INTERNATIONAL GROWTH OF U.S. FRANCHISING: CULTURAL AND LEGAL BARRIERS

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ABSTRACT

This paper examines the nature and scope of the cultural and legal barriers faced by American franchisers when they seek international expansion. A framework, where international franchising opportunities are classified in terms of the cultural distance and the extent of legal barriers, is proposed. Appropriate strategies for U.S. franchisers under varying conditions of cultural and legal challenges are identified.

IN'TRODUCTION

In a franchising arrangement, a supplier (the franchisor) grants a dealer (the franchisee) the right to market its products in exchange for some type of consideration, such as a financial commitment and an agreement to conduct business in accordance with the standards specified by the franchisor (Pride and Ferrell 2000). Franchise arrangements enable the franchiser to gain fast and selective product distribution, and enable the franchisee to start a business with limited resources and gain from the experience and brand recognition of the franchisor. Two forms of franchising are generally identified: *product/tradename franchising* and *business format franchising (Arthur Andersen* 1992). Product/tradename franchising involves the use of franchisees to distribute a product under a franchisor's trademark and is used in the retailing of automobiles, gasoline, and soft drinks. In business format franchising, franchisees replicate the franchisor's entire business concept, including the marketing strategy and plan, the operating standards and quality control (Preble and Hoffman 1995). This type of franchising currently operates under 19 broad business categories, such as convenience stores, lodging, restaurants, and business services, which can be further subdivided into as many as 67 distinct business segments (Hoffman and Preble 1991).

Over the years, franchising has become highly popular in the United States. Franchised activities generated about one-third of all retail sales in the United States in the 1990s, and this share is expected to increase to about 50 percent in the year 2000 (Moore 1991). More recently, franchise systems are being used for expansion into international markets, and this trend is expected to continue and intensify in the future (Niazamettin and Kacker 1990). In 1971, U.S. franchisors had only 3,365 units in international markets, a number that increased to about 39,000 by the 1990s *(Arthur Andersen* 1996; Preble and Hoffman 1995). In the 1990s, 20 percent of all U.S. franchise systems had foreign operations. Even though the majority of these overseas units were located in developed markets such as Canada, Japan, Europe, and Australia (Preble and Hoffman 1995), attempts by U.S. franchisors to move into the developing countries in Asia, Latin America, the Middle East, and Africa are also notable. Governments in many developing countries are becoming aware of the economic benefits that franchising can bring, and are facilitating the entry of foreign franchisors in their markets (Pelton, Strutton, and Lumpkin 1997).

Franchising is identified as a largely American export and franchised retail outlets are generally viewed as a veritable symbol of America almost anywhere in the world (Zeidman 2000). Horovitz and Kumar (1998) have suggested that franchising is the appropriate market entry strategy in countries that are culturally distant to the home market and those that have relatively few barriers (such as stiff competition, high costs, and legal restrictions) to overcome. Successful franchising relationships consist of three dimensions (Hunt 1972): 1) the business relationship (day- to-day activities that help provide acceptable products and services to customers); 2) the nonbusiness relationship (the cooperative association that exists between the franchisor and the franchisee); and 3) the legal relationship (the contract that exists between the franchisor and the franchisee, and that prescribes the responsibilities and obligations of both parties). In a foreign market environment, maintenance of the first two relationships depends on the cultural distance from the home market, while the maintenance of the third relationship depends on the extent of legal barriers that have to be encountered in the local market. The terms "cultural distance" or "legal barriers" are relative, however, and any given country market would lie somewhere along a continuum with regard to either cultural distance or the extent of legal barriers.

The purpose of this paper is to build a framework that would examine the nature of the cultural and legal barriers that are likely to be faced by U.S. franchisors as they expand internationally. The paper also seeks to identify appropriate strategies for U.S. franchisors under varying, conditions of cultural and legal challenges.

