

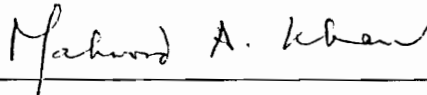
**Internal Environment, Organizational Form, and
their Impact on Financial Performance of
Hotel Chains**

by

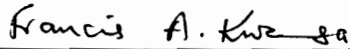
Yang Hwae Huo

Dissertation submitted to the Faculty of the
Virginia Polytechnic Institute and State University
in partial fulfillment of the requirement for the degree of
Doctor of Philosophy
in
Human Nutrition and Foods
(Hospitality and Tourism Management)

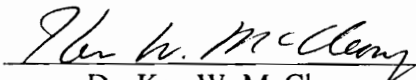
APPROVED:



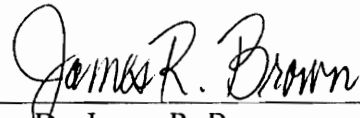
Dr. Mahmood A. Khan, Co-Chair



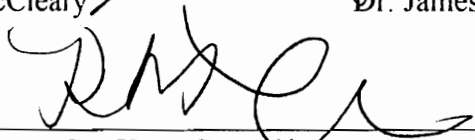
Dr. Francis A. Kwansa, Co-Chair



Dr. Ken W. McCleary



Dr. James R. Brown



Dr. Kye - Sung Chon

August, 1994

Blacksburg, Virginia

INTERNAL ENVIRONMENT, ORGANIZATIONAL FORM, AND
THEIR IMPACT ON FINANCIAL PERFORMANCE OF
HOTEL CHAINS

by

Yang Hwae Huo

Dr. Mahmood A. Khan and Dr. Francis A. Kwansa

Co-Chairmen

Hospitality and Tourism Management

(Abstract)

The primary objective of this study was to investigate the relationship between internal environment, organizational form, and financial performance in hotel chains. Using a contingency framework, this study investigated the match between internal environmental factors--such as capital scarcity, monitoring cost, and asset specificity--and organizational form--such as company owned, franchised, or combination of both--in an attempt to distinguish between high and low performing hotel chains.

The key findings of this study indicate that hotel chains which showed a "match" between the monitoring cost of their internal environmental factors and organizational form performed better than if those elements did not match. The other finding of this study indicates that hotel chains operating under different organizational forms, such as company-owned, franchised, and combination of both, did not differ in their financial performance levels which were measured in terms of return on investment and growth in unit sales.

This study contributes to the body of knowledge in the lodging industry by introducing the contingency theory in investigating the interrelationship between internal environment, organizational form, and financial performance. In other words, this study utilized internal environmental factors such as capital scarcity, monitoring costs, and asset specificity as moderators in order to measure their impact on organizational forms and financial performance relationship. Specifically, this study provides unique ways to measure the

internal environmental factors, organizational form, and financial performance: (1) capital scarcity was measured using financing activities data included in the statement cash flows, (2) organizational form of the firm was categorized into company-owned, franchised, and combination of both, and (3) financial performance was measured using return on investment (ROI) and growth in unit sales.

From the industry point of view, the findings of this study will aid in recognizing organizational form in conjunction with internal environment and financial performance. This study provides empirical support with regard to the relative models in predicting appropriate organizational form that will show better financial performance. In other words, the firm that evaluates and analyzes its internal environmental factors could have the adequate organizational form that generates high profitability.

From the theoretical point of view, this study provides a body of knowledge in franchising by providing empirical findings with regard to internal environmental factors in explaining the relationship between organizational form and financial performance. Furthermore, this study contributes to the existing agency theory literature in franchising by providing empirical research to the evaluative contingency theory.

ACKNOWLEDGMENTS

I wish to express my appreciation to Dr. Mahmood A. Khan. Throughout the course of my doctoral studies, he has encouraged and provided continuous support to build my scholarly interests. Without his guidance and direction, this dissertation would not have been possible.

Appreciation is also extended to Dr. Francis A. Kwansa, who inspired me and provoked my thoughts in understanding concepts and methodology, and developing measurement of capital scarcity and financial performance. His valuable advice and feedback as the co-chair of my advisory committee has made the completion of this dissertation possible.

My appreciation is extended to other advisory committee members. Dr. Ken W. McCleary has provided helpful suggestions and discussion about methodological aspects of this dissertation. Dr. James R. Brown of Department of Marketing has provided theoretical and methodological insight into this study. Dr. Kye-Sung Chon has provided invaluable guidance, confidence, and encouragement through my completion of this dissertation and has inspired me to pursue research in hospitality management at an earlier stage of my academic endeavor.

This dissertation is lovingly dedicated to my father and deceased mother who passed away on February 17, 1993. I am sorry that my mother did not live to see the completion of my Ph. D. degree, but I am sure that she would be happy and proud of my work.

I am deeply grateful to my wife, Hey-Sook, who has supported, encouraged, and always inspired me starting from my undergraduate study. Her love and patience have contributed towards what I am today.

My sincere appreciation is also extended to my daughters, Kyoung Eun (Michelle) and Gi Eun (Ginny), whose love and patience have refreshed me all the time.

TABLE OF CONTENTS

	Page
ABSTRACT	ii
ACKNOWLEDGMENTS	iv
TABLE OF CONTENTS	v
LIST OF TABLES	viii
LIST OF FIGURES	xii
CHAPTER I. INTRODUCTION	1
Problem of Statement	1
Problem Context	3
Theoretical Underpinning	5
Ownership Redirection Hypothesis	5
Agency Theory	7
Transaction Cost Analysis Theory	9
Internal Environment	12
Organizational Form	12
Performance	13
Objective of the Study	15
Organization of the Study	15
CHAPTER II. REVIEW OF LITERATURE	16
Nature of Franchising	16
Internal Environment and Organizational Form	18
Ownership Redirection Hypothesis	19
Agency Theory	21
Transaction Cost Analysis Theory	30
Internal Environment-Organizational Form-Performance	33
Summary	34
CHAPTER III. METHODOLOGY	35
Variables Operationalized	35
Internal Environment	37

TABLE OF CONTENTS (Continued)

	Page
Organizational Form	38
Performance Measurement	39
Financial Performance	40
Control Variables	41
Research Questions	42
Research Hypotheses	42
Measurement	56
Statistical Procedures	58
Research Design	60
Sample Size Selection	60
Data Source	61
Data Collection Process	62
Survey Instrument	62
Summary	67
 CHAPTER IV. RESULTS AND DISCUSSION	 69
Pretest Results	69
Data Collection	69
Response Rate	70
Characteristics of Respondents	70
Validity of the Instrument	71
Reliability of the Data	72
Survey Results	73
Profile of Participating Organizations	73
Variables	78
Hypotheses Testing	96
Follow up Analyses	105
Summary	113
 CHAPTER V. SUMMARY AND CONCLUSION	 124
Descriptive Statistics Discussed	125
Control Variables	129

TABLE OF CONTENTS (Continued)

	Page
Contribution of the Study	131
Implications of the Study	132
Limitation of the Study	133
Recommendations for Future Research	134
REFERENCES	136
APPENDICES	144
A. Percentiles for Performance (Growth-without Outliers)	145
B. Percentiles for Performance (ROI-without Outliers)	146
C. Percentiles for Internal Environment (Capital Scarcity-without Outliers)	147
D. Percentiles for Performance (Growth-with Outliers)	148
E. Percentiles for Performance (ROI-with Outliers)	149
F. Percentiles for Internal Environment (Capital Scarcity-with Outliers)	150
G. Pre-Test Questionnaire	151
H. Final Questionnaire	158
VITA	166

LIST OF TABLES

	Page
Table 1. Number and Percentage of Responding Firms by Segment	75
Table 2. Number and Percentage of Responding Firms by Years of Operation	76
Table 3. Number and Percentage of Responding Firms by Years of Franchising	77
Table 4. Number and Percentage of Responding Firms by Size	79
Table 4.1. Number and Percentage of Responding Firms by Size and Organizational Form	80
Table 5.1. Number and Percentage of Responding Firms by Capital Scarcity	82
Table 5.2. Cross-tabulation of Organizational Form by Capital Scarcity	83
Table 6.1. Number and Percentage of Responding Firms by Field Representatives	85
Table 6.2. Number and Percentage of Responding Firms by Frequency of Visits	86
Table 6.3. Number and Percentage of Responding Firms by Length of Stay	87
Table 6.4. Number and Percentage of Responding Firms by Monitoring Costs	88
Table 6.5. Cross-tabulation of Organizational Form by Monitoring Costs	90
Table 7.1. Number and Percentage of Responding Firms by Asset Specificity	91
Table 7.2. Cross-tabulation of Organizational Forms by Asset Specificity	92
Table 8. Number and Percentage of Responding Firms by Organizational Form	94

LIST OF TABLES (Continued)

	Page
Table 9. Number and Percentage of Responding Firms based on Financial Performance	95
Table 10. One-way Analysis of Variance: Organizational Form and Return on Investment	97
Table 11. One-way Analysis of Variance: Organizational Form and Growth in Units Sales	99
Table 12.1. Two-way Analysis of Variance: Organizational Form, Capital Scarcity and Return on Investment	102
Table 12.2. Two-way Analysis of Variance: Organizational Form, Capital Scarcity and Growth in Unit Sales	103
Table 13.1. Two-way Analysis of Variance: Organizational Form, Monitoring Costs and Return on Investment	104
Table 13.2. Two-way Analysis of Variance: Organizational Form, Monitoring Costs and Growth in Unit Sales	106
Table 14.1. Two-way Analysis of Variance: Organizational Form, Asset Specificity, and Return on Investment	107
Table 14.2. Two-way Analysis of Variance: Organizational Form, Asset Specificity, and Growth in Unit Sales	108
Table 15.1. Analysis of Covariance: Organizational Form with Size Dependent Variable: Return on Investment	109
Table 15.2. Analysis of Covariance: Organizational Form with Size Dependent Variable: Growth in Unit Sales	110
Table 16.1. Analysis of Covariance: Organizational Form with Years of Operation Dependent Variable: Return on Investment	111

LIST OF TABLES (Continued)

	Page
Table 16.2. Analysis of Covariance: Organizational Form with Years of Operation Dependent Variable: Growth in Unit Sales	112
Table 17.1. Analysis of Covariance: Organizational Form and Capital Scarcity with Years of Operation Dependent Variable: Return on Investment	114
Table 17.2. Analysis of Covariance: Organizational Form and Capital Scarcity with Years of Operation Dependent Variable: Growth in Unit Sales	115
Table 18.1. Analysis of Covariance: Organizational Form and Monitoring Cost with Years of Operation Dependent Variable: Return on Investment	116
Table 18.2. Analysis of Covariance: Organizational Form and Monitoring Cost with Years of Operation Dependent Variable: Growth in Unit Sales	117
Table 19.1. Analysis of Covariance: Organizational Form and Asset Specificity with Years of Operation Dependent Variable: Return on Investment	118
Table 19.2. Analysis of Covariance: Organizational Form and Asset Specificity with Years of Operation Dependent Variable: Growth in Unit Sales	119
Table 20.1. Analysis of Covariance: Organizational Form and Monitoring Cost with Size Dependent Variable: Return on Investment	120
Table 20.2. Analysis of Covariance: Organizational Form and Monitoring Cost with Size Dependent Variable: Growth in Unit Sales	121
Table 21.1. Analysis of Covariance: Organizational Form and Asset Specificity with Size Dependent Variable: Return on Investment	122

LIST OF TABLES (Continued)

	Page
Table 21.1. Analysis of Covariance: Organizational Form and Asset Specificity with Size Dependent Variable: Growth in Units Sales	123

LIST OF FIGURES

	Page
Figure 1. Propsed model of moderating effects of internal environmental factors on organizational form - financial performance relationship	36
Figure 2. Moderating effects of internal environmental factors on organizational form - financial performance relationship	130

CHAPTER I

Introduction

This chapter provides an introduction and justification for the research effort undertaken. It begins with a statement of the problem, followed by a brief discussion of the growing importance of the lodging industry and hotel chain franchises in particular. The discussion then turns to theoretical underpinnings regarding internal environment, organizational form and their impact on financial performance. Finally, this chapter discusses the objective of this study.

Problem Statement

Does the internal environment of an organization moderate the organizational form - financial performance relationship in the lodging industry? To answer this question, this study merges concepts from ownership redirection hypothesis, agency theory, and transaction cost analysis theory to franchising.

Ownership redirection hypothesis provides concepts of capital scarcity, management competence, and market information. This hypothesis predicts that chain operators would franchise early in their life cycle because of capital scarcity, a pattern that would be reversed in the direction of company ownership as the chain matures (Caves & Murphy, 1976; Oxenfeldt & Kelly, 1968-69). Dant, Kaufmann, and Paswan (1992) argued that underlying mechanisms of the ownership redirection theory have gone unexamined.

Agency theory, on the other hand, argues that monitoring costs for an agent (i.e., company-owned unit manager or franchised unit manager) are a central determinant of whether a unit will be company-owned or franchised (Brickley & Dark, 1987; Rubin, 1978).

Transaction cost analysis theory focuses on the governance of specific transactions and thus permits prediction of organizational form or ownership of particular units on the basis of their unique combination of transaction and production costs in the context of behavioral uncertainty of unit managers and transaction specific assets. Transaction specific assets are physical, human, and locational assets, which are devoted to the franchise relationship and cannot be easily transferred to other relationships (Brown & Nicholson, 1991; Williamson, 1985, 1991).

Researchers (Caves & Murphy, 1976; Hunt, 1973; Lafontaine, 1992; Lillis, Narayana, & Gilman, 1976; Martin, 1988; Oxenfeldt & Kelly, 1968-69; Ozanne & Hunt, 1971) have identified that ownership redirection hypothesis, agency theory, and transaction cost analysis theory are important theories and present internal environmental factors that should be considered when the firm is seeking to understand relationships between its organizational form and performance.

Much theory and research that apparently seeks to explain why organizations have different organizational forms in the context of ownership redirection, agency costs, and transaction cost have been addressed and applied in the other franchising business areas such as automobile and retail stores. Dev (1988) investigated the relationship between perceived environmental uncertainty, business strategy, and financial performance in the lodging industry. However, Dev's study is limited to the area of external environment. For the past decade, the relationship of organizational form or structure and its impact on performance has been proposed and tested in manufacturing industries (Beard & Dess, 1981; Child, 1975; Dess & Davis, 1984; Lenz, 1981). In addition, previous empirical studies (Carney & Gedajlovic, 1991; Hunt, 1973; Hunt & Nevin, 1975; Lillis et al., 1976; Martin, 1988) relied on survey observations collected from fast-food and convenience stores. In the lodging industry, few empirical studies on franchising have been conducted for the purpose of testing these theories. Although the findings of Dev's study (1988) indicated that a match between the state of the environment facing an organization and its business strategy was required for high performance, the relationship between the firm's

internal environment, its organizational form, and its financial performance remains unexplored. Thus, this study investigates the tenet that, for firms in the lodging industry, there exists an optimal pattern or match between the internal environmental factors and the firm's organizational form that shows better financial performance than those that do not.

Problem Context

The context of this study is the lodging industry, which has suffered a period of recession and oversupply of rooms, and has faced a number of significant challenges from competition. The lodging industry is one of the prominent industries to successfully adopting franchising. The International Franchise Association (1993) publishes a franchising survey, *Franchising in the Economy 1989-92*, which shows sales growth in hotels and motels. Based on the survey results from 12 hotels and motel franchisors, sales increased 10.2 % between 1989 and 1990, and increased 8.8% between 1990 to 1991. The survey also shows that the sales of company-owned hotels and motels increased 9.5% between 1989 and 1990, and 13.1% between 1990 and 1991.

The growth rate of company-owned units shows that it increased 16.1% between 1989 and 1990, but it increased only 6.5% between 1990 and 1991 and was projected to increase only 0.9% in 1992. The growth rate of franchised units increased 15.6% between 1989 and 1990, but it increased 49.0% between 1990 and 1991 and was projected to increase another 12.9% in 1992. This survey indicates that franchised units continued to grow during the past three years, and that they predicted relatively stable increases for following years.

An analysis (Baum, 1993) of the recent trends of the lodging industry is as follows:

"Hotel franchisors find they are competing against marketing and reservation consortia which utilize new technologies, selling strategies, and marketing concepts... Quality assurance is crucial to hotel franchisors as well as to franchisees. It is important that a property be maintained to deliver a high level

of customer satisfaction and to sustain a brand name and image over time. Financing of refurbishment is a major concern of hotel franchisors" (pp. 48-53).

Powers (1992) stated that the practice of treating a franchise system as a financial asset to be bought or sold, as has happened with Holiday Inn, Ramada, and Howard Johnson franchises as well as with other companies, may have undermined stability for some franchisees. He further asserted that while franchising is regarded as a means for trademark franchisors to obtain needed capital at favorable rates, especially early in a firm's life and during tight credit markets, hotel chains often provide franchisees with start up capital and established hotel chains continue to franchise units.

Olsen and Merna (1991) also asserted, "franchising always has been a powerful way of growing chains in the hospitality industry. It will continue to be an important growth vehicle throughout the decade and beyond. This will be so because when funds from capital markets become scarce, as they are at present, it is often only the franchisee who possesses a strong net worth to capitalize a deal and build a hotel."

Franchisors are often interested in maximizing revenues of the franchise system while franchisees are concerned about increasing net profits (Parsa & Kwansa, 1991). Financial performance of hospitality firms in the past decade has not been stellar due to increased competition in the industry. In addition, as the lodging industry is highly susceptible to the customers' demands and economic cycles, the current recessionary times require closer analysis of the financial performance of the organization. There is an increasing need for analyzing performance and organizational form in franchise systems that are appropriate for the slow growth economic conditions. Increasing merger and acquisition activities of the past decade also demand a new look at ownership type.

Though the importance of franchising in the lodging industry has been recognized by operators and researchers for a long time, none of the prior literature has analyzed the question of why so many lodging firms which choose to franchise also continue to operate a significant number of their outlets through company-owned units (Beheler, 1991; Henson & Pilling, 1992; Lafontaine, 1992; Wu, 1991).

As the industry continues to experience severe competitive pressures and a sluggish economy, it needs to adapt to environmental changes and acquire greater understanding of the nature of organizational form in the context of theoretical underpinning such as ownership direction hypothesis, agency theory, and transaction cost theory.

Theoretical Underpinning

Any explanation of franchising must account for the coexistence of franchisor and franchise (Minkler, 1992). For a franchisor, a decision to franchise or to own is critical to expanding its units and maintaining its brand name. Previous studies related to a firm's decision to franchise have advanced arguments to explain why franchising has become a popular form of organization and to analyze the economic and administrative significance of many terms observed in franchising agreements. The theme that has attracted probably the most theoretical and empirical interests of economists and marketing researchers can be divided into the following elements: ownership redirection hypothesis, agency theory, and transaction cost analysis theory.

Ownership Redirection Hypothesis

The ownership redirection hypothesis states that franchising is a transitory organizational form primarily useful to alleviate capital and managerial talent constraints in the early stages of developing a network of units, and the proportion of franchise units to total units would be varied or decreased as the chain matures (Caves & Murphy, 1976; Hunt, 1973; Lafontaine, 1992; Lillis et al., 1976; Martin, 1988; Oxenfeldt & Kelly, 1968-69; Ozanne & Hunt, 1971). Oxenfeldt and Kelly (1968-1969) contended that most successful franchise systems would evolve into largely company-owned chains, and only low-performing and marginal sites are expected to continue to be relegated to franchisees, since their low profitability would make such reacquisitions uneconomical.

Hunt (1973) also found that over a ten-year period, the percentage of franchisor (company)-owned units increased compared to those owned by franchisees. Caves and Murphy (1976) argued that franchisors weigh the potential returns from a change to company ownership (i.e., unit profits less current royalties from franchised operation) against the investment cost of reacquiring the franchise. In addition, Caves and Murphy (1976) found by comparing the average sales volume of franchise and company-owned establishments of 20 sectors between 1969 and 1973 that sales in average franchised establishments are smaller than sales of company-owned units across sectors.

This explanation maintains that franchising is a means for trademark owners to obtain needed capital at favorable rates, especially early in a firm's life and during tight credit markets. Oxenfeldt and Kelly (1968-69: 74) stated, "Initially many franchisors establish franchises in order to penetrate the markets as widely and rapidly as possible.... Once the desired initial coverage is attained, their emphasis usually shifts toward operating efficiencies and market development." Franchising, according to this hypothesis, is useful to firms primarily in the early stages of development when they attempt to rapidly develop a successful reputation and a network of units.

Even though a franchise distribution system offers some advantages to a franchisor as an adaptive mechanism to be utilized for finding capital to expand the growing franchise network, rapid access to markets, risk sharing within the channel, and highly motivated owner-operators, most researchers have taken the position that these advantages are most important only in the short run for market entry or expansion and have dealt with the topic of a trend toward increased franchisor operation of franchised units (Caves & Murphy, 1976; Hunt, 1973; Lafontaine, 1992; Lillis et al., 1976; Martin, 1988; Oxenfeldt & Kelly, 1968-69; Ozanne & Hunt, 1971).

Lillis et al., (1976) stated that as markets mature, franchisors operating under increasingly more favorable conditions would logically reduce the number of franchised units in favor of more easily controlled company-owned units. Minkler (1992) also argued that franchising might exist because franchisees have superior knowledge about local

markets and enjoy low search costs relative to the franchisor. In other words, franchisees have managerial competence in the context of local suppliers, marketing strategies, and consumer preferences. He also stated that the cost of information about local market conditions may be quite high and is likely to be higher in unfamiliar and volatile local markets. He further stressed that one way to minimize the cost is to enlist the services of local agents - franchisees - who possess decentralized knowledge of local markets. Therefore, the proportion of franchised versus company-owned units depends upon the firm's capital constraints, managerial competence, and market information, all of which are internal environment factors of the firm.

The basic proposition in ownership redirection hypothesis is that a firm's ability to expand its units or growth of units is limited (contingent upon) by capital scarcity, managerial competence, and market information for the local area. These internal environment factors influence the organizational form of a firm.

Agency Theory

Agency theory states that the agency problem which is the problem of monitoring the behavior and performance of a unit manager (an agent) is the key determinant of the organizational form (Alchian & Demsetz, 1972; Brickley & Dark, 1987; Carlin, 1989; Jensen & Meckling, 1976; Martin, 1988; Norton, 1988; Rubin, 1978).

The agency problem literature (Alchian & Demsetz, 1972; Blair & Kaserman, 1982; Brickley & Dark, 1987; Brickley, Dark, & Weisbach, 1991; Caves & Murphy, 1976; Jensen & Meckling, 1976; Martin, 1988; Mathewson & Winter, 1985; Norton, 1988; Rubin, 1978) contains two important considerations for the own/franchise decision. These are shirking by unit managers and the free-rider problem created by the residual claimant who bears the benefits and profits of performance and ownership elements of franchising agreements.

First, the residual claimant and ownership rights give franchisees less of an incentive to shirk, and therefore franchisees should require less monitoring than company-owned managers. Rubin (1978) and Mathewson and Winter (1985) suggested that franchising exists to ameliorate agency problems inherent in fixed wage contracts when there is costly monitoring and diffuse production and distribution. Martin (1988) argued that geographic dispersion of products and services creates special monitoring problems for the firm and that managers of company-owned units may shirk since their supervisors are not in permanent residence. Thus, monitoring cost explanations focus on the moral-hazard problem inherent in fixed-wage contracts with company-owned managers and the consequent need for some kind of monitoring.

Second, the residual claimant may give franchisees an incentive to free-ride -- an incentive to supply lower-quality products and services and to disregard the integrity of the chain (Mathewson & Winter, 1985). Klein (1980, 1985) also discussed the role of monitoring in franchising. The author identified the potential incentive for franchisees to free-ride on the overall reputation of a chain when customers purchase from more than one franchised unit. A franchisee's opportunistic behavior could cut cost and thereby supply a level of performance lower than that anticipated by customers, which would deteriorate reputation of all units in the chain. Thus, this free riding problem would increase the monitoring cost of franchisor or hotel chain.

Since production and distribution occur at many different locations, information about outlet-operator performance is asymmetrical (Rubin, 1978). Alchian and Demsetz (1972) examined these problems in the context of monitoring costs in their paper on the theory of the firm. These authors stressed that units with low monitoring costs should be company-owned because company-owned units require relatively more monitoring to assure performance, while those units more costly to monitor should be franchised because franchisees have very little incentive to shirk since they will suffer financially from any loss of business due to their shirking. Thus, franchised units require less monitoring to assure performance.

The basic proposition in agency theory is that a firm's ability to expand its units is limited (contingent upon) by opportunistic behavior of agents (unit managers). In other words, the organization form of a firm will be determined by the monitoring costs for opportunistic behavior of its agents.

Though existing empirical work on franchising has examined the way in which franchisors use company-owned and franchised units in the context of agency problems (Brickley & Dark, 1987; Brickley et al., 1991; Goldberg, 1982; Martin, 1988; Norton, 1988), none of these models has been applied to the lodging industry.

Transaction Cost Analysis Theory

Transaction cost analysis provides another perspective to understand the factors shaping organizational form. Many are derivable from the most abstract transaction cost perspective reported by Williamson (1975, 1985, 1991). An analysis of transactions focuses on achieving efficiency in the firm's administration. Transaction cost analysis provides insight into the franchise ownership and focuses on the governance of specific transactions and thus permits prediction of the organizational form of particular units on the basis of their unique combination of transaction and production costs (Williamson, 1975). In other words, the basic premise of transaction cost analysis is that the firm's decision on organizational form depends on the comparative transaction costs, that is, the costs of running a system, including the *ex ante* costs of negotiating a contract and the *ex post* costs of monitoring the performance and enforcing the behavior of the parties to contract (Williamson, 1985). Williamson (1979) used franchising as an example of a hybrid form of contractual integration which provides a solution to certain unstable market relationships. Jones and Hill (1988) viewed the economic transaction as the fundamental unit of analysis, a transaction being an exchange of goods or services from one party to another.

