

INTERNATIONAL FRANCHISE ASSESSMENT MODEL: ENTRY AND EXPANSION IN THE EUROPEAN UNION

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Abstract

The purpose of this research is to develop a quantitative International Franchise Assessment Model that would assist franchisors in planning their entry and expansion strategies into foreign markets. The model is composed of three sections: (1) an assessment of the external macro-environment of the targeted country or region, (2) an assessment of the internal micro-environment of the franchise system, and (3) an assessment of the financial and strategic considerations related to entry and expansion mode(s). This paper focuses on Section One of the model which includes three measures of the external macro-environment: market risk, market potential, and distance. The model is applied to twenty-five countries in the EU. A composite International Franchise Expansion Index is developed capturing variables deemed important in the franchise internationalization literature. The Index suggests that the UK is presently the most attractive for international franchise expansion in the EU while Malta is the least attractive.

I. INTRODUCTION

A. Growth of International Franchising

Over the last thirty-five years, franchising has grown dramatically as an international expansion mode.¹ One reason for this dramatic growth is that franchising involves less risk than other forms of internationalization

¹ See Karin Fladmoe-Lindquist, *International Franchising: Capabilities and Development*, 11 J. OF BUS. VENTURING 420 (1996); and Fredrick W. Huszagh, Sandra M. Huszagh & Faye S. McIntyre, *International Franchising in the Context of Competitive Strategy and the Theory of the Firm*, 9 INT'L MARKETING REV. 4, 5-18 (1992).

such as direct investment.² From 1971 to 1985, U.S. franchisors developed foreign outlets at a rate of 17% per year, almost twice as fast as they added domestic units.³ In 2005, more than half of U.S. based franchise companies were operating units outside the United States, representing a 53% increase since 1989.⁴

One of the most important factors influencing the dramatic growth of franchising internationally was the reduction of trade barriers initiated in 1949 through the creation of the General Agreement on Tariffs and Trade (“GATT”) which later became the World Trade Organization (“WTO”) in 1995. With 151 member states, the WTO deals with the rules of trade between nations at a near-global level and is responsible for negotiating and implementing new trade agreements and policing their member countries’ adherence to WTO agreements. In addition, growth in international franchising has been fueled by market saturation within the U.S., advances in communication and transportation, and improved foreign economic conditions.⁵ Furthermore, the international financial system has developed a strong currency exchange and has improved currency convertibility.⁶

Since increased franchisor revenue generally comes from opening new outlets rather than increasing sales at existing outlets, international expansion offers one of the most basic sources of franchise growth.⁷ Many franchise companies have benefited greatly from their expansion into foreign markets and have been able to mitigate the risk involved as a result of their understanding of the political, economic, legal, cultural and market macro-environment of the host countries.⁸ Adapting their U.S. franchise system business model to foreign market conditions and choosing appropriate entry and expansion modes are also important considerations leading to successful internationalization.⁹

² Levent Altınay & Samantha Miles, *International Franchising Decision-Making: An Application of Stakeholder Theory*, 26 *The Service Industries J.* 421–436 (2006); Nizamettin Aydin & Madhav Kacker, *International Outlook of US-Based Franchisors*, 7 *INT’L MARKETING REV.* 43–53 (1990).

³ ROBERT T. JUSTIS & RICHARD J. JUDD, *FRANCHISING*, Thomson Custom Publishing (3d ed. 2003).

⁴ Udo Schlenrich & E. Hachemi Aliouche, *Rosenberg Center Study Confirms Global Franchise Growth*, *FRANCHISING WORLD* 63–65 (Aug. 2006).

⁵ ILAN ALON, *SERVICE FRANCHISING: A GLOBAL PERSPECTIVE* 93 (Springer, 2006).

⁶ JUSTIS & JUDD, *supra* note 3.

⁷ Francine Lafontaine & David Leibsohn, *Beyond Entry: Examining McDonald’s Expansion in International Markets*, *INT’L SOC’Y OF FRANCHISING CONFERENCE PROCE.*, (2005).

⁸ Janet Adamy, *As Burgers Boom in Russia, McDonald’s Touts Discipline*, *WALL ST. J.*, Oct. 16, 2007 at A1, A17.

⁹ M. Sunil Erevelles, Veronica Horton, & Ana Marinova, *The Triadic Model: A Comprehensive Framework for Managing Country Risk*, 15 *MARKETING MGMT. J.* 1–17(2005).

B. Country Risk Assessment

However, international entry and expansion by U.S. based franchisors and other service businesses into the global marketplace have not come without risk. Substantial losses and failures have also occurred (see Exhibit 1). In order to adequately assess and manage investments in the global marketplace, it is vitally important for franchise firms to understand the risks associated with doing business in foreign markets.¹⁰

The traditional literature on country risk focuses on banking and international loan repayment, and therefore offers a more limited definition of the term based primarily on financial factors.¹¹ However, any organization involved in the global marketplace, not just banks, should be concerned with managing country risk. The term ‘country risk’ has come to be used in the internationalization literature in a broader context to include additional factors such as the culture, the legal and regulatory environment, and the local market conditions.¹²

Exhibit 1: Cases of Foreign Entry or Expansion Failure

<u>Measure</u>	<u>Company</u>	<u>Case</u>
Political/Economic	Hilton International ¹³	Hilton exited Iran as a result of revolution (1979)
	Marriott International ¹⁴	Hotel bombed by terrorists in Indonesia (2003)
Legal/Regulatory	Danone ¹⁵	Lengthy legal battle with Chinese joint venture partner (2006-2008)
	Sonesta ¹⁶	Unfavorable lease agreement which led to withdrawal from EU (1971)
Cultural Distance	Wal-Mart ¹⁷	Experienced \$1 billion pre-tax

¹⁰ Anthony Boczeko, *Country Risk*, FINANCIAL MGMT, Feb. 1, 2005, at 25–26.