CULTURAL BARRIERS

Cultural barriers stem from the differences in cultural variables (material culture, social organization, religion, language, aesthetics, popular culture, etc.) between the host and home countries. The greater the differences in these cultural variables, the greater are the "cultural distance" between the host and home countries (Eroglu 1992). The greater the cultural distance, the more challenging is the task of transferring a franchising system from the home Country (Fladmoe-Lindquist 1996). Culture affects managerial business practices such as contract negotiation with prospective franchisees, operational business practices such as day-to-day implementation of the product, price, promotion, and distribution strategies, and personnel management practices such as hiring of and communicating with employees and performance evaluations (Eroglu 1992; FladmoeLindquist 1996; Alon and McKee 1999).

The successful expansion of franchising systems into a country likely depends on its cultural "context." Hall (1976) dichotomized cultural contexts as being high or low. In a low- context culture, such as in the United States, information is contained in explicit codes that are written down or verbally expressed in exactly the way they are meant. In a high- context culture, in contrast, information is contained either in the physical context of the communication, or it is internalized in the values of the communicators, so that words are not to be taken at face value, but meaning must be inferred. Examples of high-context cultures are found in countries in the Middle East, the Far East, Latin America, and Africa. High-context cultures generally function with much less legal paperwork than is deemed necessary in low- context cultures (Keegan and Green 2000). This is likely to make franchising operations relatively difficult in highcontext cultural environments, because making local franchisees strictly comply with the franchise contract (which is the backbone of the franchising relationship) becomes more difficult in such environments. Gaining compliance with elaborate legal contracts is easier in the relatively low-context culture of the United States, and hence the country has become the top breeding ground for the franchising concept.

Alon and McKee (1999) have suggested the use of Hofstede's (1980) four dimensions of culture to assess how international expansion by a franchisor might be affected by cultural distance. They have proposed that the level of international franchising is positively related to all four of Hofstede's dimensions: individualism, power distance, uncertainty avoidance, and masculinity of a culture. The implication for American franchisors is that foreign markets should be evaluated in terms of how different they are along these four dimensions compared to the United States before a decision is made to expand into these markets.

To ensure success in international markets, U.S. franchisors must improve their understanding of the diverse cultural forces at work around the world. Sometimes, an American concept will not fit a foreign cultural lifestyle at all. For example, a wellknown American bagel franchisor sold its rights to development in Lima, Peru, without realizing that Peruvians did not eat breakfast (Bucher 1999). Adaptation to local cultural norms will often be necessary. An American restaurant franchisor allowed its Egyptian franchisees to develop special food products for the menu during the Muslim holy month of Ramadan. In Saudi Arabia and Qatar, where local customs required the seclusion of women in public places, this franchisor had to alter their restaurants to include "family areas" that women could visit (Martin 1999).

LEGAL BARRIERS

The growth of franchising has led to a multitude of laws that govern it. Until 1988, franchising was regulated on a national level only in the United States. Since then, many other countries have passed laws to govern franchising activities (Konigsberg 1999; Preble and Hoffman 1995). However, there are wide differences among countries in terms of the extent of legislation available to regulate franchising as well as the extent to which such legislation is enforced. Konigsberg (1999) has documented the franchise legislation in effect in various countries around the world. The salient features of such legislation are summarized in Table 1.

Table I

Franchise Legislation Around the World

Country	Salient Features of Franchise Legislation
United States	- Both federal and state laws that directly regulate franchising - Disclosure and registration requirements - Limitations on terminating, transfer, and renewal of franchises
Canada	- No federal legislation affecting franchising - Quebec legislation impacts franchising through Civil Code - Alberta is the only province to enact specific franchise laws
Mexico	- Disclosure requirement as per the Industrial Property Law - Registration with Mexican Institute of Industrial Property
Brazil	- Disclosure requirement and standard form franchise agreement
France	- "Loi Doubin" law requires disclosure of information
Spain	- Retail Trade Act of 1996 requires disclosure of information and registration

Table 2 Cont.

