitious plans for the U.S. From 60 outlets in Southern California, they plan to open additional outlets in California, Nevada and Arizona and maybe as far as Chicago and New York (Arnold, 2000b). The company has consulted investment bankers and may try to spin off the Asian operations of CBTL in the near future; it may also try to list the U.S. company later.

5.3 The Body Shop

The Body Shop is a value-driven, high quality skin and hair care retailer operating in 49 countries with 1,730 outlets spanning 25 languages and 12 time zones in 2000 (Annual Report and Accounts, 2000) (see Table 12). The company is famous for creating a niche market sector for naturally inspired skin and hair care products. It is estimated that in 1998/99 the Body Shop sold a product every 0.4 seconds with over 84 million customers transactions through stores worldwide, with customers sampling the current range of over 600 products and more than 400 accessories.

The success of the Body Shop, both in the U.K. and overseas, has been well documented and the growth of this company that eschews advertising and puts principles above profit, has left many a hard-nosed business executives bemused (*The Body Shop: Timely Arrival in Hong Kong*, 1991). In the company's 1998 annual report, The Financial Times voted The Body Shop the 27th most respected company in the world.

TABLE 5:6
The Body Shop's Worldwide Locations

MARKET	OUTLETS
UK & Republic of Ireland	286
Americas	410
Europe & Middle East	636
Asia-Pacific	398
TOTAL	1,730

5.3.1 Company Founders

The Body Shop was founded by entrepreneur Anita Roddick. Anita was born in a small English seaside town of a large family of Italian immigrants (Roddick, 2000).

The hardship of the post World War II period taught her family to meet their requirements by rationing and savings and Anita learnt how to survive.

Anita graduated from college and started her teaching career. She worked with the United Nations in Geneva for some time and then she decided to travel around the world for two years. She became acquainted with different traditions and customs in different countries while travelling. Upon her return to England, Anita met a young Scottish man, Gordon Roddick, who soon became her husband and business partner.

5.3.2 Company Background

In March 1976, the first branch of the Body Shop opened in the English south coast resort of Brighton on a shoestring budget of a £4,000 bank loan (Roddick, 2000). Every element of the business success was, according to Anita in her autobiography entitled *Business As Usual* (2000), attributed to the fact she “had no money.”

Anita hired a designer to design the logo for £25 and she got friends to help with filling the bottles and handwriting all the labels. She painted the premises dark green, not because she wanted to make an environmental statement, but because it was the only colour that would cover up all the damp patches on the walls. The cheapest containers Anita could find were the plastic bottles used by hospital to collect urine samples. She could not afford to buy enough bottles so she offered to refill empty containers or fill customers’ own bottles. The act of refilling, reusing and recycling became a thumbprint for the differences that would set the Body Shop apart.

The Body Shop rapidly evolved from Brighton with only around 25 hand-mixed products for sale, to a worldwide network of shops. Initially, Anita decided to franchise because she wanted to expand the business network quickly, but had insufficient funds to carry it out (*The Body Shop: Timely Arrival in Hong Kong*, 1991). Through the franchising arrangement, the Body Shop provides a business with

the products to sell, a license to use the company's name and the knowledge and expertise on how to run it. In addition, franchising also allows the principles behind the Body Shop to be passed on, which Anita believes is vital to the franchise's success. The franchisee is responsible for obtaining the money to open and run the shop independently as his or her own business, while keeping the operation strictly in tune with the fundamental principles of The Body Shop.

The success of the Body Shop is based on its relationships with stakeholders including its employees, franchisees, customers, communities, suppliers, shareholders and non-government organisations (NGOs) (*The Body Shop - Dossier in Brief*, 2000). The Body Shop believes that business has responsibility to the communities in which it operates. To this end, it supports and encourages employees throughout the world to volunteer their time in local action. Its community action covers a wide range of activities from conservation work to providing massages and counselling for people with AIDs.

5.3.3 The Body Shop's Internationalisation

In 1978, the first overseas Body Shop opened in Brussels. Two decades later, there were 286 Body Shops in the U.K. and 1,444 overseas in 2000 (Annual Report and Accounts, 2000). The company trades in 49 countries and claims a larger presence abroad than any other British retailer. In the year ending February 2000, the group's export sales totally £192.7 million – an increase of seven per cent on the previous year – and export sales accounted for 58 per cent of the total.

According to Wallace and Brown (1996), the success that the Body Shop enjoyed in the early years was that it did not charge franchise fees or royalties, preferring to let the franchisees pocket them. Most of the earnings came from wholesaling the

merchandise it makes, much like Italy's Benetton, which wholesales clothes to its stores.

A large majority (approximately 80 per cent) of overseas Body Shops are franchise (Annual Report and Accounts, 2000). It has 299 company shops in five of its foreign markets including U.S., Germany, Singapore, France and Austria (see Table 13). In each country, the Body Shop appoints a head franchisee who is then free to appoint staff and sub-franchisees as appropriate.

Table 5:7
International Locations of The Body Shop's Company Stores

COUNTRY	COMPANY SHOPS	FRANCHISE SHOPS	TOTAL SHOPS
USA	245	35	280
Germany	23	55	78
Singapore	17	-	17
France	13	4	17
Austria	1	8	9

The Body Shop regards regular communications with all its overseas franchisees to be critical in strengthening relationships (*The Body Shop: Timely Arrival in Hong Kong*, 1991). It has set up a training school in London with an ongoing series of courses open to all overseas franchisees and a library offering information and training videos. Once a year all franchisees are invited to the International Franchise Meeting to pool ideas and experiences.

The Body Shop's success in Asia has been as distinctive, as in other parts of the world. Singapore set the trend with the region's first Body Shop opening there in 1983. To date, there are 17 shops in Singapore, 29 in Malaysia, 18 in Indonesia, 58 in Taiwan, 15 in Thailand, 114 in Japan, 21 in Hong Kong, 12 in the Philippines, and 26 in South Korea.

5.3.4 Singapore

A British expatriate by the name of Anne Downer approached Anita and Gordon in the U.K. for the master franchise in Singapore. The Roddicks and Downer got on very well. “Downer was liked mined, she had the passion, energy on what the Body Shop was about and she had the money,” said Peter Tyson, the company’s head of retailing and franchising Asia-Pacific. Tyson suspected that the Roddicks and Downer might not have any legal agreement between them as both parties had no idea of the extent to which such a westernised and alternative brand would be accepted in Asia.

In the early days, Anita and her husband Gordon, who is chairman of the company, were happy if anyone wanted to open a Body Shop. Now they can pick from well over 10,000 applications received each year. The potential franchisees must demonstrate that they are sincere, committed and share the business ethics, philosophies and value of The Body Shop. They are expected to work with the Body Shop on a full-time basis and ideally live in the community where their shop is located.

Prior to 1983, Downer had had lived in Singapore for two to three years. Being an ex-nurse, Downer was attracted to The Body Shop’s naturally inspired skin and hair care products. Downer received her initial training for three weeks in the U.K. Tyson, who was the first company’s international manager, recalled that as the Body Shop was, and is still, considered an alternative business; everything in the early days was done intuitively. “At that time, it was a very oral business and the training was about how we do it here and not this is how you should do it.”

Following the initial training, the Roddicks accompanied the first shipment of merchandise to Singapore. Downer was provided discounts and 30 days credit on the

first order of the company's product. The Roddicks assisted Downer to look for the first site. Even now, the Body Shop works intimately with all its overseas franchisees in all site selections and all overseas locations must be approved by the head office.

The first store was a concessionary kiosk in the cosmetic section at Tangs, one of Singapore popular expatriate's shopping centres in Orchard Road. The first outlet had an overwhelming success and shortly after, it moved to take up a shop space at Centrepoint, one of Orchard Road's upmarket shopping centres. The success was due to the existence of some brand awareness by British expatriates and some Singaporeans who had travelled to the U.K.

Downer performed "extremely well" in growing the brand rapidly in Singapore. Body Shop International (BSI) had so much confidence in Downer's abilities that she was given the franchise rights for Singapore, Malaysia, Brunei, Thailand, Indonesia, the Philippines and Taiwan. "That was a mistake as we put too much on her," says Tyson. "We had a store in Manila and it might as well be managed from Singapore by Anne and we wouldn't dream that it would grow to 20 to 30 stores in the Philippines."

The relationship between BSI and Downer deteriorated over the years. Downer's breakdown of her personal relationship with her partner had severely affected her professional work and she unlawfully appointed franchisees who were directly reporting to her.

In 1991 Downer was given 18 months to sell the business but failed to do so because the purchase price was too exorbitant. BSI had no alternative but to terminate the agreement with Downer on October 29 1993 and physically closed all the 12 stores in Singapore. The outcome was "very acrimonious" as Downer took an

injunction against the Body Shop because she believed she had the rights to the brand in Singapore. The case was eventually settled out of court.

Six months after all the stores were closed in Singapore, the Body Shop returned to the country as company-owned stores. “We didn’t plan to have it happened like that. However, it was the early 1990’s and it was an exciting and dynamic place to be in Singapore. We want to have a presence here in Singapore and also we wanted a regional office here,” says Tyson.

The regional office in Singapore, one of four regional business units in the world, carries full profit responsibility for the Body Shop’s 13 markets in Asia-Pacific (*The Body Shop - Press Releases*, 1999). The head offices remain in Littlehampton and London and will continue to be the source of product and marketing ideas, in close-cooperation with the regions. The regional offices manage all of the retail and franchise activities within the region, while also interacting with the head offices to adapt the consumer offer to local needs. The principle behind this organisation structure is to enhance the company’s ability to be closer to the markets.

5.3.5 Hong Kong

In 1984, the Body Shop appointed Margaret Tancock as the head franchisee of Hong Kong (*The Body Shop: Timely Arrival in Hong Kong*, 1991). A resident of Hong Kong for 26 years, Tancock had already built her own fashion business of 12 “birds” garment outlets. She later sold to Michel of Hong Kong and remained as managing director to expand the chain to 25 shops under the name of the M Group.

Tancock was introduced to the Body Shop’s products by her daughter. The products’ reasonable price, their quality and the green philosophy appealed to her and she went to see the Roddicks and “got on very well. I think at that time, and perhaps

still now, they choose their franchisees very intuitively.” (*The Body Shop: Timely Arrival in Hong Kong*, 1991).

Initially, Tancock acquired the franchise in partnership with the M Group, which was not convinced that the shops would be financially viable on their own. The Roddicks made a special case and allowed the Body Shops to be set up as “corners” within the group’s existing stores. However, these failed to make much impact on customers and even when the company established two small separate shops, sales remained slow.

Tancock believed this was mainly due to their unsuitable locations, and in 1989, she decided to leave the fashion business and buy out the Body Shop franchise (*The Body Shop: Timely Arrival in Hong Kong*, 1991). She opened her first Body Shop in the prestigious Landmark centre on Hong Kong island. This was followed by a second shop in the heart of Kowloon’s Tsimshatsui shopping district and another in the nearby Ocean Centre mall.

The new shops immediately began to do well. In 1989, the operation showed a 331 per cent increase in total sales over the previous year and this upward trend continued with a further 208 per cent increase for 1990. To date, Tancock has 21 shops – mostly in prime locations (*Annual Report and Accounts*, 2000).

Marketing the products in a variety of sizes and encouraging customers to bring back the plain plastic bottles keeps prices low enough to appeal to Hong Kong’s predominantly young population. The Body Shop enjoys a loyal following, especially of women between 18 and 25 who made an average of three visits per month (Li, 1999).

One area that Tancock found difficult initially was staff training when she took over the Body Shop franchise. Sales assistants in Hong Kong “tend to be shy about

coming forward to help the customers.” (*The Body Shop: Timely Arrival in Hong Kong*, 1991). The solution has been to assign those with a less grasp of English to work in shops in predominantly Chinese areas. The training videos and the Body Shop ‘bible’ that gives detailed descriptions of all the products are translated into Mandarin. Also, staff training program such as outward bound courses for senior manager and shop managers are organised to help them overcome their fear and inhibitions.

5.3.6 Selection and Training of Head Franchisees

The selection of head franchisees of Singapore, Hong Kong and Malaysia in the 1980s had been largely done intuitively by the Roddicks. The three most important attributes the Roddicks sought in a head franchisee were the ‘3Es’ - enthusiasm, entrepreneurial and environmentally concerned.

Similar to Downer in Singapore and Tancock in Hong Kong, the Roddicks appointed Mariam Sulaiman and Mina Foong on those 3Es as the head franchisee for Malaysia in 1984. “We started very small,” said Sulaiman (<http://www.mir.com.my>). “We didn’t have much money and all we had was a lot of enthusiasm, spirit, passion. We found out how to do things for ourselves.” Between 1984 and 1995, Sulaiman successfully grew the business to 12 stores in Malaysia.

As the business becomes increasingly larger, the selection of its overseas head franchisees has become more sophisticated and financially focused. In the early days, the Body Shop was considered an alternative business and “therefore we were in secondary locations and didn’t cost too much.” However, the Body Shop is sited at all the prime locations and therefore there is need for a “financially stronger player.”

When selecting its head franchisees, the Body Shop selectively seeks business people whom not only “have the commercial sense, financial ability, and managerial

ability to do it but also liked-mindedness with a commitment to social and environmental change.”

In countries such as Japan and Korea where the scale and cost of conducting business is high, it is essential to work with a corporate company rather than an individual. These corporate companies may have managers who do not share the same the Body Shop’s philosophy. In the case of Japan, the Body Shop’s head franchisee is Jusco (*Jusco Reports 29pc First-half Drop Amid Collapse in Regional Demand*, 1998). Jusco is Japan’s third largest supermarket chain, which has stores in Japan, China, Thailand and Malaysia. It also holds the Japanese franchise rights of Laura Ashley, another British high fashion concept.

The Body Shop has a set of criteria for the initial screening of the head franchisees:

- A love of trading/retailing.
- Commitment to the Body Shop values.
- The ability to protect and promote the Body Shop brand, business, principles and philosophies.
- The ability to implement a viable shop opening strategy.
- The ability to secure prime retail locations.
- The ability to manage national retail operations.
- The ability to fund the start-up and subsequent business development costs.
- A knowledge of the cosmetic market and regulatory requirements.
- Relevant retail and commercial experience and understanding of business and cultural practices in the market.
- Experience of importation and national distribution.
- The ability to manage and motivate staff – leadership and management skills.

The selection of suitable candidate follows a systematic and rigorous process, which consists of the following phases:

- Phase I:** Applicants must obtain an initial enquiry form and formally apply to the Body Shop by completing and returning this form.
- Phase II:** Suitable candidates will be invited to fill in an application form and return it to us within a certain time-scale. The shortlisted candidates will be visited in their markets and subject to a personal, legal, financial and ethical due diligence assessment.
- Phase III:** The shortlist is further reduced following those visits to approximately three candidates, who are asked to submit a comprehensive three-year business plan. Guidelines for the business plan are provided. The business plan is then presented to a selection panel consisting of main board directors and senior management of the company in the U.K.
- Phase IV:** The selection panel will choose one candidate with whom formal discussions will be entered into. This will lead to franchise contract negotiations and hopefully, completion of the head franchise agreement and other legal documentation.
- Phase V:** Once appointed, the head franchisee's principals and management will undergo a thorough training programme in the U.K.

