

**Franchising As an Entrepreneurial Activity**  
– **A Contemporary Policy Perspective**

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Presented at the Economics and Management EMNet 2005 International Conference  
Corvinus University of Budapest, Budapest, Hungary  
15-17 September, 2005

## **Abstract**

The present study takes an entrepreneurship viewpoint look at franchising in the Finnish context. To create a theoretical background, past franchising literature is reviewed and prior studies considering franchising as entrepreneurial activity are analyzed. The current Entrepreneurship Policy Programme is utilized as a frame of the study. The question is how franchising could be used to foster SME activity in the Finnish economy and how franchising is linked to the aims of the Entrepreneurship Policy Programme? The literature analysis showed that prior franchising studies have rarely regarded franchising as a form of entrepreneurship. Likewise, theories explaining the birth, growth and survival of franchising are rather distant from entrepreneurship. However, recent franchising enquiries have taken an approach that comes closer to entrepreneurship. Franchising is a rapidly growing form of business in Finland and its importance in the economy increases. Our investigation indicated that franchising has multiple features overlapping with the Finnish small business policy agenda and its goals.

**Keywords** franchising, entrepreneurship, small business policy, Finland

This study focuses on franchising. Franchising is approached from the viewpoint of entrepreneurship, in which case franchising is understood as a form of starting and conducting entrepreneurship and business.<sup>1</sup> The approach utilized in the study is not traditional; it is relatively new and little applied. The research tradition of franchising, like that of entrepreneurship, is fairly short, its foundation is multidisciplinary and its theories are rather undeveloped.<sup>2</sup> In business studies, franchising has largely been looked at from the point of view of marketing, i.e. as a retail distribution channel solution and a form of international business, as well as from a management point of view, i.e. as a form of organization, strategy and cooperation between enterprises. Earlier franchising studies have to a large extent been isolated, insufficiently integrated and relying too much on the viewpoint of one party, the franchisor (see e.g. Elango & Fried 1997; Stanworth & Curran 1999; Hoy & Stanworth 2003a; 2003b).

Our theoretical paper is organized as follows:

## **Previous franchising research – a literature review**

Franchising research has a fairly short history. The oldest known and frequently cited studies were published in the late 1960s. The *Journal of Retailing*, an academic journal focusing on marketing channels, edited a special issue dedicated to franchising in the winter of 1968.<sup>3</sup> The issue included several articles that can be regarded as the first pioneering efforts in the field of franchising research. Research on the contents of prior franchising studies was not launched until the late 1990s. For example Kaufmann (1996) brought forward franchising-specific fields of study of interest of the industry in his overview concerning the state of franchising research. These included the following: motivation to become a franchisee, franchisee failure rates and industry growth.

Subsequently Elango and Fried (1997) analyzed extensively previously published franchising studies. As far as is known, this was the first study of its kind. Their research material consisted of 99 known and widely cited studies, all of which were first summarized, after which their content was analyzed. They divided the studies into three more comprehensive streams: franchising and society, creation of the franchising relationship, and operation of a franchising system. The classification was based on their observations of different orientations, perspectives and research questions of the studies. The first category is politically oriented, and its viewpoint is that of the societal impact of franchising. The latter two are management-oriented. The second focuses on the organizational efficiency and

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<sup>1</sup> In *New Venture Strategies* from 1980, considered a classic, Karl Vesper saw franchising as one of the main strategic forms of competitive advantage, the so-called "entry wedge", with the aid of which a new enterprise can be founded, thus giving rise to new entrepreneurship in existing competition in the market without special innovation (Vesper 1990, 192-194, 217-224). Vesper's view is in line with that of Baumol (1986). According to the idea presented by Baumol, entrepreneurs can be divided into two groups on the basis of the nature of the business idea of the enterprise founded: initiative, i.e. innovative, and imitative entrepreneurs. In franchising, the franchisor could therefore be seen as being initiative and franchisees as imitative entrepreneurs. In franchising, business concept and operation that is already working and possibly successful is reproduced in a new market area. This way franchising contributes to efficient dissemination of innovations.

<sup>2</sup> E.g. Bygrave (1989, 7-13) described the multidisciplinary background of entrepreneurship, timing the actual development of the entrepreneurship paradigm to the beginning of the 1960s, when systematic empirical entrepreneurship research began. (see also Grant & Perren 2002)

<sup>3</sup> The special issue was published in the 43<sup>rd</sup> volume of the journal.

economic profitability of franchising. The third orientation uses the existing franchising relationship and its operative issues as its starting point.