In its most general formulation, transaction cost theory holds that activities will be organized optimally when they minimize the production costs and economize the transaction costs involved in producing the desired outcome. The factors associated with transaction costs that determine the optimal level and shape of formal organization form include asset specificity, uncertainty, and frequency of transaction. The central paradigm is whether a given transaction can be undertaken at a lower cost via a market or within a hierarchy (firm). If the costs of undertaking transactions via the market are high, then the firm can gain economic benefits by internalizing the transaction within its own organization. Therefore, economic benefits from transaction cannot be obtained without associated costs. Firms must trade off the value or benefit of the assets from different organizational forms against the costs that must be incurred to realize the value of assets. It is necessary, therefore, to analyze the transaction cost in organizational form. The basic proposition in transaction cost analysis is that a firm's ability to expand its units or growth of units is limited by trading off the value and cost of the units.

Asset specificity

Transaction specific assets are nonredeployable physical and human investments that are specialized and unique to a task (Williamson, 1985). In the context of franchising, franchisees who invest in developing the franchisor's concept in their location or territory are creating value which attaches solely to the franchisor's trademark, therefore, the units are called transaction specific assets (Williamson, 1975).

The franchisee is presumed to be willing to create specific assets because of the license to use the franchisor's trademark for the period of the agreement. The franchisor, in turn, permits the franchisee to share in the value of the trademark in return for royalties and the franchisee's continued help in developing that value. However, the franchisee may be in danger of opportunistic termination.

If the franchise is terminated, all the goodwill which has been created in that market can be appropriated by the franchisor, leaving the franchisee with nothing. If the franchisor considers the value created *ex post* to be great enough to overcome the costs of termination, the franchisor may be tempted to reacquire the unit (Dant et al., 1992). Carney and Gedajlovic (1991) also advocated that much of the investment a franchisee makes is in dedicated assets (e.g., a uniquely designed building) with no alternative use and low salvage value.

Thus, transaction cost theory predicts that firms integrate when asset specificity is high, because the higher costs of vertical integration are more than offset by the benefits flowing from such an arrangement. This means, where a unit provides additional values deriving from location, human, and facility oriented factors, franchisors would prefer to own that unit rather than franchise it. When specificity is low, firms refrain from integration because the benefits of control fall short of the costs of attaining it (Erramilli & Rao, 1993).

Behavioral uncertainty is another principal factor involved in transaction cost analysis. John and Weitz (1988) asserted that behavioral uncertainty arises within the context of the exchange itself due to the opportunistic inclinations of the transacting parties. They contended that behavioral uncertainty refers to the difficulty of ascertaining the actual performance or adherence to contractual agreements. They further asserted the importance of greater control or monitoring units over agents activities. This is consistent with opportunistic behavior of agents.

The transaction cost analysis would imply opportunistic behavior of the franchisor in determining the organizational form. Therefore, the transaction cost analysis develops a theory of choice which explains not only why hotel chains have certain ownership, but also why hotel chains change from one ownership to another.

Internal Environment

The environment has considerable influence upon a firm's choice of an organizational form. There are a number of factors that should be evaluated before a firm selects organization form: (a) financial soundness, (b) marketing, and (c) human environment. These factors collectively represent internal environment (Henry, 1981). In other words, these include people and managerial talent as well as financial assets, plant facilities, and functional area skills and abilities. In order to survive in a competitive and sluggish economy, to provide goods and services to customers effectively, and to ensure its efficiency, the firm must analyze and utilize its internal environment properly and adopt the appropriate organizational form.

Ownership redirection hypothesis, agency theory, and transaction cost analysis provide the sources for the internal environment factors that affect the organizational form of the firm.

Organizational Form

Hotel chain franchises are organized and managed using these organizational forms: company-owned, franchise, or combination of both. Franchisors or hotel chains generally tend to operate their units using either company-employed managers or franchisees. The former units are referred to as company-owned and the latter units are referred to as franchised throughout this study.

Organizational form can be defined as the result of a balanced consideration of a franchisor's ability and internal environment. Rumelt (1974) stated that organizational form consists of systems of control, planning and information flow, methods of reward and punishment, the degree of delegation and techniques of coordination.

Dispersion, expansion, and new business activity may be related to the understanding of a different production and service technology, of different marketing concepts and

methods, of investment decisions, planning, control, and market information, because the environment of the new areas is uncertain, complex, and volatile (Henry, 1981). Thus, the franchisor has to identify internal environmental factors of its firm that would impact upon the choice of organizational form.

Performance

The franchise system is regarded as a portfolio of operating units that continually adjust to reflect changing costs and revenues (Anderson, 1984). Oxenfeldt and Kelly (1968-1969) state:

Initially many franchisors establish franchises in order to penetrate the market as widely and rapidly as possible, . . . Once the desired initial coverage is attained, their emphasis usually shifts toward operating efficiencies and market development. (p.74)

The implication of their theory of franchise development is that successful franchise systems would tend toward complete ownership. Hence, as capital and management constraints are eased, franchisors would become more concerned with performance.

Stern, El-Ansary, and Brown (1989) suggested that performance is a multidimensional concept. The performance of distribution channel structures and institutions is evaluated in terms of (a) system effectiveness, (b) system equity in serving various markets, (c) system productivity, and (d) system profitability.

Empirical studies done in the area of the franchise system examine the relationship between organizational form and performance (Anderson, 1984; O'Hara & Musgrave, 1990; Thomas, O'Hara, & Thomas, 1986). Rubin (1978), Shelton (1967), and Wattel (1968) have suggested that entrepreneurial franchisees will have a greater profit orientation relative to the hired managers of the company-owned units and, therefore will outperform the latter. Marquardt and Murdock (1986) argued that franchisee-run units tend to outperform company-owned units because franchisees are motivated to work

harder due to their equity investments being at risk. However, Martin (1988) found the company-owned units outperformed the franchised units by a three-to-one ratio in fifteen out of sixteen sectors examined. Caves and Murphy (1976) proposed that ownership redirection will be selectively implemented so that the repurchased units provide above average returns on investments for the franchisor, even if they have provided average returns on investment for the franchisee.

Research evidence appears inconclusive regarding which has the better financial performance-franchisee-units or company-owned units-and this argument will be explored in the rest of the study by examining the performance of each form.

Existing research on franchising focuses largely on explaining the fit between the internal environment of the firm and its organizational form. This stream of research has investigated whether the firm adopts proper organizational form in the context of its internal environmental factors such as capital scarcity, monitoring costs, and transaction specific asset. Furthermore, researchers have predicted that the firm's financial performance will be higher when the firm's organizational form matches its internal environment.

To date, however, no study has investigated the relationship between ownership and performance in the lodging industry. Specifically, the ownership redirection hypothesis, agency theory, and transaction cost theory have not been tested and applied to the lodging industry. Accordingly, the aim of this study is to test whether organizational form and financial performance (profitability), which will be measured by return on investment and growth in unit sales, are related in the lodging industry, particularly in hotel chain franchises. Furthermore, this study investigates the tenet that there exists a match between internal environmental factors and a firm's organizational form. It has been assumed that if there is a match between internal environmental factors and organizational form, the firm would have better financial performance than if there is no such match.

Objective of the Study

The main objective of this study is to examine how the internal environment of an organization combines with its organizational form to affect financial performance in hotel chain franchises. Specifically, this study will seek to determine if there is: (1) a difference in the financial performance of hotel chains which are company-owned versus those which are franchised and (2) a relationship between internal environment and organizational form, and its effect upon the financial performance of franchising chains in the lodging industry.

Organization of the Study

Chapter One has provided a problem statement, problem context, theoretical underpinning, and objective of the study. In Chapter Two, major concepts related to internal environment, organizational form, and financial performance are described. Previous empirical research studies and findings relevant to the study are also reviewed. Chapter Three presents a model that describes the moderating effect of internal environmental factors on organizational form - financial performance relationship. On the basis of existing concepts and theories, research hypotheses are presented in Chapter Three. Chapter Three also discusses research design, methodology, and data collection. Chapter Four presents the results of hypothesis testing and provides the discussion of the results. In Chapter Five, findings from the data analyses are summarized and reviewed in the context of the model. Chapter Five also presents the contribution of the study, limitation, and managerial and theoretical implications. Finally, Chapter Five offers suggestions for future research.

CHAPTER II

REVIEW OF LITERATURE

Introduction

This chapter attempts to examine the relationship between internal environment and organizational form, and its impact on financial performance. An overview of the literature on franchising, as well as research in the broader topic area of organizational form is also presented. In addition, various theories on ownership direction, agency problem, and transaction specific asset are discussed. Particular emphasis is placed on conceptual developments related to the relationship of internal environment, organizational form, and its impact on financial performance.

Nature of Franchising

Hotel chains are organized and managed using two distinct organizational forms: company-owned units or franchised units.

Franchising is a form of licensing by which the owner (the franchisor) of a product, service, or method obtains distribution through affiliated dealers (the franchisees). The International Franchise Association (1990) defines franchising as "a continuing relationship in which the franchisor provides privilege to do business, plus assistance in organizing, training, merchandising, and management in return for a consideration from the franchisee."

Over the last two decades, franchising has emerged as a popular expansion strategy for a variety of product and service companies, especially for smaller businesses that cannot afford to finance internal growth (Sherman, 1991).

From the perspective of the franchisor (Knight, 1986), franchising represents an efficient method of rapid market penetration and product distribution without the typical

capital costs associated with internal expansion. However, a growing number of franchisors--because they are undercapitalized or poorly counseled--place too great an emphasis on franchise sales rather than on franchise support and services. This will have a negative affect on the future growth of franchising. Franchisors who develop strategic plans which focus on quantity of franchisees and expansion, rather than on quality of franchises and training, are surely headed for conflict. However, franchising offers the owner a way to grow the chain without incurring large capital costs. It also offers faster expansion with no capital outlay for the franchisor (Stecker, 1993).

Shelton (1967) provided indirect evidence consistent with the belief that franchisees are better able to minimize the agency problems present in franchising chains. He obtained company records on a subset of restaurant units within the same chain which were operated under franchised and company-owned. His principal findings were as follows:

1. In 19 of the 22 restaurants where the type of management changed, profit margins were higher under franchisee operation.
2. Weekly sales at company-owned restaurants were, on average, 99.6 percent of the sales rate achieved at franchised units.
3. Profit margins, on average, were 5 times as great at franchised units as at company-owned units (9.5 percent vs. 1.8 percent).

These findings are supportive of the idea that franchisees have better incentives to maximize profits and therefore require less monitoring by the franchisor relative to company-owned units.

According to Mescon (1979), the entrepreneur views franchising as a tool to enhance competitive position. The franchisee shares the risk of expanding the market share of the franchisor by committing the capital and resources to the development of satellite locations modeled after the proprietary business format of the franchisor. The risk of business failure by the franchisor is further reduced by the improvement in competitive position, reduced vulnerability to cyclical fluctuations, the existence of a captive market for the franchisor's proprietary products and services, and the reduced administrative and overhead costs enjoyed by a franchisor (Sherman, 1991). Foster (1987) presented the

three main ingredients of a modern franchise: (1) an identity, based on a trade name protected for exclusive use by the franchise holders, (2) an operating system, or business format, ready to be transferred to the fee-paying franchise, and (3) a continuous financial relationship, usually a lump sum paid in advance, plus an ongoing royalty based on an established percentage of gross revenue. Foster also said that the franchisee is an independent business owner who contracts with the franchisor to obtain the right to put these ingredients to use. The franchisee provides nearly all the working capital to establish and develop the outlet. The franchisor supplies the idea, an established identity, a fine-tuned operating system, and the product.

According to Khan (1992), the franchisor has company-owned units for the following reasons: (1) the franchisor will be aware of the operational aspects of the units, (2) the franchisor will be conscious of the costs involved in the units, and (3) the franchisor will have an exact idea as to how franchisees may feel about proposed changes. Oxenfeldt & Kelly (1968-1969) and Brickley and Dark (1987) studied the two primary streams (whether each individual unit should be owned or franchised) of research in the chain organization. Monteverde and Teece (1982) also studied whether firms make or buy parts and Anderson and Schmittlein (1984) researched whether the firm uses direct or third party sales forces.

Internal Environment and Organizational Form

Henry (1981) stated that the internal environment of the firm has considerable influence upon a firm's choice of an organizational form. The internal environmental factors that should be evaluated before a firm selects its organization form are: (a) financial soundness, (b) marketing, and (c) human environment. More specifically, the internal environment factors include human assets such as managerial talent, as well as the skills and abilities of managers, capital, and plant facilities and services.

Ownership redirection hypothesis, agency theory, and transaction cost analysis present the internal environment that affects the organizational form of the firm. These three theories propose variables that might account for the observed variance in the organizational form. The underlying logic of the internal environmental factors and the organizational form can be traced in the literature.

Ownership redirection hypothesis

The ownership redirection hypothesis predicts that franchising is an organizational form used to alleviate capital scarcity that many firms face in the initial stages of developing a successful network of retail outlets. One of the most difficult tasks faced by the management team of a growing franchise is the development and maintenance of optimal capital for the organization. The capital requirements of the early-stage and emerging franchisor are very critical (Sherman, 1991). While it is true that franchising is less capital-intensive than the construction of additional company-owned sites, the initial startup costs for legal, accounting, and consulting fees can be extensive. Foster (1987) stated that the most common franchise fees that are collected by the franchisor consist of three parts: (a) an initial payment due on signing of the franchise agreement; (b) a continuous royalty, usually charged on the gross revenues of the outlet; (c) a royalty or contribution to a cooperative advertising fund. The Uniform Franchise Offering Circular (UFOC), which all franchisors are required to prepare, must indicate the franchisee's total initial investment. The investment breakdown includes the initial fee, the cost of procuring and developing a site, and the cost of all equipment, leases, fixtures, and inventory required to operate the business. Therefore, franchising provides less capital constraint to the franchisor. However, in contrast to Shelton's (1967) assertion that franchised units had better incentive to maximize profits than company-owned units, according to Caves and Murphy (1976), company-owned units were in most cases more profitable than franchised units.

Oxenfeldt and Kelly (1968-1969) found that a franchisee's desire to continue in the franchisor's system diminishes as the system matures. Hunt (1973) found that, over a ten-year period, the percentage of franchisor (company) owned units increased compared to those owned by franchisees. Lillis et al., (1976), in a study of competitive advantage variation over the life cycle, found significant differences in the perceived importance of owning a franchise in the various stages of the life cycle. These studies tend to suggest that the number of franchise units will decline as a firm moves along the growth stage of a product life cycle and has less capital scarcity.

Hunt (1973) attempted to test the ownership redirection theory advanced by Oxenfeldt and Kelly (1968-1969). Hunt surveyed franchisees and franchisors in three lines of business with franchising: fast food, convenience grocery, and laundry/dry cleaning. He computed various statistics on the aggregate data he collected from the fast food industry in the late 1960's. His principal findings were: (1) franchisors appeared to be increasing the proportion of internally managed units over time, (2) older and larger chain tended to have a higher proportion of company-operated outlets, and (3) the source of most company-owned unit expansion was not through franchise buy backs but instead from new unit construction. The author himself concedes that the majority of company-owned unit expansion occurred through new outlet openings rather than buy back conversions as predicted by the ownership redirection theory.

Franchisors cite three favorable reasons for company-owned units: (1) by paying company-owned unit managers a salary instead of profits, as with a franchisee, a franchisor frequently can retain more of the profits generated by its units; (2) the company-owned unit allows the franchisor to retain stronger control over its managers; (3) the company-owned unit completely avoids potential antitrust and other legal conflicts which may arise between franchisee and franchisor.

Several reasons were given by the franchisors surveyed (Lafontaine, 1992) as their primary motivation for operating franchised outlets: (1) franchisees have entrepreneurial drive and they are a source of new ideas for the system, and (2) remotely located

individual units may be prohibitively costly to monitor and more efficiently run if franchised to an individual operator.

In summary, it is possible that franchisors utilize franchisees at an early stage of development to overcome alleged capital and managerial constraints. However, there is no existing persuasive empirical support for the proposition that franchisors will subsequently buy back outlets once the alleged capital scarcity is relaxed. Recent research has cast doubt on the ownership redirection theory. Anderson (1984), Carney and Gedajlovic (1991), and Martin (1988) find no such shift from franchise to company ownership. The ownership redirection hypothesis proposes that the organizational form of the firm (whether the firm has company-owned or franchised units) will be determined by capital scarcity.

Agency Theory

The second theory is that franchising is an optimal solution to the agency problem that can plague the use of salaried managers in company-owned units. Agency theory has spawned a large amount of recent research in economics, finance, and law. As noted by Caves and Murphy (1976), a franchise agreement has two primary features: the operation of a decentralized production or distribution process and the rental of an intangible proprietary asset called a trademark or brand name. A franchisor has to monitor the units to assure and to sustain the strong brand name in order to maintain or increase the quantity of customers that a franchised unit serves. Foster (1987) argued that a franchisor offers the good name in the industry. A successful identity is one of the hallmarks of the franchise offering; therefore the franchisor must be capable of substantiating its value. The worth of a franchise identity is also derived from the recognition, reputation, and goodwill of the franchise organization.

Company operation, according to the agency problem, is only attractive when outlets are relatively easy to monitor or where franchisees would be likely to free-ride

opportunisticly on the brand name reputation of other operators. This free-riding problem has been hypothesized by several authors (Brickley & Dark, 1987; Rubin, 1978) to be most likely at locations where the probability of location specific repeat purchase is low (for example, at a fast food restaurant and a motel located along a rural interstate highway). Klein (1980) stated that given the difficulty of explicitly specifying and enforcing contractually every element of quality to be supplied by a franchisee, there is an incentive for an individual opportunistic franchisee to cheat the franchisor by supplying a lower quality of product than contracted for. This franchisee's opportunistic behavior will deteriorate the brand name and influence the other franchisees' sales and market share and hence provide the negative impact on the profit stream of the franchisor.

Many owners of growing companies fear that the decision to franchise would result in the loss of quality control over the operations and management of their business. By establishing and enforcing quality control standards, a franchisor not only assures uniformity of quality, but also satisfies an obligation imposed by law upon the owner of trademark.

In contrast to the ownership redirection literature discussed previously, authors (Brickley & Dark, 1987; Rubin, 1978) have recognized that there are costs and benefits associated with using franchisees. These predictions generally involve the comparative amounts of monitoring necessary to oversee franchised and company-operated outlets, and the influences on the organization form caused by potential free-riding problems.

According to the literature (Caves & Murphy, 1976; Klein, 1985; Rubin, 1978) on the agency problem, franchising appears to be a useful method of internalizing the costs of shirking or perquisite-taking to the unit managers. More specifically, franchisee managers are less likely to shirk relative to company managers primarily due to differences in the nature of franchise versus employment contracts. Franchise contracts usually contain a number of terms which distinguish them from typical employment contracts. Franchisees frequently pay a franchise fee to the franchisor initially. Franchise contracts are long-term in nature with a typical duration of 10 or more years. At expiration of the contract, the

franchisor has the choice of renewing or terminating the agreement. Most franchise contracts include a monthly royalty payment which is a specified percentage of the franchisee's sales. Minimum quality standards and required operating procedures are frequently specified explicitly in the franchise agreement. According to most agreements, failure to meet these standards or follow specified procedures can result in termination of the franchise.

There are three main differences between franchisee and company manager contracts. Most obvious is the residual claimant status granted to franchisees, but not to company managers. Franchisees receive the profits of their outlets. Company managers as employees of the franchisor do not receive any residual from the outlets they manage unless specified by the franchisor. Another difference is that franchisees own many of the assets and any goodwill associated with their own outlet. A final distinction is the ease with which the franchisor can terminate each type of manager. Company managers can be fired on short notice, whereas franchisees can only be terminated after thirty days' notice. It should be noted, however, that while franchisees cannot be terminated as easily as company managers, termination is much more costly to a franchisee through forfeited security deposits and any non-salvageable specific investments incurred.

Each of these differences generates agency implications between a franchisor and franchisee or company managers. Franchisees will require less monitoring against shirking behavior relative to company managers because of their residual claimant and outlet ownership rights. Franchisees have very little incentive to shirk since they will suffer financially from any loss of business. Residual claimant rights, however, can also create a detrimental incentive for franchisees to free-ride, especially if their customers have a low probability of repeat purchasing. The threat of termination of the franchise can mitigate this incentive to a great degree if franchisees have made sufficient non-salvageable investments. Alternatively, company managers have more incentive to shirk without residual claimant and ownership rights and therefore require substantial monitoring by the franchisor. Company managers, like franchisees, can be discouraged from shirking via the

threat of termination (and the implicit loss of future promotions) by the franchisor. However, company managers, if fired, will not suffer as great a financial loss as a terminated franchisee. In contrast to the existing theory on the agency problem, Brickley and Dark (1987) found that the likelihood of franchising actually involves the incentives of franchisees to shirk on quality when they serve customers who are unlikely to make repeat purchases at their particular units.

A franchisor must conduct significant amounts of on-site observational monitoring to ensure that company managers and franchisors do not shirk. The agency problem associated with company manager contracts described earlier suggests that company outlets will require relatively more monitoring to ensure performance. Because this monitoring requires supervisor visits to individual outlets, significant economic scale in monitoring may be created if company outlets are located near one another.

Several authors (Caves & Murphy, 1976; Ozanne & Hunt, 1971; Rubin, 1978) from the capital constraint literature on franchising have recognized that the costs of company outlets may be reduced in areas with high company outlet densities. Many of these authors use a hypothetical example of high outlet densities developing primarily in urban areas as a chain matures. According to this argument, the franchisor initially franchises individual outlets in urban areas until a sufficient density of outlets is achieved. Thereafter, the franchisor repurchases the cluster of outlets for conversion to company-operation, thereby realizing a cost-reducing economy of scale in monitoring.

Brickley and Dark (1987) obtained location and ownership form data on 36 franchise companies from a variety of industries (10,524 units in all). They attempted to test empirically the theory that outlet locations which are more difficult to monitor are more likely to be franchised. The authors hypothesized that the cost of monitoring an outlet is positively related to the distance between the outlet and the nearest monitoring headquarters (typically the nearest regional office of the franchisor). Moreover, Brickley and Dark (1987) attempted to indirectly test the hypothesis of Rubin (1978) and others that the cost of monitoring company-operated units is lower in urban areas. Brickley and

Dark (1987) have provided suggestive empirical support for the agency problem by finding that internally-managed units were more likely in the more populated counties. For a majority of the cases in their sample, they found that franchised units were on an average (and to a statistically significant degree) located farther from the monitoring headquarters than company-operated outlets. They also estimated the following equation and found results that were supportive of the agency argument of 36 franchise companies:

$$F = .488 - .029 \text{ LOG POPULATION} + .092 \text{ LOG DISTANCE}$$

Where: F = 1 if franchised, 0 if not.

LOG POPULATION = population (in thousands) of county where unit is located.

LOG DISTANCE = miles to nearest monitoring headquarters.

All coefficients were statistically significant and the regression R-squared equaled 0.23. The negative sign on LOG POPULATION is consistent with the view that outlet densities are greater in urban areas and these clusters generate economies of scale in monitoring company-operated outlets.

To test the free-riding implication, the authors assumed that outlets located within one mile of a freeway exit were more likely to cater to low repeat purchase probability customers. The authors found the following results using their data:

$$F = -.002 - .026 \text{ LOG POP.} + .139 \text{ LOG DIST.} + .171 \text{ FREEWAY}$$

Where: FREEWAY = 1 if an outlet is located within 1 mile of freeway exit, 0 if otherwise.

The LOG DISTANCE and FREEWAY coefficients were significant and the LOG POPULATION variable was marginally significant. The regression R-squared equaled 0.31. The positive sign on FREEWAY suggests the opposite of the free-rider prediction: Low probability of repeat purchases locations are more likely to be franchised. These results provide suggestive, but not conclusive, support for the monitoring cost and a somewhat ambiguous test of the free-rider implication. The LOGDISTANCE variable

used by Brickley and Dark (1987) may not be a very good proxy of a franchisor's true monitoring costs. One could expect to find monitors employed by the franchisor spending much of their time "in the field" closely observing outlet managers' performance. These monitors will most likely be responsible for policing specified regions or areas of outlets. With time spent in the field, monitors may not operate exclusively from the franchisor's headquarters and will probably be located closer to their areas of responsibility. Hence it may not be correct to assume that monitoring costs are a positive function of distance.

While the distance variable used by Brickley and Dark (1987) has at least some intuitive appeal, their test of the free-riding implication of Caves and Murphy (1976), Klein (1985), and other authors is somewhat less defensible. Units located near freeway exits possibly serve transient customers, but the mere proximity of a freeway does not guarantee the presence of low probability of repeat purchase problems. Given the shortcomings of the FREEWAY variable, it cannot attach much significance to Brickley and Dark's alleged refutation of the free-rider hypothesis. However, the data presented herein provide a much more rigorous test of the economies of scale in monitoring hypothesis: the potential returns to outlet concentration are measured using the actual density of company-owned outlets surrounding each unit. This measure provides a much more direct test for the existence of scale economies in monitoring.

Since franchisees do not require as much observational monitoring as company managers, it is less likely that there will be significant monitoring economies created by locating franchised units near one another.

Previous authors have also identified the potential incentive for franchisees to free-ride on the overall reputation of a chain. The essence of this argument is as follows. Franchisees share a common brand name or reputation for providing a uniform level of performance across all units of the franchise system. Consumers expect the same level of performance from a successful franchisor's outlets regardless of the particular location visited. However, a franchise could cut cost and supply a level of performance lower than anticipated by consumers which would damage the reputation of all units in the chain.