5.3.7 The Body Shop's Strategy in Asia-Pacific

In Asia-Pacific, the Body Shop is a well-established business. The Asia-Pacific comprises 13 markets across North East Asia, South East Asia and Australasia. There

were 29 new store openings in 1999, of which 13 were in Korea and eight in Taiwan (*Annual Report and Accounts*, 2000). Of the 398 stores to date, 17 are company owned.

The Body Shop practices “high market positioning” in Asia in terms of price and perception. According to Tyson, it is important that the Body Shop is positioned as an international brand and possesses a prestige brand image. However, the brand endeavours to be as inclusive as possible by targeting the 18 to 35s’ female segment, as “we wouldn’t be able to build over 350 stores if we only sell to Asians who are English educated.” This has resulted in the Body Shop becoming a valuable alternative to the premium brands.

Almost all of the Body Shop’s head franchisees in Asia, with the exception of Korea, do not appoint sub-franchisees and own all of their stores in their territories. Tyson attributes this desire by Asian head franchisees to own all their stores to the lack of lease premiums and Chinese family business (CFB) management style. In Europe, lease premiums have to be paid by tenants when leasing retail space at prime locations. The head franchisees would have to appoint sub-franchisees if they wanted to expand their business network quickly with limited funds. However, in Asia the practice of lease premiums by landlords does not exist.

The Body Shop’s head franchisees in Asia run their businesses according to the CFB style. The CFB has become the dominant form of overseas Chinese business organisation and one of the major forms of Asian business (Chen, 1995). Under this management style, the business owner tends to regard the business as the private property of the core family, and thereby is reluctant to share the ownership with others.

In Korea, sub-franchising by the Body Shop's head franchisees is required. According to Tyson, it is difficult for the head franchisee to "own all the stores and make money because getting a good location requires a lot of cash." To overcome this problem, the Body Shop appoints leaseholders of premium sites to operate the business.

The Asian head franchisee's organisational style has become the preferred model to be used by the company in newer markets. Sub-franchising suffers from three main disadvantages for the Body Shop:

- Part of the franchise's success is that it allows the principles behind the Body Shop to be passed on. With sub-franchising, it reduces the relationship between the head office and sub-franchisees and consequently the ability of the head office to achieve this objective effectively.
- Sub-franchising places an additional layer between the head office and the customers, which makes it very difficult for the head and regional offices to maintain an intimate relationship with its end consumers.
- There is a note in the franchise contract that every five years franchisees have to revamp the shops and invest more money into them. Although it places a legal obligation on all the franchisees to comply, not every one is motivated to do this. It is both time and energy consuming having to convince the head franchisees and all the individual sub-franchisees to abide by the contract.

Tyson believes that managing the Body Shop's franchisees in Asia is "all about relationship and therefore you have to spend more time with them than in Europe." "In the West, you can get on with the business but in Asia, they don't really tell you

what they are thinking as they are not confrontational, therefore you have to spend a lot of time with them to find out what it is,” says Tyson.

5.3.8 The Future

Roddick attributes the phenomenal success of the Body Shop chain to franchising, good products and a sense of community (Schmidt, 1994). She says franchising keeps the overheads down and attracts people who are motivated. The Body Shop franchisees are selected for their people skills rather than formal business training.

Over the years, the Body Shop has expanded its operations enormously. However, it has yet to enter South or Central America, Africa or India. In the 1999 company’s annual report, the Body Shop’s current and future strategy is to operate as a retailer in a select number of markets within all four regions – Asia-Pacific, Europe and Middle East, Americas and the U.K.

The Body Shop is increasingly turning away from franchising in favour of partnerships. Roddick (2000) admits in her autobiography ‘Business as Unusual’ that “franchising was a wonderful way of facilitating world-wide growth, but it may not make sense on a world-wide basis any more.” Although the company will still use franchising as “the right way of working in some places, but in others we may be looking to buy back franchises or to go into partnership with head franchisees.” Anita believes that this will give the company more control, the ability to adapt quickly and huge cost savings.

5.4 Royal Copenhagen Ice Cream

Royal Copenhagen Ice Cream (Royal Copenhagen), started by an American entrepreneur Thomas Wykoff in 1983, operates premium ice cream stores in both street front and shopping centre locations. Wykoff moved to Australia in 1969 and on one of his visits back to the U.S., he saw an old-fashioned gas-fired ice cream cone maker (Schlueter, 2001). Subsequently, he founded Royal Copenhagen as he felt that Australia had no decent ice cream at the time. It has also been reported that he was responsible to have introduced miniature golf to South Africa and Australia.

Each shop produces its own ice cream and bakes its own fresh cones daily in front of customers. Décor is Danish with warm colours, and staffs wear Danish looking uniforms. Royal Copenhagen started franchising in New South Wales in 1985 and has grown to 30 outlets in New South Wales, Queensland, Victoria, South Australia and Western Australia.

5.4.1 Royal Copenhagen's Internationalisation

Royal Copenhagen's entry into international market began in 1991 when it expanded into Singapore. Since then, it had sold franchises to Thailand, Indonesia, Malaysia, Japan and the Philippines. From 1991 to 1997, the company had 23 stores in Singapore (3), Thailand (11), Malaysia (3), the Philippines (2), Indonesia (3) and Japan (1). However, the 1997 Asian economic crisis had a severe impact on all its overseas franchises, which led to the complete withdrawal of the brand from all of its overseas markets.

All foreign master franchisees of Royal Copenhagen stumbled on to the ice cream parlour when they visited Australia as tourists. The company does not believe in actively soliciting for its master franchisees but instead prefers to rely on word-of-

mouth or unsolicited enquiries. It believes that it is the most cost effective means of recruiting potential master franchisees, as the company does not have any resources to undertake international marketing.

When Royal Copenhagen received an overseas enquiry, the screening process commenced with “getting the people to come to Australia for an interview to determine his background, retailing experience and money,” says Mel Steers, joint managing director of Royal Copenhagen. “We would try our best to conduct a preliminary investigation but in places like Indonesia, it was difficult to check on the finances.”

Steers further adds that the company would not enter into a master franchise agreement with anyone who has no retailing experience or the ability to function within the industry. A brief description of Royal Copenhagen’s overseas master franchisees is provided in Table 14.

Upon the second meeting, Royal Copenhagen would give the potential franchisee a copy of the proposal. It included a description of the initial and continuing support the franchisor would provide and a copy of the franchise agreement. The proposal would also provide the financial obligations of the franchisee that included the franchise fee, royalties, equipment, start-up capital, and working capital. The franchisee would also have to pay for all the expenses for Steers to provide support in setting up the first store in the host country.

When the negotiations had concluded, the franchisee would pay a third of the A\$100,000 franchise fee upon signing of the franchise agreement. The second instalment, which was a third of the franchise fee, would be paid when the first store commenced its construction. Finally, the remaining balance would be paid upon completion of the store.

Table 5:8
Royal Copenhagen's Overseas Master Franchisees

MARKET	BRIEF CHARACTERISTICS
• Singapore	• A family business that owned and operated a 3-star hotel.
• Indonesia	• An influential entrepreneur who was well connected to the country's ex-president Suharto's family. He also owned other franchises and restaurants.
• Malaysia	• Owner-manager of a direct marketing firm of skin-care products.
• Thailand	• Owner-manager of an employment agency that recruited, trained and contracted staff to Saudi Arabia.
• The Philippines	• Jollibee Foods Corp that owns the largest fast food hamburger chain in the country.
• Japan	• A restaurateur of a Japanese restaurant.

Royal Copenhagen provided two weeks' pre-opening training in Australia to their master franchisees and their staff. Steers would travel to the company's foreign markets to provide continuous training once or twice a year, at their expense. In hindsight, Steers felt that perhaps he should have visited them more.

With control and monitoring, the franchisor believes in adopting the flexible approach. The sales figures from the foreign master franchisees were obtained monthly and royalties were received quarterly. The royalties were six and three per cent for the first and subsequent stores respectively.

The length of the franchise agreement was 50 years. It did not include any annual review because Steers believes that "you wouldn't stand a chance to enforce contracts in countries such as Indonesia." The company believes in not putting pressure on its master franchisees.

"We are pretty flexible with design and local product adaptations but we wouldn't change the cone," says Steers. "We have produced different flavours such as durian,

sweet corn, and ice cream that was less creamy for different Asian markets. If they want durian, it's fine even though I hate the smell. I can show them how to make it. If they wanted a new uniform to go with the design, it's fine. I think it is the franchisor's job to give and bend.”

Steers further adds that franchisees become successful not because of standardisation but to learn from all the mistakes the franchisor has made. It is the franchisor's job is to “tell the franchisees what not to do so that they don't have to reinvent the wheel.”

5.4.2 Problems Encountered with Overseas Expansion

Royal Copenhagen faced several problems with its overseas master franchisees largely due to communication barrier, Asian financial crisis and a lack of market research.

5.4.2.1 Communication Barrier

Although all of Royal Copenhagen's master franchisees spoke English, with the exception of Japan, some of them were not able to communicate well. Steers had to use interpreters to communicate with the master franchisees in Japan, Thailand and Indonesia. This communication barrier had prevented Royal Copenhagen from directly communicating the philosophy and control measures to these franchisees.

“In hindsight, our master franchisee in Japan not speaking English was the problem,” recalls Steers. “He won't listen to what I say. There were lots of problems in trying to communicate to him what I wanted. I had to talk to him through an interpreter. We thought that there wasn't any risk as he was willing to bankroll everything. The difficulty was further exacerbated by an earthquake, which severely damaged the store. He also did not want to put any money into the business to

promote it. He was more interested in taking money out of the franchise to promote his real estate business.”

After the franchise agreement had been signed with most master franchisees in Asia, the business would often be assigned to a manager within the organisation. This had presented a major problem for Steers as the managers often did not fully appreciate or understand the franchise’s philosophy.

In the case with Indonesia, the manager would ignore Steer’s instructions and change things without seeking his approval. She was the master franchisee’s sister-in-law who was eager to exert her influence within the organisation. Steers also experienced the same problem with Jollibee, Royal Copenhagen’s master franchisee in the Philippines. He had to work with the vice-presidents and not with Tony Tan Caktiong, president of Jollibee Foods Corp. “However if I needed to talk to Tony or something to happen, I would have access to Tony.”

5.4.2.2 Asian Financial Crisis

The 1997 Asian financial crisis had a severe impact on all of Royal Copenhagen’s overseas operations especially in Thailand, Indonesia, and the Philippines. The high interest rates on loans, rapid depreciation of stock market and property values, and tightening of the consumers’ pockets were driving most Asian retail businesses into financial difficulties.

The Asian financial crisis was reportedly started with the unpegging of the Thai baht from the U.S. dollar on July 2 1997 (Lasserre and Schutte, 1999). It subsequently fell and by November had fallen 45 per cent against the dollar. From Thailand financial turmoil rapidly spread to Malaysia, Indonesia, the Philippines and later South Korea. The immediate effect in these countries was a severe devaluation

of currencies (in Indonesia's case, it was 70 per cent) and a massive fall in stock market values.

Royal Copenhagen's master franchisee in Thailand was paying his rent in U.S. dollar. When the Thai baht suffered a dramatic devaluation against the U.S. dollar during the Asian economic crisis, it became unsustainable to conduct the franchise. The uncertainty over the baht had resulted in little money being spent by the consumers. The business practice of paying lease in U.S. dollar was also the case with Royal Copenhagen's other master franchisees in Indonesia, and the Philippines.

5.4.2.3 Lack of Market Research

Royal Copenhagen's master franchisee in Thailand was an ethnic Indian businessman. According to Steers, it was a big mistake to have chosen someone not of Thai origin, as its master franchisee did not really possess the local knowledge as was being claimed.

"He thought he knew who the customers were," says Steers. "He said if he sold anything Western, it would sell. It's not true. The Thais are lactose intolerant and they have no familiarity with our product. Also, they would not walk and eat at the same time and they just wanted to sit. The pollution is so bad in the street that you wouldn't want to eat in the street. We didn't have enough seats to cater to them."

Another problem faced by the Thai master franchisee was the students using the ice cream parlours as a 'youth centre.' "Our first store was very close to the university and we had 90 seats," says Steers. "The university students would spread their books on the tables and sit there the whole day. We couldn't turn the tables around and there wasn't any space for others."

This phenomenon of teenagers or students using fast food restaurants as a meeting place has been observed to occur in most parts of Asia. Watson (1997) in his

ethnographic study of McDonald's in East Asia has found that from 3 to 6 p.m., McDonald's restaurants are packed with teenagers stopping for a snack on their way home from school. Large numbers of students use McDonald's as a place to do homework and prepare for exams, often in groups. Study space of any kind, public or private, is difficult to find in overcrowded cities such as Hong Kong or Singapore.

In 1995, Jollibee Foods Corp, the Philippines' dominant fast food chain, signed a franchise agreement with Royal Copenhagen with the responsibility of managing expansion into markets the franchisor did not serve (*Philippines Jollibee -3: Plans to Enter Pizza Ice Cream Mkts*, 1995). Under the agreement, Jollibee could open stores or give out sub-franchises in any country other than Australia, Indonesia, Malaysia and Thailand.

When Royal Copenhagen entered the Philippines in 1995, analysts considered the ice cream market in the country to be tough because of stiff competition from two strong local players backed by foreign food multinationals (*Philippines Jollibee -3: Plans to Enter Pizza Ice Cream Mkts*, 1995). They were Magnolia-Nestle Corp., an affiliate of local food and beverage conglomerate San Miguel Corp. and SA of Switzerland, and Selecta Dairy Products Inc., which linked up with Hershey Foods Corp. of the U.S.

The failure in the Philippines was a combination of wrong locations and a failure to scan the environment. "We had no choice with the locations of two stores which were to be the showcase to attract franchisees," says Steers. "Jollibee told us that they already got the locations and they had to build them. They were all wrong locations. Also, the family-owned largest chain of shopping malls in the Philippines prohibited us to set up ice cream parlours in their complexes. The father of the family business had given his daughter the exclusive right for ice cream parlours in all their shopping

malls. They would not even allow us to take up 30 square metres of Jollibee restaurants in some of their malls.”

In Malaysia, Royal Copenhagen’s master franchisee did not anticipate the abundance of new retail space that was added in Kuala Lumpur by the rapid development of mega shopping malls. “We were in a new shopping mall and we did well for the first six months,” says Steers. “Then, when a new shopping centre opened, all the business would move. Supply exceeded demand which caused the inability of the business to sustain the rent.”

5.4.2.4 Lessons Learned

Having had the experience of entering Asia, Royal Copenhagen’s future master franchisees must possess the following characteristics: in the order of importance: (1) organisation so as “to make things happen,” (2) contacts with shopping centre managers and not just leasing managers (3) finance with access to at least A\$500,000 and (4) experience of take-away foods but not necessary ice cream.