Table (1) has been drawn up based on the analysis of Elango and Fried (1997). It shows, by research stream, the orientation, perspective and the disciplines of research in which studies have been conducted, as well as the fundamental research questions and most commonly studied individual issues in each category.

Table 1. Previous franchising studies elaborated (applied from Elango & Fried 1997)

Main stream of franchising study	Orientation, perspective and disciplines of study	Fundamental research questions	Issues
I Franchising and society	Public-policy Utility to society <ul style="list-style-type: none"><li>• Law</li><li>• Economics</li></ul>	<i>"Should we allow franchising?"</i>  <i>"How much the franchisor might abuse the relationship to the detriment of the franchisee?"</i>	Economic efficiency vs. antitrust concern -pricing -exclusive territories and dealings -contract clauses -disclosure
II Creation of the franchising relationship	Managerial Performance and profit maximization <ul style="list-style-type: none"><li>• Management</li><li>• Management science</li><li>• Economics, econometrics</li></ul>	<i>"Should we conduct business operations separately or in collaboration with others through a franchising system?"</i>	Franchising as a form of organization -reasons to franchise -rent sharing -units to own or franchise -international franchising
III Operation of a franchising system	Managerial Franchisees existing to operationalize the goals of the franchisor <ul style="list-style-type: none"><li>• Marketing</li><li>• Retailing</li></ul>	<i>"What is the best way to operate the franchising system?"</i>	Franchising as a type of marketing channel -control, power, autonomy -co-operation -trust, commitment, satisfaction -conflicts -dependence- interdependence- independence

In addition to semantic taxonomy of earlier studies, Elango and Fried (1997) made several recommendations, particularly concerning improvement of fragmented research. Firstly, they recommended that franchising theories be extended into resource-based theory, because according to them, franchising is ultimately about pooling franchisees' and franchisor's different resources. According their view, also the franchisor should be considered an agent,

because franchisees must monitor the operation of the franchisor.<sup>4</sup> In their view, the agent theory had been applied in a limited manner. All in all, they perceived that franchisees should be looked at as an intelligent party of the franchise relationship, not only as the implementer of the franchisor's objectives, which seemed to be the dominant view applied by earlier studies. Franchisees inevitably make their own important contribution towards the success of the relationship. The franchise relationship had been looked at in a static manner. According to Elango and Fried, it has thus so far been impossible to study the changing and dynamic relationship. They feel that the fundamental question of the relationship and the ultimate advantage of franchising, the relationship between decision-making authority and division of residual claim rights, deserves further research attention. They also pointed out the need for franchising examinations in individual business industries. (Elango & Fried 1997)

In their analysis of the methods used in franchising research, Elango and Fried (1997) found several factors that had restricted the studies. Firstly, empirical studies had been exclusively based on quantitative methods, which give a limited amount of information about a large number of cases. Results aiming at generalization tend to mask variation, and the complexity which is evident in practice and which qualitative case studies are able to reveal, is often lost. According to Elango and Fried, data had often been gathered by postal questionnaires, but the amount of secondary data was also considerably high. In empirical studies on franchisees, all subjects in a sample often came from a single franchise chain, whereas in studies on franchisors various franchise listings were used for sampling. The authors also observed a significant deficiency in the variables used for measuring performance. According to them, turnover or the number of outlets were merely too simplified as measures of performance. The main problem was from whose point of view performance should be measured – that of the franchisor, the franchisees or the system as a whole. Instead of descriptive studies that currently dominate the scene, the focus should be on prescriptive studies.

Subsequent the franchise literature classification by Elango and Fried (1997), more limited classifications have been proposed in other instances. As they were developing an integrative and comprehensive explanatory model for franchising, Stanworth and Curran (1999) analyzed previous literature and listed the most frequent subjects of franchise research. They were as follows: franchisor's motives for the adoption and retention of the franchise format, franchise contracts, the franchisor-franchisee relationship, locational and pricing decisions, trends in ownership redirection, and international franchising and globalization issues. Later, Hoy, Stanworth and Purdy (2000) came up with a partly similar classification. They identified six issues that had dominated franchising research: distribution channels, contract issues, international expansion and the benefits of internationalization, growth models and degrees of survival and failure.

