

**A Causal Model of Linkages between Environment and Organizational Structure,
and Its Performance Implications in International Service Distribution:
An Empirical Study of Restaurant and Hotel Industry**

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Seehyung Kim

(ABSTRACT)

This research develops and tests a model of the service unit ownership and control patterns used by international service companies. The main purpose of this study is to investigate trivariate causal relationships among environmental factors, organizational structure, and perceived performance in the internationalization process of service firms. A service firm operating in foreign soil has a choice of three general entry mode strategies offering different degrees of ownership and control of its remote operating units located in foreign countries – full ownership arrangement, joint venture arrangement, and franchising arrangement.

The entry mode strategies chosen depend on the factors relating to internal environment of a specific firm, industry related factors in which the firm operates, and external environment of the operating units at national context. This study identifies these factors, investigates how they affect the firm's choice of entry modes, and finally examines the impact of entry mode on firm's performance. The overall model has been explained by contingency theory that conceptualizes optimal level of ownership and control mode as a response by the firm to the interplay of environmental factors and as a determinant of firm's performance. To this core can be added complementary theories which are borrowed from agency theory, transaction cost theory, and resource dependence theory. These theories explain the linkages between market entry mode and each type of environmental factors.

In order to empirically test the hypotheses, data were collected from hospitality firms regarding the ownership structure of subsidiaries located in foreign countries. As a whole, the conceptual model developed in the study received strong support from the empirical study. This study found a positive impact of contingency fit on performance and so support contingency theory in which some combinations of the environmental dimensions and organizational structure will lead to better organizational performance. Another finding of this study indicates that the increased level of ownership and control will result in enhancing the level of perceived performance. It should be noted that contingency model-based mode choice would provide managers with the optimal performance because there is not one best performing mode choice in volatile international market.

Next, the relationship of market environment with organizational structure was examined through three different perspectives. Market environment was investigated at firm, industry, and national context, which includes five factors – monitoring uncertainty, asset specificity, cultural distance, political uncertainty, and economic uncertainty. The model is suggestive of a picture in which five environmental factors vie for affecting the choice of market entry modes. All five environmental factors were found to be significantly related to firms' organizational structure. Among five environmental factors, cultural uncertainty has the largest effect on the choice of entry mode followed by monitoring uncertainty, political uncertainty, asset specificity, and economic uncertainty.

One of the important implications of this research is the inclusion of franchising as an actual management strategy and competitive business practice that is related to international ownership and control strategy. Higher degrees of uncertainty associated with the foreign market encourage external dependence of the venture, in which the operation depends more heavily on local relationships. Franchising substitutes the loss of ownership by an increase of external relationships and it takes without losing control on retail operation. Resource exploitation depends on the local market for either inputs or outputs for better performance. Understanding the fit between the each set of contingent variables and the elements of ownership and control strategy will allow marketers to determine when franchising is the suitable mode of operation in global markets.

Collectively, these results suggest that the choice of an organizational form for international service firms involves a complex balance of firm, industry, and country level factors. Managers can maximize performance by aligning entry mode strategy with external contextual circumstances as well as internal resources. Managers may also be able to make better mode choice decisions using the theory-driven criteria examined in this study, increasing their chances for financial and non-financial success.

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C H A P T E R 1

INTRODUCTION

Background

Global Trend in Service Sector

Over the past 20 years, the total volume of world trade has grown far more rapidly than the annual growth rate in world gross national product (Economist, 1997). The result is a more integrated global economy in which firms and consumers everywhere are increasingly touched by international business (Dunning, 1993; Porter, 1986). Internationalization of businesses led Leighton (1970) to describe the trend as “The Third Industrial Revolution.” This trend has been the focus of myriad of research on internationalization (e.g., Bartels, 1968; Hackett, 1976; Johanson & Vahlne, 1977; Mascarenhas, 1986; Reilly & DiAngelo, 1987; Rugman, 1980; Wells, 1968).

Global economic integration has been taken place for a variety reasons such as changing socio-economic patterns, favorable political and cultural environments, and a shift from manufacturing to service based economies (Quinn, 1999). The movement towards a global economy has also been bolstered by developments such as the lowering trade barriers in the European Community (EU), the North American Free Trade Agreement (NAFTA), the Asian-Pacific Economic Cooperation (APEC), reduction of entry barriers in many former communist countries, and the emergence of several vibrant economies in the Pacific-Rim (Cateora, 1996). Along with the deregulation of industries within these nations, saturated and highly competitive markets faced by firms in their home countries have also contributed global economy on an accelerated rate (Preble, 1992; Zhao & Olsen, 1997).

Rapid globalization of economic activities in recent years has greatly expanded the opportunities for marketing services abroad (Hassan & Kaynak, 1994). Trade in services represents 20 percent to 25 percent of all world trade, with an annual growth rate of 20 percent to 30 percent (Dahringer, 1991; Terpstra & Sarathy, 2000). According to the World Trade Organization (WTO), the value of global trade in services at the beginning of new millennium was estimated at \$1.46 trillion, which constituted about 25 percent of global merchandise trade.

The value of global trade in services has been growing at double-digit rates and this trend is expected to continue. For example, the volume of services trade grew by 14 percent in 1995 over the previous year (Economist, 1997). The service sector has accounted for the highest portion of total economic activity in Hong Kong, the USA, and France since the early 1990s (Blaine, 1996). In general, the shift towards a service-based economy in key trading countries has been evident since 1970 (Samiee, 1999). While the nature and volume of world services trade is not precisely understood, it is likely that, by the start of the new millennium, more than half the world's multinational enterprises (MNEs) will be engaged in services (Boddewyn, Halbrich, & Perry, 1986).

The period from 1980 to 1998 has brought fundamental changes to the international marketing of services (Knight, 1999). In the global economy, the internationalization of service companies has resulted in the issue of trade in services becoming a major topic at the GATT talks (Feketekuty, 1988) as the growth of the service sector is repeated in the other developed nations and many of the developing countries (Inman, 1985). Many reasons are suggested for this rise and changes in consumption of services. These include increased levels of disposable income, increased participation of women in the workforce, governmental policies, and rising lifestyle expectations (Leveson, 1985).

Among the most important of these changes in international services have been attributable to the globalization of markets and the decline of trade barriers. Most recently the trend has been accelerated by the widespread emergence of free trade under structures such as NAFTA, APEC and the EU (Knight, 1999). The emergence of modern communications and advances in information technologies that facilitate cost effective international business operations have also been very important (Knight, 1999). The ability to process and analyze data efficiently, as well as the widespread diffusion of the Internet, e-mail, cable, satellite, fax and other telecommunications technologies have made going international a highly viable and cost-effective option for various types of service providers (Business Week, 1994; Economist, 1995; Segebarth, 1990).

In short, interest in international services has grown in recent years because of three related trends: 1) the growing proportion of world trade attributable to services; 2) increasing emphasis of services in trade negotiations (Uruguay Round of the GATT); and 3) the recognition by scholars of the importance of services as an energizing force in the global economy, and as a determinant of national living standards (Riddle, 1986).

US Domestic Trend in Service Sector

One of the most widely discussed structural trends in the U.S. economy is the shift from goods production to services production. Within the United States, service industries are playing a critical role in fostering economic growth and expanding productivity. Statistical evidence indicates that the domestic economy has become predominantly service based. The U.S. Department of Labor (2002) estimates that the broad definition of services, which includes all

non-goods producing industries, accounts for nearly two-thirds of GNP and almost three-fourths of employment.

Since the early seventies, service firms have become more important to the US economy. Domestic growth of service output has outpaced both industry and agriculture between 1970 and 1990 by 12.47% and 36.03% respectively. Further, the U.S. service sector appears to enjoy a distinct competitive advantage in world trade (Reardon, Erramilli, & Dsouza, 1996).

While American merchandise trade grew at an average annual rate of 9.05% throughout the eighties, services trade was growing at a much more impressive annual rate of 18.21%. Also, even as the merchandise trade deficit kept soaring through much of the seventies and the eighties, services trade consistently exhibited surpluses every year since 1975. In 1992 the service sector had a trade surplus of \$66.1 billion (Reardon, Erramilli, & Dsouza, 1996). In an increasingly global economy, these indicators bode well for the U.S. economy.

The recent statistical figures by U.S. Department of Labor (2002) evidenced that the services division is the largest industry, both in number of establishments and number of employees. The division represents 39.1 percent of all establishments and 29.5 percent of all employment covered by unemployment insurance. Employment data for 1991 to 2001 based on an establishment survey show annual average employment in services growing in every year to reach 41.0 million in 2001. This represents an increase of 44.6 percent. Employment for the economy as a whole, in contrast, increased 22.1 percent from its trough in 1991 to 2001.

The accommodations and food services sector now approximately accounts for 15 percent and 17 percent of all service related industries, in number of establishments and number of employees respectively. In terms of value of revenue, accommodations and food services

recorded 10 percent (\$400 billion) of all service related industries in 1999 (U.S. Department of Commerce, 2001b).

The dominant role that services play throughout the U.S. economy translates into global competitiveness. Several reasons underpin the competitiveness of U.S. services firms in the global economy. First, unlike most major markets around the world, U.S. services markets are substantially unregulated. Second, this relatively open environment motivated U.S. services firms to be innovative. Economics of scale is a third factor (U.S. Department of Commerce, 2002). The USA has by far the largest net services trade surplus among key industrial nations. In terms of absolute volume, the USA is by far the largest exporter of services. U.S. services exports nearly doubled during the 1990s, reaching \$293 billion in 2000 and representing an annual average growth rate of 10 percent since 1990 (U.S. Department of Commerce, 2002).

There is every indication that in many service industries, American firms will continue to enjoy a strong competitive advantage over their foreign counterparts. A recent study by McKinsey and Co. found that the United states was more efficient than Germany, France, Japan, and the United Kingdom in five major service sectors, including airlines, telecommunications, banking, retailing, and restaurants (Bernstein, 1992).

Despite relatively open access to U.S. markets, U.S. services exports outpaced U.S. imports by \$74 billion in 2000, for a services trade surplus that offset 14 percent of the merchandise trade deficit (U.S. Department of Commerce, 2002). However, Germany and Japan do not benefit from the same global competitiveness as the USA in the services sectors and, as a result, produce significant annual services deficits, approximately \$52 billion and \$47 billion in 2000 respectively (WTO, 2002). This poor showing is quite surprising given these nations'

competitive strength and world-class performance in merchandise trade, ranked second and third respectively in 2000.

From an international competitive strength and strategy viewpoint, the USA enjoys an excellent position in global trade in services. Major markets for U.S. services exports include the European Union (\$86 billion in 2001 exports of U.S. commercial services), Japan (\$31 billion), and Canada (\$24 billion). Mexico is the largest of the emerging markets for U.S. services (\$14 billion in 2000), but notably, there are now numerous emerging markets around the world that import over \$1 billion in U.S. services each year – total of sixteen countries (U.S. Department of Commerce, 2002).

Growth of Franchising

Concurrent with the growth in services has been the growth of the concept of franchising in chain operations (U.S. Department of Commerce, 1988). During the past four decades, franchising has blossomed into a major business form. Today, over one-third of all retail sales in the USA is through franchised outlets. Additionally, approximately 20 percent of US gross national product results from franchise operations. The importance of franchising is expanding beyond domestic borders with franchising rapidly becoming the fastest growing form of business in the global economic system (Justis & Judd, 1989; Knight, 1984; Sanghavi, 1991).

In recent years franchising has become a popular ownership and control strategies for services companies competing in the global marketplace (Khan, 1999; Quinn, 1999). The strategy of franchising has enjoyed explosive growth in recent decades to where it is a major economic force today (Bradach, 1998). Simultaneously, the strategy of franchising as a mode of international entry has been maturing as a way of doing business, and is particularly well suited

for supplying a large number of services that numerous developed economies are increasingly demanding (Preble, 1992).

Burton and Cross (1995) defined international franchising as “a foreign market entry mode that involves a relationship between the entrant (the franchisor) and a host country entity, in which the former transfers, under contract, a business package (or format), which it has developed and owns, to the latter” (p. 36). This host country entity can be either a domestic franchisee, a foreign franchisee, a master franchisor, or an entity which is partly owned by the franchisor itself (Alon & Mckee, 1999b).

This growth in popularity has been facilitated not only by the host of advantages normally associated with this particular mode of expansion but also by developments in the wider international environment. Since the 1950s there are two major environmental factors favorable to the development of franchising: shift in most developed economies towards the service sector that requires a higher degree of personal service (Brandenberg, 1989; Hall & Dixon, 1988) and higher travel intensity which has enhanced the value of a brand name (Mathewson & Winter, 1985; Norton, 1988a). Service firms with favorable reputations can benefit from information asymmetry in many situations (Nayyar, 1993). In addition, the political and economical phenomena moving toward global economy have presented opportunities to companies willing to consider franchising as an entry strategy in overseas markets (Quinn, 1999).

Restaurant chains constitute an especially powerful force within the dynamic context of the franchise industry (Khan, 1999). The larger fast food franchising companies have been quite successful in transferring their systems into global markets (Khan, 1999; Preble, 1992). Of particular significance is the fact that restaurant chains represent the largest segment of chains

based around a business format (business-format franchising), in contrast to chains organized as vehicles for distributing products (product and trade name franchising), e.g., automobile dealerships and gas stations (Bradach, 1998; Khan, 1999).

Business format franchising (from hereon “franchising”) is the basis for most franchising ventures and responsible for much of the franchising in restaurants and lodging industry in the United States and internationally since 1950 (Khan, 1999). The focus of this paper is on business format franchising because it was shown to provide faster growth than product name franchising in the domestic market (Kostecka, 1988) and was the source of most of the successful international franchising ventures (Burton & Cross, 1995).

For example, fifteen of the twenty largest franchised chains are restaurants (Restaurant Business, 1995), and in 1995, nineteen restaurant chains exceeded sales of \$1 billion (Lombardi, 1996). In the restaurant industry, between 1975 and 1985, the share of sales captured by chains larger than 150 units grew from 20 percent to over 30 percent (Emerson, 1990), reflecting the growing dominance of large chains.

The largest chains have continued to experience rapid growth through the 1990s, with the fifty largest chains experiencing 8.6 percent sales growth in 1995, more than double the industry average (Restaurant Business, 1995). While distribution chains account for the bulk of the revenue that passes through chain organizations, business format chains are growing faster; more than 75 percent of all units are of the business format variety; totaling over \$250 billion in annual sales (Sabir, 1996). In addition, restaurant sales represent 50.6 percent of the money spent at business-format franchises (U.S. Department of Commerce, 1987).

With the advent of the business format or package franchise, it has proven its versatility as well. Their international ownership structure and entry strategies have varied from setting up a

subsidiary, to joint venture, and to using franchise (Preble, 1992). The business format type of franchising system has facilitated this swift transfer, with only relatively minor modifications being needed. As a consequence, the same high level of service has been possible abroad, in terms of quality, consistency, and quickness that have been customary in the U.S.

This growth of franchising is striking in light of traditional international business strategy that suggests that the preferred ownership strategy of international firms is a wholly owned subsidiary unless there are significant reasons that reduce the suitability of that approach (Root, 1987). The increasing usage of franchising by international service businesses, especially in the hospitality industry, raises questions about this traditional line of thought.

Foreign Market Entry Mode

As an increasing number of service firms enter foreign markets, important questions are being raised about global services marketing strategy (Lovelock & Yip, 1996b). Among the most critical issues in international market entry strategy is the selection of an appropriate entry mode (Terpstra & Sarathy, 2000). Choice of entry mode is critical in that it defines the flexibility with which the firm will be able to identify and adjust firm resources in the long run (Hill, Hwang, & Kim, 1990) in its drive to generate sustainable competitive advantage. Therefore, it is critical to consider the role that a service firm's international entry mode strategy plays in maintaining flexibility and protecting and developing firm resources, and thereby influencing choices of level of control and resource commitment.

Multinational companies (hereafter, often abbreviated as MNC) faced with an entry decision into a given foreign country might select different modes of entry (McIntyre, 1990). Kotler (1988) categorizes the modes of entry as exporting, licensing/franchising, joint venture,

and direct foreign investment, with each succeeding entry strategy involving more commitment, risk, control and profit potential. However, numerous ways of achieving the foreign entry objective lie within each of these broad categories (McIntyre, 1990). The impact of this decision on the success of operations in foreign soil is so tremendous that the selection of an appropriate entry mode emerges as a frontier issue in internationalization of firms (Wind & Perlmutter, 1977).

Each entry mode presents distinct pros and cons in terms of international chain distribution. However, the tradeoffs are difficult to evaluate and are little understood (Anderson & Gatignon, 1986), and few companies make a conscious, deliberate cost/benefit analysis of the options for modes of entry (Robinson, 1973). According to Anderson and Gatignon (1986), who attempt to systematically evaluate the alternatives, control is the major determinant of entry mode. These authors group seventeen modes of entry in terms of the amount of control a market entrant gains over the activities of a foreign business entity. Each mode is classified into high-, medium-, and low-control. In general, there is agreement that higher control entails high resource commitment (risk) and control (return) to a company.

In addition to determining the amount of resources the firm will commit to the foreign market, initial entry mode choice significantly affects the performance and longevity of a foreign operation (Li, 1995; Root, 1994). Therefore, it is important that managers understand the strategic implications of foreign market entry mode choice for different categories of services and moderating role of a host of other variables - internal and external to the firm - on entry mode choice.

Despite this growth, much of the research has focused on either manufacturing sector or general service sector (Erramilli & Rao, 1990; Richardson, 1987). There are differences among the different industries and even within the service sector. For example, the degree of

customization and the delivery method vary widely within the service sector (Lovelock, 1983). Some industries such as fast food have been able to standardize the service, while others such as advertising require customization. It is possible that the variation in these characteristics within the service sector affects the ownership strategy and control mode of the service companies across national border.

Statement of the Problem

Foreign markets represent the natural expansion route for successful chain companies in the service industry (Keating, 1989; Lifflander, 1970). Chains are one of the dominant forms of organizations of our times (Bradach, 1998), with a single chain often having hundreds, even thousands, of units under a common trademark in diverse locations. Managing a chain is more complicated than it looks.

To an outside observer, the local units in chain appear the same. A McDonald's restaurant in Chicago looks like largely the same as a McDonald's in Paris and Moscow. Yet beneath this veneer of similarity reside largely three different types of units - company owned, franchise, and joint venture. Although there is extensive research on domestic chain operations, relatively little research exists on international chain operations by service companies. Indeed, empirical research in the area of chain management on the topic of international entry mode itself is quite limited for hospitality firms.

Once a firm decides to enter a foreign market, it has to choose a mode of entry (hereafter, often used interchangeably with 'ownership strategy and control mode'), that is, select an institutional arrangement for organizing and conducting international business transactions (Anderson & Gatignon, 1986; Root, 1987). Firms can choose from a variety of entry modes to control firms' foreign operations. Since selection of these entry modes have a major impact on the firm's overseas business performance, selection of entry modes is regarded as a critical international business decision (Anderson & Gatignon, 1986; Hill, Hwang, & Kim, 1990; Root, 1987; Terpstra & Sarathy, 2000; Wind & Perlmutter, 1977).

For example, exporting firms can choose between two broad alternatives; exports through independent intermediaries or exports by integrated (company-owned) channels (Anderson &

Coughlan, 1987). Firms can also produce their products overseas, either through contractual modes, e.g. franchising, or via foreign direct investment (hereafter, often abbreviated as FDI), e.g., joint venture and wholly owned subsidiaries (Erramilli, 1992).

International entry mode has been described as the institutional arrangement, governance structure, or organizational structure that enables a firm to enter a market with its products, technology, human skills, management and other resources (Root, 1994). Entry mode has been described as a “frontier issue” (Wind & Perlmutter, 1977), which is “one of the most critical decisions in international marketing” (Terpstra, 1987, p. 333) since it determines how firms market their products abroad, and how firms contribute to the country’s balance of payments. Entry mode decision has a large and lasting impact on the success of a firm’s international operations (Anderson & Coughlan, 1987) since reversal of this decision entails a considerable loss of time and money (Root, 1987). Accordingly, Agarwal and Ramaswami (1992) have concluded that entry mode selection is a very important, if not a critical, strategic decision.

