

GLOBAL DIFFUSION OF FRANCHISING: A COUNTRY LEVEL EXAMINATION

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Franchising has experienced rapid international growth. This study examines strategic and country characteristics in twenty-four nations to explain the spread of franchising across borders. The size of the franchising sector along with the country factors of per capita income, urbanization, media availability, and certain cultural values were positively associated with franchising diffusion. Contrary to expectations, strategic characteristics were more important than country characteristics in explaining franchising diffusion. The implications of these findings for practice and research are discussed.

Strategic alliances are increasingly prevalent among multinational corporations (MNCs) because they offer lower cost entry into untapped markets and permit teaming up with a knowledgeable partner in the host market. Previous research on the use of strategic alliances by MNCs has focused on the use of contracts, licensing, and joint ventures. Due to franchising's fairly recent expansion in the international arena, there is a relative dearth of information about the nature and scope of its use around the world. This study seeks to fill this gap by examining the spread of franchising in international markets and those factors contributing to it.

CONCEPTUAL MODEL

Franchising is a specific type of organization strategy and is relatively new to international markets. As a result, franchising represents an innovation for adopting firms. Management theory offers two alternative frameworks to explain the growth and survival of certain types of organizational innovations such as new strategies. The first of these is the population ecology theory (e.g., Aldrich, 1979) which suggests that organization performance and survival are largely determined by the characteristics of the environment in which the organization is located. The alternative explanation is that management makes strategic choices (e.g., Barney, 1997) about their environment which affect the organization's performance and survival. To some extent these two views have been reconciled by research which has found that it is the fit between strategy and the environment that explains firm performance (e.g.,

Hitt, Ireland, and Hoskisson, 1999). Porter (1990) has conceptually integrated both environmental characteristics (e.g., resources, demand, supplies) and firm strategy and structure to explain competitive advantage at the country level of analysis. Thus, our conceptual model seeks to incorporate these two sources of explanatory variables.

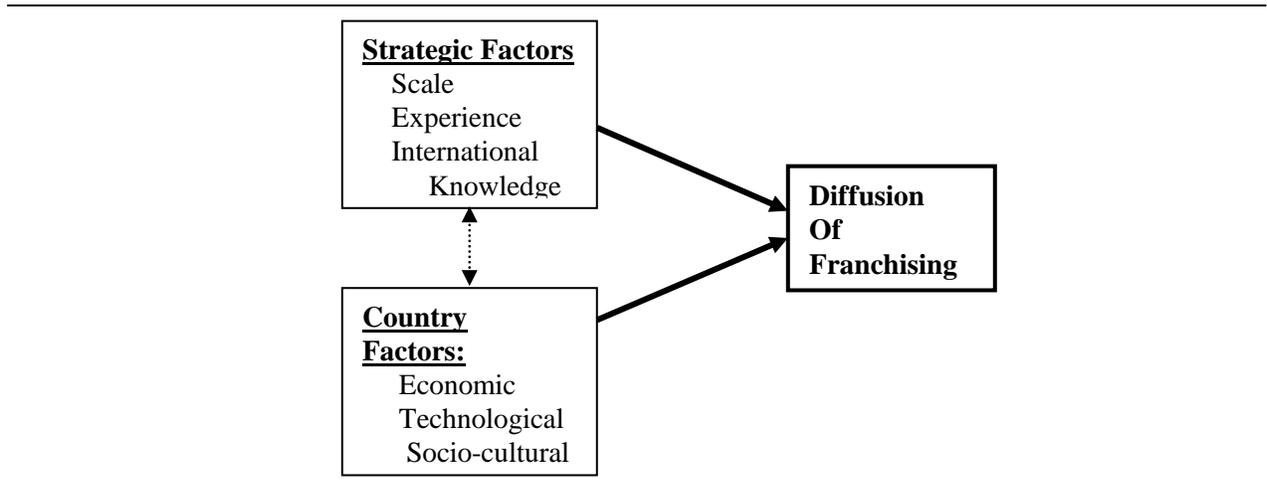
According to Rogers (1995), the innovation diffusion process is influenced by: the innovation itself (e.g., type of strategy), the relevant social system (e.g., nation), communication about the innovation, and time. Recently, O'Neill, Pouders and Buchholtz (1998) have demonstrated that theories of innovation offer insights to explain why particular strategies, such as franchising, might spread across populations of organizations. These authors have suggested the following as key factors affecting the adoption of new types of firm strategies: the environment, the organizational characteristics, and the characteristics of the strategy itself. The model, depicted in Figure 1, examines diffusion at the country level of analysis.