Australia	- Franchising Code of Conduct (1998) requires disclosure and applies to all new franchise agreements and renewals
Indonesia	- Elaborate disclosure requirement and guidelines for recruiting franchisees
South Korea	- Unfair Trade Practices in Franchising Notice deals with violations of disclosure requirements - Legislation provides for different forms of activities that could be considered to be unfair trade practices
Malaysia	- Disclosure requirement - Franchise agreement must be submitted to the government for both approval and registration

Source: Konigsberg (1999)

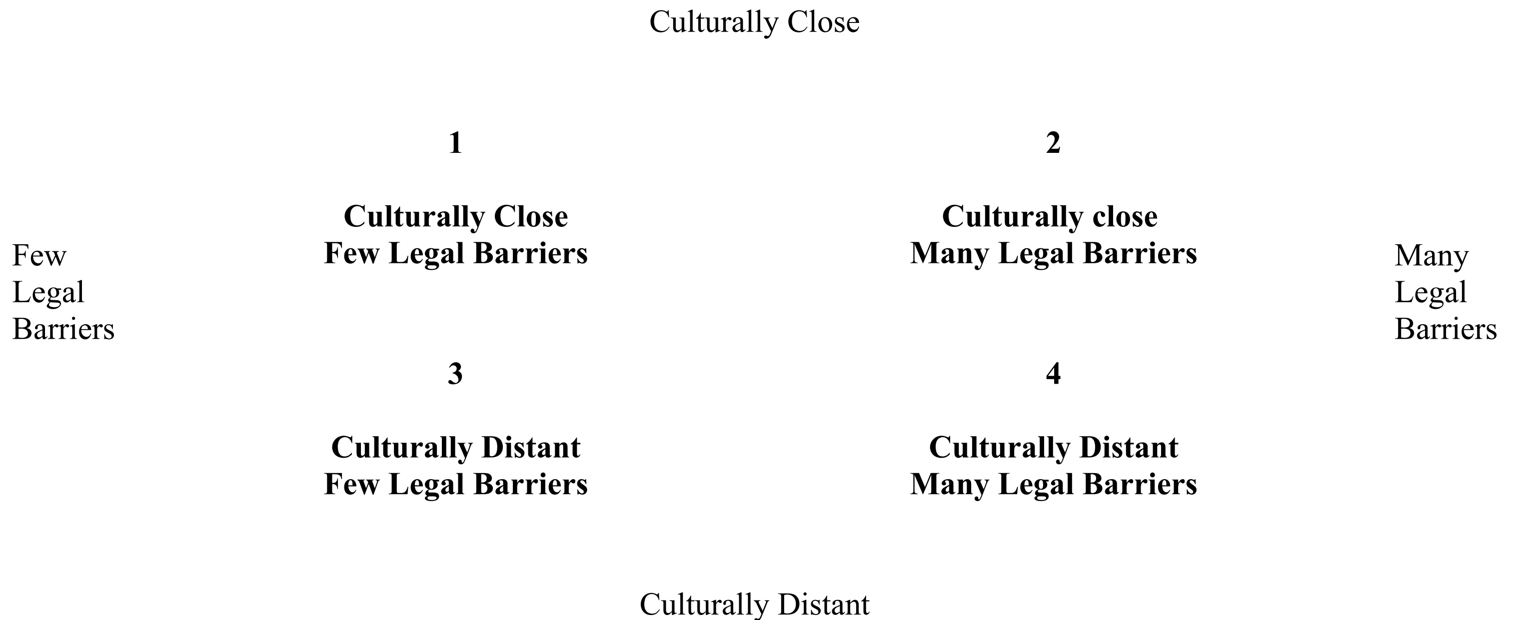
Barriers to international expansion of franchising are affected not necessarily only by the possibility of restrictive regulations in other countries, but also by the fact that foreign regulations may be very different from those encountered in the domestic U.S. market. As can be seen from Table 1, the essence of franchise legislation in most countries is a disclosure document that must include information that would enable a prospective franchisee to make an informed decision. The nature and scope of the disclosure requirement varies widely among countries, however. The International Institute for the Unification of Public Law (UNIDROIT) has undertaken an initiative to prepare a "model law" on franchising that would reconcile inter-country differences in franchise legislation (Konigsberg 1999). For the time being, the Drafting Committee of UNIDROIT has limited the scope of the model law to deal exclusively with disclosure issues. A final draft of the model law is expected to be submitted to the Governing Council of UNIDROIT for possible adoption by the year 2000 (Konigsberg 1999).