The impact of service characteristics on method of market entry has been addressed (Erramilli, 1990, 1992; Patterson & Cicic, 1995) and the effects of diversity of international environments on service design have been acknowledged (Dahringer, 1991; Czinkota & Ronkainen, 1995). There is, however, a lack of research concerning method of distribution for international services (Eriksson, Majkgard, & Sharma, 1999; Knight, 1999) and consequently little information available to aid management in foreign ownership and control strategies vis-à-vis the impact of environmental factors and the impact on performance.

Fragmented and Unrelated Considerations

A study of the literature raises following concerns. First and foremost, research on the choice of entry mode still remains very fragmented and is concerned with seemingly unrelated considerations (Sarkar & Cavusgil, 1996). As Anderson and Gatignon (1986) pointed out, relevant work is “scattered across books and journals in several disciplines, obscured by varying terminology, and separated by differences in problem setup, theory, and method” (p. 2). Especially, little research into globalization of the hospitality firms and choice of entry mode has been done over the last ten years.

Descriptive Nature of the Study

Examination of research in the choice of international entry mode at varying points in time reveals evidence that the majority of studies have been descriptive or exploratory in nature. Lack of research in restaurant industry seems to be prevalent on the issue of internationalization and foreign market entry mode. Bosereewong (1994) identified environmental factors that influence the choice of franchising methods in the Pan Pacific region. Another study completed by Sadi (1994) identified factors that cause companies to expand into foreign markets and strategies employed by fast food franchise firms in foreign markets. Both studies are descriptive in nature.

A few researchers completed a descriptive study on data analysis of multinational hotel corporations (Alexander, 1996; Davé, 1984; Dunning & McQueen, 1982; Littlejohn, 1985). Olsen, Crawford-Welch, and Tse (1991) and Segal-Horn (2000) conceptually analyzed the international strategies of multinational hospitality firms and identified specific strategies that are currently in practice. Recently, a handful of empirical studies have been done to explore the

relationships among the antecedent factors and entry mode choices in the international hotel sector (e.g., Contractor & Kundu, 1998a, 1998b; Rodríguez, 2002; Zhao & Olsen, 1997). Huo (1994) investigated the relationship between internal environment, organizational form, and financial performance in domestic settings for hotel chains.

Lack of Considerations for Theory-Driven Selection Criteria

Although international contingency variables are expected to influence international entry mode choices, few studies have investigated theory-driven selection criteria for firms' international entry mode choices and the impact of international entry mode usage on firm performance (Chan, 1995; Simmonds, 1990; Woodcock, Beamish, & Makino, 1994). Typical is Woodcock, Beamish, and Makino (1994), who explain that their “study did not test the theoretical arguments that cause performance variance” (p. 268).

Lack of Linkage between Mode Choice and Performance

Despite advances in entry mode theory, little consideration has been given to the performance implications of foreign market entry mode choices (Nitsch, Beamish, & Makino, 1996). The investigation to link between contingency model of entry mode selection and firm performance is particularly necessary given that “few researchers have explicitly measured and compared the performance of the various international entry modes, and fewer still have attempted to develop a parsimonious theoretical argument for performance differences” (Woodcock, Beamish, & Makino, 1994, p. 254).

One explanation for this lack of apparent interest is circumstantial, since subsidiary performance data are notoriously difficult to obtain. Differing national financial reporting

conventions, reluctance of parent firms to divulge non-consolidated data, and the problems of reconciling internal data from different firms even when they are obtainable are some of the reasons why the mode-performance link has not been explored more fully (Brouthers, Brouthers, & Werner, 2000). A second reason may be that researchers feel the performance issue is really secondary to mode choice; in a world of rational economic actors, each will evaluate the available options (including mode choice) on a risk-return basis, and choose the one with the highest expected pay-off (Nitsch, Beamish, & Makino, 1996).

Lack of Investigation into Independent Entry Mode

A recent study by Brouthers, Brouthers, and Werner (2000) attempted linked international entry mode choices and firm performance and examined entry mode strategies available to firms including independent modes as well as the shared and integrated equity modes of entry. But thus far a few studies have attempted to include non-equity entry mode (e.g., franchising) in relation with varying performance levels. Most previous studies to relate international entry mode choices to firm performance have constrained their examination of entry mode choices to equity modes, e.g., differences between wholly owned modes, acquisition and joint ventures (Anand & Delios, 1997; Makino & Beamish, 1998; Nitsch, Beamish, & Makino, 1996; Pan & Chi, 1999; Pan, Li, & Tse, 1999; Shrader, 2001; Simmonds, 1990; Woodcock, Beamish, & Makino, 1994).

Piecemeal Information about Environmental Components

To date, no research has been identified internal (firm level), external (national level), and industry factors simultaneously with regard to the choice of optimum level of foreign

ownership and control mode and firm performance. Although numerous variables appear to influence a firm's particular choice of entry mode in a given situation, environmental variables seem to be particularly important (Davidson, 1982; Davidson & McFetridge, 1985; Gatignon & Anderson; Goodnow; 1985; Goodnow & Hansz, 1972; Kogut & Singh, 1988; Root, 1987). The research on entry mode and the existing literature on environmental variables, however, suffer from three major shortcomings.

Examination of Simple Bivariate Relationships

First, salient phenomenon about foreign market entry modes is that very few studies have extended themselves beyond examining simple bivariate relationships (Sarkar & Cavusgil, 1996). The measurement strategy used by researchers to date has largely consisted of using single-item measures that are themselves proxy variables, e.g., R&D spending to indicate the construct extent of proprietary information (Anderson & Gatignon, 1986). Clearly, hypothesis testing would be even stronger if psychometric methods were used to develop composite measures of each construct, thereby reducing reliance on single-item measures of complex constructs (Nunnally, 1978). One advantage of this method is that the interpretability of findings using proxy variables would be greatly enhanced if they were embedded in a composite measure. Another benefit of this method is that using multiple measures allows researchers greater degrees of freedom in their approach and provides a closer correspondence between theory and data (Williamson, 1985).

Application of Global Measures

Second, research on the service sector has concentrated on the aggregate macro-economic effects of the change from a goods-producing to a service-based economy (Giarni, 1987; Shelp, 1981). As Aulakh and Kotabe (1997) note, the emphasis has been to predict entry modes at

aggregate levels. From the practical standpoints, past researchers have employed aggregate, macro-level variables to measure the impact of external environmental influences on entry mode choice (Sarkar & Cavusgil, 1996).

As Davidson (1982) points out, constraints on foreign ownership are differentiated by industry. Firms from different industries and in different entry situations may conceivably face different sets of restrictions in the same country. This could induce variation in entry mode choice that may not be adequately captured by global measures of restrictiveness. It is more effective, therefore, to measure the influence of ownership restrictions an individual industry faces in a given entry situation and relate that to the entry mode actually chosen by the firm. In other words, both dependent and independent variables ought to be measured at the micro level.

Lack of Attention for Internal Environment

Third, in parallel with arguable application of environmental factors on the choice of entry mode, the role of the firm's internal environment has attracted scant attention as well (Erramilli, 1992). While normative writings emphasize the role of the firm's resources, management capabilities, policies and preferences in entry mode choice (Goodnow, 1985; Root, 1987), empirical research has practically ignored this area. In addition, only a handful has explicitly considered non-economic variables as key antecedents of entry mode choice and examined performance related issues (Sarkar & Cavusgil, 1996).

Lack of Consideration for Industry Characteristics

Another critical debatable point on the choice of entry modes is that the literature has focused attention almost exclusively on manufacturing firms (Sarkar & Cavusgil, 1996) and thus much of research about foreign market entry mode choice is based on knowledge accumulated

from the manufacturing sector (Erramilli, 1990; Erramilli & Rao, 1993). Few researches into the ownership patterns of MNCs include service industries in the research sample (Gatignon & Anderson, 1988; Gomes-Casseres, 1985; Stopford & Wells, 1972). Since the scope of these studies has been restricted to manufacturing industry, linkage between service characteristics, e.g. inseparability and intangibility, and its impact on international entry mode selection and performance has not been considered.

Findings from one group of studies (e.g., Agarwal & Ramaswami, 1992; Terpstra & Yu, 1988; Weinstein, 1977) suggest that the factors that influence the choice of entry mode by manufacturing firms are generalizable to services. But, findings from another group of studies (e.g., Erramilli, 1990, 1991; Erramilli & Rao, 1990, 1993) suggest that those factors are not generalizable and must be adapted for application to services. The following comments are representative of the two distinct viewpoints:

“Although FDI theory was originally developed to explain foreign production, its application to service industries is considered equally appropriate... The model has been applied in the past to explain the internationalization of the hotel industry... the banking industry...and the advertising industry” (Agarwal & Ramaswami, 1992, p. 10).

“Growing stream of recent literature suggests that service firms differ from manufacturing firms... and face unique challenges in their foreign market entry and expansion process... some peculiar characteristics of service firms warrant adaptation of the underlying theory used to investigate entry mode choices” (Erramilli & Rao, 1990, p. 136).

While for most of the literature on internationalization, international marketing and export strategies is geared to the needs of the manufacturing sector (Grönroos, 1999), whether extant researches on manufacturing firms can be generalized to service firms is debatable (Erramilli, 1992). There is growing consensus among academic scholars that the production and delivery of services is distinct enough to make a wholesale transfer of goods marketing experiences inappropriate (Berry, 1980; Grönroos, 1983; Lovelock, 1983; Thomas, 1978).

Sharma and Johanson (1987) urge caution in generalizing conclusions drawn from studies involving the internationalization of manufacturing firms to service firms. In many studies of manufacturing firms (e.g., Burton & Schlegelmilch, 1987; Cavusgil & Nevin, 1981), for example, the impact on export behavior of firm characteristics such as size, age, ownership structure and sales have been investigated. However, in a recently reported study by Javalgi, Lawson, Gross, and White (1998) such firm characteristics do not seem to differentiate exporting service businesses from non-exporting.

Erramilli and Rao (1990) noticed that we know very little about how service firms enter foreign markets, and their observation holds true even today. Only a few studies (e.g., Contractor & Kundu, 1998; Domke-Damonte, 2000; Erramilli and Rao, 1993; Rodríguez, 2002) have explicitly attempted to study firms empirically in the service sector. Therefore, degree of that experience transferable to services without adaptation seems equivocal from a review of literature concerning choice of entry mode.

Location-Bound Services

A problem unique to international service industries is that many services are not exportable due to the inseparable characteristics of services (Erramilli, 1992). In other words, production and consumption of these services are simultaneous. As a result, the firm often has no

choice but to locate production in the host country. Boddewyn, Halbrich, and Perry (1986) appropriately refer to these as “location-bound services.”

Carman and Langeard (1980) are of the opinion that the inability to export and the imperative to produce on foreign soil from day one pose special risks for service firms. They also argue that service firms may encounter increased risks when attempting to internationalize because of the necessity of dealing immediately with a customer before the service company has had adequate time to understand the local preferences and business practices.

As a result, serious management mistakes are more likely to occur internationally than in a domestic setting. In part, these risks result from the inability of companies in some services to expand into international markets through traditional exports (Root, 1994). The impact of national cultural factors also complicates the international expansion effort as the service company attempts to deal with problems concerning adaptation to host country preferences. Heskett (1986) suggests that many of the factors (e.g., local staffing and control) that are critical to the success of service firms anywhere take on additional importance in the international competitive setting.

Incremental Internationalization

There are other differences between manufacturing and service firms in addition to location boundedness. One of the earliest schools of thought regarding the way in which the firm begins to internationalize its operations declares that the firm follows the following stages in the development: a) no regular export; b) export via independent representatives or agents; c) sales subsidiaries; d) production/manufacturing plants (Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975).

Chain establishment perspective is that the establishment chain describes the entry mode decision as a time-dependent process (Anderson, 1997). The explanation of a particular state (i.e., entry mode) is based on some prior state or a sequence of some prior states (Zaltman, Pinson, & Anglemar, 1973). Increased market knowledge is supposed to lead to increased market commitment and vice versa. Empirical support for the evolutionary path has been found in some studies for the manufacturing firms (Kwon & Hu, 1995; Loustarinen, 1979), but was not supported in other studies (Ayal & Raben, 1987; Millington & Bayliss, 1990; Turnbull, 1987).

Johanson and Vahlne (1990) and Sharma and Johanson (1987) suggest that the establishment chain does not seem to be valid for service industries. Based on their case studies of two Swedish consultancy firms expanding abroad, Sharma and Johanson (1987) have argued that the process of incremental internationalization observed in manufacturing firms is not evident in service firms. Findings such as these suggest a need to rigorously re-examine many of the effects thought to influence the entry of firms into global markets, and to establish whether these effects have similar relevance to service firms.

The Need for the Study

The impact of entry modes on the success of foreign operations is great, leading Wind and Perlmutter (1977) to identify entry modes as a “frontier issue” in international marketing. With service firms accounting for approximately 30 percent of world trade (Edvardson, Edvinsson, & Nystrom, 1993) and dramatic growth in international franchising in the service sector (Maynard, 1995), there is a critical need to develop a more comprehensive understanding of the issues that affect how service firms pursue internationalization.

However, most of the researchers in the international services field (Boddewyn, Halbrich, & Perry, 1986; Bower, 1968; Cowell, 1983; Edvinsson, 1985; Gaedeke, 1973; Hackett, 1976; Palmer, 1985; Sharma & Johanson, 1987; Terpstra & Yu, 1988) do not directly deal with the question of entry mode choice. Moreover, existing knowledge of entry mode choice in firms and the implication of environment and performance have been accumulated mostly in the context of manufacturing firms (Domke-Damonte, 2000; Erramilli, 1990, 1991, 1992; Erramilli & Rao, 1990, 1993; Grönroos, 1999).

There is growing consensus among academic scholars that services management is distinct enough to make a transfer of goods marketing concepts unrealistic. For instance, it has been believed high degree of control (e.g., company-owned market entry mode) entails high performance in manufacturing sector. This, however, might not be the case in service industry, in which non-equity entry mode (e.g., franchising) offering relatively low degree of control gains great popularity when service firms enter into a foreign market.

While the conceptual and empirical studies which have been conducted to date have proved valuable contributions to knowledge development on the study of international service management, it may nonetheless be contested that the subject area of internationalization of

service firm remains rooted in the early stages of development and there have been many calls for further research activity (Quinn, 1998a, 1998b; Sparks, 1995).

In particular, much of the existing literature on the choice of foreign entry mode contains and focuses in a piecemeal fashion on many seemingly unrelated factors and considerations with no identification of key constructs and their relationships (Quinn, 1999); Relevant work is separated by differences in problem setup, theory, and method. In other words, the body of literature has been limited and provided only a partial representation of internationalization of service firms in that the reciprocal interactions and influences among constructs such as environment, foreign entry mode, and performance. Therefore, there is a clear need for a unified framework within which different factors or constructs can be placed and relationships between them analyzed.

Entry modes differ greatly in their mix of advantages and drawbacks. The tradeoffs involved are to be considered in relation with environmental issues and performance. Several surveys of how firms actually make the entry mode decision indicate that few companies make a conscious, deliberate cost/benefit analysis of the options (Robinson, 1978). Despite the existence of relevant evidence, the literature does not suggest how the manager should weigh tradeoffs to arrive at a choice that maximizes risk-adjusted return on investment and to answer the question of the best mode of entry for a given function in a given situation. As a corollary of this statement is that there is a need for performance-focused studies, which necessitates that the relationships among various exogenous factors concerning foreign market entry modes be investigated for their effects on firms' performance (Sarkar & Cavusgil, 1996).

From a statistical standpoint, it is important to examine complex trivariate relationship between structure, contingency, and performance rather than simple bivariate. The use of

structural modeling should be of great use to identify the direct and indirect effect of various levels of environmental variables on the two important dependent variables, entry modes decisions and performance.

It has also been noted that there is variability within in the service industry in terms of foreign market entry modes because different segment of service sector shows various degrees of service characteristics (Fladmoe-Lindquist & Jacque, 1995). A handful of studies have been partially done for this phenomenon in the service industry in international arena. In this context, there is need for adapting this knowledge, and for developing new concepts and frameworks to meet the unique characteristics of service firms (Erramilli & Rao, 1990). In addition, there is a need to investigate the phenomena at disaggregate levels of analysis among service firms.

Theoretical Framework

As Donaldson (1995, p. 31) argued, “integration of theoretical paradigms can be obtained within the domain of organization structure through synthesis of selective elements of the different paradigms that can be brought together in a logically consistent manner.” The core explanatory framework for this study is structural contingency theory. To this core can be added complementary theoretical ideas borrowed from other theoretical frameworks such as agency theory, transaction cost theory, and resource dependence theory to produce synthesized explanatory model of international ownership and control strategies and its implication on performance in the hospitality industry by incorporating idiosyncratic characteristics of service.

Contingency Theory

The contingency theory is the primary theoretical framework applied to explain the relationships among environmental factors, foreign ownership and control strategies, and performance of hospitality firms. Contingency theory was a unifying theoretical paradigm in US organizational structural theory (Lawrence & Lorsch, 1967a; Thompson, 1967) and a major theoretical lens to view organizations prior to the contemporary period of intellectual fragmentation mostly because contingency theory constitutes a research paradigm in that there is a core theory (the idea of a structural contingency fit which affected performance) and a style of empirical research which featured comparisons of structures and contingencies across organizations (Donaldson, 2001).

The essence of the contingency theory paradigm is that organizational performance results from fitting characteristics of the organization, such as its structure, to contingencies that reflect the situation of the organization (Burns & Stalker, 1961; Lawrence & Lorsch, 1967a;

Pennings, 1992; Woodward, 1965). Change in any of contingencies such as the environment (Burns & Stalker, 1961), organizational size (Child, 1975), and organizational strategy (Chandler, 1962) tends to produce change in the corresponding structural aspect (Burns & Stalker, 1961; Chandler, 1962; Child, 1973a). This results in organizations moving into fit with their contingencies. In this way the organization moves its structure into alignment with each of these contingencies, creating an association between contingencies and organizational characteristics (Burns & Stalker, 1961; Child, 1973; Hage & Aiken, 1969; Rumelt, 1974; Woodward, 1965; Van de Van & Drazin, 1985).

Contingency theory contains the concept of a fit that affects performance, which, in turn, impels adaptive organizational change. Contingency theory provides a motivation for an organization in misfit to move into fit to gain the higher performance that fit produces (Burns & Stalker, 1961; Woodward, 1965). Therefore fit is an equilibrium because once attained, the tendency of the organization would be to stay there (Burns & Stalker, 1961).

In formal terms, there is a trivariate relationship between structure, contingency, and performance. Thus fit is central to contingency theory because it explains variations in organizational performance, organizational change, and associations between contingencies and structures – with a fit raising performance and misfit lowering performance. In this context, contingency theory is a useful framework to explain fit between foreign entry mode and environmental factors that has a positive effect on performance.

Contingency theory is traditionally concerned with organizational performance and in that broad sense is consistent with economics. However, contingency theory has mostly not drawn much on economics and tends to remain isolated from it. In the United States in the seventies, some attempts have been made to import elements of economics into organizational

theory more generally and this became increasingly influential during the eighties and into nineties (Donaldson, 2001).

Barney and Ouchi (1986) term this collective movement 'organizational economics' and use the term organizational economics to describe theoretical contributions to organization theory from economics. They are explicit in offering organizational economics as a new paradigm in organization theory. In terms of impact upon organization theory, the most important strands within organizational economics to date have been agency theory (Jensen & Meckling, 1976) and transaction costs economics (Williamson, 1975).

Hesterly, Liebeskind, and Zenger (1990) regard organizational economics as a paradigm, a framework that possesses a common set of axioms that define a unique perspective on the role and determinant of organizational forms. This they see as offering advantage over the lack of clarity and parsimony in conventional organizational and management science, as well as offering new insights unavailable from pre-existing theories (Hesterly et al., 1990). These are both based on the discipline of economics, using its concepts and language.

Agency and transaction cost theories have in common that both draw upon the model of men and women as untrustworthy, devious and pursuing their own self-interest to the detriment of the organizational collective (Jensen & Meckling, 1976; Williamson, 1985). In other words, both theories share the common concern of theorizing dishonesty and cheating by managers. In organizational economics, power is required in the form of hierarchical controls over managers. Agency theory and transaction cost theory both advocate that lower-level organizational members are using delegated authority to pursue their own interests at the expense of the interests of the organization as seen by top management, then top management should investigate

new controls to investigate, reveal and sanction (i.e., punish) such deviancy (Jensen & Meckling, 1976; Williamson, 1985).

