

**THE EFFECT OF ORGANIZATIONAL FACTORS ON  
BUSINESS GROWTH IN INTERNATIONAL  
FRANCHISES; THE CASE OF IRANIAN FOOD  
INDUSTRY**

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**Abstract**

This paper attempts to investigate the effect of Organizational Factors of international franchising on the growth of businesses in Iran's food industry. Based on the stratified random sampling, we distributed our questionnaires between 80 managers and experts of firms involved in international franchising. Data were analyzed using structural equation modeling and Smart PLS 2 software in two sections of measurement model and structural model. In the first section, the technical features of the questionnaire in terms of reliability, convergent validity, and discriminate validity. Moreover, in the second section, t-values were used for testing the research hypotheses. The results revealed the positive and significant impact of organizational dimension of international franchising including size, management international orientation, and performance experience on the growth of firms in our sample.

**Keywords:** Franchising, International Franchising, Organizational Factors of international franchising, Growth of Business, Food Industry, Structural Equation Modeling, Iran

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**Introduction:** in today's the competitive environment, only those business ventures will succeed that are more agile and proactive than their rivals and manage to penetrate more markets. In the global economy and during financial crises, international franchising is an option which allows merchants to enter new markets (Lapiedra et al, 2012). Therefore, it is essential for enterprises to devise measures that put business growth as a main priority and introduce it as the most important objective that they plan to attain. Growth through franchising is identified as a way to achieve business development (Lambing & Charles, 2007, p.57).

International franchising is a method which enables enterprises to grow beyond the boundaries of their respective countries and facilitates their development. Franchising has a great share in different sectors of the food industry and plays a significant role in ensuring a successful industry (Roh, 1998, p.188). For example, in terms of sales and also the number of stores, franchising is more prevalent in the food sector than in any other sectors in the US (Sen, 1998, p.406).

Franchising is a unique organizational method for decision making with regard to mechanisms such as distribution and vertical integration with more control over market exchange (Barringer & Ireland, 2008). Every year, many small and medium enterprises encounter failure just because they cannot mobilize new resources, find new customers or grow geographically. This is while franchising could be a suitable practice to ensure business growth for them (Alona et al. 2012). Consequently, in order for enterprises to devise suitable growth strategies, it is vital to pay special attention to organizational factors such as organizational size, managers' tendency toward internationalization, previous experience which have also been noted as the most important franchising organizational factors in the literature.

Considering the fact that the food industry sector is also one of the three leading Iranian export sectors, the present paper was conducted in the context of this industry. Thus, in light of the previous discussion, the research aims to answer an important question: do organizational factors present in international franchises such as organizational size, managers' tendency toward internationalization and previous experience influence the growth of small and medium enterprises in the food industry?

## Literature Review

### Franchising

Franchising is an organizational form comprised of a network of decentralized chain units that exist under a conventional agreement and thereby, seeks to gain competitive advantage (Michael, 2003). Under this type of venture, the local entrepreneurs who are called the franchisee, have the permission to utilize one or chain units where they have made their investment. The franchisee,

on the other hand, agrees to make a payment to the franchisor for using the franchise based on its gross sales. After all the costs including the fee for utilizing the franchise have been paid, what remains is the profit that the franchisee has made (Elango, 2007). The role of franchising as a sort of entrepreneurial activity has been studied as a means of promoting economic development. Franchising is of course unique among all the existing types of entrepreneurial activities in that it involves meeting the interests of both parties and also in that it is a distinct legal entity. An enterprise in the form of a franchise is consistent with the multifarious criteria of entrepreneurship including new venture creation, new mix completion, getting motivated after perceiving an opportunity (Ketchen et al, 2011).

### **International franchising**

The global competitive pressure which the active domestic ventures feel coming from foreign competitors that are trying to penetrate new markets by way of franchising have been heightened. International franchising is a convention that links at least two organizations in two countries in a way that each side can take advantage of the skill, expertise, and resources of the other. International franchising allows enterprises to develop using less capital and with more adaptability with change in customer preferences by joining innovative and global companies (Aliouche et al 2012).