¹¹ *Id.* at 1.

¹² Huszagh & McIntyre, *supra* note 1, at 5-18; JUSTIS & JUDD, *supra* note 3 at 22-7; Frank T. Rothaermel, Suresh Kotha & H. Kevin Steensma, *International Market Entry by U.S. Internet Firms: An Empirical Analysis of Country Risk, National Culture, and Market Size*, 32 J. OF MGMT. 56–82 (2006).

¹³ Curt R. Strand, *Lessons of a Lifetime: the Development of Hilton International*, 37 CORNELL HOTEL & RESTAURANT ADMIN. Q., 83–95 (1996).

¹⁴ BBC, *Bomb wrecks top Jakarta hotel* (August 5, 2003), available at <http://news.bbc.co.uk/2/hi/asia-pacific/3124919.stm> (last visited Mar. 29, 2009).

¹⁵ Wahaha Group, *Danone v Wahaha Acquisition: Wahaha Wins Trademark Ownership Lawsuit – Wahaha*, FLEXNEWS, Aug. 8, 2008, <http://www.flex-news-food.com/pages/18682/China/Danone/Hong-Kong/danone-wahaha-acquisition-wahaha-wins-trademark-ownership-lawsuit-wahaha.html> (last visited Mar. 29, 2009).

¹⁶ Author interviews with Sonesta executives (2008).

		loss as a result of misjudging German consumer and business culture. Exited market after 9 years (2006)
	EuroDisneyland ¹⁸	Company accused of “cultural imperialism” (1993)
Market Potential	Planet Fitness ¹⁹	Lost “first mover” advantage when German fitness center copied concept and saturated market (2004)
	Dunkin Donuts ²⁰	Company unable to achieve profitability and exited UK market (1991)

C. Franchising in the European Union

The European Union (“EU”) was selected for this study as its country members encompass a wide network of political, economic, legal, cultural and market environments. In addition, the EU has an active franchising record, with hundreds of franchisors and thousands of franchisees operating throughout Europe, generating billions of dollars in annual sales. EU members range from mature high income countries such as the United Kingdom, Germany and France to emerging countries such as Estonia and Poland. The EU presently represents a market of over 495 million consumers in twenty-seven nations, stretching from the Arctic to the Mediterranean Sea, and the Atlantic Ocean to the Aegean Sea. The EU began in 1950 with six member states. On May 1, 2004, ten new countries, mostly from Central and Eastern Europe, were added and the EU became the biggest and most powerful trading bloc in the world with 27.8 percent of the world’s exports and 25.1 percent of the world’s imports.²¹ Bulgaria and Romania subsequently joined the EU in 2007. Three candidate countries are currently waiting to become members: Croatia, Macedonia and Turkey. The objective of the European Community is to establish a common market between the Member States of the Community in which goods, people, services and capital could move freely. The assessment of

¹⁷ Mark Landler and Michael Barbaro, *No, Not Always: Wal-Mart Discovers That Its Formula Doesn’t Fit Every Culture*, WALL ST. J., Feb. 15, 2008, at C1 and C4.

¹⁸ Wikipedia.org, *Disneyland Resort Paris*, http://en.wikipedia.org/wiki/Disneyland_Resort_Paris (last visited Mar. 29, 2009).

¹⁹ Author interviews with Planet Fitness executives (2008).

²⁰ *Selling Like Hot Cakes*, TIME, Aug. 4, 2002, <http://www.time.com/time/magazine/article/0,9171,333841,00.html>.

²¹ Sophie Meunier & Kalypso Nicolaidis, *The European Union as a Conflicted Trade Power*, 13 J. OF EUROPEAN PUBLIC POL’Y 906–925 (2006).

franchising in the EU is timely, particularly in light of the potential opportunities presented by the enlargement of the EU with twelve new member countries. However, despite the fact that US-based franchisors have been operating in EU countries for many years, entry and expansion into this market does not come without risk.

The paper proceeds as follows. First we present a literature review in the fields of international franchising and country risk assessment. We then present the International Franchise Assessment Model which is composed of three sections. Section One assesses the external macro-environment of the targeted countries or regions and is the focus of this paper. Section Two (which assesses the internal micro-environment of the franchise system) and Section Three (which assesses the financial and strategic considerations related to choice of entry and expansion modes) will be the focus of future papers. We then present the Methodology and Results, followed by Conclusions.