Franchisees who cheat by decreasing quality are free-riding on the reputation of other outlets in the chain. The increase in profits generated by this strategy (through lower costs of producing substandard quality) provides the franchise with the potential incentive to free-ride. This type of free-rider problem is likely to be greatest at locations where the clientele consists primarily of mobile or non-repeat purchase type customers. Customers who purchase frequently from the same location or firm in essence "police" the performance of a seller. If dissatisfied, these customers will no longer purchase from a seller who performs (or sells goods) at a level lower than anticipated.

Goldberg (1982) recognized that franchisees, at least initially, have superior incentives to perform relative to internal management due to the nature of franchise contracts. As a chain matures and the number of outlets expands, however, Goldberg suggested that franchisee free-riding problems and conflicts between franchisor and franchisee could mount, resulting in a greater reliance on company operation. His argument is as follows: as the number of outlets increases, the franchisor will have a more difficult time of monitoring franchisees. Also the reputation of a successful chain will become more valuable over time (and as the number of outlets grows), creating a progressively greater incentive for franchisees to free-ride. Furthermore, as franchisees gain experience over time, they will become less dependent on the franchisor for managerial advice and assistance and will want to make their own decisions (i.e., with respect to pricing policy, product selection, etc.,).

Goldberg (1982) empirically tested his argument using a dataset of 25 restaurant industry franchisors during the period of 1960-1979. He estimated several specifications of his logit model with the following equation representative of his results:

$$\text{LOGPROP} = -1.430 + .0113 \text{ STATLAW} + .141 \text{ CASE2} + .143 \text{ TAX1} + .334 \text{ PUBLIC} + .203 \text{ ACQUIRED} + .074 \text{ AGE} - .0018 \text{ AGE2} + .000015 \text{ AGE3} - .000018 \text{ NSTORE} + \text{FIRM SPECIFIC DUMMIES}$$

Where:

LOGPROP = $\log(\text{prop}/(1-\text{prop}))$ and prop = proportion of outlets company owned.

AGE	= company's age.
NSTORE	= total number of outlets in chain.
STATLAW	= percentage of total number of outlets in industry which were in existence at the time a new state franchising law went into effect.
CASE2	= firm-specific dummy variable indicating whether the franchisor sold inputs to franchisees.
TAXI	= time-specific dummy variable indicating a change in the tax treatment of a franchisor's income (1969).
PUBLIC	= firm-specific dummy variable indicating year the company issued stock and became listed on a major stock exchange.
ACQUIRED	= firm-specific dummy variable indicating the year the company was acquired by another firm.

The intercept, STATLAW, PUBLIC, ACQUIRED, AGE, NSTORE, and the firm-specific dummies were significant at the 10 percent level or better. The regression R-squared was 0.85.

Goldberg (1982) claimed these results support his hypothesis, and, because of interactions between the maturity of a franchise system and the extent of free-rider problems, franchisors will turn to have more company-owned units over time. To assess the economic importance of these interactions, he calculated estimated proportions of company-owned units implied by substituting the sample mean values of all the variables into one of his regressions. Holding all other variables constant at their sample means and individually varying AGE and NSTORE, Goldberg calculated the following estimates,

1. Young firms (1-2 years old) with few units (less than 100) should own and operate about 32% of their units.
2. High-growth firms should rely more extensively on franchising to open new units since increasing the number of units (holding AGE constant) increases the predicted proportion of franchised units.
3. Increasing the age variable (holding NSTORE constant) led to higher predicted company-owned proportions [25 (50) year old firms should have 52-71% (79-93%) company-owned].

Goldberg's findings are consistent with the ownership redirection hypothesis (i.e., capital scarcity).

The free-rider problem is often cited as a possible reason for operating units internally (i.e., company-owned units) instead of using franchisees (Caves & Murphy, 1976; Klein & Saft, 1985). The manager of a company-owned unit will not have as great an incentive to free-ride since he/she does not gain financially from the associated lower costs of production. Hence, under extreme circumstances, the costs of monitoring against franchise free-riding may be so great that it could be more efficient to internally operate rather than to franchise a unit.

There is another method of dealing with the free-riding problem which does not require the substitution of company managers for franchisees. This alternative solution is to grant franchises at locations for which there is a low probability of repeat purchase to existing franchisees who operate one or more outlets at high repeat purchase locations.

Companies involved in franchising generally have identifiable brand names that help to assure the customer of uniform product quality (Brickley & Dark, 1987). The franchisee has the responsibility to deliver the products and services without deteriorating the brand image and quality that has been established by the franchisor. Thus, the franchisee ought to act as an agent to dutifully perform its managerial function in ways consistent with the well-being of the franchisor and other franchisees.

Quality assurance is especially important for a hotel chain to attract a potential customer who is not familiar with a geographic setting. In other words, though franchising is more efficient than using company-owned units when there is environmental uncertainty and when it is difficult for the franchisor to monitor the behavior of individual units (Brickley & Dark, 1987), the franchisee could cause free-riding or opportunistic behaviors that adversely affect quality. In addition, though the company-owned units can better maintain the quality and reputation of the product and service, they are vulnerable to a shirking and perquisite problem since the manager of a company-owned unit has less incentive to work hard in the context of a residual claim (Norton, 1988). Consequently, company-owned units must be more tightly monitored.

In the agency theory, the organizational form of the firm results from balancing the monitoring costs and benefits of company-owned units and franchised units as the firm seeks to maintain brand name as well as high performance. The agency theory, therefore, predicts that a franchisor's cost of monitoring for shirking in individual outlets will be greater for company-operated than for franchised outlets. In addition, this theory proposes that the firm's organizational form is determined by the costs of monitoring the units and unit managers in the context of distance of the units from the monitoring headquarters and opportunistic behavior of the unit managers.

Transaction Cost Theory

Another point of view on the question of what internal environmental factors moderate the organizational form - performance relationship began with an inquiry by Coase (1937) and has been developed by Williamson (1975, 1985). Coase (1937) suggested that the presence of transaction costs leads firms to internalize some activities that are available in the marketplace. Williamson (1975, 1985) identified some determinants of these transaction costs. He categorized the major factors that generate market transaction costs into four categories: market uncertainty, number of potential trading partners, bounded rationality, and opportunism. In this view, a firm exists because it can mediate economic transactions between its members at lower costs than a market mechanism can. Under certain conditions, markets are more efficient because they can mediate without paying the costs of managers. Under other conditions, however, a market mechanism becomes so cumbersome that it is less efficient than a bureaucracy. This transaction cost approach explicitly regards efficiency as the fundamental element in determining the nature of organizational form. Walker and Weber (1984) made a lifecycle argument about the market or buy choice. They argued that a cyclical pattern for complex components may be found in which components are brought into the firm so it can gain production

experience and reduce uncertainty and then are shifted back to the market when contracting costs can be managed.

Williamson (1979) used franchising as an example of a hybrid form of contractual integration. Franchisees who invest in developing the franchisor's concept in their location or territory are creating value which attaches solely to the franchisor's trademark. In other words, investment in assets which are specific to the requirements of a particular exchange relationship is called transaction specific assets or asset specificity (Williamson, 1975).

The transaction specific assets can be divided into human, site specific, and physical assets.

Carney and Gedajlovic (1991) also advocated that much of the investment a franchisee makes is in dedicated assets (e.g. a uniquely designed building) with no alternative use and low salvage value. Therefore, all other things being equal, high initial investment will lead to a greater company-owned form of retail outlets. Jones and Hill (1988) stated that the economic transaction is seen as the fundamental unit of analysis, a transaction being an exchange of goods or services from one party to another.

The central paradigm is whether a given transaction can be undertaken at a lower cost via a market or within a hierarchy (firm). If the costs of undertaking transactions via the market are high, then the firm can gain economic benefits by internalizing the transaction within its own organization. In other words, the transaction costs are the negotiating, monitoring, and enforcement costs that have to be borne to allow an exchange between two parties to take place. The sources of these costs are the transaction difficulties that may be present in the exchange process (Klein, Crawford, & Alchian, 1978; Williamson, 1975).

Jones and Hill (1988) presented the six main factors producing transaction difficulties as follows:

1. Bound rationality: the rationality of human behavior is limited by the actor's ability to process information.
2. Opportunism: human beings are prone to behave opportunistically.
Opportunism means self-interest seeking with guile.

3. Uncertainty and complexity: the real world is characterized by considerable uncertainty and complexity.
4. Small numbers: in the real world small numbers trading relationships are frequently found (i.e. as in an oligopoly).
5. Information impactedness: information pertaining to a transaction, or set of transaction, is frequently asymmetrically distributed between the parties to an exchange. Thus, one party might have more knowledge than another.
6. Asset specificity: this refers to investment in assets which are specific to the requirements of a particular exchange relationship.

The joining together of different pairs of these factors causes specific transaction difficulties (Jones and Hill, 1988).

Williamson (1985) recognized that transaction costs are likely to be particularly important when economic agents make relationship-specific investments, that is, investments to some extent specific to a particular set of individuals or assets. Since Williamson's (1975) definitive statement of the theory, researchers have developed more refined conceptualizations of transactions and of governance structures.

One principal factor that will determine the choice of ownership is the bureaucratic costs and economic benefits associated with managing different organizational forms. Economic benefits from internalization (company-owned) arise when the use of hierarchy economizes on the transaction costs associated with overcoming transaction difficulties (Jones & Hill, 1988). Firms must trade off the economic gains from different organizational forms against the bureaucratic costs that must be incurred to realize those gains.

Jones and Hill (1988) argued that transaction costs must be incurred in order to allow economic benefits to be achieved through the marketplace. They contended that economic benefits from integration (company-owned) are as follows: (1) integration allows a firm to invest in specialized assets, which results in the production of goods and services at a lower economic cost than when non-specialized assets are used (Klein et al., 1978), (2) internalization leads to economic benefits because it removes the possibility of resource misallocation due to information impactedness (Williamson, 1975). That is, with access to more information the firm can avoid sub-optimum decision-making and increase

the return associated with the use of resources, and (3) internalization produces economic benefits because it obviates the need to write complex contracts between the various parts of the business (Arrow, 1974). Jones and Hill (1988) asserted that the firm must balance benefits and costs when determining the choice of organizational form (i.e., franchised or company-owned units).

Internal environment-Organizational form-Performance

In general, it is logical to relate the concepts of internal environment, organizational form, and performance. Different internal environmental factors of the firm set forth different organizational form. Using a contingency theory, this study analyzes the relationship between internal environment, organizational form, and financial performance. It addresses three related questions. First, what determines the choice of organizational form for a firm in the context of internal environment? Second, why does a firm having different internal environment have different performance? Third, what determines change in organizational form by the firm over time? This analysis serves to integrate work in franchising and provides a framework for analyzing the chain's organizational form. However, it is difficult to operationalize the concepts into testable measures, nor it is easy to obtain relevant data.

As there are no empirical studies which actually demonstrate the moderating effect of internal environment on organizational form and financial performance in the lodging industry, the study of strategy - structure - performance relationship has been adopted to this study.

The strategy-structure-performance model developed by Chandler (1962) and Scott (1973) has been applied in the strategic study (Jones & Hill, 1988; Miller 1987; Rumelt, 1974; Stopford & Wells, 1972). Jones and Hill (1988) argued that the correct 'fit' between strategy and structure would produce superior performance. They used a transaction cost approach to analyze the relationship between strategy, structure, and

organizational performance. They found that high specific asset should be integrated because it resulted in the production of goods and services at a lower economic cost than when nonspecific assets are used. They defined economic costs as administrative costs that are used in monitoring employees' opportunistic behavior.

Different organizational forms are designed to accomplish different internal environment of the firm and therefore are associated with better organizational performance outcomes. As Jones and Hills (1988) suggested, superior performance is a result of having correct 'fit' between the internal environmental factors and the organizational form.

Summary

This chapter has focused on the review of literature in internal environmental factors (i.e., capital scarcity, monitoring cost, and asset specificity) in the broad context of organizational form. A review was made on the relationship between internal environmental factors and the choice of organizational form (i.e., company-owned and franchised). This included a review of ownership redirection hypothesis (Caves & Murphy, 1976; Oxenfeldt & Kelly, 1968-69), agency theory (Brickley & Dark, 1987; Rubin, 1978), and transaction cost analysis theory (Jones & Hill, 1988; Williamson, 1975, 1985). The literature describes internal environment as an integral part of the firm's choice of organizational form.

A review of the literature indicates that the topic of environment and organizational form has been generally insufficient. Specifically, the choice of organizational form is insufficient; internal environmental factors intervene between a firm's choice of organizational form and its performance. In other words, a firm's performance is dependent on the achievement of a match or fit between choice of internal environmental factors and choice of organizational form (Jones & Hill, 1988; Miller 1987; Rumelt, 1974; Stopford & Wells, 1972).

CHAPTER III

METHODOLOGY

Introduction

Following the conceptual framework developed earlier, this chapter discusses the variables selected for the determination of the relationship among internal environment, organizational form, and performance; the research questions; the research hypotheses; the research design; and data collection.

In the preceding chapters, it was proposed that organizational form and performance are related. The main objective of this study was to examine how the internal environment of an organization combines with the organizational form to affect financial performance. Thus, this study sought to determine if there is: (1) a difference in the financial performance of hotel chains which are company-owned versus those which are franchised and (2) a moderating effect by the internal environment of the organization on organizational form and its impact on financial performance.

Variables Operationalized

At the corporate level, appropriate measurements are required for the study of the organizational form (company-owned and/or franchised) - performance relationship. In this study, the internal environment of the firm is selected to be the moderating variable, the organizational form is selected to be the independent variable, and financial performance is selected to be the dependent variable.

Figure 1 depicts the conceptual framework for the study. Organizational form is shown influencing the financial performance and internal environment causes the organizational form-financial performance link to vary.

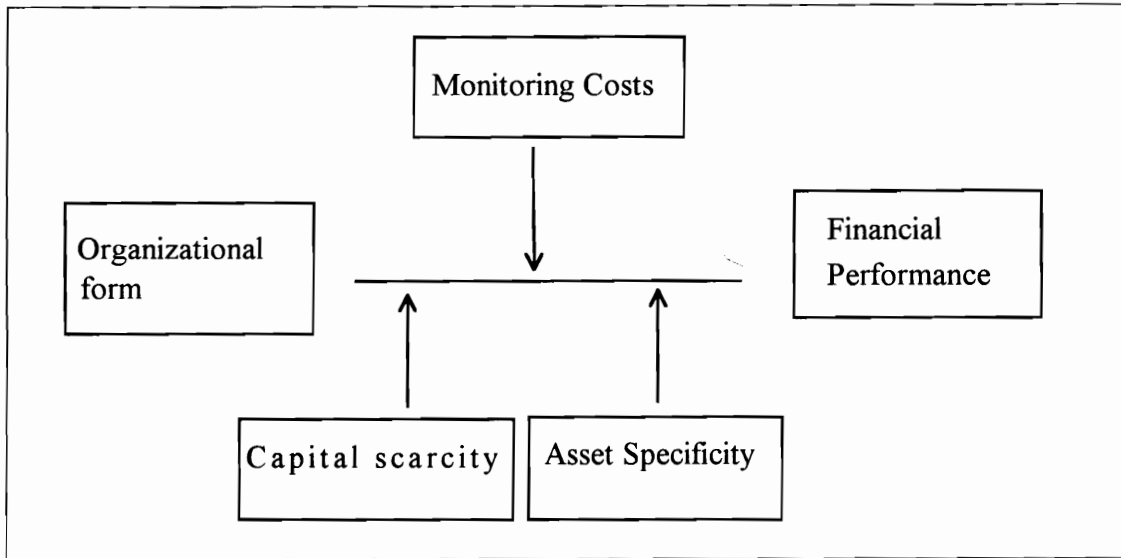


Figure 1

Moderating effect of internal environmental factors on
organizational form - financial performance relationship

Internal Environment

According to researchers (Oxenfeldt & Kelly, 1968-1969), the internal environment of the firm is a key factor which is intimately involved in the organizational form. Oxenfeldt and Kelly (1968-1969) identified three critical environmental factors whose limited availability in the short run makes franchising initially attractive to the franchisor: (1) funds needed for rapid and geographically dispersed replication of the successful business ideas being franchised; (2) reliable information regarding local conditions and the desirability and commercial viability of particular locations so that the profitable sites can be identified; and (3) a ready pool of managerial talent and labor needed to quickly implement the proven business concepts at alternative locations. Ozanne and Hunt (1971) also stated, "firms usually begin franchising because (1) they cannot generate the capital necessary to expand through company-owned units and/or (2) they believe that franchisees who "own" their businesses, will do a better job of managing the units than company managers" (p. 80). The basic proposition in ownership redirection theory is that a firm's ability to expand its units or growth of units is limited (contingent upon) by capital scarcity. These internal environmental factors influence the organizational form of a firm.

Many researchers (Brickley & Dark, 1987; Klein et al., 1978; Martin, 1988; Mathewson & Winter, 1985; Norton, 1988; Rubin, 1978) analyzed franchising from the perspective of agency theory and identified an agency problem. This problem of monitoring the behavior and performance of the unit manager (an agent) is the key determinant of the organizational form. Alchian and Demsetz (1972) examined these problems in their paper on the theory of the firm. These authors stressed that units with low monitoring costs should be company-owned, while those units more costly to monitor should be franchised.

The basic proposition in the agency theory is that a firm's ability to expand its units or growth of units is limited (contingent upon) by opportunistic behavior of unit managers.

The monitoring costs for opportunistic behavior have an influence on the organizational form of a firm.

Transaction cost theory also predicts that the firm's governance structure or organizational form is contingent upon the influence of a number of moderating factors, such as behavior uncertainty and transaction specific asset. The agents (i.e., either company-owned managers or franchisees) have the incentive to behave opportunistically (Heide & John, 1988). Asset specificity influences the franchisor to choose either a company-owned or a franchised unit.

As noted by Arnold (1982), contingency theory by definition hypothesizes that the relationship between two variables is contingent upon some third variable. The position of contingency theory is that different conditions (internal environment of the firm) call for different types of organizational form and the relationship of the internal environment and the organizational form affects the financial performance of the firm. Therefore, it is hypothesized that internal environments moderate the organizational form - performance relationship. In this study, the internal environment of the firm was assessed by three measures: capital scarcity, monitoring cost of units, and transaction specific asset.

Organizational Form

Organizational form is viewed as an independent variable in this study. Rumelt (1974) states that:

"Organizational form can be defined as the result of a balanced consideration of a franchisor's ability and internal environment. Organizational form consists of systems of control, planning and information flow, methods of reward and punishment, the degree of delegation and techniques of coordination are among the important determinants of the way of life within the enterprise" (p. 33).

According to Brickley and Dark (1987), a franchising company has company-owned and franchise units. Franchisors often do own and operate a significant proportion of their retail units and franchise some units (Carney & Gedajlovic, 1991).

The lodging industry has the same organizational form: company-owned, franchised, and combination of both. The majority of franchisors do operate both forms of units. Dant et al., (1992) provided a review of both the theoretical and empirical literature that has focused on the issue of ownership redirection in franchising. They argued that the existing evidence is inconclusive in categorizing the organizational form.

As the literature does not provide clear guidelines to determine whether the hotel chain operates fully company-owned or franchised units, a preliminary analysis of data obtained from "Lodging Hospitality" and UFOC of franchising hotel chains showed that some hotel chains (e.g., Marriott) are just starting to franchise some units. These firms usually have a small proportion of franchised units during the first and second years and in some cases may have no franchised units. Hence, in this study, these firms were referred to as company-owned. In addition, by examining the change in the proportion of units (company-owned, franchised units, or combination of both) over time for all hotel chains, the cutoff point for categorizing the organizational form was made as follows: when the proportion of company-owned units was less than 34% of total units the hotel chain was referred to as franchised and when the proportion of company-owned units was more than 66%, the hotel chain was referred to as company-owned. If the proportion of company-owned units was in between 35% and 65%, the hotel chain was referred to as combination of both form. The same guideline was applied to franchised units.

Performance Measurement

Zeithmal and Fry (1984) asserted that improving performance is the heart of management. The performance of management can be assessed by considering a number of dimensions, including effectiveness, equity, and efficiency (Stern et al., 1989).

Effectiveness refers to a goal-oriented measure of how well the commercial channel sector or any of its members met the demand for service outputs placed on it by the consumption sector. Equity explains the extent to which commercial channels serve problem-ridden markets and market segments--e.g., the disadvantaged consumers, immobile consumers, or geographically-isolated consumers. Efficiency indicates how well the organization utilizes environment in generating its output and is subdivided further into productivity and profitability. Productivity reflects the efficiency with which output is generated from environment and input used or expended. In essence, productivity is a measure of physical efficiency. Profitability refers to a general measure of the financial efficiency of a channel member--i.e., return on investment, liquidity, leverage, growth patterns in sales and profit, and growth potential in sales and profits (Stern et al., 1989).

The performance variables selected to be used in this study are limited to financial performance.

Financial performance

Financial performance is viewed as a dependent variable in this study and it is assessed by two measures: (a) return on investment and (b) growth in unit sales. Return on investment (ROI) is defined as net income/average investment or net income as a percentage of total invested capital. ROI has been a standard measure of business and corporate performance for a number of years (Anderson & Zeithaml, 1984; Buzzell & Wiersema, 1981). Although some researchers (Anderson, 1984; Padmanabhan, 1988) measured the impact of organizational form on performance, they used only one financial performance such as sales per unit rather than return on investment (ROI). Stern et al., (1989) stated that the strategic profit model (SPM) is useful for measuring the profitability of a firm. This model has been developed to evaluate and diagnose the profitability of a firm. The SPM involves multiplying a company's profit margin (return on sales) by its rate of asset turnover and its leverage ratio to derive its rate of return on investment. As the

model specifies that the firm's main objective is to generate an adequate rate of return on investment (ROI), ROI was used in this study.

Another financial performance variable to be used in this study is growth in unit sales. It is expressed by the change in total annual sales divided by the number of units. Growth in unit sales, expressed by the change in total annual sales divided by the number of units has been a standard measure of business and corporate performance for a number of years (Anderson, 1984; Buzzell & Wiersema, 1981; Padmanabhan, 1988; Zeithaml, 1984). These two financial performance measurements were obtained for the three-year period of 1990-1992 on each hotel chain.

Control Variables

Since sampled hotel chains were drawn from the lodging industry and operated in the United States, an assumption was made that they were operating under the same general (external) environment. Thus, variations in general environmental dimensions among the hotel chains in this study were essentially controlled. The analysis of respondent data was done for the industry as a whole.

The function of control variables in empirical research is to reduce the risk of attributing explanatory power to independent variables that in fact are not responsible for the occurrence of variation in the dependent variable. Control variables serve the purpose of testing whether the observed relations between independent and dependent variables are nonspurious (Nachmias & Nachmias, 1981). In addition to the internal environment, organizational form, and performance variables, other variables are examined to determine whether they contribute to the relationship between the independent and dependent variables. The variables examined are company size and age of operation.

The size of a hotel chain is an important factor for a franchisor and franchisee since the larger the size, the larger the market share, which provides the hotel chain a better position to expand its units and to achieve better performance. The size of the hotel chain is a

parameter for the recognition of its brand name to a customer, as well as to potential franchisees. In this study, size was determined by the number of operating units. In a competitive market, the number of operating units require additional investment, administrative and marketing support, and monitoring activities in order to maintain quality standards and better performance. Therefore, the number of operating units determine the structure of the hotel chain.

This study has determined whether differences in the number of operating units and age have any impact on franchising hotel chains' organization form and their financial performance.

Research Questions

Having stated the above variables, this study endeavors to address the following research questions:

1. Is there a difference in the financial performance of hotel chains which are company-owned versus those which are franchised?
2. Does the internal environment of the hotel chain moderate the relationship between the organizational form and financial performance?

Research Hypotheses

Based on the questions posed above, each research hypothesis was tested in this study.

HYPOTHESIS ONE

"No difference will be found in the financial performance of company-owned versus franchised hotel chains."

In this hypothesis, hotel chains were categorized for the purpose of analysis according to their organizational form. Their financial performance was measured by the following: (a) return on investment and (b) growth in unit sales.

Two sub-hypotheses were developed:

Hypothesis 1.1: "No difference will be found in return on investment of company-owned versus franchised hotel chains".

Hypothesis 1.2: "No difference will be found in growth in unit sales of company-owned versus franchised hotel chains".

It has been proposed that there is a relationship between organizational form and performance in some business areas, such as rental services, automobile and truck dealers, and restaurants (Anderson, 1984). As these findings indicate, different types of organizational form affect performance in restaurant firms; thus, it is hypothesized that the same relationship would exist in the lodging industry. However, researchers (Anderson, 1984; Caves & Murphy, 1976; Norton, 1988) have studied the firms' performances and organizational form by using secondary data from the Department of Commerce's "Franchising in the Economy", measuring only sales per establishment. These studies have had difficulty in finding data suitable to test the hypotheses generated by the theoretical models. In addition, whether such findings can be generalized to the lodging industry remains in doubt.

Because hypothesis one examines the relationship between financial performance (quantitative dependent variable) and organizational form (categorical independent variable) with company size and age of operation (control variable and second quantitative variable as the nuisance factor), analysis of covariance was used. Wildt and Ahtola (1978) stated that analysis of covariance is appropriate to examine the differences on the dependent variable among categories of the independent variable "controlling for" differences on the nuisance quantitative variable.

HYPOTHESIS TWO

"The link between financial performance and organizational form is moderated by evaluations of internal environment."