International franchising began gaining increasing popularity in the 1960's due to factors causing attraction and aversion. Domestic saturation, increased competition, reduced profits in the domestic markets propelled licensors to also examine the opportunities overseas. Favorable major economy and the political and geographical conditions that exist overseas act as an attractive factor for ventures to enter foreign markets. International franchising is considered as a safeguard of the industry that the enterprises use as a key strategy to improve and expand their business in unexploited markets (Alon, 2007).

### **Organizational Factors of international franchising**

Much research has been done about the aspects of international franchising. There are, however, few studies that have attempted to categorize effective factors in international franchising and show how they affect it. There are research efforts that have investigated the impact of the effective factors in international franchising from the organizational point of view introducing organizational size, managers' tendency toward internationalization, and previous experience as the three organizational aspects affecting international franchising.

### **Firm size**

Size is one of the important organizational factors in international franchises which is usually measured based on the number of employees, stores or shops attending to the task of franchising, and annual sales volume (Eroglu, 1992). The size of an enterprise in the realm of international franchises affects the degree of risk that it is exposed to as a consequence of internationalization. As larger franchises possess more resources, their cost of failure would be a lot higher, in case of failure. Similarly, they are susceptible to lower costs if they plan to become internationalized for the same reason (Elango, 2007). There is a negative relationship between an enterprise's size and the perceived risk as a result of internationalization. This is in line with the findings from the studies done by Kacher and Aydin (1990) and Grewal et al. (2011). Therefore, it can be concluded that larger franchises are subject to lower degrees of perceived risk as a consequence of internationalization.

### **Management international orientation**

Manager's tendency toward internationalization, the second organizational aspect of international franchising, suggests the mental perspective of an individual toward development in international markets. It is expressed as a function of the distance, education level, language skill, foreign trips, etc. manager's tendency toward internationalization is a result of their propensity for acquiring more interests for their business by entering international markets (Xiao et al., 2008).

It has been shown that accumulated management experience (the number of years that a company has been involved in a particular field) is one of the consequential variables that are used for explaining the managers' tendency toward internationalization (Eroglu, 1992; Sashi&Karuppur, 2002; Shane, 1996). Companies that are more experienced in an industry have a greater range of knowledge and hence can demonstrate better capacities in management control and adaptability (Hoffman et al., 2008; Mariz-Pérez&García A ´lvarez, 2009). Thus, companies that have managers who are inclined toward internationalization act better and quicker in resolving problems and their managers devise stronger competitive strategies for their business.

### **Performance experience**

The third organizational aspect of international franchising is performance experience which can affect the strategic decisions in a company as one of its sources (Ruzo et al., 2011). The previous research on franchising shows that it has experience in franchising has a major role in eliciting strategic behavior (Rondán, et al., 2010). In this regard, the accumulated experience of the rater plays an important part in decisions to enter a market (Baena and Cerviño, 2009). Franchising experience can positively affect the development of coordination and control abilities in a business when entering new markets and facilitates international expansion (Eroglu, 1992;

Shane, 1996). Therefore, companies that are more experienced in franchising act better (Elango, 2007) and this reduced the likelihood of failure (Sashi and Karappur, 2002).

Management experience is itself considered as an indicator for success which can provide a margin for the business in the competitive market (Baena and Cervino, 2012). Therefore, companies that have been old established in the market and have had a good performance can be well recognized by potential franchisees based on their outcome and good reputation.

### **Growth of Business**

The literature review on business growth indicates that growth is an important stimulus for managers to develop their business. Accordingly, higher potential business growth could attract many investments toward these businesses. When businesses begin to grow, they will need to acquire new sources to maintain their growth. Entrepreneurial enterprises have the potential capacity for growth. Growth is considered a suitable factor as it reflects the achievements in a business and boosts its ability to reward its stakeholders. Business growth is manifested in the number of years an enterprise has been involved in an activity and by its size, number of employees, sales, export, allotted time to work, etc.

Business growth is vital for the success of entrepreneurial activities. Potential growth is one of the factors that distinguish entrepreneurial enterprisers from smaller ones. Although an organization grows as a whole, organizational growth is better understood than multifaceted growth (Hughes & Morgan, 2007). Multifaceted growth approach as developed by Mintzberg (1997) is used for understanding organizational growth and change. Considering the multifaceted nature of organizations, four approaches in this field are of most importance: financial growth, strategic growth, structural development and organizational growth (Wickham, 2006, p. 516).