Meanwhile, Young, McIntyre and Green (2000) published a content analysis of 285 research papers presented at thirteen *International Society of Franchising* (ISoF)<sup>5</sup> conferences held in 1986 and 1988-1999. This provided an applicable means of inspecting earlier franchising

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<sup>4</sup> The moral hazard problem is two-sided in franchising since franchisees need to monitor the franchisor. This causes a collective action problem for franchisees. (Lafontaine 1992)

<sup>5</sup> Founded in 1986 and operating in the US, the International Society of Franchising is an international community of academic franchising scholars. The society did not meet in 1987, but after that a conference has been arranged every year jointly with the annual convention of the International Franchise Association (IFA). Nearly 30 research articles are published each year in Conference Proceedings. The latest conference arranged in March 2004 was the 18<sup>th</sup>. The number of franchising studies published so far exceeds 400. Until 1999 the Society was known as the Society of Franchising, but the name was changed due to the increasing number of international participants. At present, the Society has 148 academic members from 17 countries.

research, because the community comprises many prolific frontline researchers and scholars, and many of the studies presented at the conferences are later published in academic journals in the field. The most popular subjects of the studies analyzed were as follows: international franchising (18%), franchise management (17%), franchise relationship issues (16%), performance and growth (13%), juridical and political issues (11%), marketing (9%), nature and scope of franchising (9%), economics (3%), entrepreneurship (3%) and methodology and modeling (2%). The results of Young et al. (2000) can thus be regarded as being mostly in line with those of Elango and Fried (1997), although the studies published within the ISoF have included a relatively large number of themes related to franchising implementation, which were called for by Elango and Fried.

A total of 154 or slightly over half (54%) of the studies analyzed by Young et al. (2000) were empirical studies. Secondary data was utilized in a good third (37%) of the studies. Interviews had been used as the primary method of gathering material in one out of seven (14%) studies, while postal surveys were the most widely used method, in 50% of the studies. The least frequently used method was case study, which was only used in ten studies. On this point the observation and criticism of Elango and Fried (1997) regarding the scant utilization of case studies is in line with the results of Young et al. (2000). There is a risk that studies relying strongly on quantitative methods produce descriptive results that are of relatively little use from the viewpoint of practical business management.<sup>6</sup>

The subjects of study of empirical research were fairly equally distributed. The most commonly studied group was franchisees (39%), followed by franchisors (34%) and other interest groups (27%). The observation of Young et al. (2000) is surprising on this point, because the franchisor's perspective has generally been the dominant one. The majority of empirical studies were fairly exclusively limited to the hospitality sector, i.e. hotel and restaurant industries. One fourth of the studies analyzed had been conducted outside the United States. In addition to the US, research findings had been published from a total of 21 countries.<sup>7</sup>

## **Franchising from the viewpoint of entrepreneurship**

Franchising-related research has been carried out for some 35 years. The research has been multidisciplinary in nature. Economics, marketing, entrepreneurial research, law, sociology and psychology are some examples of sciences and disciplines in which franchising-related studies have been published. The articles have mainly been of North American origin, but increasingly from other parts of the world as well. From the 1980s onwards, active research has been carried out in this field in Europe, particularly in Great Britain, as well as in Australia. The number of studies in the field has thus grown considerably since the 1990s. Despite the tradition of franchising research and the increasing economic importance of franchising, it has often been called to question whether franchising should be accepted as a legitimate field of study in its own right, or whether it should merely be thought of as a fairly peripheral type of inquiry within some branch of science. Although poorly understood at the

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<sup>6</sup> According to Hoy (1997), the problem of the results produced by entrepreneurial studies in general is their lack of practical relevance. Hoy & Stanworth (2003a, 6) do not regard the problem to be equally serious in franchising studies.

<sup>7</sup> Sixteen studies had been published on Europe, three of them on Scandinavia. Eleven studies focused on the Soviet Union or Russia, ten on Asia, eight on Australia, two on Central and South America, while there was one study each on Africa and India.

moment, franchising is without a doubt a phenomenon worthy of study (see Hoy & Stanworth 2003a, 1-5)

Published franchising literature can be roughly classified into three schools of thought. The differences between them are based on their diverse approaches to franchising (see Hoy & Stanworth 2003b, 9-10). The first school sees franchising as functional activity of existing business, which is why it should be studied by applying the models and theories regarding those functions. Examples of this are marketing and distribution channel studies conducted within marketing research, or management and related strategic or contract-based cooperation between firms. The second school sees franchising as an original phenomenon whose characteristics can however be explained through existing theories. Examples of the approach of this second school are general business theories such as agency theory and transaction cost theory as well as life cycle theory.

The third and most recent school approaches franchising as a unique phenomenon that can only be understood by developing or applying models or theories that are particularly suited for the purpose. Franchising is thus seen as a separate, individual phenomenon. Such early attempts have been put forth by Kaufmann (1996), Stanworth and Curran (1999) as well as Hoy, Stanworth and Purdy (2000). Kaufmann took up issues of research that were explicitly franchising-specific. Stanworth and Curran developed a sociological franchising model, while Hoy et al. identified six themes that had dominated franchising studies.

