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# **FRANCHISING AS AN INTERNATIONALIZATION METHOD IN EMERGING MARKETS**

**Experiences of Robert's Coffee from Turkey**

Master's Thesis  
in International Business

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# 1 INTRODUCTION

## 1.1 Franchising decoded

Consumers in the contemporary society often use services and products produced by companies using well-known brands. One reason to this type of behavior are the increased time constraints in everyday life. These restraints in time usage are created by the fast pace of the modern society where normally the adult members of an individual family participate in the labor force. As the daily work rhythm occupies the major part of people's time, the period for consumer decisions has shortened. In this respect the use of well-known products and services is a feasible solution for the customers with time restrictions. (Blair & Lafontaine 2011, 1)

The brand-preferring behavior of the consumers makes it easy for company chains to perform their business and prosper. The benefits of chain operations compared to the traditional wholesale-retail model are related to the economies of scale in the centralization of many operations. The removal of several administrative functions from the lower levels of the organization can be executed in several business areas. In sourcing, the negotiating power of the chain is substantially stronger compared to the position of an individual wholesaler. The benefits arise also in logistics, as the deliveries of the goods can be centrally organized. Finally, perhaps the most obvious benefits of chain operations are achieved in marketing, as the brand-building is executed by the headquarters. (Finne & Sivonen 2008, 51)

Chain operations can be organized in different ways: all the chain outlets can be company owned, or the chain ownership can be divided between different entities. Franchising is one of the models of dispersed ownership in chain operations. When comparing these two options of organizing chain operations, the benefit of franchising comes from the ability to connect local entrepreneurs with larger corporations by utilizing the core competences of both of these contractual parties. Both of these partners are able to utilize their special assets, the local businessperson his tacit knowledge on the marketplace and the corporation its experience with centralized operations. (Blair & Lafontaine 2011, 2)

The origins of franchising operations date to medieval times. The word franchise comes from the old French word *franche* which was used to describe the operation of the individuals performing certain societal functions on behalf of the sovereign rulers such as kings and bishops. These activities – tax collection for example – were conducted in a certain area and at a specified place and were subject to a royalty paid by the individual to the authority. The word *royalty* is still used in the context of franchising. (Blair & Lafontaine 2011, 3)

As a business form between companies, franchising has existed since the 18th century. Strahota (2007, 65) argues that Benjamin Franklin, one of the founding fathers of the United States of America, might have been a pioneer in franchising related activities as well. A contractual document from 1733 shows, that Franklin organized his printing business in a manner which resembles the modern day franchising agreement. In the European continent, early forms of franchising were also used in the 18<sup>th</sup> century British brewery system (Karhu 2001).

While initial forms of franchising were used in the 18<sup>th</sup> century, the widespread use of the business method began only after 1850s when Isaac Singer created a distribution system for sewing machine sales. The created network was based on contracts that resembled the contemporary franchising agreements: the salesmen were paying fees to the parent company for the right to sell the products in a designated market area. Later on Singer started to purchase these selling rights back to the company because the system seemed to be more profitable to the salesmen than to the sewing machine corporation itself. Even though the distribution system of Singer did not work as profitably as anticipated, one of the first forms of franchising chains had been established. (Allen 1998)

The present-day franchising as concept cloning started to bloom a century after the Isaac Singer's sewing machine distribution system, as the well-known brands of McDonald's and Kentucky Fried Chicken (KFC) were established (Karhu 2001). The man behind the original recipe of KFC, Harland Sanders, was facing problems in his home town as the new interstate highway was going to take away the customers and destroy his roadside diner business. Sanders decided to overcome this problem by starting to sell rights to other restaurant owners to use his 13 year old chicken recipe in 1952. The founding of KFC, as well as other chains as McDonald's and Burger King, can be seen as the starting point of modern day franchising. (Allen 1998)

The United States has been the pioneer country of franchising in the modern world. In 2007 it was estimated that there were over 3 000 franchising chains operating in the US market. These companies had more than 900 000 franchised outlets in the country, which employed close to 10 million employees. The amount of the employed people is comparable to the level of workers in the manufacturing of durable goods (e.g. computers, machinery, cars, planes and steel). The direct impact of franchising in the US economy was 3.9 percent of the private sector Gross Domestic Product (GDP). This figure rises to 9.0 percent if all the spillover effects of franchising, including the purchases made by the franchisors from the non-franchising companies, are taken into consideration. (Dant, et al. 2011, 253; International Franchise Association 2008, 14–15)

The American companies brought the business form to Europe during the 1960s, most of them through the Great Britain. (Laakso 2005, 16–17) The British have been the pioneers of franchising in Europe and there were close to 900 chains operating in the country in 2009. France has, however, superseded Britain as the leading franchising country in

the continent measured in the amount of chains with almost 1400 chains. The business format has also spread widely to other European nations. In addition to the UK and France, other large franchising countries in Europe include Italy, Spain and Germany. (European Franchise Federation 2011, 4)

Compared to the USA and the leading European countries, Finland lacks popularity with respect to the amount of franchising chains operating in the country. Currently there are between 250 and 300 chains involved in franchising operations in 7 000 locations employing 50 000 people. The use of the business method in Finland is however in steady increase with an annual growth of 14 percent measured in the amount of business locations. (Finnish Franchise Association 2013b, 4)

Finland is not the only country on earth with an expanding franchise community. Similar growth figures are witnessed throughout the world (European Franchise Federation 2011, 3). Dant et al. (2011, 253) argue that franchising is the most rapidly growing form of retailing throughout the globe at the moment. In addition to the developed western economies, the business form has gained advances also in other parts of the world. The fast-growing BRICS countries (Brazil, Russia, India, China and South Africa), in which franchising is gaining a secure foothold in the market, are an illustrative example of the popularity of franchising. This can also be seen in Table 1, which exhibits the role of franchising in selected economies.

Table 1 Role of franchising in selected economies (Dant et al. 2011, 258)

Country	Number of systems	Number of outlets	People employed	Economic impact on the economy (USD bn)	Percent of the retail sector
USA <sup>1</sup>	3 000	901 093	9 000 000	802	41
China	2 600	200 000	5 000 000	63	3
India	1 150	70 000	850 000	4	2
Brazil	1 643	79 988	478 000	36	16
Russia	595	28 044	327 426	n/a	n/a
Australia	1 025	69 000	690 000	139	53
Germany	980	65 500	463 000	79	32
Finland <sup>2</sup>	250	7 000	50 000	7 <sup>3</sup>	n/a

As Table 1 shows, the use of franchising is most common in the USA by all the measured dimensions. China has reduced the gap within recent years and now there are only 400 franchised chains less operating in China compared to the USA. In this respect the

<sup>1</sup> Information adapted partly from International Franchise Association (2008, 14)

<sup>2</sup> Finnish franchising information adapted from Finnish Franchising Association (2013b, 4)

<sup>3</sup> Consolidated revenue, exchange rate of 21.10.2013

interesting aspect is the comparison of the importance of franchising in the retail sector. While in the USA franchising covers more than 40 percent of the retail sales, in China the corresponding proportion is only three percent. Alon and Welsh (2010, 11) argue that the western markets have reached the saturation point, which makes it quite hard for the franchisors to expand their operations in North American and Western European markets.

Instead, the emerging markets have gained popularity during the past decade. According to the US ministry of commerce, 75 percent of the predicted economic growth will take place in emerging markets. These markets account for 80 percent of the world's population and nearly two thirds of the known natural resources. The Big Emerging Markets<sup>4</sup> are, in particular, interesting due to their growth potential. Over 50 percent of the world's population live in these countries, while they produce only 25 percent of the global GDP. As the emerging markets contain high potential for growth, the companies using franchising as an internationalization method should put more effort in understanding this potential marketplace. (Alon et al. 2010, 11–12)

When viewing emerging markets from a European perspective, there are only a few neighboring emerging market areas in the vicinity of the European Union. One of these areas is the Republic of Turkey. With a population of over 79 million it is the 18th populated country in the world with only Russia and Germany superseding it from the European nations. Comparing the economic size of the different European markets measured in GDP at purchasing power parity exchange rates, Turkey takes the 7<sup>th</sup> position. (The World Factbook 2013) From a franchisors' perspective, Turkey is seen as one of the top ten interesting market areas in the world (Alon 2006, 17). Based on the attractiveness of the Turkish market, it has been selected as the area of interest in this study. The different aspects of the Turkish market are discussed in greater detail later.

This chapter has discussed franchising as a phenomenon on a general level and from the viewpoint of the emerging markets. Next the empirical literature on the subject is reviewed briefly.

## **1.2 Empirical findings on franchising as an internationalization method in emerging markets**

The research on franchising as an internationalization method has not gained much attention before the 2000s. The phenomenon has been studied mainly by scholars from the United States and their perspective has been to study the American firms' internationalization using franchising as a method for expansion. One example is Hackett's (1976) survey on the US franchise system where an effort was made to find out in which extent the

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<sup>4</sup> See Chapter 1.4 for definition.

business mode was used as an internationalization method. He concluded that the use of franchising had experienced a remarkable increase in the internationalization of American firms.

During the past two decades researchers have devoted more attention to the topic. Studies have been focusing on franchising as one of the entry modes among the other equity and contractual means (Fladmoe-Lindquist & Laurent 1995; Burton et al. 2000). Academics have also tried to describe the reasons behind the international franchising decision and the nature of the franchising system (Petersen & Welch 2000). In this respect, Quinn and Doherty (2000, 368) found out that the relationship and the use of power in a franchising system depends on the presence of a well-defined business concept and brand. Recently, attempts have been made to create general descriptions of franchising on a global scale. For example, in examining the differences in the rate of franchising across nations, Michael (2003) concluded that the variables of product differentiation, the development of the manufacturing sector, and the cultural distance between nations have an effect on the distribution of franchising. Aliouche and Schlenrich (2009; 2011) have made aspiring attempts in defining the most desirable markets for the US based franchisors to conduct their business. Their examination showed that the most attractive markets for American chains are the large European countries and Canada, Australia as well as Japan.

Several university graduate students have also approached the phenomenon during the past decades from the Finnish companies' perspective. The studies have focused mainly on explaining the reasons for choosing franchising as an internationalization mode and the actions of a particular company executing its foreign operations (Koskimäki 1995; Linjala 1998; Olli 1998; Sund 2005; Riihimäki 2008; Monnonen 2010; Temmes 2010). The study by Olin (2001) has been an exception in this group of studies, as the author has tried to explain the use of franchising on a wider scope by contacting several franchisors. The study showed that the Finnish companies employing franchising in their international expansion are generally large, old, and geographically widely spread.

The research on international franchising has gained more attention during the last decade. As a part of this growing interest in the phenomenon, emerging markets have been seen as an interesting research focus. For example Alon (2006) compared the market size with a variety of factors in order to find the most potential emerging markets for international franchisors. His conclusions surprisingly showed that Brazil, Russia, and Mexico were more interesting market areas for franchisors than China and India. Accordingly, Baena (2009; 2012; 2013) has made refreshing efforts to change the traditional US based research stream by studying the topic from the Spanish perspective. The studies indicate that there are many environmental factors that constrain the spread of franchising in emerging markets. In addition, the country-related features have an impact on the selected method of franchising.

The existent literature on franchising in emerging markets can be divided based on the discussed target country. In the following examination the studies are divided into four distinct groups: studies concerned with (1) China and East Asia, (2) Russia and East Europe, (3) Latin America and (4) Africa.

East Asia has gained plenty of interest in the research community during the past decade. Special interest has been devoted to studying China as a marketplace for foreign franchisors. Some of the publications have focused on describing the Chinese marketplace and its suitability for franchising (Alon & Bian 2004; Heung et al. 2008). In the examination of the Chinese real estate market, Alon and Bian (2005) found out that even though the American brands are competitive in China, there exist political risks in the market expansion. In addition to the studies of wider scope, a few case studies have been made on the peculiarities of particular foreign franchisors (English et al. 1994; Alon 2001). In a holistic investigation of the Australian franchising companies' penetration to China, Frazer (2003) observed that the problems in the entry to the market area were related to the finding of a suitable partner. In addition, in some instances the companies had not executed a proper pre-entry market research.

In contrast to the numerous investigations on the Chinese market, only a few studies have described the franchising environment of India (Thomas 2006). However, Paswan and Sharma (2004) have conducted an extensive study on the Indian customers' knowledge on the foreign franchisors' country of origin. They concluded that the franchisors should focus on the communication of their brand's home country in order to achieve the benefits of the good reputation of a particular country.

In line with the scant research on India, only a few academics have devoted attention to the smaller South-East Asian countries (Chan & Justis 1995; Goh & Lee 1996; Chen 2010). In their examination on American companies in Singapore, Choo et al. (2007) concluded that the franchisors were highly dependent on the resources and knowledge of their local partners. In this respect, the partner selection was seen as the most crucial element of the international expansion. In addition to the country-specific enquiries, some effort has been made also in describing the Asian franchising environment on a macro-level (McCosker 1996; Choo 2005).

The disintegration of the Soviet Union created a possibility to research the vast markets of the ex-communist countries also from the perspective of international franchising. Several scholars have described the new opportunities in the different parts of the former U.S.S.R (Welch & Swerdlow 1991; Christy & Haftel 1992; 1993; Welch & Swerdlow 1993; Swedrow & Bushamarin 1994). The transitional countries of Central Europe gained also some attention during the 1990s (Sanghavi 1997; Pavlin 1998; Pavlin 2000). On the contrary, only a few studies have discussed the contemporary market conditions of Russia from a franchising perspective. As a refreshing exception, Anttonen et al. (2005) have studied the market from a macro environmental viewpoint by identifying the franchising-

related characteristics of the Russian economy. They concluded that even though the market has high potential for franchisors, the obscurity of the business form and the high political risk of the country reduce its attractiveness.

The Latin America has been the focus of attention in some franchising-related studies. The US based studies have mainly been comparisons of different market areas (Falbe & Welsh, 1998). For instance, Dant et al. (2008) discovered significant differences between the emerging Brazilian market and the developed markets of France and the USA. In addition to the country-level comparisons, a few case studies have been made about franchisors' entry into Latin America. For example, Hadjimarcou and Barnes (1998) concluded that cultural knowledge and partner selection were the most important factors in the case company's expansion into the Mexican market. In this respect, the results were similar with the discoveries from Singapore (Choo et al. 2007). In line, Baena and Cerviño (2011) have brought about some differentiation to the North American dominated perspective in the studies concerning the Latin America by investigating the marketplace from a Spanish viewpoint.

African countries have received scant consideration with regard to franchising research. Recently, the consumer perceptions on foreign franchisors were researched in Egypt by Grünhagen et al. (2010). They discovered that there is a need for localization of marketing strategies, especially in the fast food industry, due to the young consumer base. Relatedly, the concept of *microfranchising* was discussed, with case studies from various African countries, in a thesis by Heinonen (2010), who concluded that the concept has potential in poverty alleviation even though it still faces many problems. Before these investigations only limited attention has been given to franchising in South Africa (Scholtz 1997).

This chapter has shown that the frequency of academic research on international franchising has recently increased, and the subject of emerging markets as the focus of studies has gained more attention. The aforementioned studies have shown that the successful expansion into emerging markets relies on the existence of a well-established business concept and brand. In addition, many researches have shown that the partner selection is especially important in the lucrative market areas of Asia and Latin America. Even though emerging markets have recently gained increasing attention from academics, there still exist understudied themes such as the expansion into the region of the Middle East. More detailed information on the literature discussed in this chapter can be found in Annex 1.

### **1.3 Objective of the research**

As a research topic, franchising as an internationalization method has been more commonly approached via quantitative modelling techniques compared to the scant number

of qualitative case studies. Elango and Fried (1997, 77) observed already in the 1990s that there is a need for more profound research using qualitative methodologies such as case studies in studying international franchising operations. Even though within the last decade the scholars have issued more case examples of the phenomenon, there still is a demand for more elaboration on the topic. As Alon et al. (2010, 30) state:

*...little research is available to explain why and how franchisors have used various modes of entry in penetrating emerging markets.*

Frazer (2003, 8) shares this view by mentioning:

*In particular, future research could examine case studies of international retail franchisors to determine characteristics associated with success or failure in overseas franchising.*

The franchising research has been dominated by the US based studies, and there clearly is a need to approach the topic from different cultural perspectives (Baena 2012, 50). As stated above in the literature review, there has been an increase in studying emerging markets as franchising targets. However, Middle East has not received much attention from this cumulating research, at least from the academics that are writing in English. This study tries to bridge these gaps by studying the phenomenon from a Finnish perspective and focusing on an understudied target country, Turkey. The research question of this study is:

*How has a Finnish franchising company been able to enter the Turkish market?*

In order to be able to study the phenomenon, the research question is divided into the following sub-questions:

- What is the internationalization strategy of the company?
- What are the characteristics of the Turkish market from the perspective of franchising?
- Which factors have helped or constrained the market entry?

The theoretical framework of the study is derived from the international business tradition as foreign entry modes are the main theme of the study. In addition, some linkages to other traditions are made since, here, franchising is under scrutiny as an entrepreneurial mode. The sub-questions of the study are deduced from the theoretical background, and they are connected to each other with a logic that is illustrated in Figure 1.

The main theoretical foundation of the study is a contingency model of global franchising strategies created by Hoffman and Preble (2006), which leads to the examination of the internationalization strategy of a company. This scrutiny includes the employed method of franchising as well as the wider strategic approach supporting it. In this instance the reasons for the selection of franchising as an internationalization method are also discussed using the agency theory and the resource-based view as theoretical instruments.

The concept of market similarity is one of the key concepts of the contingency model of franchising. This leads to the necessity of the investigation of the market conditions in which the strategies are used. As a consequence, the Turkish market environment is examined in Chapter 3 using the macro environmental model of Alon and McKee (1999). This investigation enables the comparison of the home market of the franchisor with the targeted market area.

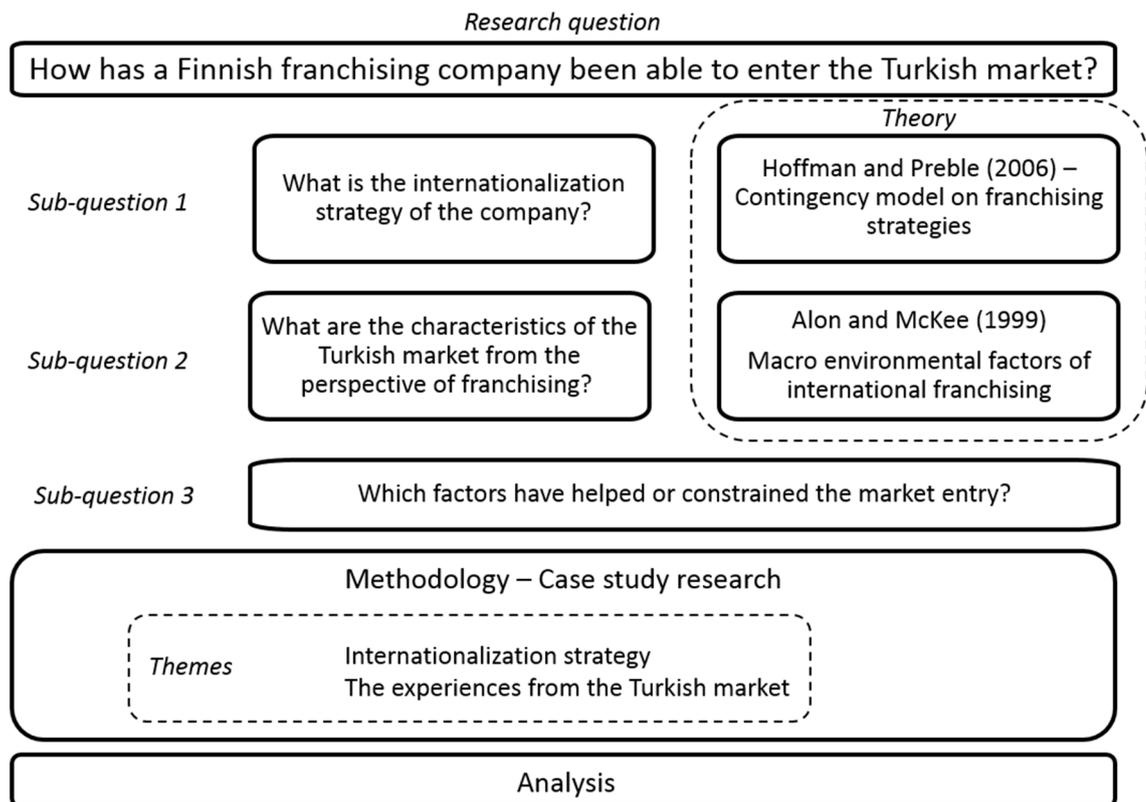


Figure 1 The structure of the study

Based on these two aspects of international expansion, the employed strategy and the market conditions, an examination is made on the factors that have helped or constrained the entry to the targeted market area. In this respect the possible problems of the international expansion are investigated and the experiences of the franchisors are highlighted. The theoretical frameworks presented in Chapter 2 are transformed into a qualitative case study research setting outlined in Chapter 4 in an effort to create new empirical evidence to enrich the research tradition of internationalization methods. The evidence is presented in Chapter 5 before moving into the concluding remarks of the study.