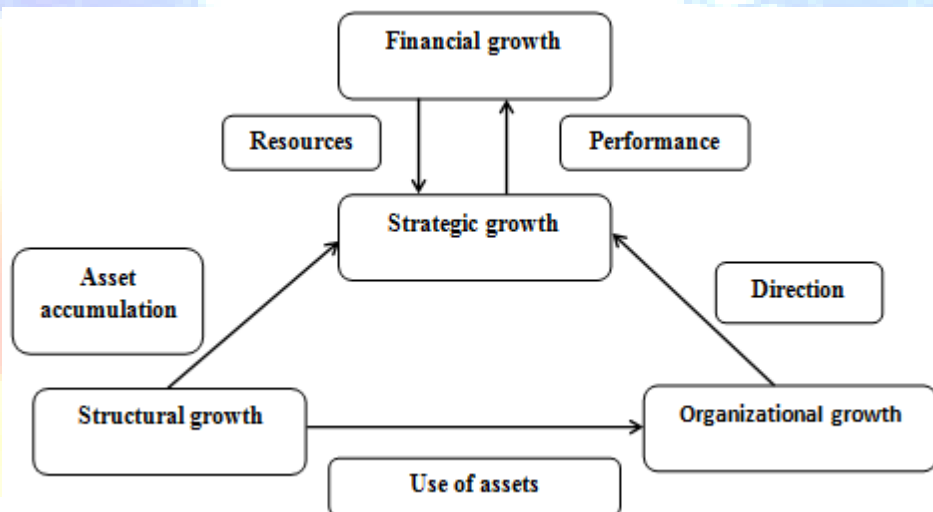
### **Dimensions of Growth of Business**

In a business that is regarded as a commercial entity, financial growth refers to turnover, costs, investments required for obtaining the turnover all of which lead to profit (Riding, 2008). Financial growth is measured by the added value that the organization creates and distributes between the stakeholders (Wickham, 2006, p. 514). Strategic growth refers to the change that is brought about by the interaction of the organization as a strategic whole with its environment. Basically, it involves any business that develops its skills for exploiting the market (Wickham, 2006, p. 515). Structural growth is related to the changes that a business makes in order to organize its internal system, especially with regard to the managerial roles and responsibilities, reporting relationships, communication links and resource control

systems (Lewis & Churchill, 1983). Organizational growth is related to the change in the organizational procedures, culture and attitude. It also pertains to the change actuates the role of entrepreneurship and leadership style to the effect of transforming the smaller organization to a larger one (Wickham, 2006, p. 514). It may provide some advantages for a business in dealing with its environment. Organizational growth focuses on changes inside an organization based on the several aspects including the business structure, culture, and the role of the entrepreneur and his management style (Eisenhardt and Schoonhoven, 1990).

These four aspects of growth are in fact the different building blocks of a unique underlying process. In the heart of the process lies the provision of valuable resources for the business springing from the foreign markets; because it creates more value and could be yet another alternative for offering. Ultimately, growth and the ensuing efficient competitive advantage are the rewards of the entrepreneur who identifying opportunities and understanding how to exploit them (Cassar, 2006). Figure 1 illustrates the four aspects of growth and their respective relations.

