Does the Theory of Entrepreneurship Suite to Franchising ?

Jenni Torikka
University of Jyväskylä, School of Business and Economics
P.O. Box 35, FI-40014 University of Jyväskylä, Finland
jenni.m.torikka@jyu.fi

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Jenni Torikka[1]

Abstract The current essay takes an entrepreneurship viewpoint toward franchising. The applicability of the general theory of entrepreneurship, presented by Shane (2003) is explored in the franchising context. Shane introduced a model of entrepreneurial process in response to the failure of prior research to provide one. According to Shane, prior research has tended to look at only part of entrepreneurial process and thus, a general theory on entrepreneurship has not been formed. Studies that consider franchising as a form of entrepreneurship are scarce as well as studies on the entrepreneurial process of a franchisee. This conceptual study examines what new aspects and what possibilities could the general theory of entrepreneurship provide to franchising research. Findings provide implications for franchising researchers, franchisors, people interested in becoming franchisees as well as for organisations planning to franchise their business.

Keywords: entrepreneurial process, entrepreneur, franchisee, franchisor

1 Introduction

The research tradition of both franchising and entrepreneurship is fairly short and foundations are multidisciplinary with theories still developing. 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 market entry; from a management point of view, i.e. as a form of organisation, strategy and cooperation between enterprises; and from a business law point of view as a form of contractual relationship. Furthermore, earlier franchising studies have to a large extent been isolated, insufficiently integrated and overly reliant on the viewpoint of the franchisor.

Since the early examinations on franchising at the end of 1960's, studies that have discussed whether franchisors and franchisees could be seen as entrepreneurs have emerged every now and then. However, in total they have been scarce in number when compared to other topics and points of view taken to franchising. Some studies have discussed topics closely related to entrepreneurship e.g. inde-

[1] Jenni Torikka
School of Business and Economics, University of Jyväskylä, P.O. Box 35, FI-40014 University of Jyväskylä, Finland
jenni.m.torikka@jyu.fi

pendence and innovation in the franchising context, but have not specifically analysed franchising as a form of entrepreneurship. Analyses on the relationship of franchising and entrepreneurship have emerged later, particularly during the last decade and they have mainly been conceptual studies.

One reason for the fact that not many entrepreneurship or franchising scholars have applied the tenets of entrepreneurship to franchising research[2] might be the long prevailed lack of general theory of entrepreneurship. Shane (2003) introduced a framework of general theory of entrepreneurship in response to the failure of prior entrepreneurship research to provide one. Shane mentioned franchising as one option to exploit an entrepreneurial opportunity and therefore, saw franchising as a form of entrepreneurship. Nevertheless, he included only few franchising investigations among the studies he introduced. This shows that despite the fact that in recent years, progress has been made in creating a general theory of entrepreneurship, franchising studies have not been included. Therefore, it can be said that franchising is not widely accepted and discussed as a form of entrepreneurship.

In this essay franchising is seen as belonging to the field of entrepreneurship i.e. franchising is understood as a form of starting and growing new ventures and organisational forms and as a mechanism for introducing new products and services to expanding markets[3]. This essay looks at the process of becoming and entrepreneur and franchisee and the framework of Shane (2003) is used as the basis for analysis. It is examined what new aspects and what possibilities could the general theory of entrepreneurship provide to franchising research. Focus of the analysis is on the first two parts of the Shane’s entrepreneurial process; opportunity discovery and decision to exploit the opportunity.

Following are some essential backdrop issues that will help to understand the context of this conceptual study. Firstly, regarding the study, it is essential to recognize the differences between forms of franchising; business format franchising, trade name and product distribution franchising. When discussing franchising in this essay, only business format franchising is considered. Secondly, the term entrepreneur does not refer here to a highly creative venture based on a new and novel product and service. Instead, it is used in a more everyday sense and is meant to be interchangeable with the term self-employed or small businessman/-

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[2] cf. for example Shane and Hoy 1996.