In addition to the research questions, certain outlines apply. As mentioned above, in geographical sense the research is defined so that the franchisees operate in the Turkish market. This is done in order to focus on a specific market area. Addressing too many target countries might needlessly widen the scope of the study and make the research less

focused. The franchisor exhibited in the case study is originated from Finland. This selection is made as an effort to create new empirical data to the otherwise US dominated research stream.

This research will contain only evidence collected from a company using business format franchising<sup>5</sup> as its tool of expansion. This is due to the fact that the European franchise community does not see traditional franchising as a part of franchising operations. In addition, in the American market, the relevance of traditional franchising has diminished as three quarters of franchising output is made by business format franchisors (International Franchise Association 2008, 16). Defining the research only to business format franchising is also feasible due to its nature as a peculiar arrangement between companies. While traditionally franchised chains can easily be confused with normal chain operations, business format franchising is in every aspect undoubtedly a recognizable form of franchising.

## 1.4 Defining franchising

Franchising is understood as a business contract between two separate companies. In this agreement the parent company – the franchisor – gives the local entrepreneur – the franchisee – the right to use its trademark, product or the whole business format in a specified area at a certain time frame. In addition to the business-oriented explanation of the word, it is also used in other instances as well. In the USA the government grants permissions to the companies in certain industries to operate in certain areas by using a franchise bidding process. To give an example, this process is used in cable TV industry. In addition to these two examples of the use of the word franchising, it is also used in the American sports industry where a certain team is granted the permission to operate in a particular geographical area. (Blair & Lafontaine 2011, 4)

To elaborate more on the meaning of franchising in the business context, the definition of the term can be understood as Elango and Fried (1997, 69) have described it:

*Franchising is an organizational form in which a company grants an individual of another company the right to do business in a prescribed manner over a certain period of time in a specified place in return for royalties or the payment of other fees.*

In this respect franchising is typically divided into three different forms (Karhu 2001, 197–198; Laakso 2005, 35–36):

- *Trademark Franchising* is a mode of business, where the franchisor gives another company a right to use the brand of the company, mainly for marketing

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<sup>5</sup> See Chapter 1.4 for a definition.

purposes. Hotel chains and car dealers can be seen as examples of this form of franchising.

- *Product Distribution Franchising* means that the franchisor gives the right to the franchisee to act as the only distributor of its products in a certain market area.
- *Business Format Franchising* is the most developed form of franchising. It is a situation where the franchisor gives the franchisee the right to use the created concept in a certain market area.

The first two of these forms can also be bundled together to create a category that is called traditional franchising, which is namely the oldest version of the business model. The above discussed Singer distribution system falls in this category with the modern day car dealers, soft-drink producers and oil stations. In traditional franchising the franchisor is a manufacturer of finished or semi-finished products and sells these products to the franchisees. The local entrepreneurs do not normally pay a constant fee to the parent company, as the corporation takes its profits out of the products sold to the franchisee. (Blair & Lafontaine 2011, 6)

Compared to traditional franchising, companies involved in business format franchising create a much deeper relationship with regard to the exchanged products, commissions and also the level of control. In this type of entrepreneurship, the whole business format of the parent company is set down into manuals and guidebooks, and is further given to the local entrepreneur. The two-way connection between the contractual parties is ample as the corporation not only exercises its control over the entrepreneur but also helps the local company in many aspects of the business process. This aid comprises e.g. advertising, product development and corporative functions, such as accounting services. (Blair & Lafontaine 2011, 6)

The distinction of franchising into these categories is important from the international point of view, because the scope of franchising is different in separate parts of the world. The Franchise Rule Compliance Guide (2008, 1) of the US government distinguishes three different fundamentals that a business relationship must have in order to be called franchising. (1) The franchisee must license its trademark to the franchisee and (2) exercise substantial control on the business operations of the local entrepreneur. In addition, (3) the franchisee must pay at least 500 dollars to the franchisor within the first six months of the relationship. This ample interpretation includes both traditional and business format franchising. (Blair & Lafontaine 2011, 4) In most parts of Europe however traditional franchising is not included in the franchising statistics and these forms of business activity are not included in the discussion of franchising. According to the Finnish Franchising Association (2013), franchising is a contractual agreement of two separate legal entities set up in order to transfer a specified business concept created by the franchisor to the franchisee in exchange of financial compensation. The association also recognizes the

existence of traditional franchising but states that it is not considered as a part of franchising in the European definition of the business model.

In addition to the different points of view in the separate continents regarding the scope of franchising, it is important to make a distinction between traditional and business format franchising for another reason. The distinction between these two categories enables the American press to use those figures that are favorable to franchising. As traditional franchising is counted as a part of franchising in the USA, the proportion of the business model in the American economy is considerably higher compared to the European statistics. On the other hand, due to the high growth numbers in the use of business format franchising, it is convenient for the US based franchising organizations to use only these numbers when describing the boom of the business method. (Blair & Lafontaine 2011, 8)

The growth of the use of business format franchising has been rapid in the past couple of decades. An example of this fast increase in the use of the business model can be given from the USA, where the government collected official data on franchising up until 1986: the use of traditional franchising superseded the use of business format franchising, as 73 percent of sales generated in franchising operations were realized by traditional franchisors. (Blair & Lafontaine 2011, 6) However, two decades later the setting has turned vice-versa, as majority of the output in the American franchising business is created by business format franchisors. According to the International Franchise Association (2008, 16) 82 percent of the franchisors' output in 2007 were made by business format franchisors. These numbers are from the US market only, but as it is the largest franchising market in the world, these figures reflect fairly well the situation in the world economy.

The term *emerging markets* can be defined in many different ways depending on the intentions of the interpreter. The term was originally introduced by Antoine van Agtmael in 1981 while trying to discover an attractive name for a third-world investment fund. Ever since the term has been widely used and remodeled for different purposes. Recently some have argued that the term is obsolete due to the fact that some countries have ascended closer to the category of the developed nations. However, no other term has yet superseded the term emerging markets when describing nations other than the developed nations with high growth potential. (Economist, 2008)

There are usually three features to be considered when an emerging market is discussed. First, the level of economic development in an economy must be relatively low in order to be called as emerging. GDP per capita is a practical indicator in this respect, because it takes into consideration not only the size of the market but also the amount of the population in it. Second, the market must have experienced notable economic growth rates in long run. The measuring of GDP growth rates are again a practical method for observing the increase of economic activity. Finally, the market governance aspects must be considered in classifying markets as emerging. In this respect country risk (including the elements of government regulation, bribery, ownership restrictions, controls of capital

flows, and import restrictions) is seen as the most important factor in separating the emerging markets from the developed ones. (Alon et al. 2010, 13–14)

Different organizations have used at least some of these criteria in classifying countries and areas as emerging markets throughout the last decades. During the Clinton administration, the US government identified ten emerging markets as the Big Emerging Markets<sup>6</sup>. These markets were identified as the most lucrative ones for future growth opportunities for the US corporations. At the time, these markets were importing as much from the USA as Japan and European countries combined. (Kader et al. 1996) A lot has changed from these days, but it can still be argued that the economic importance of these market areas has not decreased in the last two decades.

The International Monetary Fund (IMF) divides countries in two categories: the advanced economies<sup>7</sup> and the emerging markets and developing economies. The division is not based on any conclusive criteria or profound research, and the purpose of the categorization is only to facilitate comparison and analysis of different groups of countries. In this categorization a selected group of nations is "raised" in the group of developed nations, whereas the remaining 154 countries are considered as emerging or developing. (International Monetary Fund 2013, 137–138)

In addition to the aged interpretation of the US government and the quite ample construction of the IMF, there are several organizations that categorize countries as emerging markets depending on various criteria. One of these is the financial support tools provider MSCI's<sup>8</sup> categorization of countries into developed, emerging and frontier markets. This division is based on criteria that encompass two of the three features mentioned above. Market growth statistics are excluded from the criteria, but instead financial parameters are taken into consideration. The allocation made by MSCI narrows down the amount of emerging markets into a set of 21 countries<sup>9</sup>. The indices made by commercial companies are updated annually. As an example the status of Greece, which has been under economic turmoil since the financial crisis hit the country in 2008, was changed from a developed market to an emerging market in November 2013. (MSCI Market Classification Framework 2014)

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<sup>6</sup> Argentina, ASEAN countries (Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam), Brazil, the Chinese Economic Area (China, Hong Kong, Macau and Taiwan), India, Mexico, Poland, South Africa, South Korea and Turkey.

<sup>7</sup> Australia, Austria, Belgium, Canada, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxemburg, Malta, the Netherlands, New Zealand, Norway, Portugal, San Marino, Singapore, the Slovak Republic, Sweden, Switzerland, Slovenia, Spain, Taiwan, the United Kingdom and the United States.

<sup>8</sup> The abbreviation MSCI is derived from Morgan Stanley Capital International. However, Morgan Stanley has not been the owner of the company since 2009.

<sup>9</sup> Brazil, Chile, China, Colombia, the Czech Republic, Egypt, Greece, Hungary, Indonesia, India, Korea, Malaysia, Mexico, Peru, the Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.

## **2 ENTRY MODES OF INTERNATIONAL BUSINESS**

### **2.1 The tradition of international business with regard to entry modes**

The background of international business theory originates from the traditional trade theories of the 18<sup>th</sup> century. The seminal work *Den Nationnale Winsten* by Anders Chydenius in 1765 was one of the first attempts in the western literature in trying to explain the benefits of free trade between nations. The book was published during the Swedish parliamentary season as an effort to persuade the statesmen to grant foreign trading rights to the Finnish west coast towns. The groundbreaking ideas of Chydenius criticized the dominant policies, and stated that in order to maximize the wealth of a nation, the mercantilist restrictions should be removed and freedom of trade in every aspect should be emphasized. This thought was based on a liberalist assumption which implied that the selfishness of the people and the market mechanisms of supply and demand would in the end provide the best result for the nation as well. (The Anders Chydenius Foundation 2013)

The ideas of Chydenius were a century ahead of his time but as he published his works in Sweden rather than in Paris or London (Uhr 1964, 85), instead, a decade later a Scottish academic Adam Smith (1776) rose to world fame by publishing the classical theory of economics. The theory suggested that production in a country should be guided by the absolute advantage it possesses with regard to its resources. According to this concept the unequal spread of assets should lead to specialization and export of surplus production. (Zucchella & Scabini 2007, 29)

Smith's theory was further developed by David Ricardo (1817), who introduced the concept of competitive advantage. This "evolution" of absolute advantage proposed that countries should focus their effort on the production of goods in which it had higher comparative advantage. Commodities of lower comparative advantage were supposed to be imported from other countries. The presumption of both Smith's and Ricardo's theories was that countries were the actors in the world economy, not companies. (Zucchella & Scabini 2007, 29)

The focus of research shifted from nation states to enterprises as the main players in the international business (at the latest) during the 1960s, when several authors started to examine why and how enterprises conducted business across borders (Zucchella & Scabini 2007, 29). The literature of international business and foreign operation methods in particular can be divided into two mainstreams: (1) the economic-strategic stream of research and (2) the behaviorist approaches of internationalization. Many theories can be placed under both of these main approaches and the studies are quite heterogeneous compared to each other: as the selection of different entry modes is wide, so is the group of

theories behind them. Many researchers use both streams in their studies and therefore the approaches should be seen as complementary to each other. (Welch et al. 2007, 20)

According to the economic-strategic stream of research, the choice of entry mode is eventually a selection of the desired level of control versus the flexibility and risk in the international operation. This line of research sees large-sized companies as the main actors in foreign transactions. Costs as the basis of decisions is a key variable in this tradition and decisions are expected to be made rationally. The behaviorist school on the other hand describes internationalization as an incremental process, in which new knowledge creation is seen as the most important asset of the companies involved in foreign exchange. The process perspective opposes the view of rational decision making and rather expects that the internationalization of a firm in many cases is full of ambiguity, especially when small inexperienced firms are discussed. (Welch et al. 2007, 20, 33–34)

According to Zucchella et al. (2007, 30), the most important theories of the economic-strategic stream are the market power approach, the product life cycle approach, the internalization theory, transaction cost theory and the eclectic paradigm. Behavioral theories are further divided into the organizational learning school, the network approach, the innovation model and the knowledge-based view. Welch et al. (2007, 18–42) mainly support this division between the two mainstreams. In their view, however, the knowledge-based view is seen as a part of a resource-based approach created by the strategic management scholars.

The market power approach was introduced by Stephen Hymer in 1960 (Hymer 1976). It was one of the first attempts to explain how companies engage in foreign operations. The study proposes that the internationalization of large companies is a result of market saturation and a monopolistic position at the home market of the enterprise. After establishing a strong position at the domestic market, firms try to duplicate this process in foreign countries. By acting in different markets, multinational enterprises learn skills which give them an advantage compared to local companies and help them in penetrating new markets. Hymer also introduced the concept of market imperfections, which in his theory were the reason why companies have chosen to internationalize by making investments in foreign markets rather than by exporting. Due to market imperfections, the enterprises are able to gain more profit by using their tacit knowledge internally instead of selling it to other companies in perfectly working markets. (Welch et al. 2007, 21–22)

The resource-based view presented by strategic management scholars (see e.g. (Wernerfelt 1984; Barney 1991) can be seen as a continuation of the concept of market imperfections. According to the resource-based view, companies' competitive advantage is determined largely by the valuable assets that they possess. These important resources can be both tangible, such as raw materials, and intangible, such as human capital, su-

preme technology, and financial capabilities or legal know-how. The success of an enterprise is seen as an outcome of the relationship between the firm's resources and the company's strategy to exploit them. (Welch et al. 2007, 22)

The Product Life Cycle model was created by Vernon (1966) in a time when the United States was a leading pioneer in technological innovations. The internationalization of products was supposed to have a close connection to its life cycle. Vernon divided the internationalization process into four subsequent phases. In (1) the introduction period the product was manufactured and sold in the US market with a high margin. During (2) the growth stage the product was still produced in the USA, but was also exported to other countries, mainly to Europe. In (3) the maturity stage the product started to face competition from other companies, and the production had to be relocated close to the end market in the search for lower manufacturing costs. In (4) the final phase the demand for the product was declining. This forced the company to move the production to countries of very low production costs in order to gain profits until the abandoning of the product. The US centered Product Life Cycle model became obsolete already during the 1970s, when innovations started to rise from other countries as well. (Zucchella & Scabini 2007, 32–33)

The transaction cost and internalization theories have been one of the leading traditions in the recent decades. These approaches have been especially used when the activity and existence of multinational corporations have been under scrutiny. The theories were first developed by Coase (1937) and later elaborated by several international business scholars (Williamsson 1975; Buckley & Casson 1976; Hennart 1982). According to these theories, an enterprise faces transaction costs when buying assets from the markets. These costs include for example drafting, negotiating, monitoring and enforcing contracts. In perfectly working markets with large amount of suppliers, these costs would be close to zero. However, in the reality there are imperfections in the markets, such as imperfect information and opportunistic behavior of actors. These imperfections raise the transaction costs, which makes it more convenient for the companies to internalize their transactions rather than conduct them in the market. In this view, market operations and vertical integration can be seen as two different options for a firm to organize its actions. (Welch et al. 2007, 24–25)

The reasoning behind the transaction cost approaches that favor in-house activities over market operations is based on three aspects. First, the international transactions might contain specific assets, such as unique production technologies, which makes it difficult for the company to trust these facilities in the hands of another companies. Second, the uncertainty involved in foreign operations might lead to complex contractual relations when operating with other companies. By incorporating the transactions, the company is able to avoid complicated negotiations with other firms. Third, the high frequency of international transactions is viewed as a factor favoring in-house activities,

because after the initial fixed costs in international company-owned operations, the variable costs of internal transactions are substantially lower compared to the transactions conducted in markets. (Welch et al. 2007, 24–25)

The Eclectic Paradigm was created by John Dunning (1988), who attempted to create an analytical framework by combining existing theories explaining the internationalization of a firm. Dunning realized the limitations of his framework and did not try to predict the behavior of a particular firm. Instead he aimed to synthesize the existing literature. According to the eclectic paradigm, to conduct international operations a firm must possess either ownership advantages (O), location-specific advantages (L) or internalization advantages (I). This three-phased division encompasses the market power theory, resource-based view, international trade theory and the transaction cost approaches. (Welch et al. 2007, 30–31; Zucchella & Scabini 2007, 35–36)

The behavioral theories of international business have been created on the foundations of organizational learning processes and the behavioral theory (Simon 1955; Penrose 1959; Cyert & March 1963; Aharoni 1966). Based on these theories, several models have been developed, which emphasize the process perspective of internationalization and especially the practical knowledge that enterprises gain through internationalization process (Johanson & Wiedersheim-Paul 1975; Johanson & Vahlne 1977; Luostarinen 1979). Perhaps the most well-known model is the Uppsala model by Johanson and Vahlne (1977), who suggest that the internationalization of a firm is an incremental process which is conducted during a relatively long period. According to the model, the process of entering foreign markets advances through four stages; (1) non-regular export activities, (2) export through agents, (3) sales office abroad and (4) manufacturing subsidiary. The firms tend to begin their internationalization process through markets, which are at a close psychic distance, i.e. culturally close to their home market. (Welch et al. 2007, 34–35; Zucchella & Scabini 2007, 40–41)

The network model was introduced by Johanson and Mattsson (Johanson & Mattsson 1988), who suggested that internationalization of a firm depends more on its position in an international network rather than on firm-specific valuable assets or psychic distance. The approach depicts four different types of situations for a firm in a network; (1) the early starter, (2) the late starter, (3) the lonely international and (4) the international among others. In each of these situations, a firm's position differs with regard to the degrees of internationalization of the market and the firm itself. The network model takes a slightly different stance towards knowledge creation than the process models. In this approach, knowledge is created also in the exchange between the network members, not only between the firm and the market, as the Uppsala model suggests. (Zucchella & Scabini 2007, 48–50)

The knowledge-based view of a company has been elaborated by several scholars after Penrose (1959) had created the concept in the 1950s (Demsetz 1988; Kogut & Zander

1993; Conner & Prahalad 1996; Nahapiet & Ghoshal 1998). According to this approach, knowledge, which is created through firms' participation in incremental learning processes in the market, is the most important possession of an enterprise. The compiled knowledge is later distributed to other markets within the organization, which gives the enterprise an advantage with respect to local companies. (Zucchella & Scabini 2007, 49–50). The knowledge-based view can be seen as a predecessor to the resource-based view of the firm created by the strategic management scholars. This approach however has close connection also to the behaviorist theories of international business, as incremental knowledge creation is seen as the most important factor in these approaches. (Welch et al. 2007, 33)