It is hypothesized that internal environment moderates the organizational form - financial performance relationship. Here, the expectation is that hotel chains which are aware of the importance of their internal environment adopt appropriate organizational form, thus performing at levels higher than hotel chains that are less aware of the importance of their internal environment. In other words, if internal environment of the organization and organizational form do not match each other, financial performance would be low and vice versa. The expectation is that the relationship between the organizational form and the financial performance of the hotel chain is contingent upon the influence of their internal environment.

The following is a discussion of the specific internal environmental factors to be examined in this study, and the appropriate sub-hypotheses regarding them.

Capital Scarcity.

One advantage of franchising is that it provides a way for a franchisor to enjoy many of the advantages of controlling retail outlets without actually having to finance them. Thomas et al., (1990) argued that franchisee-owned units are vehicles for marketing and distributing the product when the franchisor faces the constraints of limited capital and managerial environment. Their study on pooled time-series cross-sectional analysis using 10 years of data for 10 franchised business activities shows that the only significant determinant of the percentage of company ownership was franchisee sales per establishment.

Caves and Murphy (1976) argued that franchisors weigh the potential returns from a change to company ownership (i.e., unit profits less current royalties from franchised

operation) against the investment cost of reacquiring the franchise. Ozanne and Hunt (1971) asserted that many firms are in franchising because they do not have the necessary capital to expand through company-operated units. Oxenfeldt and Thompson (1969) argued that franchisors create franchise systems because they have too little capital to consider a wholly-owned chain. This explanation maintains that franchising is a means for trademark owners to obtain needed capital at favorable rates and during tight credit markets. Hence:

Hypothesis 2-1: "The link between financial performance and organizational form is moderated by capital scarcity."

When a firm has capital scarcity, the firm that operates the units under the company-owned concept would have low financial performance because there is little money to invest in advertising, product development, monitoring to maintain service and product quality, training the unit managers, and installing a new technology (e.g., reservation system, property management system). Therefore, it is hypothesized that:

H2-1a: The company-owned firm has low financial performance when it has capital scarcity.

When a firm has capital scarcity and operates its units through franchising, the firm would have high financial performance, since franchisees are typically required by contract to spend a fixed percentage of revenue on advertising and to provide capital to the franchisor through franchising fees (i.e., royalty fees, reservation fees, etc.). So, the addition of a franchise unit would provide the pool of funds available to a franchised firm (franchisor) for producing goods and services. In addition, the franchisor could allocate the capital for administration costs and product development. This helps build consumer demand as well as demand for franchises. Therefore, it is hypothesized that:

H2-1b: The franchising firm has high financial performance when it has capital scarcity.

When a firm has abundant capital, the firm that operates company-owned units would have high financial performance because the firm could invest money in advertising, product development, and monitoring to maintain quality, and the company-owned firm (franchisor) could capture all the economic rents that are generated in its company-owned units. Therefore, it is hypothesized that:

H2-1c: The company-owned firm has high financial performance when it has abundant capital.

When a firm has abundant capital, the firm could provide both initial and ongoing support and assistance to a franchise system; in the form of training, operations, and support staff, and invest in research and development for the introduction of new products and services. Consequently, the unit's performance could be increased. However, as the franchisees claim all economic rents except franchising fees, or if the franchisor must share economic rents with franchisees due to a franchising contract, the franchised firm would have low financial performance compared to that of company-owned units. Therefore, it is hypothesized that:

H2-1d: The franchising firm has low financial performance when it has abundant capital.

The above four hypotheses can be visualized more clearly through the following matrix:

Form	Capital Scarcity	Capital Scarcity
	High	Low (capital abundant)
Franchising firm	(H) Performance	(L) Performance
Company-owned	(L) Performance	(H) Performance

Monitoring cost.

Agency theory suggests that the agency problem, which is the problem of monitoring the behavior and performance of a unit manager (an agent), is the key determinant of the organizational form (Brickley & Dark, 1987; Martin, 1988; Norton, 1988; Rubin, 1978). The basic proposition in agency theory is that a firm's ability to expand its units or growth of units is limited (contingent upon) by opportunistic behavior of unit managers and unit distance. The monitoring costs for opportunistic behavior influence the organizational form of a firm. In other words, the agency problems associated with a company-owned manager suggest that the company-owned unit would require relatively more monitoring to assure performance.

Alchian and Demsetz (1972) argued that the system would show more total profit if shirking is controlled so that there are gains to both parties from the profit-sharing agreement. Mathewson and Winter (1985) asserted that free riding occurs where franchisees take advantage of and benefit from each other's efforts. Klein (1980) also discussed the role of monitoring in franchising. The author emphasized an *ex post facto* moral hazard problem that gives franchisees the incentive to adulterate the good or service (cheat) in order to reduce costs. This incentive increases the cost of franchising because it increases the proportion of non-repeat customers and raises the cost of monitoring.

Brickley and Dark (1987), who investigated organizational form of the franchisor from an agency theory perspective with primary disaggregated data, found that (a) the cost of

monitoring unit managers and (b) high employee-monitoring costs, low initial investment costs per unit, and higher frequency of repeat customers in a particular unit were key determinants of organizational choice. Monitoring cost explanations focus on the moral-hazard problem inherent in fixed-wage contracts and the consequent need for some kind of monitoring. Since production and distribution occur at many different locations, information about outlet-operator performance is asymmetrical (Rubin, 1978).

Opportunistic behavior and distance of the unit would affect the monitoring costs of a unit manager and the costs of monitoring lead to the prediction that the franchisor would have more company-owned units when the monitoring costs are low or have more franchised units when the monitoring costs are high. The franchisor's performance would also be influenced by monitoring costs, because the franchisor bears all costs of monitoring if it has company-owned units or the costs would be shared with the franchisees if the firm has franchised units. Thus, it is hypothesized that monitoring costs of a unit manager would moderate the organizational form and financial performance relationship. In formal terms,

Hypothesis 2-2: "The link between financial performance and organizational form is moderated by the costs of monitoring the unit manager".

A franchised unit located far from its monitoring headquarters initially would require high monitoring costs due to its long distance. However, a firm which operates through franchising would have high financial performance because franchisees have very little incentive to shirk since they would suffer financially from any loss of business due to their shirking. In addition, franchisees pay royalties, which creates an incentive for the franchisor to be efficient in policing and maintaining value (Rubin, 1978). Consequently, franchisors could share the monitoring costs with franchisees. Therefore, franchisors who operate units through franchising would eventually have low monitoring costs and high financial performance. Therefore, it is hypothesized that:

H2-2a: The franchising firm has high financial performance when it has high monitoring costs.

A firm that operates through franchising and whose franchised units are located far from the monitoring headquarters would require less monitoring costs since the franchisor predicts that franchisees have very little incentive to shirk due to residual claimant rights. Residual claimant rights, however, can also create a detrimental incentive for franchisees to free-ride, especially if their customers have a low probability of repeat repurchasing. Customers who purchase frequently from the same location or firm in essence "police" the performance of a seller. If dissatisfied, these customers would no longer purchase from a seller who performs at a level lower than anticipated. This loss of future sales punishes the seller by reducing the level of his or her profits (Klein & Leffler, 1981). When a firm has low monitoring costs and operates its units through franchising, its financial performance would be low since franchisees are motivated to free ride. As the danger of free riding is greatest where repeat customers constitute a small proportion of unit sales and the units are located near highway exits and if franchisees are allowed to provide nonstandardized packages of goods and services, the behaviors of one franchisee might negatively impact the outcomes of other franchisees. In addition, the entire franchise system is less likely to maintain a coherent image to its customers and, hence, is less able to maintain repeat customers and to capture potential franchisees. Furthermore, opportunistic franchisees share the cost of failing to perform appropriate behaviors with those who do, rather than bearing that cost themselves (Martin, 1988). Consequently, the entire franchise system or the franchisor would have low financial performance. Therefore, it is hypothesized that:

H2-2b: The franchising firm has low financial performance when it has low monitoring costs.

The firm which operates through company-owned units and is located near monitoring headquarters and in urban areas would have low monitoring costs. The franchisor would require less investment into the units as the managers would have less moral hazard problems due to diminished incentive to shirk. The franchisor would invest money in advertising, product development, and training. In other words, the franchisor's overhead costs would be low due to less monitoring of the unit, and the entire system would have a constant or even higher customer demand because the firm could maintain a quality standard and invest more money in its advertising and product development, thus resulting in high financial performance. Therefore, it is hypothesized that:

H2-2c: The company-owned firm has high financial performance when it has less monitoring costs.

The firm which operates through company-owned units and is located far away from the monitoring headquarters would have high opportunism because of monitoring difficulties. Brickley and Dark (1987) argued that company managers need more monitoring than franchisees because managers receive salaries and pose a risk of shirking. Consequently, the firm's overhead costs for the units would eventually increase due to the distance of the units from the monitoring headquarters and in order to monitor the opportunistic behaviors of unit managers. This would cause return on investment to go down, assuming constant investment on the units. Therefore, it is hypothesized that:

H2-2d: The company-owned firm has low financial performance when it has high monitoring costs.

Hypothesis 2 can be visualized more clearly through the following matrix:

Organizational Form	Monitoring Cost High	Monitoring Cost Low
Franchising	(H) Performance	(L) Performance
Company-owned	(L) Performance	(H) Performance

Asset specificity.

Transaction cost analysis provides an integrative explanation of the various factors that moderate the organizational form - financial performance relationship. The factors associated with transaction costs include asset specificity, uncertainty, and frequency of transaction. Transaction-specific assets are those human and physical assets (tangible and intangible) required to support exchange and which are specialized to the exchange relationship. Those assets are devoted to the franchise relationship and cannot be easily transferred to other relationships. If the relationship were to be terminated, the value of these assets would be largely lost because their salvage value outside the relationship is very low (Heide & John, 1988). In other words, franchisees invest in developing the franchisor's concept in their location or territory, thereby creating value which attaches solely to the franchisor's trademark. These assets make the agents (franchisee) vulnerable to opportunistic behavior. However, the franchisor has to compare the benefit of wholly owned operation (full-control mode) with the cost involved in this transaction. Establishment of a wholly-owned operation entails significant internal organization or bureaucratic costs, including investments in legal, administrative, and operating infrastructures (Davidson & McFetridge, 1985).

Anderson (1985, 1988) defined asset specificity as the extent of specialization in knowledge or working relationships between the salesperson and the company or the customer. He assessed two types of uncertainty in this situation: the difficulty of evaluation of performance and environmental unpredictability. Williamson (1985) identified behavioral uncertainty as the other principal factor involved in transaction cost

analysis. Behavioral uncertainty arises within the context of the exchange itself due to the opportunistic inclinations of the transacting parties (John & Weitz, 1988). They (John & Weitz, 1988; Williamson, 1985) predicted that behavioral uncertainty of the unit managers could be solved through managerial supervision and high control.

Transaction cost analysis (i.e., transaction specific asset and behavioral uncertainty) provides a useful framework for analyzing whether firms develop appropriate organizational form. Transaction cost theory predicts that firms integrate (company-owned) when asset specificity and behavioral uncertainty is high (Williamson, 1985), because the higher costs of vertical integration are more than offset by the benefits flowing from such an arrangement (Erramilli & Rao, 1993). When specificity is low, hotel chains refrain from integration because benefits of control fall short of the costs of attaining it. Because much of the investment a franchisee makes is specific asset with no alternative use, the franchisee should demand a higher rate of return to permit him/her to fully depreciate the value of the assets over the duration of a contract. Thus, efforts that the franchisee contributes to his/her units would be much greater than that of a company-owned unit manager, so the performance of franchised units would be higher compared to that of company-owned units. In addition, behavior uncertainty of franchised units is much lower because a franchisee's compensation varies directly with unit performance. In formal terms,

Hypothesis 2-3: The link between financial performance and organizational form is moderated by asset specificity.

Specialized human assets are present to varying degrees in organizational form. The time and effort employed to acquire firm-specific knowledge needed for downstream activities is perhaps the most common form of these investments found in the distribution channels (Heide & John, 1988).

John and Weitz (1988) found that high specific asset and uncertainty consistently increased the use of direct channels (company-owned). When a firm has these high transaction specific assets, the firm which operates as company-owned units would have high financial performance because of (a) the better monitoring and surveillance properties of organization relative to markets, and (b) the reduction of profit from opportunistic behavior, since employees do not ordinarily have claims to profit streams (John & Weitz, 1988). Integration allows firms to invest in specialized assets, which results in the production of goods and services at a lower economic cost than when non-specialized assets are used (Klein et al, 1978).

As a unit (either company-owned or franchised) has more customized service and the unit manager has professional skills in running the units, the unit would generate high performance. Consequently, the franchising firm or the franchisor could have high performance as it captures all of the economic rents of owning units. Therefore, it is hypothesized that:

H2-3a: The company-owned firm has high financial performance when it has high asset specificity.

When a firm has high transaction specific assets, such as high value of a brand name, brand name capital creates control problems because it is especially subject to degradation (Klein, 1980; Klein & Leffler, 1981). Transaction cost analysis suggests that where the potential for free riding is high, the firm should operate its unit as company-owned unit. This suggests that the franchisor could control owning units more efficiently when the value of a brand name is high. However, if the firm operates its units through franchising, the franchisees would have high opportunism because of free-riding incentives. Consequently, the franchising firm has high overhead costs in order to reduce the opportunistic behavior of franchisees.

The franchisee is presumed to be willing to create the value of asset because of (a) the license to use the franchisor's trademark for the period of the agreement and (b) highly specific investment in equipment. Thus, the franchisee's investment in his premises creates a highly specific asset which creates constant demand from customers. The performance of franchised units would be higher due to high asset specificity compared to that of company-owned units. However, the franchisor that operates the units through franchising could claim only royalty fees as opposed to the franchisees' residual claim on their units. In other words, the franchisor's performance would be low because the franchisor must share the economic rents with franchisees and the franchisor would allocate high monitoring costs. Therefore, it is hypothesized that:

H2-3b: The franchising firm has low financial performance when it has high asset specificity.

When a firm has units that have low transaction specific assets, the firm which operates through franchising would have a franchisee that is asked through a contract to provide high levels of professional skills, specialized know-how, and customized services. The franchisee would thus have to make significant investments in acquiring skills, expertise, and customized services (Erramilli & Rao, 1993). Low transaction specific assets would provide motivation and incentive for franchisees to receive a residual claim in their units. In addition, the behavioral uncertainty of franchisees would be low because their original investment would be in the franchise and they would devote themselves to operating their units, thus eventually requiring low monitoring costs by the franchisor. Consequently, the franchisees would render more franchising fees, as well as royalty fees, to the franchisors, and the franchisors would contribute less investment to develop the unit as franchisees share the investment in training, advertising, and facility design, while, requiring lower monitoring costs. Therefore, the franchising firm would have high financial performance. This relationship is hypothesized as follows:

H2-3c: The franchising firm has high financial performance when it has low asset specificity.

Low asset specificity is expected in early stages of development (Sharma & Dominguez, 1992). Sharma and Dominguez (1992) suggested that when assets are very non-specific the firm can easily replace intermediaries (franchisees). However, when a firm has units that have low specific assets and it operates its units as company-owned ownership, the unit managers have less professional skills and customized service. Therefore, the franchisor has to provide professional expertise and skills through several years of education and training, and consequently, its investment on low specific asset would be increased. In addition, the governance cost or control costs including costs for monitoring the performance of those units would be high due to high uncertainty of the units relative to markets. The firm's investment on low asset specificity would be increased. Consequently, the firm that operates as company-owned units would have low financial performance. Therefore, it is hypothesized that:

H2-3d: The company-owned firm has low financial performance when it has low asset specificity.

Hypothesis 2-3 can be visualized more clearly through the following matrix:

Organizational Form	Asset Specificity High	Asset Specificity Low
Franchising	(L) Performance	(H) Performance
Company-owned	(H) Performance	(L) Performance

In order to test these hypotheses, the hotel chains were divided according to their organizational form: company-owned, franchised, or combination of both. Within each

organizational form, the hotel chains' financial performance was measured by: (a) return on investment and (b) growth in sales.

Measurement

Items reflecting the factors underlying internal environment, capital scarcity, monitoring costs, and transactional specific asset were measured as follows:

Capital scarcity

As there are no empirical studies that have measured capital scarcity of the firm, this study applies the capital structure theory, which shows that firms prefer to finance with internally generated funds; that is, with retained earnings and depreciation. If more funds are needed, then the firm would go to the external capital markets, first issuing debt, then common stock as a last resort (Brigham & Gapenski, 1987). The first step in developing the measurement of capital scarcity is to review the statement of cash flows which is organized into three sections: (a) operating activities, (b) investing activities, and (c) financing activities. Among these three categories, the financing activities aspect would be utilized to measure the capital scarcity of the firm.

Financing activities include (a) obtaining resources from owners and providing them with a return on, and a return of, their investment and (b) obtaining resources from creditors and repaying the amounts borrowed or otherwise settling the obligation. Cash inflows from financing activities include proceeds from the issuance of equity securities and from bonds, mortgages, notes, and other short- or long-term borrowings. Cash outflows for financing activities include payments of dividends, outlays to repurchase the entity's shares, and repayments of amounts borrowed. By analyzing the debt and equity portion of financing activities, if the net proceeds are negative, it can be determined that retained earnings are used. Consequently, the firm is placed into low capital scarcity

category. When the firm uses internally generated funds, such as retained earnings, it implies that the firm has low capital scarcity, and when the firm issues equity or uses debt, it implies that the firm has high capital scarcity.

Another indicator of the firm's capital scarcity is given by whether or not it provides financing to its franchisees (Lafontaine, 1992). Lafontaine argued that a franchisor must have access to capital if he is already providing financing to his franchisees. Furthermore, she suggested that growth in the total number of units in the chain over the last two years would be a proxy for the franchisor's desired growth and thus provides a measure of a franchisor's need for capital. In this study, Lafontaine's measurement of growth rate was used to measure capital scarcity. If the growth rate was more than one-half the difference comparing the two consecutive years, it was determined that the firm has capital scarcity.

Monitoring costs

Brickley and Dark (1987) utilized the distance between the unit and the nearest monitoring headquarters to measure the monitoring costs. They found that franchised units were located farther from the monitoring headquarters than company-owned units and those franchised units that were located near highway had more free riding problems. In the study of McDonald, Mark Kuga (1989) also determined that the units that are far from their monitoring headquarters (more than 100 miles) have high monitoring costs. For this study, the units located more than 100 miles from the monitoring headquarters were determined as high monitoring costs. Jone and Weitz (1988) measured environmental and behavioral uncertainty which include sales forecasts, predictability of environment, and difficulties of monitoring trends. Based on these, the measurement of monitoring costs was developed by computing the average response to three variables: number of field representatives, frequency of travel, and length of stay.

Transaction specific asset

The measure of transaction-asset specificity is developed by adapting the specific assets scale used by Anderson (1985, 1988), Heide and John (1988), John and Weitz (1988), and Klein, Frazier, and Roth (1990), and by devising measures based upon Erramilli and Rao (1993) which were applied to the service sector. In order to measure this variable, John and Weitz (1988) capitalized on the notion that products requiring a good deal of training and experience specific to the line represent situations where specific assets are present. Erramilli and Rao (1993) introduced an idiosyncratic service that is defined as one which is characterized by "high" levels of professional skills, specialized know-how, and customization. They suggested that delivery of idiosyncratic services is characterized by high asset specificity. Asset specificity was measured on Likert-type scales anchored by "1: strongly disagree" and "7: strongly agree." If it is marked on 1 and 2, it was determined as low asset specificity and if it is marked on 6 and 7, the asset was determined as high asset specificity.

Statistical Procedures

Internal environment can be modeled as affecting either the strength or the form of organizational form-financial performance relationships. If internal environment affects the strength of the organizational form-financial performance relationship, it is called a homologizer moderator. With a homologizer, the magnitude of the organizational form-financial performance relationship differs significantly for firms in different environmental conditions. It is important to note that, for this homologizer relationship to be true, internal environment must exhibit no significant direct relationship with organizational form and no significant direct relationship with financial performance. Therefore, if internal environment relates significantly either to organizational form or to financial performance, then a subgrouping approach is inappropriate and internal

environment does not moderate the strength of the organizational form-financial performance relationship (Arnold, 1982).

When internal environment affects the organizational form-financial performance relationship, it is called either a pure or a quasi-moderator. With a pure moderator, internal environment interacts with organization form but is not directly related to either organizational form to financial performance. With a quasi-moderator, internal environment not only interacts with organizational form but also is directly related to financial performance, or to organizational form, or to both (McArthur & Nystrom, 1991).

Two-way analysis of variance was performed to measure the relationship between financial performance (criterion variable) and organizational form (predictor variable) with regard to internal environment (moderator variable). In other words, moderator effects were represented as interactions between organizational form and internal environments (moderating variables). All interaction effects were represented by cross products of the main effects as recommended by Neter, Wasserman, and Kunter (1983). Arnold (1982) also stated the way to measure the relationship of criterion variable (Y) and predictor variable (X) with moderator variable (Z) was as follows:

If both the degree and form of the relationship of Y to X do remain constant across different values of Z, then the relationship is said to be constant or unconditional with regard to Z. If, on the other hand, either the degree or form of the relationship between Y and X is not constant but changes systematically across different values of Z, then the relationship is conditional upon Z. If the degree of relationship varies with Z, then a situation of differential validity can be obtained. If the form of relationship varies with Z, then X and Z are said to interact in determining Y (or equivalently, Y is said to be a joint function of X and Z), and it can be said that the form of the relationship of X to Y is "conditioned by," "depends on," or "varies with" Z .

The dependent variable (financial performance) for this study is measured as a function of the following two independent variables (internal environment and organizational form) and their interaction term and it is described by following equation:

$$Y = f(X, Z, XZ, C)$$

Y (criterion): financial performance (ROI, growth in unit sales)

X (predictor): organizational form (company-owned, franchised, combination of both)

Z (potential moderator): internal environment (capital scarcity, monitoring cost, asset specificity)

C (control variables): company size and age of operation

Research Design

Since this study is researching relatively unexplored (empirically) phenomena, it was conducted in the field using the survey method. The relevant unit of analysis was the franchising hotel chain and the relevant perspective was that of the vice president of franchise development and/or one of the directors responsible for development.

This study explored how each organizational form performed its function in the context of internal environmental factors. The period under investigation was from 1990 to 1992. In order to maximize generalizability with respect to population, measurement of variables, and existential concepts of the participants, Dillman's (1978) techniques for increasing the response rate of mailed questionnaires were utilized. The questionnaire was mailed to all hotel chains (cooperate headquarters) that operated and owned units (company-owned) and franchised units in the United States. A follow-up letter was used to increase the response rate.

Sample Size Selection

All 58 franchising hotel chains participated in this study operated in the United States. As some hotel chains have various brands, total sample size was expanded to 81. For example, Holiday Inns Franchising has "Holiday Inn," "Holiday Inn Crowne Plaza," "Holiday Inn Express," and "Holiday Inn Garden Court".

The information about the hotel chains was obtained from the hotels and motels sections of the directory of the International Franchising Association (IFA) and "Lodging Hospitality".

Because the relationship of ownership to performance has been a relatively unexamined empirical phenomenon in lodging literature, selecting which hotel chains to examine was one of the most important decisions made in this study. In selecting the hotel chains, several criteria were used. First, all franchising hotel chains were selected based upon their class, such as first class, mid-price class, and budget class. Similarity was desirable because different classes were likely to have different management styles. Second, the sample size to test the hypotheses was composed of hotel chains that operate and manage either solely company-owned or franchised units.

The unit of analysis was the corporation represented by the hotel chains that operated and managed units (company-owned) and franchised units. The corporate executive responsible for franchising development and one of the directors responsible for development responded for this study.

Since sample hotel chains were drawn from the same industry, the assumption was made that they were operating under the same operating conditions, i.e. recession, inflation, regulations, and laws.

Data source

The information on the hotel chains came from the following data sources:

- (1) Uniform Franchise Offering Circular (UFOC)
- (2) Annual Report
- (3) IFA's Franchise Opportunity Guide
- (4) The Rating Guide to Franchise
- (5) Worldwide Franchising Directory
- (6) Lodging Hospitality, 1987-1993 edition

Data collection process

The vice president or director of franchise development of selected hotel chains and his/her selected members of development were asked to complete a mailed questionnaire. Because the performance of units might be subject to short-term (one-year) fluctuations and might not be representative of their long-term results, respondents were asked to report the average performance of their units over the period 1990-1992.

Survey Instrument

The survey questionnaire was divided into three sections: (a) hotel information, (b) internal environment, and (c) financial performance.

I. Hotel information

In this section, questions are posed which give a demographic profile of the hotel chains. The basic hotel information was prepared and gathered by utilizing the UFOC, the hotel's annual report, Lodging Hospitality, and IFA's Franchise Opportunity Guide. These questions were included in the mail questionnaire in order to verify the information and obtain additional details.

Question 1. Your functional area of responsibility can best be described as:
_____ (e.g. President, Vice President of Development, etc.)

Question 2. Please indicate below in what segment of the lodging industry your hotel brand competes:

(Circle a number)

- a. First class*
- b. Mid-priced class*
- c. Economy class*
- d. Other _____ please specify*

Please indicate your hotel chain if your hotel uses other segmentation.

Question 3. Please indicate year that company was founded: 19____
year that franchising started: 19____

Question 4. What is the total number of units?

	Company-owned units	Franchised units
Y1992	_____	_____
Y1991	_____	_____
Y1990	_____	_____

Hotel chains were grouped and analyzed according to their number of years in operation (Q-3) and company size (Q-4), thus establishing control variables in order to determine whether the observed relations between independent and dependent variables were nonspurious. In other words, it was determined whether the age or size of the firm had any impact on franchising hotel chains' organization form and their financial performance.

These questions provided general information about the responding hotel chains.