The focal point of our model is the diffusion of franchising across national borders and consists of three elements. Strategic characteristics refer to the specific attributes of the innovation itself that are likely to attract (or repel) others to adopt (not adopt) it (i.e., franchising) and, thereby, diffuse it through a population. Country characteristics refer to those aspects of the environment that are likely to facilitate the diffusion of franchise strategies across borders. The specific characteristics are

derived mostly from the franchising literature. This exploratory study limits its focus to examining the

direct effects only (dark arrows in Fig. 1).

Figure 1
Model of Factors Facilitating the International Diffusion of Franchising



PROPOSITIONS AND HYPOTHESES

Strategic Characteristics

Characteristics of strategic alliances have been found to be associated with the use of different international entry modes and with international franchising in particular (e.g., Huszagh, Huszagh and McIntyre, 1992); thus, the following proposition is offered:

***PI:** Certain strategic characteristics of franchising will be associated with the diffusion of franchising across borders.*

As a strategy franchising is based on offering products/services with consistent features and quality in all markets. This standardization presents more of a challenge in international markets because franchisors operate in different business and cultural contexts (Aydin and Kacker, 1990). This dispersion in different environments requires a higher degree of control or monitoring by the franchisor. Two key monitoring capabilities include scale (or size) and experience. Larger franchise systems can develop economies of scale in monitoring, effectively lowering the per unit cost of monitoring franchisees (Huszagh, et al., 1992). Larger systems also have economies of scale in promotion, which is critical to the

expansion of franchise systems. Furthermore, monitoring capabilities can be improved with experience. Experienced franchisors are better at standardization, site selection (Huszagh, et al., 1992), and in monitoring their franchisees (Julian and Castrogiovanni, 1995). Consequently, experienced franchisors are more likely to feel confident in expanding internationally (e.g., Shane, 1996). The preceding discussion leads to the following hypothesis:

H1: The diffusion of franchising in nations will be positively related to monitoring capabilities based on:

- (a) scale or size and
- (b) learning or experience.

Firms that expand abroad acquire knowledge about foreign sites. International knowledge reduces the perceived risks of distant markets (Eroglu, 1992). Moreover, firms having international knowledge gain experience in making limited adaptations to the franchise concept (Walker 1989) to maintain overall system efficiency and to facilitate the monitoring of dispersed units. Porter (1990) has argued that rivalry in an industry contributes to international competitive advantage for firms because competition brings out the best in firms as

they jockey for market position. The presence of international franchisors serves two purposes: it motivates the growth of local franchisors who seek to protect their markets, and it provides sources of ideas wherein local firms adopt franchising methods from successful foreign firms (Hoffman and Preble, 1993). Thus, the following hypothesis is offered.

H2: The diffusion of franchising in nations will be positively associated with international knowledge.

Country Characteristics

Strategies are formulated by matching firm capabilities with environmental characteristics (e.g., Hitt, et al., 1999). The environment can be segmented into the following sectors (e.g., Alon and McKee, 1999): economic, technological, socio-cultural, and political. These sectors will be used as the organizing framework for identifying country characteristics that are most likely to encourage the diffusion of franchising across borders. Industry observers have noted that the recent growth of international franchising has occurred in countries that, A...are politically stable, urbanized, have a high level of economic growth, and have a substantial middle class with considerable disposable income.≡ (Walker, 1989). Consequently, the following is proposed:

P2: Certain country characteristics will be associated with the diffusion of franchising across national borders.

Economic Sector. Since franchising is dominated by service or products associated with services (Hoffman and Preble, 1993), the importance of a viable economy and available income to pay for services is crucial to the growth of business activity via franchising. In particular, a high per capita income is associated with franchise growth (Yavas and Vardiabasis, 1987) because consumers can then afford to pay for services rather than perform them themselves. As economies become more affluent, there is a greater shift to services. Franchising is an effective strategy for services because it permits consumers to buy intangible services with greater confidence (Cross and Walker, 1987) due to the branding, standardization, and quality control provided by most franchises. Thus, the size of the service

sector provides more opportunities for firms to expand via franchising. This leads to the following hypothesis.