[3] 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 Baumol (1986), 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. Franchisors 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.

woman (cf. Stanworth, 1995b).[4] This is congruent with the definitions for entrepreneurship used by Shane (2003) as well as with the assumptions he makes regarding entrepreneurial process[5]. It is also in line with Shane's description of innovation. According to Shane, entrepreneurial process requires some form of innovation, but it can be much milder than the Schumpeterian (1934) innovation. What is needed is a recombination of resources into a new form. This type of milder innovation is often associated with Kirznerian (1997) perspective. Worth of noticing is that neither one of the perspectives guarantees success or growth. Lastly, approach applied in this study is to consider franchisees as entrepreneurs. Over the past years, several contrary statements have been presented against the view (see e.g. Rubin, 1978; Norton, 1988; Anderson, Condon and Dunkelberg, 1992).

This essay is organised to review prior franchising research, to portray the key features of the general theory of entrepreneurship introduced by Shane (2003), to examine what new aspects and what possibilities could the Shane's framework provide to franchising research and to present conclusions and recommendations for future research.

3 Literature review

3.1 Previous franchising research

Analysis based on the work of Elango and Fried, 1997; Hoy, Stanworth and Purdy, 2000; Young, McIntyre and Green, 2000; Combs and Ketchen, 2003; Hoy and Stanworth, 2003a and 2003b; Dant, 2008

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[4] Entrepreneurship and entrepreneurial in the English language are often qualitative statements of people who take care of their firms in a certain way. There are other languages, such as Finnish, where no other terms or synonyms (with connotations to growth orientation or self employment) for entrepreneur exist. International comparisons are difficult, because the core term entrepreneurship is very culturally oriented (Huuskonen, 1992, 194).

[5] By founding of a new business Shane (2003) meant forming of a business venture or not-for-profit organisation that previously was not in existence. As self employment he defined performing work for personal profit rather than for wages paid by others. Furthermore, depending on the situation, self employed person may incorporate business and employ others. Shane also assumed that being entrepreneurial does not require the creation of a new firm and that entrepreneur can use market mechanisms, such as licensing or franchising, to exploit entrepreneurial opportunities.

3.2 Franchising from the viewpoint of entrepreneurship

Analysis based on the work of Shane anf Hoy 1996; Kaufmann, 1996; Kaufmann and Dant, 1999; Hoy, Stanworth and Purdy, 2000; Hoy and Shane 2003; Tuunanen and Hoy, 2007; Tuunanen, 2007

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3.3 The process of becoming a franchisee

Analysis based on the work of Kaufmann and Stanworth, 1995; Stanworth and Kaufmann, 1996; Price, 1997; Kaufmann, 1999; Williams, 1999; Kaufmann and Dant, 1999; Guilloux, Gauzente, Kalika and Dubost, 2004; Bennett, Fraser and Weaven, 2009

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3.4. Entrepreneurial process by Shane

3.4.1 The individual-opportunity nexus framework

The study of entrepreneurship spans a wide range of fields including decision sciences, economics, management, sociology, psychology, history etc. Thus, entrepreneurs, their behavior and firms have been examined from different disciplinary ankles. However, no prevalent consensus regarding the definitions, the process of becoming an entrepreneur or the factors influencing the process, have been reached. Shane (2003) presented a conceptual framework for entrepreneurship in response to the failure of prior research to provide one. According to Shane, prior research has tended to look at only part of entrepreneurial process and thus, a general theory on entrepreneurship has not been formed. The individual-opportunity nexus framework of Shane examines the characteristics of opportunities, the individuals who discover and exploit them, the processes of resource acquisition and organising, and the strategies used to exploit and protect the profits from those efforts.

Some of the key assumptions of the Shane's framework were the following: entrepreneurship is a process (see also e.g. Bird 1989; Huuskonen 1992; Bygrave, 2004).[6] Additionally, entrepreneurial opportunities are objective and exist independent of the actors in a system[7]. Moreover, specific individuals are required in discovery and exploitation of entrepreneurial opportunities since opportunities themselves lack agency.

As said by Shane, the entrepreneurial process involves the identification and evaluation of opportunity, the decision whether or not to exploit the opportunity, the efforts to obtain resources, the process for organising those resources into a new combination and the development of a strategy for the new venture. Additionally, he indicated that all the different activities of the process are influenced by individual- (psychological and demographic) and environmental- (industry and macro-environment) factors. The framework of Shane assumes that the entrepreneurial activity is directional and ordered, but it accepts the possibility of feedback loops and non-linearity. Earlier, but supportive to Shane's assumptions was Huuskonen's (1992) notion that if a person gives up the intention to become an entrepreneur the negative decision might not be permanent. The decision connects back to background, personal and environmental factors and the process may start again later. The findings of Huuskonen are by and large congruent with Bird (1989).