II. Internal Environment

The nature of an organization's internal environment affects the organizational form, either company-owned or franchised. Internal environment refers to factors that have been put forth to explain the existence of organizational form. The purpose of this set of questions was to ascertain the internal environmental factors of a hotel chain. There were three factors of internal environment: capital scarcity (Q-5), monitoring costs (Q-6), and asset specificity (Q-7). These measures indicate the degree of capital scarcity, the degree of monitoring costs, and the degree of asset specificity. The respondents were asked as to how their hotel considered each of the following factors in determining the organizational

form affecting the financial performance of operating units. The questions were developed by identifying theories related to franchising, especially in the lodging industry.

Question for capital scarcity:

Question 5. Please indicate the proceeds of financing activities in a statement of cash flows from the period 1990 through 1992.

	<i>Proceeds of long-term debt</i>	<i>Proceeds from issuing common stock</i>	<i>Payments on capital lease obligations</i>	<i>Dividends paid</i>
<i>Y1992</i>	_____	_____	_____	_____
<i>Y1991</i>	_____	_____	_____	_____
<i>Y1990</i>	_____	_____	_____	_____

Respondents were asked to analyze the long term debt and equity portion of financing activities from the statement of cash flows, if the net proceeds were negative, it was determined that retained earnings are used. Consequently, the firm assigned in the low capital scarcity category. Therefore, when the firm used internally generated funds such as retained earnings, it implied that the firm had low capital scarcity, and when the firm issued equity or used debt, it implied that the firm had high capital scarcity.

Question for monitoring costs

Question 6a. How many "field representatives" are in your hotel chain? _____

Question 6b. Do you or field representatives visit each unit? Yes () No ()

If "yes" how often do you or "field representatives" visit/travel the unit?

- | | |
|-------------------------------|-------------------------------|
| <i>a. once a month</i> | <i>b. twice a month</i> |
| <i>c. once every 3 months</i> | <i>d. once every 6 months</i> |
| <i>e. once every year</i> | <i>f. as needed</i> |
| <i>g. never</i> | |

Question 6c. What is the approximate length of stay for a typical visit?

- a. less than one day*
- b. one day*
- c. two days*
- d. three days*
- e. more than three days*

Question 6d. What is the average distance of units from the monitoring/regional headquarters?

_____ miles

Question 6e. What are the costs for visiting/traveling the unit? (such as, travel expenses, accommodation, meals)

\$ _____ per unit per visit

These questions were to determine the monitoring costs with regard to opportunistic behavior of the unit managers. Responses to each of the four items in Q-6 (a through d) regarding the monitoring of the units were used to indirectly measure the costs of monitoring the units and unit managers. The average costs of monitoring unit managers (Q-6e) were determined from the survey responses.

Question for asset specificity

A Likert-type scale was used to measure the asset specificity which was scored by "1: strongly disagree" to "7: strongly agree." The numbers reported by the respondents indicated how the franchisor perceives the asset. If it was marked on 1 and 2, it was determined as low asset specificity, and if it was marked on 6 and 7, the asset was determined as high asset specificity.

The following questions (Q-7a through Q-7h) were adapted from Anderson (1985, 1988), John and Weitz (1988), Heide and John (1988), and Erramilli and Rao (1993).

Question 7: Asset Specificity

The scale attempts to measure the level of assets. Please circle one that match your perception on transaction specific asset.

	Strongly Agree					Strongly Disagree	
<i>a. The facilities, supplies, and services are highly specialized --They could not be used with any other brand.</i>	1	2	3	4	5	6	7
<i>b. The furnishings, fixtures, equipment, and supplies at the hotel could not be as easily transferred from the current location to a other location.</i>	1	2	3	4	5	6	7
<i>c. The systems and procedures the franchisees use with this brand could not be used for any other hotel brand without major changes.</i>	1	2	3	4	5	6	7
<i>d. This hotel has invested in furnishings, fixtures, equipment, and supplies for this brand that couldn't be used with another hotel brand.</i>	1	2	3	4	5	6	7
<i>e. To market services under this brand, franchisors have had specialized training that franchisees couldn't use with another brand.</i>	1	2	3	4	5	6	7
<i>f. The hotel has spent a lot of time and effort to develop a strong customer base for this particular brand.</i>	1	2	3	4	5	6	7
<i>g. Franchisees have spent a lot of time and effort learning special selling techniques for this hotel brand.</i>	1	2	3	4	5	6	7
<i>h. If franchisees switched to a competitive brand, franchisees would loose a lot of the investment franchisees have made in marketing and services.</i>	1	2	3	4	5	6	7

Three major measurements for asset specificity were used in this study: (a) human asset including professional skills, training, specialized know-how, customization, (b) physical asset including facilities, supplies, and (c) locational assets.

Financial Performance:

Two performance measures were used in this study: (a) growth in unit sales and (b) return on investment. Each of these measures was taken over six year period, 1990-1992.

They were measured by the percentages reported by the respondent, and/or in the Uniform Franchising Offering Circular (UFOC) and an annual report of each hotel chain were used.

Question 8a. Please indicate below your hotel's percentage of growth in unit sales for the period 1990 through 1992.

	Y1992	Y1991	Y1990
Percentage			

Growth in unit sales = change in total annual sales / number of units

The growth in unit sales examined the reliance on new units for growth in order to observe the economic impact on the hotel-chain operator of adding a new franchise or company-owned unit.

Question 8b. Please indicate below your hotel's percentage of return on investment for the period 1990 through 1992.

	Y1992	Y1991	Y1990
Percentage			

Return on investment = income after taxes/ invested capital

This question determined the financial status with regard to profitability of participating hotel chains.

The above performance measures were used to determine whether there was a significant difference in the franchisor who had company-owned and/or franchised units that achieved higher performance than those that did not.

Summary

In this chapter the research framework was defined, research questions were raised, and research hypotheses were established. Further, the research design, data collection methods, and statistical analyses methods were discussed. The results are presented in the following chapter.

CHAPTER IV

RESULTS AND DISCUSSIONS

Introduction

In this chapter, the results of the research with regard to pretest, the data collected, statistical analyses, and hypotheses testing are presented.

Pretest Results

A total of six lodging organizations were selected for the pretest. These organizations represented a cross section of private and public lodging firms. Furthermore, they represented organizations that operated in each class of three price based segments of the lodging industry: first class, mid-priced, and economy class.

Selection of the pretest organizations was predicated in an attempt to include organizations that were likely to have different organizational forms and segments.

One of the primary objectives in conducting the pretest was to refine and validate the survey instrument used to measure internal environmental factors, that is, to include capital scarcity, monitoring costs, and asset specificity that would be indicative of how franchising hotel chains react upon their internal environmental factors. Six firms provided one or more suggestions regarding monitoring costs variable. Based on the feedback, the questionnaire was further modified for the final format (See Appendix G and H).

Data Collection

A total of 81 lodging organizations that are operating under franchising or company and/or combination of both, across the nation were mailed survey questionnaire packet. This packet included:

1. A cover letter briefly describing the research and requesting the firm's cooperation.
2. Three parts of the questionnaire related to internal environmental factors: capital scarcity, agency problem (monitoring costs, distance, number of field representatives, number of visits, and lengths of stay), and transaction asset specificity (location, physical, and customer).
3. Two parts related to financial performance: return on investment and growth in unit sales.

A self-addressed and postage paid return envelope was enclosed. A modified version of the total design method (Dillman, 1978) was utilized for the survey. The Dillman method specifies an approach to mail and telephone surveys which have proven to result in relatively high response rate if conscientiously followed. The cover letter and accompanying questionnaires were mailed out on May 23, 1994. A reminder letter was mailed two weeks after the first mailing. Telephone calls were made in order to verify and fill out all the necessary data.

Response Rate

From a total of 81 lodging firms, 35 firms participated and returned the survey, with 30 being usable, a 37.04 percent response rate. With regard to the responsibility of the respondents, the majority of the respondents were from presidents of companies ($\underline{n}=12$, 40%), followed by senior vice presidents of operations ($\underline{n}=8$, 27%), vice presidents of franchise development ($\underline{n}=6$, 20%), and directors of development ($\underline{n}=4$, 13%).

Characteristics of Respondents

Discussion of survey data

Before presenting the results, a brief discussion on the validity and reliability of the survey instrument is presented. Realizing a single study cannot achieve validity

(Cronbach, 1971), and that this study is exploratory in nature, a host of steps were taken to enhance the validity and reliability of the instrument and the data collected.

Validity of the instrument

Validity and reliability are two important properties of a research instrument. Validity of an instrument means that it measures what it is designed to measure (Nachmias and Nachmias, 1981). The following methods for validity were performed:

1. Multi-trait Multi-method

Results were obtained by a multi-trait multi-method approach to enhance construct validity. This approach was found to be a useful tool by many authors (Campbell & Fiske, 1959; Churchill, 1979; Farh, Hoffman, & Hegarty, 1984). The following two methods were used in conjunction with the multi-trait multi-method:

- a. Each of the three variables that were under study. Internal environmental factors, organizational form, and financial performance, was measured by several attributes. Internal environmental factors were measured based on ownership redirection hypothesis, agency theory, and transaction cost analysis theory. Three attributes of organizational form, company-ownership, franchising, and combination of both, were measured by analyzing the proportion of ownership of each organization over five years. The financial performance was measured by return on investment (ROI) and growth in unit sales.
- b. Data were acquired through a survey method by means of direct mailing. Secondary data such as uniform franchise offering circular (UFOC) and annual report also were utilized to supplement the analysis. Financial data collected from these sources were used as a random check for consistency between the self-typing of the directors or vice presidents on the financial performance measures versus the actual performances that were reported publicly.

2. Content validity was also used. The content validity of the questionnaire was enhanced through a review of questionnaire items used by previous researchers (Anderson, 1984; Brickley & Dark, 1987; Caves & Murphy, 1976; Erramilli & Rao, 1993; Heide & John, 1988; John & Weitz, 1988; Lafontaine, 1992; Norton, 1988). The content validity of the financial performance variables, return on investment and growth in unit sales, have been established in studies relating to marketing, management, economy and hospitality management (Cook, 1985; Jacobson, 1990; Szymanski, Bharadwaj, & Varadarajan, 1993). Geller (1985) investigated the relative importance of ten commonly used hotel performance goals. His study found profitability and growth were the most frequently cited goals of hotel executives.
3. The information sought by this study was provided by chief executives or presidents and their top management team of franchising development or operations executives. It was believed that these respondents should be most influential and knowledgeable about firm's internal environment, organizational form, and financial performance to participate in the study. This self-typing approach has been shown to be a valid research method of collecting data (Pearce & Robinson, 1982).

Reliability of the Data

The essential criterion for any instrument is that it produces data that are reliable (Crone & Foster, 1993). Reliability refers to the degree to which the observations are consistent or stable (Rosenthal & Rosnow, 1984). Carmines and Zeller (1979) also assert that "fundamentally, reliability concerns the extent to which an experiment, test, or any measuring procedure yields the same results on repeated trials."

1. The data received from hotel companies were supplemented by UFOC, annual report, IFA's Franchise Opportunity Guide, The Rating Guide to Franchise, and Worldwide Franchising Directory. The information on unit size, type of organization, years of

operation, and financial data were verified with above sources to confirm the reliability of the measures.

2. Test of Normality - Tests were performed to establish the normality of the data distribution and internal reliability of the survey questions.

These tests include stem-leaf (Tukey, 1977) and box plots. Appendices A to F show the diagrams of stem-leaf and box plots with statistical information on the normality of variables. As most asterisks or samples form straight lines and cover most of the plus signs, and values of W in Moments are larger than 0.5, the data are a sample from a normal distribution. A few performance data provided by some companies were considered to be outliers, thus these outliers were deleted from the hypothesis testing.

Appendices A to F show also plots of each measure of monitoring cost and performance variables for the total sample, with and without outliers.

Survey Results

Based upon the 30 responses received, information regarding segment of lodging industry, years of operation, years of franchising, and size of company (number of units) is presented in tables Table 1 to 8. This is followed by results on the three variables: internal environmental factors, organizational form, and financial performance.

Hypotheses were established to examine the relationship between internal environmental factors, organizational form and their impact on performance. One-way analysis of variance (ANOVA), two-way analysis of variance, analysis of covariance (ANCOVA), and two-way analysis of covariance were employed to test for the significance of association between these variables.

The profiles of participating organizations are discussed in the following sections.

Lodging industry segment

Table 1 presents the distribution of respondents by price based segment. Hotels ranged from "first class" to "economy class" with "economy class" leading in respondents ($n=22$, 73.3%), followed by "first class" and "mid-priced class" with ($n=5$, 16.7%), and ($n=3$, 10.0%), respectively. When the respondents compared with the population of hotels, the "first class", mid-priced class", and "economy class" represented 33.3%, 25%, and 42.3%, respectively.

Years of operation (Age)

The respondents were also asked to indicate the number of years the firm has been in operation. The largest group ($n=8$, 26.7%) of responding firms has been in operation for six to ten years, followed by those in operation for 16 to 20 years ($n=6$, 20.0%) and 31 years and over ($n=6$, 20.0%), and 11 to 15 years ($n=4$, 13.3%). The sample shows that half of the firms has been in the lodging business fifteen years or less (See Table 2).

Years of franchising

Table 3 presents the frequency distribution of the respondents based on their years of franchising. The largest group ($n=8$, 36.4%) of responding firms had six to ten years of franchising experience, followed by the firms with less than five ($n=4$, 18.2%) and 11 to 15 years ($n=4$, 18.2%). The sample showed majority of the firms ($n=16$, 72.8%) with fifteen years or less franchising experience.

Size of company (Number of units)

Table 4 illustrates the sizes of the responding firms. The size of a company is indicated

Table 1. Number and Percentage of Responding Firms by Segment

S	Frequency	Percent	Cumulative	Cumulative
			Frequency	Percent
E	22	73.3	22	73.3
F	5	16.7	27	90.0
M	3	10.0	30	100.0

E=economy Class

F= first Class

M=mid-price Class

Table 2. Number and Percentage of Responding Firms by Years of Operation

Years	Frequency	Percent

Less than 5	3	10.0
6 - 10	8	26.7
11 - 15	4	13.3
16 - 20	6	20.0
21 - 25	2	7.0
26 - 30	1	3.0
31 years and over	6	20.0

Table 3. Number and Percentage of Responding Firms by Years of Franchising

Years	Frequency	Percent

Less than 5	4	18.2
5 - 10	8	36.4
11 - 15	4	18.2
16 - 20	1	5.0
21 - 25	0	0.0
26 - 30	2	9.1
31 years and over	3	13.6

by the total number of hotel units that are company owned, franchised, or a combination of company-owned and franchised. About thirty percent ($n=9$) of the responding firms had a company size of less than twenty-five. About twenty-seven percent of the responding firms had a size of 101 to 250 units.

Table 4.1 presents the size of the responding firms by organizational form. About seventeen percent ($n=5$) of the responded firms that operated under franchising had a company size of 101-250 and 251-1000 units.

The frequency distribution of the respondents by the number of units provided the basis for developing equally distributed categories of the size variable for further analysis.

Variables

Internal Environmental Factors

The measurement of internal environmental factors reflects how the firm reacts to these factors in the context of choosing organizational form and the firm's financial performance. From the concepts of ownership redirection hypothesis, agency theory, and transaction cost analysis theory, respondents were asked to indicate how the firm considers each of the internal environmental factors that impact upon the choice of organizational form and financial performance of operating units.

Capital scarcity

As there are no empirical studies that have directly measured capital scarcity of the firm, this study applied the pecking order hypothesis of capital structure that firms prefer to finance with internally generated funds; that is, retained earnings and depreciation. In addition, since the firm would go to the external capital markets when it needs more capital, the firm would generate it through proceeds of long-term debt, and eventually

Table 4. Number and Percentage of Responding Firms by Size

Unit	Frequency	Percent
<hr/>		
Less than 25	9	30.00
26 - 100	7	23.33
101 - 250	8	26.67
251 - 1000	6	20.00
Total	30	100.00

Table 4.1 Number and Percentage of Responding Firms by Size and Organizational Form

Unit	B	C	F	Total
Less than 25	3	3	3	9
26 - 100	2	4	1	7
101 - 250	2	2	4	8
251 - 1000	1	0	5	6
Total	8	9	13	30

B = combination of company owned and franchised

C = company-owned

F = franchised

issuing common stock as a last resort. The measurement of capital scarcity was to review the statement of cash flows by analyzing financing activities which include (a) obtaining resources from owners and providing them with a return on, and a return of, their investment and (b) obtaining resources from creditors and repaying the amounts borrowed or otherwise settling the obligation. Cash inflows and outflows from financing activities of a company were analyzed through proceeds from the issuance of equity securities and from bonds, mortgages, long-term borrowings, as well as payments of dividends, outlays to repurchase the entity's shares, and repayments of amounts borrowed.

By analyzing the debt and equity portion of financing activities shown on company's statement of cash flows for three years, and responses to the questionnaire, each firm was categorized into high or low capital scarcity. If the net proceeds were negative, then the firm had high capital scarcity. If the net proceeds do not show a consistent pattern over the period of investigation, then the firm was placed in a moderate capital scarcity category. If the firm had positive net proceeds, then the firm had low capital scarcity.

Table 5.1 presents a number and percentage of responding firms by capital scarcity. Twelve companies (40.0%) had capital scarcity and another twelve companies (40.0%) had low capital scarcity. Six (20.0%) companies belonged to the moderate category. The results of the analysis presented here indicated that the firms of a company-owned form had low capital scarcity while the firms of a franchised form had high capital scarcity. In other words, while high capital scarcity organizations tended to feature franchising, low capital scarcity organizations tended to feature company ownership. The analysis also shows that the firms had combination of both form posses in-between capital scarcity (See Table 5.2).

Monitoring costs

The studies by Shelton (1967) and Brickley and Dark (1987) suggested that

Table 5.1. Number and Percentage of Responding Firms by Capital Scarcity

CS	Frequency	Percent	Cumulative	Cumulative
			Frequency	Percent
H	12	40.0	12	40.0
L	12	40.0	24	80.0
M	6	20.0	30	100.0

H = high capital scarcity
L = low capital scarcity
M = moderate capital scarcity

Table 5.2. Cross-tabulation of Organizational Form by Capital Scarcity

TABLE OF FORM BY CS

FORM (Organizational Form)		CS (Capital Scarcity)		
Frequency		H	L	M
B		2	2	4
C		1	7	1
F		9	3	1
Total		12	12	6
		40.00	40.00	20.00
				100.00

H = high capital scarcity
L = low capital scarcity
M = moderate capital scarcity

B = combination of company-owned and franchised
C = company-owned
F = franchised

monitoring cost is an important consideration in the choice of organizational form. However, monitoring cost is varied depending on length of field representatives or monitors, unit size, and problems of units and unit managers. Therefore, respondents were asked to indicate the number of field representatives or monitors and frequency of travel to each unit. Another proxy of a franchisor's monitoring costs was a distance of unit from the monitoring center. Respondents were asked to indicate the distance of a unit, however, respondents indicated that the distance varied with each unit; some firms responded that it is in the range of 20, 1000, and even 2000 miles and some firms indicated simply "varied". Therefore, the distance variable was not utilized as a proxy of "true" monitoring costs.

To measure the cost of monitoring a unit, the number of field representatives, frequency of visit, and lengths of stay were employed. Table 6.1 to 6.3 present the number and percentage of responding firms by above variables. The number of field representatives were in the range of one ($n=5$, 16.7%) to ten ($n=1$, 3.3%) (See table 6.1).

Other proxies for measuring the costs of monitoring was frequency of trip to units and length of stay. Table 6.2 illustrates that 53% of the companies (16) visited their units once every three months and 10% visited twice a year. Table 6.3 illustrates the length of stay for each visit. Sixteen (53.3%) companies indicated that they stayed at the units "one day" and fourteen companies (46.7%) responded "two days."

Three proxies for measuring the monitoring costs were combined to generate a composite cost for each responding company. This was done by multiply the number of representatives, frequency of visit, and lengths of stay and divided by number of hotels. Finally, companies were divided into two categories based upon the median: "high" and "low" monitoring costs. Table 6.4 illustrates the number and percentage of responding firms by monitoring costs. Nineteen (63.3%) companies showed that they had "low monitoring costs" and eleven (36.7%) companies showed that they had "high monitoring costs."

Table 6.1. Number and Percentage of Responding Firms by Field Representatives

REP	Cumulative		Cumulative	
	Frequency	Percent	Frequency	Percent
1	5	16.7	5	16.7
2	7	23.3	12	40.0
3	4	13.3	16	53.3
4	3	10.0	19	63.3
5	3	10.0	22	73.3
6	3	10.0	25	83.3
8	3	10.0	28	93.3
9	1	3.3	29	96.7
10	1	3.3	30	100.0

REP = number of field representatives

Table 6.2. Number and Percentage of Responding Firms by Frequency of Visits

F	Frequency	Percent	Cumulative	Cumulative
			Frequency	Percent
1	3	10.0	3	10.0
2	3	10.0	6	20.0
3	5	16.7	11	36.7
4	16	53.3	27	90.0
5	3	10.0	30	100.0

F = frequency of visit

1 = as needed

2 = twice a month

3 = once a month

4 = quarterly

5 = biannually

Table 6.3. Number and Percentage of Responding Firms by Length of Stay

L	Frequency	Percent	Cumulative	Cumulative
			Frequency	Percent
2	16	53.3	16	53.3
3	14	46.7	30	100.0

L = lengths of stay
2 = one day
3 = two days

Table 6.4. Number and Percentage of Responding Firms by Monitoring Costs

MO	Frequency	Percent	Cumulative	Cumulative
			Frequency	Percent

H	11	36.7	11	36.7
L	19	63.3	30	100.0

MO = monitoring costs
H = high monitoring costs
L = low monitoring costs

Table 6.5 presents a cross-tabulation of the respondents by organizational form and monitoring costs. Nine franchising firms (30.0%) had "low monitoring costs", while three company-owned (10.0%) firms had "high monitoring costs." The results of the analysis indicated that the firms of a company-owned form had low monitoring cost while the firms of a franchised form had high monitoring cost. In other words, while high monitoring cost organizations tended to feature franchising, low monitoring costs organizations tended to feature company ownership.

Asset specificity

Transaction-specific assets are those human and physical assets (tangible and intangible) required to support exchange and which are specialized to the exchange relationship. Those assets are devoted to the franchise relationship and cannot be easily transferred to other relationship.

The questionnaire was designed to measure the respondent's perception of asset specificity. A frequency distribution of asset specificity scores was developed to determine the cutoffs for the high and low groups. The high asset specificity group were those companies within the 75th percentile, and low asset specificity group were those companies that fell in the 25th percentile.

Table 7.1 illustrates the number and percentage of responding firms by asset specificity. Twenty four (80%) companies indicated "high asset specificity" and six (20%) companies indicated "low asset specificity".

Table 7.2 presents a cross-tabulation of the respondents by organizational form and monitoring costs. The results of the analysis indicated that the firms of a combination of both form had low asset specificity while the firms of a franchised form had high asset specificity. In other words, while high asset specificity organizations tended to feature franchising, low asset specificity organizations tended to feature combination of both form.

Table 6.5. Cross-tabulation of Organizational Form by Monitoring Costs

TABLE OF FORM BY MO			
FORM	MO (Monitoring Costs)		
Frequency	H	L	Total
B	4	4	8
C	3	6	9
F	4	9	13
Total	11	19	30
	36.67	63.33	100.00

B = combination of company owned and franchised

C = company-owned

F = franchised

H = high monitoring costs

L = low monitoring costs

Table 7.1. Number and Percentage of Responding Firms by Asset Specificity

ASSET	Frequency	Percent	Cumulative Frequency	Cumulative Percent
H	24	80.0	24	80.0
L	6	20.0	30	100.0

H = high asset specificity

L = low asset specificity

Table 7.2. Cross-tabulation of Organizational Form by Asset Specificity

TABLE OF FORM BY ASSET				
FORM	ASSET (Asset Specificity)			
Frequency	H	L		Total
B	8	0		8
C	5	4		9
F	11	2		13
Total	24	6		30
	80.00	20.00		100.00

H = high asset specificity

L = low asset specificity

B = combination of company-owned and franchised

C = company-owned

F = franchised

Organizational Form

In this study, the organizational form is indicated by the number of firms that operated through company-owned, franchising, and combination of both. By examining the change in the proportion of units (company-owned, franchised units, or combination of both) over time as reported on the questionnaires and verified through secondary sources such as the company's UFOC and Lodging Hospitality, firms were categorized with respect to organizational form. If the proportion of company owned units is less than 34% of total units the hotel chain is referred as franchised and when the proportion of company-owned units is more than 66% the hotel chain is referred to as company-owned. If the proportion of company-owned units is between 35% and 65% the hotel chain is referred to as combination form.

Table 8 presents the number (frequency) and percentage of responding firms by their organizational form. There is a fairly even distribution of firms in each of the categories. A majority of the respondents were franchised form ($n=13$, 43.3%), followed by company-owned ($n=9$, 30.0%) and combination of both ($n=8$, 26.7%). These categories of organizational form were utilized as independent variables.

Financial Performance

The dependent variable, financial performance of a firm was measured by return on investment (ROI) and growth in unit sales, for the period 1990 through 1992. In terms of these two measures of performance, there were a wide range of responses. ROI percentage ranged from -6.45% to 27.1% with half of the total respondents indicating -5% to 5% (See Table 9).