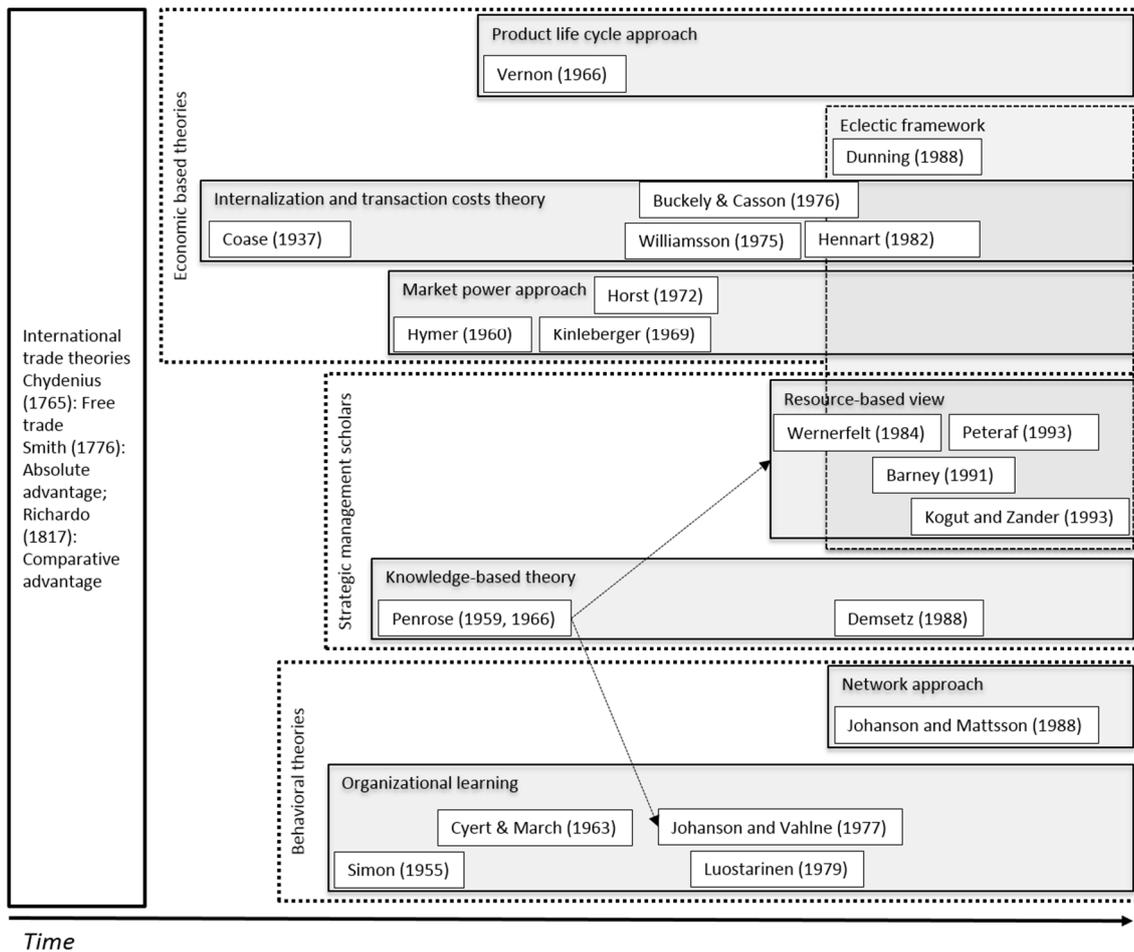


Figure 2 The evolution of the relevant international business theories with regard to foreign entry modes (adapted from Welch et al. 2007, 18–42)

Due to the ambiguous role of the knowledge based view as a contributor to both theoretical streams, the division of the existing literature into these two schools is somewhat artificial. The timely development of the theories discussed in this chapter is illustrated

in Figure 2. However, this presentation is far from comprehensive. If anything, the objective of this illustration is to show the reader the development and relations of the most important theories concerning international entry modes during the past decades.

## 2.2 The link between entry modes and theory

There is a close connection between entry modes and foreign market operations. It might even be argued that the way in which companies conduct business in international markets is a direct consequence of the entry mode they have chosen when establishing themselves in a foreign market. (Welch et al. 2007, 3)

According to Welch et al. (2007, 3–4), foreign operation modes can be divided in three categories. The division between contractual modes, exporting and investment modes are illustrated in Figure 3. These three categories are a generalization of a complex reality, in which different mode combinations are a part of the everyday life of businesses. As an example, a contractual joint venture between two companies with equal share of ownership falls into two of these categories.

Contractual Modes	Exporting	Investment Modes
<ul style="list-style-type: none"> <li>• Franchising</li> <li>• Licensing</li> <li>• Management contracts</li> <li>• Subcontracting</li> <li>• Project operations</li> <li>• Alliances</li> </ul>	<ul style="list-style-type: none"> <li>• Indirect</li> <li>• Direct: agent/distribuidor</li> <li>• Own sales office/subsidiary</li> </ul>	<ul style="list-style-type: none"> <li>• Minority share (alliance)</li> <li>• 50/50</li> <li>• Majority share</li> <li>• 100% owned</li> </ul>

Figure 3 International entry modes (adapted from Welch et al. 2007, 4)

The different theoretical approaches of international business theory presented in the previous chapter take varying stances to the modes of operation in foreign markets. Generally it seems that theories based on the economic-strategic view are more often in favor of investment modes as a resolution to the existing market imperfections. On the contrary, the behavioral school emphasizes the use of contractual modes and exporting as in their view the internalization of a firm is a gradual process. The relation of the presented theories and foreign operation modes is illustrated in Figure 4.

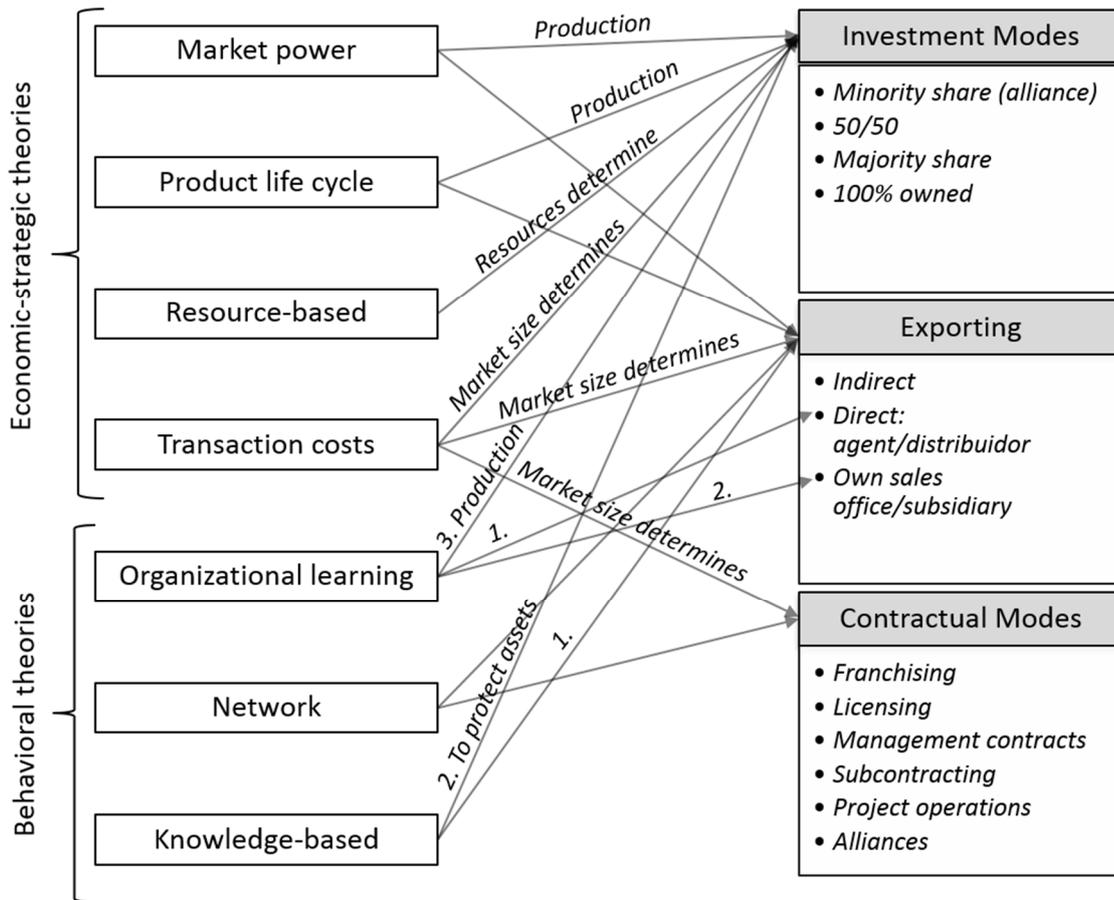


Figure 4 The connection between international business theories and modes of operation (adapted from Welch et al. 2007, 22, 25; Zucchella & Scabini 2007, 42, 48, 52)

The product life cycle theory and the market power theory both view the entry modes simply as a choice between exporting and foreign direct investment (FDI). However, the rationale behind these theories differs. Whereas the former views the maturing lifecycle of a product as a motivation to establish production sites abroad, the latter assumes that the use of FDIs is rather a consequence of the tacit knowledge gained by the high market power and previous foreign experiences. As an elaboration of the market power theory, the resource-based view also emphasizes the use of fully owned equity modes in order to safeguard the firms' valuable assets. The approach however recognizes the possibility to use shared ownership structures in order to gain resources from other companies. (Welch et al. 2007, 22–23)

The transaction cost approach shares the interpretation of the resource-based view concerning the utility of a highly controlled equity mode when important firm specific assets are involved. However, it also recognizes the possibility to use the whole scale of entry mode options depending on the incurred costs and the size of the market. (Welch et al. 2007, 25) According to Buckley and Casson (1981, 80), the differing fixed and variable

costs of exporting, licensing and FDIs lead to a setting where their use depends on the market size. According to their simple model, exporting is feasible in small markets and FDIs in large ones. Under certain conditions licensing would be the least costly mode in mediocre markets.

As the economic-strategic theories suggest that FDIs are the most desired way of internationalization, the behaviorist school emphasizes the importance of external transactions between the company and the market, at least in the early stages of internationalization. The organizational learning approach views that exports are the main method of international operation until sufficient knowledge and presence in the foreign market is established. This viewpoint is shared by the academics of the knowledge-based view. It is noteworthy however, that both of these schools view FDIs as the end state of the internationalization when companies grow larger. (Zucchella & Scabini 2007, 42, 48, 52)

The network approach can be seen to differ from the other internationalization methods as it emphasizes the interconnectedness of companies in foreign operations. This is especially the case with the modern entrepreneurs using a so called born global strategy. This strategy relies highly on the use of entrepreneurial networks in acquiring resources and competencies, which leads to the use of contractual methods such as partnerships and alliances. FDIs in the form of joint ventures are not however ruled out from the available methods of internationalization even in the network approach. (Welch et al. 2007, 38–39)

### **2.3 The traditional explanations of franchising**

When shifting the focus from various international business theories and entry modes to franchising, two theoretical approaches stand out. According to Combs et al. (2004, 909), the majority of franchising research has drawn their theoretical assumptions from either agency theory or resource scarcity. Agency theory discusses the relationships between the parent company and its representatives abroad, and sees franchising as a solution for a better outcome for the franchisor. Resource scarcity is seen as an explanation to the use of franchising as a tool for growth.

Agency theory is closely connected to transaction cost theory as it discusses one area of market imperfections, the information asymmetries. These asymmetries exist in the relationship of two actors, the principal and the agent. An agency relation exists under certain circumstances i.e. when the principal delegates some sort of authority to the agent. An example of an agency relation is the chain operations of an international company, where the parent company gives the foreign sales agent a right to operate on its behalf in a foreign market. Information asymmetries between the actors can be divided into pre- and post-contractual issues. Before the contract has been made, the asymmetries consist

of the lack of information about the possible agents. After the relationship has been established, the asymmetries result in problems related to the controlling of the agent. The agents might not have the same goals with the principal in every aspect and the latter is faced with expenses called the agency costs when controlling the agents. (Combs et al. 2004, 910; Welch et al. 2007, 27)

The difference in the goals of the principal and the agent is the most important assumption of the agency theory. Due to the different goals, the agents might not present all the relevant information about their knowledge and skills. In addition, the agents are assumed not to make all the effort that is at their disposal. To counter these discrepancies, the principal can use either monitoring or incentive alignment. Monitoring is defined as all the means that provide information about the agents' behavior to the principal. Incentive alignment has been shown to be effective when the agents work according to the principal's interests when pursuing their own incentives. (Garg & Rasheed 2006, 4)

Incentive alignment in franchising is conducted through residual claimancy. This means that the franchisee claims all the residual profit after the costs of the business and the royalties to the franchisor are paid. In this way the incentives of the two parties are aligned as the entrepreneur profits the most from increased sales and profitability. This might not be the case when a company opens a subsidiary and hires a manager to run it. Manager normally enjoys a fixed salary, which from the perspective of agency theory means that there is a risk of effort avoidance. Using franchising, the corporation partly avoids these problems by granting the entrepreneur the right to be the residual claimant. (Garg & Rasheed 2006, 5)

The problematic relationship between the corporate headquarters and a chain manager is called a vertical agency problem. Even though franchising reduces vertical agency problems, it does not remove them totally, because opportunistic behavior can happen also in a franchising relationship. The franchisor can for example put franchisees in a difficult position by granting franchises to entrepreneurs too close to each other. The franchisee might, on his side, fail to obey the chain's quality standards or reveal confidential information about the chains operations. (Combs et al. 2004, 911)

In comparison to the vertical agency problem which is normally reduced by franchising, a horizontal agency problem is often related to franchising operations. This means that franchisees can act as free riders in the chain operations. The investments of one franchisee create goodwill among customers, and all the franchisees gain from the enhanced customer satisfactory equally, which can lead to a situation where some franchisees are unwilling to invest. Customer mobility is tightly associated to the horizontal agency problem. Locations with lower possibility to attract repeat customers, which can be the case e.g. in highway restaurants, might be prone to offer lower quality products or services. On the contrary, remote locations in rural areas need to sustain high level of

service because the possibility and need to gain repeat customers is high. (Combs et al. 2004, 912)

Even though agency theory is a good and often used approach in explaining the existence of franchising, it also has some shortcomings. First, agency theory predicts that the propensity to franchise depends on the increase of monitoring costs. This suggests that units close to the company headquarters would be company owned due to the low monitoring costs. However, there are also chains that are fully franchised. The second limitation of agency theory is its inability to explain the co-existence of company-owned outlets and franchised units in the same geographical area. As the theory suggests, due to the similar monitoring cost in a certain area, all units should either be franchised or company-owned. Finally, agency theory does not explain the existence of multi-unit franchises where the same franchisee is authorized to operate several units. The residual claimancy benefit of franchising would require the franchisee to be present in one unit all the time. Instead, in multi-unit franchising the franchisee is required to hire unit managers, which in agency theory's perspective negates the benefits of the arrangement. (Gillis & Castrogiovanni 2010, 88)

The theoretical perspective of resource scarcity has been another widely used viewpoint in franchising research. Oxenfeldt and Kelly (1968, 74) originally introduced the idea that franchising is used by young companies with limited resources in the early phase of their expansion. According to their view, the franchisors would like to operate company-owned outlets already in the beginning of their existence, but they lack the resources to do so. This is why they choose to use the resources of the entrepreneurs as franchisees in order to advance quickly to new markets before their competitors do so. As stated by the authors (Oxenfeldt & Kelly 1968, 74) in their life-cycle model, the franchisor would inevitably acquire the franchised outlet after the market conditions would be stabilized in order to gain the maximum profit.

Resource scarcity theory is based on three fundamentals. First, according to this perspective, the economies of scale are important to successful chain operations. Even though franchising is less profitable than company-owned chains, the enterprises use them in order to reach scale economies. The second main assumption of resource scarcity is that franchising is an easy way in reaching scarce resources of managerial skills, local market knowledge, and financial capital. By using the capital of local entrepreneurs, the franchisor is able to expand more quickly than by cumulating own capital and hiring new managers. The final assumption of resource scarcity is that the company-owned units are more profitable than the franchised units. Eventually the market would be saturated, which would lead to the need to enhance profitability. This would lead to incremental acquisitions of the most profitable franchisees and the establishment of new company owned outlets in order to gain profits. (Gillis & Castrogiovanni 2010, 76–77)

In line with these basic fundamentals, resource scarcity theory provides a framework for explaining the initiation of franchising for a young company. Academics have tried to investigate the initiation process of franchising in itself and the reasons behind the decision to franchise. These studies have been partially problematic because the franchisees might want to justify their decisions to franchise rather than give the right reasons for initiation. Still, some researchers have found evidence in favor of resource scarcity theory, as, according to empirical evidence, the pursuit of scarce resources has been one of the main reasons behind franchising initiation. (Gillis & Castrogiovanni 2010, 77)

Another assumption of resource scarcity is the prediction that in the birth stage the companies should franchise heavily, but the frequency of the use of the business method should diminish when time passes. The quantity of franchising usage has been studied from the perspective of three variables: the firm's age, size and growth rate. First, resource scarcity theory predicts that in long run the propensity of franchising should decrease. Empirical studies on the relation between the companies' age and the frequency have however witnessed no such pattern. The second assumption of the theory is that as the size of the franchising system rises, the willingness to franchise should decrease as the firms' own resources grow. Yet, recent studies have concluded in inconsistent statements: both supporting and contradicting evidence has been presented. The empirical evidence on the last variable, growth rate, is also two-sided. Resource scarcity theory explains the role of growth as a factor that increases the rate of franchising. However, whereas some academics argue that a positive correlation exists because franchising allows the firms to grow faster, others have witnessed a negative correlation. (Gillis & Castrogiovanni 2010, 80)

To summarize, it can be said that despite its shortcomings, agency theory has been able to explain the propensity to franchise. According to the empirical evidence, there seems to be a tradeoff between company ownership and franchising which can be explained through agency costs. Resource scarcity on the other hand has been convincing in explaining the reasons behind the decision to franchise. The existing evidence, however, does not fully support the prediction that franchising would decline as the markets mature. (Gillis & Castrogiovanni 2010, 87)

## **2.4 International franchising strategies**

When taking steps from theory towards practice it should be kept in mind that franchising as an internationalization method is not as simple as it might seem, since there are several possibilities for a franchisor to execute its franchising strategies. In addition to the company-owned option, which cannot be counted as franchising, there are four generic strategies available for internationalization: (1) direct franchising, (2) joint venture, (3) master

franchising, and (4) area development agreement. (Welch et al. 2007, 57) These strategies are exhibited in Figure 5.

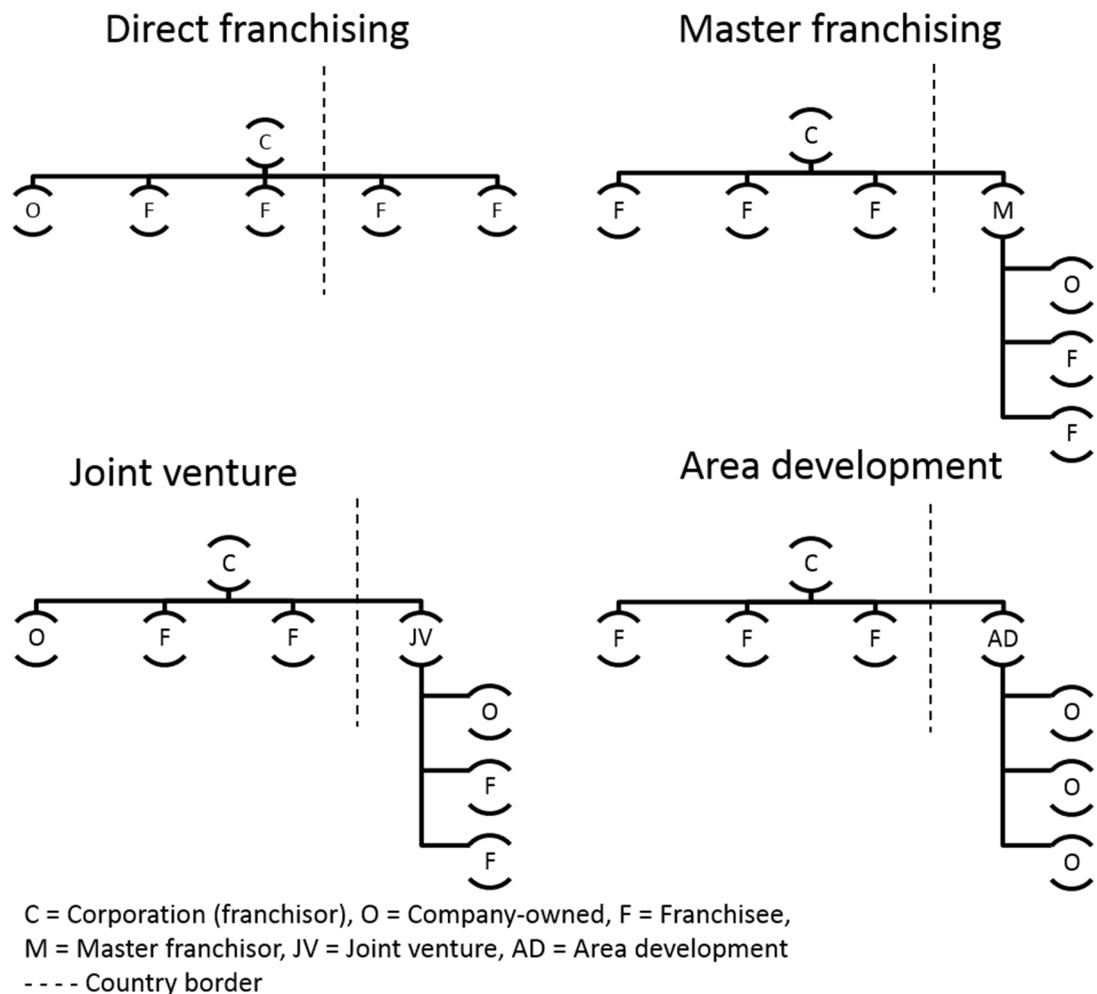


Figure 5 Internationalization methods of franchising (adapted from Laakso 1995, 59–63)

In direct franchising the franchisor is responsible for the direct monitoring of all the entrepreneurs in the foreign country. The role of the franchisor in the foreign market is exactly the same compared to its role in the home country. According to Welch et al. (2007, 55), direct franchising is not the most preferred method of international franchising, but can be an efficient tool in the early establishment of the chain abroad. By using direct franchising in the beginning of the foreign operation in a new market, the company receives the immediate feedback from the market and is able to react quickly if needs for adjustments arise. In the other forms of franchising the use of intermediaries might inhibit the flow of information.