3.4.2 Key postulations of the individual-opportunity nexus framework

Shane reviewed both theoretical and empirical research on entrepreneurship and thus, he presented both conceptual and operational definitions of entrepreneurship. First, he defined entrepreneurship as an activity involving the discovery, evaluation and exploitation of opportunities to introduce new goods and services, ways of organising, markets, processes and raw materials through organising efforts that previously had not existed. Second, the operational measures he adduced were new firm formation and self employment. By *founding of a new business* Shane meant the forming of a business venture or not-for-profit organisation that previously was not in existence. As *self employment* he defined performing work for personal profit rather than for wages paid by others. Furthermore, Shane indicated that depending on the situation, self employed person may incorporate business and employ others.

Along with examining the entrepreneurial process, he looked at studies on business operations and performance and introduced four operational measures of performance: 1) *survival* (continuation of the entrepreneurial effort), 2) *growth* (an increase in the new venture's employment and sales), 3) *profitability/income* (the

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[6] Entrepreneurship has also been seen as a *career*, for instance by Bird, 1989; Katz, 1994; Dyer, 1994; Henderson and Robertson, 1999; Feldman and Bolino, 2000; Carter, Gartner, Shaver and Gatewood, 2003.

[7] The view represented by Shane is called *discovery view* of entrepreneurship and it is in marked contrast to an alternate *creative view*, according to which opportunities do not exist in any objective form, but are merely a social construction (Shane 2003, xi).

surplus of revenues over costs) and 4) *experiencing initial public offering* (the sale of stock to the public).

According to Shane's model *entrepreneurship requires*: 1) Existence of opportunities or situations in which people believe that they can use new means-ends frameworks to recombine resources to generate profit. 2) Differences between people. People differ in access or ability to recognise information about opportunities. Further, entrepreneurship requires that a person acts upon an opportunity. Therefore, people vary in their ability and willingness to recognise and act upon opportunities which influences the entrepreneurial process. 3) Risk bearing because exploitation of opportunity is uncertain. 4) Organizing, i.e. creation of a new way of exploiting the opportunity that did not previously exist. 5) Some form of innovation meaning the recombination of resources into a new form according to the judgment of the entrepreneur. In addition, Shane described what *entrepreneurship does not require*: 1) The creation of new firms to exploit opportunities. 2) The entrepreneurial effort to be undertaken by a single entrepreneur alone. 3) Successful outcomes. 4) The factors explaining one part of the entrepreneurial process to explain other parts.

Essential in Shane's model is the definition of *innovation*. According to him, entrepreneurial process requires some form of innovation, but it can be much milder than the Schumpeterian (1934) innovation resulting in new combinations that speed up creative destruction. What is needed is a recombination of resources into a new form. This type of milder innovation is often associated with Kirznerian (1997) perspective. Worth of noticing is that neither one of the perspectives guarantees success or growth.

Shane (2003, 18) defined an *entrepreneurial opportunity* as a situation in which a person can create a new means-ends framework for recombining resources that the entrepreneur believes will yield a profit. He continued by saying that the main difference between an entrepreneurial opportunity and many other situations in which people seek profit is that an entrepreneurial opportunity requires the creation of a new means-ends framework rather than just optimising within an old framework. Further, according to Shane (2003, 39) *entrepreneurial decision-making*[8] involves making non-optimised decisions through the formation of new means-ends frameworks. At the same time, the creation of new means-ends framework involves judgmental decision-making. And because the exercise of judgment involves making different decisions than others, an entrepreneur must either possess different information than others or interpret the same information differently. Resulting from this, entrepreneurial decision-making involves creativity.

3.4.3 Discovery of entrepreneurial opportunities

[8] Entrepreneurial decision-making has also been called judgemental decision-making (Casson 1982, 1995) and effectuation (Sarasvathy 2001).