A CULTURAL AND LEGAL FRAMEWORK FOR INTERNATIONAL FRANCHISING

Considering the cultural and legal barriers discussed above, a framework to identify international growth opportunities for American franchisors is presented in Figure 1. The framework includes two dimensions: the extent of the cultural distance of a proposed market from the United States, and the extent of legal barriers that an American franchisor may face in that proposed market. Strategy options for expanding into countries represented by the four cells in the framework are presented next.

Figure 1

The Cultural and Legal Framework of International Franchising Expansion



Cell 1: Culturally Close Markets with Few Legal Barriers

These are the easiest markets for U.S. franchisors to expand into. The franchising business format can be directly transferred to the foreign market without the need for substantial, if any, modifications. These markets are mostly located in the advanced industrial economies of North America, Western Europe, and Oceania. Naturally, these are the first international markets targeted by American franchisors. For example, most U.S.-based franchisors planning international franchises choose Canada as the first site of international expansion *(Arthur Andersen* 1996). The United Kingdom, and Australia represent other attractive markets in this category.

Cell 4: Culturally Distant Markets with Many Legal Barriers

In contrast with the countries in Cell 1, the countries in Cell 4 are the most difficult markets for American franchisors to enter and sustain their business in. As the cultural distance increases, the transferability of the franchising system decreases (Fladmoe-Lindquist 1996). This undermines the standardization of the business format that is the very strength of a franchising system. Extensive adaptation to local markets is necessary, which increases the cost of internationalization. The relatively high-context nature of these cultures also makes it difficult to enforce elaborate franchising contracts. Unfamiliar laws and many legal restrictions (such as multiple licensing requirements and laws to ensure extensive protection to local franchisees) further add to the costs of entering these markets. Cell 4 is represented mostly by emerging markets such as those in the Middle East, South Asia, and Africa.

Cell 2/3: Culturally CIose/Distant Markets with Many/Few Legal Barriers

The challenges to entering these markets lie somewhere between those for markets in Cell 1 and Cell 4. In countries that are Culturally close to the United States but have relatively more legal barriers (Italy and Spain are representative examples), product/trade name franchising may be a better operating choice than business format franchising. Because of the cultural proximity, the product or the brand name can be relatively easily transferred, but substantial differences in the legal environments may hinder the pursuit of an identical business format where franchisees in the foreign market have the same rights and obligations as those in the home market. A greater degree of adaptation in the business format than in the product itself will be necessary in these markets.

The strategy in countries that are culturally distant from the United States but have relatively fewer legal barriers (Japan, France, and Russia are examples) should be the opposite. Here, the cultural differences will force greater adaptation of the product and its delivery method than the rules of doing business that can be preserved because of similar legal conditions. For example, McDonald's serves beer in France and Pizza Inn had to add fish as a topping to its pizzas in Russia (Bucher 1999). In Japan, McDonald's targets all advertising to younger people, because the eating habits of older Japanese are very difficult to change (Chan and Justis 1990).

CONCLUSION

International growth opportunities for American franchisors is increasing, but in expanding into foreign markets with a business concept that is traditionally American (Zeidman 2000), franchisors face many challenges. This paper examines the impact of cultural and legal factors on the international growth of U.S. franchisors. Based on the cultural distance of foreign markets from the United States, and the extent of legal barriers present in these markets, this paper has categorized international franchising opportunities into four contrasting environments (Figure 1) and has identified appropriate strategies for success under each of these four conditions.

Future work in this area should include clustering of all international markets into appropriate cells of the suggested framework, with more detailed strategy prescriptions arising out of the effort. The impact of economic, demographic, and political risk factors on international franchising has been researched in some detail (Alon and McKee 1999). The effect of cultural and legal barriers should be integrated with these factors to further refine the feasibility studies of American franchisors that seek to expand their business to other countries.

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