II. LITERATURE REVIEW

Despite the growing importance of franchising internationally, relatively little theoretical attention has been given to the subject.²² In addition, cross-country comparisons of international franchising are rare, mostly because of a lack of data.²³ However, failure to adequately understand the political, economic, legal, cultural and market conditions of a foreign country can have a substantial negative impact on the outcome of a firm's investment in that country.²⁴ Yet, despite the complexity and risk involved, franchised firms often enter foreign markets based mainly on intuition or personal experience.²⁵

Two primary factors fueling internationalization are the 'push' factor of market saturation in the home country and the 'pull' factor of market opportunities in foreign countries.²⁶ However, it is not imperative that markets at home are saturated in order for franchise firms to be interested in taking advantage of opportunities in foreign markets.²⁷ Two primary reasons that US-based franchisors do not internationalize are a lack

²² See Levent Altınay & Samantha Miles, *International Franchising Decision-Making: An Application of Stakeholder Theory*, 26 SERVICE INDUSTRIES J. 421 (2006).

²³ Francine Lafontaine, *Franchising: Myth, Reality, and What it May All Mean to You*, FIN. TIMES MASTERING MGMT. REV. 32-35 (Oct. 1999).

²⁴ Seung H. Han & James E. Diekmann, *Approaches for Making Risk-Based Go/No-Go Decision for International Projects*, 127 J. OF CONSTRUCTION ENGINEERING AND MGMT. 300-308 (2001).

²⁵ See *id.*

²⁶ ALON, *supra* note 5 at 93; Sevgin Eroglu, *The Internationalization Process of Franchise Systems: A Conceptual Model*, 9 INT'L MARKETING REV. 19-30 (1992); JUSTIS & JUDD, *supra* note 3.

²⁷ Lafontaine & Liebsohn, *supra* note 7, at 15.

of international expertise and limited financial resources.²⁸ A further area of concern to franchisors is the risk involved in entering or expanding into a foreign country.²⁹ Perceived risk can be defined as the uncertainty a company faces when they cannot foresee the consequences of their actions.³⁰ For a venture to be considered 'risky' it must have the potential to significantly affect the profit or other goals of the company.³¹ Country risk can be defined as "either an outright loss or an unanticipated lower earnings stream in cross border business, caused by economic, financial or sociopolitical events or conditions in a particular country that are not under the control of a private enterprise or individual."³² A thorough evaluation of the risks involved in entering or expanding into a specific country can help franchisors in their decision-making process. The purpose of this article, therefore, is to present a model that can help franchisors identify and evaluate the risks involved in the decision of whether or not to enter or expand in specific countries.

III. MEASURES

The measures used in this study are a result of an extensive search of the relevant literature in the field of internationalization (specifically, international franchising and country risk assessment) as well as semi-structured interviews conducted by the authors with senior executives in the franchise community from the International Franchise Association in 2005-2006. The key macro-environmental measures identified in the internationalization literature for assessing country risk are political, economic, legal/regulatory, cultural/social, and market (see Exhibit 2). It should be kept in mind, however, that although these measures are discussed separately, they are not independent, but rather are related to and reinforce one another.

A. Political and Economic Risk

The unfavorability of the political and economic climate of a host country is a key factor mentioned by US franchisors as a deterrent to internationalization.³³ The political and economic climate can be influenced by many different events that are often inter-related and may result in reluctance by a firm to invest in a particular foreign country or region. Political events such as taxation, expropriation, nationalization,

²⁸ Aydin & Kacker, *supra* note 2.

²⁹ *Id.*; Eroglu, *supra* note 26.

³⁰ Eroglu, *supra* note 26.

³¹ J.C. Cosset & B. Doutriaux de la Riancerie, *Political Risks and Foreign Exchange Rates: An Efficient-Markets Approach*, 16 J. OF INT'L BUS. STUDIES 21-55 (1985).

³² Han & Diekman, *supra* note 24, at 301.

³³ Aydin & Kacker, *supra* note 2.

currency devaluations and foreign exchange control can cause drastic changes in a country's economic environment resulting in inflation, economic instability, capital flight, debt defaulting, strikes or boycotts that may prove detrimental to foreign business interests.³⁴ One of the greatest current global political threats is the potential breakdown of the Doha Development Round of Trade Negotiations, the centerpiece of global trade liberalization. Such a breakdown could result in countries re-establishing trade protection barriers leading to unstable and unfavorable foreign economic climates.³⁵ Other foreign threats include armed conflicts, rebellions, unrest and disorder.³⁶ In addition, spiking global energy prices can have a substantial negative economic impact on investments in foreign markets.³⁷ The liquidity crisis in the financial markets and currency fluctuations also pose serious economic threats.

Exhibit 2: Macro-Environmental Measures of Country Risk Assessment

Year	Author(s)	Measures
1992*	Eroglu	Political, Economic, Cultural
	Distance, Currency	
1992*	Huszagh, et al.	Legal-Political, Macroeconomic,
	Socio-Cultural,	
		Technological
2001	Han & Diekmann	Political, Economic,
	Cultural/Legal, Technical	
2003*	Justis & Judd	Political, Economic, Legal, Market
	Demand	
2005	Erevelles, et al.	Political, Economic, Socio-
	cultural, Financial	
2005	Vij	Political, Economic, Social
2006*	Alon	Political, Economic, Distance,
	Demographic	
2006	Rothaermel, et al.	Country Risk, National Culture,
	Market Size	
2008	World Economic Forum	Geopolitics, Economics, Society,
	Environment,	
		Technology

³⁴See Ephraim Clark & Radu Tunaru, *Quantification of Political Risk With Multiple Dependent Sources*, 27 J. OF ECON. & FIN. 125–135 (2003).