Agency Theory

The second part of the theoretical framework used to test issue of internal environment and develop testable hypotheses at the firm level is agency theory (Eisenhardt, 1989; Jensen & Meckling, 1976; Levinthal, 1988). “An agency relationship is present whenever one party (the principal) depends on another party (the agent) to undertake some action on the principal’s behalf” (Bergen, Dutta, & Walker, 1992, p. 1).

Agency theories assume that organizations want to minimize their organizational costs, “the costs of aligning the incentives of principals and agents, including bonding and monitoring and the related forgone output attributable to those activities” (Norton, 1988a, p. 202). In organizational applications of agency theory, the principal is the owner while the agent is the manager who controls but does not own the corporation. In the case of franchising, the franchisor is the principal and the franchisee is the agent.

Agency theory holds that organizations can be analyzed in terms of a conflict of interest between principals and agents (Jensen & Meckling, 1976). In particular, agency theory is concerned with the ability of the principal (i.e., a service corporation) to evaluate and control the behavior of an agent (i.e., a service unit). In agency theory, agents misuse the discretion that has been delegated to them by the principal to benefit the agents themselves while deceitfully harming the interests of the principal (Jensen & Meckling, 1976).

Agency theory holds that losses to the principal can be stemmed by closely controlling the agent, through various devices such as monitoring and sanctioning, including control over

executives by a non-executive board of directors (Fama & Jensen, 1983; Jensen & Meckling, 1976). The general problem of evaluation arises when such evaluation is difficult or expensive to conduct, and there is a lack of goal congruence and asymmetry of risk preferences between the principal and agent. Under these conditions, agents may engage in deceptive behavior such as shirking or misrepresentation of skills and abilities.

As service firms move from the domestic to the international environment, such opportunistic behavior by service unit operators can increase the risk for the service company, and the design of appropriate compensation packages takes on added importance. As a result, the control of potentially opportunistic behavior is a central concern of international service companies (Brickley & Dark, 1987). This framework is useful for testing the relationship between a company (principal) and its service units (agent) located and operating at foreign soil because the value of a service company's trademark or reputation in the chain distribution can be adversely affected by the behavior of service units who act as agents of the principal.

Transaction Cost Theory

Since this research also tests the influence of industry factors on foreign ownership and control strategies, a transaction cost theory (Williamson, 1985) will be applied to supplement the contingency theory. A transaction cost theory is also termed as transaction cost economics (in Williamson's terminology) or transaction cost analysis (terminology used in subsequent studies, as in Anderson & Gatignon, 1986). All three terminologies will hereafter be often abbreviated as TCA.

In the last decade applications of transaction cost theory have become fairly common in the entry mode investigation (Anderson & Gatignon, 1986). The composition of several

dimensions such as specific assets, the frequency of economic exchange and uncertainty surrounding the exchange of resources between buyer and seller is decisive for the way cost efficient governance modes are assigned to the transaction (Williamson, 1979). The particular governance structure depends on the comparative transaction costs.

The TCA approach begins with the assumption that under competitive markets, market-contracting arrangements, or low-control modes, are favored because threat of replacement forces suppliers to perform efficiently. Under restricted bargaining market, however, wholly-owned operations or full-control modes are favored because the firm can significantly reduce its transaction costs by replacing external suppliers with its own employees, whose behavior it can monitor and control more effectively (Hennart, 1989).

Thus, market failure is the primary antecedent to the firm's decision to integrate and assume greater control. From the TCA perspective, the most important determinant of market failure is the presence of transaction-specific assets, which is defined nonredeployable physical and human investments that are specialized and unique to a task (Williamson, 1986). For example, the delivery of a certain service may be predicated on the existence of an uncommon set of professional know-how and skills.

TCA holds that market failure occurs such that the normal economic actors to perform effectively breaks down and has to be replaced by hierarchical controls. In the large corporation with a multi-level hierarchy, middle managers begin to subordinate the corporate goals of the maximization of profit in favour of their personal self-aggrandizement through excessive salaries and perquisites and so on. This opportunistic behavior can be curbed by setting up a multidivisional structure in which corporate staff vigilantly monitors the divisions on behalf of the corporate center (Williamson, 1970, 1971, 1981b, 1985).

Again, market failure can occur in transactions where a supplier to a firm makes asset investments specific to that transaction, therefore transforming the exchange into bilateral monopoly away from market-determined prices. Haggling over price is liable to ensue and the avoidance of such transactions costs is attained by recourse to administration of both transacting parties through vertical integration (Alchian & Woodward, 1988; Williamson, 1975, 1981b, 1985); thus the duplicity and untrustworthiness of managers in the two firms is resolved by placing a common boss over them.

In certain situations, transaction cost theory specifies the adoption of a third, or hybrid, governance form such as long-term contracting (Williamson, 1991a). Gatignon and Anderson (1988) postulate that, in choosing entry modes, firms make trade-offs between control (i.e., benefit of integration) and cost of resource commitments (i.e., cost of integration). TCA predicts that firms integrate when asset specificity is high and firms restrain from integration when specificity is low because the benefits of integration (control) fall short of the costs of attaining it. In this context, the benefits of integration under market failure must be compared with the costs of integration because establishment of an integrated operation entails significant internal organization or bureaucratic costs. High overhead costs caused by integration process also results in high switching costs.

As such, control is assumed to carry a high price. Hennart (1982) suggests that transactional considerations are useful in explaining the observed variations in the magnitude of foreign direct investment in service and trade sectors. Transaction cost analysis focuses on the costs of bargaining and negotiating under conditions where one or both parties have invested substantially in physical or human resources that are not easily or inexpensively used for alternative purposes: transaction specific assets (from hereon, often used interchangeably with

‘asset specificity’). This research extends transaction cost theory to the industry level to test the impact of industry differences on the ownership and control strategies of international hospitality firms.

Resource Dependence Theory

The last part of the model tests the impact of environmental factors in the national context on ownership and control strategies in the foreign market. Studies on environmental influences on adaptive organizational behavior have generally focused on two major aspects of the environment. One is environmental uncertainty as perceived by managers (Lawrence & Lorsch, 1967b; Yasai-Ardekani, 1986), and the other is scarcity of critical resources (Pfeffer & Salancik, 1978). This study reflects the effect of both uncertainty and resource scarcity in relation with ownership structure and control strategies for hospitality firms operating in foreign countries.

The use of uncertainty as an environmental variable flows from an information uncertainty view of organizations that treats environments as a source of information (Galbraith, 1973; Lawrence & Lorsch, 1967a). In contrast, the use of resource availability or scarcity as an environmental variable flows from a resource dependence view of organizations that treats environments as arenas in which all compete for resources (Aldrich, 1979; Aldrich & Pfeffer, 1976; Pfeffer & Salancik, 1978).

The hypotheses for the national context rely on resource dependence theory, which holds that organizations are dependent upon external resources and seek to manage them through a variety of means (Pfeffer & Salancik, 1978). It is premised on a rejection of the idea that the organization is a rational instrument for goal attainment (Pfeffer & Salancik, 1978), which is

central to structural contingency theory (Chandler, 1962; Donaldson, 1985; Parsons, 1961). The theory is a political model of organizations that gives primacy to maintenance of autonomy by the organization (Pfeffer & Salancik, 1978).

Resource dependence theory asserts that organizations can control their environments through building interorganizational relationships such as franchising, joint ventures, and so forth; to put another way, by active relations work to change the surrounding organizational field (Pfeffer & Salancik, 1978). The view taken of managers and management is negative in resource dependence theory, which is explicitly stated that managers make little difference to organizational success and that their role is often mainly symbolic (Pfeffer & Salancik, 1978).

From the information uncertainty perspective developed by Barnard (1938), Lawrence and Lorsch (1967a) and Duncan (1972) argued that imperfect knowledge about the environment created uncertainty for firms. It was also posited that managers would perceive the environment in ways that were consistent with their training and personal characteristics. As such, managerial perceptions played a significant role in determining the amount of uncertainty managers perceived in the environment.

As the business world becomes more global and the level of international competition continues to increase, managers will find themselves facing increasingly complex strategic decisions. Perhaps first and foremost among these decisions are the decisions relating to methods of expanding (i.e., entry modes) the firms' international operations (Brouthers, 1995). However, as one considers the prospects of international expansion one can not help but be aware of the many and varied risks facing firms in the foreign market. In going overseas, firms face, in addition to domestic sources of uncertainty, foreign exchange and political risk (Mascarenhas, 1882). Unfamiliarity with operating in a new environment, aggravated by labor restrictions,

different cultures, and infrastructural difficulties, contributes to the uncertainty of the international environment that hospitality firms face.

Carman and Langeard (1980) have stated that service firms face far greater risks in international expansion than do product firms due to its inherent service characteristics such as inseparability and intangibility. National environmental characteristics such as risk and uncertainty, influence management perception that, in turn, leads to an influence on the structure of the organization (Yasai-Ardekani, 1986) when entering foreign markets. Vernon (1985) and Miller (1992) have also suggested that the perception of a more comprehensive international risk and the strategic choice of entry mode may be related. Miller (1992) provides details of general environment, which refers to variables that are consistent across all industries within a given foreign country such as political risk, economic uncertainty, and social uncertainty.

Mascarenhas (1982) argued that if domestic business environment can be labeled uncertain, the international business environment is doubly so. In going overseas markets, firms face increasing level of complexity, heterogeneity, dynamism, illiberality or munificence (Child, 1972; Covin & Slevin, 1989; Dess & Beard, 1984; Duncan, 1972; Thompson, 1967). Due to unfamiliar and/or precarious environmental settings and the relative lack of exploitable opportunities, firms' decision on control strategies of foreign operations may reflect the growing dependence of organizations on their environments. It is possible that firms resort to contractual arrangements to ensure stability in their planning process and organizational performance (Koberg & Ungson, 1987).

Viewed from both information uncertainty and resource dependence perspective, long-term contracts (e.g., franchising) may be used to stabilize relations among organizations and to eliminate some environmental uncertainty (Guetzkow, 1966). In this spirit, franchising is a valid

vehicle for interorganizational relationships (Alon & McKee, 1999b), especially in international operations for firms. Shane (1996b) concluded that franchising is a critical means of long-term strategic choice for international service firms.

Purpose of the Study

Although manufacturing industries are still primarily responsible for the growing level of interdependence and integration in the world economy, services have recently experienced a phenomenal growth in international markets (Fladmoe-Lindquist & Jacque, 1995). The international dimension of this research reflects a growing concern in the service business literature regarding the internationalization of hospitality companies. Since so little is known about how firms in the hospitality industry enter foreign markets, it focuses on how foreign market entry decisions in hospitality firms could be analyzed and understood. It explains the variation in the outcomes of these decisions, which highlights the impact of environmental components on international business decisions.

The primary goal of this study is the development of an integrated theoretical model, expressed in testable propositions, for integrating the literature on entry mode into a unified framework, especially being able to be applied in the hospitality industry. Much of the literature on modes of entry does not suggest hypotheses but considerations (Anderson & Gatignon, 1986); the pros and cons of foreign entry modes are weighted against an alternative that is usually unspecified. Hence, predictions are difficult to make. In contrast, the framework presented here yields testable propositions based on the control-resource commitment and/or risk-return tradeoff. For example, a notable advantage of transaction cost analysis in this regard is the default hypothesis: low-resource commitment is preferable until proven otherwise. The presence of a default hypothesis is especially helpful for theory testing because it provides a testable prediction.

The theory, which comes mainly from theories of organizational study, is explicitly concerned with weighing tradeoffs on the choice of entry mode and with maximizing

performance. In the international context, this research examines the ownership structure and control strategies for hospitality firms. In particular, this study investigates relationships among environmental factors, modes of entry providing different level of control and resource commitment, and firms' performance. The theory investigates and supports relationships among constructs in terms of theoretical frameworks that borrowed from contingency theory, organizational economics (includes agency theory and transaction cost theory), and resource dependence theory. The analysis discovers whether fit between environment and organizational structure yields better performance and further evaluates the appropriateness of particular entry strategies and their impact on performance.

Another objective of this study is to identify the determinants of the modes of entry and control decision by international hospitality firms. The results of an empirical investigation of the influence of some important environmental components at each level of firm, industry and national context impinging on entry mode choice are reported. Specifically, the study examines how these factors affect the choice of entry modes offering different degree of control and resource commitment. The determinants of a service firm's organizational choice between equity based and non-equity based control, which have elicited some theoretical answers and a few empirical tests in a domestic setting, have never been addressed in relation with firm's performance in an international context before, especially in hospitality industry.

Finally, franchising, which accounts for a significant share of the U.S. domestic service industry, has also become a major strategic component in the international expansion of U.S. service firms (Boddewyn, Halbrich, & Perry, 1986). This study explains the modes of entry chosen in terms of degree of control and introduces the idea of international franchising as an alternative control mode to wholly-owned and joint venture foreign operations.

Research Questions

As more and more firms from the service sector enter foreign markets, some questions, which are of interest to both academicians and practitioners, are increasingly asked: “How do service firms enter individual foreign markets?”, “How environmental factors influence the entry mode choices of a multinational service firms?”, and “How different entry modes offering different degrees of control affect firm’s performance?”. The answers to these and other related questions in the area of international management of services are not at all clear mainly because most of the large body of research on entry mode and the performance implications of internationalization has been completed in the manufacturing context (Domke-Damonte, 2000).

This research attempts to explain relationships among environmental factors, pattern of ownership structure and control strategies, and performance for the hospitality firms in international context. This study tests the impact of environmental factors on whether hospitality companies choose to use full equity (e.g., wholly-owned subsidiary), partial equity (e.g., joint venture), or nonequity (e.g., franchise agreement) arrangements to control its foreign service units. The concept of ownership and control patterns in this study describes not only using particular ownership structure but also the simultaneous operation of the different alternative control arrangements to perform similar task across national boundaries by hospitality firms.

The general research questions that this study asks are; first, how environment factors in national context affect the ownership structure and control strategies of international hospitality companies; second, how different entry modes offering different degrees of control affect firm’s performance. Three sub-questions may be derived from the first general question: How are ownership and control strategies of international hospitality companies affected by 1) principal

agent issues at the firm level; 2) transaction costs at the industry level; and 3) perceived information uncertainty and resource dependence at the national level.

Research Boundary

Several researchers have argued that there is tremendous variation within the service sector in the way that services are produced and delivered (Boddewyn, Halbrich, & Perry, 1986; Lovelock & Yip, 1996a; Sarathy, 1994; Swartz, Bowen, & Brown, 1992; Zeithaml, Parasuraman, & Berry, 1985). These researchers have recommended that more attention be given to comparing the various sub-sectors within services to identify what strategic practices are effective for specific types of services in particular situations.

Since considerable variability exists with respect to idiosyncratic aspects of services and environmental characteristics across categories, it would be problematic and perhaps even misleading to treat service industry as a homogeneous population for research purposes. Although the definition of the service sector varies widely, service firms in this research include those classed as services in the North American Industry Classification System (NAICS) developed by the U.S. Department of Commerce in 1997.

The U.S. Department of Commerce (2001b) has classified service industries into 11 major groups and further divided into more than 50 different categories of service activity with greater degree of specificity. According to U.S. Department of Commerce (2001a), NAICS is based on a production concept, defining industries by grouping together establishments that use similar processes and inputs to produce a goods or a service. Inputs include types of labor and skills, capital equipment, and intermediate materials. In many cases, intangible inputs may be important, especially in service industries.

This study investigates only international service companies in the NAICS categories of ‘accommodation’ (NAICS code 721X) and ‘food services & drinking places’ (NAICS code 722x), hereinafter referred to as the hospitality industry. NAICS includes industries such as

hotel, motel, bed and breakfast inns, restaurant, limited-service eating places, special food services, and drinking places for both code 721X and 722X. Two industries were selected mainly because they have a longer history of international operations and a higher rate of international involvement.

For the research purpose, this study also examines only firms whose primary business is the provision of consumer services that utilize business-format chains across national borders. Business formats are specific trademarked management plans for the delivery of the service. These formats are discussed in detail in Chapter 2.

From the perspective of molecular modeling approach of services by Shostack (1977, 1982), both categories can also be classified as balanced entity equally weighted between goods and services. Consequently, it was decided in this study to focus on two categories of services based upon NAICS in the service industry and to examine that industry's development in detail by focusing on key environmental factors affecting patterns of ownership and control strategies that have been employed to enter foreign markets.

Contribution of the Study

Erramilli and Rao (1990) note that “so little is known about how service firms enter foreign markets” (p. 136). Furthermore, Clark, Rajaratnam, and Smith (1996) point out that “for international services, theory lags practice by a considerable degree, and many important questions await answers” (p. 9).

This research addresses an important issue in response to their calls for more theoretical work on services marketing and strategy in the international arena. This study recognizes that foreign market entry decisions for services must be understood separately from those of manufactured goods. Therefore, current research focuses on the management of service companies and can be used to analyze foreign market entry mode choices of service firms, recognizing the unique characteristics of service sector.

First, this study presents a theoretical model of entry mode choice and control strategies that extends extant theoretical frameworks that borrowed from contingency theory, organizational economics, and resource dependence framework by highlighting the significance of the broad characteristics of services in entry mode selection. This study also provides a synthesis of the literature at the conceptual-construct level and empirically tests several hypotheses drawn from conceptual foundations, a necessary step to making generalizations of interest to scholars and practitioners (Bradley, 1987). For managers, the advantage of such a unified framework is that it allows them to combine a set of insightful as well as often partial analyses to better address the totality of the multidimensional and complex entry mode decision.

Another contribution of the study is to examine how contingency factors affect the choice between integrated and non-integrated entry modes on a continuum, which sets this study apart from many recent empirical investigations that have framed entry mode choice in dichotomous

terms (e.g., Anderson & Coughlan, 1987; Davidson & McFetridge, 1985; Gatignon & Anderson, 1988). This study also empirically investigates the impact of entry mode strategy on firm's performance. In this sense, this research is important from a managerial perspective because it will attempt to understand the international factors that influence firms' ownership and control strategies. Practitioners can use this research to gain a better understanding of the pattern of foreign ownership and control strategies that can affect firms' performance in international context.

At last, another contribution of this research is the inclusion of franchising as an actual management strategy and competitive business practice that is related to international ownership and control strategy. The growth of franchising in international business over the ten years has been substantial (U.S. Department of Commerce, 1988). In most service sector research, franchising is treated as a marketing distribution channel rather than a management strategy that is concerned with the issues of ownership, control, and structure of the corporation. Preliminary research indicates that it is an important business strategy alternative to a full or partial equity position (Martin 1988; Olsen, 1993) for the distribution of service across national borders.

Khan (1999) points out that expanding international markets for US restaurant firms is attributable to increasing competition and domestic saturation with scores of other reasons. He contends that franchising is a competitive business practice for US restaurant firms expanding foreign markets. Further, Lilien (1979) notes that business practices that are followed by firms in a competitive industry provide information about what practices are efficient.

Organization of the Study

Following this introduction chapter, Chapter 2 contains a review of relevant literature and the extent of findings on entry mode and control strategies. Chapter 3 provides major constructs with regard to environmental factors, foreign entry modes, and performance based upon the theoretical frameworks that are used in this research. Building on the literature discussed and theoretical frameworks provided in Chapter 3, research hypotheses are presented in Chapter 4.

Next, Chapter 5 discusses methodological process of this study. The methods and procedures used for data collection and data analysis are discussed. Statistical results from the data analyses are also summarized and reviewed in the context of theoretical model. In chapter 6, the primary purpose of the research and the specific research questions and hypotheses are evaluated. Chapter 7 details findings of the study with respect to the research questions and hypotheses. This chapter also provides conclusions based on the study results with a discussion of the limitations of the study and outlines an agenda for future research.

Summary

This study borrows the notion of contingency theory, which suggests that the selected entry mode must conform to the particular industry, firm, and country factors faced by the entering firm. Supplemental theoretical reasoning may more fully explain foreign market entry strategies to match environments and performance differences between entry modes.