As Steers had encountered major communication problems with master franchisees or managers who were highly entrepreneurial, he would seek future candidates who are more compliant. “They are buying our knowledge and they must realise that if they want to change, they shouldn’t buy into the system in the first place.”

6 DATA ANALYSIS

This chapter interprets the results of the individual cases discussed in the 'Research Methodology' chapter and relates these results to the literature reviewed in Chapter 2 and the conceptual model in Chapter 4. Yin's (1994) pattern matching and explanation-building was used when analysing the data. Using Yin's (1994) and Eisenhardt's (1989) approach, each case is looked at as a separate entity for unique patterns, which can be generalised across cases to identify possible points of merger. The techniques for data display originally identified by Miles and Huberman (1994) were employed in this analysis.

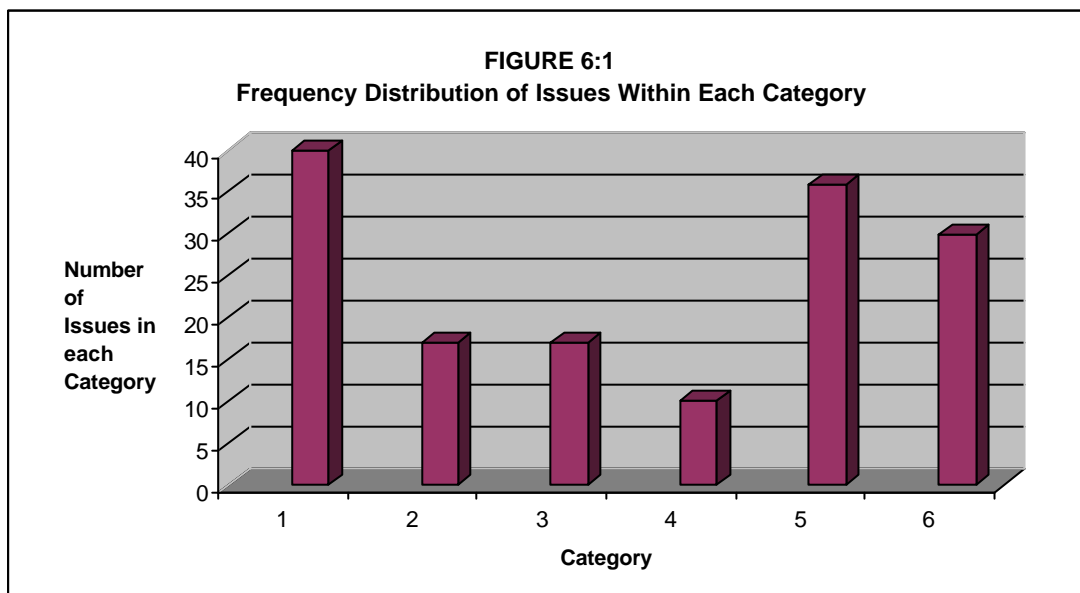
The coding analysis (reducing the data to key events in key categories) showed that four main categories were relevant. In addition, two new categories were established – collectively coded as 'marketing approach' and 'partnership management.' Figure 1 show the frequency distribution for the number of coded issues relating to each category as obtained from the analysis of the four cases. This shows that Distance Management, Contract Enforcement, Cultural Adaptability, Host Country Risk Management, Marketing Approach and Partnership Management were the most frequently referred to categories and therefore should be considered as critical to successful international franchising in Asia.

In the following section of this chapter, each of the categories will be discussed in detail in regard to the research findings. The final model is displayed in the 'Conclusion and Recommendations' chapter.

6.1 Distance Management

The ability to monitor and control franchisees over long distances has been empirically identified as an important capability that distinguishes domestic from

international franchisors (Shane, 1996a). The management of distant locations involves a complex set of skills that may not be commonly possessed by entrepreneurs and may involve as much ‘art’ as ‘science’ which is often gained through experience (Aharoni, 1996). Monitoring franchisees closely has also been found to be a good mechanism for controlling franchisee opportunism (Norton, 1988). Franchisors can monitor against opportunism by inspecting franchisee facilities, examining their records, and by specifying and verifying equipment usage or minimum standards



Note: 1. Distance Management. 2. Contract Enforcement. 3. Cultural Adaptability. 4. Host Country Risk Management. 5. Marketing Approach. 6. Partnership Management

Table 15 summarises this study’s evidence on distance management. The constructs included control and monitoring, field support, key staff management, information exchange, and franchisee training.

While it has been acknowledged that monitoring franchisees closely is effective for controlling franchisee opportunism, the means by which it is carried out is a delicate issue within franchising. Too much control might be counter-productive (Stanworth, 1995). The desire for independence, autonomy and self-fulfillment remains a basic

motive for franchisees to join the franchise systems (Peterson and Dant, 1990). Hence, excessive levels of control might not be welcomed (Mockler and Easop, 1968) and may even impact adversely on franchisees' performance levels.

As Table 15 indicates, there is a high variation in the control and monitoring of master franchisees exercised by the four firms. Dome, Coffee Bean and Tea Leaf (CBTL) and the Body Shop closely control and monitor their master franchisees' foreign operations to ensure consistent quality.

For example, Dome conducted regular audits to monitor the progress and performance of the franchise operations in all its overseas markets. The audits are conducted quarterly during the first year, bi-annually during the second year and annually for subsequent years. Each outlet is being audited comprehensively on 132 items. In contrast, there was little mention of control and monitoring by Royal Copenhagen of their previous foreign franchisees in Asia.

In franchising, monitoring frequently requires the direct observation of the activities of franchisees (Carney and Gedajlovic, 1991). The effect of distance intensifies the ability of the franchisor to closely monitor the foreign franchisees' activities. There is a need for international franchisors to have adequate human resources who have supervisory capability to undertake this observation (Combs and Castrogiovanni, 1994).

The data shown in Table 15 indicate that close control and monitoring is closely associated with the franchisor's level of field support. All firms, except Royal Copenhagen, have regional offices in Singapore to provide pre-opening, administrative and marketing support to the markets in the Asian region. In the case of Dome and the Body Shop, managers are regularly sent from the head or regional office to visit the outlets either for training or auditing.

TABLE 6:1
Distance Management

FIRM	CONTROL & MONITORING	FIELD SUPPORT	KEY STAFF MANAGEMENT	INFORMATION EXCHANGE	FRANCHISEE TRAINING
Dome Coffees	<ul style="list-style-type: none"> • Provides four trademarked operating manuals to master franchisees. • A list of 132 individual items to audit individual stores. • Audits are conducted quarterly during the 1st year, bi-annually the 2nd year, and annual for subsequent years. • “Very clear do’s in our branding, image, taste of coffee and marketing principles.” 	<ul style="list-style-type: none"> • Director of International Sales. • Regional General Manager based in Singapore. • Outlet managers from home country who could work overseas. They were being sent to the first few outlets in each host country. • The franchisor would stay for a month in a host country often. 	<ul style="list-style-type: none"> • Master franchisees must seek the approval of the hiring of operations manager. • Assists master franchisees in recruiting key staff. • Extensive training of key staff for a month in the regional head office. 	<ul style="list-style-type: none"> • “Phil (the franchisor) is very happy and generous to share his experience with me.” • Communicates clearly what the do’s and don’ts of the company are to the master franchisees. 	<ul style="list-style-type: none"> • Provides training to the inaugural team in Singapore for a month • Provides training on coffee brewing in the host country four months leading to the opening of the first outlet.

TABLE 15 (continued)

FIRM	CONTROL & MONITORING	FIELD SUPPORT	KEY STAFF MANAGEMENT	INFORMATION EXCHANGE	FRANCHISEE TRAINING
Coffee Bean & Tea Leaf	<ul style="list-style-type: none"> • Coffee is roasted in LA, which is vacuum packed and distributed to all its markets. • The firm's highly popular ice-blended mix, which is a company's trade secret, is shipped to all its overseas markets. • Had 43 company-owned stores in LA prior to expanding to its first overseas market in Singapore. 	<ul style="list-style-type: none"> • The previous owner visited Singapore for 2 weeks to assist in the opening of the first store. • The company has established a regional office in Singapore to provide training and recruitment support for the region. 	<ul style="list-style-type: none"> • The previous owner provided no assistance in recruitment of key managers. They were recruited with the assistance of a local consultant. 	<ul style="list-style-type: none"> • Regular communications were made between the franchisor and franchisees during the early stages of expansion into Singapore. 	<ul style="list-style-type: none"> • The first master franchisee and key managers spent 6 weeks training in the US.

TABLE 15 (continued)

FIRM	CONTROL & MONITORING	FIELD SUPPORT	KEY STAFF MANAGEMENT	INFORMATION EXCHANGE	FRANCHISEE TRAINING
<p>The Body Shop</p>	<ul style="list-style-type: none"> • The firm had 1,730 stores in the world and therefore would have acquired extensive experience and expertise in control and monitoring. • The firm does not believe in controlling the franchisees in a dogmatic manner but seek cooperation by regular communication. • The regional office in Singapore enables the firm to be closer to its head franchisees and customers in Asia. 	<ul style="list-style-type: none"> • In the early days, the founders would travel to the market to assist in opening the first store. • Since it has become a public-listed company, it has tremendous human resources to support its master franchisees. 	<ul style="list-style-type: none"> • The firm assists the head franchisees to recruit key managers. • The key managers must be able to speak English. 	<ul style="list-style-type: none"> • The firm regards regular communication with its overseas franchisees critical in strengthening relationships. • "...in Asia, they don't really tell you what they are thinking as they are not confrontational, therefore you have to spend a lot of time with them to find out what it is." 	<ul style="list-style-type: none"> • The head franchisee's principals and management will undergo a thorough training program in the UK.

TABLE 15 (continued)

FIRM	CONTROL & MONITORING	FIELD SUPPORT	KEY STAFF MANAGEMENT	INFORMATION EXCHANGE	FRANCHISEE TRAINING
Royal Copenhagen Ice Cream	<ul style="list-style-type: none"> A very flexible approach to control and monitor the business. 	<ul style="list-style-type: none"> Only one person, the joint managing director, was responsible for the international operation. 	<ul style="list-style-type: none"> As the firm had no input in selecting the key managers, it presented a major problem as they often did not fully appreciate the franchise's philosophy. 	<ul style="list-style-type: none"> Little communication occurred between the franchisor and the master franchisees. 	<ul style="list-style-type: none"> The master franchisees and key staff were provided two weeks' pre-opening training. The franchisor would travel to the host market to provide continuous training once or twice a year at their expense.

In the early days of Dome's operation in Singapore, the franchisor spent considerable time working with the local key managers to "fine-tune" the business format. This suggests that the franchisor should be running a successful domestic operation, with strong administrative and management support, that allows him or her to spend considerable time away from the business. Shane (1996a) pointed out that the higher the growth of the franchisor, the more successful it is, and therefore the more resources it may have to devote to its globalisation efforts. This is likely to be a challenge for small firms that lack adequate managerial resources to permit time for such intensive commitments to offshore franchise developments.

As Table 15 indicates, the master franchisees of the four firms are corporations that run businesses in different industries in Asia. For example, Dome's Malaysian master franchisee owns a chain of high fashion retail shops and the Body Shop's master franchisee in Japan runs the third largest supermarket chain in that country. This suggests that the franchisor will be working with company managers rather than the master franchisee that often has interests in other businesses. Therefore, it is important to ensure that the master franchisees hire key managers who are qualified and appropriate in running the franchise business.

For example, Dome works intimately with its master franchisees in recruiting and interviewing key staff, especially the operations manager. In the franchise agreement, the master franchisee should seek the approval of the appointment of the operations manager, who is solely responsible for the overall performance of the business.

Sachdev, Bello and Pilling (1994) referred to the provision of information by the franchisor to the franchisees as a device for influencing franchisee behaviour. This is seen as an indirect form of control. Dant, Li and Wortzel (1995) have also found that

information exchange can contribute significantly to improving the quality of franchisor-franchisee relationship.

When asked about information exchange between franchisor and franchisees, Dome's regional general manager said: "Communications between the franchisor and the foreign master franchisees are at most times confined to the top management only." In some instances this results in a breakdown in communication as the message filters from top management to the frontline staff. To prevent such an occurrence, the Dome manager ensures that every staff member at all the foreign outlets knows him personally. As the level of knowledge amongst the operational staff is relatively low in these markets, he frequently receives a telephone call from an outlet manager or a cook when a problem arises. While this process of intensive personal contact between the franchisor and master franchisee staff is feasible for a relatively small firm such as Dome, it may pose challenges for larger companies or serve as an impediment to growth among expanding operations.

This evidence on regular communication is also found with the Body Shop. The firm's head of franchising believes that managing franchisees in Asia is "all about relationship." He further adds "in Asia they don't really tell you what they are thinking as they are not confrontational, therefore you have to spend a lot of time with them to find out what it is."

Dependency of the franchisee on the franchisor for training has been identified as one of the mechanisms available to the franchisor to ensure compliance and so mitigate against dilution of goodwill (Burton, Cross and Rhodes, 2000). A study on 386 franchisors in the U.S. undertaken by Arthur Andersen (1996) found that a large proportion brought their international franchisees to the U.S. for training.

As Table 15 indicates, the initial pre-store training of the master franchisees for the four firms was also conducted in the home country. For example, the Singaporean master franchisee and key managers of CBTL spent six weeks training in the U.S. Dome's key managers were trained in Singapore for a month. However, the difference between the first three firms and Royal Copenhagen was the level of continuous training provided to the master franchisees.

For example, Dome in Malaysia has a full-time local training manager, who works very closely with the franchisor's regional general manager, dedicated to managing the continuous training needs of all the staff. In contrast, Royal Copenhagen visited its master franchisees only once or twice a year to provide continuous training.

6.2 Contract Enforcement

An important aspect of distance management is the structure of the international franchise contract (Rubin, 1978; LaFontaine and Kaufmann, 1994). As a means of channel management the contractual arrangements of a franchise facilitate a high degree of organisational and operational control by firms over their outlets (Pilotti and Pozzana, 1991). This ability to exercise close control can ensure the imposition of more consistent and uniform standards across a network compared with those attainable from looser forms of third-party distribution such as dealers, licenses and tenants (Wicking, 1993; Mendelsohn, 1992).

Contract details such as fees, royalties, advertising contributions and length of agreement vary little within the domestic context (Abell, 1990). However, in the international environment, the franchise contract varies substantially. In addition to laws specifically governing franchising, a wide range of other statutes may affect franchising in various countries (Maynard, 1995). They cover trademarks, antitrust

issues, taxes, contracts, technology transfer, currency control, foreign investment, and import and export restrictions. Therefore having the ability to negotiate contractual modifications (Root, 1987) and handle contract enforcement is important for successful international development (Hood and Young, 1979).

Table 16 summarises this study's evidence on contract enforcement. The constructs include negotiated contractual modifications; fees, royalties and levies; protecting intellectual property; and proprietary capabilities.