In this study, franchising is understood as a form of entrepreneurship and as part of entrepreneurship research. The conceptual starting point of the study is the uniqueness of franchising, which can be described and explained both by applying existing theories from other fields of science and by developing them in a franchising context (cf. 2<sup>nd</sup> & 3<sup>rd</sup> schools). Franchising is defined in the same way as Curran & Stanworth (1983, 11) ended up defining it as they studied the evolution of the franchising concept in earlier studies: "A business form essentially consisting of an organization (the franchisor) with a market-tested business package centered on a product or service, entering into a continuing contractual relationship with franchisees, typically self-financed and independently owner-managed small firms, operating under the franchisor's trade name to produce and/or market goods or services according to a format specified by the franchisor."<sup>8</sup>

Franchising is properly suited as a field of entrepreneurship research. As a discipline, entrepreneurship comes close to and overlaps many subjects in the field of business economy, such as marketing, management and accounting, while having a multidisciplinary background. The interrelation between entrepreneurship and franchising can be justified e.g. by the fact that franchising research is about entrepreneurial cooperation between two different types of entrepreneurs, franchisor and franchisees (Shane & Hoy 1996). Spinelli, Rosenberg and Birley (2004, xvi) agree with the prior view, as they perceive franchisors and franchisees as entrepreneurs (see also Stanworth 1995). In addition, franchising can be defined as a type of entrepreneurial organization. The operation of the franchisor, i.e. setting up the franchise system, and the operation of the franchisee, i.e. implementation of

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<sup>8</sup> The definition is of European origin, and it describes most accurately Business Format Franchising as opposed to Product Distribution and Trade Name Franchising. The definition has several deficiencies, e.g. in relation to market testing, financing and size of franchisee, as the authors later became aware of as well (see Stanworth & Curran 1999). In spite of this, the definition cannot be said to be in contradiction with the general definition developed later in this study, which does not have the shortcomings mentioned. The criteria drawn up to support the definition, i.e. specific franchising characteristics, made it rather exclusive (see Tuunanen 2003).

entrepreneurship within the franchise chain, are undoubtedly entrepreneurial activities (Hoy & Shane 1998). Vesper (1980) defines franchising as one form of entering the market upon which a new business and entrepreneurship can be based on.

The above views of Hoy and Shane have later received support from the study of Kaufmann and Dant (1999). It should however be taken into account that the view of franchising as entrepreneurship is strongly contradictory to the previously widely held belief according to which franchising was even seen as the antithesis of entrepreneurship. According to this view, franchising is multiplication of successful business operation that does not call for creativity, which is a typical feature of entrepreneurship (Kaufmann & Dant 1999, 6).<sup>9</sup>

Hoy and Shane (1998) identified significant overlapping between entrepreneurship and franchising in the seven main approaches prevalent in entrepreneurship research. By entrepreneurship research they referred to studies where the only unit of analysis was venture, i.e. not individual nor environment, all three of which are included simultaneously in the analysis of the process view of entrepreneurship. The venture as part of entrepreneurship research forms an entity of its own, with characteristics that distinguish it from the traditional firm or organization view (cf. Davidsson & Wiklund 2001). The subject of study is value creation through venture establishment or acquisition, albeit so that entrepreneurial actions prior to and subsequent start-up are included in the examination. Approaches to entrepreneurship research (Hoy 1995) and their links to franchising are as follows:

*Incubator Organizations.*<sup>10</sup> Franchise systems act as incubators of new ventures and franchise operations.

*Business Plans.* The franchisor requires that the franchisees have a business plan, which are therefore much more common in franchising than in independent business. In the United States, franchisors are obliged by authorities to draw up a public “business plan”, a document entitled Uniform Franchise Offering Circular, in order to ensure access to information of potential franchisees.

*Investment criteria.* Franchising is a source of capital needed for growth when other sources of financing are not necessarily available to the franchisor. Venture capitalists have played an increasing role as financiers of franchise systems.

*Success factors.* Studies on franchisors’ and franchisees’ failure and survival are a subject of constant study. The aim here is to compare the results obtained to the failure and survival of stand-alone firms.

*Corridor Principle.* Franchisors recruit potential franchisees among active entrepreneurs. In addition, franchisors have often worked as entrepreneurs or business managers prior to launching franchising.