The objective of this study is to extend this line of theoretical reasoning to explain what contingency factors have effect on the ownership and control modes. In addition, this study examines whether certain contingent mode characteristics produce performance differences among the full equity-based, partial equity-based, and non-equity based international entry modes. Finally, this study develops and tests a model that explains the relationships among environments, organizational structure, and performance.

Three sub-objectives are part of this design:

1. To integrate the literature on services with that of international ownership management and control structure.
2. To combine contingency factors into one mode and investigate fit between contingency factors and foreign entry modes based upon notions borrowed from transaction cost theory, agency theory, and resource dependence theory.
3. To examine the impact of fit between environment and organizational structure on performance. A theoretical relationship is developed for international entry modes that are based on the contingency characteristics of environment and organizational control factors. This model suggests that different foreign ownership strategies have different performance outcomes based upon their resource and organizational control demands.

CHAPTER 2

REVIEW OF LITERATURE

Internationalization of Services

Internationalization Process of Services

A traditional way for service firms to start going abroad is to follow manufacturers that they are supplying with services in their domestic markets (Grönroos, 1999). When their clients internationalize, they get an opportunity to go along and sometimes almost are forced to do so (Vandermerwe & Chadwick, 1989; Weinstein, 1977). For example, in studies of the banking and advertising industries, following clients was found to be a major reason for internationalizing (Nigh, Kang, & Krishnan, 1986; Terpstra & Yu, 1988). Now, ways of internationalizing services have become more diverse as the development of new technologies for electronic commerce has made services less dependent on local operations (Winsted & Patterson, 1998).

In the literature, there has been a discussion about whether the internationalization of services and goods differ from each other. Some authors claim that the same factors influence the choice of entry mode by service firms and manufacturers of goods (e.g., Agarwal & Ramaswami, 1992; Terpstra & Yu, 1988). Boddewyn, Halbrich, and Perry (1986) discuss their application of multinational corporation (MNC) definitions, measurements, and theories to service multinationals. They conclude, “no special FDI-MNC theories for international service firms are necessary. The existing ones can be readily accommodated through relatively simple qualifications and elaborations...” (Boddewyn, Halbrich, and Perry, 1986, p. 54).

This observation permits researchers to employ existing theories, which are largely based on the experiences of manufacturing firms, for the purpose of understanding entry mode choice

in the service sector. For example, Agarwal and Ramaswami (1992) studied the choice of entry mode by equipment leasing service providers as compared to manufacturers of goods and found no differences. The reason for this may be that this type of service does not require permanent local presence in a foreign market (Ekeledo & Sivakumar, 1998). Others again conclude that the basic process of entering foreign markets is the same for service firms as for manufacturers, whereas the implementation of this process differs between these two types of firms (Dunning, 1993; Sharma & Johanson, 1987).

While researches about entry mode selection comes from examining manufacturing firms, entry mode choice and ownership strategy in international services have not been examined explicitly (Preble, 1992). In traditional international marketing models focusing on the needs of manufacturing firms, the internationalization process can start in a minor scale using indirect export channels followed by a step-by-step move towards more direct channels. The Scandinavian stages models of entry suggest a sequential pattern of entry into successive foreign markets, coupled with a progressive deepening of commitment to each market. Increasing commitment is particularly important in the thinking of the Uppsala School (Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975).

As suggested by Johanson and Vahlne (1977), firms tend to follow a sequential or evolutionary approach to internationalization with a company advancing from export activity through agent and sales subsidiaries to setting up a manufacturing subsidiary as they gradually accumulate experiential knowledge of a foreign market. This enables the firm gradually to increase its understanding of quality expectations, personnel requirements, distribution and media structures, and buying behavior peculiarities on the foreign market (Grönroos, 1999). Closely associated with stages models is the notion of psychic distance, which attempts to

conceptualize and measure the cultural distance between countries and markets (Hallen & Wiedersheim-Paul, 1979).

However, other authors claim that entry modes for manufactured goods cannot as such be transferred to services because the situation is different for service firms (Erramilli, 1990; Erramilli & Rao, 1993; O' Farrell et al., 1996). Although an increasing number of manufacturing markets, especially high-technology products requiring a degree of customization (i.e., a service input), display very similar characteristics to services, a subtle difference is that although customization and client supplier interaction may be important to manufacturing, they are fundamentally inherent in business service transactions (O' Farrell, Wood, & Zheng, 1998). One way or the other, it immediately faces all this and other problems related to entering a foreign market (Carman & Langeard, 1980).

The sequential approach to internationalization has little direct application to restaurant, retail food service, or hotel operators who can be more usefully characterized as soft-service firms classified by Erramilli and Rao (1990). Zimmerman (1999) and Grönroos (1999) note that service firms may have to enter foreign markets, not in sequential stages initiated with exporting like a goods manufacturer but "all at once." These firms market services where it is difficult or impossible to decouple production and consumption (Preble, 1992). Thus, service firms have to find an entry mode and a strategy that helps them to cope with this situation as well as possible (Grönroos, 1999).

Moreover, it may be expected that the relative importance of the generic elements of each entry mode will differ as a result of industry-specific factors (Buckley & Prescott, 1989). In general, inter-industry differences are relevant because important aspects of the services offered differ, e.g., the technology used to produce the service, degree of standardization or customer

adaptation, degree of intangibility and information asymmetry, the need for customer interaction, the need for a physical presence; or because customers differ (the need to provide a relatively sophisticated service offering); or because competitive conditions vary (O'Farrell et al., 1998). Subtle variations are likely in entry modes used by firms in different service sectors. Consequently, the choice of course depends on the type of service and market in various service industries.

Manufacturing firms follow a linear pattern in their entry behavior, favoring low-control modes of operation, such as exporting, when they first engage in international marketing and preferring sole ownership once they gain more international marketing experience. In contrast, Erramilli and Rao (1990) found that a greater proportion of market-seeking service firms adopted entry modes involving collaboration with external entities.

Erramilli (1991) also found a U-shaped relationship between experience and desired control in the choice of entry mode by service firms. The U-shaped pattern of the service firms suggest that they prefer sole ownership during the early years of their foreign market experience; favor shared-control operating modes, such as joint venture, as they gain some international experience and revert to sole ownership once their international experience becomes extensive. Erramilli's explanation for the U-shaped pattern was lack of experience.

Other explanations have been suggested, such as client-following motives discussed by Weinstein (1977) and Erramilli and Rao (1990). Service firms that accompany their home country client abroad are already experienced in their market niche and are ready to adopt sole ownership in the foreign market from the start. Perhaps as firms gain some experience, catch the attention of regulators, or try to avoid such attention, they are willing to team up with local firms. Later, after gaining extensive international experience and becoming more confident in coping

with the risks of sole ownership, those firms favor wholly owned subsidiaries. Irrespective of the explanation of the U-shaped phenomenon, the important point is that it is different from the pattern found for manufacturing firms.

Nature of International Services

Services represent the new frontier in international business for most businesses from the developed, post-industrial nations (Knight, 1999). The service sector of developed economies has become progressively more important; not only are more organizations providing services generally, but also an increasing trend towards globalization/internationalization of services is recognized (Cicic, Patterson, & Shoham, 1999; Grönroos, 1999). Indeed, international trade in services is growing at a faster rate than other areas and accounts for one-fifth of world trade (Stauss & Mang, 1999).

However, the study of international services has been hindered by peculiar nature of services, by lack of data, lack of international agreements, and by a general neglect of the topic by scholars (Clark et al, 1996). Some attribute this neglect to Adam Smith's bias in regarding services as non-productive activities. This view, taken up by subsequent negations of economists, is generally acknowledged to have retarded the development of research on international services until recent decades (DeLuanay & Gadrey, 1992).

In particular, services imply unique characteristics that pose special challenges to the providing firms. Intensive customer contact, extensive customization requirements, cultural adaptation and degree of intangibility, all appear to be factors that distinguish most services from goods offerings in the internationalization process (Knight, 1999). Overall, international entry for service firms will tend to be relatively more complex than for traditional manufacturers.

Furthermore, foreign entry via direct investment is costly, suggesting that the most successful international service firms will tend to be large, holding substantial resources.

International services differ critically from domestic services in two respects: they necessarily involve something crossing national boundaries; and they have some type of engagement with a foreign culture (Clark et al, 1996). In this respect, they are similar to international products. However, crossing national boundaries is conceptually simple for products, but varied and complex for services. Also, because services are fundamentally people centered, culture sensitivity is more problematic than for merchandise. Considering these critical points, Clark et al. (1996) propose the following general definition: international services are “deeds, performances, efforts, conducted across national boundaries in critical contact with foreign cultures” (p. 15).

In a broad sense, Kotler and Armstrong (1991) define a service as “an activity or benefit that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product” (p. 603). Renting a hotel room, dining out in a restaurant, and traveling on an airplane –all involve buying a service. Unlike physical, tangible goods, services are usually regarded as performances (e.g., legal services) or experience (e.g., spectator sports or live theater), which may be equipment based (e.g., telecommunications, radio, TV) or people based (e.g., management consulting) (Grönroos, 1990; Patterson & Cicic, 1995). Some characteristics such as service provider’s objectives (profit or nonprofit) and ownership (private or public) may be combined to produce quite different types of service organizations (Bateson, 1989; Lovelock, 1984).

Whether public or private, profit or nonprofit, services entail unique features that distinguish them from manufactured goods. Services characteristics greatly affect, even within

the service industry, foreign ownership and control strategies. As Erramilli (1990) argues, it appears that the foreign market entry behavior in the service sector is characterized by considerable diversity, especially in comparison with the manufacturing sector. To understand the reason for this, we have to examine the unique characteristics of service, which make successful foreign operation of services more difficult than that for physical goods.

Much of the literature on international business has taken on a manufacturing perspective, often implicit rather than explicit (Buckley, Pass, & Prescott, 1992). More recent literature has paid attention to the internationalization of service firms and this has necessitated paying attention to the question of defining a service. Thus it seems to be critical to integrate the various existing strands of literature on service industries in an attempt to understand the behavior of internationalizing service firms.

To begin with, the characteristics that distinguish services from goods are highlighted, and next classificatory systems for types of international activity are introduced. While several authors (e.g., Enis & Roering, 1981; Wyckham, Fitzroy, & Mandry, 1975) have disputed the need for a separate treatment of services in marketing management, many studies, both in economics (Fuchs, 1968; Stanback, 1979) and management (Berry, 1975, 1980, 1983; Rathmell, 1966, 1974; Sasser, 1976; Sasser & Arbeit, 1978; Upah, 1980; Upah & Uhr, 1981), have stressed the specificities of services.

According to Zeithaml, Parasuraman, and Berry (1985), four characteristics are considered and most commonly recognized typical of the service sector: intangibility (from which follow characteristics such as non-transportability, information asymmetry, and ownership), heterogeneity, perishability, and inseparability (from which follow characteristics such as customer involvement in the provision of service). Few services display all these

features, although most exhibit more than one. Due to the heterogeneity nature of service industry, it would be virtually impossible to identify a list of characteristics applicable to all sectors (Buckley, Pass, & Prescott, 1992). All of these characteristics impact the nature of the service offering and the manner in which it is promoted, priced and distributed.

Intangibility

First, services are largely intangible (Berry, 1980; Lovelock, 1981; Rathmell, 1966, 1974; Shostack, 1977) and cannot be touched, felt, seen, transported, or stored (Kotler & Armstrong, 1991), which give rise to information asymmetry between the customer and the service provider (Holmström, 1985). One of the characteristics of services is that the service provision is only considered as output from the moment at which it is sold. Until this moment, it is only a potential output. Rather, they are ‘experience’ which cannot be clearly assessed before consumption (Berry, 1980; Rathmell, 1966).

Intangibility, according to Bateson (1979), is the salient distinction between goods and services from which all other differences emerge. Accordingly, intangibility is one of the factors that is responsible for distinguishing foreign market entry behavior in the service and manufacturing sectors. A common consequence of these different aspects, particularly intangibility, has been difficulty in defining the output of services and therefore in measuring this output (Gallouj, 1997). Services quality is more difficult to assess than is quality for goods. Prices are also more difficult to set, since customers find it difficult to determine a price-value relationship (Dahringer, 1991).

In many service businesses, it is difficult to monitor and evaluate the quality of the service that is being provided. At the international level, service monitoring and quality control

becomes more difficult as a result of distance and cultural factors (Heskett, 1986). From the perspective of service quality model developed by Zeithaml et al. (1985), provision of services in unfamiliar cultural environment results in gap between customers' expectations and management perceptions, which give rise to the problem of controlling service quality. The essential core of culture consists of traditional (i.e., historically derived and selected) ideas and especially their attached values (Kluckhohn, 1951).

Kroeber and Parsons (1958) arrived at a cross disciplinary definition of culture as “transmitted and created content and patterns of values, ideas, and other symbolic-meaningful systems as factors in the shaping of human behavior and the artifacts produced through behavior” (p. 583). A value is “a broad tendency to prefer certain states of affairs over others” (Hofstede, 2001, p. 5). It is also in line with Rokeach's (1972) definition: “To say that a person has a value is to say that he has an enduring belief that a specific mode of conduct or end-state of existence is personally and socially preferable to alternative modes of conduct or end-states of existence” (pp. 159-160). As such value is centered on the concept of culture and customer expectation is closely linked to personal or social values. However, values are invisible until they become evident.

Lack of learning time from day one operation in foreign soil mainly due to the inseparable characteristic of services leads to the ignorance of customers' values on expected service quality, which is one of the causes of not meeting customer expectations. The key reasons leading to this gap are insufficient marketing research, inadequate use of marketing research, and the lack of interaction between firm and customer. A need to increase the control over service quality by reducing the gap between customers' expectations and management

perceptions may make a firm select external markets (e.g., franchising) as an entry mode with the intention of gaining benefit from local agents' market knowledge.

The initial interaction between customer and service provider can become critical because once customers are disappointed, it may be difficult to regain them. If the service is expensive, the customer may be encouraged to give up or search for a substitute service. If the service is inexpensive and a substitute service is available, customers may be more inclined to move to an alternate provider than to give the failing service a second chance.

The intangible nature of services makes it difficult for a customer to examine the quality of the service before committing to a purchase. In general terms, the customer buys performance, expertise, and experience. Most often, the customer buys the promise of a reduction of uncertainty for decisions in the field concerned (Wittreich, 1966). From this perspective, the output of service provision can be considered as a process in which knowledge is made available, transformed and transferred (Gallouj, 1997). To reduce uncertainty, buyers thus look for signs of service quality. They draw conclusions about quality from the place, people, equipment, communication material, and price that they can see. Therefore, as Levitt (1981) suggested, the service provider's task is to make the service tangible in one or more ways. Whereas product marketers try to add intangibles to their tangible offers, service marketers try to add tangibles to their intangible offers.

As a result, reputation, partly represented by the trademark is very important to both the service provider and the customer. For example, McDonald's sued and eventually won in an American court the cancellation of the franchise contract with its Paris franchisee. McDonald's contended that the franchisee had not maintained the required standards of service and food quality and had acted in a way that was injurious to the reputation of the company.

Following the work of Nelson (1970), Darby and Karni (1973) examined the consumer's 'search for quality.' They postulated that measurement of the quality of merchandise, whether in terms of physical attributes or of the subjective valuation of those attributes, poses problems because it can only take place after the act of purchase. This typology raises the question of qualities that are not intrinsic components of goods or services. In fact, any goods or services can be composed of any proportion of each of the above dimensions. Moreover, the perception of the qualities of goods or services varies considerably depending on the consumers involved.

Their work, taken up by Zeithaml (1981) in an article: "How consumer evaluation processes differ between goods and services," highlights three essential groups of product attributes (both goods and services): (1) search qualities apply to products which the client can touch, see, taste and therefore analyze and evaluate before buying; (2) experience qualities apply to products whose qualities only become apparent after being bought, i.e., during consumption; (3) credence qualities apply to products whose qualities cannot be evaluated by the client, even after consumption, because the client lacks the necessary knowledge or capacity.

In reality, all products combine tangible and intangible dimensions. The range of tangibility that goods and services possess varies across the industries, even within the service industries (Rushton & Carson, 1985; Shostack, 1977, 1982). Molecular modeling approach developed by Shostack (1977, 1982) visualizes scale of market entities by placing (in)tangibility at one extreme of the spectrum. Entities at either end of the scale can, for convenience, be simply called 'products' or 'services,' since their dominance is so pronounced. At one extreme of the spectrum, while salt is highly tangible and physical, it is marketed as possessing an intangible dimension, 'reliability,' as witnessed in the Morton Salt slogan, "when it rains, it pours."

At the other extreme of the spectrum, teaching - imparting knowledge - is highly intangible, but educators frequently use physical symbols (diplomas, tests, books, and classroom design) to provide a physical reassurance of the presence of the product. Similarly lawyers and doctors take care in decorating their offices to project quality assurance through the symbols used in decorating. As such services are often accompanied by physical objects that cannot be categorized as true product elements. Shostack (1982) call these objects 'evidence,' which play the critical role of verifying either the existence or the completion of a service.

There are two kinds of service evidence: peripheral evidence and essential evidence. Peripheral evidence, while it is actually possessed as part of purchase, typically has little or no independence value. Meanwhile, essential evidence cannot be possessed by the consumer. Nevertheless, it may be so dominant in its impact on service purchase and use that it must be considered virtually an element in its own right (Shostack, 1982).

Whether peripheral or essential, service evidence is at the heart of service image, for it is evidence that provides the clues and the confirmations (or contradictions) that the consumer seeks and needs in order to formulate a specific mental reality for service. Further, along with intangible characteristics of service, service evidence tends to impact on the choice of optimal level of foreign ownership and control strategies because of interaction of local values indigenous to culture.

Service classifications developed by Shostack (1982) and Darby and Karni (1973) particularly seem well suited to the analysis of service activities. In professional services, the output appears difficult to isolate or quantify, which make it difficult, if not impossible, for the customer to measure it. Thus we can say that the majority of intellectual services will be located in the third category, i.e., credence qualities, insofar as the customer is faced with a strong

asymmetry of information (customer has less information and knowledge of the problem than the service provider).

However, we might expect the evaluation of certain services of other types, such as hotel industry, to fall under the category of ‘experience qualities,’ particularly characterized by highly standardized services and essential evidence. Moreover, it is possible to imagine that in certain, admittedly rare situations, large firms have a relatively precise idea of the type of benefit expected. In this case, we would be looking principally within the dimensions of ‘search qualities.’

Foodservice and lodging firms, two representative industries in hospitality industry, are balanced entity under molecular modeling approach because these industries are stuck in the middle on the spectrum under the scale of (in)tangibility. Hybrid entities, towards the middle of the scale, must be treated especially carefully by the marketers, for here product and service elements are almost balanced, and disrupting this balance can have a major impact on market perception of the overall entity (Shostack, 1977, 1982).

In relative sense within the service industry, degree of intangibility of fast food outlets on the spectrum is less likely to be weighted when compared to advertising agencies, airlines, consulting, or teaching. On the other hand, in terms of scale of market entities, fast food industry is tangible dominant within the service industry. In this context, Shostack (1977, 1982) noted that different nomenclature and categories make cross-national comparisons difficult. For example, while gas and electricity production and distribution are classified as goods by most governments, they are classified as services in the United States. In France, meals eaten at restaurants are considered services that involve goods; in the United State they are considered as goods that involve services (Fontaine, 1989).

Information Asymmetry

In line with the intangible characteristic of services, information asymmetry is related to the process nature of services that relies on the exchange of information for a service to be created and delivered (Holmström, 1985). Both the customer and the service provider experience inadequate information to make fully informed choices. The customer is unclear as to the various options and quality of the future service.

Customers make purchase decisions on the basis of the price and quality of the various alternatives they are considering. The quality of a service is, however, difficult to evaluate because of its intangibility and the simultaneity with which it is produced and consumed (Holmström, 1985; Mills, 1986). This difficulty complicated the choice decision for customers. Hence, customers seek information that will allow them to make better choices (Stigler, 1961).

Generally, the service providers have more information than customers do about the true quality of their services. This information asymmetry leads to moral hazard for providers, giving them an incentive to exert less than complete effort in delivering services. For customers, the asymmetry leads to adverse selection or the likelihood of picking a poor quality service (Holmström, 1985; Mills, 1986).