H3: The diffusion of franchising in nations will be positively associated with the following economic factors: (a) higher income levels, and (b) the relative size of the service sector.

Technological Sector. This sector often refers to infrastructures such as communications, financial services, and transportation. Of these, communications are probably the most salient to the diffusion of franchising. Franchisors bundle a trade or brand name with a good or service to sell to entrepreneurs in return for fees or royalties (Hoffman and Preble, 1993). Investment must be made in promotion and communication media to develop a brand name. The need to maintain brand equity also motivates franchise systems to expand in order to develop economies of scale in promotion by spreading the cost over more units (Carney and Gedajlovic, 1991). Thus, a communication infrastructure appears to be vital to facilitating the spread of franchise systems.

H4: The diffusion of franchising in nations will be positively related to the penetration of communication media, such as: newspapers, radio, and television.

Social Sector. Social trends reflect changes in demography and lifestyles which influence consumer demands in the long term. Researchers (e.g., Hoffman and Preble, 1993; Walker, 1989) have noted the following social changes to be important sources of franchise growth: a substantial middle class, increased education, urbanization, and an increased number of women in the labor force. Yavas and Vardiabasis (1987) found a positive relationship between the growth of franchising in the Pacific Basin and urbanization and female participation in the labor force.

Education is an important country characteristic, given the nature of franchising strategies. Building brand equity depends on having an educated public who can discriminate rationally among the many messages they receive to make prudent purchases or investments. Urbanization has a positive influence on the spread of franchising because

people living in urban areas are no longer self-sufficient and must use their wages to buy goods and services (e.g., Hoffman and Preble, 1993).

Economic affluence, increased education, and urbanization have combined to increase female participation in the labor force. As more women join the labor force, households must now purchase the many goods and services women once provided for the family at home (Alon and McKee, 1999). This provides more opportunities for franchise businesses. Thus,

H5: The diffusion of franchising in nations will be positively associated with the following social trends: (a) increased education, (b) increased urbanization, and (c) increased female participation in the labor force.

Cultural Sector. One of the distinguishing features of crossing borders is encountering different values, patterns of behavior and thought which are often referred to as culture. Consistent with our conceptual model, this study's focus is on identifying selected cultural values that are likely to facilitate the use (therefore the spread) of franchising across borders. Values from the most widely used taxonomy of culture developed by Hofstede (1991) have been selected for this study because they align well with the concept of reducing the perceived risks of cross-border interaction (Eroglu, 1992).

Hofstede's research (1991) has revealed that cultures differ on tolerance for ambiguity or uncertainty avoidance. Thus, entrepreneurs from cultures that have a low uncertainty avoidance (high tolerance for ambiguity) might be more likely to adopt new strategies such as franchising because of their willingness to take calculated risks. Furthermore, cultures that favor individual achievement and competition tend to reward entrepreneurship. Thus, cultures with individualistic values are more likely to develop organizational strategies based on entrepreneurship such as franchising. Consequently,

H6: The diffusion of franchising across borders will be positively associated with national cultures possessing the following values: (a) low uncertainty avoidance, and

(b) high individualism.

Political Sector. The political activities considered here refer to government actions/policies that may either hinder or help the conduct of business across borders and the use of franchising in particular. Certain government actions/policies (e.g., taxes, tariffs, currency) increase the perceived risks of entering international markets by franchisors (Eroglu, 1992). Government actions/policies may pose risks affecting imports, royalty repatriation, profitability (exchange rates) among others (Alon and McKee, 1999). Political risk may even affect the conduct of a franchisee's business as franchise contracts vary significantly in international markets and such variability across country markets raise the costs of monitoring activity by franchisors across borders (Julian and Castrogiovanni, 1995). Thus,

H7: The diffusion of franchising in nations will be associated with lower levels of political risk.

Strategic Versus Country Factors

The preceding discussion strongly suggests that both strategic and country-related variables affect the cross-border diffusion of franchising. This raises the following question: which of these alternative explanations: environmental determinism or strategic choice has the most effect on the diffusion of franchising? Drawing on the innovation, strategy, and franchising literatures, the picture is not clear. The results of the innovation diffusion literature is mixed regarding firm-based versus environmental determinants of innovation diffusion.