Shane brought out the following things related to the role of individuals in the discovery of opportunities. According to him, people discover opportunities that others do not see for two reasons: 1) they have better access to information about the existence of the opportunity. Previous life experience (especially job and variable life experience), social network structure (social ties and their strength) and information search (systematic search) influence the likelihood that people will gain early access to information valuable for recognising opportunities. 2) People are better able to identify opportunities than others if they can more easily recognise opportunities, given the same amount of information. Person's absorptive capacity and cognitive processes influence his/her ability to recognise opportunities given a certain amount of information. The most important aspects of absorptive capacity are prior knowledge about markets and how to serve the markets whereas the most important cognitive processes are intelligence, perceptive ability, creativity and not seeing risks (entrepreneurs tend to see opportunities where others see risks).

A measure often applied in studies examining the entrepreneurial decision-making process is intentions. Shane (2003) mentioned that intentions serve entrepreneurial opportunity recognition. Bird (1988) defined entrepreneurial intentions as entrepreneurs' states of mind that direct attention, experience, and action toward a business concept and set the form and direction of organisations at their inception. She continued by saying that organisational outcomes such as survival, development, growth and change are based on entrepreneurs' intentions. When discussing about intentions, Huuskonen (1992) presented paths of selection related to becoming an entrepreneur. At first level is the general public, at the second level are the ones interested in becoming entrepreneurs, then the ones considering entrepreneurship, next the ones who intend to become entrepreneurs and finally, the ones who become entrepreneurs.

3.4.4 Exploitation of entrepreneurial opportunities

Shane saw entrepreneurship as a process including various phases and activities. He indicated that all the different activities of the process are influenced by individual- (psychological and demographic) and environmental- (industry and macro-environment) factors. When looking at the decision to exploit the entrepreneurial opportunity, he brought up that both psychological and demographic individual differences have a powerful effect on who exploits entrepreneurial opportunities and who does not. He defined individual differences as any type of variation among people, including things that are stable over time as well as things that change over time. The entrepreneurial literature has shown that the people who engage in entrepreneurial activity are not randomly determined and certain individual characteristics are associated with that decision.

Individual non-psychological factors. Shane listed the following non-psychological factors as the ones influencing the decision to exploit: opportunity cost, married/working spouse, education, career experience, age and social position. People are more likely to exploit opportunities as the gap between expected utility of exploiting opportunities and the alternative uses of their time is bigger.

The gap is larger if a person has a lower *opportunity cost* to alternative uses of his/her time. Thus, people who have higher incomes are less likely and people who are unemployed are more likely to exploit opportunities. Being *married and having a working spouse* increases the likelihood that a person will exploit entrepreneurial opportunity because a working spouse allows an individual to better bear the uncertainty of income from entrepreneurial activity. Likewise, more-educated people are more likely to exploit opportunities than less-educated people, because *education* provides people with information and skills that will make them better able to exploit opportunities. According to Shane, *career experience* (general business experience, industry experience, functional experience in management, marketing and product development as well as previous start-up experience) provides another source of information and skills useful to the pursuit of opportunity. Similarly, parental entrepreneurial experience increases the likelihood of opportunity exploitation since parents can act as role models. *Age*, on the other hand, has a curvilinear relationship with entrepreneurial opportunity exploitation: initially age increases the likelihood of opportunity exploitation, but as people age, they are less likely to exploit opportunities since they are less likely to bear uncertainty and their opportunity costs rise. Person's *social position* also influences his/her tendency to exploit entrepreneurial opportunities: social status gives "creditworthiness" and social contacts provide information useful to the exploitation process.

Regarding the influence of the non-psychological individual factors on a person's performance at entrepreneurial activities, Shane presented the following study results: Opportunity cost has a negative influence whereas being married and having a working spouse, education, general business experience, industry experience, start-up experience, parental entrepreneurial experience and social ties have positive effect on performance at entrepreneurial activities. Age, on the other hand, has a similar inverted U-shaped relationship with performance at entrepreneurial activities as it has with exploiting entrepreneurial activities.

Individual psychological factors. With the non-psychological factors mentioned above, Shane (2003) discussed on psychological factors influencing the tendency of people to exploit entrepreneurial opportunities. He divided the factors on three categories: aspects of personality and motives (extraversion, agreeableness, need for achievement, risk-taking and independence), core self-evaluation (internal locus of control and self efficacy) and cognitive characteristics (overconfidence, representativeness and intuition).