Customers of services may economize on information acquisition costs by favoring current service providers with whom they are satisfied when evaluating alternative providers of other needed services. Therefore, service providers who have made a favorable impression on existing customers find it easier to influence them than entirely new customers to try new goods or services.

From the perspective of customers, reputation reduces some adverse consequences of information asymmetry. However, failure to meet customer and employee expectations about

new services can also adversely affect existing services, conversely, unfavorable reputations for existing services can adversely affect new services (Heskett, 1986; Nayyar, 1990). The service deliverer may also be unclear as to the preferences of the customer and may only receive partial information at the time of a service request. Because information may be very customer dependent, the involvement of the customer in the creation and delivery of the service creates a condition in which each service interaction has the potential to vary significantly.

In some service industries, such as fast food restaurants that operate with a relatively fixed menu, it has been possible to standardize the service process and the amount of information asymmetry is minimal. However, in other areas such as medicine, significant levels of information asymmetry exist for both provider and customer, and the miscommunication of critical information by either party can result in serious, even fatal, results.

In order to minimize the uncertainty, service firms that are engaged in international business activities can organize their business transactions through market contracting (e.g., franchising) rather than internalizing these transactions within the organization (full integration), or by some other mode reflecting an intermediate degree of integration.

Heterogeneity

Second characteristic, heterogeneity is connected to variability in the performance of service providers; their quality depends on who provides them and when, where, and how they are provided (Kotler & Armstrong, 1991). Services are highly heterogeneous in the sense that, unlike products, no one service performance is identical to another and they are never the same from one consumption experience to another. Each service encounter is unique and often highly customized (Zeithaml et al., 1985). Heterogeneity in service output is a critical problem for labor-intensive services (Zeithaml et al., 1985) and intellectual services.

Langeard et al. (1981) stated, “Many different employees may be in contact with an individual customer, raising a problem of consistency of behavior” (p. 16). Different service performance from the same individual may also be noted: “People’s performance day in and day out fluctuates up and down. The level of consistency that you can count on and try to communicate to the consumer is not a certain thing” (Knisely, 1979, p. 58).

For instance, a dining out experience, even if provided by the same server at the same hour on the same day of the week, will be different from the previous one. Some hotels have reputations for providing better service than others. Within a given hotel, one registration desk employee may be cheerful and efficient while another standing just a few feet away may be unpleasant and slow. Even the quality of single employee’s service varies according to his or her energy and frame of mind at the time of each customer contact. As the production of a wide array of services is embodied in the firm’s personnel there is, potentially, wide variation in the way the service is produced, and the quality of service (Langeard et al., 1981).

This heterogeneity poses problems of quality control, and of providing consistency in the service communicated to customers and in that ultimately delivered (Buckley et al., 1992). Service firms can take several steps toward quality control. They carefully select and train personnel to give good service. Service firms can also provide employee incentives that emphasize quality. A firm regularly checks customer satisfaction through suggestion and complaint systems, customer surveys, and comparison-shopping (Heskett, 1987). How a firm handles problems resulting from service variability can dramatically affect customer perceptions of service quality.

A provision of services in a different cultural environment faces dissimilar value systems, which play a critical role in maintaining quality control. Bem (1970) states, “values are ends, not

means, and their desirability is either non-consciously taken for granted...or seen as a direct derivation from one's experience or from some external authority" (p. 16). Values are mutually related and form value systems or hierarchies, but these systems need not be in a state of harmony and internal value conflicts are one of the sources of uncertainty in social systems (Hofstede, 2001).

Thus, standardization of the service product and, hence, quality control, is difficult to achieve and an onerous task due to the different values indigenous to foreign culture. As a consequence, service marketers are considerably challenged to manage service characteristics to allow services to be marketed successfully across national boundaries. Recently, it was found that international service providers in some industries might not even profit from the economies of scale believed to benefit traditional goods producers due to the variability of services (Katrishen & Scordis, 1998).

Perishability

The third attribute, inability to store, is related to the issue of perishability of the service, meaning that they must usually be consumed at the time they are produced and services cannot be stored, or they will be lost (Berry, 1975; Bessom & Jackson, 1975; Holmström, 1985; Lovelock, 1981; Thomas, 1978). Researchers indicate that one of the distinguishing features of a service is its perishable nature (Mills, 1986; Heskett, 1986). Perishability relates to the ephemeral nature of services. As a result, they cannot be inventoried for later sales or use after production.

Supply-and-demand balancing becomes more difficult since services cannot be stored (Zeithaml et al., 1985). The perishability of services is not a problem when demand is steady. When demand fluctuates, however, service firms often have difficult problems. Service firms can

use several strategies for producing a better match between demand and supply (Sasser, 1976). For example, non-peak demand can be increased, as when McDonald's offered its Egg McMuffin breakfast and hotels developed mini-vacation weekends. Complementary services can be offered during peak times to provide alternatives to waiting customers, such as cocktail lounges to sit in while waiting for a restaurant table. Reservation systems can help to manage the demand level.

There is, however, some disagreement over whether services are not storable. Riddle (1986) suggests that perishability may be a misleading indicator of services because there are numerous cases of goods, such as bakery products, that are also perishable and that some services, such as auto maintenance and repair, may be as durable as some goods. Krishna (1987) divides services into hard and soft services to distinguish between those services that must be provided immediately, and those that decouple the service creation and the delivery process, e.g., consulting services. He maintains that the previous lack of recognition of this division within services research has led to mixed and confusing findings.

Despite the different perspectives of perishability issue suggested by Krishna (1987), in general, since services are perishable and when not sold they cannot be stored, managing the demand is both critical and challenging. It is challenging because it requires better pricing and distribution structures (Zimmerman, 1999). Direct delivery and short distribution channels are essential. Offering services at convenient locations to stay closer to the customer as well as hiring skilled personnel are crucial to meet demand further helps to better manage the capacity of the operation in an efficient way (Javalgi & White, 2002). Under these conditions, evidence suggests that service firms tend to prefer a local presence through the establishment of subsidiaries such as FDI, joint venture, or franchising (Erramilli & Rao, 1993).

Inseparability

A service firm that plans to start to market its services internationally has to find a way of making its services accessible in the chosen foreign market. Once this has been done, a local service offering has to be developed in the new market (Grönroos, 1990). Regardless of how much of the service can be produced in a back office on the home market, some of the service offering is always produced locally due to the inseparable characteristic.

The fourth characteristic, inseparability refers to the simultaneous, not sequential, nature of production and consumption that characterizes most services (Mills, 1986; Zeithaml et al., 1985). Unlike physical goods that are produced, then stored, later sold, and still later consumed, services are first sold, then produced and consumed at the same time (Grönroos, 1977; Regan, 1963). Since inseparability means the producer of the service becomes part of the total service (Erramilli, 1990) such as the restaurant server becomes part of the dining experience, inseparability “forces the buyer into intimate contact with the production process” (Carmen & Langeard, 1980, p. 8).

Because of inseparability of production and consumption of services, both the provider and the client affect the service outcome. If a person provides the service, then the service provider is a part of the service. In most situations, the client is also present as the service is produced, and thus provider-client interaction is a special feature of services marketing. The diversity and unpredictability of customer demands, and the on-site participation of the customer which is often necessary for the performance of the service, are major sources of uncertainty in the service creation process (Argote, 1982), especially in the culturally different foreign market.

Pushing the limits even further, the customer may interact with each other during the service production process. For example, in a restaurant, an intoxicated patron will negatively

impact the experiences of other customers. Consequently, inseparability of production and consumption often creates the service encounter or “the moment of truth” situation (Zeithaml & Bitner, 2000). More importantly, each encounter contributes to the customer’s overall satisfaction and loyalty.

Two alternative approaches have been taken regarding input uncertainty. A case has been made for both increasing customer participation in service operations (Lovelock & Young, 1979), and for including customers as partial employees who co-produce the service within the boundaries of the service organization (Bowen & Schneider, 1985; Mills, Chase, & Margulies, 1983). Thus, organizational efficiency can be realized by increasing customer intensiveness of service operations (Gartner & Reissman, 1974).

Inseparability is the most distinguishable feature in foreign entry behavior within the service industry and at the center of differences in entry behavior between manufactured goods and services (Erramilli & Rao, 1990, 1993; Sampson & Snape, 1985). Inseparability often necessitates production of services at the consumption sites, or close buyer-seller interaction; Inseparability requires the producer and consumer to be physically proximate during its consumption (Grönroos, 1983). For example, the delivery of services by hotels and restaurants requires physical proximity between provider and consumer.

Due to the inseparable attribute of services, producer and the seller are the same entity, making only direct distribution possible in most cases (Upah, 1980) and causing marketing and production to be highly interactive (Grönroos, 1978). As a consequence, entry modes that require a physical separation of production and consumption, such as exporting, cannot be employed. In line with inseparable characteristic of service, Root (1987) and Carman and Langeard (1980) rule out the export option for service firms. Thus services must depend on non-export modes, such as

sole ownership, joint venture, or franchising contract for foreign market entry (Ekeledo & Sivakumar, 1998).

Inseparability of production and consumption (Mills, 1986) affects the learning time available to the service deliverer. In a tightly coupled system as with some services (e.g., foodservices or lodging), there is a minimal amount of time to make and correct mistakes. This inseparability of production and consumption raises the cost of failure. This is one of the main points of Carman and Langeard (1980), who contend that this inseparability and high cost of failure makes expanding service businesses overseas riskier than for goods-producing firms. As a result, service providers face special risks in foreign markets in that they must meet consumers on foreign soil from the first day without the benefit of experience from gradual internationalization that exporting provides.

Erramilli (1990, 1991, 1992) and Erramilli and Rao (1990, 1993) have addressed international entry mode approached by multinational service firms. Erramilli (1990) examined the international services activities of 175 US firms in seven major categories. These firms primarily targeted industrialized countries in the developed world. The most popular entry mode was characterized by considerable diversity, particularly when compared to the manufacturing sector. Erramilli (1990) concluded that the inseparability aspect of services is a key factor that distinguishes firms' entry modes from those of traditional manufacturers. Many services are relatively pure, being performed and consumed simultaneously at the same location. For those types of services, exporting is not possible. Where such services are to be provided, the firm must invest in facility through which service providers interact directly with buyers.

McLaughlin and Fitzsimmons (1996) have also pointed to numerous distinctive factors that must be considered by managers seeking to internationalize a particular service offering.

Because of the intensity of human involvement in services, degree of customer contact is a critical factor that is likely to spell the difference between success and failure. The complexity and extent of required customization is important if the service is subject to substantial modification in light of specific country circumstances. Especially with complex services, cultural adaptation is potentially expensive and may make internationalization very difficult to attain. The labor intensity of offering is critical, particularly if the service requires a great deal of well-educated or highly trained workers.

Although customer participates in the service creation and delivery process and acts as an important 'factor of production', such customer involvement does not necessarily require that she or he and the service provider be in immediate physical proximity (Riddle, 1986). It is possible for the customer and the provider to be located in different places or for the provision and the actual receipt of the service to occur at different times. It also has been argued that decoupling service organization-customer relationships maximizes service system efficiency (Chase & Tansik, 1983). Thompson (1967) argues for buffering the technical core from environmental and customer disturbances. Within this perspective, customers may constrain the potential efficiency of the service system (Chase, 1978; Chase & Tansik, 1983).

According to Erramilli (1990), inseparability is not a universal phenomenon in service industries. In fact, the production and consumption stages for many services are completely separable because of the very nature of the service provided, or owing to technological developments, e.g., telecommunications making long distance banking possible (Erramilli, 1990). Separability of services can also be explained by the fact that most types of services incorporate some element of tangibility (e.g., disks by software firms). To the extent the tangibility component increases, it appears that the associated service, or critical elements of it,

can be physically exported to a distant buyer. Exporting is therefore not only possible but also a frequently exercised option in certain types of service industries once production and consumption of service can be decoupled. This selective, as opposed to universal, prevalence of inseparability is a fundamental reason for the observed diversity within the service sector.

Customer involvement in service delivery system may affect either positively or negatively the outcome of the service transaction. It becomes almost impossible to separate the marketing, production, and even the human resource systems (Lovelock, 1984). On the other hand, production and consumption of service can be decoupled for certain types of service industries (Riddle, 1986). Thus, the involvement of the customer in the provision of the service is one of the central distinguishing characteristics of services (Fuchs, 1985; Mills, 1986; Riddle, 1986) in terms of choice of foreign market ownership and control strategies. Both of these competing strategies claim to enhance the use of resources within the service sector and to reduce the level of input uncertainty the firm experiences.

Implications of Service Characteristics in International Businesses

Having characterized the distinctive attributes of services it could be concluded that services are different from goods. However, the manifest definition of service is complicated by the fact that there are few pure goods or services (Buckley et al., 1992). Many goods embody non-factor services in their production and distribution and many services involve some physical goods in their make-up, both being supplied simultaneously at the point of sale (Dunning, 1989). The distinction between goods and services cannot be viewed as a simple black and white categorization. It rather depends on the extent to which the service is embodied in physical

attributes within the overall package implicitly based on the degree of tangibility/intangibility of the goods or service.

Shostack (1977) developed Rathmell's (1966) idea of a goods-service continuum to map out the combination of physical and experiential attributes in a range of goods and services contending that the greater the degree of intangible elements in a market entity, the greater will be the divergence from product marketing in priorities and approach. Although this continuum was designed to identify differences in approach to marketing functions, it would be plausible to assume that the great degree of intangible elements would be likely to support the idea of foreign expansion strategies differing from those traditionally associated with product manufacturing. From Shostack's model, therefore, the internationalization of, say, hospitality industry would be expected to show a different pattern from that of legal consulting. This expectation stems from literature on the international activities of service firms.

Boddewyn, Halbrich, and Perry (1986) classify types of international service according to their tradeability, based on the extent to which services are embodied in physical goods and the degree of inseparability in provision of the service: (1) service commodities, which are distinct from their production process, are tradable across national boundaries and are thus exportable; (2) where production cannot be separated from consumption as in the case of legal advice, a foreign presence is necessary; (3) where services comprise a mix of distinct commodities and location bound service elements, some location substitution is possible.

Another attempt is made by Erramilli and Rao (1990) to explain the variation of foreign market entry mode choice in the service sector by taking into account the unique characteristics of service firms. They describe a classification scheme that cuts across industry categories: hard and soft service firms. It is difficult or even impossible to decouple production and consumption

(e.g., restaurants) for soft service firms. Meanwhile, it is feasible to separate production and consumption (e.g., software firms) for hard service firms. Such a classification yields important insights into the variation of entry mode choice. Soft service firms cannot export (since exporting necessarily requires a separation of producer and consumer) and have to rely on contractual methods (e.g., franchising) or foreign direct investment (e.g., wholly owned subsidiaries) to effect foreign market entry. On the other hand, hard service firms can and often do export.

Patterson and Cicic (1995) devise a classification framework of international service providers in order to differentiate various marketing practices. In their empirical study, they note that degree of tangibility and degree of face-to-face contact with clients in the service delivery are among the most useful dimensions with which to consider services in the international context.

Sampson and Snape (1985) also take inseparability as the key distinguishing factor between goods and services. They categorize services according to their tradeability, proposing that “separated” services, that is those which do not require direct contact between supplier and consumer, are the only services which can be exported as distinct from those which demand movement of factors of production to the consumer (e.g., restaurant or hotel) or movement of the consumer to factors of production (e.g., tourism).

Based on the concepts proposed by Lovelock (1983) and Schemenner (1986), Vandermerwe and Chadwick (1989) developed a two-axis configuration for explaining the internationalization of services. While Lovelock (1983) acknowledged the goods-service continuum, his model does little to reflect the true interaction of the two extremes. Building on these themes, Vandermerwe and Chadwick (1989) combine “relative involvement of goods” with the degree of “consumer/producer interaction” to develop a matrix of service industries

wherein clusters of services can be distinguished according to the typical modes of market servicing most appropriate for international expansion.

In their scheme, the three appropriate entry modes of emergent clusters can be classified as exporting, reliance on third parties (e.g., franchising), and foreign direct investment. Export involves minimum presence and control, being most appropriate where a firm can export the good providing the service, or export the service through some physical embodiment included in the service package. A presence can also be achieved through the third party (e.g., franchise) whilst control is achieved through the supply of key assets (e.g., management know-how, training, brand names). Foreign direct investment is most appropriate where the service is “people-embodied” and where there is a high degree of producer/consumer interaction. Control over delivery is therefore a key feature, achievable through the establishment of branches or subsidiaries, and mergers or acquisitions.

Classificatory matrix highlights the significance of the impact of the degree of service intangibility and inseparability on the foreign market ownership and control decision of internationalizing firms despite simplicity and flaw of model in terms of its ability to explain the behavior of all firms within the disparate industries. There is evidence that the intrinsic nature of the service may be a major influence on the organizational form of market servicing from wide array of distribution arrangements.

Foreign operations in services may also be conducted by non-service multinationals. Many manufacturing firms engage in service activities to support their manufacturing operations (e.g., transport, after-sales servicing and repairs). This further complicates the analysis of international service operations (Markusen, 1989). However, for the purpose of this assessment a

distinction is drawn between service activities of multinational enterprises and the service sector, the latter forming the focus of analysis.

The product specific elements in the market servicing decision have been shown to be very important in manufacturing (Buckley et al., 1990) and are also important in services (e.g., fast food restaurants vs. consultancy). In general, the models of international entry mode choice recognize product characteristics as among the determinants of that choice.

However, many of those models focus on one kind of product characteristics such as micro type (e.g., Goodnow, 1985). Micro characteristics of products are item-specific attributes such as composition, weight/value ratio, packaging, brand name or image, technology, and so forth. They differentiate goods or services of the same kind from one another. Product characteristics can also be viewed in macro terms. The macro characteristics of a product are the attributes that distinguish classes of products from one another (Ekeledo & Sivakumar, 1998). For instance, characteristics such as perishability, tangibility, separability, and heterogeneity distinguish services from goods (Zeithaml et al., 1985).

Both macro and micro characteristics of a product are important for entry mode choice. The macro characteristics of a firm's product allow managers to target specific entry modes and determinants as inputs in selecting an optimal entry mode. Micro characteristics, on the other hand, distinguish the firm's product from similar products; they reflect the proprietary content of the product. For example, a need to protect the proprietary content of a product may make a firm select sole ownership as an entry mode (Anderson & Gatignon, 1986).

Classification Schemes of International Services

Many authors have argued that service firms differ in significant ways from manufacturing firms due to the primary characteristics to distinguish the output of service firms from that of manufacturing firms (Bell, 1981; Bowen & Jones, 1986; Buckley, Pass, & Prescott, 1992; Lovelock & Yip, 1996a; Sarathy, 1994). Other authors have further pointed out that significant differences exist between the various types of services (Boddewyn, Halbrich, & Perry, 1986; Lovelock & Yip, 1996a; Silvestro, Fitzgerald, Johnston, & Voss, 1992; Thomas, 1978). Recent literature by Domke-Damonte (2000) on services acknowledges the obvious fact that different service sectors can exhibit very different characteristics.

Because much of the research investigating international entry decisions of service firms has used only one service industry (e.g., Contractor & Kundu, 1998a, 1998b; Davé, 1984; Dunning & Kundu, 1995; Dunning & McQueen, 1982; Litteljohn, 1985; Nigh, Cho, & Krishnan, 1986; Rodríguez, 2002; Terpstra & Yu, 1988; Zhao & Olsen, 1997) or an arbitrary combination of service firms across multiple industries (e.g., Alexander & Lockwood, 1996; Erramilli & Rao, 1990; Vargas & Manoochchri, 1995), it is necessary to identify how variations between the types of services (Boddewyn, Halbrich, & Perry, 1986; Sharma & Johanson, 1987). Certain degree of variations in service attributes may influence entry mode choices as services with different coordination needs require different forms of control of foreign affiliates to develop interconnected networks of causally ambiguous resources (Black & Boal, 1994; Erramilli & Rao, 1990).

The tremendous heterogeneity in the service sector leads to widely differing international trade and investment patterns in the service sector (Shelp, 1981). The heterogeneity poses a major challenge to researchers trying to study behavior of diverse firms in one common

conceptual framework. Some sort of a classification scheme to reduce this heterogeneity is almost imperative. Recognizing this need, some economists (Riddle, 1986; Sampson & Snape, 1985; Shelp, 1981) have proposed methods to classify services.