This study did not find strong evidence of all the franchisors having the ability to negotiate contractual modifications and contract enforcement. This is concerning as the prolonged nature of the franchise contract (usually 10 to 20 years) exposes the franchisor to problems associated with choosing the wrong master, ensuring quality and being sued by the master franchisee's constituents (Justis and Judd, 1986). However, the data in Table 16 suggest that the negotiating power of a franchisor is commensurate with the degree of success the franchise brand enjoys within the market.

Dome's schedule of fees for its Indonesian master franchisee is considerably different to its previous master franchisees. The firm was able to insist on a higher franchise fee, from A\$175,000 to A\$200,000, because of its successful track record in Asia. Similarly, the Body Shop has the power to impose on its franchisees a contractual obligation to revamp their stores and invest more money into them every five years.

Overall Dome, CBTL and Royal Copenhagen appear to be making few modifications to their international franchise agreement, which is the template used for domestic franchising. These small firms rely heavily on the professional expertise and advice of their solicitors who specialise in domestic and international

franchising. Therefore, having an appropriate solicitor who specialises in international franchising will compensate for the lack of ability to negotiate contractual modifications and handle contract enforcement.

According to Norton (1988), the franchisor has the right to revoke the franchise agreement without return of the franchise fee if the franchisee does not adhere to his or her contractual obligations. As Table 16 indicates, the franchisor has also the right to revoke the franchise agreement if the franchisee does not achieve its performance schedule.

This is consistent with Negre (1997) empirical study of U.S. master franchisees operating in France from 1985 to 1991. This study identified that one of the key variables associated with failure was the extremely strict opening quota for master franchisees no matter what happened in the market. He suggested that there is a need for more flexibility in the franchise agreement to take account of the changing market environment.

In the case of Dome and CBTL, the performance schedule of three outlets in a market within 18 months seems to be a reasonable target to demand of a foreign master franchisee in Asia. In contrast, there was little mention of performance schedule or annual performance review by Royal Copenhagen, as the firm believes in not putting pressure on its master franchisees. Further, the firm's joint managing director believes that it would be futile to impose any performance standard, because "you wouldn't stand a chance to enforce contracts in countries such as Indonesia."

When business relationships are established between two independent entities in a market setting, each party has an incentive to act opportunistically (Williamson, 1985). This is especially found to be prevalent in international transactions (Huszagh et al., 1992).

TABLE 6:2
Contract Enforcement

FIRM	NEGOTIATE CONTRACTUAL MODIFICATIONS	FEES, ROYALTIES & LEVIES	PROTECTING INTELLECTUAL PROPERTY	PROPRIETARY CAPABILITIES
Dome	<ul style="list-style-type: none"> • Works with an experienced solicitor in modifying the contract, which is the template used for domestic franchising. • “Not many modifications being made in our international franchise agreement compared to our domestic one.” • Franchise fee and term of agreement for Indonesia are different to the other markets, as experience has shown that the current fees are inadequate for providing the support needed. • Performance schedule of 3 outlets within 18 months in each market. • All product innovations are to be approved by the franchisor. This is not done in a dogmatic manner but in a manner that is regarded as adding value. 	<ul style="list-style-type: none"> • Franchise fee of A\$175,000 (non-refundable) and royalty of 3% of gross sales. They are considered to be competitively priced. • The master franchisee in Singapore has partly hijacked the brand by refusing to pay royalties for a concept borrowed from the franchisor. 	<ul style="list-style-type: none"> • The Singaporean partner had set up a concept similar to Dome on its own without paying any fees or royalties for it. Subsequently, he had sold it as a franchise to Malaysia. • “Our Singaporean partners took Dome’s agreement and changed a few words, substituting Dome with Olio Dome.” • Conducts a comprehensive audit to monitor and protect its intellectual property. • “We don’t allow our future master franchisees to use Dome in their company name so as to protect our intellectual property.” 	<ul style="list-style-type: none"> • When the support of roasting and supplying coffee was withdrawn twice from Singapore twice, sales suffered. • Constantly bring to the relationship knowledge, experience and expertise so as to be regarded by the master franchisee as an asset.

TABLE 16 (continued)

FIRM	NEGOTIATE CONTRACTUAL MODIFICATIONS	FEES, ROYALTIES & LEVIES	PROTECTING INTELLECTUAL PROPERTY	PROPRIETARY CAPABILITIES
Coffee Bean & Tea Leaf	<ul style="list-style-type: none"> Performance schedule of 8 outlets in 12 months. 	<ul style="list-style-type: none"> It is understood that franchise fees and royalties were being paid but the details are not available. 	<ul style="list-style-type: none"> The intellectual property rests with the franchisor.. 	<ul style="list-style-type: none"> The company has capabilities in producing a wide range of coffee products, especially its ice-blended which is hugely popular.
The Body Shop	<ul style="list-style-type: none"> In the early days, no contracts were signed between the franchisor and franchisees. However, as the company has gone public, negotiating contractual modification has become more sophisticated. The company terminated the agreement with the former master franchisee in Singapore. The outcome was “very acrimonious” which forced the firm to physically close all the 12 stores 	<ul style="list-style-type: none"> In the early years, no franchise fees or royalties were charged. Most of the earnings came from wholesaling of the merchandise. There is a note in the franchise agreement that every 5 years the franchisees have to revamp the shops and invest more money into them. Although it places a legal obligation on all the franchisees, not everyone is motivated to follow suit. 	<ul style="list-style-type: none"> Regular communication and monitoring to ensure that its property rights are not violated. The head franchisee is provided the license to use the company’s name. 	<ul style="list-style-type: none"> The company has capability in creating and manufacturing naturally inspired hair and skin care products. The company does not engage in any advertising but tremendous publicity from its social responsibilities.

TABLE 16 (continued)

FIRM	NEGOTIATE CONTRACTUAL MODIFICATIONS	FEES, ROYALTIES & LEVIES	PROTECTING INTELLECTUAL PROPERTY	PROPRIETARY CAPABILITIES
Royal Copenhagen Ice Cream	<ul style="list-style-type: none"> • The firm used the same franchise domestic agreement template with great flexibilities. • The contract did not include any annual review because the franchisor believes that “you wouldn’t stand a chance to enforce contracts in countries such as Indonesia.” • The franchisor believes in not putting pressure on its master franchisees 	<ul style="list-style-type: none"> • The franchisee would pay the A\$100,000 (non-refundable) franchise fee in 3 equal installments: upon signing of the agreement, when the first store commenced its construction and upon completion of the store. • The firm adopted a very flexible approach in managing the overseas foreign master franchisees. 	<ul style="list-style-type: none"> • Standard clauses in protecting intellectual property. • Minimal supervision to ensure that property rights were not violated. 	<ul style="list-style-type: none"> • The firm has capability in producing its proprietary ice cream and cones.

Given the greater potential for opportunism in the international area, franchisors that intend to expand overseas need to create incentives for franchisees not to act opportunistically. One way to control opportunism is through the use of ex-ante bonding in a contract (Norton, 1988). If a franchisee has to pay bond that is forfeited if he or she acts opportunistically, the franchisee has a financial incentive to avoid opportunistic behaviour. Typically, franchisees pay franchisors the use of their franchise system in two ways – through an up-front fee and ongoing royalties and advertising levy as a percentage of sales revenue.

As Table 16 indicates, all the four firms demand that master franchisees pay an upfront franchise fee of between A\$100,000 to A\$200,000 and ongoing royalties as a percentage of sales revenues. It is interesting to note that the Body Shop did not impose franchisee fees and royalties on their international franchisees in the early days. Most of the earnings came from wholesaling of the merchandise.

Prior research has shown that the higher the franchise fee relative to the size of the royalty and advertisement payments, the greater the cost to the franchisee of agreement termination, and the more the franchisee needs to adhere to the franchise system (Carney and Gedajlovic; Norton, 1988; Combs and Castrogiovanni, 1994). The data gathered from the cases do not appear to support this finding. It appears that the bond or franchise fee may not serve as an effective tool in Asia when the master franchisee is more likely a company with strong financial resources.

The Dome's case illustrates the ineffectiveness of the ex-ante bond to reduce franchisee opportunism. The Singaporean master franchisee had "hijacked" the brand on numerous occasions, which the company's international director claimed that it was "their plan or end game" right from the start. According to the firm's regional general manager, it is a phenomenon that is not uncommon among franchisees in

Asia. He said: “The problem with franchisees in Asia is that at one stage in their business, they think they know better than the franchisors with their local knowledge. When they get bolder, they will likely to hijack the brand.”

Why do Asian franchisees exhibit such ‘brand hijack’ behaviour? This could be attributed to three reasons. The first, as previously mentioned, relates to the ineffectiveness of the ex-ante bond. The second could be due to the unsophisticated level of legislative protection of intellectual property rights found in most parts of Asia (Deng, Townsend, Robert, and Quensel, 1996). Finally, the franchise concept in Asia could differ greatly to the franchisor’s original business format in the home country. This is perhaps due to the modifications that the master franchisees forced upon the franchisors to make to adapt to Asian consumers.

According to Combs and Castrogiovanni (1994), the bond serves as a particular effective tool when the franchisee invests a large percentage of his or her money in the purchase of the outlets. Under these circumstances, termination of the franchise agreement often results in great financial hardship for the franchisee. The preference shown by most master franchisees in Asia to own all their stores within their territories requires the franchisor to work with a company rather than an individual. The franchise fee would have to be a significant amount, in order to operate as an effective tool to prevent a company from acting opportunistically.

When asked why Dome would not charge considerably more than A\$175,000, the international director said: “We would like to charge much more, but it is a price that we think is competitive. We are not the only ones offering the franchise and we are not big enough to be able to charge an amount much higher than that.”

This inability to charge a high upfront fee presents a problem for any smaller franchise company, especially when it enters Asia for the first time. It would be

difficult for the franchisor to justify the high upfront fee without any past record of success in the region.

It is common for franchise agreements to include clauses prohibiting master franchisees from operating a similar business in a given territory and/or time period once the agreement terminates (Burton, Cross and Rhodes, 2000). However, the threat remains that, once fully conversant with the format, the master franchisees may establish operations in direct competition with the franchisor, before or after the contract officially ends. Nevertheless, in each market entered, franchisors can incur a once-off sunk cost as they take steps to legally safeguard the intellectual property embodied within their franchise format, as well as incurring continuing costs to ensure that property rights are not violated *ex-post* by any local enterprise (Falbe and Dandridge, 1992).

All firms examined in this study took steps to legally safeguard their firms' intellectual property in each market they entered. However, not every firm has been vigilant in ensuring that its property rights are not violated *ex-post* by the master franchisee. Strong evidence of continuing vigilance has been found with all the four firms except Royal Copenhagen. The other three firms have field representatives based in the region who monitor their franchisees closely. As Dome's regional general manager put it succinctly: "I have become the custodian of Dome concepts and ideals."

Dome's international director said: "What we are selling is not the coffee, muffins...but our intellectual property. If we are vigilant in our franchisees following closely to the our intellectual property which includes the logo, corporate colour, uniforms, chairs, etc. then when the franchisee succeed, we can say to them: 'Well, didn't I say so that if you follow everything in the format, you are going to be

successful.’ But if we are slack about our intellectual property, for example not having to follow exactly the right colour coded green in the logo, then when they succeed, they can point to us and tell us that they don’t need us any more, they can do it by themselves.”

In contrast, there was little mention of continuing monitoring by Royal Copenhagen to ensure that its property rights were not violated. What was mentioned suggested that the franchisor did not incur continuing costs to protect the firm’s intellectual property rights. For example, the joint managing director provided two weeks’ pre-opening training in Australia to their master franchisees and their staff. This would be followed by a visit to these franchisees only once or twice a year for training.

The study found that in Asia, master franchisees are often tempted to “hijack” the brand once they have gained the operational know-how in running the business. This is consistent with the study by Hall and Dixon (1988), which found that franchisees resent the continued control on their business by the franchisor once they become competent with the system in which they are working. Then they begin to question the fees being paid to the franchisor and the standards and policies of the franchisor (Knight, 1986). One suggested solution used by Dome to manage conflict is to continuously provide value to the master franchisees so as to avoid being regarded as irrelevant. The key to value adding is “the degree of knowledge, experience and expertise the franchisor can constantly bring to the relationship.”

The other firms have also found to use proprietary capabilities in their control of their master franchisees in Asia. In the case of Dome, the master franchisee had tried secretly to roast coffee by himself but sales suffered significantly as a result of that. This evidence of controlling by the use of proprietary capabilities is also found with the other three firms: CBTL with its expertise in developing its trademarked ice-

blended coffee, the Body Shop with its range of natural skin and hair care products and Royal Copenhagen with its special taste of ice-cream and cone.

6.3 Cultural Adaptability

Table 17 provides a summary of this study's evidence on the need of the franchisor to adapt its concept, business format, and products to the culture of the host country. The data from this research indicate that franchisors practice both standardisation and adaptation in their international efforts.

The cultural environment adds complexity to franchising in a foreign country (Huszagh et al., 1992). Culture impacts the negotiation of contracts, the daily operations, the hiring of personnel, as well as the format of the franchise (Fladmoe-Lindquist, 1996; Justis and Judd, 1989). The very strength of the franchise format, its standardisation, makes its successful replication in foreign markets difficult (Aydin and Kacker, 1990). Frequently, modifications may be needed not just in the recipes and menu selections, but in the operations as well (Sadi, 1994).

The debate over standardisation versus adaptation is an ongoing one within the international marketing and internationalisation literature. Franchising requires a high degree of standardisation to be effective, however, in foreign markets the pressure to adapt the product or service is frequently great. The local partner (with local knowledge) is frequently the party with the greatest ability to find suitable adaptable strategies. This may result in the power of the relationship shifts towards the master franchisee in countries where the level of adaptation is greatest. For smaller firms, with limited managerial and financial resources, the power of a master franchisee can be substantial enough to cause the type of problems experienced by Dome.

TABLE 6:3
Cultural Adaptability

FIRM	CONCEPT STANDARDISATION	MODIFYING BUSINESS FORMAT	PRODUCT MODIFICATIONS
Dome	<ul style="list-style-type: none"> Coffee remains a sacred cow that is precluded from being altered. “Our branding, image and marketing principles must be strictly adhered to by all our franchisees.” 	<ul style="list-style-type: none"> Modified the business format to include a wider range of hot food items, which is essential as it is nearly impossible to survive just by selling coffee alone. Develops coffee kiosks in shopping malls and commercial areas. Special training is provided to staff to be more forward in approaching the customers. 	<ul style="list-style-type: none"> 30 per cent of the menu has been allowed on foods to suit local taste. The chefs from the home country are working with the chefs in host country to create a range of distinctive dishes.
Coffee Bean & Tea Leaf	<ul style="list-style-type: none"> Branding and image are consistent in host markets are consistent with that of home market. 	<ul style="list-style-type: none"> “I wanted to expand the menu to include sandwiches as Singaporeans need to have food with their coffees.” Special training is provided to staff to be more forward in greeting and helping the customers. 	<ul style="list-style-type: none"> “I felt the drinks were too sweet for Asians, so I proposed some changes.”