As stated by Laakso (1995, 59), there are several preconditions for the use of direct franchising. First, usually the geographical and cultural distances between the home and

foreign markets are low when direct franchising is used. Second, the purpose of the franchisor is to establish only a limited number of locations in the foreign market in order to facilitate coordination and training with each of the units. Further, the business format should be so simple that there would not be a need to establish separate support functions in the target country. Finally, direct franchising suits well in situations where the establishment of a subsidiary in the target market is complicated due to legislation or taxation issues.

The benefit of direct franchising stems from the close contractual proximity of the franchisee, which enables close control and feedback. Moreover, it is the most profitable form of franchising as no additional hierarchical layers exist. The difficulties of the method include the need for profound knowledge about the target market and its peculiarities. Laakso (1995, 60) also distinguishes the use of a subsidiary as one separate form of international franchising operations, where the franchisor sets up a wholly-owned parent company in the target market in order to facilitate the establishment of the market operations. Here the establishment of a subsidiary is seen as a part of direct franchising as the franchisor still remains the provider of the franchise rights in the country.

Compared to direct franchising, a more commonly employed form of foreign market entry is the use of joint ventures. The level of the franchisors' ownership in joint ventures can vary from minority shares to majority ownership, but the basic idea in a joint venture is simple: the royalty payments are replaced by the profit for invested capital. Typically the joint venture arrangement is used to gain both local knowledge and capital for operations. However, there have been examples of joint ventures in which the franchisors have entered the venture without a capital contribution. In these cases the franchisor provides the business concept in exchange for a minority share and the partner provides the capital to run the business. (Welch et al. 2007, 57)

The benefits of a joint venture operation lie mainly in the local knowledge provided by the contract partner. In many cases a joint venture is the only operational mode available, if an equity mode is considered due to the lack of market expertise from the franchisor's side. In addition, a joint venture is a tool for the corporation to reduce risks compared to wholly owned operations, as the risks are divided between the partners. The problems of joint venture operations are usually related to the cooperation between the partnering companies. Due to the local knowledge of the partner, the foreign franchisor is usually in a worse position if disagreements occur. It is also more difficult to walk out of a joint venture agreement than from a contractual deal in direct franchising. (Laakso 1995, 62)

Third and the most commonly used method in international franchising is master franchising, in which the franchisor gives a local company all the franchise rights in a specified market area, which in many instances is a country as a whole. In this arrangement the master franchisee has the right to establish company-owned outlets in the market and

make contracts with individual franchisees in order to expand the network in the market. In master franchising the royalties obtained from the franchisees are divided between the franchisor and the master franchisee. For example, if a royalty of 11 percent is paid by the local entrepreneur, seven percent might go to the master franchisee and the remaining four percent to the creator of the concept. (Welch et al. 2007, 55)

Master franchising is probably the fastest way of expanding a franchising network internationally. The benefits of the operation mode lie in the outsourcing of the business risks and capital acquisition as the master franchisee has the main responsibility in the investments to the chain. This internationalization method is fit for situations where the franchisor does not have the financial resources and the local knowledge to conduct the operations in the market. The problems of master franchising originate from the partner selection. For internationally known brands the partner might be easy to find, but in the case of an unknown brand, finding a right partner might be more difficult. If a wrong partner is selected, the whole brand of the franchisor might be at jeopardy, at least in the particular country. Another downside of master franchising is, obviously, the lesser profitability compared to direct franchising or joint ventures. (Laakso 1995, 64)

The fourth method of franchising, the area development agreement, can be seen as a variant of the master franchising arrangement. In this form of internationalization the franchisee, or the area developer, is given the rights to establish company-owned outlets in a certain area. The authority to sub-franchise the concept to other entrepreneurs is retained by the franchisor itself in this arrangement. Normally the royalty payments in this method operate in a similar way compared to master franchising. The area development agreement works well in situations, where a reliable partner with sufficient resources is found. The problems of the method are to do with the concentration of the risks to a single entrepreneur. (Laakso 1995, 64)

In addition to these generic strategies of international franchising, Hoffman and Preble (2006, 35) have identified the need for a more strategic approach on international franchising expansion. In their view, the generic modes of franchising expansion should be seen as alternative options, which should be employed in conjunction with a certain strategic approach. As an answer, they have recognized three types of strategic approaches: first-mover strategies, platform strategies and conversion strategies.

The importance of timing in international operations has increased. In a first-mover strategy the company is a pioneer in a particular market in a given business. There is plenty of evidence from the benefits of a first-mover strategy, as the pioneers usually enjoy larger market shares compared to their followers or late entrants. The gained benefits of the first-mover strategy also seem to last long and bring sustainable competitive advantage to companies utilizing it. The advantages of the strategy include the acquisition of the best locations and the creation of a strong local reputation. The strategy is usually employed by experienced companies that have a vast knowledge from expansion in the

home market coupled with skills in recruitment and management of franchisees. (Hoffman & Preble 2006, 36–37)

The second strategic approach is related to a franchisor that wants to expand to a region with high market potential, but where there are complexity and high risks involved. In this kind of a region the individual countries have differences in political stability, economic development, and culture. However, at the same time cultural similarities are also present to some degree. Thus, it would be suitable for the franchisor to employ a platform strategy, where the expanding is initiated in the most business-friendly country of the region. By gaining experience in this market about the regional characteristics, the company is able to prepare for the entry to similar but more difficult markets. For example, the United Kingdom has been used as a platform by the US companies in entering the European market due to language issues and the United Kingdom's reputation as an established franchising community. (Hoffman & Preble 2006, 40)

The third strategic approach presented in the model by Hoffman and Preble (2006, 42) is the use of conversion strategies. In such an arrangement, the market entry is conducted by acquiring existing firms in the target country. The targeted companies might be independent businesses, chains, or franchisees of other franchisors. It has been estimated that 20 percent of global franchising operations until the 1990s consisted of conversion strategies. The approach has proven to be very useful particularly in saturated markets, where market entry would be difficult by means of establishing new companies. By using a conversion strategy, a franchisor can quickly access vital resources such as know-how and expertise in local conditions. In addition, compared to the establishment of a new outlet from scratch, this strategy helps the franchisor in reaching successful locations rapidly.

By further elaborating these strategic approaches Hoffman and Preble (2006, 37–44) have produced a set of propositions combining the above mentioned strategies with the generic strategies of franchising. In their interpretation, the generic strategies are outlined to direct franchising, master franchising and area development agreement. The propositions are exhibited in Table 2.

Table 2 Propositions regarding the strategies of international franchising (adapted from Hoffman & Preble 2006, 37–44)

Code	Proposition
P1	Franchisors facing domestic market saturation and rapidly growing markets abroad are more likely to utilize first-mover strategies for international expansion.
P1a	Experienced franchisors pursuing first-mover strategies to enter similar markets are more likely to employ direct or area franchising.
P1b	Franchisors pursuing first-mover strategies to enter dissimilar markets are more likely to employ master franchising over direct or area franchising.
P1c	Inexperienced franchisors pursuing first-mover strategies to enter similar markets are more likely to employ direct franchising.
P2	Franchisors are more likely to employ a platform strategy when expanding into a complex region by first entering the most business-friendly nation within the region.
P2a	Franchisors pursuing platform strategies in similar markets are more likely to employ either direct or area franchising for market entry.
P2b	Experienced franchisors pursuing platform strategies in dissimilar markets are more likely to employ master franchising for market entry.
P3	Franchisors are more likely to use a conversion strategy to expand into host countries that are saturated, competitive, and high cost.
P3a	Experienced franchisors pursuing conversion strategies in similar international markets are more likely to employ area franchising.
P3b	Experienced franchisors pursuing conversion strategies in dissimilar international markets are more likely to employ master franchising.
P3c	Inexperienced franchisors pursuing conversion strategies in similar international markets are more likely to employ direct franchising.

Finally, based on the strategic approaches to international expansion, the generic franchising approaches and the elaborated propositions, the authors (Hoffman & Preble 2006, 45) have created a contingency model in explaining the logic of international expansion using franchising. According to this model, which is exhibited in Figure 6, in rapid growth environments the franchisors should seek to use first mover strategies in order to gain the benefits of the growing market. Using this strategy in similar markets both the inexperienced and the experienced companies should employ direct franchising as their strategy. In dissimilar markets, the preferred mode is master franchising in order to overcome the possible obstacles of the market environment. (Hoffman & Preble 2006, 45)

As seen in the above propositions, a platform strategy should be utilized when entering complex market areas with different environments in it. In similar markets both the experienced and the inexperienced franchisors should use direct franchising when operating

in the business-friendly platform country. The experienced franchisors seeking an entry into the dissimilar markets should do it via a master franchising agreement. (Hoffman & Preble 2006, 46)

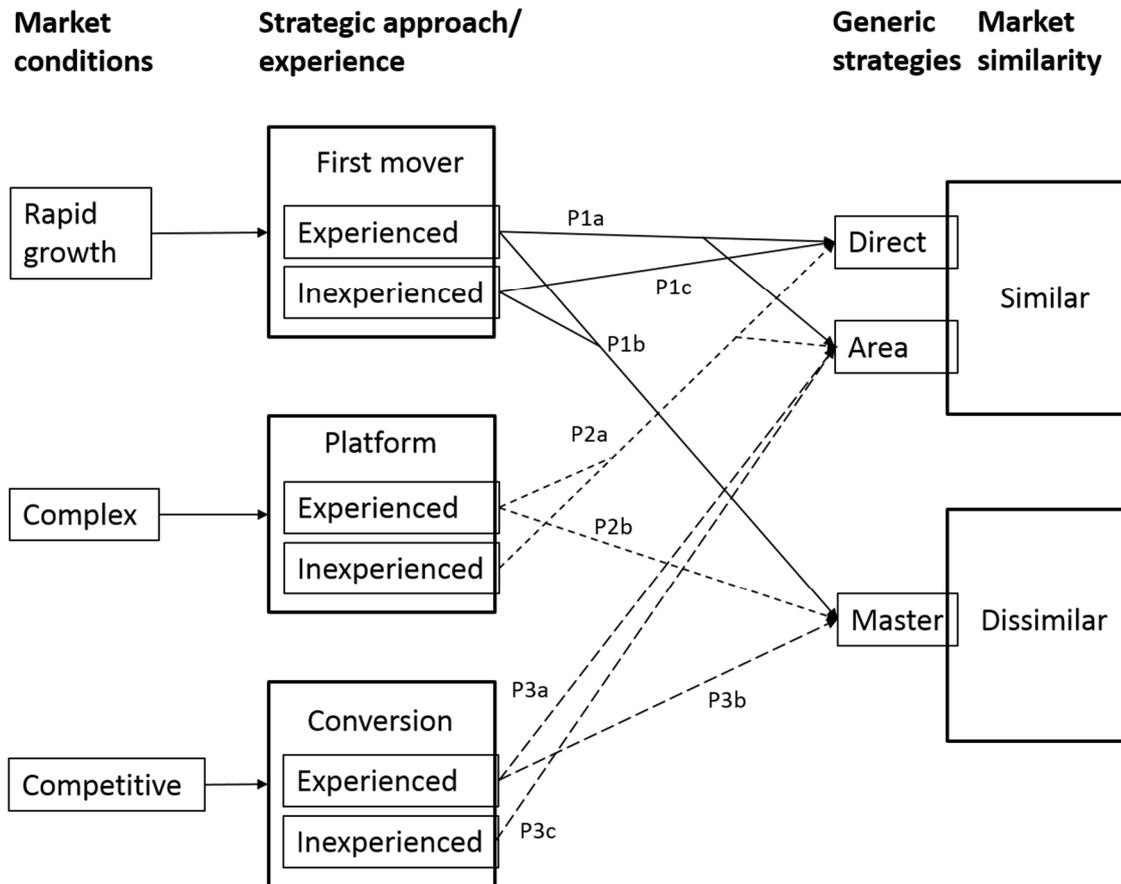


Figure 6 A model explaining international franchising strategies (adapted from Hoffman & Preble 2006, 45)

Finally, in competitive and possibly saturated market conditions, the franchisors should acquire existing units in their expansion using conversion strategies. The experienced franchisors using conversion strategies should engage in area development agreements in similar markets. In dissimilar markets, master franchising agreements should be employed. The inexperienced franchisors should engage in similar markets also by using area development agreements. In both cases, when using platform and conversion strategies, the inexperienced franchisors should avoid entering dissimilar, especially high risk markets before they have acquired sufficient international experience. (Hoffman & Preble 2006, 46)

To fully understand the contingency model and its propositions, definitions must be made with regard to the experience of the franchisors and the market conditions in which the strategies are applied. According to previous studies in the expansion of international franchising (Huszagh et al. 1992; Julian & Castrogiovanni 1995; Shane 1996), the size

and experience of the franchisors are major explaining factors both in the internationalization decision and the successful expansion to foreign markets. Large and experienced companies usually have a recognizable brand, and compared to smaller companies they possess better competences in site selection, standardization, recruitment, and monitoring of franchisees. In the context of the presented contingency model, a company is considered to be experienced when it has operated in its domestic market for more than five years and has expanded its network to over 100 units. (Hoffman & Preble 2006, 32, 38) The definitions for market conditions analysis are done in the following chapter, which presents the model that is used in this research to evaluate the differences of certain market areas.

## **2.5 Analytical tools for market evaluation**

The evaluation of market similarities is not straightforward as there are numerous factors that can be used in describing the conditions of separate market areas. The comparison of countries based on one factor might lead to an assumption that the market areas are similar. However, another factor could point to the conclusion of dissimilar markets. Alon and McKee (1999, 76) addressed the issue by creating a macro environmental model which could be used in evaluating the differences of the multifaceted market environments from a franchisor's perspective. The model was developed particularly from the viewpoint of business format franchising. In the modelling, the international market factors are divided into economic, demographic, distance, and political dimensions. By evaluating the factors within each of these dimensions, a comparison can be made between separate international markets in the search for the most suitable target for expansion.

The factors identified by Alon and McKee (1999, 78) are exhibited in Table 3, in which the factors are divided under the aforementioned four categories. In the view of the authors, after a thorough evaluation of the ten different factors, a numeric value should be given to each of them. A sum of the obtained scores indicates the market's attractiveness to business format franchisors. Values above zero would reflect favorable conditions for franchising, and scores below zero would illustrate unfavorable market conditions.

The economic dimension includes three factors: (1) individual income, (2) economic growth, and (3) urbanization. The income of individuals in a particular country is important because it is an indicator of the possibility of the citizens to use the services of the franchised outlets. In the model, the evaluation of individuals' income is done by using the GDP per capita of an economy as the measured variable. The level of economic growth of the market is seen as one of the most important factors for franchisors expanding into foreign markets. The measurement of this factor is done by observing the rate of

GDP growth in a given timeframe. In the model, the timeframe of seven years was selected in order to negate short term fluctuations. The final economic factor is the level of urbanization, which has been viewed as an important factor of franchising expansion due to its ability to demonstrate the level of the concentration of potential customers in urban areas. Urbanization can be measured as the percentage of the population living in urban areas from the total population. (Alon & McKee 1999, 79)

Table 3 Environmental factors for market condition evaluation (adapted from Alon & McKee 1999, 78)

<b>Economic dimension</b>	-2 Very low		Very high +2		
GDP per capita					
Average GDP growth					
Level of urbanization					
<b>Demographic dimension</b>	-2 Very low		Very high +2		
Extent of middle class					
Population growth					
Proportion of female labor participation					
<b>Distance dimension</b>	-2 Very high		Very low +2		
Physical distance					
Cultural distance					
<b>Political dimension</b>	-2 Very high		Very low +2		
Internal political risk					
External political risk					

The demographic dimension includes (1) the size of middle class, (2) population growth, and (3) female labor force participation. The size of the middle class is considered important because the services of the majority of franchisors are usually modified according to the needs of the middle class. Population growth is viewed as an important factor because it illustrates the growth of the future potential of the market. Finally, a high proportion in the female labor participation is considered as a factor benefitting franchisors because many of the franchised chains offer services that have traditionally been made by housewives. The shift from household to paid employment of the female population hence increases the demand of the franchised chains' products. All of the demographic factors can be measured as a percentage from the total population of a country. (Alon & McKee 1999, 79)

When shifting focus from economic and demographic dimensions to distance and political dimensions, it is important to notice that the evaluation of the favorability of the factors changes. As in the first two categories high values are seen as favorable, in the latter dimensions these are viewed as unfavorable. The distance dimension is divided into (1) the physical distance and (2) the cultural distance. Historically it has been witnessed that companies tend to internationalize to neighboring countries in their early expansion.

The problem of high geographical distance is twofold. On one hand, the monitoring of the franchisee is difficult at large distances. On the other hand, the logistical support of the chain can be expensive. Distance can be measured in absolute distance or in the travel time between two places. (Alon & McKee 1999, 80)

The cultural distance between the home and host countries is seen as an important factor in internationalization as it affects many instances of daily operations such as negotiations and personnel recruitment. In addition, the transferability of the business concept might be more difficult in a culturally different environment as the consumer preferences vary between the nations. High cultural distance is often viewed as a factor increasing the costs of internationalization. Cultural distance can be measured by using Hofstede's (1991) factors of power distance, individualism/collectivism, uncertainty avoidance and masculinity/femininity. (Alon & McKee 1999, 80)

The political dimension is divided into (1) internal and (2) external risks. The internal risks are caused by the conditions of the host country and consist of governmental regulations, political stability, the proliferation of bribery, and ownership restrictions. The external risks include the foreign exchange rates and import restrictions, which originate from the relations between the home country of the franchisor, the host country, and third party nations. The external risks can hamper the operations of a franchised chain in two ways. First, the fluctuation of the currency can affect the amount of royalties received from the market. Second, the franchised chains often import supplies from the home country, which makes them vulnerable to high import restrictions and toll charges. (Alon & McKee 1999, 80) According to Alon (2006a, 76), the measurement of corruption can be made by comparing the indices made by Transparency International. In addition, the regulatory environment of a country can be evaluated using the rankings of World Bank in their publication *Doing Business*. External risks can be evaluated by observing the currency fluctuation and the amount of import restrictions.