³⁵ Kenneth E. Sheve & Matthew J. Slaughter, *A New Deal for Globalization*, 86 FOREIGN AFFAIRS 434–47 (2007).

³⁶ Charles W. Hofer & Terry P. Haller, *Globescan: A Way to Better International Risk Assessment*, 1 J. OF BUS. STRATEGY 41, 41–56 (1980).

³⁷Mary Anastasia O'Grady, *The Real Key to Development*, WALL ST. J., Jan. 15, 2008, at A13.

*Franchise-specific study

B. Legal and Regulatory Risk

The legal and regulatory system of a country can have a strong causal effect on the flow of foreign capital into that country.³⁸ Risk management is especially important in environments where the host country's legal policies and regulations significantly increase firm risk and uncertainty.³⁹ Some of the legal problems that franchisors face in foreign markets include restrictions on the ownership and control of corporate property, repatriation of profits, and lack of protection of intellectual property.⁴⁰ In addition, foreign governments may impose discriminatory pricing intervention policies, restrictive foreign exchange currency controls or discriminatory tax laws.⁴¹ Franchisors have sometimes incorrectly assumed that the legal environment for franchising in the United State is similar to that in a foreign country.⁴² The reality is that international franchisors need to be much more keenly aware of the legal jurisdictions they are entering into than when franchising domestically.⁴³

C. Market Potential

Larger markets offer more potential and therefore more incentives for firms to invest.⁴⁴ For example, even though China is culturally very different from the United States, the size of its market and its market potential are so great that many firms have been willing to enter this market despite the risks.⁴⁵ In addition, larger markets allow firms to exploit economies of scale. A study that examined McDonald's expansion in international markets indicated that franchisors favor countries with greater market potential, such as a higher GDP, a larger population and greater purchasing power.⁴⁶

³⁸ Lafontaine, *supra* note 7, at 5.

³⁹ Fladmoe-Lindquist, *supra* note 1, at 422.

⁴⁰ Fladmoe-Lindquist, *supra* note 1, at 426.

⁴¹ Boczko, *supra* note 10, at 25.

⁴² Fladmoe-Lindquist, *supra* note 1, at 425.

⁴³ Christopher A. Nowak, John Pratt & Carol E. Zwisler, *International Franchising in an Unclear and Uncertain Legal Environment*, Paper presented at the 29th Annual Forum on Franchising by the American Bar Association, (Oct. 11-13, 2006), Boston, MA, pages 1-39.

⁴⁴ Rothermael et al., *supra* note 12, at 11.

⁴⁵ *Id.*

⁴⁶ Lafontaine, *supra* note 7, at 11-12.

D. Cultural and Geographical Distance

Culture has been defined as “the collective programming of the mind that distinguishes one group or category of people from another.”⁴⁷ The cultural environment adds further complexity and risk to franchising in a foreign country.⁴⁸ Cultural distance refers to the difference in the culture and language of the host and home countries.⁴⁹ The very strength of the franchise format, its standardization, makes its successful replication in foreign markets difficult if cultural distance is great.⁵⁰ Since international markets that are culturally different are more likely to present higher levels of risk and uncertainty, franchised firms generally prefer to make investments in foreign countries with cultures that are similar to their own.⁵¹ Hofstede identified four areas of cultural distance that have been widely used in the internationalization literature: (1) power distance (how the culture deals with inequality), (2) avoidance of uncertainty, (3) individualism versus collectivism, and (4) masculinity versus femininity.⁵²

Geographic distance has also been shown to have an impact on international expansion.⁵³ The challenge of managing geographic distance is a major concern in the context of international franchising.⁵⁴ In general, franchisors favor markets that are culturally and geographically closer to the home country than those that are further away.⁵⁵

E. International Franchise Assessment Model

The objective of this research is to develop a quantitative tool that could assist franchisors in evaluating their international entry and expansion plans. In general, two major perspectives impact a firm’s decision of whether to enter or expand in a foreign market: (1) the external macro-environment of the proposed host country, and (2) the internal micro-environment of the franchise system. In addition to taking these two perspectives into account, franchise firms also need to conduct a strategic

⁴⁷ GEERT HOFSTEDE, *CULTURAL CONSEQUENCES: COMPARING VALUES, BEHAVIORS, INSTITUTIONS, AND ORGANIZATIONS ACROSS NATIONS* 9 (Sage Publications, 2007).

⁴⁸ Altinay, *supra* note 2, at 432; Fladmoe, *supra* note 1 at 422; Huszagh, *supra* note 12 at 4.

⁴⁹ Rothaermel et al., *supra* note 12, at 4.

⁵⁰ See Fladmoe-Lindquist, *supra* note 1, at 423.

⁵¹ Lafontaine, *supra* note 7 at 6; Rothaermel, *supra* note 12, at 4.

⁵² HOFSTEDE, *supra* note 47, at 79-279.

⁵³ ALON, *supra* note 5, at 96; Lafontaine, *supra* note 7, at 4.

⁵⁴ Fladmoe-Lindquist, *supra* note 1 at 420.