**Figure 1. Dimensions of growth of business**



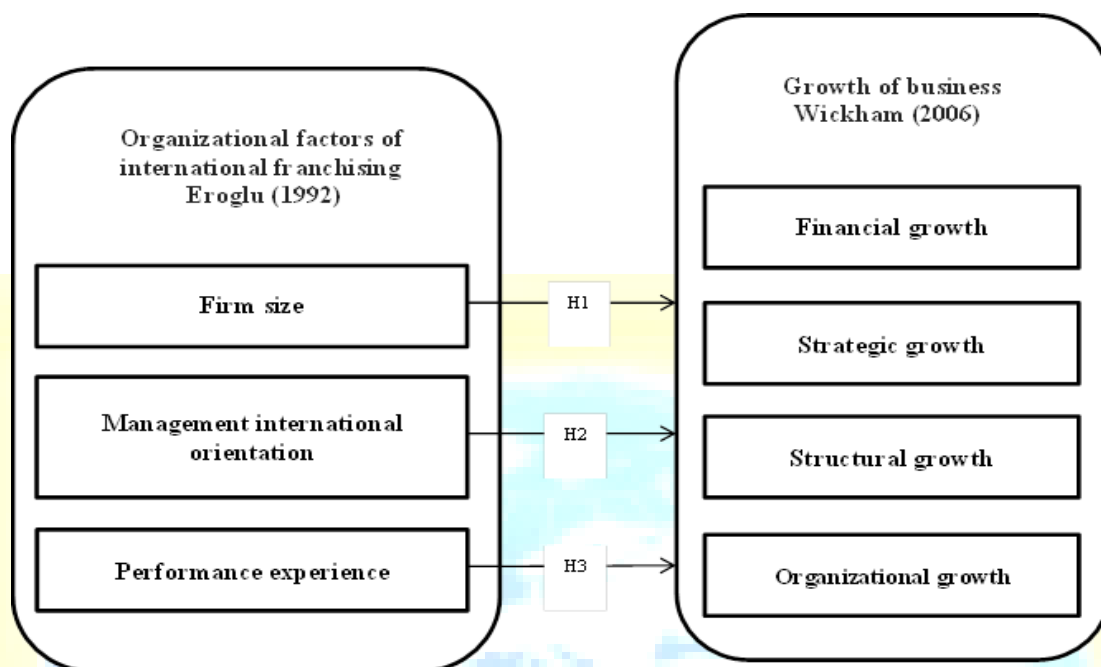
Source: (Wickham, 2006)

### Theoretical Framework

Several studies have done relating to the present research. However, the impact of organizational factor of international franchising on business growth is rare, especially with focus on the financial, structural, strategic, and organizational aspects. This indicates the innovativeness of the present paper in comparison to the other studies. Eroglu (1992) has

proposed a model related to the international franchising that has used by too many scholars. Accordingly, we used this model for proposing our conceptual model presented in figure 3:

**Figure 3. Theoretical framework of research**



Based on the theoretical framework of the research, the hypotheses are as follows. The following hypotheses have been derived from the research theoretical framework which itself is a summary of the previous literature reviews and the related earlier studies.

**H1:** Firm size has a significant influence on growth of businesses.

**H2:** Management international orientation has a significant influence on growth of businesses.

**H3:** Performance experience has a significant influence on growth of businesses.

## RESEARCH METHODOLOGY

The present paper is empirical in terms of purpose and employs a descriptive-survey method for collecting quantitative data. In this line, a questionnaire was designed by the authors in order to collect data from individuals engaged in franchises (active managers and experts in the field of international food industry franchises). The Structural Equation Modeling (SEM) was used for the data analysis and the Smart PLS 2 software was employed to evaluate the research's overall conceptual model. This research method is the best instrument for analyzing the relationships between complex variables where the sample size is small and the data distribution is non-normal (Diamantopoulos et al., 2012). The structural equation

modeling is composed of two parts: the measurement model and the structural model (Kline, 2010). Variables in the model are divided into two categories: observed and latent. Observed variables include the questions or statements from the questionnaire and the latent variables appear as the main dimensions and constructs. It is important to note that latent variables themselves exist on two levels: first-order and second-order. Second-order latent variables include the research main constructs (i.e. organizational variable reinforces tendency toward franchising) and the first-order variables include the constructs and dimensions i.e. firm size, management international orientation, performance experience. Moreover, the growth of businesses has also been mentioned as a first-order latent variable comprising of four questions. Table 1 illustrates the variables and the pertinent questionnaire statements:

**Table 1. Latent variables and Manifest variable (Questions)**

Latent variables of secondorder	Latent variables of first order (Dimensions)	Manifest variables
Organizational factor of international franchising	Firm size	5
	Management international orientation	5
	Performance experience	3
	Growth of business	4
Total of number questions		17