The range for growth in unit sales was from -8.63% to over 21% with half of the total respondents indicating a growth of 6% to 10%. Twenty ($n=6$) percent of the firms

Table 8. Number and Percentage of Responding Firms by Organizational Form

FORM	Frequency	Percent
<hr/>		
B	8	26.67
C	9	30.00
F	13	43.33
Total	30	100.0

B = combination of company-owned and franchised
C = company-owned
F = franchised

Table 9. Number and Percentage of Responding Firms based on Financial Performance

Financial Performance ROI	Number of Responding Firms	Percentage %
Less than -5 %	1	3.33
-5 to -1 %	6	20
0 to 5 %	9	30
6 to 10 %	6	20
11 to 15 %	3	10
16 to 20 %	2	6.67
21 to 30 %	3	10
Total	30	100
<u>Growth in Unit Sales</u>		
Less then -5 %	2	6.67
-5 to -1 %	0	0
0 % to 5 %	7	23.33
6 to 10 %	15	50
11 to 15 %	4	13.33
16 to 20 %	1	3.33
21 to 30 %	1	3.33
Total	30	100

enjoyed a growth rate of 6% or more. For the entire sample, the mean score for ROI was 6.99 % and the mean score for growth in unit sales was 7.28%.

Hypotheses Testing

The principal purpose of this study was to investigate the association between internal environmental factors, organizational form, and their relationship to the financial performance of lodging industry. Chapter III presented the basic model guiding this study, the research questions, and two principal hypotheses to be tested. This section of the chapter presents the results of the statistical tests performed on these two hypotheses. The discussion and implications arising from these results are presented in Chapter V.

HYPOTHESIS ONE

"No difference will be found in the financial performance of company-owned versus franchised hotel chains."

This null hypothesis examines the contention that all organizational forms are equally effective and do not account for any differences in the financial performance of hotel chains. Organizational form was categorized into company-owned, franchised, and combination of both form. Since the organizational form variable was categorical, a one-way analysis of variance (ANOVA) test was performed using return on investment (ROI) as the dependent variable.

Table 10 presents the results of the one-way ANOVA test. The result shows no significant relationship between organizational form and performance, $F = 1.83$, $p > .05$. In other words, the results indicates that there was no statistically significant relationship between the hotels' organizational form and performance measured in terms of ROI.

Table 10. One-way analysis of variance: Organizational form and ROI (Return on Investment)

General Linear Models Procedure

Dependent Variable: ROI

Source	DF	Sum of Squares	Mean Square	F Value	Pr > F
Model	2	267.81345130	133.90672565	1.83	0.1794
Error	27	1973.53593536	73.09392353		
Corrected Total	29	2241.34938667			

Duncan's Multiple Range Test for variable: ROI

Means with the same letter are not significantly different

Duncan Grouping	Mean	N	FORM
A	9.721	13	f
A	7.142	9	c
A	2.371	8	b

B = combination of company-owned and franchised
 C = company-owned
 F = franchised

The choice of a performance measure is often based on tradeoffs that may be biased in favor of one type of test. In order to verify the test results, Duncan's multiple range test for variable (ROI) was conducted. All testing results showed that there was no significant difference among the group means (i.e., the mean score for each organizational form).

The analysis using an alternate performance measure, growth in unit sales (G) was conducted. Table 11 presents the results of the analysis using this measure. The results indicated that there was no statistically significant relationship between the hotels' organizational form and financial performance measured in terms of growth in unit sales, $F = 0.89$, $p > .05$.

Although the above tests were not statistically significant, the pattern emerging from the analysis deserved examination. By analyzing the mean score for each form with regards to ROI, franchised form (9.72%) outperformed company-owned form (7.14%) which, in turn, outperformed combination form (2.37%) (See Table 10). On further examination the mean scores for growth in unit sales of responding hotels (mean = 7.28%) showed, company-owned form (8.997%) outperformed franchised form (7.53%) which, in turn, outperformed combination form (4.95%) (See Table 11).

The emerging patterns do not provide conclusive evidence as to which organizational form has the best financial performance. However, franchised form was the best when ROI was measured while company-owned was the best when growth in unit sales was measured. Nevertheless, the combination form consistently underperformed the other organizational firms regardless of the financial performance measure used.

HYPOTHESIS TWO

"The link between financial performance and organizational form is not moderated by evaluations of internal environment."

This study examined the contention that employing internal environment in hotel chains that have different organizational forms is not related to performance. In other words, a

Table 11. One-way analysis of variance: Organizational form and Growth in Unit Sales

General Linear Models Procedure					
Dependent Variable: G					
Source	DF	Sum of Squares	Mean Square	F Value	Pr > F
Model	2	70.08375897	35.04187949	0.89	0.4223
Error	27	1062.98825769	39.36993547		
Corrected Total	29	1133.07201667			

Duncan's Multiple Range Test for variable: ROI

Means with the same letter are not significantly different.

Grouping	Mean	N	FORM
A	8.977	9	c
A	7.534	13	f
A	4.952	8	b

B = combination of company-owned and franchised
C = company-owned
F = franchised

"match" or interaction between internal environmental factors and organizational form does not have to occur for hotel chains to perform better.

Hypothesis two is divided into three subhypotheses in the context of three internal environmental factors.

Hypothesis 2-1: "The link between financial performance and organizational form is not moderated by capital scarcity."

Hypothesis 2-2: "The link between financial performance and organizational form is not moderated by the cost of monitoring the unit manager."

Hypothesis 2-3: "The link between financial performance and organizational form is not moderated by asset specificity."

In order to reject these null hypotheses, it would have to be shown that hotel chains did in fact had to match their organizational form to their internal environmental factors to perform better. As stated in Chapter III, in hypothesis 2-1, it would have to be shown that hotel chains facing a high capital scarcity, higher performance would be associated with hotels operating units through a franchised form. However, lower performance would be associated with hotels operating units through a company-owned form. In addition, for hotel chains facing a low capital scarcity or abundant capital, higher performance would be associated with hotels operating units through a company-owned form while lower performance would be associated with hotels operating units through a franchised form.

In hypothesis 2-2, for hotel chains facing high monitoring costs (agency problem), higher performance would be associated with hotels operating units through a franchised form while lower performance would be associated with hotels operating units through a company-owned form. Similarly, for hotel chains facing low monitoring costs, higher performance would be associated with hotels operating units through a company-owned form while lower performance would be associated with hotels operating units through a franchised form.

In hypothesis 2-3, for hotel chains perceiving high asset specificity, higher performance would be associated with hotels operating units through a company-owned form while lower performance would be associated with hotels operating units through a franchised form. Similarly, for hotel chains facing low monitoring costs, higher performance would be associated with hotels operating units through a franchised form while lower performance would be associated with hotels operating units through a company-owned form.

In order to test hypotheses 2-1 to 2-3, a two-way analysis of variance was conducted using internal environment factors separately: capital scarcity (high and low), monitoring costs (high and low), and asset specificity (high and low). These categorical variables were utilized as moderator variables. Organizational form was an independent categorical variable with three forms (company-owned, franchised, and combination of both). Both financial performance measures (ROI and growth in unit sales) were also used separately as continuous dependent variables.

The results of the analysis indicated that there was no statistically significant interaction effect of the hotel's organizational form and capital scarcity on financial performance measured in terms of ROI and growth in unit sales. This was evident from the high p value denoting insignificance of the interaction term, $F = 1.25$, $p > .05$ and $F = 0.21$, $p > .05$, respectively (See Table 12.1 and 12.2). In these cases, the null hypothesis that organizational form and capital scarcity do not interact to affect financial performance cannot be rejected.

The results of the analysis shown in Table 13.1 indicate that there is significant interaction effect of the hotel's organizational form and monitoring costs on financial performance measured in terms of ROI, $F = 3.06$, $p < .05$. The cell means presented in Table 13.1 provide information on how monitoring cost and organizational form are matched in relation to financial performance in terms of ROI. In the high monitoring cost environment, the franchising and company-owned firms outperformed combination firm. In the low monitoring cost environment, the franchising and company-owned firm have

Table 12.1. Two-way analysis of variance: Organizational Form, Capital Scarcity and Return on Investment (ROI)

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	506.66638020	3.44	0.0511
CS	2	65.61459287	0.45	0.6466
FORM*CS	4	367.11469689	1.25	0.3223
Form = organizational form				
CS = capital scarcity				
Form*CS = interaction of organizational form and capital scarcity				

Table 12.2. Two-way analysis of variance: Organizational Form, Capital Scarcity and Growth in Unit Sales

General Linear Models Procedure

Dependent Variable: Growth in Unit Sales

Source	DF	Type III SS	F Value	Pr > F
FORM	2	35.79049364	0.38	0.6916
CS	2	35.10645910	0.37	0.6964
FORM*CS	4	39.54973453	0.21	0.9315

Form = organizational form
CS = capital scarcity
Form*CS = interaction of organizational form and capital scarcity

Table 13.1. Two-way analysis of variance: Organizational Form, Monitoring Cost and Return on Investment (ROI)

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	216.9940522	1.58	0.2267
MO	1	80.7730164	1.18	0.2889
FORM*MO	2	283.0883144	3.06	0.0493*

Form = organizational form
MO = monitoring cost
Form*MO = interaction of organizational form and monitoring cost

Cell Means Compared			
Form	MO	N	ROI
Franchised	H	4	10.34
Franchised	L	10	5.36
Company-owned	H	3	-1.81
Company-owned	L	5	12.07
Combination	H	4	6.55
Combination	L	6	6.19

* Significant

low performance while the combination of both firm has higher performance. These results indicate that the hypothesis that the franchising firm has high financial performance when it has high monitoring costs in terms of ROI was supported. Furthermore, the hypothesis that the company-owned firm has low financial performance when it has high monitoring costs in terms of ROI was supported. However, there was no significant interaction effect of the hotels' organizational form and monitoring costs on financial performance in terms of growth in unit sales, $F = 0.67$, $p > .05$ (See Table 13.2). In this case, the null hypothesis that organizational form and monitoring costs do not interact to affect financial performance (growth in unit sales) was failed to reject.

The results of the analysis shown in Table 14.1 and 14.2 indicate that there was no statistically significant interaction effect of the hotel's organizational form and asset specificity on ROI, $F = 0.49$, $p > .05$ and growth in unit sales, $F = 0.48$, $p > .05$. In these cases, the null hypothesis that organizational form and asset specificity do not interact to affect financial performance (i.e., ROI and growth in unit sales) cannot be rejected.

Follow-up Analyses

This section of the chapter reports the results of some additional follow-up statistical tests performed on additional variables in the data set. First, analysis of covariance (ANCOVA) using size as a covariate (control variable) was conducted. Table 15.1 presents the results of the analysis using the financial performance (ROI) measure. The results of the analysis presented here indicate that there was no significant relationship between the hotel's size and performance measured in terms of ROI, $F = 14.99$, $p > .05$, and growth in unit sale, $F = 2.64$, $p > .05$ (See Table 15.2).

Second, another ANCOVA test was conducted using years of operation as a covariate. Table 16.1 and 16.2 presents the results of the analysis using the ROI and growth in unit sales as dependent variables. The results also indicate that there was no significant

Table 13.2. Two-way analysis of variance: Organizational Form, Monitoring Cost and Growth in Unit Sales

General Linear Models Procedure				
Dependent Variable: Growth in Unit Sales				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	95.9455173	1.18	0.2267
MO	1	48.8234926	1.20	0.2834
FORM*MO	2	54.5735880	0.67	0.5195

Form = organizational form
MO = monitoring cost
Form*MO = interaction of organizational form and monitoring cost

Table 14.1. Two-way analysis of variance: Organizational Form, Asset Specificity, and Return on Investment (ROI)

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	268.98983795	1.71	0.2005
ASSET	1	3.93992482	0.05	0.8245
FORM*ASSET	1	38.55721934	0.49	0.4897
FORM = organizational form				
ASSET = asset specificity				
FORM*ASSET = interaction of organizational form and asset specificity				

Table 14.2. Two-way analysis of variance: Organizational Form, Asset Specificity, and Growth in Unit Sales

General Linear Models Procedure				
Dependent Variable: Growth in Unit Sales				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	44.4195200	0.56	0.5793
ASSET	1	45.3337797	1.14	0.2961
FORM*ASSET	1	19.2672886	0.48	0.4930

FORM = organizational form
ASSET = asset specificity
FORM*ASSET = interaction of organizational form and asset specificity

Table 15.1. Analysis of covariance: Organizational Form with Size

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	22.2116667	2.17	0.4328
SIZE	26	1995.8623304	14.99	0.2018

FORM = organizational form
SIZE = size of operation (units)

Table 15.2 . Analysis of covariance: Organizational Form with Size

General Linear Models Procedure				
Dependent Variable: Growth in Unit Sales				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	3.0929167	0.10	0.9112
SIZE	26	1038.5087804	2.64	0.4563

Table 16.1. Analysis of covariance: Organizational Form with Years of Operation

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	162.4389149	1.01	0.4036
YEAR	18	1273.7379286	0.88	0.6148

Table 16.2. Analysis of covariance: Organizational Form with Years of Operation

General Linear Models Procedure				
Dependent Variable: Growth in Unit Sales				
				.
Source	DF	Type III SS	F Value	Pr > F
FORM	2	9.1522713	0.06	0.9399
YEAR	18	394.2105850	0.30	0.9860

relationship between the hotel's years of operation and performance: ROI and growth in unit sales, $F = 6.88$, $p > .05$ and $F = 0.30$, $p > .05$, respectively.

Third, another ANCOVA test was conducted using years of operation and size as a covariate in the conjunction of internal environmental factors, such as capital scarcity, monitoring costs, and asset specificity. Table 17.1 to 21.2 present the results of the analysis using the ROI and growth in unit sales as dependent variables. The results also indicate that there were no significant relationship between the hotel's years of operation and size, and performance.

Summary and Conclusion

This chapter has presented a profile of firms that participated in the study and descriptive statistics pertaining to these firms. Statistical tests to examine the relationships among the variables being studied were presented and briefly discussed. Control variables (size and years of operation) were also evaluated. Summary of the hypotheses testing are as follows:

Hypothesis One was accepted because hotel chains operating under different organizational form did not differ in their financial performance levels.

Hypothesis Two - 1 (capital scarcity) and 3 (asset specificity) were accepted because hotel chains that showed a match between their internal organizational factors (capital scarcity and asset specificity) and organizational form performed similarly compared to those that did not show a match.

Hypothesis Two - 2 (monitoring costs) was rejected because hotel chains that showed a match between their monitoring cost and organizational form performed better than those that did not.

Table 17.1. Analysis of covariance: Organizational Form and Capital Scarcity with Years of Operation

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	438.8674907	3.46	0.0900
CS	2	283.9270932	2.24	0.1769
YEAR	18	1500.0615328	1.32	0.3730

Table 17.2. Analysis of covariance: Organizational Form and Capital Scarcity with Years of Operation

General Linear Models Procedure

Dependent Variable: Growth in Unit Sales

Source	DF	Type III SS	F Value	Pr > F
FORM	2	2.47082079	0.01	0.9869
CS	2	2.38280278	0.01	0.9874
YEAR	18	356.58883169	0.21	0.9964

Table 18.1. Analysis of covariance: Organizational Form and Monitoring Cost with Years of Operation

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	130.4172812	0.90	0.4441
MO	1	104.8754037	1.45	0.2634
YEAR	18	1351.5040605	1.04	0.5080

Table 18.2. Analysis of covariance: Organizational Form and Monitoring Cost with Years of Operation

General Linear Models Procedure

Dependent Variable: Growth in Unit Sales

Source	DF	Type III SS	F Value	Pr > F
FORM	2	72.3976569	0.64	0.5507
MO	1	215.0411627	3.82	0.0863
YEAR	18	577.4371265	0.57	0.8467

Table 19.1. Analysis of covariance: Organizational Form and Asset Specificity with
Years of Operation

General Linear Models Procedure

Dependent Variable: ROI

Source	DF	Type III SS	F Value	Pr > F
FORM	2	195.0233497	1.14	0.3666
ASSET	1	0.6295821	0.01	0.9337
YEAR	18	1289.5507403	0.84	0.6440

Table 19.2. Analysis of covariance: Organizational Form and Asset Specificity with Years of Operation

General Linear Models Procedure				
Dependent Variable: Growth in Unit Sales				
Source	DF	Type III SS	F Value	Pr > F
FORM	2	17.20623484	0.11	0.8983
ASSET	1	31.92721484	0.40	0.5431
YEAR	18	390.95182726	0.27	0.9892

Table 20.1. Analysis of covariance: Organizational Form and Monitoring Cost with Size

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type I SS	F Value	Pr > F
FORM	2	267.8134513	26.15	0.1370
MO	1	42.3185904	8.27	0.2131
SIZE	25	1926.0973449	15.05	0.2013

Table 20.2. Analysis of covariance: Organizational Form and Monitoring Cost with Size

General Linear Models Procedure

Dependent Variable: Growth in Unit Sales

Source	DF	Type I SS	F Value	Pr > F
FORM	2	70.0837590	2.32	0.4213
MO	1	35.3753225	2.34	0.3687
SIZE	25	1012.4879352	2.68	0.4534

Table 21.1. Analysis of covariance: Organizational Form and Asset Specificity with Size

General Linear Models Procedure				
Dependent Variable: ROI				
Source	DF	Type I SS	F Value	Pr > F
FORM	2	267.8134513	26.15	0.1370
ASSET	1	0.0260891	0.01	0.9546
SIZE	25	1968.3898462	15.38	0.1992

Table 21.2. Analysis of covariance: Organizational Form and Asset Specificity with Size

General Linear Models Procedure				
Dependent Variable: Growth in Unit Sales				
Source	DF	Type I SS	F Value	Pr > F
FORM	2	70.0837590	2.32	0.4213
ASSET	1	38.7466738	2.56	0.3555
SIZE	25	1009.1165838	2.67	0.4540

CHAPTER V

SUMMARY AND CONCLUSION

Introduction

In the first section of the chapter, the findings of the study are summarized with the results of hypotheses tests. In the following section, the contributions of the study are presented followed by implications for hotel chains and franchising theory. Discussion of the limitations of the study and recommendations for further research are also presented.

This study was conducted based on the concept of the ownership redirection hypothesis, agency theory, and transaction cost analysis theory to examine the proposition that internal environment of an organization moderates the organizational form - financial performance relationship in the lodging industry.

The sample consisted of hotel chains that operate under franchise system. Pertinent data were collected through survey research and analyzed by the computerized "SAS" program. Demographics of the hotel chains as well as information on internal environmental factors, organizational form, and financial performance were derived and presented in the form of frequency distributions. Two main hypotheses were tested which dealt with the relationship between internal environmental factors (capital scarcity, monitoring costs, and asset specificity), organizational form (company-owned, franchised, and combination of both form), and financial performance (return on investment and growth in unit sales). Selected tests included analysis of variance (ANOVA) and analysis of covariance (ANCOVA). General Linear Models (GLM) procedure was used because of unbalanced sample size groups. Alpha value of 0.05 was applied to test for significance.

Descriptive Statistics Discussed

This section discusses the results of the analysis drawn from the descriptive statistics.

Size and years of operation

This study included hotel chains with more than thirteen units. "Young" companies whose organizational form was classified as company-owned tended to have smaller units compared to franchising hotel chains. As companies got "older" their choice of organizational form tended to be the combination of both.

Years of operation and organizational form

Forty percent of the responding hotel chains had belonged in the range of eight to fourteen years of operation. This observation was not consistent with the researchers' findings (Oxenfeldt & Kelly, 1968-1969; Caves & Murphy, 1976). It was expected that the hotel chains with relatively few years of operational experience would have more franchising units compared to the hotel chains with more years of experience. However, the findings showed that hotels with more years of operation had a high proportion of franchised unit. It can be concluded that the years of operation did not explain performance as measured by ROI or growth in unit sales.

A summary of findings with regard to the two hypotheses is as follows:

HYPOTHESIS ONE

"No difference will be found in the financial performance of company-owned versus franchised hotel chains."

The differences of financial performance among organizational form were conducted using analysis of variance (ANOVA). The result of the analysis indicated that hotel chains operating under different organizational form did not differ in their financial performance levels. Thus, hypothesis one was not rejected.

HYPOTHESIS TWO

"The link between financial performance and organizational form is not moderated by evaluations of internal environment."

Hypothesis two was divided into three subhypotheses in the context of three internal environmental factors.

Hypothesis 2-1: "The link between financial performance and organizational form is not moderated by capital scarcity."

The results indicated that there was no statistically significant relationship among the three variables. The link between financial performance and organizational form was not moderated by capital scarcity of the firm. Thus, hypothesis 2-1 was not rejected.

Hypothesis 2-2: "The link between financial performance and organizational form is not moderated by the cost of monitoring the unit manager."

The proposed interaction effect between the cost of monitoring the unit manager and organizational form to financial performance in terms of ROI and growth in unit sales was measured by using two-way analysis of variance. The results indicated a statistically significant relationship between the hotels' monitoring costs and organizational form and performance measured in terms of ROI. This result is the most significant contribution of this study.

In the high monitoring cost environment, the franchising firm outperformed combination of both firm. The franchising and company-owned units performed relatively well. In the low monitoring cost environment, the franchising firm and company-owned firm showed low performance compared to that of hotel chains which had combination of both form. These results indicated that the franchising firm had high financial performance (ROI) when the firm was in the situation of high monitoring costs environment. Furthermore, the company-owned firm showed high financial performance (ROI) when the firm was high monitoring costs. Table 22 presents the results of relationship between organizational form and monitoring cost.

However, the result of ANOVA test indicates that there was no significant difference when growth unit in sales was measured. Thus, the link between financial performance and organizational form was moderated by monitoring costs when the financial performance was measured in terms of ROI. In other words, monitoring costs was a key internal environmental factor in organizational form and financial performance (ROI) relationship.

Hypothesis 2-3: "The link between financial performance and organizational form is not moderated by asset specificity."

In addition to employing concept from an ownership redirection hypothesis such as capital scarcity and agency, transaction-cost analysis theory such as asset specificity was employed in this study to test whether this internal environmental factor moderated the relationship between organizational form and performance.

Two financial performance were measured separately. The results indicated that there was no statistically significant relationship among the three variables. Thus, the link

Table 22. Results of Moderating Effect of Monitoring Cost and Organizational Form to Financial Performance (ROI)

Organizational Form	Monitoring Cost High	Monitoring Cost Low
Franchising	(H) ROI	(L) ROI
Company-owned	(L) ROI	(H) ROI
Combination of both*	(M) ROI	(M) ROI

* combination of both: combination of company-owned and franchised unit

ROI = return on investment

H = high

L = low

M = moderate

between financial performance and organizational form was not moderated by asset specificity, consequently hypothesis 2-3 was not rejected.

Internal Environment, Organizational Form, and Financial Performance

The results showed a statistically significant effect of the interaction between monitoring cost and organizational form on financial performance in terms of return on investment (ROI). This result validated the contingency approach on which this study was based. The results imply that hotel chains need to "match" their internal environment and organizational form in order to have better performance. Figure 2 shows the results of moderating effect by internal environment. The finding of this study also showed that the firm's performance varied depending on the performance measure used.

Control Variables

The control variable, size of a hotel chain, had no impact on the two performance measures. This finding did not support the general perception on size and performance relationship. As most franchising hotels chains had larger units in the lodging industry, they could have an advantage of access to resources, capital, and economies of scale in marketing and advertising, and would experience better performance. In addition, these results did not support the findings of Marquardt and Murdock (1986) who argued that "since franchisors with large unit size enjoy a high capital leverage advantage in the franchisee-run units, they can realize a higher profit-to-sales dollar ratio in such units as compared to the company-owned units."

Another control variable, years of operation, had no impact on both financial performance measures. This finding did not support the findings of Baucus, Baucus, and Human (1993). They argued that the franchisor's choice of organizational form and future financial performance depended on the age of the operation. Hotel operators or

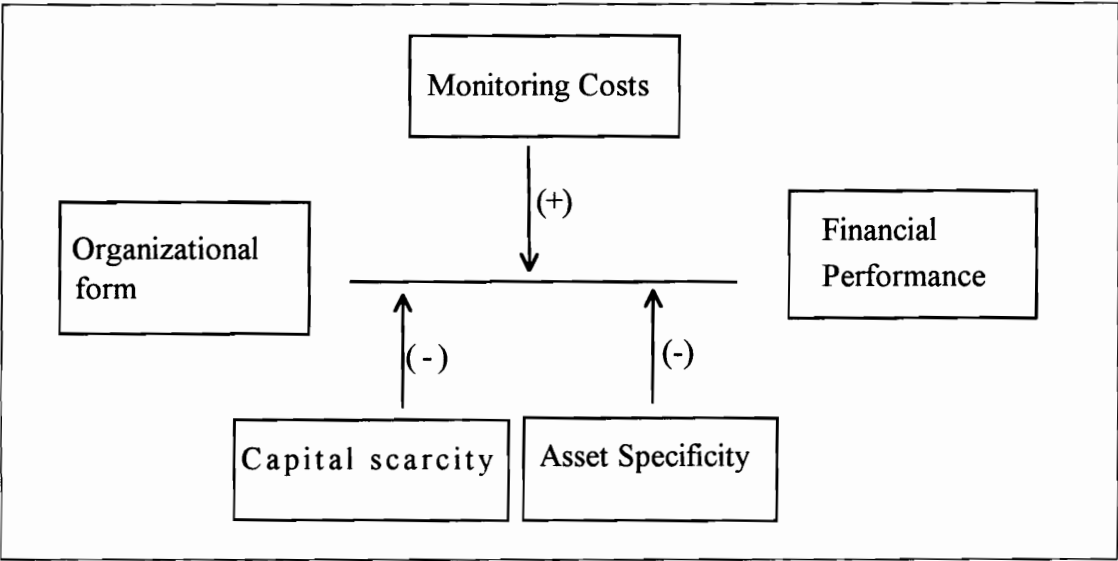


Figure 2

Moderating effect of internal environmental factors on organizational form - financial performance relationship

franchisors should realize that the value they receive from franchisees is reflected not only by the age and size of the operation but also by the quality of services provided to franchisees and unit managers, the means of assuring quality in the system, the effectiveness of corporate marketing, and the overall management skill level (Baucus, Baucus, & Human, 1993).