Echoing the macro environmental dimensions of Alon and McKee (1999), an illustrative example of a country analysis has been made on Russia by Anttonen et al. (2005). In their evaluation, the market environment was divided into demographic, economic, cultural, political, and regulatory dimensions. A similar classification is employed in the following chapter with the exception that regulatory dimension is included in the political dimension. The evaluation of the Turkish market is made in order to establish a foundation for further analysis, as one of the objectives of this research is to describe the characteristics of Turkey as a marketplace for franchisors.

### 3 TURKISH MARKET IN 2013

#### 3.1 Economic environment

Prior to the 1980s, the Turkish economy was under the state's firm guidance. The government was a major investor especially in the heavy industries, energy and infrastructure, and the investment projects in the country were centrally directed from the capital of Ankara without local government participation. Besides the state-owned companies, majority of the private sector businesses were conducted by a small number of large companies. Along with the state-owned enterprises, these family-owned conglomerates were responsible for the country's international trade, which was heavily controlled by using import restrictions in order to protect the domestic industrial base. The large private companies were mainly based in Istanbul and the port cities of Izmir and Adana. In addition to these enterprises, only very small local companies existed. (Özcan & Turunc 2011, 64–65)

The urbanization of the largest cities of Turkey and the growing interest of the people in the lowest societal classes towards the inequality of income distribution led to wide unrests during the 1970s. After the coup d'état of 1980 and the restoration of democracy in the country in 1983, Prime Minister Turgut Özal commenced the liberalization of the economy. During the 1980s and 1990s the restrictions on international trade were boldly dismantled, and the economy started to evolve from a closed state-led market towards an export oriented economy. The support for entrepreneurship and the privatization of the state-owned companies led to a large increase in the amount of small and medium-sized enterprises (SMEs), which fueled the urbanization and the industrialization of the country. By 2000, as a result of the industrialization, manufacturing sector accounted for over 75 percent of the country's exports superseding agriculture, the formerly dominant export sector. (Özcan & Turunc 2011, 68)

The urbanization led to the formation of new metropolises, as the rural population migrated to the regional centers of the Anatolian peninsula. Today there are seven cities in Turkey with a population of over one million: Istanbul (13.5), Ankara (4.4), Izmir (2.8), Bursa (1.7), Adana (1.6.), Gaziantep (1.4) and Konya (1.1) (Citypopulation 2012). The cities are highlighted in the map of Turkey in Figure 7. These cities along with the other major rural centers are the engine of the Turkish economy, which is the 17<sup>th</sup> largest in the world measured in GDP at purchasing power parity exchange rates (The World Factbook 2013). In the recent years, the country's GDP has been growing at a pace comparable to other developing nations in Europe and Central Asia. When a comparison is made to the economies of the EU, the level of economic growth in Turkey supersedes the growth of the developed European nations. For example, whereas the seven year average annual

growth of the Turkish economy was 3.9 percent in 2006–2012, the corresponding figure of Finland was only 1.1 percent. (World Bank 2013a)



Figure 7 The map of Turkey (The World Factbook 2013)

As shown in the previous chapter, the level of individual income is an important factor when a market is evaluated from a franchisor's perspective. As Table 4 shows, the level of individual income measured in GDP per capita has risen in Turkey during the first decade of the 21<sup>st</sup> century. However, the increase in the growth of this indicator has slowed down in the very recent years. Compared to other emerging markets, Turkey's individual income level is among the highest ones, but the contrast to the developed western economies still remains steep. As the comparison between Turkey and Finland shows, the level of GDP per capita in Finland is over four times higher than in Turkey. This gap is, however, narrowed when the price levels of different countries are measured, as the Turkish income level is nearly doubled in such comparison. Nevertheless, the high difference still exists. (World Bank 2013a).

High inflation has been one of the challenges of the Turkish economy in the past decades. However, during the very recent years the annual rise of prices in the country has been stabilized to a level below ten percent. According to Birch and Harrison (Birch & Harrison 2013, 7), in the short term the inflation levels are facing uncertainties due to the recent political protests in Turkey and the uncertainties in the neighboring countries such as Syria. Nevertheless, the inflation is expected to ease in the coming years given that the internal political situation in the country is clarified.

Table 4 Comparison of economic indicators between Turkey and Finland (World Bank 2013a)

Indicator	Country	2006	2007	2008	2009	2010	2011	2012
GDP (Billion USD, real exchange rate)	TR	531	647	730	615	731	775	789
	FI	208	246	272	239	235	262	248
GDP Growth Rate (%)	TR	6.9	4.6	0.7	- 4.8	9.2	8.8	2.2
	FI	4.4	5.3	0.3	- 8.5	3.3	2.8	- 0.2
GDP Per Capita (1 000 USD)	TR	7.7	9.3	10.4	8.6	10.1	10.6	10.7
	FI	39.5	46.5	51.2	44.8	43.9	48.8	46.2
Inflation (%)	TR	10.5	8.8	10.4	6.3	8.6	6.5	8.9
	FI	1.6	2.5	4.5	0.0	1.2	3.4	2.8
Unemployment	TR	10.2	10.3	11.0	14.0	11.9	9.8	n/a
	FI	7.6	6.8	6.3	8.2	8.4	7.7	n/a
FDI Inflows (Billion USD)	TR	20.2	22.0	19.8	8.7	9.0	16.0	13.0
	FI	4.6	22.0	19.8	- 8.8	12.2	- 5.8	1.9
Exports (% of GDP)	TR	22.7	22.3	23.9	23.3	21.2	24.0	26.4
	FI	45.5	45.8	46.8	37.3	40.3	40.8	39.7
Imports (% of GDP)	TR	27.6	27.5	28.3	24.4	26.8	32.6	31.6
	FI	40.8	40.7	43.1	35.7	39.0	41.5	40.3
Growth Competitiveness Index (world ranking) <sup>10</sup>	TR	58	53	63	61	61	59	43
	FI	6	6	6	6	7	4	3
Average Exchange Rate (EUR/TRY bid) <sup>11</sup>		1.8	1.8	1.9	2.2	2.0	2.3	2.3

The future development of the Turkish economy in the short term is connected to the debt crisis of the Eurozone and to the ongoing political uncertainties in Turkey. Even though Turkey has tried to diversify its trade and investment connections towards the Middle East, the development of the European demand is still one of the major drivers of the country's economy. Accordingly, even though there are uncertainties related to the short-term development of the economy, the long-term economic outlook of Turkey seems to be favorable for strong growth due to the well trained labor market, the advantageous geographical location and the warming relations with the EU. However, the unknown outcome of the negotiations on Turkey's accession to become a member of the EU is a factor that shadows also the future economic development of the country. (Birch & Harrison 2013, 14)

<sup>10</sup> Adapted from World Economic Forum (2013)

<sup>11</sup> Adapted from OANDA Corporation (2013)

### 3.2 Demographic environment

With a population of 74 million, Turkey is the second largest neighbor of the EU after Russia, and from the EU countries only Germany supersedes Turkey in terms of population. In addition, Turkey is geographically larger than any of the EU member states and is located in a position between the EU and the Middle East. The population of the country has risen steadily during the past years and is, in the future, likely to grow faster than in the developed western nations. According to Özcan and Turunc (2011, 68), the urbanization of the country has been fast. In the 1980s only 40 percent of the population lived in urban centers, but, as Table 5 shows, the level of urbanization has now risen up to 72 percent of the population, which is quite close to the figures of the developed European nations such as Finland. (World Bank 2013a)

Table 5 Comparison of demographic indicators of Turkey and Finland (World Bank 2013a)

Indicator	Turkey (2011)	Finland (2011)	
Population (million)	74.0	5.4	
Population growth rate (annual %)	1.3	0.5	
Surface area (sq. km)	780 000	340 000	
Urbanization (%)	72	84	
Population density (inhabitants/sq. km)	95	18	
Life expectancy, female (years)	78	84	
Life expectancy, male (years)	71	77	
Female labor force participation (%)	28	56	
Male labor force participation (%)	71	64	
Poverty rate (% of population below 2 USD (PPP) per day)	4.7 (2010)	n/a	
Income distribution (% obtained of total wealth of the country)	lowest 10 %	2	4
	low-income	18	4
	highest 10 %	30	21

According to Alon and McKee (1999, 79), high female labor participation has been associated with high levels of franchising in the society. In the case of Turkey, the labor market is still quite masculine as only 28 percent of the female working population is actively participating in the labor market. In contrast, in the developed western economies the corresponding figures are generally above 50 percent. (World Bank 2013a) In the view of Birch and Harrison (2013, 7), one of the major challenges of the Turkish labor market is the ability in the future to create sufficient jobs for the growing labor force. One of the probable causes of the labor force growth is the increasing involvement of women in the labor market, as the government's objective is to increase the level of female labor participation up to 35 percent by 2023.

The term *middle class* is commonly used but rarely well-defined classification. The expression is related to the income distribution of a country, and one way to describe the extent of the middle class is to compare the proportions of the different income classes. Comparing the income distribution of Turkey and Finland, it can be seen that the proportion of the people between the lowest and highest ten percent income classes does not differ substantially between these two countries (Turkey 68 %, Finland 76 %). (Statistics Finland 2011; World Bank 2013a) However, according to Reijo (2005), a better measure for the size of the low-income class is the comparison of income levels with the median salary of a country. In the EU, a person is generally viewed as a part of the low-income class in a case where the income level is lower than 60 percent of the median salary. In Finland, this level is quite close to the level of the lowest ten percent income class, but according to the Turkish Statistical Institute (2010), the corresponding level in Turkey is at 18 percent. Following this reasoning, the size of the middle class in Turkey can be considered to be 51 percent of the population compared to Finland's 76 percent.

### **3.3 Cultural environment**

Turkey is an Islamic nation, but politics and religion are separated from each other in the constitution of the country. Operating in a Muslim country can be difficult to a company originating from an EU country due to cultural and linguistic differences. However, Turkey is a rare example of the coexistence of an Islamic culture and a democratic political system, which makes it an attractive investment target from a western point of view. (Dogan & Carstenson 2013, 108)

The Hofstede's cultural variables of power distance, individualism/collectivism, masculinity/femininity, and uncertainty avoidance have been widely used when discussing the differences of national cultures. A comparison has been made in Figure 8 between Turkey and Finland on these dimensions. Power distance is an indicator of the people's approval of inequality in the country. High scores of Turkey on this dimension suggest that people are willing to accept the ruling of authorities and the unequal distribution of power more easily than in Finland, where the power distance is quite low. The individual dimension reflects the interdependence of the members of a society. Turkey with its low score in this variable can be seen as a collectivist nation, where individuals generally see themselves as a part of larger families, clans or organizations. Trust and loyalty among the group members are key values within the society, and relations rely much on the confidence established between individuals belonging to these groups. (The Hofstede Center 2013)

The third dimension of masculinity vs. femininity is about the people's perceptions on the quality of life. In a masculine society the individuals are motivated by the possibility

to succeed in their field of expertise and by the potential admiration of others. On the contrary, in a feminine community the quality of life itself is viewed as more important than the individuals' success. The score of Turkey in the middle of the extremes suggest that some level of open competition between the individuals exists in the country. However, the score is slightly on the side of femininity, which implies that the softer aspects of the culture are also seen as important. The final dimension of uncertainty avoidance deals with the individuals' perceptions on unknown situations. Turkey's high score on this variable suggests that laws and rules are largely used in the society in order to avoid uncertainties. In addition, religious habits are common social patterns, which are used in order to ease tension in many situations. (The Hofstede Center 2013)

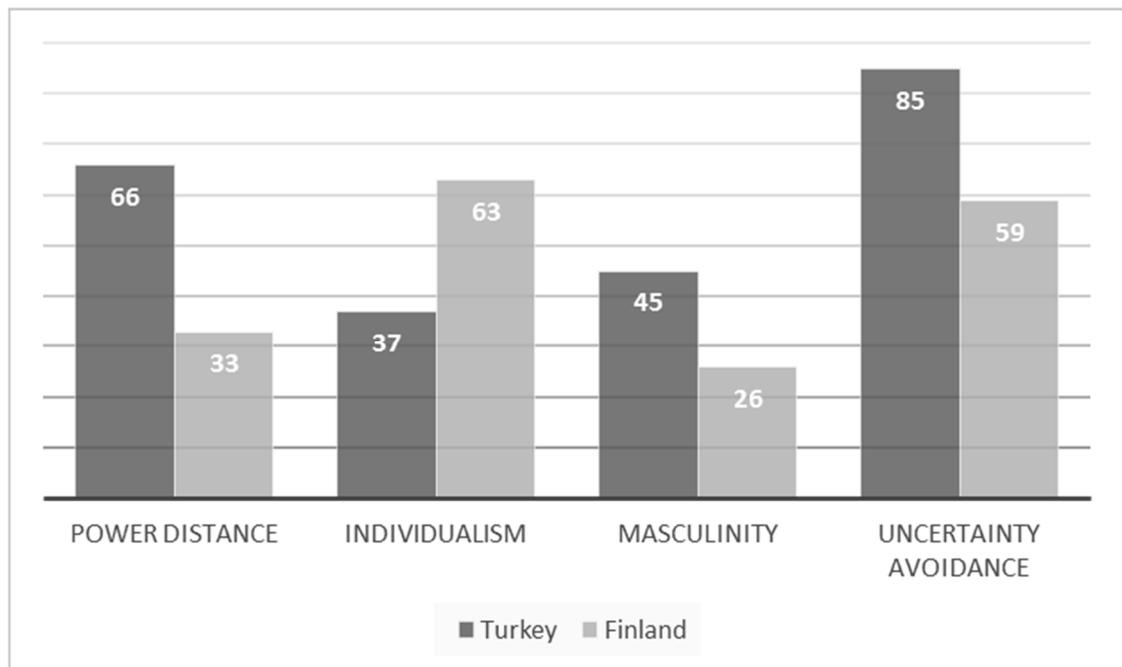


Figure 8 Comparison of Hofstede's cultural variables between Turkey and Finland (The Hofstede Center 2013)

When the cultural environment is discussed from a franchisors' perspective, two of the above dimensions gain attention. High levels of individualism and masculinity have been associated with wide usage of franchising in different countries. (Anttonen et al. 2005, 7) In this respect, the Turkish market does not seem to be the ideal cultural environment for franchising, as collectivism and femininity are the dominant factors in these dimensions.

As earlier mentioned, a strong entrepreneurial culture of a country is seen as a factor facilitating the franchisors' entry into the market. In the view of McCuddy et al. (2011, 101), Turkey does not have a long history of entrepreneurship. This view is backed up by the statistics of the World Bank (2013b), which indicate that the establishment rate of new companies in Turkey is not at the same level with the European nations. In the past

nine years close to 50 000 new enterprises have been established annually in Turkey. By scaling this figure with the quantity of working population in the country, we end up with an approximation indicating that only one company per 1 000 employed persons has been established annually during the past years<sup>12</sup>. This figure cannot be viewed very high compared to the members of the EU. For example, in Finland, the density of new business entries has been constantly over two units, and many other European countries score even higher. However, interestingly Germany, the economic engine of Europe, scores similar values with Turkey.

### 3.4 Political environment

Turkey's political landscape has been dominated by the Justice and Development Party (AKP) and its leader Recep Tayyip Erdogan since the party's formation and victory in the parliamentary elections of 2002. The government has continued the reforms launched by their predecessors, and the country started the accession negotiations on the possible EU membership in 2005. (Özcan & Turunc 2011, 70) However, specially in the governments second term, the pace of the reforms has slowed down. According to Rahigh-Aghsan (2011, 43) there exist two possible explanations to this development. While some academics argue that there are fundamental differences in the world views of the EU countries and the islamic Turkey, others state that the slowdown in the accession reforms is merely a result of a more pragmatic approach taken by the ruling party in the pursuit of popularity in the country.

The reason for this pragmatic approach lies in the history of political Islam in the country. The ideology emerged in the 1970s as a counterforce for the pro-Westernization tradition of the country. The movement has, however, transformed and divided into two sub-groups of ideologies. The first one, which represents the minority, seeks for a Turkish state based on Islamic values, and views the cooperation of the country more natural with its Middle Eastern neighbors rather than with the EU. The second sub-group, which is represented by the ruling AKP party, has adopted a more pragmatic approach, and views the rapprochement with the EU as a practical tool in the creation of an "Islamic democracy" in the country. Recently, however, it can be argued that the ruling regime of Erdogan has started to move towards stricter Islamic values, at the expense of the EU accession. There are examples (e.g. the higher education reform, which allowed the Islamist high school students to enter academic careers without a university degree) of the government's actions that have rather been made based on religious ideologies than on the pursuit of democracy in the society. In addition, the government has taken steps towards

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<sup>12</sup> The World Bank calls this as the *New Business Entry* -index.

a more authoritarian society with regard to fundamental human rights such as the freedom of speech and the freedom of assembly. (Rahigh-Aghsan 2011, 44–45)

Partly due to this authoritarian development, the current political situation of Turkey is clouded by the events of summer 2013, when the civil insurrection in Istanbul and other parts of the country were fiercely repressed by the security forces of the country. In addition, the increased government control over the media during the past few years has also raised questions about the state of the democratic development of the country. However, the recently announced large administrative reforms might, in turn, increase confidence on the positive development of the country. (Economist 2013)

In addition to the civil protest of summer 2013, the country has recently faced political turmoil in the form of a corruption scandal. On December 2013 the Istanbul authorities detained several persons accused of corruption, and many of them were closely affiliated to the ruling party AKP. As political stability has been the cornerstone of the country's positive economic development during the Erdogan administration, the corruption scandal might have a long-lasting effect on the future economic development of Turkey. The scandal has already resulted in the depreciation of the local currency and in a flee of capital from the country, but the long-lasting effects cannot be predicted yet. The political status of the AKP regime will be tested soon, as all the major elections (local, presidential and general elections) are scheduled within the following eighteen months. (Letsch 2014)

The level of bureaucracy in the country can be measured by examining the *Ease of Doing Business Index* created by the World Bank (2013c). In the most recent measurement, Turkey occupies the 69<sup>th</sup> position among 189 countries, whereas Finland takes the 12<sup>th</sup> position. The position of Turkey is slightly above the average of the European and Central Asian nations, when the developed western economies are excluded from the examination. When the bureaucratic environment of Turkey is viewed in detail, the country is doing well in the areas of contract enforcement, investor protection, and the availability of electricity. On the contrary, the most challenging aspects of the economy from a bureaucratic perspective deal with construction permits, resolving insolvency, and the difficulty in starting new businesses. In the most unfavorable measured variable, dealing with construction permits, it was discovered that companies have to take 20 procedural steps, which take nearly six months of time, when establishing a warehouse in Istanbul.

The measuring of the level of corruption in an economy can be done by examining the *Corruption Perceptions Index* by Transparency International (2012). The index measures the perceived level of corruption in the public sector by collecting opinions from independent analysis organizations around the world. The index has a range from zero to 100 (the higher the score the less corrupted the nation). Recently Turkey has gradually increased its performance resulting in an index score of 49 in the measurement of 2012. With this number it takes the 54<sup>th</sup> position among 176 nations worldwide. The majority of European countries rank better than Turkey in the comparison, i.e. Finland is one of

the least corrupted ones in the world. However, some developed European economies such as Italy fall behind Turkey.

### 3.5 A comparison of Finnish and Turkish markets

In order to be able to utilize the contingency model of international franchising by Hoffman and Preble (2006) presented in Chapter 2.4, the market similarity between the franchisor's home country and the targeted market has to be tackled. As a summary of the data presented in Chapter 3, the macro environmental model of Alon and McKee (1999) is used here as a tool for comparison of the Finnish and Turkish markets. The original purpose of the environmental model was the evaluation of different target markets from a franchisor's perspective. Consequently, the Turkish market's attractiveness is examined from a Finnish perspective in Table 6.

The evaluation of the aspects of the Turkish market, however, only addresses the question of the attractiveness of the market for Finnish franchisors. In order to answer the question of market similarity, the aspects of the Finnish market have to be addressed as well. Thus, the Finnish and Turkish markets are both evaluated with the macro environmental model. The examination is based on the researcher's individual judgment, and the outcome could be different if the observations were made by another person.