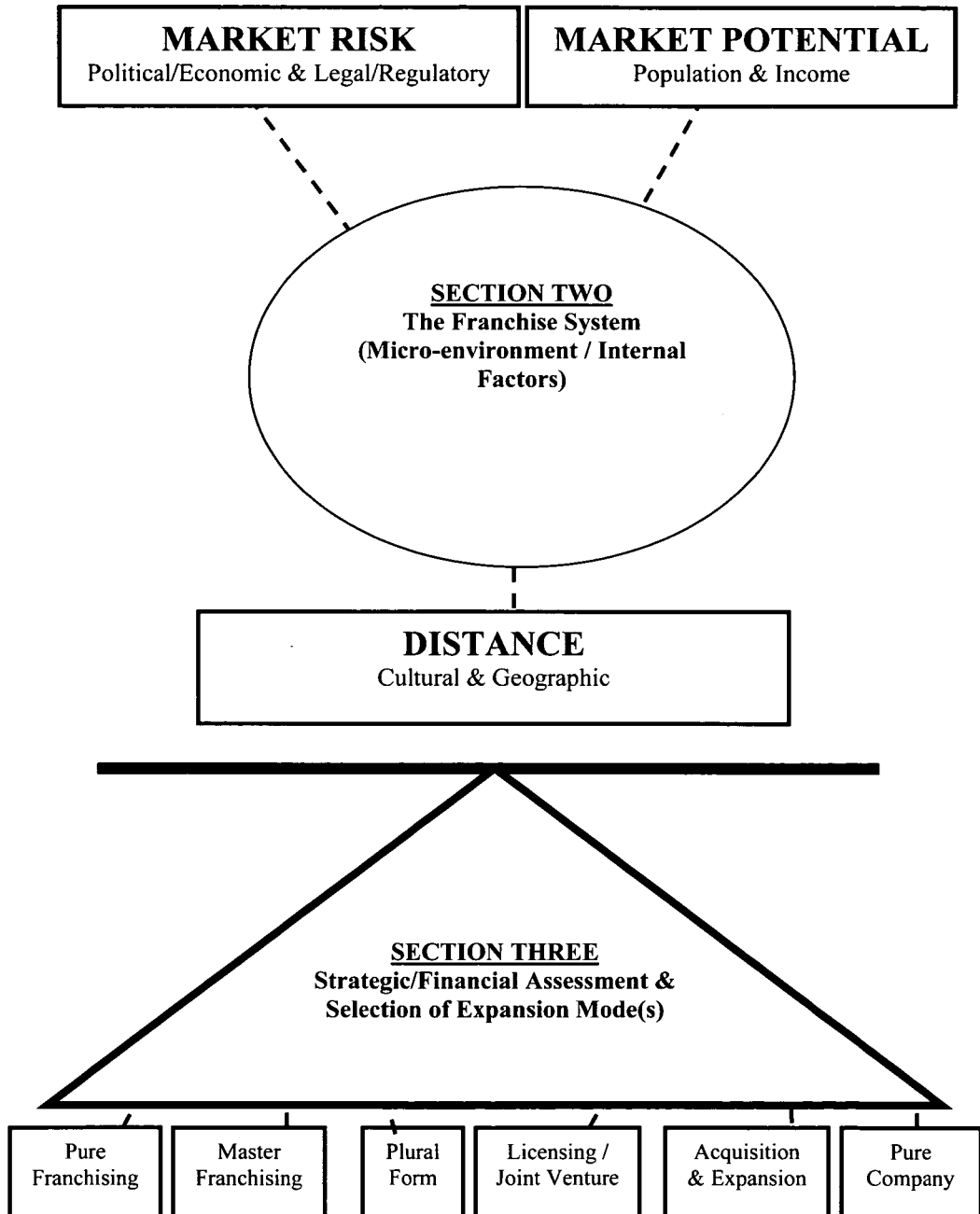
⁵⁵ ALON, *supra* note 5, at 98-99.

and financial assessment of the proposed international opportunity in order to choose the optimal entry/expansion mode.

The proposed International Franchise Assessment Model is hierarchical in nature and is divided into three sections (see Exhibit 3). Section One assesses the external macro-environment of the targeted country and is comprised of three measures: market risk, market potential, and distance. This section of the model is the focus of the present study. Section Two assesses the internal micro-environment of the franchise system. The measures for this section could include, for example, the product and service concept, operations and management, staffing requirements, site and physical plant, supply chain needs, and infrastructure requirements. This section of the model will be part of a future research initiative. Section Three assesses financial factors such as capital requirements (equity and debt), unit profitability, return on investment, and the long-term viability of the proposed entry or expansion in a foreign location. This financial assessment is a key factor influencing the 'Stop-Hold-Go' decision and determining the selection of the optimal strategic entry and/or expansion mode(s). These entry and expansion modes could include, for example, pure franchising, master franchising, plural form (both franchised and company-owned units), licensing and joint ventures, acquisitions and expansion, and pure company (company-owned units). This section of the model will also be part of a future research initiative. It should be noted, however, that although rational empirically-based models are almost universally accepted as useful tools to assist practitioners in evaluating complex business situations, no model is foolproof. International entry and expansion decisions made by franchisors need to be tailored to their respective franchise system and adapted to the unique conditions of each targeted host country. In addition, business strategies require constant re-assessment in view of the ever-changing nature of the regional, national and global marketplace.