TABLE 17 (continued)

FIRM	CONCEPT STANDARDISATION	MODIFYING BUSINESS FORMAT	PRODUCT MODIFICATIONS
<p>The Body Shop</p>	<ul style="list-style-type: none"> • Branding, image, shop design format and products are uniform worldwide. 	<ul style="list-style-type: none"> • Special training is provided to staff in Asia to be more forward in helping the customers. • The company’s training videos and ‘bible’ that give detailed descriptions of all the products are translated in Mandarin. 	<ul style="list-style-type: none"> • There are no modifications to all its products sold worldwide. The only thing that is different is the retail-mix. For example, skin care products are more popular than bath products.
<p>Royal Copenhagen Ice Cream</p>	<ul style="list-style-type: none"> • The company had no clear branding or image and did not insist on the master franchisees to adopt a uniform positioning. • The firm was very flexible in the altering of the concept by the master franchisees. However, one thing that it will not changed was its cone. • “We are pretty flexible with design and local product adaptations.” • “If they wanted a new uniform to go with the design, it’s fine. I think it is the franchisor’s job to give and bend.” 	<ul style="list-style-type: none"> • The firm gave the master franchisees great flexibility in designing the shop design to suit local conditions. • No special training was provided to the staff in Asia to overcome their lack of confidence. 	<ul style="list-style-type: none"> • “We have produced different flavours such as durian, sweet corn and ice cream that was less creamy for different Asian markets.”

This is consistent with the findings of Hopkins (1996), which found that 75 per cent of his sample indicated that both standardisation and adaptation were important. Furthermore, despite the expectations that cultural differences may affect the demand for their products or services, most franchisors felt that maintaining standardisation was more important than adaptation. Hopkins (1996) suggested that too many alterations to the franchise's core product or service will threaten the standardisation which customers come to expect with a particular franchise.

Standardisation is enforced by Dome, CBTL and the Body Shop on branding to ensure that the brand image and value is being perceived consistently by its target customers in all markets. In contrast, Royal Copenhagen was not vigilant about its brand image in all its overseas markets. The firm's joint managing director said: "We are pretty flexible with design and local product adaptations. If they wanted a new uniform to go with the design, it's fine. I think it is the franchisor's job to give and bend."

The Dome's case illustrates the practice of brand standardisation. In Australia, Dome' brand image is one of style and sophistication, which is reflected in its store design, products, ambience and packaging. The early cafes in Asia resembled the Australian cafes in every detail, from the design and interiors right down to the chairs. Dome' regional general manger explained: "Our branding, image and marketing principles must be strictly adhered to by all our franchisees...we may lose some customers but they will come back as they associate us with the good things in life. It is a place to see and be seen."

The data shown in Table 17 indicate that all firms, except Royal Copenhagen, provide special training to frontline staff in Asia to be more forward in greeting and helping the customers. The reason is largely attributed to culture and language

difficulties. The Body Shop in Hong Kong has found sales assistants generally shy about coming forward to help the customers because of their poor grasp of English and it is not a cultural norm to be assertive.

Adaptation has also been applied to the product offering by Dome, CBTL and Royal Copenhagen. In their home countries these firms have a limited range of food items in their outlets. However, they had to include a wider range of hot food items in Asia as Asians need to have food with their coffees and the high rental costs would make it nearly impossible to survive just by selling coffee alone.

In the case of Dome, all master franchisees are not allowed full autonomy in modifying the menu to suit local tastes. However, the company keeps a close watch on any new product innovations that are being introduced by the franchisees. This is critical to maintain the integrity of Dome's concept as foreign master franchisees are often tempted to introduce local fare to satisfy its customers. The solution is to 'domify' the local food by giving it a Dome appearance. The food must be "colourful, sexy" and "jazz it up to give a fusion theme" so as "to maintain the European presence."

This limited flexibility to alter its menu is also being practiced by fast food giants such as McDonald's and Kentucky Fried Chicken (KFC) (Watson, 1997; Tanzer, 1993). McDonald's around the world offers the standard menu of hamburgers, chicken and fish sandwiches along with its world famous french fries. Some markets offer one or two local items to appeal to customer preferences and to offer variety. Examples are durian milk shakes in Malaysia, Singapore and Thailand, spaghetti in the Philippines, mutton burgers and vegetable dishes in India, and corn soup and teriyaki burgers in Japan.

In contrast, the Body Shop makes no modifications to all its products sold worldwide. The only thing that is different is the retail-mix. For example, skin care products are more popular in Asia, where it is mostly hot and humid, than bath products. Unlike food which is culturally sensitive, hair and skin-care products can be considered a 'global product' that requires no modification to suit cultural differences.

6.4 Host Country Risk Management

Previous research on international franchising has suggested that risk management issues such as government policies, regulations, macroeconomic variations and monetary uncertainties are important to franchisors (Miller, 1992; Hacket, 1976). In recent years, the greatest growth in international franchising occurred in Asia, South America, Central America and Mexico (Arthur Andersen, 1996). This is because the markets of most of the developed countries became increasingly saturated and competitive. Therefore, as more and more foreign franchisors expand to culturally diverse countries such as East Asia, host country policy evaluation and foreign exchange management are fundamental capabilities that are important for franchisors to develop.

Understanding host country government policies concerning the transfer and repatriation of dividends, fees and royalties has been found to be an important capability for the international franchisor (Aydin and Kacker, 1990; Lafili and Van Ranst, 1990). The data from this research indicated a different view. These findings are summarised in Table 18. All the firms, except the Body Shop, conduct very little host country government policy evaluation. The reasons for this could be attributed to a lack of resources and a reactive approach to market expansion.

TABLE 6:4
Host Country Risk Management

FIRM	EVALUATE GOVERNMENT POLICIES	FOREIGN EXCHANGE RISK
Dome	<ul style="list-style-type: none"> Initially, no active evaluation was conducted as most enquires were made unsolicited. On those occasions where information were needed, the franchisor had used Austrade and other governmental agencies. The regional general manager conducts evaluation of government policies after the agreement has been signed between the franchisor and franchisees. 	<ul style="list-style-type: none"> Negotiates and agrees on a fixed US\$ for a period of between three and six months.
Coffee Bean & Tea Leaf	<ul style="list-style-type: none"> Very little evaluation was undertaken by the previous owner in their entry into Singapore. They didn't even know where Singapore was. For the current owner, he undertakes evaluation of government policies on a ad hoc manner because he believes in unsolicited enquires only 	<ul style="list-style-type: none"> The franchise fees and royalties were paid in US dollars but the details of managing the exchange rate are unknown.
The Body Shop	<ul style="list-style-type: none"> In the early days, the evaluation of government policies was done haphazardly. However, since the company has gone public, it has the resources to conduct the evaluation effectively. 	<ul style="list-style-type: none"> A very sophisticated exchange risk management with the use of forward foreign currency contracts.
Royal Copenhagen Ice Cream	<ul style="list-style-type: none"> No active evaluation was conducted as most enquires were made unsolicited. 	<ul style="list-style-type: none"> No exchange risk management.

If the ability to monitor and evaluate the host country government policies is found to be important by previous studies, then this research suggests that the smaller firms will be disadvantaged in relation to larger firms. It may also raise the possibility that the smaller firms will rely more heavily on their local master franchisee in the target market. This again increases the power of the master franchisee.

The complexity of foreign regulations can prove to be difficult for a franchisor to grasp, as it requires time and money to develop such an expertise. Advice on such issues is available from many franchise consultants and government agencies, but may be too expensive for smaller franchisors (Fladmoe-Linquist, 1996).

In contrast, the Body Shop, which is a public-listed company, is able to evaluate foreign government policies effectively because it has both human and financial resources to undertake the task.

As Table 18 indicates, all the firms, except the Body Shop, prefer unsolicited enquires to enter into new markets. They believe that when a potential franchisee has taken the initiative in making the first approach, he or she would be aware of the magnitude of risk entering the chosen foreign marketplace. The franchisor also relies on potential master franchisees' knowledge and information on foreign market risk. The joint managing director of Royal Copenhagen said: "We never go to them, they came to us as...it is the most effective means of recruiting potential master franchisees, as we don't have any resources to undertake international marketing."

As the evidence of this study and past research have shown that the desire to internationalise was often motivated by a third party, such as a franchisee or a foreign national (Welch, 1992), franchisors should analyse the environments of a host country in order to evaluate the receptivity of the franchise system. Furthermore, an erroneous decision about a host country can be embarrassing, at best, and detrimental to the

brand equity of the franchisor, at worst. It is suggested that franchisors make use of the macro environmental model of international franchising developed by Alon and McKee (1999) to evaluate and rate international locations. The model divides the host country factors into economic, demographic, distance and political dimensions.

The need to manage the effects of exchange rate movement arises from the impact of fluctuating home and host country exchange rates on franchise contracts (Huszagh, Huszagh, and McIntyre, 1992). Many franchisors require that some inputs into the franchise operation be imported from the home country. Therefore, any major change in the exchange rate can increase the franchisor's economic exposure.

As Table 18 indicates, there was no evidence of franchisors, with the exception of the Body Shop, possessing this particular capability in managing exchange rate movements. This could be attributed to the complexities in managing exchange rates that fluctuate on a daily basis. Dome negotiated and agreed with all the master franchisees on a fixed U.S. dollar exchange rate for between three to six months. Meroni (1990) has also found this periodic rate adjustment approach being used by international franchisors (Meroni, 1990).

Dome's international director explained: "You can have a sophisticated system of managing exchange risk, but fixing a rate for a certain period is uncomplicated to administer and understand." In contrast, the Body Shop has a very sophisticated exchange risk management system that involves the use of forward foreign currency contracts.

6.5 Marketing Approach

Several market entry strategies have found to be used by franchisors in managing their foreign franchisees when expanding into Asia (TDB and Arthur Andersen, 1996;

Chan and Justis, 1990). They include master franchising, joint venture, establishing a franchising agreement with the local government as master franchisee and regional franchising. Table 19 summarises this study's evidence on the marketing approach that is essential to gain a competitive advantage for the franchisee in the foreign market. The constructs included market entry, site location, and market positioning.

As Table 19 indicates, the most popular form of franchising used in Asia appears to be master franchising. This is consistent with a recent study conducted on U.S. franchisors which found that master franchising was the most popular mode of entry into distant and cultural dissimilar markets such as Asia (Arthur Andersen, 1996). There is, nevertheless, evidence that the sale of a master franchise as a quick 'off the peg' method of establishing a franchise operation has often encountered problems relating to differences in the social, economical and cultural environment of the two countries which have necessitated substantial adaptations and modifications to the original product, systems and marketing (Forward and Fulop, 1993).

Many large international franchisors, such as McDonald's and Kott Koatings, have reported to object to master franchising because of the fear of losing control of their franchise systems (Ryans Jr., Lotz and Krampf, 1999; Lowell, 1991). These major firms prefer to make investments with their partners or franchisees because it changes the relationship and gives them greater control as shareholder of the operating companies. In contrast, master franchising seems to be a popular mode of market entry for the four firms in Asia. This is largely attributed to their lack of financial resources to make investment in their overseas operations.

The study reveals that a unique form of master franchising is practiced in Asia. Instead of sub-franchising the units, the master franchisees prefer to own and run the entire units. When the CEO of CBTL was asked why, he said: "The reason is

attributed largely to the limited size of the marketplace as the products are targeted at specific niche markets rather than the general public...coupled with the high cost of rent, franchisees will not be able to be financially viable if the ownership is limited to one or two stores.”

This form of master franchising comes close to what Burton, Cross and Rhodes (2000) describe as an area development franchise. In an area development franchise, the area developer is permitted only to establish and operate its own units. Therefore, it is important that the master franchisee is a business or conglomerate corporation, rather than an individual, which has the financial and administrative resources to build and manage a multi-unit operation. However, the balance of power in the franchisor/franchisee relationship in this case may perhaps be tilted toward the franchisee. Past studies have identified several sources of franchisee power (Hough, 1986; Brandenburg, 1989; Ralston, 1989; Smith, 1990). Franchisors are dependent upon their franchisees to follow the business format as stipulated so as not to bring the franchisor’s name into disrepute (Fulop and Forward, 1997). Franchisors may also be reluctant to challenge disgruntled franchisees for fear of provoking court cases, adverse publicity and increased legislation. Not least, the power of franchisees has been enhanced via the increasing growth of multi-outlet and area franchisees in many networks (Ralston, 1989).

Location, widely acknowledged as a determinant of outlet performance, has attracted limited attention in the franchising literature (e.g. Falbe and Dandridge, 1992). Given the retail focus of franchising, generally and of this study, location should be examined as a determinant of outlet performance. Location is commonly cited as “the three secrets of success” for retail business and a “key component of the retailing mix” (Brown, 1994, p. 542).

TABLE 6:5
Marketing Approach

FIRM	MARKET ENTRY	SITE LOCATION	MARKET POSITIONING
Dome	<ul style="list-style-type: none"> • Joint venture with a Singaporean firm to expand into seven Asian markets. • Master franchising is used to enter other markets. • The master franchisees in all Asian markets own all the outlets rather than sub-franchising them. 	<ul style="list-style-type: none"> • Site approval and help with negotiation with the landlord. • The first site at each market was situated at key strategic locations with high visibility. 	<ul style="list-style-type: none"> • European Café concept. • “Expensive and exclusive.” • “Customers don’t come to Dome to eat completely local food. We’ll give it a Dome appearance. We must maintain our European presence.” • Positions at the top end. • Targets the PMEB. • The firm has gone into a suburb and has been accepted quite successfully.
Coffee Bean & Tea Leaf	<ul style="list-style-type: none"> • It entered Singapore, Malaysia and Taiwan by master franchising. • Prefers to use company-owned stores in Hong Kong, Taiwan, Australia and US. Whereas for complex markets such as Japan, the Philippines and the Middle East, franchising is preferred. • The current owner does not allow the master franchisees to sub-franchise in Asia. 	<ul style="list-style-type: none"> • The first outlets in Singapore and Malaysia are in key strategic locations with high visibility. 	<ul style="list-style-type: none"> • The firm targets the youth, who are the teens and working adults in their twenties. • Aligns itself with other major brands targeting the youth market. • Image to encourage trial but it must have good products to achieve brand loyalty. • The firm has established outlets in the suburbs to try and appeal to the critical mass.

TABLE 19 (continued)

FIRM	MARKET ENTRY	SITE LOCATION	MARKET POSITIONING
The Body Shop	<ul style="list-style-type: none"> • A majority of the firm's overseas stores are franchises. • Initially entered Singapore by master franchising. When the franchise agreement was terminated, the mode changed into company-owned. • To allow the head franchisee to own all the stores rather than to sub-franchise them. 	<ul style="list-style-type: none"> • The first few outlets in Singapore and Hong Kong were in strategic locations where British expatriates shopped. • In the early days, the business was located in alternative sites. However, these days it is situated at all the prime locations and there is need for a financially stronger player. 	<ul style="list-style-type: none"> • The brand is positioned as an international brand and possesses a prestige brand image. • The brand also tries to be as inclusive as possible by targeting the 18 to 35's female segment.
Royal Copenhagen Ice Cream	<ul style="list-style-type: none"> • The firm used master franchising only when entering the Asian markets. 	<ul style="list-style-type: none"> • The first few locations were not in strategic sites and did not serve as a showcase to attract franchisees. 	<ul style="list-style-type: none"> • No clear market positioning.