Porter (1990) argues that international competitive advantage is driven primarily by country specific factors. Systematic studies of international franchise system expansion have focused primarily on organizational and strategic determinants of growth rather than environmental factors. O'Neill, et al. (1998) suggest that environmental variables are positively related to the extent, as well as the speed of diffusion; whereas, strategic variables are more closely related to the speed of diffusion. Since this study focuses more on the extent rather than the speed of diffusion, environmental determinants are likely to be more important

predictors. Hence,

P3: Environment (country factors) will be more strongly related to the diffusion of franchising across borders than strategic choice.

THE STUDY

Sample and Data Collection

Data on franchising activity and national statistics were obtained on twenty-four countries (see Appendix A) drawn from the Council of Multinational Franchisors and Distributors plus nine other nations identified by the researchers as having franchise associations. Questionnaires were faxed to each association along with one follow-up letter resulting in a 73% response rate. Country data was obtained from United Nations and World Bank publications.

The nations surveyed have a median number of 209 franchisor firms each averaging over 9,000 franchisees worldwide. Approximately 11% of the franchisors are foreign-owned. The sampled nations also appear to fit the profile of countries suitable for franchising. The nations are highly urban (76%); have an average GDP of \$14,134 per capita; possess a substantial service sector (43%); have considerable female participation in the labor force (37%); average 10 years of education; and have widely diffuse media outlets.

Variable Measures. *Diffusion of franchising* is defined as the physical spread of franchising within a country. A ratio measure of franchising diffusion within its potential market was developed by dividing the number of franchised units in each nation by the average population reported for each country.

The *size* of the franchise sector was measured as the total number of franchisors in the country. Franchising *experience* of a nation was determined by the age of its franchise association. The franchise sector's *international experience* was assessed using the total number of foreign franchisors who had membership in the country's franchise association.

Country characteristics were measured as follows. *Personal income* was assessed using GDP per capita while the importance of the *service sector*

was measured as the percentage of the labor force working in services. *Education* level was assessed by the average number of years of formal education; *urbanization* was the percentage of the population living in cities; and *female participation* in the labor force was percentage of women in the labor force. *Media* infrastructure was represented by the ratios of televisions, radios, and newspapers per population converted to decimal equivalents. Data on two *cultural values* were obtained from Hofstede (1991). Uncertainty avoidance is a society's fear of the unknown. Individualism refers to the extent to which people in society prefer to operate alone or in groups. Each value is measured on a n index ranging from 0 to 100. *Political risk* was measured using a three point scale (1=low risk, 2=some risk, 3=risky). A nation's score on the scale was derived based on responses to two open-ended questions from the survey regarding the existence of national laws or taxes that might affect franchising activity.

Data Analysis

The analysis of the seven hypotheses relating to the first two propositions, which examine the separate effect of strategic and country factors on franchising diffusion, were explored by first, examining the bivariate correlations. The hypotheses were then tested using partial correlations wherein variables within the same class were controlled for; i.e., franchising, economic, social, etc. The third proposition concerning the impact of strategic versus country factors on franchising diffusion was examined in a regression analysis using only the significant variables from the previous analyses.

FINDINGS

The first proposition that strategic factors would be associated with the diffusion of franchising at the national level received some support. Monitoring derived from scale or size is positively related to franchising diffusion supporting H1a both the bivariate ($r = .75$) and the partial ($pr = .57$) correlations are positive and significant (see Table 1). Monitoring capability based on experience did not seem to be associated with the diffusion of franchising. While the bivariate correlations reveals that franchising experience is positively correlated ($r = .55$) with franchising diffusion, the

partial correlation ($pr = -.03$) is not significant contrary to H1b.

The internationalization of national franchise sectors was not significantly related to the diffusion of franchising as hypothesized (H2). The bivariate correlation of internationalization with diffusion is negative and not significant. Controlling for other strategic factors does not change the bivariate results in Table 1.