Shane (2003) depicted the five aspects of personality and motives in a following way: *extraversion* is an aspect of personality associated with persuasive ability. Extraversion incorporates the attributes of sociability, assertiveness, activeness, ambition, initiative, impetuousness, expressiveness, gregariousness, talkativeness, surgency and exhibitionism. Extraversion will increase the likelihood that a person will exploit entrepreneurial opportunities because opportunity exploitation involves persuading others that the opportunity that she/he has identified is valuable. *Agreeableness* is an aspect of personality that incorporates the attributes of friendliness, social conformity, compliance, flexibility, tendency to trust, cooperativeness, tendency to forgive, tolerance, soft heartedness and courteousness. People possessing this aspect of personality are less likely than other people to exploit opportunities because opportunity exploitation requires a person to be critical and sceptical so as to separate more valuable information from less valuable information when making the decision to exploit. *Need for achievement* is a motivation that leads people to undertake activities and tasks that involve personal responsibility for outcomes, demand individual effort and skill, involve moderate risk and provide clear feedback. People who are higher in need for achievement will be more likely to exploit entrepreneurial opportunities because it requires solving novel and ill-specified problems as well as sustaining goal-directed activity over long period of time and involves goal-setting, planning and information gathering. *Risk taking propensity* is an aspect of personality that measures peoples' willingness to engage in risky activity. Risk-taking propensity increases a person's tendency to exploit entrepreneurial opportunities because risk bearing is a fundamental part of entrepreneurship. *Desire for independence* is an aspect of personality in which people prefer to engage in independent action rather than action involving others. People with strong desire for independence are more likely to exploit entrepreneurial opportunities because entrepreneurial activity entails following one's own judgment as opposed to following the judgement of others.

As stated by Shane, core self evaluation is a psychological construct including the dimensions of self efficacy/self esteem and locus of control, that focus on people's sense of control over their external environment. These dimensions influence the likelihood of a person to exploit entrepreneurial activities. Shane portrayed these dimensions as follows: *locus of control* is a person's belief that she/he can influence the environment in which she/he is. People with an internal locus of control have a stronger sense that they can control their own environment, and will be more likely than people with external locus of control to exploit an entrepreneurial opportunity. *Self efficacy* is the belief in one's own ability to perform a given task and it increases the person's willingness to exploit an entrepreneurial opportunity.

Shane indicated that cognitive characteristics are factors that influence how people think and make decisions. Cognitive characteristics tend to be much less stable over time than motives and core self evaluation and tend to be more heavily influenced by a person's perception of a situation. Three cognitive characteristics presented by Shane influence the exploitation of opportunities: overconfidence, representativeness and intuition. O*verconfidence* is the belief in the accuracy of one's own judgment that is too high given actual data. Overconfidence encourages people to exploit entrepreneurial opportunities because it leads people to take action in situations which they do not have enough information to assess the likelihood of their success, but where further investigation would reveal the poor odds, short opportunity half-life or low opportunity value facing them. Overconfidence also leads people to follow their own information instead of listening that provided by others, to disregard disconfirming information and to misperceive the riskiness of actions. *Representativeness* is the willingness to generalise from small samples that do not represent a population. It increases the likelihood of opportunity exploitation because it makes people more likely to make decisions in situations where there is little historical information to guide decisions, where greater effort to analyse information will not resolve uncertainty, where people are not experts and where quick action is required. *Intuition* is a belief or feeling that something is true without actually demonstrating its truthfulness. Intuitive decision-making will increase the likelihood of opportunity exploitation because a decision to exploit an entrepreneurial opportunity must be made under time pressure, uncertainty and limited information.

Regarding the influence of the psychological individual factors on a person's performance at entrepreneurial activities, Shane (2003) presented the following study results: extraversion and need for achievement have positive effect on performance at entrepreneurial activities whereas the effect of risk-taking propensity and desire for independence is negative. Moreover, he stated that prior research has shown that both internal locus of control and intuition have positive effect on performance at entrepreneurial activities.