Table 6 Comparison of the Finnish and Turkish markets (adapted from Alon & McKee 1999, 78)

<b>Economic dimension</b>	-2 Very low		Very high +2		
GDP per capita		TR			FI
7 year average GDP growth		FI		TR	
Level of urbanization				TR	FI
<b>Demographic dimension</b>	-2 Very low		Very high +2		
Extent of middle class			TR		FI
Population growth		FI		TR	
Proportion of female labor participation		TR			FI
<b>Distance dimension</b>	-2 Very high		Very low +2		
Physical distance				TR	
Cultural distance		TR			
<b>Political dimension</b>	-2 Very high		Very low +2		
Internal political risk			TR		FI
External political risk			TR		FI

The comparison of the countries' economic dimensions shows that there are differences in the level of GDP per capita and the long-term growth. The gap is wider in the figures of GDP per capita compared to the GDP growth. On the contrary, the examination

of the level of urbanization shows that the proportion of the urban population in the countries is quite similar. In the demographic dimension, there are differences in all of the factors. The main difference is witnessed in the proportion of female labor participation, but the extent of middle class and population growth reveal also quite large differences.

The distance dimension differs from the other dimensions, as the value for both markets is the same. Thus, the variables of physical and cultural distance can only be used in the examination of the attractiveness of the Turkish market. The distance of 2200 km between Helsinki and Istanbul cannot be viewed as very large in the global scale, which increases the attractiveness of the Turkish market. On the contrary, the comparison of Hofstede's dimensions (The Hofstede Center 2013) shows that there are cultural differences between the countries that lowers the attractiveness of the Turkish market. The scrutiny on the political dimension shows, that the Finnish market is quite risk-free compared to the Turkish market.

Regardless of the shortcomings of this subjective evaluation, it can be argued that there exist differences between the Turkish and Finnish market from a franchisor's perspective. Based on this reasoning, these two markets are viewed as dissimilar, when the contingency model of Hoffman and Preble (2006) is used. When the comparisons of the markets is summarized, Turkey receives a score of +1. This would imply that when the market is observed from the perspective of a Finnish franchisor, it is seen as an average market with respect to its attractiveness in international franchising.

## 4 RESEARCH DESIGN

### 4.1 Methodology

The selection of a methodology for a study starts with a philosophical reasoning of the fundamentals of research in general. This is done because the use of methodologies is connected to the basic philosophical assumptions behind them. There are two extremes in the ontological and epistemological reasoning. The ontological objectivism, which is closely related to the empiricist position in epistemology, assumes that the existence of the world is not related to people's actions, and that the reality can be objectively measured. In the other extreme of the philosophical continuum is the subjectivist point of view, which assumes that an objective world does not exist as the reality is constructed in the social interaction of people. (Eriksson & Kovalainen 2008, 14–20)

This study is positioned in the middle of this philosophical continuum. On one hand, the testing of a model of international entry modes is close to the research philosophy of positivism, which is generally used in the theory testing of quantitative research. On the other hand, the pursuit of practical knowledge on international operations relies more on interpretivism and constructionism, which assume that the world is constructed through human experience.

Methodology can be defined as the philosophy of methods that guides the researcher in the formation of the research design (Eriksson & Kovalainen 2008, 16). Methodologies can be divided into quantitative and qualitative approaches. Quantitative research is a theory-based approach, where hypotheses are deduced from existing theories and tested in a real-life environment by using samples of large populations. The research is mathematically oriented and tries to either describe the features of the numeric data or find explanations and causalities that are statistically significant. (Gillham, 2010, 9; Kananen 2013, 26)

As quantitative research is about describing and generalizing issues through statistical results, qualitative research is about understanding and giving meanings to studied phenomena. This is done by engaging in interaction with the study subjects, who are, in many instances, human actors. In this respect, the researcher can be seen as an integral part of the research process due to the close cooperation with the actors in the field during the gathering of the empirical data. (Gillham 2010, 10; Kananen 2013, 27) Qualitative research is particularly suitable for situations where prior knowledge on the studied issue is modest. In this kind of setting, qualitative research can be used as an exploratory study focusing on the yet unstructured problem. In this respect, qualitative research has been

used by many quantitative researchers as a pre-study methodology before the actual quantitative inquiry. Qualitative research, however, can also be used even if there is no connection with quantitative studies. (Eriksson & Kovalainen 2008, 5)

A qualitative perspective is selected in this study as the methodological approach, as the objective of the research is to understand and find detailed explanations on the internationalization of franchisors into an emerging market. By tackling the studied issue through human interaction, more detailed and abundant information can be obtained compared to the quantitative analysis. As the objective of this study is to create a holistic understanding on the discussed phenomenon, a case study research methodology is selected.

Case study research can be viewed as one of the qualitative research methodologies. However, quantitative research methods can also be used in case study research, which makes it a hybrid methodology between the two research traditions. In a case study, the studied phenomenon is a set of human activities, which take place in the real world. The case is investigated in order to be able to answer the established research question. The case can be an individual person, a group of people, or a larger community such as a whole city. (Gillham 2010, 1) Case studies can focus on other issues than individuals as well (e.g. on organizational change, decisions and programs). In addition, a case study can examine as wide an issue as the role of a particular country in the world economy. In this respect the actual unit of analysis could be for example the economic policy or trade and capital flows. (Yin 2009, 30)

The purpose of a case study is to interpret the meaning, understand the phenomenon, and create a thick description of the studied case. (Eriksson & Kovalainen 2008, 117) There are many different types of case studies that can be utilized. To give some examples, case studies have been described as intrinsic, instrumental, collective, theory-seeking, theory-testing, story-telling, picture-drawing, descriptive, interpretative, and evaluative. (Simons 2013, 21) In sum, according to Eriksson and Kovalainen (2008, 118), case studies can be divided into intensive and extensive case studies. An intensive case study focuses on one particular case, and the purpose of the study is to learn and understand how the particular case works. In this respect, the verbalized narrative of the studied phenomenon is seen as the most important outcome of the research. By exploring the subject from many different angles, an insightful portrayal about the case can be established.

The purpose of an extensive case study is to compare several different cases in order to test, elaborate or develop theory. By collecting similar empirical data on all of the cases, the researcher enables the comparison of the cases, which commonly leads to theoretical reasoning. One particular case does not stand out in extensive case study as the most important part of the study, but only as a part of the process in the theory testing. Extensive case study can be viewed to have a close connection with the grounded theory

methodology, where theory is created from the empirical material inductively. In this approach, the theory's emergence from the empirical data is seen as important, and, thus, pre-defined theoretical propositions are not used. (Eriksson & Kovalainen 2008, 122–123)

Yin (2009, 46) divides case studies in quite a similar way compared to the intensive-extensive distinction. In his categorization, there are either single or multiple case studies. In addition, both of these can be divided further into holistic or embedded case designs. Single case studies are comparable with the intensive case study, where there is only one particular case under scrutiny. Multiple case studies are then again similar to extensive case studies that emphasize the comparison of several different cases.

According to Yin (2009, 48–49), there are five different occasions on which the use of a single case study should be preferred. First, it suits well the situations in which the theoretical foundation is well known. In these instances the study's purpose is to test the theory in practice, and as an outcome it can confirm, challenge, or extend the existing theory. Second, the use of this type of a case design is well justified when the event is so rare that it must be documented in order to get acquainted with the phenomenon. Third, a single case study can be used in the demonstration of a typical case or an average example of a given issue. Fourth, it can be used in a revelatory case, in which the researcher focuses on an event that has not been studied before. Finally, single case study approach is suitable when the case requires observation over a longer period of time. In these longitudinal studies the single case is examined at least in two different moments of time.

The multiple case study has advantages as its scope is considered to be wider and the evidence obtained more robust compared to a single case study. However, a single case study can be conducted with fewer resources and it can create deeper understanding of a particular case. Multiple case studies have been mistakenly discussed in the past as synonymous to the multiple respondents in survey. However, it should be considered as a replication design rather than a sampling design. The different cases should be selected so that they predict the same results than the first one. Other option is to select some of the cases in a manner that they predict the opposite results, but in an anticipated way. The precondition for the use of multiple case study method is the formulation of a rich theoretical framework, because the results will be reflected through the created framework. (Yin 2009, 54)

The single and multiple case studies can either be holistic or embedded studies. In single case studies, a holistic approach means that there is only one unit of analysis in the case, for example one individual or one organization. If the organization is investigated by using an embedded strategy, the different levels of the corporation would act as separate units of analysis. For instance, when examining an organization such as a hospital, one unit of analysis could be the clinical services, as the other unit of analysis could be the employed nurses of the hospital. If the hospital was examined only on a general level,

the approach would on the contrary be holistic. (Yin 2009, 52) In a multiple case study there can also be several units of analysis within each case, which would make it an embedded study. It must be remembered, however, that the analysis of the different units must stay within the particular case. (Yin 2009, 59)

## **4.2 Case selection**

A single case study was selected as the design of this study. As mentioned above, when the theoretical background of a study is clear, a single case study can be used in order to confirm, challenge or extend the existing theory. Here the model of Hoffman and Preble (2006) on international franchising was used as the theoretical background, which was tested in an empirical setting. By examining a single company's endeavor in the international market, evidence can be gathered either in favor of or against the theoretical setting. Another factor favoring the selection of a single case study design was the rareness of the discussed phenomenon. As Turkey was the target country and the study was performed from a Finnish perspective, the academic literature has not yet focused on this issue from a franchising perspective. In this respect, there was a need for the documentation of a case example to understand the phenomenon better.

In the view of Eriksson and Koistinen (2005, 5–6), one of the most critical phases of a case study research is the defining of the case itself. In business research, it is common that the headline of the study implies that a particular company is the case of the research. However, in many instances the enterprise is only the context of the case and the focus of the study is in fact a particular part of the company. In this kind of a setting the actual case could be a business unit, the owners, the management, a brand or a product line of the company. In this research a Finnish coffee house company was viewed as the context of the study and the focus of attention, the actual case and the unit of analysis, was the internationalization process of the enterprise.

According to Simons (2013, 30), a case can be selected for intrinsic or instrumental reason. In an intrinsic selection the case itself is of particular interest to the researcher, whereas instrumental selection is made when a broader phenomenon is interesting to the wider academic community, not the case example itself. In an intrinsic selection there are no options for the case selection, as the interesting case itself is the driving force of the research. On the contrary, there are generally many options in an instrumental case selection. Criteria for the right case selection might arise from the discussed issue itself. In addition, factors such as geographical location, willingness of persons to participate in the study and the closeness to the academic's home town can be considered as criteria for selection.

In this study the instrumental selection was used, as the studied phenomenon was the focus of interest rather than any single case company. One criterion that arose from the studied context was the internationalization experience of a company. The model of Hoffman and Preble (2006) suggests that experienced and large companies are viewed as more capable in entering foreign markets than the inexperienced ones. The less experienced companies are advised not to engage in dissimilar markets using platform or conversion strategies. In this respect, as Finland and Turkey were defined as dissimilar markets, it was seen interesting to study a Finnish company that was viewed as inexperienced in international operations.

Based on the variable of internationalization experience, a Finnish coffee house company Robert's Coffee was selected as the case company of the study. Even though the company had operated in the international market since the 1990s, the expansion of the enterprise had not been fast, as the company had less than 100 coffee shops in Finland and abroad (Robert's Coffee 2013). As mentioned in the presentation of the model of Hoffman and Preble (2006), to be considered as experienced, a company should have operated for more than five years in its domestic market and expanded its network into more than 100 locations. In this respect, Robert's Coffee met the age criteria with over two decades of experience, but due to its limited network size it was considered in this study as an inexperienced international company.

### **4.3 Data collection**

Case study research is a mixed-method research tradition, where multiple sources of evidence can be used. It is not uncommon for case studies to utilize both qualitative and quantitative methods for data collection (Eriksson & Kovalainen 2008, 127). The empirical data can be gathered from sources such as interviews, statistics, surveys, participant observation, minutes of meetings, notes, diaries and brochures (Eriksson & Koistinen, 2005, 27). According to Simons (2013, 43) the sources of data in case study research can be divided into interviews, observation and document analysis. This study utilized interviews as the data collection method.

Interviews can be divided into structured and unstructured interviews. The latter can be also called in-depth interviews, which are in common in business research (Eriksson & Kovalainen 2008, 125). An in-depth interview has four purposes: (1) the documentation of the interviewee's thoughts on the discussed topic, (2) the learning of both the interviewer and the interviewee during the process through active participation in the conversation, (3) the in-depth interview offers the interviewer a possibility to make sudden changes in the course of action of the interview (when an interesting topic arises in the conversation, the interview can be shifted to unplanned directions, which might enrich

the gathered data), and (4) interview enables the discovery of feelings that would be impossible to detect by pure observation. (Simons 2013, 43)

Compared to the more structured forms of interviews, the benefit of an in-depth interview is the richness of the empirical material gathered from the conversation (Gillham 2010, 62) By using interviews, the core issues of the phenomenon can be accessed quickly, and a deeper understanding can be achieved compared to other data gathering methods. For example, the possibility of asking follow up questions is a major advantage of the method. (Simons 2013, 43)

The empirical evidence of this study was collected in an in-depth interview conducted at the headquarters of Robert's Coffee in Helsinki on June 18<sup>th</sup>, 2013 by interviewing the chief financial officer (CFO) of the company, who is also responsible for the company's international franchising operations. During the 45-minute interview the themes of (1) internationalization of the company and (2) the experiences from the Turkish market were discussed. The interview themes were supplemented by supporting questions, which are exhibited in Appendix 2. In addition, attempts were made to reach other employees of the company in order to cumulate the empirical data. The managing director of Robert's Coffee in Turkey was contacted in the end of 2013, but regardless of the promises made he never replied to the interview questions that were sent to him. The headquarters of Robert's Coffee was contacted again in the beginning of 2014 in order to reach the Turkish managing director, but again the researcher was not contacted despite of the made promises.

Many kinds of written or digital documents can be used as empirical data of a case study. The documents can either be the primary source of evidence or they can be supportive to other methods such as interviews. (Eriksson & Kovalainen 2008, 126) In this study, documents were used in the form of the company's financial statements and Internet pages. The electronic material was used when describing the company features such as financial figures, history, products, and the franchising concept.

#### **4.4 Analysis and interpretation**

Analysis can be defined as the procedure that leads to organizing and making sense of the empirical material in order to produce a deeper understanding about the studied case and give answers to the research problems (Simons 2013, 117). Analysis is probably one of the most difficult aspects of a case study research. In the beginning of the analysis the researcher has to think about the substance of the case study itself, as the analysis methods are different depending on the study's relation to theory and the empirical material. Analysis can be divided into two parts. First, the empirical data must be organized and classified in order to be able to make sense of the material. Second, the classified material must

be interpreted in order to understand the data and answer the research questions. (Eriksson & Koistinen 2005, 30)

The organizing of empirical evidence is normally done through coding, which means that the researcher develops certain code words that can be used in classifying the data. These codes can either be derived from the theoretical background (pre-coding) or from the empirical evidence (subsequent coding). In pre-coding the theoretical background of the study must be well known by the researcher in order to be able to derive the right codes. In subsequent coding the empirical material must be familiarized thoroughly so that the right coding structure can be built.

The theoretical foundation of this study was thoroughly reviewed before the analysis, and the research questions were derived from theoretical models. The research could have been viewed as a deductive study, where the emphasis is on theoretical propositions rather than on inductive theory formulation. In this respect, the logical choice would have been to use theory-based codes in order to break down the empirical evidence, make classifications and finally interpret the data. However, breaking the data into simple variables can be risky, as Eriksson and Koistinen (2005, 30) state that this might lead to the loss of comprehensive understanding of the material when it is extracted from its context. Based on this view, as the empirical material of this study was based on only one interview, the possible shortcomings of coding and labeling of the data could exceed its benefits.

An alternative for coding is an approach called the straight interpretation, in which no coding is performed, but the empirical data is analyzed directly. The straight interpretation emphasizes the storytelling aspect of case study research as the researcher is interpreting the material during the writing process. In this respect the writing process itself is seen as the method of new knowledge creation. (Eriksson & Koistinen 2005, 31) Straight interpretation was used in this study as the method for interpretation, and the story of the case company is exhibited in the next chapter.

Interpretation of the data is an intuitive and hermeneutic process in which the empirical material is viewed from all different angles in order to produce the answers to the research questions. However, there are no fixed rules for interpretation in case studies, and every academic has to create an own form of interpretation. (Simons 2013, 118)

## **4.5 Trustworthiness**

Trustworthiness in quantitative research is measured by validity, reliability and objectivity. For studies pursuing statistical relevance, generalizability (external validity) is an important factor. Thus, some researchers have criticized qualitative research for its inability to meet the aspects of trustworthiness that are used in quantitative enquiries. The inability to generalize has been viewed as one of the main deficiencies of qualitative research.

There are, however, methods in qualitative research that can be used in enhancing the trustworthiness of studies, which can be viewed as comparable to the methods used in statistical research. These are (1) credibility (comparable to internal validity), (2) transferability (external validity/generalizability), (3) dependability (reliability) and (4) confirmability (objectivity). (Shenton 2004, 63–64)

In quantitative research, measures for internal validity are taken in order to make sure that the tests are measuring the intended issues. The equivalent term in qualitative research is credibility, in which the researcher tries to make sure that the empirical material reflects the real world. The credibility of the study can be enhanced in many ways including the use of well-known research methods, selecting informants randomly, triangulation of methods, assuring the honesty of informants and frequent debriefing with the study supervisors and peers. Examination of previous studies is also seen as a method for enhancing the credibility of a study, because the only way to compare qualitative studies is through its theoretical background. (Shenton 2004, 64–69) A particular effort was made in this study to examine the previous research of franchising in order to improve the credibility of the study.

Transferability is the qualitative equivalent to generalizability in quantitative research (Shenton 2004, 69). In the view of Yin (2009, 38), qualitative research and case studies in particular are generalized through the theoretical background of the phenomenon in an approach which is called *analytic generalization*. This is a contrasting view to the *statistical generalization*, which is common in social sciences and quantitative studies. It is important to make a distinction between these two forms of generalization. The statistical generalization is made in quantitative surveys by comparing the characteristics of the selected sample to the whole population of the studied phenomenon. The generalization is made by calculating mathematical confidence levels on the size and variation within the sample and the population.

The attempt of using statistical generalization in case studies can be considered as a mistake, because the selected case is not a sample of the population and has not been selected in the same manner as in quantitative surveys. Even when using a multiple case study approach, it should be noted that the case examples are not samples of a population. They rather resemble multiple experiments in a laboratory test. In the context of case studies, the theoretical background of the study is seen as the mirror which reflects the results of the study to other studies. In this sense the study is generalized analytically through the theoretical literature. If there is more than one case study supporting an existing theory, it can be said that the theory is generalizable. (Yin 2009, 39) As one objective of the current study was to test the internationalization model of Hoffman and Preble (2006), the foundations for the possible generalization were made if the results were favoring the model. If similar case examples are made in the future, the model can be viewed as reflecting the reality.

Reliability in quantitative studies concerns the repeatability of the research. This means that the results of a study should be similar compared to previous studies if the setting, techniques and methods were equal. In qualitative research, dependability (the term for reliability in qualitative research) issues are problematic, because the research setting can never be the same. Some academics have argued that dependability has close ties with credibility, and as such, when the solidness of credibility is assured, the dependability issues are also covered. In order to enhance the dependability of a study, the researcher should document in detail all the aspects of the process in order to facilitate future academics in repeating the study if needed. (Shenton 2004, 71)

Confirmability is the qualitative researcher's equivalent to objectivity in quantitative research. The role of triangulation has been viewed as important in fading the suspects for human bias in the study. In addition, confirmability can be enhanced by similar means than those in the case of dependability i.e. by a detailed documentation of the research process. When the researcher's decisions are exhibited thoroughly in the study, the objectivity can be assured. (Shenton 2004, 72)

## 5 THE INTERNATIONALIZATION OF ROBERT'S COFFEE TO TURKEY

### 5.1 Presentation of Robert's Coffee

The story of the Finnish case company started in 1987 with the establishment of a coffee roasting house in Helsinki. The simple business idea was to offer the best and the freshest coffee to the customers in Finland. The guiding principle of the company can be summarized as follows:

*Coffee is a dark, strong, savory and before anything a fresh stimulant (Robert's Coffee 2013).*

Today the company is a coffee manufacturer with two separate business areas. The core of the family enterprise is the coffee products business area, which operates under the brand *by Robert Paulig*. The company's coffee products are sold to retailers such as Kesko, S-Group, Lidl and Stockmann. In addition, the products are sold to various hotels, restaurants and catering services, and they are used in the company's coffee shops. (Paulig 2013)<sup>13</sup> The company focuses on the roasting of special coffees, and the coffee product portfolio ranges from original coffee roasts to diverse blends, including some specialities such as the stomach-friendly coffee product line and the coffee products branded with the famous Finnish fantasy figures *The Moomins*. Additionally, the company offers a wide variety of tee products. (Robert's Coffee 2014)

The company's coffee shop business area is branded under the trademark *Robert's Coffee*. Currently the company has approximately 75 coffee shops in Finland, Sweden, Estonia, Singapore, Japan, Turkey, Moldova, Azerbaijan and Iraq. Forty of these outlets are located in Finland, nine in Sweden, two in Estonia and Moldova, one in Singapore, Japan, Azerbaijan and Iraq, and the remaining 18 in Turkey. The coffee shops are located mainly in the capital and metropolitan areas of the different countries. For example, in Finland and Sweden close to two thirds of the coffee shops are located in the capital areas of the countries. Furthermore, in Turkey many of the restaurants are situated in the Istanbul metropolitan area.