Some services can be exported; others can be licensed; many more can be offered only through physical facilities that the firm establishes at the buyer's location (Knight, 1999). Within the service industry, different degree of service characteristics put great impact on the choice of modes of entry and control level as well as firm's performance. Indeed, according to Richardson (1987) "...the heterogeneous nature of (international) services...have led many to question whether the same...theory can apply...equally to all service sectors" (p. 60).

Several other scholars addressed this call and attempted to rationalize this heterogeneity in various classification efforts to suit different purposes. What these schemes have in common is the implicit concern of how, or in what form, services cross national boundaries. In order to identify the most appropriate entry modes for the various types of services, a typology is needed which aids firms in ascertaining the best methods for taking their particular service offering abroad (Patterson & Cicic, 1995). Understanding typology gives us useful insight into most appropriate control modes and operating in a foreign soil.

Although numerous classifications for services trade have been offered, industry-based classifications have been commonly used. Winsted and Patterson (1998), for example, focus on the international market-entry strategies of engineering consulting firms. However, this might not be impractical given the diversity of so many unrelated service sectors or the ignorance of the commonality of seemingly different service industries. The problem of heterogeneity could be, to some extent, circumvented by performing industry specific studies. As Lovelock (1983) points out, such an approach fails to provide insights on issues that extend across industry boundaries.

The formation of appropriate generic foreign market entry strategies is handicapped by the unavailability of generally accepted classification method for services (Samiee, 1999). The range of services offered internationally is quite broad and belongs to diverse industries that have developed highly specialized skills, capabilities and knowledge over a period of time that enables them to compete internationally. Meaningful analyses and appropriate entry strategies in services sectors can emerge when very similar entities are grouped together (Samiee, 1999). In the absence of a more integrative classification method, relevant services theories may not emerge and this issue has been stated in the literature (e.g., Clark, Rajaratnam, & Smith, 1996).

Extant classification schemes for services (e.g., Bateson, 1992; Lovelock, 1983; Mills & Marguliers, 1980; Stell & Donoho, 1996) are not appropriate for grouping internationally traded services, especially for use in analyzing and explaining entry modes in foreign markets. Much of the literature on services tends to be conceptual and primarily develops frameworks for designing and managing the service providing organization. For example, Mills' (1986) framework classifies service companies as maintenance-interactive, task-interactive, or professional-interactive based on the relationship of the service company with its customers and the external environment.

The various frameworks used in services marketing are extensively reviewed by Lovelock (1983), who proposed five classification schemes for services based on variables such as the need for quality control or the need for the customer to be physically present during the service provision process, which encompass: the nature of the service act; the type of relationship the service organization has with its customers; the amount of room there is for customization and judgment; the nature of demand and supply for the service and how the service is delivered.

Lovelock (1983) classification scheme for services allows education (an exportable service) and psychotherapy (a non-exportable service) to be placed in the mental stimulus category. However, his classification schemes did not address the issue of services that cross national boundaries, and therefore offer little guidance for us in our endeavor here. In addition, for analyzing and explaining entry in foreign markets, this classification of education and psychotherapy violates an important criterion of a good classification scheme: classes must be mutually exclusive (Hunt, 1991).

To address this problem, researchers have developed classification schemes for international services. To distinguish between the various service types, service typologies include as their primary variables the intangibility and inseparability of the service (Boddewyn, Halbrich, & Perry, 1986; Silvestro, Fitzgerald, Johnston, & Voss, 1992). The intangibility dimension has been well researched in the strategic marketing literature (Bell, 1981; Bowen & Bowers, 1986; Judd, 1964; Nayyar & Templeton, 1991; Shostack, 1977) and describes the inability of customers and service providers to measure the quality of the service before consumption. The inseparability dimension has received an equally large amount of attention (Bell, 1981; Chase, 1978; Mills & Margulies, 1980) and describes the level of involvement of the customer required to produce the service.

Lovelock and Yip (1996a) propose the classification of services into three groups: (1) People-processing services are those that involve tangible action to customers (e.g., restaurants, health care), thus necessitating a local presence by the international marketer. (2) Possession-processing services involve intangible actions to merchandise in an effort to enhance the value of the merchandise to the customer (e.g., transportation, appliance repair), and the customer is not involved in the process. (3) Information-base services are those that provide some value for the

customer as a result of the collection, analysis and manipulation of data (e.g., accounting, insurance) and only minimally involve the customer. This classification method is articulate and thought provoking, but these categories are not mutually exclusive and exhaustive for all services.

According to Domke-Damonte (2000), intangible and inseparable dimensions mirror the three types of throughput technology: long-linked, mediating, or intensive, which is originally described by Thompson (1967). He contends for different degrees of interconnectivity and subsequent differences for interconnected relationships between distinct nodes of the service production process both spatially and temporally for each of the throughput types. These dimensions increase from long-linked technologies to more intensive service throughput technologies, and decision making is forced to lower levels within the organization to buffer the greater risk involved in the provision of the service (Dunning, 1988). In Lovelock and Yip (1996a) scheme, each type of service is most closely reflected in the information processing, possession processing, and people processing service respectively.

Long-linked technologies require the least interaction with the customer and the influence of the customer can be buffered from the throughput process. This type of service can be a foreign tradable service (Boddewyn et al., 1986) such as computer software (Brouthers, 1995). In mediating throughput technologies, customer interaction can be partially buffered from the core technology. Bowen (1990) has operationalized this type of service by using such service as quick service restaurants. Boddewyn et al. (1986) referred to this type of service as combination service. Intensive throughput technologies include the customer on a short-term basis in the throughput process. As a consequent, separation of customer from the service production process

is impossible since it is the customer who is being processed. Dunning and Kundu (1995) have operationalized this type of service with hotels.

Patterson and Cicic (1995) empirically examined a conceptual framework of services in international markets initially proposed by Vandermerwe and Chadwick (1989) and offer a useful classification along two axes, based on the need for face-to-face contact with customers during service delivery and the degree of service intangibility (or the relative involvement of goods in the service package). The resultant cells are thus labeled: (1) Low face-to-face and low tangibility service is the location free professional services; (2) High face-to-face and low tangibility service is the location bound customized projects; (3) Low face-to-face and high tangibility service is the standardized services packages; (4) High face-to-face and high tangibility service is the value added customized services.

Value-added customized services such as a major hotel exhibit a profile most conducive to international expansion and perceive international markets as potentially more profitable than domestic markets. Their management perceives a significantly higher benefit of internationalization than do firms in other cells, and associate it with relatively high levels of profitability. Entry strategies are much more limited because of the need for close client/supplier interaction during service delivery. Due to the limitation of proximity to their clients for service delivery, they must rely on non-export modes of entry. They usually use a franchise/licensing or management arrangement for delivery and distribution of their services overseas (Patterson & Cicic, 1995).

Consideration of who or what crosses a national boundary in the transaction suggests a meta-classification of international services (Clark et al., 1996). On this basis, Clark et al. (1996) revealed four idealized types: (1) contact-based services (2) vehicle-based services (3) asset-

based services (4) object-based services. A service becomes international when it crosses national boundaries using one of these modes. The mode by which the service crosses a national boundary critically determines how it engages the foreign culture it encounters.

Contact-based services cross national boundaries in the sense that people (producers or consumers) move into or out of a nation to engage in transactions. Therefore, they are deeds, acts, or performances by service actors, who cross national boundaries to conduct transactions in direct contact with counterpart service actors, e.g., consultancy services and temporary labor.

Vehicle-based services cross national boundaries in the sense that communications are directed into and out of the nation via radio, TV and satellite transmissions, wires and/or other facilitating vehicles. They can also be defined as deeds, acts, or performances with location joining properties allowing service producers to create the effects of their presence without actually being present, transacted across national boundaries via an instrumental framework, e.g., raw data transfer from New York to Ireland via satellite for processing.

Asset-based services cross national boundaries in the sense that commercial service ideas tied to foreign direct investment enter a nation to establish an operating platform. From the culture centered perspective, asset-base services are deeds, acts or performances transacted across national boundaries in the context of dedicated physical assets substantially owned or controlled from the home country, critically reflective of home country commercial service ideas, e.g., hotels, retail stores, and banks.

Lastly, object-base services cross national boundaries in the sense that physical objects impregnated with services move into the nation. In other words, object-based services are contact-based services fixed or embedded in physical objects that cross national boundaries, e.g., computer software and video cassettes, air transportation, etc.

Contact-based services are the purest of the international service types because they necessarily exhibit all of the classic service characteristics – intangibility, heterogeneity, perishability, and inseparability. The other types exhibit these in varying degrees and can be viewed as pure contact-based service with certain assumptions relaxed. Moreover, in the international arena, the effect of culture is most tellingly seen in contact-based services, where human beings must interact and communicate directly.

In their study, Erramilli and Rao (1990) describe a classification scheme that cuts across industry categories and, instead, utilizes certain marketing relevant characteristics as its basis. Erramilli (1990) has classified services for foreign markets into hard services and soft services. A soft service (e.g., food service, health care, laundry and lodging service) requires simultaneity of production and consumption and such services require major local presence by the service firm or a representative that acts on its behalf. Such decoupling is not possible, however, for soft services. It requires physical proximity between the service provider and consumer, consumer involvement during service transfer, or the consumer's possession being serviced, enabling production and consumption to take place simultaneously. Examples of soft services include food service, lodging, healthcare, advertising, car rental, management consulting, and customized data processing.

In contrast, a hard service (e.g., insurance, music, architectural design, or education) requires limited or no local presence by the exporter and permits, to a major extent, separation of production and consumption. Therefore, a hard service can be exported. A hard service could be produced in one country, embodied in some tangible form such as a disk, blueprint, or document and exported to another country. Examples include packaged software, engineering design, R&D services, architectural services, and some types of banking. It does not require movement of

producer to consumer, or vice versa, for consumption. A hard service has both a manufactured goods component and a service component. However, like any other type of service, the primary source of utility to the consumer is the service element of the product. The goods component of a hard service is incidental to the service; the goods element often serves as a storage medium or a vehicle for transmission.

Such a classification yields important insights into the variation of entry mode choice. Soft-service firms cannot export since exporting necessarily requires a separation of producer and consumer. Therefore they have to rely on contractual methods (e.g., franchising) or foreign direct investment (e.g., joint ventures or wholly owned subsidiaries) to effect foreign market entry. On the other hand, hard-service firms can and often do export. Services are of course very diverse, ranging from what Erramilli (1990) labels hard services to soft services and include a range of services somewhere in between. Following Erramilli's typology, Ekeledo and Sivakumar (1998) empirically tested and found that the foreign market entry mode does not differ significantly between hard services and manufactured goods, whereas it differs significantly between hard services and soft services.

The classification scheme developed by researchers (e.g., Clark, Terry, Rajaratnam, & Smith, 1996; Lovelock & Yip, 1996a; Patterson & Cicic, 1995; Sampson & Snape, 1985) for services in relation with international entry mode can be applied and compressed to service classification scheme developed by Erramilli (1990). According to the Sampson and Snape (1985), the standard theories of international trade (developed mainly for manufacturing) are generalizable to hard services but not to soft services. In the Patterson and Cicic scheme, location bounded customized projects and value-added customized services characterized as high client-contact services (e.g., accommodation services) are soft services, while location-free professional

services characterized as low client-contact services (e.g., distance education courses and design services) are hard services.

In the Clark-Rajaratnam-Smith scheme, vehicle-based and object-based services are hard services (e.g., computer services and video cassettes), whereas contact-based and asset-based services are soft services (e.g., hotels). In the Lovelock-Yip scheme, people-processing services (e.g., health care) and possession-processing services (e.g., car repair) are soft services, while information-processing services (e.g., education) are hard services.

Intangibility is the fundamental difference between a service and manufactured goods (Zeithaml, Parasuraman, & Berry, 1985). A soft service becomes a hard service once the production and consumption of the soft service can be decoupled. The hard service and soft service classification scheme meaningfully reduces the large diversity of the service sector and useful insights about international entry modes that extend beyond the individual service industries. It also suggests explanations for the observed similarities and dissimilarities between the entry mode behavior of some service businesses and manufacturing business. This study focuses on soft services, and thereafter service industry means soft services.

A service becomes international when it crosses national boundaries using contractual methods or foreign direct investment. The mode by which the service crosses a national boundary critically determines how it engages the foreign culture it encounters. Thus, international services differ from domestic services in two respects: 1) they involve something crossing national boundaries and 2) they involve some type of engagement with a foreign culture (Clark & Rajaratnam, 1999).

The typologies sketched out above imply that international services will be culture-sensitive in different degrees because culture bearers (people) interact in service production and

consumption in different ways and to different degrees. For example, while contact-based services, soft services, and people-processing services, by definition, require direct interaction of the culture bearers in the transaction, object-based service transactions usually do not. Moreover, some cultures are quite similar, others very different.

Thus the entry mode in which the service crosses a national boundary, and the degree of cultural difference, critically determine the nature of service's relationship with the foreign environment and, therefore, its culture-sensitivity. Pushing the limits even further, mode of foreign market entry and degree of control difference, either integration or market contract, are of paramount importance in terms of service firm's performance and long term efficiency.

The transaction cost theory predicts that customization increases the need for entry modes characterized by a greater degree of control and integration. Erramilli (1990) contends that within the hard service industries, computer firms appear more likely to export via agents and distributors (low degree of control and integration) than engineering firms that seem to prefer direct-to-customer exporting (high degree of control and integration). This could be attributed to the fact that many software firms export fairly standardized products, while engineering firms deal in more customized services which require one-on-one interaction with overseas customers.

The same reasoning can be employed to explain the differences within the soft service industries. For example consumer services, particularly fast food, lodging, and car rental, are more amenable to standardization. It is, therefore, not surprising that franchising is such a common method of entry for these services. On the other hand, services such as advertising, banking, and management consulting are more customized. As a result, firms providing these services use entry modes that are characterized by a high degree of integration (e.g., wholly-owned subsidiary).

A comparison of the entry mode choice patterns across various service industries reveals a picture of remarkable diversity (Erramilli, 1990). Foreign market entry behavior in industries dominated by hard services appears to be similar to that observed in the manufacturing sector (Ekeledo & Sivakumar, 1998). These service firms have the same entry mode options as their manufacturing counterparts. On the other hand, soft service industries differ quite dramatically from manufacturing firms in their foreign market behavior. Simultaneity of production and consumption means exporting is not possible for these firms. As a result, they have a more restricted set of entry modes available to them.

Given the diverse nature of international services, no single theory of international services will emerge is probably correct (Richardson, 1987). This diversity in the service sector poses a challenge to managers and researchers alike. However, the classification schemes proposed may serve as the starting point for studying different related theories and different organizational structure of the service firms operating in international market.

International Ownership Strategy

The empirical research on international ownership strategies has focused primarily on market entry (Krishna, 1987; Paloheimo, 1986; Root, 1987). This research stream examines the market entry choices of a firm, either services or goods producing, in entering a foreign market. The mode used to enter a firm's first foreign market is of critical importance since it is likely to affect the degree of success in that market. Previous research primarily examines goods producing firms in the research samples (Gatignon & Anderson, 1988; Gomes-Casseres, 1985; Stopford & Wells, 1972). However, a previous article by Anderson and Gatignon (1986) suggests that such investigations should be extended to examine the on-going ownership strategies, not just those used to enter a particular market.

Having decided to perform a business function outside its domestic market, an entrant has to determine the appropriate entry mode for organizing its foreign business activities. Entry mode has been defined as an institutional arrangement for organizing and carrying out international business transactions, such as contractual transfers, joint ventures, and wholly owned operations (Root, 1987). Like their manufacturing counterparts, service firms often have a range of entry modes to choose from direct exporting, exporting through agents, through foreign direct investment (FDI) in wholly-owned subsidiaries or branch offices or by adopting various contractual modes (e.g., joint ventures, licensing, franchising) (Erramilli, 1992; O' Farrell, Wood, & Zheng, 1998).

Although there are vast array of alternatives for the would-be entrant, they are tapered off to three choices, including; full equity arrangement (e.g., a wholly owned subsidiary), partial equity arrangement (e.g., a joint venture, in which the entrant could be majority, equal, or minority partner), or a nonequity arrangement (e.g., franchising or licensing) (Erramilli, 1991;

Hill & Hwang, 1990; Vandermerwe & Chadwick, 1989). Many, though not all, can opt to export (Erramilli, 1992). More specifically, an examination of the literature (e.g., Daniels & Radebaugh, 1989; Justis & Judd, 1989) on franchising indicates that the major restaurant companies to enter foreign markets have used those three approaches. The decision of which entry strategy to employ depends on a large number of factors (Root, 1987).

Each of these entry modes is consistent with a different level of control, resource commitment, and dissemination of risk (Hill, Hwang, & Kim, 1990); Each of these modes of entry had different implications for the degree of control that an international service firm can exercise over the foreign operation, the resources it must commit to the foreign operation, and the risks that it must bear to expand into the foreign country. Thus, identifying the appropriate entry mode in a given context is necessarily a difficult and complex task. The choice, however, is a critical determinant of the likely success of the foreign operation (Davidson, 1982; Killing, 1982; Root, 1987).

Corporate equity ownership and franchise contracts are polar organizational and control modes for the creation and delivery of services (Fladmoe-Lindquist & Jacque, 1995). In a corporate equity arrangement, the parent firm either wholly owns and manages the service unit or relies on some type of joint venture agreement. In franchise arrangement, the owner of a service concept (principal/franchisor) enters into a contract with an unrelated party (agent/franchisee) to use a specific business formatted service concept to sell services or goods under the franchisor's trademark. However, the principal does not invest funds of its own in the local service unit as the franchisee assumes responsibility for the construction, maintenance, and management of the local operation (Fladmoe-Lindquist & Jacque, 1995).

Full Ownership Arrangement

Corporate equity arrangements for international consumer services may involve either full or partial equity arrangements. The expansion of firms into the international market has typically involved the full equity approach. The use of full equity ownership as a corporate strategy is often regarded as the more popular and preferred choice by service businesses (Riddle, 1986). Direct entry means that the service firm establishes a service-producing organization of its own on the foreign market; direct investment involves the creation of company-owned stores or wholly owned subsidiaries in a foreign country (Grönroos, 1999; Quinn, 1998).

International asset-based services are acts, deeds or performances transacted across national boundaries in the context of dedicated physical assets (e.g., hotels, restaurants, retail stores, etc.) substantially owned or controlled from the home country, critically reflective of home-country capabilities (Clark et al., 1996; Kogut, 1991). These capabilities are the product of history, culture and chance, and significantly affect the firm's organizational structure, mode of operation and entry, orientation toward the market and product offerings, which critically affect the firm's market performance.

For manufactured goods in the first stage of a learning process, a sales office can be such an organization. For a service firm, a local organization normally has to be able to produce and deliver the service from the beginning. The time for learning becomes short. Almost from day one the firm has to be able to cope with problems with production, human resource management and consumer behavior. In addition, the local government may consider the new, international service provider a threat to local firms and even to national pride (Grönroos, 1999).

Firms from the same national environment share the same organizing capabilities, and so tend to respond to market problems in characteristically similar ways (Clark & Rajaratnam, 1999). Foreign direct investment is the critical means of control of remote units by which one nation's capabilities are injected into a foreign environment (Kogut, 1991; Nicolaides, 1991). Thus, the subsidiary form of entry would be a likely choice for service firms to employ in countries where there are no legal barriers to setting them up, the cultural distance is small, and the parent firm has sufficient resources that the entrant is willing to commit to a country where the political and economic risks are perceived as small (Preble, 1992).

When host country legal requirements permit, a company may decide to enter a foreign market by making a direct investment in a fully owned subsidiary and then, depending on a company's objectives and resources, operate company-owned stores and/or sell franchises to local entrepreneurs (Preble, 1992). This strategy would be more likely to be used in countries where the risk (political, social, economic, etc.) is perceived as relatively low due to factors like the similarity of markets (Davidson, 1982) and the existence of a low cultural distance between home and host countries (Buckley & Prescott, 1991; Hofstede, 1980).