As Table 19 indicates, all the stores of the first three successful firms were located at high traffic, high visible locations in each Asian market. This suggests that it is critical for an international franchisor to work with an overseas partner in Asia who is able to access premium sites, especially for the early ones. As prime retail space is precious and rents are prohibitive, it is important that the foreign partners have real estate contacts and financial strength to undertake such a task. One reason may be that in most Asian countries, the cities are the main centers where tourists, expatriates, youth and professionals go to for shopping, socialising and entertaining.

For example, the first site of CBTL was in one of Singapore's prestigious shopping centers in the city. This was followed by a string of 34 stores located at prime shopping sites all over the island state. Another example is the Body Shop in Hong Kong. Sales of the early stores were disappointing due to their unsuitable locations. When the master franchisee decided to locate the stores in Hong Kong's prestigious high-visibility sites, the business experienced a phenomenal increase of over 300 per cent in turnover.

In contrast, the failure of Royal Copenhagen at most of its Asian markets was due to wrong locations. The joint managing director claimed: "We had no choice with the locations of two stores which were to be the showcase to attract franchisees...Jollibee told us that they already got the locations and they had to build them they were all wrong locations."

This has found to be consistent with the location strategy undertaken by a highly successful global franchise giant such as McDonald's. For example, the master franchisee of Japan ignored McDonald's advice to begin building the stores in the suburbs in 1971 (Love, 1995). McDonald's first unit in Japan, he argued, had to go in the Ginza, the international shopping bazaar in downtown Tokyo. It is where all new

imported products get their initial exposure to the Japanese market. It is also where one million people pass each day, including thousands of Americans. Since then, McDonald's Japan had expanded to more than 2,400 outlets.

The data shown in Table 19 indicates that master franchisees are generally expected to seek approval from their franchisors in locating new stores. This suggests that franchisors should possess the capability and experience in site selection, as location is often the most important ingredient of success for retail business.

Strong market positioning by the western fast food restaurants has been found to be one of the key factors for success in Asia (Love, 1995; Watson, 1997; Wee, 1997). This is illustrated by examining the introduction of Kentucky Fried Chicken (KFC) and McDonald's in Hong Kong (Li and Khan, 1995). KFC opened the first store in Hong Kong in 1973. Within a short span of 12 months, the firm added 10 units. However, two year later KFC closed down all 11 units and withdrew the concept from Hong Kong. It could be attributed to a combination of poor locations and uncertain market positioning and pricing.

The same year that KFC left, McDonald's arrived, bringing with it an approach different from KFC's. First, McDonald's made massive advertising and marketing efforts toward its target customers-children and teenagers. Second, new units were added carefully and gradually after intense market research. Third, a competitive pricing strategy positioned the restaurants well in the target market.

As Table 19 indicates, the three successful firms have very clear ideas of what their target markets or niches are. According to Alexander (1997), niche retailers are among the most successful international operations. Dome's positioning is "expensive and exclusive" as its target market is the professionals, managers, executives and businessmen (PMEBs). CBTL targets the youth market, who are the

teens and working adults in their twenties. The Body Shop is positioned as “an international brand and possesses a prestige brand image.” In contrast, there was little mention of market positioning or target market by Royal Copenhagen.

6.6 Partnership Management

Franchising provides a unique organisational relationship in which the franchisor and franchisee each bring important qualities to the business or partnership (Falbe and Dandridge, 1992). The franchise system enables the advantages of a proven business format offered by the franchisor and the local knowledge of the franchisee to join together (Stanworth, 1988). Their joint contribution and interdependence have made franchising a very powerful form of organisational structure.

Table 20 summarises this study’s evidence on the partner relationship management. The constructs included partner recruitment, desired characteristics, and relationship management.

Previous research suggests that companies receiving inquiries or proposals from prospective or existing franchisees’ or unsolicited enquires was cited by a large number of respondents as a key motivator for foreign expansion of U.S. franchisors (Arthur Andersen, 1996; Walker, 1989; Hackett, 1976; Walker and Etzel, 1973).

The data shown in Table 20 indicates that unsolicited enquiries are also likely to be a popular means of franchisee recruitment in Asia. Why do firms in the study show a strong preference to use unsolicited enquiries to recruit master franchisees in Asia? One reason may be due to a lack of financial resources. All of the firms did not have a budget to actively advertise or exhibit to recruit potential foreign master franchisees.

The unsolicited approach from a third party was considered to be a highly cost effective means to recruit. The approach in all cases came about accidentally by

master franchisees discovering the concepts while holidaying in the home countries or one of the firms' host markets. For example, Domes Coffee's Singaporean master franchisee discovered the concept after he immigrated to Australia. The Malaysian and Indonesia master franchisees came upon the concept in Singapore. The Filipino franchisee was introduced to Dome by the Malaysian master franchisee.

The second reason may be the "mouse-trap" mentality adopted by the franchisor. This notion stems from the belief that if one builds a better mouse-trap, consumers are going to beat a path to the creator. The unsolicited approach from a third party was considered to be more beneficial than actively pursuing potential franchisees through advertisements. The company's preference for this approach was based on the belief that a potential franchisee who initiates the first contact, has normally given a lot of thought to the venture, in terms of the degree of risk involved and the amount of financial resources required to make it a success (Quinn, 1998). It was felt that such a franchisee would be more likely to take up the franchise, because "he would have already liked the concept," than someone just simply replying to an advertisement in the press.

Although the Body Shop relied on unsolicited enquiries in its early days, it is currently pursuing a more aggressive approach to attracting franchisees. As the competition within the natural, environmentally friendly cosmetics and toiletries market becomes increasingly intensified, there is a need for the firm to be more selective in attracting more experienced and higher quality operators.

The firm's head of franchise explained: "In the early days, the Body Shop was considered an alternative business and therefore we were in secondary locations and didn't cost too much. However, the firm is sited at all the prime locations and therefore there is a need for a financially stronger player."

TABLE 6:6
Partnership Management

FIRM	PARTNER RECRUITMENT	DESIRED CHARACTERISTICS	RELATIONSHIP MANAGEMENT
Dome	<ul style="list-style-type: none"> • Unsolicited enquiries. • Usually works with those who enquired and no ‘trawling’ of the market for any other potential candidates • These days, the franchise selection process is more sophisticated which requires a potential franchisee to pay a deposit of US\$5,000 when submitting the application form and business plan. 	<ul style="list-style-type: none"> • The master franchisee’s characteristics the firm looks for are financial ability, corporate structure and passionate about coffee. • The master franchisees are entrepreneurial individuals in businesses ranging from food and beverage and high fashion in Asia. • The master franchisees in all markets strongly believe in the brand 	<ul style="list-style-type: none"> • Hired a local regional GM who is a highly experienced, entrepreneurial and skilful manager in the local food industry. “I’ve become a custodian of Dome concepts and ideals.” • The regional GM is accessible not only to top management but also the middle managers as well. • Established a regional head office in Singapore to service the Asian markets. • To support the master franchisee in making its operation profitable. • The regional general manager acts as conduit between the franchisor and franchisees.

TABLE 20 (continued)

FIRM	PARTNER RECRUITMENT	DESIRED CHARACTERISTICS	RELATIONSHIP MANAGEMENT
Coffee Bean & Tea Leaf	<ul style="list-style-type: none"> • Unsolicited enquiries. • A strong believer of the potential franchisee making the approach first. 	<ul style="list-style-type: none"> • The master franchisee has tremendous financial resources to operate about 50 stores in Singapore, Malaysia and Taiwan. • The Asian operations are run by an entrepreneurial family who owns an entertainment and designer retail company • The current owner would look for master franchisees who owns a public-listed company, has the fund to open between 30 to 40 outlets and runs a successful business. The most important thing he looks for is the passion for coffee. 	<ul style="list-style-type: none"> • After the acquisition, a regional office has been set up in Singapore to recruit, train and support master franchisees in Asia. • Having born and lived in Singapore, the current owner has extensive knowledge of operating in Asia.

TABLE 20 (continued)

FIRM	PARTNER RECRUITMENT	DESIRED CHARACTERISTICS	RELATIONSHIP MANAGEMENT
The Body Shop	<ul style="list-style-type: none"> • The early days' franchisees were recruited by unsolicited enquiries. As the business grows larger, it takes on a more proactive role in franchisee recruitment. • Since the business has grown larger, the selection process has been more sophisticated and financially focused. • Potential head franchisees undergo a systematic and rigorous process that includes developing a three year business plan. 	<ul style="list-style-type: none"> • In the early days, the franchisor selected their master franchisees because they were liked. Also, they must be liked-minded on what the company was about. They must also be working on the business full-time. • The master franchisees are entrepreneurs who are liked-mindedness with a commitment to social and environmental change. 	<ul style="list-style-type: none"> • The firm set up a regional office in Singapore to carry full profit responsibility for its 13 markets in Asia-Pacific. • The regional office in Asia is headed by an experienced international manager who has spent numerous years in the region.

TABLE 20 (continued)

FIRM	PARTNER RECRUITMENT	DESIRED CHARACTERISTICS	RELATIONSHIP MANAGEMENT
Royal Copenhagen Ice Cream	<ul style="list-style-type: none"> • Unsolicited enquiries. • The company does not believe in actively soliciting for its master franchisees. 	<ul style="list-style-type: none"> • Worked with those who enquired only without trawling the market for other potentials. • Used to select master franchisees who primarily had the money. Now, it would not work with anyone who has no retailing experience or the ability to function within the industry. • Worked with master franchisees who could not speak English and they presented tremendous communication barriers. • An ethnic Indian was selected as the master franchisee in Thailand who claimed he had local knowledge, which he didn't. • Master franchisees must possess these characteristics: an organisation, contacts with shopping center managers, access to at least A\$500,000 and experience of take-away foods. 	<ul style="list-style-type: none"> • No regional field support was provided when the firm expanded into Asia. • The franchisor fundamentally left the running of the business according to the master franchisees who possessed the local knowledge

The evidence of the franchisor becoming more selective in the appointment of its overseas master franchisee as the performance of its foreign operations grows is consistent with that at Dome. For example, Dome was unheard of in Asia when it first entered Singapore in 1993. As the number of stores grew in Singapore, it attracted numerous unsolicited enquires from travellers around the region. This has enabled Dome to consider several potential candidates in each of its recent markets, such as Indonesia and Dubai, to eventually select the right overseas partner.

As Table 20 indicates, all the cases used master franchising as a means to enter markets in Asia. Therefore it may become critical for a franchisor to identify the master franchisee characteristics that are required for success in Asia. There have been several studies conducted in determining desired franchisee characteristics (Anderson, Clarence and Dunkelberg, 1992; Hing, 1995; Knight, 1986; Stanworth, 1995; Withane, 1991). However, no research has hitherto been done, especially in Asia, on determining master franchisee characteristics. The published articles on this matter tend to be mostly of the trade magazine variety.

The data in Table 20 show that the master franchisee characteristics associated with success in Asia are financial strength, entrepreneurial and like-mindedness. As Table 19 indicates, master franchisees in Asia, instead of practicing sub-franchising, prefer to own and operate all their stores. Therefore, it is critical that the master franchisee has the financial resources to own multiple units. This suggests that the master franchisee is likely to be a business or conglomerate corporation.

For example, the master franchisee of CBTL, who owns a highly successful luxury watch distributorship and regional entertainment company in Asia, owns and operates 63 outlets in Singapore, Malaysia and Taiwan. Another example is the Body Shop's

Japanese master franchisee, which has the country's third largest supermarket chain, owns and operates 114 shops in Japan.

In a study of 36 New Zealand franchisees within a single retail franchise system, Fenwick and Strombom (1998) found that higher performing franchisees behaved more as employees of the franchisor rather than as independent entrepreneurs. This finding is consistent with the view that franchisees are midway between independent entrepreneurs and employee managers on an independence-dependence continuum, with greater motivation and commitment than expected from an employee manager (Knight, 1984; Withane, 1991).

The franchisee's decision-making independence does allow for entrepreneurship in local market development and may benefit the franchisor indirectly (Dandridge and Falbe, 1994). Whether the entrepreneurial behaviour results in better than average performance for the franchisee will depend upon the peculiarities of the local market, the abilities of franchisee and the effectiveness of the franchise system itself (Fenwick and Strombom, 1998).

Although these studies were conducted on domestic franchisees, they imply that a master franchisee's entrepreneurial flair will have an impact on a franchisor's overseas performance. This has been evident with the case of McDonald's. The company's phenomenal international growth by recruiting and training individuals with motivation and entrepreneurial talent has been reported in several sources (*McDonald's: Hong Kong Individuals Before Investors*, 1991; Love, 1995; Watson, 1997). This practice has also been found to be consistent with the findings of the four firms.

The data shown in Table 20 indicate that the success of the franchisor operating in a completely different culture in Asia may depend on the entrepreneurial ability of the

overseas partner. The partner should be able to give the foreign brand a homegrown flavour without deviating from the fundamentals that made the concept work in the home country.

For example, CBTL's ex-master franchisee in Singapore started working in the family business when he was 15 years old. When his father died, he inherited the business at 29 years old. The family business owns a luxury watch distributorship in Indonesia, music retail in Malaysia and a regional entertainment company in Singapore. Four years after opening the first store in Singapore, the business has grown to 63 outlets in the Asian region. In December 2000, he was awarded Entrepreneur of the Year by Singapore Tourism Board.

Another example is the co-founder of The Body Shop franchise in Malaysia. Since she opened the first store in 1984, the business has grown to its current 29 outlets. In recognition of her efforts in the world of business, she was awarded the 1993 Entrepreneur of the Year by PENIAGAWATI (The Association of Bumiputra Business and Professional Women).

Although it is important that master franchisees in Asia demonstrate great entrepreneurial talent, the data in Table 20 indicate that they should also be able to "take instructions" from the franchisors. This is consistent with Knight's (1984) and Withane's (1991) view that the franchisee is an intermediate between an employee manager and independent owner in terms of decision-making independence. The extent of this independence will vary between franchise systems according to the constraints imposed by each franchise agreement.

The Royal Copenhagen case illustrates that the entrepreneurial flair of the foreign master franchisees should be closely managed by the franchisor to achieve success. All the firm's ex-master franchisees in Asia were considered as entrepreneurs in their

own rights. However, they were given great latitude in managing the franchise operations in their own markets. This has resulted in poor sales performance and inconsistent brand image in all the firm's markets in Asia.