*Corporate Culture.* In franchising, the franchisor must be able to establish and maintain circumstance where new franchisees are recruited and where they own and manage units

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<sup>9</sup> For example Rubin (1978) and Anderson, Condon and Dunkelberg (1992) have not kept franchisees as entrepreneurs.

<sup>10</sup> In this connection, incubator refers to the organization the entrepreneur comes from prior to establishment of the venture, i.e. not incubator in the traditional sense of the word.



independently (i.e. franchised units) or along with the franchisor (i.e. company-owned units; dual distribution).

*Life Cycle Models.* In franchising, the key issue is to understand the birth of the business organization and its later evolution into a franchise system.

Kaufmann and Dant (1999) combined research focusing on franchising, franchisors and franchisees into a separate, essential field of entrepreneurship research. They based this on an extensive analysis where definitions of entrepreneurship were first divided into three semantic groups, after which the applicability of franchising was compared to their contents. The three groups of concept were personal traits perspective, process perspective, and activities perspective.<sup>11</sup> As a result of the comparisons carried out, franchising was observed to be almost fully compatible with the concepts of entrepreneurship. According to the authors, the notions of entrepreneurship research are closely associated to manufacturing-type business, which on the other hand is alien to the commonly prevailing retail-type franchising.

In addition, Kaufmann and Dant (1999) pointed out four special franchising-related research themes that have relevance to entrepreneurship research. They were the following:

*Franchisor as Retail Entrepreneur.* In retail franchising, often relying on narrow niche segments, the scale of economically profitable business is significantly smaller compared to manufacturing. Franchising often involves development of a unique and efficient operative system where service provision is industrialized and transferable to franchisees. Identification, utilization and distribution of such concepts are well suited as a subject of study in entrepreneurship.

*Entrepreneurial Partnership of Franchising.* Franchising is based on an entrepreneurial partnership, where the concept innovated by the franchisor is distributed to the market through a network of outlets owned and managed locally by franchisees. There are unique risks and challenges involved in the local markets and outlet locations, even though the multiplied concept is the same.

*Franchisee entrepreneur.* For the franchisor, franchising is a means of acquiring capital and of solving the agency problem. The franchisor's risk is linked to development of the brand, while that of franchisees is linked to development of the local markets. All environments restrict entrepreneurship, but in franchising there are clear restrictions related to changing the concept. On the other hand, the franchisee is given a relatively large amount of freedom with respect to operating in the local market. The decision-making process where a new entrepreneur chooses franchising instead of setting up a stand-alone business deserves more investigation.

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<sup>11</sup> The authors were aware of the deficiencies regarding the concepts of entrepreneurship as well as the lack of consensus concerning a universal concept of entrepreneurship (e.g. Low & MacMillan 1988; Amit, Glosten & Muller 1993). Therefore they concluded to define entrepreneurship as a personal quality that is manifested by an individual engaged in entrepreneurial activity, which in turn is defined as the activities of a unique individual called an entrepreneur (Kaufmann & Dant 1999, 9). Moreover, they applied view presented by Venkataraman (1998). According that view entrepreneurship as a scholarly field should seek to understand *how* opportunities for profit are discovered and exploited, *by whom*, and with what *consequences*. The view was in line with three perspectives given to classify various definitions of entrepreneurship: how (*action*), by whom (*traits*), and consequences (*process*) (see also Shane & Venkataraman 2000).

*Multi-unit franchisee.* Multi-unit franchisees are an increasingly common phenomenon in franchising. Multi-unit franchisee is most commonly the result of expansion of individual franchise owners as they open new outlets, or a result of an area development contract. Multi-unit franchisees change the balance of power and risks in the franchisee-franchisor relationship. It is still unclear how franchisors choose franchisees as collaborative partners in different circumstances.

Kaufmann and Dant (1999) mentioned the importance of franchising for the national economy, both in terms of domestic and foreign trade, as an additional motivation for defining franchising as a separate area of research (cf. also Kaufmann 1996; Lafontaine 1996).

Stanworth and Curran (1999) regard franchising undoubtedly as a manifestation of modern economic individualism, where key cultural values typical of a competitive capitalistic system such as autonomy, independence, material rewards and even creativity are emphasized. These values have previously been linked too exclusively to traditional forms of entrepreneurship.

The strength of the entrepreneurship perspective lies in its comprehensiveness and its integrative nature. Entrepreneurship is properly suited as an approach for analyzing the phenomenon under study, both as a whole and on different analysis levels, e.g. franchisor (organization level), franchisee (individual level) and economy (macro level). According to the basic premise of the study, franchising is entrepreneurship, and franchising cannot appear without entrepreneurship.