Exhibit 3: International Franchise Assessment Model

SECTION ONE
Target Country (Macro-environment / External Factors)



F. Methodology

We captured the factors identified as important for international franchise expansion in a composite index. These factors are market risk (political/economic and legal/regulatory), market potential, and distance (geographic and cultural). In order to build a numeric index of international franchise expansion, it is necessary to find proxies that allow us to quantify these variables. The proxies used are described below.

G. Market Risk

Market risk is a composite index comprised of two indicators: political/economic risk and legal/regulatory risk. For political/economic risk, we rely on the widely used Country Risk Index developed by Euromoney. Euromoney is a leading source of country-level risk data that captures a country's political and economic risk.⁵⁶ Euromoney began its country rating services in 1979 and now publishes country ratings twice a year.⁵⁷ It computes a composite country risk score using a weighted average on nine different risk dimensions. The nine dimensions and their assigned weights are political risk (25%), economic performance (25%), debt indicators (10%), debt in default or rescheduled (10%), credit ratings (10%), access to bank finance (5%), access to short-term markets (5%), access to capital markets (5%), and forfeiting (5%). The higher the score the better, with 100 being a perfect score. As of September 2007, Luxemburg had the highest score at 99.59 while Lithuania, with a score of 63.84, was last in the EU. The EU Political/Economic Risk Index is shown in Appendix 1.

To proxy each country's legal/regulatory risk, we use the Ease of Doing Business Index developed by the World Bank (2006). The Ease of Doing Business Index captures most of the critical legal and regulatory risks involved in operating a business in a given country. Countries are ranked based on the ease of starting a business, dealing with licenses, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business. Countries are ranked from 1 to 155. The index is computed by taking the simple average of country percentile rankings on each of the ten factors. A high ranking means that the country's regulatory environment is conducive to the operation of business. In the EU, Denmark

⁵⁶ See generally, Euromoney, About Us, <http://www.euromoney.com/aboutus.aspx> (last visited Mar. 15, 2009).

⁵⁷ *Id.*

had the highest ranking, while Malta had the lowest. The EU Legal/Regulatory Risk Index is shown in Appendix 2.

H. Market Potential

Two variables are used to capture a country's market potential: population (number of potential customers) and GDP per capita (purchasing power of these potential customers). First, all EU countries are ranked based on their respective population size. They are then re-ranked based on their respective per capita GDP. A Market Potential ranking is then developed based on the average of the population and per capita GDP rankings for each country. In the EU, the UK is the highest ranked country while Latvia is 25th. The EU Market Potential Index is shown in Appendix 3.

I. Distance

We use a composite index of distance made up of two indicators: cultural distance and geographic distance. Geographic distance is proxied by the travel time it takes to reach the country of interest from the United States. The less time, the higher the country ranking. Ireland is ranked first while Cyprus is ranked 25th. For cultural distance, we use an indicator based on differences in cultural dimensions developed by Hofstede.⁵⁸ These dimensions are uncertainty avoidance, individualism, masculinity, and power distance. A large number of academic studies have used similar measures of cultural distance.⁵⁹ Kogut and Singh proposed a procedure that computed a cultural distance measure based on the Hofstede cultural dimensions.⁶⁰ The cultural distance between the United States and the EU countries is computed as follows:

$$CD_j = \sum_{i=1}^4 \{(I_{ij} - I_{iu})^2 / V_i\} / 4,$$

I_{ij} stands for the index for the i^{th} cultural dimension and j^{th} country, V_i is the variance of the index of the i^{th} dimension, u indicates the United States, and CD_j is cultural difference of the j^{th} country from the United States. Countries are ranked from smallest cultural distance from the US to the largest cultural distance. The UK is ranked first while Slovenia is ranked 25th. The EU Distance Index is shown in Appendix 4.

⁵⁸ HOFSTEDE, *supra* note 47, at 56.

⁵⁹ Laszlo Tihanyi, David A. Griffith & Craig J. Russell, *The Effect of Cultural Distance on Entry Mode Choice, International Diversification and MNE Performance: A Meta-Analysis*, 36 J. OF INT'L BUS. STUDIES 270, 270–283 (2005).

⁶⁰ B Kogut & H. Singh, *The Effect of National Culture on the Choice of Entry Mode*, 19 J. OF INT'L BUS. STUDIES 411, 411–432 (1988).

J. Results

For each EU country, a score is computed as the average of their rankings along the different dimensions: Market Risk (political/economic risk and legal/regulatory risk), Market Potential (population and per capita GDP), and Distance (cultural and geographic). The countries are then ranked from lowest score to highest score to form a composite International Franchise Expansion Index (see Exhibit 4). The UK is ranked highest due to its scores in Legal/Regulatory Risk (1st), Market Potential (2nd), and Distance (1st). Malta, on the other hand, is last due to its low scores in Legal/Regulatory Risk (25th), Market Potential (24th), and Distance (20th).