Support was found for the second proposition that country characteristics would be significantly associated with the diffusion of franchising. Hypothesis (H3a) is supported in the case of income diffusion and income reveal that income is

positively and significantly associated with but not supported for the service sector (H3b). Both the bivariate and partial ($pr = .56$) correlations between diffusion; whereas, the service sector is not significantly correlated ($pr = -.04$) with diffusion.

Hypothesis H4 concerning communication media was supported for television but not for radio or newspaper media. The bivariate correlations in Table 1 reveal T.V. and radio to be highly and significantly correlated to the diffusion of franchising while newspapers are not significantly correlated with diffusion. Controlling for other media, only television retains its significant correlation ($pr = .63$) with diffusion partially supporting the hypothesis.

TABLE 1
Bivariate and Partial Correlations of Diffusion of Franchising
with Selected Strategic and Country Factors

Partial Hypotheses (pr)	Variables	Bivariate Corr. (r)	Control Variables	Corr.	Results
STRATEGIC FACTORS (Proposition 1):					
# 1	a) Size of Franchise Sector	.75**	Age, Internat.	.57 ⁺	Supported
	b) Experience	.55*	Size	-.03	Refuted
#2	Internationalization	-.32	Size	.31	Refuted
COUNTRY FACTORS:					
# 3	Economic Factors				
	a) Income	.56**	Service	.55**	Supported
	b) Service Sector	.12	Income	-.04	Refuted
# 4	Communications				
	a) Newspaper	.18	Television	-.06	Refuted
	b) Radio	.53**	Television	-.05	Refuted
	c) Television	.75**	Radio	.63**	Supported
# 5	Social Trends				
	a) Education	.46*	Urban., Fem.	.40 ⁺	Supported
	b) Urbanization	.30	Labor	.26	Refuted
	c) Female Labor	.13	Education	-.06	Refuted
# 6	Cultural Values				
	a) Uncertainty	-.28	Individualism	-.22	Refuted
	Avoidance	.52*	Uncertain. Avoid.	.50**	Supported
	b) Individualism				
# 7	Political Risk	-.06	Income	-.19	Refuted

**P#.01, *P#.05, + P#.10

Some support was found for H5 which indicated that the social trends of education, urbanization, and female participation in the labor force would be positively related to the diffusion of franchising in nations. An examination of the bivariate correlations between diffusion and education reveals a positive and significant correlation ($r = .46$), but those with urbanization and female labor are positive but not significant. These relationships remained essentially the same when other social trends were controlled for in Table 1. Only the partial correlation for education is significant ($pr = .40$) supporting H5a; H5b & c were not supported. These results suggest that urbanization (H5b) may also be relevant to franchising diffusion, but not as much so. However, female labor force participation (H5c) was virtually uncorrelated with diffusion when controlling for other social factors.

The culture hypothesis for uncertainty avoidance (H6a) value was not supported, neither correlation ($r = -.28$; $pr = -.22$) was significant. The negative partial correlation with uncertainty avoidance suggests that diffusion is associated with low uncertainty avoidance as predicted, but the correlation was not significant. The individualistic values of a culture (H6b) were positively related to diffusion as predicted. Both the bivariate and

partial ($pr = .50$) correlations with diffusion were positive and significant, supporting H6b.

Political risk was negatively associated ($pr = -.19$) with franchising diffusion consistent with hypothesis H7, but it was not significant, therefore, failing to support the hypothesis.

The third proposition concerning the greater importance of country factors to diffusion was not supported (see Table 2); The results reveal the opposite to be true; strategic factors were relatively more important in explaining the diffusion of franchising in nations. In order to explore the proposition a hierarchical regression analysis was used entering the strategic factors first and then the country factors. The variable television had to be dropped from this analysis due to its multicollinearity with other variables.

The regression results in Table 2 indicate that the strategic factor of the scale or size of the franchising sector accounted for 56% of the variance explained in the diffusion of franchising by the equation. The country variables explained only 9% of the variance and that was not significant. Thus, contrary to our

TABLE 2
Regression of Diffusion of Franchising
on Selected Strategic and Country Variables

	$\blackspadesuit R^2$	Beta
<u>Strategic Factors:</u>	.56**	
Size of Franchising Sector		.54*
<u>Country Factors:</u>	.09	
Education		.21
GDP/Capita		.23
Individualist Values		.04
Equation:	Adj. $R^2 = .54$, $F = 6.98^{**}$	(df: 4, 15)

**P#.01, *P#.05

proposition, strategic factors explained significantly more of the variance in diffusion of franchising in nations than did country factors.