Contribution of Study

This study has taken an initial step toward developing an understanding of the internal environmental factors, organizational form, and their impact on financial performance of franchising hotel chains. Although statistically many tests were found to be not significant, some of the findings present practical information to hotel operators, researchers, and educators.

Despite its importance to the lodging industry, franchising has not been the focus of vigorous research studies and theory building as has been the case in economics, management, and marketing disciplines.

This exploratory study contributes to the body of knowledge in the lodging industry in the following ways:

First, this study presents a way of investigating the possible interrelationship between internal environment, organizational form, and financial performance in the lodging industry. This is the first empirical study that has applied these three concepts (i.e., internal environment, organizational form, and financial performance (ROI and growth in unit sales) in the lodging industry. This study employed the contingency theory using internal environment as a moderator. In other words, this is the first empirical study that has applied three internal environmental factors (i.e., capital scarcity, monitoring costs, and asset specificity) in the lodging industry. This is also the first study that relied on primary data rather than secondary data. These approaches constitute substantive

contributions to an understanding of an organization in conjunction with a franchising system in the lodging industry.

Second, this study provides unique ways to measure the internal environmental factors, organizational form, and financial performance: (1) capital scarcity was measured using data of financing activities in the statement cash flows, (2) proportioned organizational form and categorized into (a) franchised, (b) company-owned, and (c) combination of both, and (3) financial performance was measured using return on investment (ROI) and growth in unit sales.

Third, this study provides empirical support with regard to the relative models in predicting appropriate organizational form that will show better financial performance. In other words, the firm that evaluates and analyzes its internal environmental factors could have the right organization form that generates high profitability. Furthermore, this study contributes to the existing agency theory literature in franchising by providing empirical research results for the already advance evaluative contingency theory.

Implications of the Research Findings

The implications of the findings with respect to the lodging industry are discussed in the following section.

Managerial implication

The results of this study indicate that hotel chains employ different organizational forms to improve their profitability. The choice of organizational form employed depends upon internal environmental factors. The franchised form appears to be appropriate where monitoring cost of unit and unit manager is high. In addition, the company-owned form appears to be appropriate where monitoring cost is low.

The monitoring costs for the manager of company-owned units and franchised units can influence the structure of administrative expenses in the income statement. Since the financial performance of the units is related to the hotel's income statement, the manner in which monitoring costs are minimized would be crucial to the hotel chains that operate through company-owned form.

Theoretical implications

This study contributes to a better understanding of internal environmental factors of the hotel operation. From the theoretical point of view, the study provides evidence of a relationship between organizational form and financial performance. Different organizational forms can be employed in different internal environments in order to enhance performance.

Furthermore, this study has applied agency theory (Alchian & Demsetz, 1972; Jensen & Meckling, 1976; Rubin, 1978), the concepts of asset specificity and opportunism (Heide & John, 1988; John & Weitz, 1988; Klein & Saft, 1985; Williamson, 1975, 1985) as well as capital theory (Caves & Murphy, 1976; Oxenfeldt & Kelly, 1968-1969). The findings of this study support Williamson's principle (1975, 1985, 1991). Williamson stated that asset specificity, such as the product, brand name, and location or specialized input into the unit, would not moderate the organizational form and performance relationship. The way to measure the intensity of asset specificity should be extended in the context of benefits and costs by employing moderating factors such as frequency of contract, units size, risk, market share, and legal issues (e.g., cannibalization or encroachment).

Limitation of the Study

Identifiable limitations of this study should be noted. Generalizability of this study's results is limited because of the small sample size. The generalizability of the results of

this study is also limited because the firms were drawn from a single service industry. In addition, the ability to generalize the results obtained from this study to the population of all hotel chains across the nation is limited by other factors. These limitations include management contracting hotel companies were not included in the sample.

The environmental factors were limited to three internal factors. Other factors such as market density, customer perception, and competitors were not considered. In measuring asset specificity, the study utilized the self-typing approach. Perception-based responses from humans is subject to error, and perception would vary depending upon the individual respondent's title, years of experience, and working environment. This could result in a respondent's own perception instead of what is true of the organization.

The cutoff point in categorizing organizational form was arbitrary and this could have introduced a bias on categorizing the hotel chains. Some respondents from this study were from the smaller and private hotel chains that were interested in learning more about internal environment and organizational form. There should be more communication between the practitioners and researchers.

Implication and Recommendations for Future Research

Future researchers could focus on the restaurant industry. Since the size of the restaurant industry is much larger, there will be a great opportunity to increase the sample size.

Further research should be conducted to examine whether one or more of the internal environmental factors need to be redefined, and to determine whether external environmental factors could impact more heavily on the relationship between organizational form and financial performance.

Future researchers can investigate whether the proportion of company-owned and franchised units is a result of repurchase activity and/or reshaping the organizational form

by the hotel operator due to capital, management confidence, market information or demand from the market.

There is potential for newly opened units to adversely affect the sales of nearby incumbent units of the same chain. In other words, the organizational form permits the hotel chains (franchisors) to act as suppliers as well as competitors to their franchisees. Thus the impact of organizational form on market share should be studied.

A further study should be extended to identify the importance of master franchisees. Master franchisees act like mini-franchisors and they have their own unit and grant franchises to prospective franchisees. They also collect fees and royalty payments, which they in turn pay to the franchisor (Khan, 1992). Since this type of arrangement could provide efficiency to the hotel company due to geographic and marketing reasons, the contribution of this arrangement in the context of capital, agency problem, and performance to the hotel chains should be investigated.

REFERENCES

- Alchian, A. A., & Demsetz, H. (1972). Production, information costs, and economic organization. American Economic Review, 62(5), 777-795.
- Anderson, E. (1984). The growth and performance of franchise systems: company versus franchise ownership. Journal of Economics and Business, 36(December), 421-31.
- _____. & Schmittlein, D.C. (1984). Integration of the sales force: An empirical examination. Rand Journal of Economics, 15(3), 385-395.
- _____. & Zeithaml, C. P. (1984). Stage of the product life cycle, business strategy, and business performance. Academy of Management Journal, 27(1), 5-24.
- Anderson, E. (1985). The salesperson as outside agent or employee: A transaction cost analysis. Marketing Science, 4(Summer), 234-53.
- _____. (1988). Transaction costs as determinants of opportunism in integrated and independent sales forces. Journal of Economic Behavior and Organization, 9, 247-264.
- Arnold, H. J. (1982). Moderator variables: A clarification of conceptual, analytic, and psychometric issues. Organizational Behavior and Human Performance, 29, 143-174.
- Arrow, K. J. (1974). The Limits of Organization, New York: Norton.
- Baucus, D. A., Baucus, M. S., & Human, S. E. (1993). Choosing a franchise: How base fees and royalties relate to the value of the franchise. Journal of Small Business Management, 31(2), 91-104.
- Baum, C. (1993, February). Franchising evolves worldwide as technology, competition grow. HOTELS, p. 48-53.
- Beard, D. W., & Dess, G. G. (1981). Corporate-level strategy, business-level strategy, and firm performance. Academy of Management Review, 24(4), 663-688.
- Beheler, R. (1991). Control in various organizational forms: an empirical study of company owned and franchisee units' health inspections. Proceedings of the Fifth Conference of the Society of Franchising, 1-4.
- Blair, R. D., & Kaserman, D. L. (1982). Optimal franchising. Southern Economic Journal, 49, 494-505.

- Brickley, J. A., & Dark, F. H. (1987). The choice of organizational form: The case of franchising. Journal of Financial Economics, 18, 401-20.
- _____, _____, & Weisbach, M. A. (1991). The economic effects of franchise termination laws, Journal of Law and Economics, 34, 101-132.
- Brigham, E. F., & Gapenski, L. C. (1987). Intermediate Financial Management (2nd ed.). Hinsdale, IL: Dryden Press.
- Brown, J. R., & Nicholson, C. Y. (1991) Governance structures in a franchised channel of distribution. Proceedings of the Fifth Conference of the Society of Franchising, 5.
- Buzzell, R. D., & Wiersema, F. D. (1981). Successful share building strategies. Harvard Business Review, 59(1), 134-144.
- Campbell, D. T., & Fiske, D. W. (1959). Convergent and discriminant validation by the multitrait-multimethod matrix. Psychological Bulletin, 56, 81-105.
- Carlin, P. A. (1989). Why the incidence of shirking varies across employers. Journal of Behavioral Economics, 18(2), 61-73.
- Carmines, E. G., & Zeller, R. A. (1979). Reliability and validity. Sage University Paper series on Quantitative Applications in the Social Sciences, Newbury Park, CA: Sage Publications.
- Carney, M. & Gedajlovic, E. (1991). Vertical integration in franchise systems: Agency theory and resource explanations. Strategic Management Journal, 12, 607-629.
- Caves, R. E., & Murphy, W. F. (1976). Franchising: firm, markets, and intangible assets. Southern Economic Journal, 42, 45-59.
- Chandler, A. D. (1962). Strategy and Structure. New York: MIT Press.
- Child, J. (1975). Managerial and organizational factors associated with company performance - part II: A contingency analysis. Journal of Management Studies, 12, 12-27.
- Churchhill, G. A. (1979). A paradigm for developing better measures of marketing constructs. Journal of Marketing Research, 16, 64-73.
- Coase, R. N. (1937). The nature of the firm. Economica, 4(November), 386-405.

- Cook, V. J., Jr. (1985). The net present value of market share. Journal of Marketing, 49 (Summer), 49-63.
- Cronbach, D. A. (1971). Test validation in educational measurement (2nd ed.). Washington, DC: American Council on Education. 443-507.
- Dant, R., Kaufmann, P., & Paswan, A., (1992). Ownership redirection in franchising channels. Journal of Public Policy and Marketing, 11, 1-12.
- Davidson, W. H., & McFetridge, D. G. (1985). Key Characteristics in the choice of international technology transfer mode. Journal of International Business Studies, 16(2), 5-21.
- Dess, G. G., & Davis, P. S. (1984). Porter's (1980) general strategies as determinants of strategic group membership and organizational performance. Academy of Management Journal, 27(3), 467-488.
- Dev, C. (1988). Environmental uncertainty, business strategy, and financial performance: A study of the lodging industry. Unpublished Doctoral Dissertation, Virginia Polytechnic Institute and State University, Blacksburg, VA.
- Dillman, D. A. (1978). Mail and telephone surveys. New York: John Wiley and Sons.
- Erramilli, M. K., & Rao, C. P. (1993). Service firms' international entry mode choice: A modified transaction-cost analysis approach. Journal of Marketing, 57(July), 19-38.
- Farh, J. L., Hoffman, R. C., & Hegarty, W. H. (1984). Assessing environmental scanning at the sub-unit level: A multitrait multimethod analysis. Decision Sciences, 15, 197-220.
- Foster, D. (1987). The Complete Franchise Book. Rocklin, California: Prima Publishing and Communications. pp. 181-183.
- Geller, A. N. (1985). The current state of hotel information systems. The Cornell Hotel and Restaurant Administration Quarterly, May, 4-17.
- Goldberg, J. (1982). A transactions cost analysis of franchising with empirical applications to the restaurant industry. Unpublished doctoral dissertation, University of Pennsylvania.
- Heide, J. & John, G. (1988). The role of dependence balancing in safeguarding transaction-specific assets in conventional channels. Journal of Marketing, 52(January), 20-35.

- Henry, H. W. (1981). Strategic management: Longer view broader options. Survey of Business, 16 (4), 4-9.
- Henson, S. & Pilling, B. (1992). An organizational ecology perspective on the development of franchise systems. Proceedings of the Sixth Conference of the Society of Franchising, 4-5.
- Hunt, S. (1972). The socioeconomic consequences of the franchise system of distribution. Journal of Marketing, 36(July), 32-38.
- _____. (1973). The trend toward company-operated units in franchise chains. Journal of Retailing, 49, 3-12.
- _____. & Nevin, J. R. (1975). Tying agreements in franchising. Journal of Marketing, 39 (July), 20-26.
- International Franchise Association. (1990). Franchising in the Economy 1988-1990. Washington, DC: International Franchise Association Educational Foundation, Inc.
- International Franchise Association. (1993). Franchising in the Economy 1989-1992. Washington, DC: International Franchise Association Educational Foundation, Inc.
- Jacobson, R. (1990). Unobservable effects and business performance. Marketing Science, 9(Winter), 74-85.
- Jensen, M. & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs and capital structure. Journal of Financial Economics, 3, 305-360.
- Jones, G. R., & Hill, C. W. (1988). Transaction cost analysis of strategy-structure choice. Strategic Management Journal, 9, 159-172.
- John, G., & Weitz, B. A. (1988). Forward integration into distribution: An empirical test of transaction cost analysis. Journal of Law, Economics, and Organization, 4(2), 337-355.
- Khan, M. (1992). Restaurant Franchising. New York: Van Nostrand Reinhold.
- Klein, B. (1980). Transaction cost determinants of "unfair" contractual arrangements. American Economic Review, 70(2), 356-362.
- _____. (1985). Transaction cost determinants of "unfair" contractual agreements. American Economic Association, (May), 358-359.

- _____, Frazier, G. L., & Roth, V. J. (1990). A transaction cost analysis model of channel integration in international markets. Journal of Marketing Research, 27(2), 196-208.
- _____, & Leffler, K. B. (1981). The role of market forces in assuming contractual performance. Journal of Political Economy, 89, 615-641.
- _____, & Saft, L. (1985). The law and economics of franchise tying contracts. Journal of Law and Economics, 28(May), 345-361.
- Knight, R. (1986). Franchising from the franchisor and franchisee points of view. Journal of Small Business Management, (July), 8-15.
- Kuga, M. W. (1989). The Decision to Franchise: Theory and evidence. University Microfilms International, 1707.
- Lafontaine, F. (1992). How and why do franchisors do what they do: a survey report. Proceedings of the Sixth Conference of the Society of Franchising, 3-9.
- Lenz, R. T. (1981). Determinants of organizational performance: An interdisciplinary review. Strategic Management Journal, 2, 131-154.
- Lillis, C., Narayana, C., & Gilman, J. (1976). Competitive advantage variation over the life cycle of franchise. Journal of Marketing, 40(October), 77-80.
- Marquardt, R. A., & Murdock, G. W. (1986). An evaluation of franchising trends and their implications for the retailing industry. Proceedings of the 1986 Conference of the Society of Franchising, Lincoln, Neb.: International Center for Franchise Studies, University of Nebraska.
- Martin, R. E. (1988). Franchising and risk management. The American Economic Review, 78(5), 954-968.
- Mathewson, G. F., & Winter, R. A. (1985). The economics of franchise contracts. Journal of Law and Economics, 28, 503-526.
- McArthur, A. W., & Nystrom, P. C. (1991). Environmental dynamism, complexity, and munificence as moderators of strategy-performance relationships. Journal of Business Research, 23(4), 349-361.
- Mescon, T. (1979). Entrepreneurship in the real estate industry: a comparative analysis of independent and franchise brokers. Unpublished doctoral dissertation, University of Georgia.

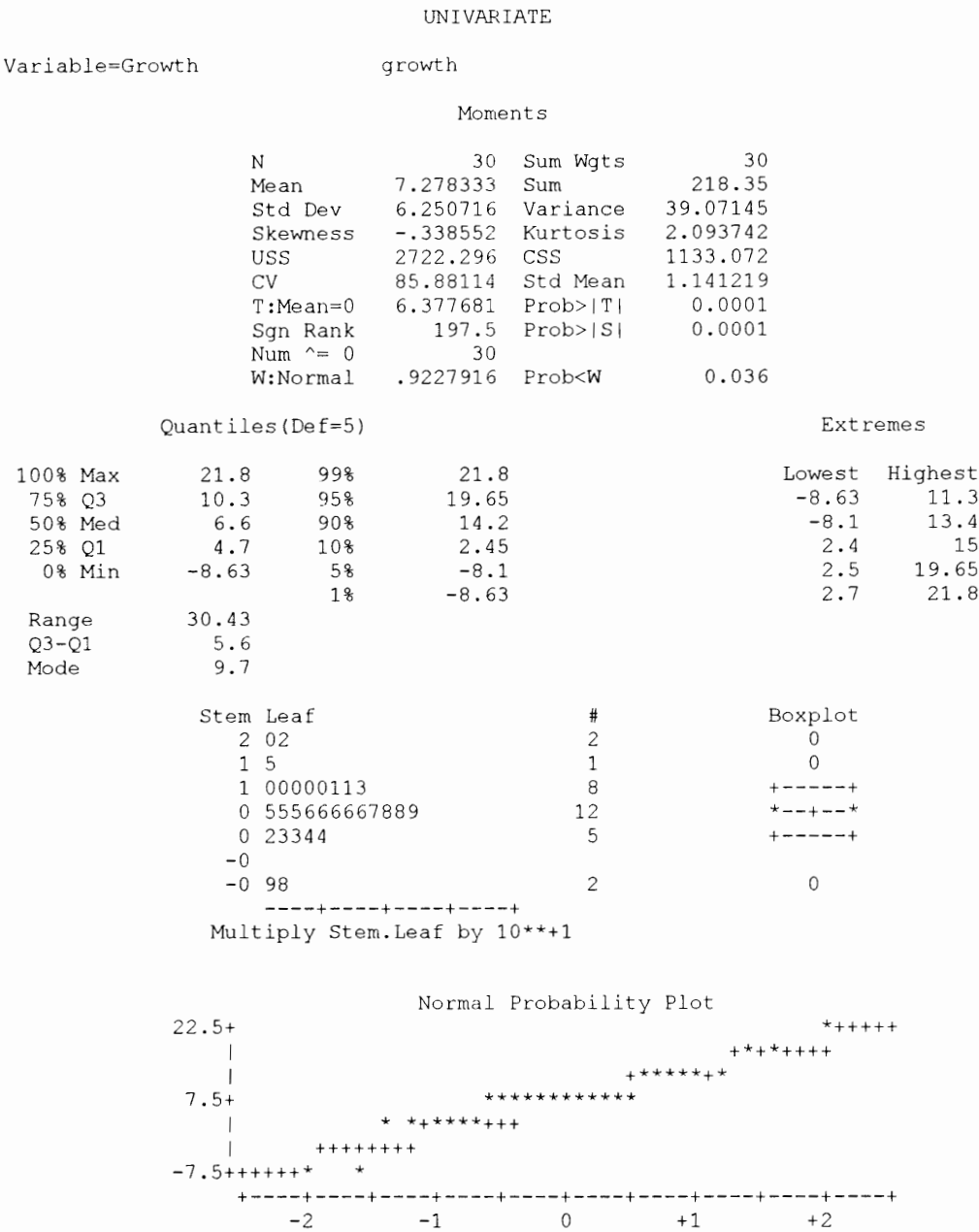
- Miller, D. (1987). Strategy making and structure: Analysis and implications for performance. Academy of Management Journal, 30(1), 7-32.
- Minkler, A. P. (1992). Why firms franchise: A search cost theory. Journal of Institutional and Theoretical Economics, 148, 240-259.
- Monteverde, K. & Teece, D. J. (1982). Supplier switching costs and vertical integration in the automobile industry. Bell Journal of Economics, 13(1), 206-213.
- Nachmias, D. & Nachmias, C. (1981). Research method in the social sciences. New York; St. Martin's Press.
- Neter, J., Wasserman, W., & Kunter, M. H. (1985). Applied Linear Statistical Model (2nd ed.). Homewood, IL: Irwin.
- Norton, S. (1988). An empirical look at franchising as an organizational form. Journal of Business, 61(2), 197-218.
- Olsen, M. D., & Merna K. M. (1991, August). Trends. Hotel and Motel Management, p. 50.
- O'Hara, M. J., & Thomas, W. L. (1986). Franchise systems: The internal dynamics of sales growth and dual distribution. Proceedings of the 1986 Conference of the Society of Franchising, Lincoln, Neb.: International Center for Franchise Studies, University of Nebraska.
- Oxenfeldt, A., & Kelly A. (1968-1969). Will successful franchise systems ultimately become wholly-owned chain? Journal of Retailing, 44, 69-83.
- _____ & Thompson, D. (1969). Franchising in perspective. Journal of Retailing, (Winter), 3-13.
- Ozanne, U. & Hunt, H. (1971). The Economic Effect of Franchising. U.S. Senate, Select Committee on Small Business, Washington, DC: U.S. Government Printing Office.
- Padmanabhanm, K. (1988). Channel Control: Do successful franchise systems ultimately become wholly-owned chains. Journal of Midwest Marketing, 3(Fall), 17-36.
- Parsa, H. G., & Kwansa, F. A. (1991). Financial performance and strategic options in franchise systems: A study of the hospitality industry. Proceedings of the Fifth Conference of the Society of Franchising, 1-21.

- Pearce, J. A. & Robinson, R. B. (1982). Strategic Management. Homewood, Illinois: Richard D. Irwin.
- Powers, T. (1992). Introduction to management in the hospitality industry (4th ed.). New York, New York: John Wiley & Sons, Inc.
- Rosenthal, R., & Rosnow, R. L. (1984). Essentials of behavioral research. New York: McGraw-Hill.
- Rubin, P. (1978). The theory of the firm and the structure of the franchise contract. Journal of Law and Economics, 21, 223-234.
- Rumelt, R. P. (1974). Strategy, structure, and economic performance. Boston, Massachusetts: Harvard University Press.
- Scott, B. R. (1973). The new industrial state: Old myths and new realities. Harvard Business Review, 51(2), 133-148.
- Sharma, A., & Dominguez, L. V. (1992). Channel evolution: A framework for analysis. Journal of the Academy of Marketing Science, 20(1), 1-15.
- Shelton, J. P. (1967). Allocative efficiency vs. 'x-efficiency': Comment. American Economic Review, 1252-1258
- Sherman, A. (1991). Franchising and Licensing, New York, New York: AMACOM 290-295.
- Stecker, M. (1993). Multiarea Development and Expansion Strategies. The Franchising Handbook, New York, New York: AMACOM. 466.
- Stern, L. W., El-Ansary, A. I. & Brown, J. R. (1989). Management in marketing channels. Englewood Cliffs, NJ: Prentice-Hall.
- Stopford, J. M. & Wells, L. T. (1972). Managing the Multinational Enterprise, New York: Basic Books.
- Szymanski, D. M., Bharadwaj, S. G., & Varadarajan, R. P. (1993). An analysis of the market share-profitability relationship. Journal of Marketing, 57(July), 1-18.
- Thomas, W. L., O'Hara, M. J., & Musgrave, F. W. (1990). The effects of ownership and investment upon the performance of franchise systems. American Economist, 34(1), 54-61.

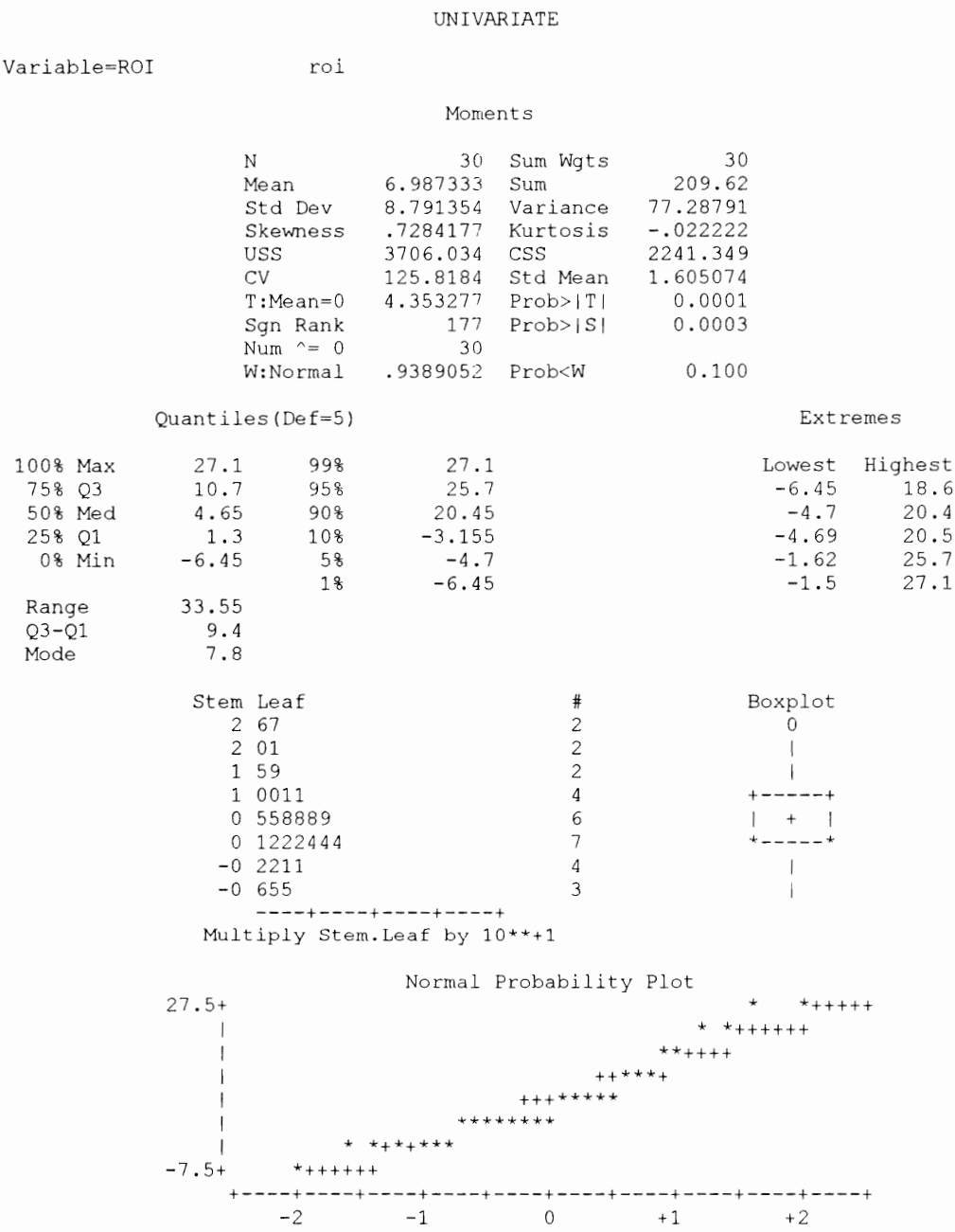
- Tukey, J. W. (1977). Exploratory Data Analysis. Reading, MA: Addison-Wesley Publishing Company.
- Wattel, H. (1968). Are franchisors realistic and successful in their selection of franchisees? Journal of Retailing, 44(Winter), 54-68.
- Walker, G. & Weber, D. (1984). A transaction cost approach to make-or-buy-decisions. Administrative Science Quarterly, 29(3), 373-391.
- Wildt, A., & Ahtola, O. (1978). Analysis of Covariance. Newbury Park, California: Sage Publications.
- Williamson, O. (1975). Markets and Hierarchies. New York, New York: Free Press.
- _____. (1979). Transaction-cost economics: The governance of contractual relations. Journal of Law and Economics, 22(October), 233-262.
- _____. (1980). The organization of work. Journal of Economic Behavior and Organization, 1, 5-38.
- _____. (1985). The Economic Institution of Capitalism. New York, New York: Free Press.
- _____. (1991). Comparative economic organization: The analysis of discrete structural alternatives. Administrative Science Quarterly, 36, 269-96.
- Wu, L. (1991). Quality assurance, brand loyalty and the pricing of motel services. Proceedings of the Fifth Conference of the Society of Franchising, 1-5.
- Zeithaml, C. P., & Fry, L. W. (1984). Contextual and strategic differences among mature businesses in four dynamic performance situations. Academy of Management Journal, 27(4), 841-860.