Although the first two characteristics are highly desired, all the four franchisors, except Royal Copenhagen, hastened to add that the most important ingredient they seek in a foreign partner is like-mindedness. This enables the franchisor not only the ability to develop a bond with the franchisee quickly but also the opportunity to develop "brand champion."

The Body Shop case illustrates the importance of franchisors working with like-minded partners. When selecting its head franchisees, the Body Shop selectively seeks business people whom not only "have the commercial sense, financial ability, and managerial ability to do it but also like-mindedness with a commitment to social and environmental change." The founder and all the master franchisees share the company's principle of commitment to the environment and community. Each shop encourages its employees to participate in community service projects and allows them up to four paid hours per month to do so.

The strong shared value between the franchisor and franchisees has also resulted in the franchisees becoming brand champions of the Body Shop. For example, during the 1997 Asian economic crisis, the master franchisee in Hong Kong, who is a great believer of the brand, was undeterred in the face of a retail slump to continue her plan to open six new stores (Gopalan, 1997).

In contrast, Royal Copenhagen's ex-master franchisees in Asia were principally interested in "making money" and lacked the "passion" for the brand. Consequently, when the retail slump occurred as a result of the Asian financial crisis, the firm's ex-master franchisees immediately abandoned the stores to concentrate on their other

businesses. This evidence is supported by the experience of several U.S. international franchisors who have failed in certain overseas markets because their selection of the master franchisees were based strictly on their ability to invest (Maynard, 1995).

Variations in cultural norms such as power distance, Confucian dynamism, and individualism can affect local implementation by international firms (Hofstede, 1990; Hofstede and Bond, 1988). According to Perlmutter and Hennis (1986), compatibility between partners is the most important factor in the endurance of a good alliance and differences between national cultures, if not understood, can lead to poor communication, mutual distrust and the end of the alliance. As Table 20 indicates, all the firms, except for Royal Copenhagen, have representatives based in Singapore who have extensive knowledge of business practices in Asia who acts as “a conduit between the franchisor and master franchisees.”

The regional general manager of Dome is a Singaporean who is a highly experienced manager with an intimate knowledge of the Asian culture. He considers this as an important lesson for foreign franchisors when dealing with master franchisees in Asia. Due to cultural differences, the foreign franchisor is often regarded by the master franchisee never to fully understand the intricacies of the Asian culture. Therefore, most franchisor’s ideas, policies and suggestions are viewed as questionable in their application to the local market environment.

The research of culture that has consistently received recognition by both scholars and practitioners is the work of Hofstede (1980; 1983; 1984). Hofstede’s four dimensions of individualism versus collectivism, uncertainty avoidance, masculinity, and power distance have been well documented in the literature in the past two decades (Abratt, Nel and Higgs, 1992; Geletkanycz, 1997; Vitell, Nwachukwu, and Barnes, 1993). Hofstede and Bond (1988) recently developed a fifth dimension,

Confucian Dynamism, which is designed to assess a culture's tendency toward certain Confucian traits such as concept of time.

Studies conducted by Hofstede (1980) and Hofstede and Bond (1988) suggest that Asian managers, as opposed to their Western counterparts, are large power distance, weak uncertainty avoidance, collectivistic, moderately masculine, and long-term orientation individuals. For instance, the foreign franchisor may be task-oriented and favour quick results, while the Asian master franchisee has a long-term view and is more oriented towards building a long-term relationship with the franchisor. Such cultural differences will likely create tensions and increase the probability of conflict between the partners (Moran, 1980). Successful franchising in East Asia, therefore, requires both an understanding of the business and the partners' cultures.

When the regional head of franchising of the Body Shop was asked on managing partners in Asia, he said: "It is about relationship and therefore you have to spend more time with them than in Europe. In the West, you can get on with the business but in Asia, they don't really tell you what they are thinking as they are not confrontational, therefore you have to spend a lot of time with them to find out what it is."

7 FINDINGS

All of the four proposed relationships were strongly supported except for P₄. This could be attributed to three out of four cases, being small firms, were found lacking either in having the resources or capability in managing host country's risk. However, the Body Shop, which is a large multinational company, has been found to have this particular capability. However, the results from this study indicate that this capability will improve with time as a firm gains resources and international experience. The study has made a significant contribution in identifying two new categories that have mostly been neglected by researchers in international franchising.

7.1 Propositions Discussed

The four research propositions are discussed in this section. The first proposition addressed was as follows:

P₁: The success of international franchising in East Asia will be contingent on having a strong capability in distance management.

Strong capability in distance management, which includes the constructs of control and monitoring, field support, key staff management, information exchange, and franchisee training, was found to enhance success in international franchising in East Asia. This ability also serves as an effective mechanism for controlling franchisee opportunism (Norton, 1988). From the four cases, the results indicate that a foreign franchisor needs to spend considerable time with the master franchisees in East Asia in order to master this capability of distance management that is unique in the region. This suggests that the franchisor must own a successful domestic operation, with strong administrative and management support, that allows one to spend considerable time away from the business.

The second proposition addressed was as follows:

- P₂** The success of international franchising in East Asia will be contingent on having a strong capability in handling contract negotiations and enforcement.

With regards to contract enforcement, the study found that it is not the franchisors, but their solicitors, who are important in having the ability to negotiate contractual modifications and contract enforcement. This indicates that having the appropriate solicitor who specializes in international franchising will compensate for the lack of ability of the franchisors to negotiate contractual modifications and handle contract enforcement. The negotiating power of a franchisor is dependent on the degree of success the franchise brand enjoys in the region. Therefore, it will be extremely difficult for a foreign franchise firm, which expands into East Asia for the first time, to impose a high upfront franchise fee to reduce franchise opportunism.

This should be worrying for any potential foreign franchisor, especially when it is found that most East Asian master franchisees have a tendency to hijack the franchise brand. The possible solutions to this predicament are to (1) have a highly reputable and experienced solicitor in international franchising to handle contractual negotiations with East Asian master franchisees, (2) ensure that intellectual property laws are enforceable in the host countries, and (3) avoid making drastic modifications to the business format in the host countries that becomes significantly different to the original one. However, lawyers often are adversarial and can potentially complicate understandings between the franchisor and franchisees with legal terminology (Lane and Beamish, 1990). This suggests that there is a need for a franchisor to develop capabilities in contractual modifications and negotiation over time.

The third proposition addressed was as follows:

- P₃** The success of international franchising in East Asia will be contingent on having a strong capability in cultural adaptability.

Cultural adaptability was found to influence the performance of international franchisor in East Asia. This indicates that the franchisor should not only adapt the product, price and business format but the way franchisee relationship is traditionally being managed in the domestic market if success is to be had in East Asia. The study also found that franchisors practice both standardisation and adaptation in their international operations in East Asia. This practice emanates from the concern of the franchisors in losing the integrity of the franchise concept, which is found in the standardisation of the business format, if too many alterations to the franchise's core product or service are being made. Standardisation is found in the franchise brand image and value while adaptation, albeit allowed on some of its products or services, is being closely monitored by franchisors.

The fourth proposition was as follows:

- P₄** The success of international franchising in East Asia will be contingent on having a strong capability in host country risk management, including host country policy evaluation and foreign exchange management.

This study has found that smaller franchise firms do not possess strong capability in host country risk management. The complexity of foreign regulations can be difficult for a smaller franchise firm to grasp, as it requires a considerable amount of time and money to develop such a capability. This research indicates that the smaller firms rely heavily on their local master franchisees in the target market. This behaviour results in smaller franchise firms preferring unsolicited enquiries when entering into cultural distant markets such as East Asia. Therefore, it is important for a smaller franchise firm to work with a master franchisee in East Asia who has the capability to evaluate foreign country government policies. However, as the Body Shop indicates, large firms are found to possess the capability to effectively evaluate foreign government policies and manage foreign exchange risk. Therefore, this proposition is

not being rejected, as it deserves to be researched further with the inclusion of large franchise firms in the sample.

7.2 The Model

Using coding techniques (Easterby-Smith, Thorpe, and Lowe, 1993), key categories were first identified from the literature research and then further developed with findings from the primary research. Two new categories called 'Marketing Approach' and 'Partnership Management' have emerged from this research.

This model (Figure 2) shows the six main categories and factors as found in the research. The key factors within each category are listed below to show the areas of activity that should be performed by an international franchisor to achieve success in East Asia.

Category: Distance Management

Factors:

- Have adequate resources to provide *control and monitoring system* (including a detailed audit and reporting system) to ensure product consistency and quality.
- Have adequate resources to provide local *field support*.
- Have the resources and capability to *manage key staff* of master franchisees.
- Need to *exchange information* or communicate regularly with the master franchisees.
- Have the resources to provide *franchisees training* (initial and continuous) in foreign markets.

Category: Contract Enforcement

Factors:

- Have a solicitor who specializes in international franchising law to *negotiate contractual modifications*.

- Need to work very hard to achieve success quickly in the early markets to gain the power to negotiate with future master franchisees to obtain higher *fees, royalties and levies*.
- Need to ensure that *intellectual property* is well protected when operating in East Asia.
- Need to possess a high level of *proprietary capabilities* to reduce franchisee opportunism in East Asia.

Category: Cultural Adaptability

Factors:

- Have clear *concept standardisation* (including brand and product policies) that is strictly adhered to by all master franchisees.
- Work closely together with master franchisees in East Asia to make limited *modifications to the business format* and products to suit local market needs.
- Monitor closely any *product modifications* and innovations introduced by the master franchisees to maintain the integrity of the concept.

Category: Host Country Risk Management

Factors:

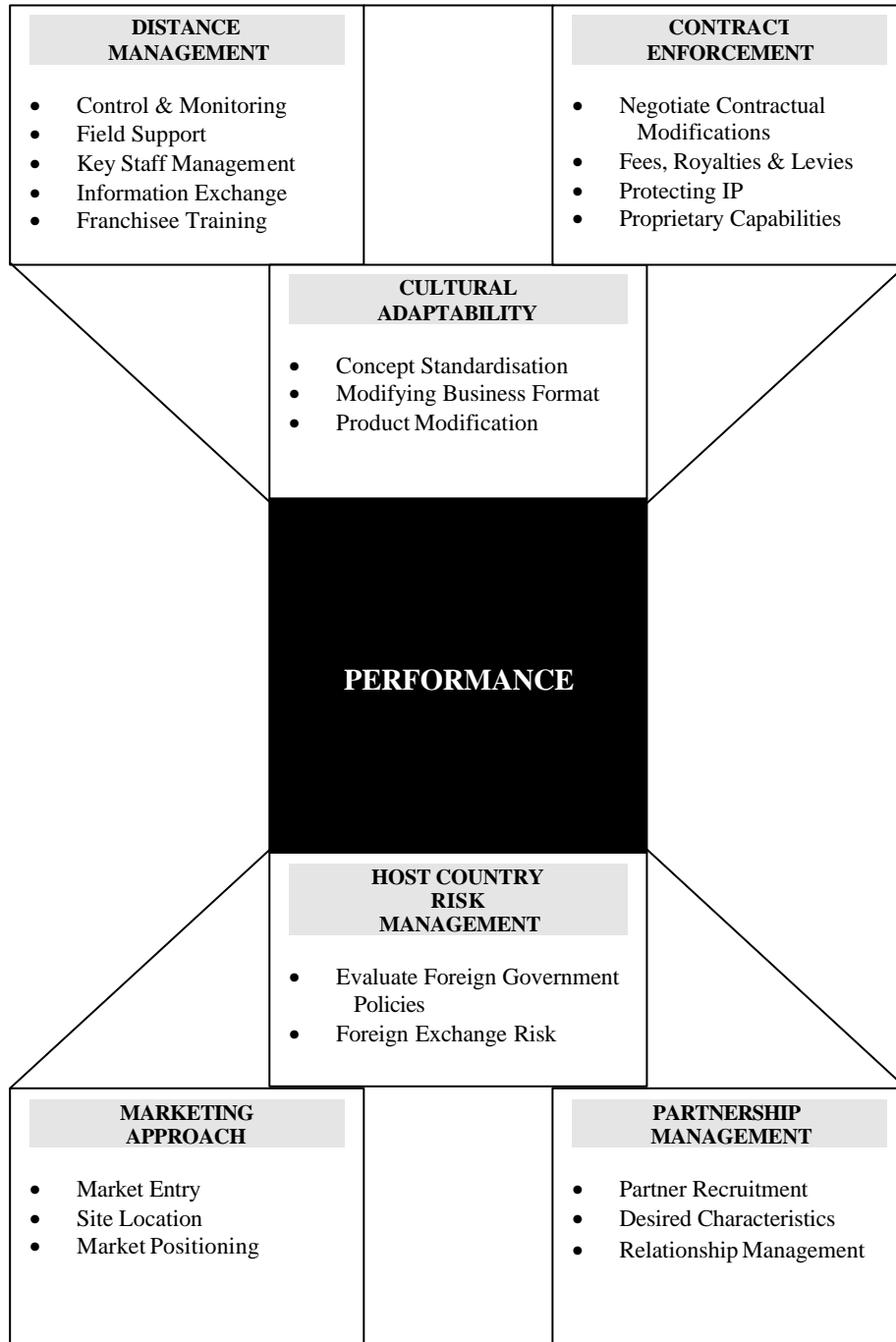
- Work with master franchisees who have the capability to undertake *evaluation of foreign country government policies*.
- Develop a cost effective system of managing *foreign exchange risk*, which is uncomplicated to administer and understand.

Category: Marketing Approach

Factors:

- Need to adopt a relatively riskier market entry mode (i.e. master franchising to joint ventures) as international experience and resources grow to gain greater control and financial returns.
- Need to have site locations that are situated on premium sites in East Asia.
- Need to have clear *market positioning* in East Asia.

FIGURE 7:1
A Model of CSFs of International Franchising in East Asia



Category: Partnership Management

Factors:

- Need to adopt a more aggressive proactive approach in *recruiting* of potential overseas master franchisee or partner.
- Have master franchisees who possess the *characteristics* of financial strength, entrepreneurial and like-mindedness.
- Need to demonstrate a commitment to establish a long term working *relationship* with the master franchisees in East Asia.

8 CONCLUSIONS AND RECOMMENDATIONS

This study attempts to answer several research questions, based on concepts discussed in international franchising literature. The purpose of this chapter is to integrate the findings from the research to determine the critical success factors of international franchising in East Asia. Firstly, the three research questions are answered. Then, this is followed by a presentation of the conclusions. Finally, various recommendations for future research are made.

8.1 Answering the Research Questions

The *first* question examines how foreign franchisors expand into East Asia. As previously discussed, master franchising has been the most popular market entry mode used by foreign firms to franchise into distant and culturally dissimilar countries such as East Asia. The franchisor is able to expand rapidly in a foreign market by taking advantage of the foreign franchisee's capital and local knowledge. Although this market entry mode is low in risk, it also suffers from low in control and returns. This has led to large international franchisors such as McDonald's (Ryans Jr., Lotz and Krampf, 1999) and Kott Koatings (Lowell, 1991) preferring to use joint venture to gain greater control and returns of their overseas operations.