Exhibit 4: International Franchise EU Expansion Index

Ranking	Country	Composite Score	Political/Economic Risk	Legal/Regulatory Risk ⁶¹	Market Potential	Distance
1	UK	3.0	8	2	1	1
2	Ireland	4.8	4	3	11	1
3	Netherlands	5.5	5	9	4	4
4	Germany	5.8	9	8	3	3
5	Denmark	7.0	2	1	8	17
6	Belgium	9.0	10	7	7	12
7	Sweden	9.0	3	5	6	22
8	Finland	9.3	6	4	13	14
9	France	9.8	11	13	2	13
10	Luxembourg	10.0	1	17	14	8
11	Italy	10.5	13	19	5	5
12	Austria	12.8	7	11	10	23
13	Spain	14.0	12	16	9	19
14	Estonia	15.0	23	6	22	9
15	Czech Rep.	15.8	19	21	17	6
16	Hungary	16.0	21	18	18	7
17	Portugal	16.3	14	15	15	21
18	Latvia	17.3	24	10	25	10

19	Cyprus	18.0	18	24	19	11
20	Poland	18.5	20	22	16	16
21	Slovak Rep.	18.5	22	14	20	18
22	Lithuani a	18.8	25	12	23	15
23	Greece	19.0	16	23	12	25
24	Slovenia	20.0	15	20	21	24
25	Malta	21.5	17	25	24	20

These results suggest that, for a US franchisor, the UK would be the most attractive market for expansion, while Malta would be the least attractive.

IV. CONCLUSION

Franchising has experienced dramatic growth in the international marketplace over the past thirty-five years and many franchise companies have benefited greatly from their expansion into foreign markets. However, although franchising generally involves less risk than other forms of internationalization such as direct investment, it is by no means risk-free. In order to adequately assess and manage investments in the global marketplace, it is vitally important for franchise firms to understand the many diverse factors associated with doing business in foreign markets. Yet, despite the complexity of internationalization, many franchise firms enter foreign markets without an adequate understanding of the risks involved.

The purpose of this research was therefore to develop a conceptual hierarchical model that could help franchisors in evaluating their international entry and expansion plans. The model is comprised of three sections: Section One assesses the external macro-environment of the targeted host country; Section Two assesses the internal micro-environment of the franchise system; and Section Three assesses financial factors and the long-term viability of the proposed entry or expansion in a foreign location. This financial assessment is a key factor influencing the 'Stop-Hold-Go' decision and determining the selection of the optimal strategic entry and/or expansion mode(s). The focus of this article is on Section One of the model, the external macro-environment of the proposed host country. The key factors identified in the macro-environment include market risk (political, economic, legal and regulatory factors), market potential (population and per capita GDP), and distance (cultural and geographic factors). A composite International Franchise Expansion Index was then developed using well-established proxies in order to quantify the various factors. The Index ranks countries according to the attractiveness of their macro-environments to US based franchisors. The Index was then operationalized

using data from the twenty-five countries of the European Union. The results indicate that the United Kingdom is the most attractive EU country for international franchise entry and expansion while Malta is the least attractive.

The International Franchise Expansion Index can be used by US-based franchisors as a starting point in assessing the relative risks involved in the macro-environment of EU countries. It is therefore a useful tool for franchisors in understanding and managing the risks involved in their plans to internationalize. The conceptual model and index should be viewed as a first important step in integrating the critical external macro-environmental factors of the host country and the internal micro-environmental factors of the franchise system. Further research still needs to be undertaken in order to identify relevant firm-specific factors (Section 2 of the model) and optimal modes of foreign entry or expansion (Section 3 of the model).

APPENDICES

APPENDIX 1: EU Political / Economic Risk Index

CO UN TR Y	Ove rall Scor e	Politi cal Risk	Econo mic Perfor mance	Debt Indic ators	Debt in Default or Reschedul ed	Cred it Rati ngs	Access to Bank Finance	Access to Short term Markets	Access to capital Markets	For eign Rating	RA NK ING
	100 %	25%	25%	10%	10%	10%	5%	5%	5%	5%	
Austria	93.33	24.2	19.25	10.0	10	10	5	5	5	4.88	7
Belgium	91.88	23.65	18.98	10.0	10	9.38	5	5	5	4.88	10
Cyprus	76.24	19.36	13.49	10.0	10	7.5	5	5	2.43	3.46	18
Czech Rep.	71.50	19.7	11.79	8.81	10	6.88	0.76	5	4.3	4.27	19
Denmark	95.78	24.47	22.04	10.0	10	10	5	5	5	4.27	2
Estonia	67.12	19.11	10.62	7.84	10	7.08	1.87	3.93	3.37	3.29	23
Finland	94.11	24.68	19.55	10.0	10	10	5	5	5	4.88	6
France	91.73	23.84	18.01	10.0	10	10	5	5	5	4.88	11
Germany	92.37	24.23	18.26	10.0	10	10	5	5	5	4.88	9
Greece	81.77	21.21	13.75	10.0	10	7.08	5	5	5	4.73	16
Hungary	68.93	18.03	10.47	7.76	10	6.04	2.86	5	4.14	4.63	21
Ireland	94.65	24.3	20.47	10.0	10	10	5	5	5	4.88	4
Italy	85.97	22.23	16.35	10.0	10	8.13	5	5	5	4.27	13
Latvia	64.96	17.83	9.88	7.01	10	6.25	4.6	2.87	3.23	3.29	24
Lithuania	63.84	17.69	10.24	8.59	10	6.88	1.12	2.87	3.29	3.17	25
Luxembourg	99.59	25	24.71	10.0	10	10	5	5	5	4.88	1
Malta	77.49	20.11	12.24	10.0	10	7.08	5	5	5	3.05	17
Netherlands	94.39	24.59	19.91	10.0	10	10	5	5	5	4.88	5