The relatively short and multidisciplinary research tradition of franchising and the multi-level study of the phenomenon has produced quite a large number of individual studies that are poorly linked to each other, with too much emphasis on the franchisor point of view (see e.g. Stanworth & Curran 1999; Hoy & Stanworth 2003). Franchising studies have also been limited by the reigning paradigm (cf. Elango & Fried 1997). Franchising has been explained with the aid of common economic theories. The theories used have been separate, but complementary within a franchising context. A genuine, strong theory of franchising has not yet been developed. The model of Stanworth and Curran (1999) has been a pioneering effort to come up with such a model.

Theories, especially the oldest and the most commonly used theories explaining franchising, transaction cost theory and agency theory, have limited explanatory power, because their focus on franchising is very narrow: franchisor's choice of organization (management perspective) from the viewpoint of profit maximization and economic efficiency (economics perspective). In fact, transaction cost theory does not even recognize hybrid-form organizations between markets and hierarchies, of which franchising is one example. That is why many franchising-related phenomena have remained without a satisfactory theoretical explanation.

Theories that are more applicable, more recent and hitherto less used in the franchising context include resource-based theory and property rights theory. The strength of resource-based theory lies in its capacity to take into account both parties involved in the business operation, i.e. the cooperation, and the complementary and synergistic nature of their immaterial and material resources in business initiation and implementation. Property rights theory, on the other hand, complements and deepens the resource-based theory, because it too sees the cooperation as being resource-based. Strategic and operational decision rights,

ownership rights and residual income rights between the parties involved can be derived from resources. The division of rights is set down in the franchise contract, which is of strategic significance for both parties and which according to definition gives in itself rise to franchising. Property rights theory is suited for studying both business partners, and it can in principle be utilized on all levels of the model of Stanworth and Curran (1999). In addition, it focuses on the key issues of franchising as pointed out by Elango and Fried (1997), which should be given significantly more attention in future research. Putting it simply, a synthesis of resource-based theory and property rights theory takes us closer to a more comprehensive and flexible network theory, with the aid of which it may be very possible to model franchising as cooperation between companies.

The acceptance of franchising as an independent and legitimate field of study will very likely strengthen its independent theoretical development in the future. It has been estimated that strong theoretical development is close at hand, as pressure has increased to come up with better, i.e. holistic, integrative franchising theories with better explanatory power. Integrating customer markets into franchising theories remains one of the challenges for the future.

## **Overlook of franchising in Finland**

Franchising is a relatively recent form of entrepreneurship in Finland: it is still poorly known and recognized despite its growing importance in the global and national economy. First domestic franchise dates back to 1970's and a stream of franchises were initiated in the beginning of 1990's. Franchising grew between 1999 and 2003 nearly 15% annually in Finland. The latest usable franchising statistics from year 2003 show that there were a total of 177 franchise systems operating in Finland. Of these, 76 operated in retail, 71 in services and the remaining 30 in the restaurant sector. One fourth (n=44) of the franchise systems were of foreign origin and 75% were Finnish. As many as one in five (21%) of the Finnish franchise systems had gone international, and 8% stated the intention of entering the international market at a later date. The franchise chains had about 6,600 outlets, two thirds of which were owned and managed by a local franchisee. Franchise systems aiming at growth in the short term made up 75% of all franchise systems, and the targeted increase in the number of outlets was over 700. The high number may reflect the short tradition and early life-cycle stage of franchising in Finland, and the importance of franchising as a growth strategy. About half of the chains reported that they were in the growth phase of their life cycle, and one in five stated that they were only just entering the market. Problems in recruiting suitable franchise candidates has for many years been the biggest obstacle to strong growth in the sector. As a result of the obstacles, targeted growth has not been achieved. The total number of franchisees was about 3,700, which corresponds to about 1.7% of active companies in Finland. The number of jobs created by franchise systems was estimated at about 46,000 (less than 2% of the Finnish workforce). Combined turnover of the franchise systems came to about €4,88 billion which is around 3.4% of the Finnish GDP).

## **Business policy perspective**

At present there are more enterprises in Finland than ever before, a total of 230,400. The number of entrepreneurs, 213,000 (farming excluded) makes up 9% of the total workforce. The number is however significantly lower than in European countries with higher entrepreneurial activity (see Hyrsky & Lipponen 2004). In Finland, entrepreneurship seems

to be commonly held in high regard, and the atmosphere promoting entrepreneurship has developed in a positive manner. Despite this, there are too few of those who choose an entrepreneurial career. Culturally, we are still far from an entrepreneurial society (cf. Hyrsky 2001).