APPENDICES

Appendix A. Percentiles for Performance (without outliers)



Appendix B. Percentiles for Performance (without outliers)



Appendix C. Percentiles for Internal Environment (without outliers)

UNIVARIATE

Variable=CS

capital scarcity

Moments

N	30	Sum Wgts	30
Mean	1.8	Sum	54
Std Dev	.7611244	Variance	.5793103
Skewness	.3619779	Kurtosis	-1.14101
USS	114	CSS	16.8
CV	42.28469	Std Mean	.1389617
T:Mean=0	12.95321	Prob> T	0.0001
Sgn Rank	232.5	Prob> S	0.0001
Num ^= 0	30		
W:Normal	0.79	Prob<W	0.001

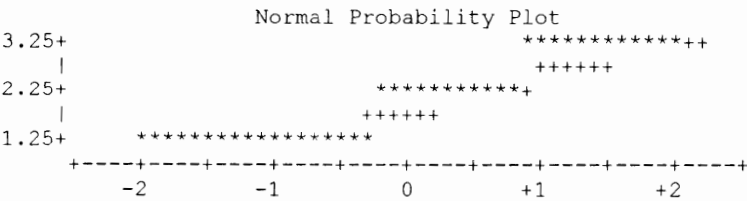
Quantiles (Def=5)

100% Max	3	99%	3
75% Q3	2	95%	3
50% Med	2	90%	3
25% Q1	1	10%	1
0% Min	1	5%	1
		1%	1
Range	2		
Q3-Q1	1		
Mode	1		

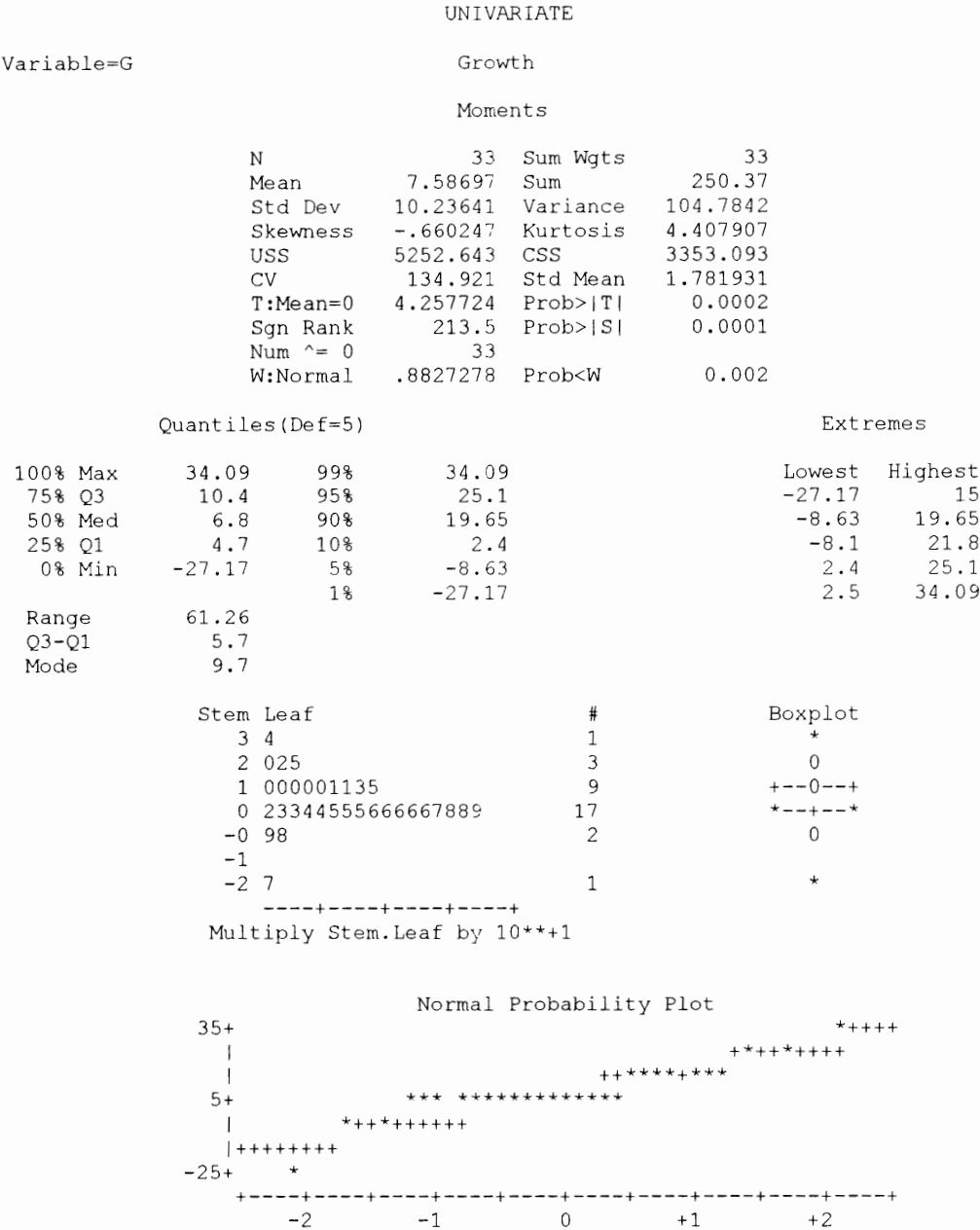
Extremes

Lowest	Highest
1	3
1	3
1	3
1	3
1	3

Stem	Leaf	#	Boxplot
3	000000	6	
2			
2	00000000000000	12	*-----*
1			+
1	00000000000000	12	+-----+
-----+-----+-----+-----+			



Appendix D. Percentiles for Performance (with outliers)



Appendix E. Percentiles for Performance (without outliers)

Variable=ROI

ROI

Moments

N	33	Sum Wgts	33
Mean	5.951515	Sum	196.4
Std Dev	10.11065	Variance	102.2252
Skewness	.0548871	Kurtosis	.3076057
USS	4440.083	CSS	3271.205
CV	169.8836	Std Mean	1.760038
T:Mean=0	3.381471	Prob> T	0.0019
Sgn Rank	171.5	Prob> S	0.0022
Num ^= 0	33		
W:Normal	.9815305	Prob<W	0.865

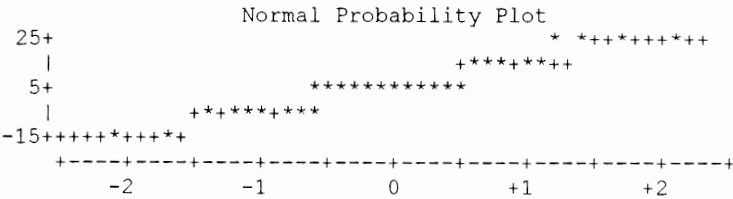
Quantiles (Def=5)

100% Max	27.1	99%	27.1
75% Q3	10.7	95%	25.7
50% Med	4.6	90%	20.4
25% Q1	-0.51	10%	-4.7
0% Min	-18.8	5%	-10.72
		1%	-18.8
Range	45.9		
Q3-Q1	11.21		
Mode	7.8		

Extremes

Lowest	Highest
-18.8	18.6
-10.72	20.4
-6.45	20.5
-4.7	25.7
-4.69	27.1

Stem Leaf	#	Boxplot
2 0167	4	
1 0011569	7	+-----+
0 1222444558889	13	*-----*
-0 6552211	7	+-----+
-1 91	2	0
-----+-----+-----+-----+		
Multiply Stem.Leaf by 10**+1		



Appendix F. Percentiles for Internal Environment (with outliers)

Variable=CS

Capital Scarcity

Moments

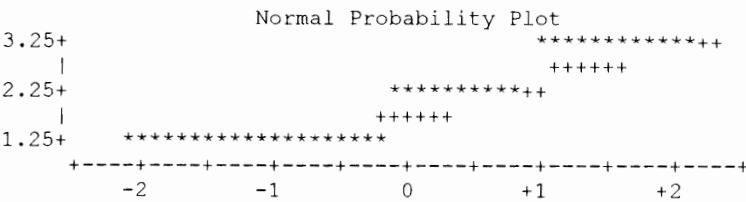
N	33	Sum Wgts	33
Mean	1.727273	Sum	57
Std Dev	.7612788	Variance	.5795455
Skewness	.5159599	Kurtosis	-1.05756
USS	117	CSS	18.54545
CV	44.07404	Std Mean	.1325216
T:Mean=0	13.03389	Prob> T	0.0001
Sgn Rank	280.5	Prob> S	0.0001
Num ^= 0	33		
W:Normal	0.771006	Prob<W	0.001

Quantiles (Def=5)

				Lowest	Highest
100% Max	3	99%	3		
75% Q3	2	95%	3	1	3
50% Med	2	90%	3	1	3
25% Q1	1	10%	1	1	3
0% Min	1	5%	1	1	3
		1%	1	1	3
Range	2				
Q3-Q1	1				
Mode	1				

Extremes

Stem	Leaf	#	Boxplot
3	000000	6	
2			
2	000000000000	12	*-----*
1			+
1	00000000000000	15	+-----+
-----+-----+-----+-----+			



APPENDIX G

PRE-TEST QUESTIONNAIRE

April 18, 1994

Dear (Mr. Mrs. Ms. Last Name):

As you are well aware, the hospitality industry is highly competitive. Does your organization select a right form based upon the evaluation of internal environment? Does your hotel chain show good financial performance? To answer these questions, the Department of Hospitality and Tourism Management at Virginia Polytechnic Institute and State University is conducting a study of a franchising in the lodging industry. The objective of this study is to examine how the internal environment of an organization combines with a organizational form (company-own or franchise) affect financial performance. This study is a basis for a doctoral dissertation and would be of great benefit to our lodging industry.

Your hotel has been selected to participate in this national study. We would very much like to have you involved in this study. The enclosed questionnaires are designed to let you express your company's opinion. As there is no right or wrong answer each question, your company's True Opinions is very import and valuable to this study. The success of this study depend largely on your participation. All information will be held in **strictest confidence**. It will be reported only in the form of statistical summaries so that information about your hotel **cannot be identified**.

Once you have completed the questionnaire, please seal in the enclosed postage-free envelope and mail it to us. We look forward to receiving your responses by **May 10**, 1994. We would be happy to answer any questions at any time. You should feel free to contact us. The telephone number is (703) 951-4117.

We appreciate you in advance for your time and cooperation.

Sincerely,

Yang H. Huo
Doctoral Candidate

Enclosures

**A NATIONWIDE STUDY OF INTERNAL ENVIRONMENT,
ORGANIZATIONAL FORM, AND THEIR EFFECTS UPON PERFORMANCE
IN HOTEL CHAINS**

I. Hotel Information

1. Your functional area of responsibility can best be described as: _____
(e.g. President, Vice President of Development, etc.)

2. Please indicate below in what segment of the lodging industry your hotel brand competes:

(Circle a number)

- a. Super luxury
- b. Luxury
- c. Mid-priced
- d. Luxury budget
- e. Economy
- f. Other _____ (please specify)

Please indicate your hotel chain if your hotel uses other segmentation.

3. Please indicate the ONE category that describes the type of your hotel chain.

(Circle a number)

- a. Public company
- b. Privately owned company

4. Please indicate year that company was founded: 19_____
year that franchising started: 19_____

Please continue on the next page.

II. Internal Environment

The nature of an organization's internal environment affects the organizational form, either company-owned or franchised. The following is a list of internal environment factors identified by theories related to franchising especially in the lodging industry. Please indicate how your hotel considers each of the following factors in determining the organizational form and affecting the financial performance of operating units.

1. Capital Scarcity

1-a. Please indicate the proceeds of financing activities in a statement of cash flows from the period 1990 through 1992.

	Proceeds of long-term debt	Proceeds from issuing common stock	Payments on capital lease obligations	Dividends paid
Y1992	_____	_____	_____	_____
Y1991	_____	_____	_____	_____
Y1990	_____	_____	_____	_____

(Proceeds = (proceeds of long-term debt + proceeds from issuing common stock) - (payments on capital lease obligations + dividends paid))

1b. What is the total number of units?

	Company-owned Units	Franchised Units
Y1992	_____	_____
Y1991	_____	_____
Y1990	_____	_____

Please continue on the next page.

2. Monitoring costs

2a. How many "field representatives" in your hotel chain? _____

2b. Do you or field representatives visit each unit? Yes () No ()

2c. If "yes" how often do you or "field representatives" visit or travel the unit (on average)?

- | | |
|------------------------|------------------------|
| a. once a month | b. twice a month |
| c. once every 3 months | d. once every 6 months |
| e. once every year | f. as needed |
| g. never | |

2d. What is the approximate length of stay for a typical visit?

- | | |
|-------------------------|---------------|
| a. less than one day | b. one day |
| c. two days | d. three days |
| e. more than three days | |

2e. What are the costs for visiting/traveling the unit? (such as travel expenses, accommodation, meals)

\$_____ per unit per visit

2f. How accurate do you think the sales of units reports that are generated by unit managers?

Sales reports are quite accurate and dependable	1	2	3	4	5	Sales reports are quite inaccurate and not dependable
---	---	---	---	---	---	---

2g. What is the average distance of units from the monitoring headquarters?

_____ miles

Please continue on the next page.

3. Asset Specificity

The following questions ask about the level of investment your hotel has made in its affiliation with its marketing partner. If you strongly disagree with the statement, circle "1"; if you strongly agree, circle "7".

	Strongly Disagree						Strongly Agree
1. The facilities, supplies, and services are highly specialized --They could not be used with any other brand.	1	2	3	4	5	6	7
2. The furnishings, fixtures, equipment, and supplies at the hotel could not be as easily transferred from the current brand to a comparable brand.	1	2	3	4	5	6	7
3. The systems and procedures the franchisees use with this brand could not be used for any other hotels brand without major changes.	1	2	3	4	5	6	7
4. This hotel has invested in furnishings, fixtures, equipment, and supplies for this brand that couldn't be used with another hotel brand.	1	2	3	4	5	6	7
5. To market services under this brand, franchisors have had specialized training that franchisees couldn't use with another brand.	1	2	3	4	5	6	7
6. The hotel has spent a lot of time and effort to develop a strong customer base for this particular brand.	1	2	3	4	5	6	7
7. Franchisees have spent a lot of time and effort learning special selling techniques for this hotel brand.	1	2	3	4	5	6	7
8. If franchisees switched to a competitive brand, franchisees would lose of the investment franchisees have made in marketing and services.	1	2	3	4	5	6	7

Please continue on the next page.

III. Financial Performance

1. Please indicate below your hotel's percentage of growth in unit sales for the period 1990 through 1992.

(Growth in unit sales = change in total annual sales / number of units)

2. Please indicate below your hotel's percentage of return on investment for the period 1990 through 1992.

(Return on investment = income before fixed costs / invested capital)

Thank you for your cooperation.

APPENDIX H
FINAL QUESTIONNAIRE

May 18, 1994

Dear (Mr. Mrs. Ms. Last Name):

As you are well aware, the hospitality industry is highly competitive. Does your organization select a right form based upon the evaluation of internal environment? Does your hotel chain show good financial performance? To answer these questions, the Department of Hospitality and Tourism Management at Virginia Polytechnic Institute and State University is conducting a study of a franchising in the lodging industry. The objective of this study is to examine how the internal environment of an organization combines with a organizational form (company-own or franchise) affect financial performance. This study is a basis for a doctoral dissertation and would be of great benefit to our lodging industry.

Your hotel has been selected to participate in this national study. We would very much like to have you involved in this study. The enclosed questionnaires are designed to let you express your company's opinion. As there is no right or wrong answer each question, your company's True Opinions is very import and valuable to this study. The success of this study depend largely on your participation. All information will be held in **strictest confidence**. It will be reported only in the form of statistical summaries so that information about your hotel **cannot be identified**.

Once you have completed the questionnaire, please seal in the enclosed postage-free envelope and mail it to us. We look forward to receiving your responses by **May 10**, 1994. We would be happy to answer any questions at any time. You should feel free to contact us. The telephone number is (703) 951-4117.

We appreciate you in advance for your time and cooperation.

Sincerely,

Yang H. Huo
Doctoral Candidate

Enclosures

REMINDER LETTER

June 15, 1994

Dear (Mr. Mrs. Ms. LAST NAME):

About two weeks ago, a set of questionnaires relating to a nationwide study of internal environment, organizational form and performance was mailed to your company.

Because it was a blind mailing there is no way to determine whether or not you have responded. If you and a member of your company have already completed and returned questionnaires, please accept our sincere thanks. If not, it would be appreciated if you would take a few minutes and mail our questionnaires today. It is extremely important that your company participates in this study for it to be truly representative of the U.S. lodging industry.

In case you have not received the questionnaire, or it got misplaced, please call me right now (703) 951-4117 and I will sent another one right away.

Thank you for your cooperation.

Sincerely,

Yang H. Huo
Doctoral Candidate

**A NATIONWIDE STUDY OF INTERNAL ENVIRONMENT,
ORGANIZATIONAL FORM, AND THEIR EFFECTS UPON PERFORMANCE
IN HOTEL CHAINS**

**If your hotel chain has multi brands, please complete this questionnaire for each
brand.**

I. Hotel Information

1. Your functional area of responsibility can best be described as: _____
(e.g. President, Vice President of Development, etc.)

2. Please indicate below in what segment of the lodging industry your hotel brand
competes:

(Circle a number)

- a. First class
- b. Mid-priced class
- c. Economy class
- f. Other _____ (please specify)

3. Please indicate year that company was founded: 19_____
year that franchising started: 19_____

4. What is the number of units?

	Company-owned Units	Franchised Units
Y1992	_____	_____
Y1991	_____	_____
Y1990	_____	_____

"Company-owned" means those properties which are owned and operated by; (1) the franchisor or (2) a hotel chain.

Please continue on the next page.

II. Internal Environment

The nature of an organization's internal environment affects the organizational form, either company-owned or franchised. The following is a list of internal environment factors identified by theories related to franchising especially in the lodging industry. Please indicate how your hotel considers each of the following factors in determining the organizational form and affecting the financial performance of operating units.

II-1. Capital Scarcity

Please indicate the proceeds of financing activities in a statement of cash flows from the period 1990 through 1992.

The information on financial data will be held in **strictest confidence** and will be reported only in the form of summaries so that information about an individual hotel chain **cannot be identified**.

	Proceeds of long-term debt	Proceeds from issuing common stock	Payments on capital lease obligations	Dividends paid
Y1992	_____	_____	_____	_____
Y1991	_____	_____	_____	_____
Y1990	_____	_____	_____	_____

If you provide copies of "balance sheet", "income statement", and "statement of cash flow", we will calculate them.

Please continue on the next page.

II-2. Monitoring costs

a. How many "field representatives"* are in your hotel chain? _____

* field representatives are those who visit a unit and supervise or monitor all activities, and inspect a unit to insure that the unit keeps a quality standard.

b. If "yes" how often do you or "field representatives" visit or travel the unit (on average)?

- | | |
|------------------------|------------------------|
| a. once a month | b. twice a month |
| c. once every 3 months | d. once every 6 months |
| e. once every year | f. as needed |
| g. never | |

c. What is the approximate length of stay for a typical visit?

- | | |
|-------------------------|---------------|
| a. less than one day | b. one day |
| c. two days | d. three days |
| e. more than three days | |

d. What are the approximate costs for visiting or traveling the unit? (travel expenses, accommodation, meals)

\$_____ per unit per visit

e. What is the average distance of units from the monitoring/regional headquarters?

_____ miles

II-3. Asset Specificity

The following questions ask about the level of investment your hotel has made in its affiliation with its marketing partner. If you strongly disagree with the statement, circle "1"; if you strongly agree, circle "7".

	Strongly Disagree					Strongly Agree	
1. The facilities, supplies, and services are highly specialized --They could not be used with any other brand.	1	2	3	4	5	6	7
2. The furnishings, fixtures, equipment, and supplies at the hotel could not be easily transferred from the current location to other location.	1	2	3	4	5	6	7
3. The systems and procedures the franchisees use with this brand could not be used for any other hotel brand without major changes.	1	2	3	4	5	6	7
4. This hotel has invested in furnishings, fixtures, equipment, and supplies for this brand that couldn't be used with another hotel brand.	1	2	3	4	5	6	7
5. To market services under this brand, franchisors have had specialized training that franchisees couldn't use with another brand.	1	2	3	4	5	6	7
6. The hotel has spent a lot of time and effort to develop a strong customer base for this particular brand.	1	2	3	4	5	6	7
7. Franchisees have spent a lot of time and effort learning special selling techniques for this hotel brand.	1	2	3	4	5	6	7
8. If franchisees switched to a competitive brand, franchisees would lose a lot of the investment franchisees have made in marketing and services.	1	2	3	4	5	6	7

Please continue on the next page.

III. Financial Performance

The information on financial data will be held in **strictest confidence** and will be reported only in the form of summaries so that information about an individual hotel chain **cannot be identified**.

If you provide copies of "balance sheet", "income statement", and "statement of cash flow", or "annual sales or revenue", we will calculate.

1. Which of the following ranges best indicates the **growth in unit sales** for the period of 1990 through 1992: (Please circle the number)

- 1992: -5% -4 -3 -2 -1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21-25 26-30 31over
- 1991: -5% -4 -3 -2 -1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21-25 26-30 31over
- 1990: -5% -4 -3 -2 -1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21-25 26-30 31over

(Growth in unit sales = change in total annual sales / number of units)

2. Please indicate below your hotel's percentage of **return on investment** for the period 1990 through 1992.

- 1992: -5% -4 -3 -2 -1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21-25 26-30 31over
- 1991: -5% -4 -3 -2 -1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21-25 26-30 31over
- 1990: -5% -4 -3 -2 -1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21-25 26-30 31over

(Return on investment = net profit after tax / net worth (equity or invested capital)

For your information

Dun & Bradstreet Industry Norms and Key Financial Ratios reports the "Return on assets", and "Return on net worth" for the period of 1990-1992 in the lodging industry as follows:

	92			91			90		
	UQ	MED	LQ	UQ	MED	LQ	UQ	MED	LQ
ROA	8.9	2.7	(1.0)	10.1	3.1	(0.9)	10.6	3.6	(0.5)
RON	30.2	9.1	(1.5)	33.6	10	(1.2)	29.2	11	(0.3)

RON (Return on net worth) is obtained by dividing net profit after tax by net worth (equity) which includes capital stock, paid in or capital surplus and retained earnings, appropriated and unappropriated, less cost of treasury stock.

_____ Yes, I would like to have an executive summary of this national survey.

Thank you for your time and cooperation.

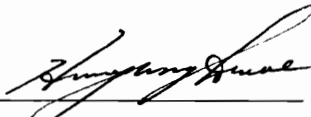
VITA

Yang Hwae Huo, son of Chae Huo and Soon Book Chung, was born on October 10, 1955 in Inchon, Korea. He received a Bachelor of Science in Business from Brigham Young University in Hawaii in 1985. He was awarded the degree of Master of Science in Hotel Administration from the University of Nevada, Las Vegas in Las Vegas in 1987.

Upon completion of graduate studies, he began his working career with Seoul Hilton International as a Sales Executive and Inter-continental Hotel Seoul as a Sales Manager and subsequently as a Marketing Plan Manager. While he was serving at two hotels, he was in charge of foreign accounts including airlines, embassy, and meeting and convention, special events, marketing research, and marketing plan. He had taught the Management Information Systems (MIS) in the Airline Industry and Hospitality Industry course at Kyoung-Won University and the Introduction to the Hospitality Industry course at Han Yang University in Korea.

He started his Ph.D. program in Hospitality and Tourism Management at Virginia Polytechnic Institute and State University in January, 1991. He had been an instructor for the Field Study (or Internship) course and a teaching assistant for the Financial Management (graduate course) and Hospitality Accounting courses for two years.

Effective August 1994, he will be an assistant professor at Manfred Steinfeld Program in Hospitality Management at Roosevelt University in Chicago.



Yang Hwae Huo