Pol and	68.9 8	18.4 9	10.3	8.45	10	6.46	1.25	5	4.39	4.6 3	20
Port uga l	84.3 0	22.4 9	13.38	10.0	10	8.54	5	5	5	4.8 8	14
Slo vak Rep .	67.3 2	18.6 2	10.66	8.66	10	7.08	0.76	3.87	3.9	3.7 8	22
Slo ven ia	82.3 1	21.6 7	13.23	10.0	10	8.75	5	4.6	4.43	4.6 3	15
Spa in	88.9 2	22.9 6	16.08	10.0	10	10	5	5	5	4.8 8	12
Sw ede n	94.9 2	24.6 8	20.37	10.0	10	10	5	5	5	4.8 8	3
U. K.	93.1 8	24.0 4	19.27	10.0	10	10	5	5	5	5	8

Source: Euromoney Country Risk Index (2007)

APPENDIX 2: EU Legal/Regulatory Risk Index

COUNTRY	Starting a Business	Dealing with Licenses	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business	Overall RANKING
Austria	83	40	62	30	26	122	80	12	6	21	25
Belgium	19	37	36	161	48	12	65	48	22	9	19
Cyprus											NA
Czech Rep.	91	83	55	54	26	83	113	30	97	108	56
Denmark	18	6	10	39	13	19	13	2	30	7	5
Estonia	20	14	156	21	48	33	31	7	29	50	17
Finland	16	39	127	17	26	51	83	5	7	1	13
France	12	17	144	159	36	64	82	25	14	32	31
Germany	71	16	137	47	3	83	67	10	15	29	20
Greece	152	42	142	93	84	158	86	65	87	38	100
Hungary	67	87	81	96	26	107	127	45	12	53	45
Ireland	5	20	37	79	7	5	6	20	39	6	8
Italy	65	78	56	49	68	51	122	62	155	25	53
Latvia	30	82	96	85	13	51	20	19	3	64	22
Lithuania	57	57	124	4	36	83	71	23	18	31	26
Luxembourg	41	36	164	116	97	107	17	32	2	46	42
Malta											NA
Netherlands	41	84	92	22	13	98	36	14	36	8	21
Poland	129	156	78	81	68	33	125	40	68	88	74
Portugal	38	112	157	65	68	33	66	31	49	20	37
Slovak Rep.	72	50	75	5	7	98	122	90	50	36	32
Slovenia	120	62	166	99	68	19	63	69	79	34	55
Spain	118	46	154	42	13	83	93	47	55	17	38
Sweden	22	17	107	7	36	51	42	6	53	19	14
U.K.	6	54	21	19	1	9	12	27	24	10	6

¹ World Bank, Ease of Doing Business, 2006 (Cyprus and Malta were not included in the World Bank's Ease of Doing Business rankings (Legal/Regulatory Risk). We ranked them just above the highest (worst) ranked EU country (Greece)).

APPENDIX 3: EU Market Potential Index

COUNTRY	Population	GDP per Capita	Index Average	RANKING
Austria	14	6	10.00	10
Belgium	9	9	9.00	7
Cyprus	23	13	18.00	19
Czech Rep.	11	19	15.00	17
Denmark	15	3	9.00	8
Estonia	22	21	21.50	22
Finland	17	7	12.00	13
France	2	10	6.00	2
Germany	1	11	6.00	3
Greece	8	15	11.50	12
Hungary	12	20	16.00	18
Ireland	18	2	10.00	11
Italy	4	12	8.00	5
Latvia	20	25	22.50	25
Lithuania	19	24	21.50	23
Luxemburg	24	1	12.50	14
Malta	25	18	21.50	24
Netherland	7	5	6.00	4
Poland	6	23	14.50	16
Portugal	10	16	13.00	15
Slovak Rep.	16	22	19.00	20
Slovenia	21	17	19.00	21
Spain	5	14	9.50	9
Sweden	13	4	8.50	6
U.K.	3	8	5.50	1

APPENDIX 4: EU Distance Index

COUNTRY	Cultural Distance	Geographic Distance	Average ¹	RANKING
Austria	21	13	27.5	23
Belgium	17	7	20.5	12
Cyprus	7	25	19.5	11
Czech Rep.	8	16	16	6
Denmark	19	10	24	17
Estonia	9	17	17.5	9
Finland	15	12	21	14
France	18	5	20.5	13
Germany	3	9	7.5	3
Greece	23	24	35	25
Hungary	5	22	16	7
Ireland	2	1	2.5	1
Italy	4	14	11	5
Latvia	10	18	19	10
Lithuania	11	21	21.5	15
Luxemburg	12	8	16	8
Malta	13	23	24.5	20
Netherland	6	6	9	4
Poland	16	15	23.5	16
Portugal	24	2	25	21
Slovak Rep.	14	20	24	18
Slovenia	25	19	34.5	24
Spain	22	4	24	19
Sweden	20	11	25.5	22
U.K.	1	3	2.5	1

¹ Cultural and geographic distances were computed as explained in the Methodology section of the paper. The rankings were arrived at by computing a weighted average of the cultural distance (67%) and geographic distance (33%).