DISCUSSION

This study represents a departure from previous research in that it seeks to explain rather than merely describe the spread of franchising internationally. Furthermore, the study takes a global perspective rather than that of a particular nation. Support was found for our model that both strategic and country characteristics are related to franchising diffusion across borders. Contrary to our expectations strategic factors proved to be relatively more important in our model.

Some of the contributions of this research include support for strategic choice models of organization and the identification of the importance of certain media and cultural values to the spread of franchising globally. The size of the franchise sector explained far more of the variance in the diffusion of franchising than did country factors. This finding is not that surprising in retrospect. While key country characteristics may be important to establish franchise activity in a nation, the spread of such activity depends on strategic characteristics of the firms in the aggregate who must compete against other forms of business to penetrate the market place.

Also of particular interest were the findings relating to television media and culture. Although our data revealed that radio was more available on average ($\beta = 56\%$) than television ($\beta = 33\%$) and newspapers ($\beta = 32\%$) in the countries surveyed, television was the only media with a strong positive relationship to the diffusion of franchising controlling for other media. It may be that the warmer medium (McLuhan, 1967) is more effective in building brand recognition of franchise systems or that people who have televisions or access to them have more disposable income to support franchises.

To our knowledge, this is the first study to identify a relationship between a specific cultural value and

the degree of franchising activity within a nation. Franchising has been viewed as an entrepreneurial venture (Hoy and Shane, 1998), and individualism has long been associated with traditional entrepreneurial activity (Hofstede, 1991). These results indicate that this culture-entrepreneur relationship can now be extended to franchising activity as well.

The results of this study must be approached with caution due to small sample size and data limitations. Nevertheless, 50% of the relationships examined were in the predicted direction. These results appear to be encouraging for an exploratory study. Using a country level of analysis, the sample was small although it appears to encompass 73% of the nations known to have a significant franchise sector. Data on franchise sectors is spotty at best largely because it is a method for conducting business rather than being an identifiable industry. As a result we were unable to obtain data on a wider variety of strategic franchise factors. Given sample limitations, the full model as depicted could not be tested even for a more restricted set of variables. However, our partial tests were supportive of five of our seven hypotheses. This suggests that the main thrusts of this study appear to be in the right direction. Thus, we discuss some implications for practice and research.

IMPLICATIONS

Multinational firms considering franchise strategies for their expansion plans should pay attention to the existence of a developed franchise sector which facilitates growth. Country characteristics to look for, that are important to the growth of franchising, include per capita income, an educated population, widely dispersed mass media, and cultural values conducive to entrepreneurship. The latter enhances the possibility of finding a sufficient number of franchisees.

Potential franchisees might consider the support a larger franchise sector within the target country might provide for their success. Franchisees should also be aware of the relevant country characteristics found here to ensure that their

national market offers the proper infrastructure for franchise growth.

This growth, in turn, makes the market attractive to other new entrants.

Franchise associations need to market franchise opportunities. One way to do this would be to use the country characteristics identified here as indicators of franchising market opportunities within their nation, and to communicate these market characteristics to external franchise companies.

The results of this study are encouraging for developing future research on the factors affecting the diffusion of franchising. Conceptually more work is necessary to refine the model specifying the key variables affecting the spread of franchising.

Examining these relationships at the organization level of analysis would permit the use of larger samples of organizations from a few countries to investigate specific firm-level strategic characteristics. This would permit researchers to develop more specific organizational implications. The impact of culture on the franchising diffusion process also appears to be a particular avenue for future research. Above all, we hope this study will move research on international franchising from purely descriptive studies to those providing explanations for the growing global franchising phenomenon.

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APPENDIX A Countries Investigated by Continent

Africa

South Africa

Asia

Hong Kong

Indonesia

Japan

Singapore

Australia/New Zealand (one assn. for both nations)

North America

Canada

Mexico

United States

South America

Argentina

Brazil

Chile

Europe

Austria

France

Germany

Hungary

Ireland

Italy

Netherlands

Russia

Spain

Sweden

Switzerland

United Kingdom

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