All the company's coffee shops are franchised outlets with the exception of one outlet attached to the company headquarters in Helsinki. This company-owned outlet is used as the test laboratory of the enterprise, where new products are introduced and experimented, and it is viewed as an important tool for the firm in maintaining the contact with the consumer market.

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<sup>13</sup> If not indicated otherwise, all the contents of this chapter is based on the interview of the company's CFO. Direct quotations are translations from Finnish made by the researcher.

Robert's coffee is a family owned company where the founder and chief executive officer (CEO) Robert Paulig is nowadays focusing more on product development, as the innovative products (such as the aforementioned stomach-friendly coffee, which is based on a patented manufacturing process) are the heart of the company. In 2012, the son and daughter of Robert Paulig took more responsible roles within the company. The son Carl-Gustav Paulig, acting as CFO, is responsible for the financial and retail operations of the company, whereas the daughter Henrika Paulig is in charge of the concept development of the coffee shop business area. Moreover, the parent company has approximately 20 employees in Finland, and the franchised chain employs hundreds of persons in different countries.

The family of Paulig has a long and prestige history in the Finnish economy. The story begun in 1876 when Gustav Paulig founded a company specializing in the importing of colonial products such as coffee and spices. The company's decision to begin the roasting of coffee in 1904 can be viewed as the establishment of the Finnish roasting industry. The company has also introduced many other novelties into the Finnish society. For example, during the Second World War the company purchased machinery to produce and distribute frozen food, which had not been done before in Finland. At first, the equipment was used to deliver fresh meat to the Finnish Army, and after the war the frozen food factory was used in introducing convenience food to the Finnish population. (Paulig Group 2001)

The company *Ab Gustav Paulig Oy* and its successor *Paulig Group* have been owned by the Paulig family throughout its 140-year history. Gustav Paulig's wife Bertha ran the company after her husband had died in the beginning of the 20<sup>th</sup> century, and their son Eduard continued as the managing director until the end of the 1940s. (Paulig Group 2001) The death of Eduard Paulig's son Henrik in the 1980s led to a dispute within the family about the possible stock exchange listing of the company. As a result of this disagreement, Robert Paulig, the son of Henrik Paulig, had to step aside from the company. (Kaleva 2006) The Paulig Group sued the companies of Robert Paulig in 2006 in order to prevent them from using the family name in the marketing of its products. The process ended in 2010 resulting in a partial prohibition of the brand name usage. However, Robert Paulig still can use the brand *by Robert Paulig* in the marketing of his products. (YLE 2010)

Robert Paulig decided to establish Robert's Coffee because there was a lack of special coffees in the shelves of the Finnish retailers. He had already gained experience in managing a coffee shop chain when he worked as the head of the *Nissen* chain during his time in *Ab Gustav Paulig Oy*. There had been a flourishing coffee shop culture in Finland before the wartime, but it had not recovered yet in the 1980s. Robert Paulig saw that the time was right for the rise of a new coffee shop culture in Finland. (Saksa 2013)

The businesses of Robert's Coffee are conducted by different companies, which belong to a corporate group of *Moroke Holding Ab*. The group consists of companies called *Oy*

*Contest Ab, Oy Skinnvest Ab, Crash-Invest Ab and Oy Coffeelings Ab.* (Moroke Holding Ab 2012; 2013) Even though some of these companies have businesses that are not directly related to Robert's Coffee, the financial figures of Moroke Holding Ab can be viewed as representing the economic performance of the coffee house company. The economic indicators of Robert's Coffee are illustrated in Table 6.

Table 7 The economic indicators of Robert's Coffee (Moroke Holding Ab 2012; 2013)

Indicator (EUR)	2010	2011	2012
Revenue	4 240 000	4 910 000	4 960 000
<i>Materials and services</i>	- 2 700 000	- 3 150 000	- 3 140 000
<i>Personnel expenses</i>	- 657 000	- 621 000	- 603 000
<i>Depreciations</i>	- 324 000	- 199 000	- 196 000
<i>Other expenses</i>	- 776 000	- 711 000	- 649 000
Operating profit	- 158 000	229 000	605 000
<i>Financial expenses</i>	- 81 000	- 93 100	- 105 000
<i>Taxes</i>	- 13 800	- 47 700	- 145 000
Net profit after taxes	- 252 000	87 900	356 000
<i>Capital</i>	745 000	702 000	1 830 000
<i>Liabilities</i>	2 830 000	2 650 000	3 730 000
Balance sheet	3 570 000	3 350 000	5 560 000
Operating margin (%)	3,9	8,7	16 (5,0) <sup>14</sup>
Income before extraordinary items to turnover (%)	1,7	5,9	11 (4,1)
Net profit (%)	- 5,9	1,8	7 (1,4)
Return on assets (%)	- 4,4	6,8	11 (6,5)
Equity ratio (%)	21	21	33 (30)
Relative indebtedness (%)	67	54	75 (33)

The company has recently generated revenue close to five million annually with an increase of 16 percent from 2010 to 2011. Accordingly, the net profits have increased resulting in a positive income in 2011 and 2012. The company's profitability has increased during the observed three years, as the net profit ratio<sup>15</sup> and the return on assets<sup>16</sup> have enhanced from the negative figure of 2010 into a quite fine result in 2012. Even though the net profit has been negative in 2010, it can be witnessed that the company's core functions were still profitable, as the ratios of the operating margin<sup>17</sup> and the income before extraordinary items to turnover<sup>18</sup> were still positive.

<sup>14</sup> The average financial figures of the Finnish restaurant industry in 2012 are shown in parenthesis (Statistics Finland 2012).

<sup>15</sup> Net profit / revenue (Balance Consulting 2014).

<sup>16</sup> Operating profit / balance sheet (Balance Consulting 2014).

<sup>17</sup> (Operating profit + depreciations) / revenue (Balance Consulting 2014).

<sup>18</sup> (Net profit + depreciations) / revenue (Balance Consulting 2014).

When a comparison is made to the financial figures of the restaurant industry in Finland, the company's performance has been above average measured in all the aspects of profitability in 2012. When the industry average figures are compared to the previous years (assuming that the variation of the industry averages is low between consecutive years), it can be stated that the year 2011 was a year of an average performance for Robert's Coffee. Consequently, a similar comparison to year 2010 shows below average performance for the company.

The capital structure of the company has been quite indebted, as the equity ratio<sup>19</sup> has been only 21 percent in 2010 and 2011. However, in 2012 the proportion of capital in the balance sheet has risen above the industry average up to 33 percent, which has enhanced the company's resilience against possible losses in the future. The relation of the company's liabilities to revenues has also been quite high, especially in 2012 when the relative indebtedness<sup>20</sup> was 75 percent. This increases the demand for higher operating margins in order to cover the expenses generated by the liabilities. Despite of the relative indebtedness of the company, Robert's Coffee seems to be performing well in the light of financial figures when compared to the average figures of the Finnish restaurant industry.

## 5.2 Internationalization Strategy

The company established its first outlets in Finland in 1992, and already during the same year the internationalization of the company started with the establishment of coffee shops in Sweden. Currently the majority of the company's coffee shops in Finland and Sweden are concentrated in the capital areas of the two countries. However, in both countries there are a few outlets in distant locations such as in the Finnish Lapland and in the Swedish island of Öland as well. (Robert's Coffee 2013) The international expansion of the company continued in the 1990s by the establishment of two outlets in the capital of Estonia, Tallinn. The small size and the comparably low purchasing power of the population have been the main reason for the company not to expand further in Estonia.

The company's internationalization strategy is focused on the establishment of coffee shops in the transportation hubs, as stated by the firm CFO (Paulig 2013):

*We want to be at the airports, railway stations, in such locations where the mobility of people is high. For a long time, for instance, our coffee was served in the airplanes of Finnair around the world. When the plane descended to an airport in Singapore or in Turkey, there was Robert's Coffee again at the airport... ..This kind of a chain, where Robert's Coffee is always present.*

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<sup>19</sup> Capital / balance sheet (Balance Consulting 2014).

<sup>20</sup> Liabilities / balance sheet (Balance Consulting 2014).

Based on this strategy, cooperation with a large airport restaurateur led to the establishment of several outlets in the airports of Finland, Sweden and as far as in Singapore. At its best, there were up to five coffee shops at the Arlanda airport in Sweden. Now the Helsinki airport coffee shop contract has been given to another company and the amount of coffee shops in Stockholm has reduced to two outlets. However, the coffee shop in Singapore still remains operational.

The company has recently continued its oriental expansion by opening a coffee shop in Japan with plans to open at least three more. The establishment of a coffee shop in the country has been a long process, as the company has been selling coffee into the market for more than ten years. However, only until recently, the company had not been able to find a suitable partner to open coffee shops in the country.

The company does not actively seek for new partners abroad. The international expansion rather continues when foreign entrepreneurs contact the company with a proposal for opening negotiations for establishing a franchising agreement in a particular country. The partner selection in international franchising has been viewed as problematic. The discovery of a suitable partner is a time consuming task and also includes the risk of failure. In the worst case, i.e. if a wrong partner is selected, the work in a particular market has to be started from scratch all over again.

The parent company itself focuses on Finland, as there are still plenty of expanding opportunities in the home market. The competition between coffee houses in Finland is rather low compared e.g. to the Swedish market, as the only competing coffee house chains in Finland are the American company Starbucks and the Swedish firm Wayne's. Both of them have only a few outlets in the country. The American competitor's disadvantage is the rigid structure of the company, as all the coffee shops are guided directly from the USA. In addition, their cost structure is quite high, which requires a large market area in order to run a profitable business. This limits their possible expansion in Finland. The Swedish competitor had to replace recently the master franchisor in Finland, which led to the closing and re-establishment of the chain within a short timetable. This maneuver damaged their reputation in the country. Robert's Coffee has calculated that there is room for at least a hundred coffee shops for the company in the Finnish market. The company will most likely take a more active role in foreign markets when the home market starts to show signs of saturation. Until then, the foreign operations are acting as a good supplement to the home market operations.

Even though the company is not actively seeking rapid expansion internationally, different markets have been screened from a coffee manufacturer's perspective. For example, Russia is not seen as the most favorable market for coffee house companies, as Russians have traditionally preferred tea over coffee. In addition, 90 percent of the country's coffee consumption is covered by instant coffee, which is not part of Robert's Coffee's product catalogue. Moreover, the company considers that the risks in the Russian market

are too high for them to establish itself in the market. However, if positive development takes place in the country, the situation must be re-evaluated.

Robert's Coffee's international expansion has been made by using franchising as the foreign operation method. Master franchising is nowadays the main method used, but direct franchising has also been employed. The operations in Sweden started with direct franchising agreements, as an employee of the company move into the country and started to operate franchises in Stockholm. However, after a roughly eight years of operation the company decided to change the operating form to master franchising. Master franchising is also used as the preferred option in Turkey, whereas direct franchising is still the employed method in Estonia and Singapore. The reason for using franchising as the mode of operation has been purely a risk management issue, as foreign direct investments require large capital contributions. By using franchising, the parent company can operate with relatively small and agile organization, and the entrepreneurial risk of foreign endeavors is mainly on the "shoulders" of local partners. The company has no intentions to change this well tried strategy in the future.

### **5.3 Expansion into Turkey**

The expansion to Turkey is a good example of the demand-based internationalization of the company, as the initiative for the endeavor came from a Turkish businessman who had lived many years in Finland. He had familiarized with the concept of Robert's Coffee and believed that it could succeed in the Turkish market environment. The expansion to Turkey began in the beginning of the 2000s by the establishment of a master franchising agreement with the entrepreneur, and the chain was rapidly expanded throughout the country, and even into the nearby countries of Moldova, Azerbaijan and Iraq. The current state of the chains network in the area is exhibited in Figure 9.

The highest concentration of Robert's Coffee's outlets is in the most populated city of the country, Istanbul, and the chain has consisted of close to 30 coffee shops at the most. However, the smoking ban of 2009<sup>21</sup> affected the whole industry and resulted in the decrease of the size of the company's network in Turkey. Recently, the restaurant industry has started to recover from the decrease in the amount of customers due to the smoking ban, and in the beginning of the year 2013 the master franchisor opened a new outlet in the Turkish side of Cyprus.

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<sup>21</sup> In Turkey, a law was passed in 2008 which prohibited smoking in taxis, shopping centers and large workplaces. In the second phase of July 2009 smoking was banned also in restaurants, bars and cafés. (Lewis 2009)



Figure 9 Robert's Coffee's outlets in Turkey, Azerbaijan, Iraq and Moldova (Robert's Coffee Türkiye 2013; The World Factbook 2013).

The distribution of labor between the parent company in Finland and the entrepreneur in Turkey is clear. Whereas the local partner has been granted the right to establish new outlets in the area, the parent company is responsible for the delivery of raw materials. The Finnish franchisor delivers coffee, tea and spin-off products such as mugs into Turkey, and is responsible for the development of the brand. Corporative services such as financial or site-building support are not offered. In addition to the raw material deliveries, the parent company exercises quality control throughout the world in order to make sure that the concept is used in a proper manner. The franchisor's visits are not only for controlling the entrepreneurs, but also for concept development purposes. The rich discussions with the local personnel are a good method for receiving feedback in order to further develop the brand. The visits from Finland are highly appreciated by the local entrepreneurs.

The market conditions of Turkey are generally favorable to Robert's Coffee. The physical distance to the market is not viewed as a problem. The transportation connections have developed during the decades, and even transportations to the Far East can be handled without major challenges. The cultural difference between Turkey and Finland is not viewed as a challenge for the company. On the contrary, the company's branding as a Finnish coffee manufacturer can be viewed as a competitive advantage for the enterprise in the effort to differentiate themselves from the competitors. Finland is known in Turkey as a coffee country, and the Paulig family has long traditions in the business. A company coming into the market from this kind of a setting is seen as refreshing. The company faces competition in the market from international players such as Starbucks, Caribou

Coffee and Costa Coffee, and also from a few local players. The competition however is not viewed as fierce as in Sweden for example.

According to the experiences of Robert's Coffee, the market characteristics in Turkey are somewhat different than in Finland. Coffee shops in Turkey are more comparable to a restaurant than a coffee shop in Finland. In Turkey, all the coffee shops utilize table service and it is common for people to dress well and spend more time in coffee shops, whereas in the Nordic countries the visit to a café is more of an everyday action. From a business perspective, there are differences as well. Franchising as a business method is fairly new in Turkey, and the utilizing of royal payments as a compensation for brand usage has not been common in the country. The landscape of the business is however changing due to the growing participation of foreign chains in the market.

The business culture of Turkey is also different with respect to contractual issues. In Turkey the personal relations play a more important role than contracts:

*It is more verbal and they rather shake hands (Paulig 2013).*

Thus, differences can be observed in the practices for example to those in Japan, where contracts are complied with up to the last letter.

As the delivery of raw materials to foreign markets are one of the main foreign processes of the company, transportation has also been a source of problems in internationalization. Robert's Coffee employs road, air and maritime transportation in the delivery of raw materials depending on the market area. The Japanese deliveries are made by airplane, Swedish by trucks and ferries. At first, there were difficulties in the shipments to distant locations such as Singapore. The company has, however, learned quickly and now the transportation to the other side of the world is executed efficiently. To Turkey, the deliveries are made in large quantities either by trucks or ships. As the company's CFO states (Paulig 2013):

*The largest problems come from operating outside the EU, and they are related to importing.*

The Turkish customs have been a particular problem to the company, as high customs tariffs are issued on imported processed goods such as roasted coffee. This has led to plans of establishing a roasting house in the country to avoid the customs tariffs, as the charges for raw coffee are very low. The roasting house would be operated and owned by the master franchisee, and the role of the parent company would be limited to the training of personnel in the facility. In addition to the customs charges, the parent company has not faced bureaucratic problems or corruption in the country. The company has also avoided the exchange risk by demanding all payments in euros.

## 5.4 Key findings

The case company has been presented in the previous chapters, and its international operations have been discussed with a particular focus on the Turkish market. The key empirical findings of the chapters are exhibited in Table 7.

Robert's Coffee is the largest coffee house chain in Finland measured in the amount of business locations. The family owned company was established in 1987 and started its international expansion in 1992. Nowadays the company operates in nine countries of Europe and Asia with 75 franchised coffee shops. In addition, the company produces and sells roasted coffee and tea products mainly in Finland. The parent company generates an annual revenue of five million euros, and employs close to 20 persons in Finland. In addition, the coffee shop chain employs hundreds of persons in different countries.

Table 8 Summary of the empirical findings

Company presentation	General information	Family owned business, established in 1987, headquarters in Helsinki
	Business areas	Robert's Coffee-chain, coffee production and distribution under the brand of by Robert Paulig
	Number of coffee shops	Finland: 40, Turkey: 18, Sweden: 9, Estonia: 2, Moldova: 2, Singapore: 1, Japan: 1, Iraq: 1, Azerbaijan: 1; Total 75 coffee shops
Internationalization strategy	Objective	To locate in the transportation hubs (airports, railway stations)
	Employed form of franchising in different market areas	Sweden: Master franchising (previously direct franchising) Estonia: Direct franchising Singapore: Direct franchising Japan: Direct franchising Turkey (including Moldova and Azerbaijan): Master franchising
	Reason for method selection	Master franchising: Risk management, low capital contribution Direct franchising: Low quantity of coffee shops
Expansion into Turkey	Competition	Three international chains, a few locals, less competition than e.g. in Sweden
	Consumer preferences	Table service, fine clothing
	Business culture	Verbal agreements are common, franchising is not yet a very widespread business form
	Challenges	High customs tariffs on roasted coffee

The internationalization strategy of Robert's Coffee is based on locating the coffee shops in the transportation hubs of the different countries. Following this strategy the

majority of the company's outlets are situated in the capital areas and metropolises of several countries. The company has chosen to expand by using franchising as the preferred method of internationalization. Consequently, master franchising is the most common form of franchising used in the different markets, but countries with only few coffee shops are also contracted through direct franchising agreements. The decision of using franchising, especially master franchising, has been made purely for risk management issues. As the parent company focuses on the development of the home market in Finland, the master franchisees abroad are granted the right to sub-franchise the concept to other entrepreneurs in their respective market areas. The use of master franchising is a practical method for the parent company to outsource the business risks to the local entrepreneurs. In addition, the method allows the company to operate with a lower capital contribution.

The expansion of Robert's Coffee into Turkey has been a result of a suddenly emerged opportunity, when a Turkish businessman contacted the company with intentions of expanding the chain into Turkey. The business culture of the country is different compared to the Nordic countries. As written agreements are a prerequisite of conducting business in Finland, in Turkey verbal agreements are relied more, especially in the early stages of involvement in business endeavors. Moreover, the Turkish market also differs with respect to the consumer behavior. Turkish people tend to dress very well in coffee shops and they expect table service, whereas in Finland coffee shop visits are more a mundane event.

The competition in the Turkish market is not as fierce as in the Nordic countries. There are a few international and domestic competitors in the country, but the large size of the market allows all the companies to expand their network. For Robert's Coffee, the most challenging aspect of the expansion into the Turkish market has been the customs tariffs, which are substantially high on roasted coffee. The company has reacted to this challenge by planning the establishment of a roasting house in the country. By exporting raw coffee instead of processed coffee the company will be able to avoid high customs tariffs.