Some potential advantages to the firm of setting up a subsidiary would be a better understanding of the local market, increased control and less sharing of profits (Anderson & Gatignon, 1986). Canada fits the criteria just mentioned and was, in fact, the foreign market where 57 percent (84 of 151 franchisors) of Walker's (1989) respondents made their initial expansion and is a principal market for 8 out of 10 U.S. fast food franchising companies, several of whom operate subsidiaries there (Preble, 1992).

It is believed that this approach provides the greatest control by the parent firm over the provision and sale of services by the on-site service provider (Root, 1987). Control of the

subsidiary activities is considered to be critical to the successful implementation of corporate strategy because it increases the ability of the parent firm to coordinate activities and implement strategies (Anderson & Gatignon, 1986). Furthermore, such control is considered to provide the greatest share of returns from foreign receipts.

However, there are disadvantages to a wholly owned subsidiary position. This strategy requires substantial investment by the parent firm (Vernon, 1983). It is possible that it is not in the best interests of the firm to dedicate significant amounts of human, financial and physical resources (Anderson & Gatignon, 1986). Furthermore, at the international level, full equity positions are affected by the issues of national sovereignty of host countries. Many national governments discourage wholly-owned subsidiary positions by foreign firms out of concern for national security and independence even though the service itself may not be considered of strategic importance. For such reasons, national law may prohibit such ownership strategies (Root, 1987).

In order to decrease the potential problems with direct entry strategy, instead of establishing a new organization of its own the internationalizing firm can acquire a local firm operating on the same service market. This way one gets access to knowledge about the market as well as about how to manage the service operation in the foreign environment. A central issue in such an acquisition is to keep the key people in the acquired firm. Without them the internationalizing service firm may easily find itself in the same position as when establishing a totally new operation (Grönroos, 1999).

Joint Venture Arrangement

In service business, it is also possible to expand through the use of joint venture arrangements in which the parent firm invests partial rather than complete equity in the local operation (Justis & Judd, 1989). There is a growing use of joint venture agreements for international expansion by all firms (Gomes-Casseres, 1985). Joint ventures provide joint ownership and control over the use and outcomes of assets (Kogut & Singh, 1988). In this approach, the service concept developer may operate the facility while an investor actually owns the physical service outlet. This is the approach used by Kentucky Fried Chicken in Japan in its arrangement with Mitsubishi. It is also possible to have reverse arrangement in which the service concept developer owns the facility but a local company provides the actual service (Fladmoe-Lindquist, 1991).

The choice to enter to foreign market by a joint venture is considered against other alternatives, and is influenced by the size of the targeted firm relative to that of the foreign firm, by the characteristics of the industry, and by the cultural characteristics of the foreign and home countries (Caves & Mehra, 1986). Buckley and Casson (1988, 1996) summarize the conditions conducive to international joint ventures as: the possession of complementary assets, opportunities for collusion, and barriers to full integration – economic, financial, legal or political. Stopford and Wells (1972) and Hladik (1985) noted that the responsibilities assigned to the joint venture are influenced by the capabilities of the foreign country and of both partners, in addition to possible conflict between the subsidiary and the foreign partner.

The international joint venture literature has focused on partner selection (Beamish, 1987; Geringer, 1991; Kogut & Singh, 1988), management strategy (Gomes-Casseres, 1990; Harrigan, 1988; Killing, 1983) and measurement of performance (Blodgett, 1992; Gomes-Casseres, 1987;

Gulati, 1995; Inkpen & Birkenshaw, 1994; Kogut, 1989; Nitsch, Beamish, & Makino, 1996; Woodcock, Beamish, & Makino, 1994). The studies on international joint ventures have also found that equity share is influenced by the strategic importance of the R&D or marketing expenditures and product diversity (Fagre & Wells, 1982; Stopford & Wells, 1972).

Joint ventures have been considered an intermediate form between licensing and whole ownership (Teece, 1986b). A joint venture agreement is similar to the master franchise in that the franchisor seeks a form of partnership with the foreign franchisee. Unlike master franchising, however, this agreement does not involve the granting of exclusive territorial rights or the right to subfranchise (Quinn, 1998b). The lower costs of a joint venture, compared to using a fully owned subsidiary, as well as the link to a local company with its greater local knowledge, may appeal to some companies. The joint venture method of entry is often preferable for entry to culturally distant markets. In Japan, for instance, successful franchises such as Seven-Eleven operate joint ventures wherein the western company provides the system know-how and unique product or service and the Japanese company provides local knowledge of the resource, distribution and consumer markets (Sanghavi, 1991).

A joint venture arrangement with a local firm offers the local partner new growth opportunities at the same time as it gives the international partner much-needed local know-how (Grönroos, 1999). This approach allows for investment, control, and profits to be shared, entrepreneurial initiative to be harnessed, and governmental requirements for local equity participation to be satisfied. The joint form of organization is frequently used by fast-food companies to start operations in an international market (Preble, 1992). McDonald's earliest joint venture was set up in Japan in 1971 with Den Fujita as the local partner in a 50/50 percentage agreement (Love, 1986).

Joint venture may be used to bypass market inefficiencies. Equity control and both parties' sharing in the profits or losses attained through the venture's performance serve to align the interests of the parent firms, reducing the opportunism that may arise in contractual agreements (Hennart, 1988; Stuckey, 1983). Complete ex ante specification of ongoing activities and behavior requirements is therefore not required (Kogut, 1988). The joint venture form may also allow for a monitoring mechanism, since joint venture owners may be legally entitled to independently verified financial information as well as to information acquired through direct observation (Osborn & Baughn, 1990).

Though a joint venture represent a partial internalization, it does not involve complete pooling of the parent's profit streams or the establishment of a single hierarchy. As Harrigan (1988) noted, shared ownership and shared decision-making arrangements can be cumbersome to manage and may reduce the speed with which many actions in pursuit of global strategies can be taken. Although the parties can renegotiate the provisions of both contractual agreements and joint ventures at any time, a joint venture is normally considered more difficult and costly than a contractual agreement to establish, terminate, and fundamentally change (Harrigan, 1988). In addition, differences between home and host cultures in multinational joint ventures may amplify the effort and time required to build a common hierarchy that bridges the gaps in partners' culture, linguistic, and organizational traditions (Anderson & Gatignon, 1986; Moroi & Itami, 1987; Zimmerman, 1985).

In many countries, governments permit only minority interest joint ventures (Preble, 1992). Justis and Judd (1989) suggest that joint ventures are frequently used for international service expansion and may even be required by national law, such as in the case of Mexico, who requires a 49 percent share of ownership by the foreign franchisor. As of January 1987, a new

law in the Soviet Union permits joint ventures where the foreign company holds a 49 percent equity stake and a local partner or government entity holds a 51 percent share (Preble, 1992). Pizza Hut has opened two full service units in the Soviet Union under such an agreement (Restaurant Business, 1988). Most East Asian countries have similar regulations restricting foreign companies to minority interest joint ventures (Chan & Justis, 1990; Justis & Judd, 1989).

Thus, the joint venture form of entry mode would most likely be employed in countries where host governments allow only this type of entry, which normally requires significant percentage of local equity participation. Firm resources would need to be substantial (but less than the subsidiary mode), with the commitment to the host country being low, due in part to relatively large cultural distance and high levels of political and economic risk. In short, joint ventures may offer some potential for protection and control, but at substantial administrative costs. The time and costs involved in developing multiparty equity arrangements coupled with the need for give-and-take in jointly managed ventures gives the joint venture form of governance less strategic flexibility than less binding forms of cooperation offer (Harrigan, 1988).

Unlike the domestic studies, a few have investigated the choice of joint ventures among other alternatives for entry in the field of international business (Kogut, 1988). Many of these studies have examined the use of joint ventures as a response to governmental regulations, especially in developing countries, through an analysis of a few cases (Friedman & Kalmanoff, 1961; Tomlinson, 1970). Gomes-Casseres (1985) examines the use of joint ventures by multinational firms. His findings suggest that multinational firms prefer joint ventures when they need the capabilities of a local firm. His research sample, however, included only firms involved in the goods-producing sectors.

Hennart (1991a) investigated the use of joint ventures in the United State by Japanese firms. He concluded that Japanese parent firms used American joint ventures when 1) they were venturing in an area outside of their own industry; 2) they were entering the American market for the first time; or 3) they wished to have access to resources held by an American firm. Hennart (1991a) also suggests that the reasons that Japanese firms use American joint ventures appear to be similar to the reasons that American parent firms use joint ventures. His research, however, does not include service industries either.

There has been little specific empirical research regarding joint ventures by service industries. Riddle (1986) only briefly mentions joint ventures as one of the newer alternative forms of international investment. Harrigan's (1985) extensive study of joint ventures includes several service industries. The findings suggest that joint ventures are needed to be able to move more quickly to maintain a competitive advantage due to the mobility and perishability of services. However, these industries include the financial and information services in a domestic setting rather than at the international level. The industries in her global joint venture studies are again from the goods-producing sectors, primarily pharmaceuticals, automobiles, engines, and medical products.

Franchise Arrangement

Indirect entry is used when the service firm wants to avoid establishing a local operation that is totally or partly owned by itself. Nevertheless, the firm wants to establish a permanent operation in the foreign market (Grönroos, 1999). In the lodging business and in the restaurant industry, for example, franchising is an often-used concept for indirect entry into a foreign market (Contractor & Kundu, 1998a; Hing, 1999; Khan, 1999). In a sense, franchising resembles indirect export of manufactured goods, where the export makes use of middlemen on the local market who have the local knowledge needed to penetrate the market (Grönroos, 1999).

Local service firms or individuals get the exclusive right to a marketing concept, which also may include rights to a certain operational mode, and in this way the concept can be replicated as much as existing demand allows all over the foreign market (Khan, 1999). The internationalizing firm as the franchisor gets the local knowledge that the franchisees possess, whereas franchisees get an opportunity to grow with a new and perhaps well-established concept. As far as the need for market knowledge is concerned, indirect entry is probably the least risky of the internationalizing strategies discussed so far. Conversely, the internationalizing firm's control over the foreign operations is normally more limited when using this entry strategy.

Franchising has emerged in recent years as a significant strategy for business growth. Strategic alliances are being formed with increasing frequency today as managers are devising flexible approaches for responding to changing competitive environments (Devlin & Bleakley, 1988). Franchising is an important form of strategic alliance and is proving adaptability in a wide variety of industries and professions (Hoffman & Preble, 1991). Especially, international franchising is of paramount importance in terms of choice of entry mode (Asheghian & Ebrahimi, 1990). Franchising operations represent low degrees of ownership, vertical integration,

resource commitment, and risk from the firm's perspective (Kotler & Armstrong, 1991). In general, a firm has to share control with external entities.

Franchising History and Concept

The origins of franchising date back to the middle ages when King John reportedly granted franchises to tax collectors (Ayling, 1988). Business franchise systems started in the 18th century with German brewers who contracted with beer halls to serve as their distributors (Forbes, 1982). Widespread use of franchise strategies in the U.S. started in the 1850's when the Singer Sewing Machine Company introduced license/franchise-like arrangements and began the practice of selling products to its own sales force who in turn had to find markets for them (Hackett, 1976, 1977; Mendelsohn, 1992b; Tarbuton, 1986; Vaughn, 1979). Most early franchises involved the linking of manufacturers with whole-sellers or retailers in an effort to expand rapidly on a national scale. Producers of motor vehicles, gasoline, and soft drinkers were representative of early franchisors (Forbes, 1982).

During the 1920s and 1930s, similar license/franchise relationships were developed by petrol companies and some wholesalers and retailers (Ayling, 1988; Baillieu, 1988; Brown, 1988). Business format franchising began in the United States and dates from the late 1940s and early 1950s (Ayling, 1988; Grant, 1985; Hall & Dixon, 1988). According to Mendelsohn (1992a) this business format has become established in 140 countries where it is in varying stages of development depending upon the economic, cultural, and legislative environment.

The practice of franchising is widespread in most Western economies, particularly in the restaurant and hotel sectors (Hing, 1999). Franchising was introduced to the restaurant sector in the 1930s by Howard Johnson to expand his North American operation to over 100 restaurants

by the 1940s (Rudnick, 1984). In the mid-1940s, Dairy Queen, currently one of the top franchise systems in the USA (Technomic Inc, 1991), was established, while the 1950s and 1960s witnessed the establishment and proliferation of McDonald's, Pizza Hut and Kentucky Fried Chicken (Rudnick, 1984). Naisbitt group predicts that franchising in the U.S. will generate \$1trillion of sales annually by the year 2005 and account for half of all retail sales (Petzinger, 1987).

Franchising has been defined as an organizational form “in which the owner of a protected trademark grants to another person, for some consideration, the right to operate under this trademark for the purpose of producing or distributing a product or service” (Caves & Murphy, 1976, p. 572). In the above definition the franchisee acts as sales agent or distributor in standard or commodity businesses distinguished mainly by their brand. To put another way, franchising is an arrangement of organizations, where, a manufacturer or marketer of a product or service grants exclusive rights to local, independent entrepreneurs to conduct business in prescribed manner in a certain place over a specified period of time in return of a payment or royalty and conformance to quality standards (Ayling, 1988; Justis & Judd, 1989; Seltz, 1982). The franchisor grants rights to one or more franchisees resulting in a network of organizations pursuing similar goals (Hoffman & Preble, 1991).

The typical franchising contract includes: details on the duration of the contract, franchising fees and other payments, the sales of goods or services to the franchisee, auditing requirements and formats, site selection and territory rights, business site preparation, trademarks and commercial symbols, use of trade names and operating procedures, promotion and advertising, training programs and requirements, franchisor's right to inspection of franchisee, managerial assistance provided by the franchisor, franchise business procedures, specific

products and services that are to be purchased by the franchisee, regulations regarding the disclosure of confidential information, covenants not to compete, renewal and termination, and obligations of the franchisee on termination or expiration of the franchising agreement (Justis & Judd, 1989; Khan, 1999).

Why Firms to Franchise

As a means of channel management the contractual arrangements of a franchise facilitate a high level of control on marketing policies, organizational and operational, by firms over their outlets (Pilotti & Pozzana, 1991). This ability to exercise close control can ensure the imposition of more consistent and uniform standards across a network compared with those attainable from looser forms of third-party distribution such as dealers, licensees and tenants (Mendelsohn, 1992b; Wicking, 1993).

In recent years, as competitive conditions have intensified, there has been a trend for the conversion of looser forms of third party distribution into franchised outlets (conversion franchising) (Brandenberg, 1989). Conversion franchising occurs when a franchisor adds new franchisees to a franchised system by recruiting existing independent entrepreneurs and/or franchisees from other franchised systems (Hoffman & Preble, 2003; Khan, 1999). Both parties – franchisors and franchisees – benefits financially; the franchisor benefits buy established and tested business site, and franchisee benefits by recognition of brand names and the franchisor's assistance (Khan, 1999).

In the study of franchising as a form of divestment, Baroncelli and Manaresi (1997) found that at the time of needs for growth and competitive restructuring, companies often carry out divestments by changing the form of control on retail operations, from ownership to

contractual relationships (i.e., franchising). This view is somewhat different from the conventional asset analysis that a divestment will necessarily determine a reduction of the strategic scope of the business (Duhaimé & Grant, 1984; Hayes, 1972). They argue that divesting assets and substituting them with contractual relationships can lead to a variety of strategic achievements and can help coping with environmental contingencies.

Due to the investment of capital and manpower made by franchisees in their outlets franchising requires a smaller financial investment by franchisors and involves a lower capital risk than a company-owned network (Ayling, 1988; Mendelsohn, 1992b; Sanghavi, 1990; Tarbutton, 1986). The input of franchisee capital into the business also allows the firm to expand rapidly, increase market share, and improve its overall competitive position, while at the same time satisfy resource constraints (Brown, 1988; Digman, 1986). Economies of scale in purchasing and advertising are likely as the system grows, and brand identification and motivated management are expected to be additional benefits that accrue from employing a franchise system (Feldes & Digman, 1986).

Nevertheless, there is some evidence that the cost in money, time and manpower of developing the franchise system in the early stages is often underestimated by franchisors (Forward & Fulop, 1993; Tarbutton, 1986). Even so, as a result of investing their own wealth in the business franchisees are usually highly motivated which should translate into a dedicated effort to achieve high sales, control costs and quality and provide a high standard of customer service. In other words, at outlet level franchising should enable a large firm to acquire some of the strengths associated with small owner-operated businesses (Brandenberg, 1989; Caves & Murphy, 1976; Hunt, 1973; Oxenfeldt & Thompson, 1969; Sanghavi, 1990; Stanworth, 1991).

Franchising has also been seen as a means by which some firms can ease recruitment problems (Baillieu, 1988; Brown, 1988; Forward & Fulop, 1993; Hough, 1986). Where a firm has either experienced difficulty in attracting or affording outlet managers of the required caliber, or with the appropriate specialist knowledge, franchising may help to solve such staffing problems compared with a company manager because franchisees can be offered additional incentives. These include the opportunity of being their own boss; having the backing of a successful organization; products supplied at favorable prices, and the possibility of building up a business that may be sold on at a profit (Forward & Fulop, 1996).

In addition to the organizational advantages described above, for many firms franchising has become the preferred option over alternative business formats due to the developments in the socio-economic environment. Since the 1950s two major environmental factors have been favorable to the development of franchising. First, the shift in most developed economies towards the service sector which requires a higher degree of personal service (Brandenberg, 1989; Hall & Dixon, 1988). Second, some of the expansion of franchising has been explained by a higher travel intensity which has enhanced the value of a brand name (Mathewson & Winter, 1985; Norton, 1988a).

From the franchisee perspective, there are reasons why they joined a franchising system. Baron and Schmidt (1991) found that franchisees wanted to run their businesses independently but felt that the availability of backup help, entering a business at less cost with a proven product/service and brand name, and reduced risks of failure made franchising attractive. Similarly, Knight (1986) surveyed franchisees and found that the benefit of a known trade name, the higher independence and job satisfaction enjoyed, and easier business development were the primary reasons to be a franchisee. Willingness to work hard and a desire to succeed were seen

as the most important characteristics of a successful franchisee. The franchisor also frequently provides management assistance in the areas of business location, store design, operating procedures, purchasing, and promotion (Khan, 1999; Preble, 1992). All these reasons are supported conceptually by Caves and Murphy (1976).

The inherent advantages of franchising over independent business activity is evidenced by a survival rate after five years in operation of 77 percent for franchised businesses versus 8 percent for independent business ventures (Bond, 1985). One explanation for this difference is that environmental factors such as financial resources, a skilled labor force and the availability of support services promote the creation of new organizations (Aldrich, 1979; Pennings, 1982). Organizational knowledge and collective experience are associated with the success of new venture (Aldrich, 1990; Timmons, 1979). The franchising system either provides these resources or offers substitutes for them, for example, better financing and financial terms for franchises, better management and labor training and better support services. Research on franchising indicates that the availability of environmental support may be particularly important in a lean environment (Falbe & Dandridge, 1991)

Firms that are operating successfully and in an innovative fashion in their domestic market are frequently motivated to set up a franchise system by the perceived competitive advantages that it can offer. This is particularly true for small, successful companies that are operating under conditions of rapid market growth (i.e., 10 to 20 percent annually), but are in a weak competitive position due to their small relative market shares (Preble, 1992). If these firms desire widespread outlets and convenient availability of products and/or service, they are positioned well to pursue a market development strategy by setting up a franchise system.

Despite these advantages, franchising poses certain systemic risks compared to other forms of business (Hoffman & Preble, 1991). For example, while franchisees benefit from common recognition from a well-known trade name, their exposure to risk also increases. Environmental and health concerns affect not only the franchisor and selected franchisees of a fast-food chain but all members of the system. Criminal incidents that occur at one franchise unit may have repercussions in the way the public perceives the entire franchise. Thus, in addition to the usual business risk, franchises may be vulnerable to added system risks.

There are also certain agency costs associated with franchising: horizontal and vertical free riding. Horizontal free riding arises when franchisees reduce quality within their unit, thereby pursuing personal benefits through cost savings, while the loss incurred by providing low quality service is disseminated through the entire system operating under the same brand. Vertical free riding occurs when the franchisor benefits by reducing the quality of their inputs, the costs being borne by franchisees (Hopkinson & Hogarth-Scott, 1999). Franchising can, therefore, alleviate agency costs but simultaneously create some monitoring costs. Accordingly, franchising is an efficient organizational form only when there are net agency cost benefits.