Industry factors. According to Shane, people with same individual characteristics will make very different decisions about founding a firm depending on the industry context were they find themselves. Furthermore, industry differences affect the performance of people at entrepreneurial activities. However, prior research has not been able to identify different industries as supportive or supportive of new firm formation and thus, researchers have examined the effect of a smaller set of theoretically driven industry differences in the rate of new firm formation. In general, research has focused on five categories of industry differences: knowledge conditions, demand conditions, industry life cycles, appropriability conditions and industry structure.

Shane (2003) portrayed these industry differences and their influences on the exploitation of entrepreneurial opportunities through firm formation as follows: *Knowledge conditions* are the aspects of the industry that affect how people gather information about the production of goods and services in an industry. Knowledge conditions include such factors as the R & D intensity of the industry, the reliance on innovation by small firms, the degree which an industry relies on public sector institutions to innovate and the level of uncertainty in the industry. Firm formation is shown to be more common in industries that are more R&D intensive, in which extra-value chain sources of innovation are more important, that have a greater level of small firm innovation and that are less uncertain. *Demand conditions* include such factors as the size, growth rate and segmentation of the industry. Empirical evidence shows that firm formation is more common in industries that are larger, faster growing and more segmented. Shane indicated that there is empirical evidence on three areas of study under *industry life cycles* i.e. industry age, dominant design and firm density. Empirical evidence shows that firm formation is more common in industries that are younger and have not yet converged on a dominant design. Further, new firm formation is shown to initially increase with the number of firms already in the industry and to decline when the number reaches a high level. *Appropriability conditions* examine the ability of entrepreneurs to capture the returns to opportunity exploitation as a function of patents, complementary assets and other methods of appropriating the returns to innovation. The empirical evidence, although very limited, shows that firm formation is more common in industries in which patents are more important, and complementary assets in manufacturing, marketing and distribution are less important in appropriating the returns to innovation. *Industry structure* is the set of characteristics that affect the long-term competitive dynamics, cost structure and profitability of an industry. Earlier research has examined six dimensions of industry structure that influence new firm formation: industry profitability, input costs, capital intensity, advertising intensity, industry concentration and average firm size. Empirical evidence shows that firm formation is more common in industries that are more profitable, have lower cost inputs, are less capital and advertising intensive, les concentrated and have lower average firm size.

Regarding the influence of the industry factors on venture performance, Shane (2003) presented the following study results: Of the dimensions of the knowledge conditions, industry uncertainty seems to affect negatively on new firm performance whereas the effect of market size and market growth are positive. Of the dimensions of industry life cycles, industry age, presence of a dominant design and density of firms affect negatively on new firm performance. Of the dimensions of industry structure, capital intensity, industry concentration and average firm size have a negative influence on new firm performance.

Environmental factors. As indicated by Shane (2003), people’s decisions to exploit entrepreneurial opportunities are affected by the context in which they operate and one important dimension of the context is the institutional environment. Institutional environment consists of the economic, political and cultural context in which the entrepreneur finds her/himself. Therefore, it includes both the set of incentives to which economists believe people respond as well as the social setting that sociologist believe determines legitimate and acceptable behaviour. Related to the context Shane brought out the choice between productive and unproductive entrepreneurial activities and that institutional environment influences people’s willingness to engage in socially productive entrepreneurial activity.

Shane summarised the effect of the institutional environment on entrepreneurial opportunity exploitation as follows: *Economic environment* – income, capital gains and property taxes reduce the level of opportunity exploitation where as economic growth, societal wealth, low rates of inflation and stable economic conditions increase the level of opportunity exploitation. *Political environment* – political freedom, strong rule of law, property rights and decentralisation of power increase the level of opportunity exploitation. *Socio-cultural environment* – social desirability of entrepreneurship, presence of entrepreneurial role models and specific cultural beliefs increase the level of opportunity exploitation.

Regarding the influence of the industry factors on venture performance, Shane (2003) presented the following study results: of the aspects of economic environment, there is some empirical evidence of the influence of wealth and taxes on performance of new ventures. Wealth has a positive effect and taxes a negative effect. Noteworthy is, that the empirical evidence was scarce on both. Shane did not present empirical results on any of the aspects of political or socio-cultural environments to new venture performance. Shane mentioned that the institutional environment probably influences opportunity recognition, but there is very little theoretical or empirical research discussing the relationship.

Discussion and implications

Work in process, to be filled in later

Propositions for future studies

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