At the beginning of 2000, the Ministry of Trade and Industry launched an Entrepreneurship Project, which was included in the then Government's programme. The objective of the project was to promote stable economic growth, employment and competitiveness by enhancing the establishment of new firms and the growth and development of existing companies. The project was implemented in an ongoing basis which meant that measures were consecutively initiated and applied to promote entrepreneurship and business activities.

Initially a concrete objective for the entrepreneurship policy programme was set. It was declared that there is a need for 90,000 new small business owners by the year 2010. The figure was based on two things. First, the government set an employment goal of 100,000 new jobs and 30,000 new enterprises were required to reach that goal. Second, it was predicted that 60,000 enterprises will undergo a transition of ownership from one generation or owner to other during this decade. Nonetheless, the objective was rephrased afterwards and the programme does not include specified targets anymore. The main focus of the programme is on concrete projects that support entrepreneurship. Responsibilities and schedules are set up for each project to help coordination process and the follow-up measures. (Entrepreneurship Policy Programme, 2005)

In 2003 the current government launched an Entrepreneurship Policy Programme, which continued the work already done within the Entrepreneurship Project. The Ministry of Trade and Industry leads and coordinates the programme. The main objectives of the programme are to safeguard a stable and predictable operational environment for enterprises, to ensure that resources available for promotion of entrepreneurship in various administrative branches will be utilised to the full and efficiently and to place Finland among the top countries in Europe in terms of excellent conditions for business.

The contents of the Entrepreneurship policy program are in line with the strategic outlines of the report Green Paper: Entrepreneurship in Europe drawn up by the European Commission (Commission of the European Communities 2003). The general objectives of the policy program are included in the government agenda of Prime Minister Matti Vanhanen's cabinet entitled "Employment, entrepreneurship and common solidarity: the keys to an economic rebound". According to the government agenda, the aim of business policy is to promote economic growth and employment, to diversify production structure, to support stable regional development and to ensure the competitiveness of the Finnish economy. The aim of economic policy is to promote the establishment and growth of businesses, generation transfers and internationalization. The entrepreneurship policy program charts e.g. how entrepreneurship can be made more attractive as a career alternative, and how the operation and expansion of SMEs during the initial and growth phase as well as woman entrepreneurship can be supported. In addition, legislation will be developed so that unnecessary bankruptcies of viable businesses can be avoided. (see Hallitusohjelma 2003)

The key to increased employment and generation of economic growth seems to be growth oriented entrepreneurship. It has been estimated that 3-5% of new businesses generate as many as three fourths of all new jobs created by new businesses. Sixty-one per cent of the

fast growing businesses operate in the service sector, which is somewhat surprising. (Hyrsky & Lipponen 2004, 35, 73)

In an international perspective, maintaining Finland's current high economic competitiveness calls for expansion of the foundation of productivity growth, so that the standard of living of the welfare society can be raised. The GDP shares of business industries with poor productivity growth are quite significant, and the industries are overly dependent on domestic demand. Such service business categories include transportation, education, business services as well as health care and social services. Harmful labor market and goods regulation should be reduced in order to increase productivity growth and openness of the economy. The greatest opportunities are probably linked to setting up entrepreneur-driven well-being services. Compared to other OECD countries, there is more regulation and lack of competition in Finland. In addition, the public sector as well as the state-owned companies make up a large share of total production, while the share of foreign subsidiaries operating Finland is low. (see Lipponen & Viitamo 2003, 1, 9, 79-82)

## **Overlapping features of franchising and business policy**

Franchising does in fact have multiple linkages to today's Finnish business policy and promotion of entrepreneurship. Franchising is not presented here as a universal remedy, but rather as a mean among others for achieving goals. Several facts indicate that franchising will continue to grow in Finland in the near future as well. By fostering and speeding up this growth a number of outcomes can be achieved that have been now set as objectives for business, economic and entrepreneurship policy. The following features that have come up in the course of this study conjoin franchising to the current business-policy debate.

*Striving for growth.* Franchising is a growth strategy enabling fast regional expansion of business. Growth is the inherent characteristic of franchising and one of the prerequisites behind its success. Regionally, franchisee-owned units within franchise systems are often established peripherally, outside centers of growth as well. This may affect the supply and availability of goods and services in smaller towns and rural areas and therefore contribute towards a more balanced regional development. Growth firms, so called gazelles, are a rare phenomenon in Finland. An about one in 600 firm in Finland seems to be gazelle business characterized by fast and strong growth (Halttunen 2004, 297). Franchisors may be similar kind of growth oriented and growth intense businesses. It is necessary to state that perspectives and research of growth enterprises have been too limited in scope. Growth has traditionally been seen only as the organic growth of firms, as growth obtained through diversification or as growth through corporate acquisitions or mergers (cf. Halttunen 2004). The growth of franchising is multidimensional and occurs on various levels (cf. Tuunanen & Koironen 1998). The growth of the franchisor through a franchise-form hybrid organization deserves more attention, as growth can be measured immediately as the start-ups of new ventures, not just in terms of turnover generated or jobs created.