As firms gain in international experience and financial strength, it is evident that they would switch to market entry modes (i.e. joint venture or sole venture) that would provide them greater control and returns of their overseas operations, as is seen in the Body Shop and Coffee Bean and Tea Leaf cases. Dome may well need to consider adopting joint venture if it desires higher control and returns in the future. However, master franchising appears to be a popular mode of market entry for

franchisors, especially for small- to medium-sized firms, in their initial entry into East Asia.

This study suggests that a unique form of master franchising is being practiced in East Asia. The master franchisees prefer to own and manage, rather than sub-franchising, all the units in their territories. The reason is largely attributed to the limited size of the marketplace as these foreign products are targeted at niches, which would make the venture financially unviable if the ownership is limited to one or two stores. Therefore, it is important that the master franchisee is a business or conglomerate corporation, rather than an individual, which has the financial and administrative resources to develop and manage multiple units. In the case of Dome, its master franchisees in East Asia are operators of successful businesses in high fashion, real estate development and food and beverage.

The *second* question deals with how foreign franchisors manage their overseas partners in East Asia. It is evident from the cases that effective partnership management in East Asia commences with the franchisor recruiting the right partners with the desired characteristics and subsequently developing a long-term mutually beneficial working relationship with the partners.

This study indicates that there is a difference between the approach to overseas expansion between small and large franchises. Small franchises tend to adopt a reactive approach via unsolicited enquires in their early stages of their overseas expansion. The reasons appear to be two fold. One relates to a lack of financial resources. All the firms, except the Body Shop, did not have a budget to actively advertise or exhibit to recruit potential master franchisees. The second stems from the belief that a potential franchisee who initiates the first contact is likely to take up the franchise because he or she has already experienced the concept and liked it.

As a firm's size, international experience and financial resources grow, it is evident that it increasingly adopts a more aggressive approach to recruiting franchisees, as is seen in the Body Shop and Dome cases. This is due to a need in attracting more experienced and higher quality operators to achieve a strong competitive foothold in the overseas markets.

This evolutionary, sequential build-up of foreign commitments by franchises over time is consistent with the "theory of export internationalisation" widespread in export behaviour research (Bilkey, 1978; Cavusgil, 1984; Reid, 1981). According to this theory, a firm's resource commitment towards its overseas expansion increases as its foreign market experience and knowledge increases over time.

The study has found that the master franchisee characteristics most associated with success in East Asia are financial strength, entrepreneurial and like-mindedness, as evident in the cases of Dome, the Body Shop and the Coffee Bean and Tea Leaf. It is important to note that all these three characteristics should be found in a master franchisee.

An excellent example is Royal Copenhagen, which failed in East Asia because its ex-master franchisees, albeit highly entrepreneurial, had little financial resources and were not like-minded. Therefore, not only should the master franchisee be financially strong and highly entrepreneurial, it should also share the same value with the franchisor. This will result in the franchisees becoming "brand champions" so that they will not abandon the stores to concentrate on their other businesses during tough economic times, as evidence in the cases of Dome, Coffee Bean and Tea Leaf and the Body Shop.

This study reveals that the success of managing partners in East Asia depends on the ability of the franchisor to reduce franchisee opportunism, by constantly adding

value to the relationship and demonstrating a commitment towards a long-term meaningful working relationship with the partners. The failure of the franchisor to successfully manage partners in East Asia may result in its intellectual property being clandestinely “hijacked,” brand equity considerably reduced, and concept significantly altered.

As previously discussed, the franchisor may reduce franchisee opportunism by legal enforcement, the payment of an upfront franchise fee, and close control and monitoring of franchisees. The study indicates that the power of the franchisor to impose these conditions positively relates to the performance of its concept in East Asia, as evidenced in the case of Dome and the Body Shop. Although previous studies have found the ability of the firm to negotiate contractual modifications (Root, 1987; 1992) and handle contract enforcement as important for successful international development, this study did not find strong evidence among the cases studied of such ability. This perhaps could be attributed to the size of the firms, which prevents the hiring of an in-housed legal counsel, and the inability of the franchisor to comprehend the complexities of international law. Therefore, small-to medium-sized firms rely heavily on the professional expertise and advice of their solicitors who are specialists in the area of domestic and international franchising. However, lawyers often are adversarial and can potentially complicate understandings between the franchisor and franchisees with legal terminology (Lane and Beamish, 1990). This suggests that there is a need for a franchisor to develop capabilities in contractual modifications and negotiation over time.

The payment of an upfront fee, especially a significant amount, prevents the franchisees in acting opportunistically. However, this study suggests that the upfront fee, if not significantly large enough, may not be effective in reducing franchisee

opportunism in East Asia. As previously mentioned, successful franchising in East Asia depends on working with a business or conglomerate corporation, rather than an individual, which has the financial and administrative resources to develop and manage multiple units. Therefore, the franchisee fee should be significant enough, well above A\$300,000, to “hurt” the company if it acts opportunistically.

In East Asia, it is appears that master franchisees may be tempted to hijack the brand once they have gained the operational know-how in running the business. This is consistent with a study conducted by Lane and Beamish (1990) on 66 joint ventures in Latin America, Africa, Southeast Asia and the Caribbean Region. They found that many alliances in these countries collapsed after the simple technology provided by the foreign parent had been assimilated by the local partner and no upgrading was provided. The local partner felt that there was no longer a major advantage for the foreign partner and consequently would strike out alone. Therefore, it is important that the franchisor continuously provides value to the master franchisees and possesses a set of proprietary capabilities so as to avoid being regarded as superfluous. An excellent example is Dome’s proprietary knowledge, experience and expertise in product (i.e. coffee roasting and ‘fusion’ cuisine), marketing, operation, and retail management that it constantly shares with the master franchisees.

This study reveals that franchisors should demonstrate a willingness to establish a long-term relationship with the partners in East Asia. This means that the franchisor has to spend a considerable amount of time to get to know the franchisees both personally and professionally, as evidenced in Dome and the Body Shop cases. Due to cultural differences, the foreign franchisor is not expected to fully understand the intricacies of the East Asian culture. To overcome this difficulty, the franchisor is to hire a representative to be based in East Asia who has extensive knowledge of East

Asian culture and business practices. This representative acts as a conduit between the franchisor and master franchisees in East Asia.

The *final* question examines why some foreign franchisors are more successful in East Asia than others. With respect to this question, the answers of the two previous research questions have already provided several valuable lessons. There are also lessons to be learnt in how the franchisor approaches the issue of adaptability to suit local market needs, how the franchisor evaluates the risk of entering a foreign market, and what marketing approaches to pursue in the respective foreign markets.

With respect to the issue of adaptability, this study suggests that franchisors practice both standardisation and adaptation at the same time. This is valuable. From the cases studied, a foreign franchisor is required to make adaptations to the business format when franchising in East Asia or any international market. Modifications may often be needed not just in the recipes and menu selections, but in the operations as well (Sadi, 1994). However, standardisation is strictly adhered to by successful franchisors on branding to ensure that the brand image and value is being perceived consistently by its target customers in all markets, as evidenced in Dome, the Body Shop and Coffee Bean and Tea Leaf cases.

An excellent example is Dome's approach to adaptation in East Asia. The firm's branding, image, marketing principles and core product (i.e. coffee) are standardised across all markets. However, it allows 30 per cent of the firm's menu to be modified by the master franchisees to suit local tastes. It is evident from the cases studied that the master franchisees in East Asia are often tempted to introduce local fare to satisfy its customers. Therefore, it is important that the franchisors monitor their franchisees closely on any new product innovations that might undermine the integrity of the concept.

Although previous research on international franchising has suggested that it is important for a franchisor to possess the capability of evaluating and/or managing foreign country's risk (Miller, 1992; Hacket, 1976), this study did not find strong evidence among the cases studied of such ability. The reason could be attributed to the use of unsolicited enquiries to enter overseas markets, which places the onus on the potential franchisees to demonstrate that it is relatively risk free to enter the chosen foreign marketplace. Therefore, the reactive internationalisation approach undertaken by most franchisors has precluded them from developing strong capability in foreign country risk management.

With regards to marketing approaches, it is evident from the cases studied that excellent location and strong market positioning are critical to achieving success in foreign markets. In the case of Dome, the Body Shop and Coffee Bean and Tea Leaf, all their stores were located at high traffic, high visible locations in all their markets in East Asia. Therefore, it is critical for a franchisor to work with an overseas partner in East Asia who is able to access premium sites, which are precious and prohibitively expensive.

This study has found that strong market positioning is critical in gaining a competitive advantage for the franchise operation in the foreign marketplace. As evidenced by the cases studied, Dome, the Body Shop and Coffee Bean and Tea Leaf have very clear ideas of what their target markets are. It appears that these firms are pursuing niches, which include professionals, teenagers and young working adults (see Chapter 3 for a demographic and psychographic description of various key market segments in Singapore), which offer high potential for success and profits.

8.2 Conclusions

The key aim of this study was to identify possible critical success factors of international franchising in East Asia. Initially a synthesis of the available literature showed that key success factors could be categorised into distance management, contract enforcement, cultural adaptability, host country risk management, marketing approach and partnership management. However, it was unclear as to the component factors, which could be included within these categories. This lack of information was largely caused by a paucity of research in the area.

The research in this study enabled a model to be established and the component factors within each category to be explored and listed. The key findings are briefly summarised under each main category of the model:

- **Distance Management** – Successful franchisors have an effective management support system for store openings, close control and monitoring, training (initial and continuous), and regular communication to reduce franchisee opportunism in East Asia. This can be best achieved by the provision of local field support.
- **Contract Enforcement** – Franchisors work with solicitors who are highly experienced and knowledgeable in international franchising law to negotiate contractual modifications and contract enforcement. However, the power of the franchisor to negotiate on fees, restrictions and performance depends largely on how successful the concept has performed so far in East Asia and the extent of the firm's proprietary capabilities.
- **Cultural Adaptability** – Standardisation is strictly enforced by successful franchisors on branding across all markets in East Asia. However, restricted modifications are allowed on products, business format and service delivery to reflect cultural differences in East Asia. Successful franchisors monitor product

modifications and innovations by the East Asian franchisees closely to ensure that the integrity of the franchise concept is maintained.

- **Host Country Risk Management** – Franchisors appear not overly concerned about evaluating foreign country policies because of their trust and reliance on foreign franchisees' local knowledge and information. Simple and unsophisticated risk management methods are used by franchisors to manage foreign exchange risk.
- **Marketing Approach** – Master franchising is the most popular market entry mode for foreign franchisors entering East Asia. Having stores in premium locations and strong market positioning are highly essential in competing successfully in East Asia. The master franchisees of successful franchisors are found to have the financial capabilities and contacts to access premium retail locations in the respective East Asian cities. Successful franchisors are also found to practice niche marketing to target markets such as professionals, teenagers and young working adults.
- **Partnership Management** – Unsolicited enquiries are preferred by foreign franchisors when entering East Asia. However, as a firm gains international experience and resources, it increasingly adopts an aggressive approach to recruit potential master franchisees. The master franchisee characteristics closely associated with success in East Asia are financial strength, entrepreneurial and like-mindedness. Effective management of partners in East Asia is only achieved when the franchisor and franchisees commit to a close working relationship. This relationship can be developed rapidly by the hiring of an experienced manager who has an intimate knowledge of the East Asian culture.

8.3 Recommendations for Future Research

There clearly needs to be more research performed to further investigate and validate the categories and factors within the categories for successful international franchising in East Asia. Based on the findings of the cases studied, several directions for future research are recommended.

The conceptual model that has been constructed in this research can be further developed and used in three ways. Firstly, further inductive studies, involving various franchisors competing in a specific industry (e.g. bookstores, fast-food restaurants, personal service, etc.) or country (e.g. China, Singapore or the Philippines) can be carried out to check on the scope of the categories and factors. Such an exercise would add to the robustness and validity of the models (Eisenhardt, 1989).

Secondly, the model can also be used to make meaningful comparisons of case study analysis of franchisors of different origins in a specific geographical region (e.g. North Asia, East Asia or Southeast Asia) or country (Japan, Indonesia or Malaysia). Such comprehensive studies would provide valuable insights into the different competitive strategies employed or competitive advantages enjoyed by different franchisors (say between a Singaporean and an Australian franchisor).

Thirdly, the model serves a useful platform for hypothesis testing using quantitative techniques to validate the correlation between the categories and factors. Following this, multivariate data analysis can be used to determine if there exists any relationship between these factors and firm's performance. This would allow researchers to draw more general conclusions. The possible hypotheses for this quantitative study could include:

H1: There are statistically significant differences in the critical success factors of international franchising between small and large firms.

H2: Franchisors who possess strong capability in distance management will result in achieving high performance in international franchising.

H3: Franchisors who possess a strong capability in contract enforcement will result in achieving high performance in international franchising.

H4: Franchisors who possess a strong capability in cultural adaptability will result in achieving high performance in international franchising.

H5: Franchisors who possess a strong capability in host country risk management will result in achieving high performance in international franchising.

H6: Franchisors who possess a strong capability in marketing approach will result in achieving high performance in international franchising.

H7: Franchisors who possess a strong capability in partnership management will result in achieving high performance in international franchising.

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10 APPENDIX A: GUIDELINE FOR INTERVIEW QUESTIONS

- Background information and company history
 1. When, how and why did the business begin?
 2. Who are the owners involved in the business?
 3. How did you begin franchising domestically?
 4. When did you first go overseas? When did you expand into Asia?
 5. Why and how did you go into Asia?
 6. Why did you select the particular market entry mode to enter Asia?
 7. Which country did you first enter and why?
 8. Which Asian markets are you operating now?
 9. Have you used the same market entry mode for all the Asian markets? Why?

- Distance Management
 10. How do you control and monitor your franchisees' performance?
 11. What difficulties have you faced in managing your franchisees in Asia?
 12. What support do you provide your franchisees in Asia?
 13. How often do you communicate with your franchisees in Asia?
 14. What sort of information do you communicate with your franchisees?

- Contract Enforcement
 15. Who are involved from both sides during the negotiations?
 16. What were the major issues considered during the negotiations of the franchise agreement?
 17. How different is the international franchise agreement compared to the domestic one?
 18. Did you face any difficulties in negotiating with the Asian partners?
 19. How much are the franchise fees, royalties and levies?
 20. Have you experienced any difficulties in enforcing the contract with the Asian partners?
 21. Have you experienced any difficulties in the protection of the company's intellectual property in Asia?

- Cultural Adaptability

22. Do you practice adaptation in Asia? Why and what are they?
23. How do you know how much to adapt in Asia?
24. How do you know if the adaptation will work?
25. What resources do you have in managing adaptation and innovation?
26. Are there any other cultural issues that would require adaptation of the business?

- Host Country Risk Management

27. Did you evaluate foreign government policies before you entered the market? Why or why not?
28. What were the foreign government policies you evaluated?
29. What resources do you have in evaluating foreign government policies?
30. How do you manage foreign exchange risk?
31. Are there any other issues in managing the risk of entering overseas market?