The research population consists of managers and experts engaged in active firms in food industry franchises which count to 130 individuals. Using the stratified random sampling method, a number of firms were selected based on similar levels of production as the categories. Then, sampling was carried out among each category. Three categories were formed and three firms with similar levels of production were put in each category. However, the data analysis results have been suitable only for all the presented firms and their categorization. The sample size was calculated using the Cochran formula. The assumptions include  $p=q=50\%$  (based on the probability approach),  $Z$  score as the standard normal distribution at the 95% confidence interval equals to 1.96,  $D$  as the estimated error rate equal to 8% and  $N$  as the population counting to 130 individuals.  $n = \frac{z^2 p q N}{N d^2 + z^2 p q} = 70$



The sample size was determined with 70 individuals, however, 80 questionnaires were distributed, just in case, among the statistical population across the firms from which 68 were filled out and collected (85% rate of return).

The present paper's questionnaire consists of three parts: the first part contains 13 questions about the organizational aspect of the tendency toward international franchising; part two contains 4 items about Growth of business. The questionnaire was designed according to the 5 point Likert scale. Table (2) illustrates these aspects and their reliability indices.

### Reliability

The PLS software was used in order to ascertain the reliability of the questionnaire. Reliability was measured based on two criteria: (1) Cronbach's Alpha; (2) composite reliability (CR). The Cronbach's Alpha value and composite reliability coefficient greater than 0.7 indicate acceptable reliability (Hulland, 1999). Illustrated in table (2), the results pertaining to these criteria suggest acceptable reliability for the research.

**Table 2. Criteria of reliability about research variables**

Composite reliability (CR)	Cronbach's Alpha	Second order variables	First order variables
0.812	0.754	Firm size	Dimension of organizational of international franchising
0.876	0.712	Management international orientation	
0.818	0.719	Performance experience	
0.889	0.843	-	Growth of business

The validity of the questionnaire was examined by the discriminant and convergent validity criteria specific to SEM. In this stage, particularly, the Average Variance Extracted (AVE) criterion was used in order to assess the convergent validity the result of which is depicted in table (3) for the research variables:

**Table 3. AVE values for research constructs**

Variable	Performance experience	Management international orientation	Firm size	Growth of business
AVE	0.716	0.608	0.641	0.723

The acceptable baseline value for the AVE is 0.5 (Fornell & Larker, 1981). As shown in the table above, all the AVE values for the constructs are higher than 0.5 and this supports the convergent reliability of the questionnaire.

As for the discriminant validity, the difference between the indices of one construct and those of another construct are compared with each other in the model. This is done by comparing the square root of the AVE of each construct with the correlation coefficient values between the constructs. As can be seen from table (4), the main diagonal values of the matrix (square root of the AVE coefficients for each construct) are greater than the values below and above the main diameter (correlation coefficients between each construct and other constructs). This demonstrates the discriminant validity of the constructs.

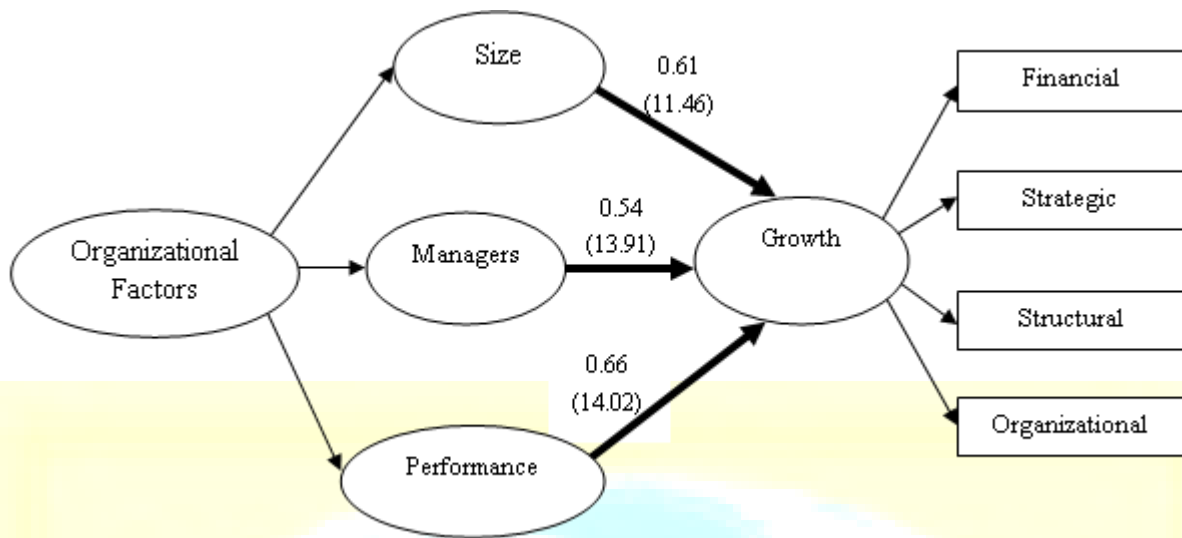
**Table 4. Comparison between the squared AVEs and constructs correlations**