## 6 CONCLUSIONS

### 6.1 Theoretical discussion

The objective of this study has been to discover how the Finnish companies have utilized franchising as an internationalization method in the Turkish market. This has been done by presenting a case example of a Finnish coffee house company Robert's Coffee and its expansion to the discussed market area. A theoretical model of Hoffman and Preble (2006) on franchisors' international expansion has been used in explaining the internationalization possibilities of companies engaging in foreign markets. The reflections on the model's propositions and the real-life actions of the case company require reasoning on three variables: company experience, market similarity, and market characteristics.

First, the issue of company experience was tackled in Chapter 4.2 where it was defined that the case company is viewed as an inexperienced international franchisor in this research. Second, market similarities were discussed in Chapter 3.5, which showed that there are sufficient differences between the Turkish and the Finnish market in order to conclude that they can be viewed as dissimilar markets in the theoretical context of this research, that is, the empirical evidence presented supports this view of the market differences. The third variable, market characteristics, is a more complicated issue. The theoretical model of this research suggests that the actions of franchisors are different depending on the environmental conditions of the market. These conditions are divided into rapid growth, complex and competitive environments. The problem with this division is the fact that a rapid growth environment can exist also in the context of a complex market area. This has to be kept in mind when the experiences from the case example are reflected in the light of the theoretical framework.

Turkey can be viewed as a part of the Middle East, which is a complex area with differences between the countries. However, certain cultural similarities in the region can be observed. This would imply that the region should be approached by a franchisor with a platform strategy, where the most business-friendly country is engaged first in order to gain experience from the marketplace. The theoretical model of this research suggests that inexperienced franchisors should not engage in complex areas before they have retained sufficient knowledge on international operations. However, as the case example shows, Robert's Coffee has entered the area by employing master franchising despite the fact that it has been classified as an inexperienced firm. In this respect, the findings of the research suggest that the model is incomplete in a sense that it does not take into account the possibility of the expansion of an inexperienced franchisor into complex regions in dissimilar market conditions.

If the Turkish market on the other hand is viewed purely as a rapid-growth environment, the setting changes. During the past seven years, the Turkish GDP has grown at an average annual rate of four percent. This is not a very high figure when compared to the rapid-growth markets such as China, but when a comparison is made to the developed market of Europe and America, the growth rate has been fast. If the market is seen as a rapid-growth market in the applied theoretical framework, the empirical results support the model's proposition P1b, which suggests that both inexperienced and experienced franchisors are employing master franchising when entering dissimilar markets in a high growth environment. This has been the reality in the case of Robert's Coffee.

When the research questions are discussed in detail, it is found that the internationalization strategy of the case company is based on the use of direct and master franchising in different markets. The strategic choice to employ franchising has been made in order to maintain the agile organization structure of the company, exploit the capital contributions of the local entrepreneurs in foreign countries and reduce the financial risk of the international operations.

From a franchisors' perspective, the Turkish market is lucrative due to its rapid growth in the recent years. In addition, the growth potential of the market is high as the GDP per capita level is low compared to western economies. However, from a franchisors' perspective this might not be viewed simply as a favorable condition, as already existing high income levels have also been viewed as benefitting factors for franchisors. When the demographic factors of the market are investigated, it can be concluded that there is room for improvement in the market with regard to the size of the country's middle class and the engagement of women in the workforce. The comparably rapid population growth and the government's willingness to increase the female labor participation can however be viewed as positive developments for franchisors.

When the Turkish market is viewed from a Finnish franchisors' perspective, the cultural distance can be considered as an obstacle for the companies entering the market. However, as the empirical evidence shows, in some instances the different cultural background can also be a competitive advantage for the company. The examination of the political dimension shows that the external risks related to customs charges emerge as the major challenge when importing goods to the country. Other difficulties were not discovered in this case example with regard to the political dimension. However, as the market examination in Chapter 3 shows, there is room for improvement in the Turkish market conditions with regard to bureaucracy and corruption.

The experiences of Robert's Coffee show that the finding of a suitable partner is crucial in international franchising operations, particularly when master franchising is discussed. The discovery of a reliable partner when expanding the network into Turkey has helped the company to establish itself in the market. It can be also argued, that without the initial

contact from the Turkish entrepreneur, the company would not have expanded to the market in the first place. A major factor that has constrained the market entry and the expansion of the company in the Turkish market has been the customs charges imposed on the deliveries of roasted coffee. This obstacle has been viewed so substantial that the company is planning on establishing a local roasting house in order to avoid the tariffs.

Based on the findings of this study, a few theoretical implications can be found. First, the empirical evidence presented here support the theoretical model of Hoffman and Preble (2006). The model was able to predict the internationalization of an inexperienced franchisor in rapid growth environments into a dissimilar market, as the empirical evidence shows that the case company uses master franchising in its Turkish operations. However, the model needs further development as it does not take into consideration the possibility of an inexperienced franchisors' internationalization into dissimilar markets in a complex market environment.

Second, the macro environmental model of Alon and Mckee (1999) proved to be a practical tool for the comparison of different market areas from a franchisors' perspective. However, the distance dimension might need some readjustment. According to the variable of physical dimension, it is assumed that the controlling of a partner is more difficult in distant locations. The case example here shows that the geographical distance between the markets was not viewed as a challenging factor, as in the contemporary world the travelling to distant places is rather trouble-free. Third, evidence was found in favor of the resource scarcity theory, which suggests that franchising is selected as an internationalization method due to the lack of resources as evidenced by the case presented here.

## **6.2 Managerial implications**

From a managerial perspective, the findings of this study imply that the most crucial aspect of international franchising concerns the partner selection in the foreign market. The selection process is a difficult and a time consuming task, and the selection of a wrong partner might lead to severe problems in the foreign market. For managers wishing to operate in the Turkish market, the lessons learned here suggest that the customs charges in Turkey are to be considered when the market is entered. This is especially the case when a company is an exporter of processed goods comparable to roasted coffee. If possible, the companies should consider the establishment of a production facility in Turkey in order to exploit the low customs tariffs of raw materials.

Finnish companies seeking expansion into Turkey should also be aware of the cultural differences between the two nations. In Turkey, the reliance on verbal agreements is more common than in Finland, especially in the early stages of market engagement. This might come as a surprise to a Finnish entrepreneur, who has become accustomed to written

agreements made in the beginning of a business relationship. In addition, in consumer business the local habits should always be taken into consideration before entering into the Turkish market. The consumer preferences, with regard to e.g. table service in restaurants, are different in the discussed countries.

### **6.3 Suggestions for further research**

In addition to its merits, this study has also limitations. Due to the study's nature as a single case study, no analytic generalization can be made to other situations. This could be done only if similar case studies would in the future provide evidence with regard to a similar theoretical framework applied here. The study has also methodological insufficiencies, as the empirical material was collected in only one interview. The use of an additional data acquisition method would have increased the credibility and the trustworthiness of the study. In addition, the use of multiple sources would have enabled the appropriate use of data analysis methods such as coding and categorizing.

There are many possibilities for researchers to continue the investigation of the discussed phenomenon. One option could be the quantitative examination of franchisors in order to find out the explanatory power of the applied theoretical model. Another suggestion for further research is the execution of case studies based on the same theoretical background in order to further test the model's explanatory power through analytical generalization. The possible enquiries utilizing the model of Hoffman and Preble (2006) could be done from different perspectives. For example, the focus could be on the Turkish market by examining franchisors originating from different cultural backgrounds. The model could be tested also from a single company's perspective by exploring all the markets where the company operates. Especially the perspective of an experienced franchisor could be explored.

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## APPENDIX 1      EMPIRICAL FINDINGS ON FRANCHISING AS AN INTERNATIONALIZATION METHOD

Author (s)	Purpose	Method	Results
<b>FRANCHISING AS AN INTERNATIONALIZATION METHOD</b>			
Hackett (1976)	Study the entry motivations, ownership practices, marketing strategies, profit profiles and problems of US franchise operations abroad	N=83, Qualitative US nationwide survey, 83 respondents were engaged in international franchising operations	Ownership: domestically company owned and abroad franchising, marketing: alterations only with regard to local tastes, profits: normal distribution of less and greater profits, problems: government interference and red tape
Fladmoe, Lindquist & Laurent (1995)	Explain the determinants of choice between franchising and equity modes in international operations	N=12, Quantitative logistic regression on a data of 12 companies (data from annual reports and interviews)	Cultural distance: F, Geographical distance: F, International experience high: F, High advertising: E, Restrictions on investment: F, Political turmoil: E, Currency: no effect (F = Franchising, E = Equity modes)
Koskimäki (1995)	Study the recruitment process of franchise entrepreneurs from franchisors perspective	Qualitative Case study, interviews	Differences between theory and the case company (Martela Oy) practices
Linjala (1998)	How export franchising benefits the value creation of a company	N=3, Qualitative case study, 2 interviews with a Finnish franchisor and 1 interview with a related consultant	The case-example proves that franchising is a working method in the internationalization of Finnish businesses
Olli (1998)	Analyze the applicability of franchising as an internationalizing strategy for a Finnish log cabin company	N=2, Qualitative Case study, 2 interviews in a Finnish company	Franchising is applicable
Burton, Cross & Rhodes (2000)	Develop a model of the choice between franchising-out directly or through an intermediary	N=15, Quantitative Ordinary Least Squares estimation on UK franchisors	Direct franchising is used by larger franchisors to establish smaller franchise systems while more experienced franchisors with larger domestic operations employ intermediaries
Petersen & Welch (2000)	How and why franchising may be used as a means of expanding international retail operations at a later stage of internationalization	N=2, Survey (secondary data) qualitative case study, 2 interviews	Foreign subsidiaries and own retail outlets precede low-commitment franchising operations in the retail sector

Quinn & Doherty (2000)	Develop understanding of the nature of power and control in international retail franchising	N=1, Qualitative ethnographic study in one UK based retail franchisor	The use of power and control in franchising relationships depends on the existence of a defined concept and brand. When a clear concept exists, coercive sources of power are used. On the contrary, only non-coercive sources of power are used when clear concept does not exist.
Olin (2001)	What are the factors that lead to the internationalization of Finnish franchising chains	Quantitative Survey to Finnish companies	Large, old and widely spread chains internationalize with franchising, fast growth and high dependency on price leads to the use of franchising. In service sector some of these don't apply
Michael (2003)	Why the rate of franchising differs across nations	Quantitative regression analysis	Theoretical: franchising is not culturally bound to the United States, product differentiation is an important variable affecting rate of franchising; Managerial: nations with highly developed manufacturing sectors are not good choices, Franchisors should choose nations with high media capacity, cultural distance appears to matter
Sund (2005)	Why and how Finnish service franchise companies enter the Russian market	N=1, Qualitative Case study, 1 interview in a Finnish company, quantitative survey to the pizzeria customers in Russia	Home market saturation, entry mode wholly owned subsidiary
Aliouche, Hachemi & Schlenrich (2009)	Develop a model that would assist franchisors in expansion strategies into foreign markets	Quantitative semi-structured interview + secondary data (e.g. GDP per capita)	Most desirable targets are UK, Ireland, Netherlands, Germany and Denmark
Aliouche & Schlenrich (2011)	Create worldwide index of target markets for US franchisors - better version of their 2009 model	N=104, Quantitative survey on US companies	Most desirable targets are UK, Canada, Germany, Australia, and Japan -> e.g. China 37.

<b>FRANCHISING AS AN INTERNATIONALIZATION METHOD IN EMERGING MARKETS - GENERAL</b>			
Alon (2006)	To develop a general framework for assessing the economic potential of a country from the perspective of an international franchisor	Quantitative, simple manipulation of data from various sources: the World bank and previous studies	Largest market size for international franchises in emerging markets: Brazil, Russia, Mexico, China, India, Argentina, Turkey, Poland, Colombia, South Africa
Baena (2009)	To present a model of the determining factors in a franchiser's decision regarding mode of entry into emerging nations	N=34, Quantitative Ordinary Least Squares regression analysis on 34 Spanish franchisors in emerging markets	Direct franchising: may not be suitable when geographical distance is long; may be appropriate when there is political instability, medium-low per capita income and substantial levels of unemployment rates and efficiency of contract enforcement. Master franchising: markets with higher per capita income, high unemployment, and efficient contract enforcement. Political stability and efficient contract enforcement increase joint ventures and FDI
Baena (2012)	How market conditions may constrain diffusion of franchising into emerging markets	N=63, Quantitative regression analysis on a data of 63 Spanish companies outlets in emerging markets	Geographical distance, uncertainty avoidance, individualism, political stability, corruption, gross domestic product, efficiency of contract enforcement, and entrepreneurship are able to constrain the spread of franchising across emerging nations
<b>FRANCHISING AS AN INTERNATIONALIZATION METHOD IN EMERGING MARKETS - CHINA, INDIA AND EAST ASIA</b>			
Alon (2001)	Review Kodak's operations in China	N=1, Qualitative case study, 1 interview	Kodak success in China has been based on three major strategies: Franchise for rapid distribution, Invest in business infrastructure with a long-term planning horizon, Tie close relationships with multiple levels of government

Frazer (2003)	Examine of the expansion strategies of Australian fast-food franchisors into the China market	N=9, Qualitative case study, 9 semi-structured telephone interviews with follow up interviews	China has not been popular destination, has not been entirely positive, problems with obtaining good personnel and partners, insufficient research conducted prior to entry
Alon & Bian (2004)	Examine the opportunities and threats to franchising in China	Qualitative case study, interviews	Expansion will rely on the ability to train and recruit highly qualified professionals
Paswan & Sharma (2004)	Investigate the relationship between accuracy of brand-country of origin (COO) knowledge and the COO image, in an emerging franchising market	N=695, Quantitative factor and correlations analysis on 695 Structured interviews in 5 major cities of India	Brand-COO knowledge is important for a more informed and probably accurate COO image, more accurate brand-COO knowledge leads to better market leverage and positioning
Alon & Bian (2005)	Examine the development of the commercial real estate market in China in a historical context	N=1, Qualitative case study, 1 interview	Franchisees strong positioning in the market creates an advantage, American brand name is competitive in China, political risk exists, the real estate market of Shanghai is highly competitive and nearly saturated
Choo (2005)	Explore how international franchisors develop monitoring capabilities that are needed to compete in East Asia	N=3, Qualitative case study, interviews of key managers in three foreign companies in East Asia	The amount of franchise fee, size of the franchisor, level of franchising experience, degree of internationalization contract, good capabilities in franchisee selection, guarding of brand equity, local knowledge and adaptation process all effect to franchisee opportunism avoidance
Thomas (2006)	Explain the challenges of franchising of service products in emerging markets	N=23, Qualitative case study, 23 interviews in Delhi and Bombay	Industry rationales for adapting television programs prove to be a paradoxical mix of economic pragmatism and cultural hybridity

Choo, Mazzarol & Soutar (2007)	Examine the principal construct of franchisee resources in international franchising	N=13, Qualitative case study, 13 interviews of 5 American companies operating in Singapore	American companies depend highly on the resources of their Asian franchisees, careful franchisee selection becomes critical; key resources of a franchisee are: strong financial strength, ability to secure retail space, location knowledge and ability to modify the franchising concept accordingly
Heung, Zhang & Jiang (2008)	Investigate the possibilities of state-owned hotels in China joining international hotel franchising	N=22, Qualitative case study, two rounds of interviews in 12 Chinese hotels, 22 general managers interviewed	Majority of state-owned independent hotels have intentions to join an international franchise operation in the next 5 years, major factors affecting the franchising of state-owned hotels in China were identified
Chen (2010)	Interpret the strategic motives for the adoption of a multiple unit franchising agreement as the expanded strategy into Taiwan from the perspective of the master franchisors	N=4, Qualitative Interviews of 4 case study companies	International multi-unit franchising outlet is better than the international single-unit franchising outlet in overseas expansion
<b>FRANCHISING AS AN INTERNATIONALIZATION METHOD IN EMERGING MARKETS - RUSSIA AND EAST EUROPE</b>			
Anttonen, Tuunanen & Alon (2005)	Provide a general environmental framework for analyzing the international franchising environments in Russia	Qualitative literature review	SWOT: S: Franchising is a less risky entry mode; W: franchising is not well known, unique culture and language; O: Large and growing market, need for western products; T: Very high political risk, monetary instability, underdeveloped infrastructure, crime and corruption, limited amount of capital, especially foreign currency, corruption is rather common

<b>FRANCHISING AS AN INTERNATIONALIZATION METHOD IN EMERGING MARKETS - LATIN AMERICA</b>			
Falbe & Welch (1998)	Extend the study of franchisee success and failure, compare the perceptions in different nations	Quantitative survey to Canadian, US and Mexican franchisors. Factor analysis, variance analysis, covariance analysis	The respondents' perceptions of the importance of system quality, brand name, local environment and communication, and other scales of franchisor and franchisee activities differed by country of origin. Additionally, neither business type nor franchise size had any effect on perceptions of success or failure.
Hadjimarcou & Barnes (1998)	Examine the process of international market expansion by a small franchisor	N=2, Qualitative case study, 2 interviews	Importance of partner selection and strategic alliances, concept adaptation, cultural knowledge
Dant, Perrigot & Cliquet (2008)	Compare the plural form phenomenon across Brazil, France, and the United States and to test some variables likely to explain the observed differences	Quantitative analysis of variance (MANOVA) on secondary data	Significant differences across the three compared countries
Baena & Cerviño (2011)	Create an explanatory model that explores host country factor in the rate of Spanish franchise diffusion in Latin American countries	N=63, Quantitative regression analysis on a data of 63 Spanish companies outlets in Latin America	The study provides insights which prove that international franchising expansion into Latin America countries depends on various country variables that franchisors may evaluate before selecting suitable markets to enter
<b>FRANCHISING AS AN INTERNATIONALIZATION METHOD IN EMERGING MARKETS - AFRICA</b>			
Grünhagen, Witte & Pryor (2009)	Exploring consumer conceptualizations of the various impacts of US-based franchising in Egypt To explore consumer conceptualization is of the various impacts of US-based franchising in Egypt	N=5, Qualitative focus group research: five focus groups at an Egyptian University	Healthy product line extension can create sales growth, localization of marketing strategies are needed, fast food consumption is perceived as a domain of the youth which drives change to marketing strategies
Heinonen (2010)	Describe microfranchising as a new concept	N=9, Qualitative content analysis: 9 microfranchising companies operating in Sub-Sahara region	Microfranchising has potential in poverty alleviation, but still faces many problems

## APPENDIX 2 INTERVIEW THEMES AND SUPPORTIVE QUESTIONS

### THEME 1: INTERNATIONALIZATION STRATEGY

- The history of company's internationalization?
- In which countries does the company operate?
- What are the objectives of the internationalization?
- How systematic is the market selection process of the company?
- Does the company evaluate different market areas before selection (e.g. economic, cultural, demographical or political factors)?
- What franchising method the company has employed in different target countries?
- Why the company has chosen franchising as an international method?
- Was franchising selected as a way to obtain external capital to operations from local entrepreneurs?
- Does the company own shares of the companies abroad or are the arrangements purely contractual based?
- Why has the company used (or not used) FDI's in their internationalization?
- Do the markets environmental factors affect the internationalization method selection (e.g. economic, cultural, demographical or political factors)?

#### *SUPPORTIVE QUESTIONS, IF DIRECT OR AREA FRANCHISING IS USED*

- Was the mode employed in order to retain the highest possible profit with regard to other franchising methods?
- Were the cultural and geographical differences between home and foreign market when the method was selected?
- Did the legislative environment have an effect to the choice of the mode?

#### *SUPPORTIVE QUESTIONS, IF MASTER FRANCHISING IS USED*

- Was the mode selected due to the lack of knowledge of the target market?
- Was the low capital requirement affect the mode selection?
- Was the low risk of the mode an affecting factor?

### THEME 2: EXPERIENCES FROM THE TURKISH MARKET

- Who represents the chain in the Turkish market?
- What is the company's role in the operations in Turkey?
- How does the company control the operations in Turkey?
- What kind of challenges has the company had in Turkey (e.g. problems in controlling the franchisees)?
- How does the company ensure the high quality standards in brand and concept usage?
- How would you describe the competition in the Turkish market?