*Franchising lowers the threshold to entrepreneurship.* Earlier studies have shown that franchising creates entrepreneurial career opportunities for persons who do not necessarily pose the prerequisites required of self-employment and who would not become small business owners if franchising were not available as an option (see Stanworth & Curran 1999). The initial training provided by the franchisor and continuing support services, in addition to a pre-tested business concept that may be based on a well-known trade name

lower significantly the threshold to become small business owners. Franchising increases entrepreneurial opportunities in society by increasing the number of potential self-employed.

*The birth of vital new firms.* The growth aimed at by the franchisor occurs in cooperation with the franchisees. Growth gives rise to new ventures. The entrepreneurial risk of franchised enterprises that have been set up has been claimed to be considerably lower than that of other SMEs, because the survival rates of franchisees' ventures are higher. Franchising may thus lower mortality among new enterprises. According to statistics, 53% of enterprises established in Finland have ceased after the first five years of operation (Hyrsky & Lipponen 2004). It has been estimated that the corresponding figure for franchise ventures that have ceased their operation during that time is around 10-12%. Franchising gives rise to new enterprises, and they are based on a healthy and vital foundation.

*Woman entrepreneurship.* Studies show that franchising creates entrepreneurial opportunities for females in particular. Several reasons have been given for this: business industry explanation, risk-taking propensity, family or couple based entrepreneurship and the versatile support provided by the franchisor (Tuunanen 2002). If there is an aim to promote women's self-employment in particular, franchising offers one avenue. This is closely linked to prevailing entrepreneurial growth potential in the service sector.

*Internationalization.* Besides being a growth strategy, franchising is also a form of internationalization. Internationalized Finnish franchise systems generate export income for our country. Studies show that Finnish franchisors have been active in their internationalization efforts, and the number of those who are planning to go international in the future is relatively high. According to statistics of tax authorities, only some 3.5% of all firms in Finland are export firms (see Hyrsky & Lipponen 2004, 71). Promoting franchising would thus also indirectly increase enterprises' internationalization. In terms of internationalization, increased attention should be focused on the markets close at hand, the Nordic countries, the Baltic area, Central and Western Europe. Russia is however the area that merits special attention. Compared to the domestic Finnish market, the metropolitan areas of St. Petersburg and Moscow make up a market that is more than three times larger, and its purchase power is increasing all the time. Finnish companies have a number of advantages when it comes to making use of the Russian market. (cf. Koiranen & Tuunanen 1996; Tuunanen & Koiranen 1998; Anttonen & Tuunanen 2004; Anttonen, Tuunanen & Alon 2005)

*Franchising creates efficiency and competition.* The service sector offers the greatest potential for productivity growth as well as an increase in franchising in Finland. Deregulation and opening up public sector service provision for private companies and competition is crucial. Many well-being, social, healthcare, elderly and housekeeping services as well as personal services can be provided, and are already partly provided by the private sector. In the United States, for example, these services have in recent years been among the fastest growing business categories in franchising. There is no reason to doubt why this could not happen also in Finland and other Western countries that have experienced World War II and where the relative proportion of elderly people is constantly growing.

*Generating new franchise businesses.* New innovative franchise concepts can be innovated in Finland, in addition to which they can be imported here by contract. Alternatively, they can be imitated and adapted to the domestic market. New concepts can also be based on the

utilization of high technology and be information/competence-intensive in nature (e.g. people working in expert professions).

*Young Finnish franchising culture.* The gap in the franchising knowledge and competence in our country has been a fact, although there has been some improvement as franchising has grown. Increased awareness and strengthened competence promote the growth and success of franchising. Since franchising penetration in our country is lower than in the comparative countries, there seems to be unexploited potential. Lack of appropriate future franchisees is a factor that limits faster growth of franchising in our country in particular.

The special characteristics of franchising listed above are features that make franchising as a multifaceted form of entrepreneurship worthy of more attention in research, education and the business policy applied. The list shows several potential areas where franchising can be utilized to foster SME activity in the Finnish economy. There are many linkages between inherent features of franchising and present business policy and its goals.