	Firm size	Management international orientation	Performance experience
Firm size	<b>0.821</b>		
Management international orientation	0.142	<b>0.833</b>	
Performance experience	0.229	0.221	<b>0.877</b>

### Structural Model

In this stage, the causal relationships between organizational aspect of international franchising and growth of business were evaluated in a structural form. It is evident from the figure below that the impact of these aspects on growth is significant. This figure is the output of the model ran by the Smart PLS software and has two types of coefficients. The standardized coefficients of factor loadings which vary between -1 and +1 and the t-value coefficients have been shown in parentheses. The standardized factor coefficients show that each variable has an impact on the other one and the t-value coefficients reflect the significance of the hypotheses such that when these values are greater than 1.96 it could be concluded on the 95% confidence interval that the hypotheses are significant and the impacts are supported.

Figure 4. Output of Theoretical framework in Smart PLS



The PLS output supports the research hypotheses (Table 5). Since all the t-values are greater than 1.96, therefore, this supports all the hypotheses.

Table 5. The results of testing hypotheses

Hypotheses	t-values	Loadings
H1: Firm size → Growth of business	11.46	0.61
H2: Management international orientation → Growth of business	13.91	0.54
H3: Performance experience → Growth of business	14.02	0.66

### Discussion and Conclusion

As mentioned previously, growth and development are often considered as one of the most important goals that every business aspires to achieve. As a result, one of the most notable economic advancements in the recent century, having majorly affected the economic activities in different countries, springs from international franchising as a new means of doing business. The main advantage of franchising as a method of entering international markets is in that it allows the development of the business activities with a faster pace and in a greater extent and yet with lower costs, comparatively. Considering that the present research hypotheses were all confirmed suggests that the organizational elements of tendency toward international franchising including company size, senior managers' tendency toward international activities, and managers' experience in fields related to internationalizing businesses can positively and meaningfully affect the business growth in the food industry enterprises. There are many research efforts supporting the present research findings. For instance, the findings of ,Roh (2002), Oloutu and Awoseila (2011), Gillis and Castrogiovanni

(2012) argued that organizational factors are among the most important factors that can significantly affect growth in businesses. Therefore, the present research results (following the confirmation of the 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> hypotheses) are consistent with their study.

Therefore, considering the significant role of international franchising on business growth it is recommended that special attention be paid to such enterprises and the conditions be facilitated for them to thrive as they greatly contribute to economic development. By paying attention to their organizational size, the business owners and managers in the food industry can effectively contribute to their business growth. It is thus recommended that a great deal of R&D in these enterprises be allotted to investigating their size and how to control it in order to boost growth. On the other hand, as the second research hypothesis proved that managers' tendency toward internationalization affect business growth, it is then recommended that through enabling programs such as training, the managers be familiarized with concepts of international franchising so as to heighten their proclivity toward this strategy. Finally as the third hypothesis suggests, the experience of companies in the field of international franchising can affect their growth. It is therefore recommended that entering into cooperation agreements with leading foreign companies in the food industry be considered in the domestic companies' main agenda. Focusing on this type of cooperation and gaining the necessary experience in this field can pave the way to growth and development.

On the other hand, since the domestic food manufacturing companies in Iran possess a competitive advantage, it is recommended that they consider granting franchises in neighboring countries in their main strategic agenda. Future research can also examine the role of international franchising in improving employment and the effects that international franchising could have on enhancing or accelerating technology transfer in developing countries.

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