Although franchising may be the most rapid method for international growth, it tends to limit the franchisor's profit. The parent company could retain a much larger percentage of after-tax profits if international growth were achieved through outlets owned and operated by the parent company (Grub, 1972). With the exception of exporting, franchising may be the least profitable method of developing foreign markets because of the existence of second and third parties who share profits.

Franchising may also create additional competitors. A disenchanted franchisee could, in the absence of legal restraints, terminate the agreement and begin a similar business entirely on

its own (Grub, 1972). In this case, the former franchisee would carry with him the managerial know-how imparted by the franchisor as well as any trade that may have been revealed during their relationship.

Theoretical Explanations for Franchising

The franchise system may be regarded as a portfolio of operating units that continually adjusted to reflect changing costs and revenue opportunities (Anderson, 1984; Markland & Furst, 1974). The most debated topic in franchising research is the reason a firm chooses to franchise rather than expand through company-owned units.

Research has focused on two competing theories: resource scarcity and agency. Both theories seek to provide explanations not only for the widespread expansion of franchising, but also the reasons why many franchisors use a plural form - simultaneous operation of a mix of franchised and company-owned outlets - to maintain uniformity and achieve systemwide adaptation to changing environments, and the determinants of the relative proportions of company-owned and franchised outlets in a network (Bradach, 1997, 1998; Bradach & Eccles, 1989).

Resource Scarcity Theory

In resource constraint theory (also known as ownership redirection theory), franchising is viewed predominantly as a means of easing the financial and managerial constraints upon the growth and expansion of small to medium size firms because the franchisee supplies both financial and managerial resources, and thus transferring risk from the firm (principal) to the franchisee (agent) (Caves & Murphy, 1976; Hunt, 1972; Oxenfeldt & Thompson, 1968-1969).

Oxenfeldt and Kelly (1968-1969) proposed that a young company with a limited supply of financial capital and human capital, or managerial talent becomes a franchisor in order to use the franchisee's resources to expand. Then as the organization can generate sufficient capital internally, the franchisor would alter take over the larger units from franchisees as organizations matured, and franchise organizations eventually would become company-owned chains. This view has become known as 'resource scarcity,' which is related with the franchise redirection debate (e.g., Carney & Gedajlovic, 1991) or life cycle view of franchising (e.g., Caves & Murphy, 1976; Crandall, 1970; Hall & Dixon, 1988; Hunt, 1973, 1977; Lillis, Narayana, & Gilman, 1976; Norton, 1988a; Oxenfeldt & Thompson, 1968-1969).

Rubin (1978) has a similar prediction but for different reasons. He postulates that as the franchisor becomes successful, franchisor will have more outlets in a given area. This concentration of outlets should reduce average monitoring costs and make it efficient to convert the franchised stores back into company owned ones. Notwithstanding the different underlying reasons, both theories suggest a decreased use of franchising as the chain matures.

There are empirical studies which tend to support the franchising life cycle view by Oxenfeldt and Kelly (1968-1969). Initial empirical support for this view was provided by Hunt (1973), who found an aggregate trend towards company-owned units in the fast food, convenience grocery, and laundry/dry cleaning industry. He also found that the percentage of company owned establishments increased over the period of 1960-1971, and larger and older units are likely to become company-owned units.

Caves and Murphy (1976) observed a similar trend towards company ownership in restaurants, hotels, and motels. They have provided some empirical evidence that supports the contention that franchisors have sought to own the most prosperous units and franchise the

marginal outlets. Likewise, in a survey of fast food franchises, Lillis, Narayana, and Gilman (1976) found that the benefit of rapid market expansion encouraged franchising during the embryonic life cycle stages, but that fully integrated distribution channel became more popular as the franchise full-fledged.

Additional evidence was provided by Anderson (1984), who found that the percentage of units owned by franchisors systematically increased over a period of ten years. The importance of resources for firms in the infant stages of growth is also evidenced by Thompson (1992) and Sen (1993). According to Sen (1993), new franchisors charge a higher initial fee than older franchisors. Carney and Gedajlovic (1991) applied factor analysis to isolate different franchising strategies, some of which appear to be associated with resource scarcity and increased company ownership upon maturity.

The use of franchising to overcome financial constraints receives support from surveys of franchisors conducted by Dant (1995), who find that capital access is one of the important reasons for franchisors adopting franchising as a growth strategy. Bush, Tatham, and Hair (1976) also provide rationale for resource constraint view of franchising. They contend that franchisees, typically drawn from the markets into which the chain intends to expand, also provide important real estate and demand expertise otherwise unavailable to the firm.

Not only do the franchise fees generate cash that the franchisor needs to create the supporting infra-structure for the growing system, but the franchisees also typically provide the fixed investment for equipment, signage, and often, building and land (Dant, 1995). Martin (1988) provides some evidence of life cycle effects of franchising and the role of franchising in facilitating capital supply.

Human capital constraints may also operate in the form of the “Penrose effect,” that is the lack of managerial capability and human capital within smaller or younger companies. Capable managers may be co-opted through franchising to overcome this Penrose (1959) type of constraint (Thompson, 1994). As the Penrose limit recedes over time, so the comparative advantage swings back toward company ownership and a life cycle is generated. Norton (1988a) emphasizes franchisor’s need for human capital and managerial talent as a reason for franchising at the early stages of firm expansion and market penetration, but internal organization is preferred at mature stages of firm growth. Hence, resource constraint theory is associated with the ownership redirection debate.

From a strategic choice of system structure perspective, Minkler (1990) has put forward a search explanation and focused on the franchisee’s capacity to provide local market expertise, in which franchising is preferred where local market knowledge is required, but subsequent learning by the franchisor renders company ownership feasible. In a similar vein, Zeller, Achabal, and Brown (1980) stress the importance of the strategic choice of system structure. In particular, they have contended that a master franchising system may be preferred to an individual franchising system because master franchise facilitates system harmony and “buy-back” opportunities.

As indicated above, franchising is primarily viewed as a strategy for extending distribution channels through geographic expansion with limited financial resources and market information/knowledge. Sen (1998) investigated the use of franchising as a growth strategy in the US restaurant industry. The results show that the relationship between the change in franchising and outlet expansion weakens for larger firms. This is because larger firms have their own resources and do not have to depend on franchisees for outlet growth.

As empirical research indicated, franchisors perceive growth as an important reason for franchising (Dant, 1996; Lafontaine & Kaufmann, 1994). Whether franchising is initially the most efficient source of capital or not, as the system matures, the financial and human capital constraints are gradually relaxed. When this occurs, the resource constraints argument predicts that the proportion of company-owned units will increase as the franchisor moves toward a completely company-owned chain. As a corollary of that argument is that the franchise life cycle theory is supported.

Agency Theory

The resource scarcity view does not explain why franchising is used by many businesses who clearly have full access to capital markets (Lafontaine & Kaufmann, 1994). Resource scarcity view has been criticized by Rubin (1978) who contends that raising capital via franchising is less efficient than raising funds from investors, and therefore other factors than the need for capital must be the reason for franchising. He contends that the franchisor is able to reduce risk by investing in the entire system and hence has a lower cost of capital more available to the franchisor than to the franchisee.

In their survey of franchisors, as opposed to Oxenfeldt and Kelly's (1968-1969) prediction, Lafontaine and Kaufmann (1994) find that complete ownership of all outlets is not desired by any of the respondents. Moreover, less than 2 percent of the franchisors want to own a majority of the units within the chain. This suggests that in spite of lower resource constraints, franchising still might be the preferred option for larger firms because of synergistic benefits. Lafontaine (1992), examining on Rubin's (1978) argument, pointed out that franchising may be a

less expensive source of capital if there are incentive issues at the outlet level, and argues that capital may after all be procured from franchisees than from investors.

Instead of by capital scarcity, the existence of franchising is explained by agency theory (Brickley & Dark, 1987; Mathewson & Winter, 1985; Rubin, 1978). Following the theory of efficient capital markets, organizational economics, particularly agency theory, shed different perspective on ownership structure of organizations. Agency theory focuses on risk sharing and efficient reduction of monitoring costs arising from moral hazards as primary considerations shaping ownership structure. Agency perspective holds that managers (the agents) will tend to shirk in their duty to the firm (the principal) because their compensation is fixed. As a result, high monitoring costs will be incurred by the firm to ensure that its managers act in the firm's best interest. Hence, franchisee-owned units are likely to perform better than company-owned units because the contract between the principal (franchisor) and agent (franchisee) is designed to keep their financial interests closely aligned.

While company-owned units generally seem to offer employees higher wage increases over time than franchise-owned units (Krueger, 1991), company-owned units under-performed franchised units (Shelton, 1967). Krueger (1991) found that closer supervision is linked with lower wage rates in franchised units. Higher pay is used in company-owned units as the incentive to prevent staff from shirking. According to franchisors, the high level of motivation of franchisees compared to paid employees is the most important advantage offered by franchising (Lillis, Narayana, & Gilman, 1976). This may be a result of the franchisee having a marginal opportunity cost of labor below that of a hired employee (Caves & Murphy, 1976). Franchising therefore provides an economically efficient system of control.

Support for the agency theory view was provided by Brickley and Dark (1987), who found that high employee monitoring costs, and low capital investment cost per unit favored franchising over company-owned units. By giving the franchisee a claim to a large part of the profits of the outlet, the franchisor is assured that the franchisee will exert right amount of effort in managing the store and hence reduce monitoring costs (Brickley & Dark, 1987; Caves & Murphy, 1976; Lafontaine, 1992; Lafontaine & Kaufmann, 1994; Mathewson & Winter, 1985; Sen, 1993, 1998).

By including in the contract a variable payment to the franchisor based on outlet sales (i.e., royalties), the franchisee is assured that the franchisor also has incentives to put sufficient effort into the management of the overall system (Blair & Kaserman, 1982; Lal, 1990; Mathewson & Winter, 1985; Rubin, 1978). This line of reasoning suggests that the alignment of franchisor and franchisee interests attained through the franchise agreement produces a more efficient operation than could be achieved through vertical integration and internal control (Lafontaine & Kaufmann, 1994).

Units drawing low frequency of repeat customers or non-repeat business per unit are less likely to be franchised than are units in areas of repeat business. This is because the incentive to free ride on brand capital is high where customers are not expected to return to the unit (Brickley & Dark, 1987; Dahlstrom & Nygaard, 1994; Norton, 1988b). Geographic dispersion is associated with higher usage of franchising since the monitoring of units is more difficult (Combs & Castrogiovanni, 1994; Norton, 1988b). Other researchers (e.g., Dahlstrom & Nygaard, 1994; O' Hara & Musgrave, 1990; Thompson, 1992, 1994) also found no support for the life cycle theory of franchise development and for the notion of resource scarcity but did find significant support for the agency theory and risk-spreading perspectives.

Plural Form/ Tapered Integration

The resource constraint argument for franchising assumes that company-ownership is the preferred method of operation. On the other hand, the agency argument suggests that franchising should be the preferred method. As individual franchise system mature, these theories predict different patterns in the evolution of the mix of franchised and company owned units. In a unique approach to this question, researchers attempted to incorporate both theories. The concept of tapered integration (Harrigan, 1984) has been applied to understand the strategic choice to maintain a plural form, mix of both company-owned and franchisee-owned outlets, within the same system (Bradach, 1997).

At present, many retail companies opt for plural form organizations mixing franchised units and company owned units (Bradach, 1997; Cliquet, 2000a). For instance, the fast food franchise chains display considerable variance in ownership patterns. McDonald's and Burger King, in 1997, had franchised approximately 79 and 91 percent of their total outlets, respectively; however, the analogous 1997 figures for Kentucky Fried Chicken (KFC), Church's Chicken, and Krystal were 52, 34, and 25 percent, respectively (Bond, 1997).

Cliquet and Croizean (2002) contend that franchising and company owned systems are not opposing but rather complementary organizational forms, which parallels the concept of "make and buy" (Anderson & Weitz, 1986) rather than "make or buy" principle stemming from the transaction cost theory (Williamson, 1975). Bradach and Eccles (1989) incorporate the concept of tapered integration from economics to argue that the firms often strategically employ "plural forms" of organization. Plural forms are defined as arrangements "where distinct organizational control mechanisms are operated simultaneously for the same function by the same firm" (Bradach & Eccles, 1989, p. 112).

Bradach and Eccles (1989) combine the use of price, authority and trust-based governance mechanisms to organize their exchange relationships and argue that three concepts should be seen as independent and compatible control mechanisms. It is also suggested that these three mechanisms can be blended in various ways by firms for strategic grounds to establish unwavering and simultaneously coexisting plural transactional forms (Dant, Kaufmann, & Paswan, 1992). In their view, a combination of control mechanisms rather than a preference for one ideal type permits the firm to reap synergistic benefits unavailable if only one form is used (Dant & Kaufmann, 2003).

Building on concept of overall control mechanisms, Bradach and Eccles (1989) suggest that franchise systems employ dual distribution not only because some individual outlets are best suited one form and some for the other, but also because the existence of each form positively impacts the management of the other side of the business. The plural form rationale for franchising discusses the choice of unit ownership at the strategic level (Bradach, 1997, 1998) like resource constraint view.

Several researchers identified an array of potential synergistic benefits that can accrue to franchise systems adopting a plural form strategy (Cliquet, 2000a, 2000b; Cliquet & Croizean, 2002; Dant & Kaufmann, 2003; Dant, Kaufmann, & Paswan, 1992; Lafontaine & Kaufmann, 1994). Stable dual distribution remains a possibility to the extent that there are synergy effects derived from retaining a combination of company-owned and franchised-owned outlets (Dant, Kaufmann, & Paswan, 1992). This view of synergistic advantages suggests the choice of a mixed ownership structure that inclines toward neither more full franchised nor toward more fully company-owned systems (Dant & Kaufmann, 2003).

Lafontaine and Kaufmann (1994) provide evidence of the effectiveness of a “ratcheting strategy” of dual distribution. For example, within this strategy, having franchised units can provide a source of market knowledge, objective input on policies and innovative ideas that can be incorporated into the company owned units (Lafontaine & Kaufmann, 1994). Residual claimancy provides motives to franchisees to identify cost saving and revenue boosting ideas that franchisors can adopt and put into practice in company owned stores (Dant & Kaufmann, 2003).

Conversely, company owned outlets are a platform for more systematic R&D activity, and for testing new policies or programs (Dant & Kaufmann, 2003). Having company owned outlets allows franchisors to identify opportunities beyond the capacity of individual franchisees, and gain direct knowledge of operational details crucial to curtail cheating problems, e.g. free-riding and opportunistic bargaining, thereby protecting the entire system from the deleterious effects of brand name deterioration (Walker & Weber, 1984). The experience gained with direct exposure to marketplace in the form of company owned units could also be exploited to negotiate with and control the franchisees more effectively (Dant, Kaufmann, & Paswan, 1992).

Using cross sectional data, a number of researchers have examined the contractual mix of individual franchisors by comparing the proportion of company-owned units between old and new franchised businesses at a particular point in time to assess the effect of franchisor maturity on the ownership mix. Norton (1988a) has concluded that in view of the variety of observed franchise ownership no single factor accounts for the incidence of franchise contracts, while Martin (1988) found that capital needs, market competition, monitoring costs, and the need to reach minimum efficient scale were reasons to franchise, and thus argues that franchising can only be explained by taking elements from both these theoretical perspectives.

Carney and Gedajlovic (1991) developed a path model of the franchising life cycle that synthesized the resource scarcity and agency views based on a study of franchising patterns. They argue that franchising can only be explained by taking elements from both these theoretical perspectives. Another findings by Lafontaine (1992) are similar in that franchising is prevalent when there are incentive problems but firms also use franchising to grow faster, though the constraints that franchising must overcome may not always be financial.

The theoretical perspective of plural forms or tapered integration suggests a tendency toward maintaining a steady state of mixed distribution. Lillis, Narayana and Gilman (1976) found that the benefits of franchising that franchisors recognized in an embryonic stage of franchise system, such as resource availability, risk sharing, market expansion and even to a lesser extent franchisee motivation, began to diminish as the system reached late maturity. The advantages of a plural form of organization structure, learned through the ongoing management of the system, might act to balance the diminishing magnitude of the more palpable direct benefits of franchising (Lafontaine & Kaufmann, 1994).

Bradach (1997, 1998) has demonstrated the superiority of plural form of organizational structure compared to franchising and company owned systems using data from a field study of five mature US fast food chains. In a similar study, Lafontaine and Kaufmann (1994) found that franchisors intended to continue to operate a combination of company owned and franchised outlets with a relatively limited use of company owned units. They point out that franchisors want to increase company owned units at the age of 16 years in chain life cycle span to exploit synergistic effects associated with the plural form albeit the better incentive structure achieved through franchising, and not at all in an effort to attain the near complete ownership envisioned by capital constraint theory.

Cliquet (2000) has attempted to reinforce this opinion by showing the advantages of plural structure of franchising systems in hotel chains in France not only for mature chains but also for any company all along the life cycle. According to Cliquet (2000), at the saturation stage, a plural form organization should yield more profitability because of higher motivation of the chain at the local level, better information about the market, and easier control of both company units and franchisees through company units. As indicated by Cliquet & Croizean (2002), the decisions made in choosing the ratio of franchise/company owned outlets depend primarily on operator position within the chain life cycle in terms of spatial coverage.

In recent study of a national mail survey of the franchised fast food restaurant franchisors, Dant and Kaufmann (2003) investigated the firm's recognition of the synergistic benefits of dual distribution. The results, however, indicate that although franchisors recognize the advantages of plural form organizations or mixed distribution strategy and retain that mix of ownership types over time, the strength of that recognition failed to predict the steady state. They showed some evidence of ownership redirection hypothesis of converting existing franchised outlets to company outlets as fast food systems mature and gain greater access to resources.

At the international context, Laulajainen, Abe, and Laulajainen (1993) have conjectured that if "several modes may coexist in a country but one normally dominates." They also note that "it is logical that owned stores should predominate in near and familiar markets, and franchises elsewhere" (p. 115). In addition to the geographical proxy explanation for the mixed ownership of organizations, Manolis, Dahlstrom, and Nygaard (1995) explain the reason for coexistence of franchises and company owned outlets based upon the difficulty of quality maintenance due to free riding behavior.

Types of Franchise Arrangements

There are primarily two major types of franchising that are used by service firms: product/trade name franchises and business format franchises. The difference between product/trade name franchising and business format franchising is that the latter offers a method of operation or business system that includes a strategic plan for growth and ongoing guidance (Falbe & Dandridge, 1992).

Product and Trade Name Franchising

The product and trade name type of franchising is associated with a dealer/supplier relationship (U.S. Department of Commerce, 1988) in which the dealer receives a contract to act as an exclusive or semi-exclusive sales representative for a manufacturer or supplier (Falbe & Dandridge, 1992). Product-Trade name franchising refers to alliances in which the franchisee distributes the franchisor's product under the franchisor's trademark (Hoffman & Preble, 1991). Most early franchises involved the linking of manufacturers with wholesalers or retailers in an effort to expand rapidly on a national scale (Preble, 1992). This type of franchise is often associated with automobile dealerships such as General Motors, Ford and Chrysler, gasoline service stations like Texaco or Mobile, and soft drink bottlers like Coca Cola and Pepsi (U.S. Department of Commerce, 1988; Vaughn, 1979).

International Franchising Association (IFA) (1990) reported that this category of franchisor generated almost \$503 billion in sales in 1990 or 70 percent of all franchise sales. Although product and trade name franchising is still the principal type of franchising, it has declined in franchise sales (U.S. Department of Commerce, 1988). Product and trade name franchising accounts for around 70 percent of all franchising sales due in part to the very high

unit price of cars or the very high volume of gasoline. This type of franchising is of far less interest at present because it is a mature field characterized by market saturation, intense competition and a decline in number of business units (Falbe & Dandridge, 1992).

Business Format Franchising

A relatively new form of franchising, which has accounted for most of the growth of franchising in the U.S. and internationally since 1950, is that of business format franchising (Vaughn, 1979). Throughout the 1950s and 1960s a fast growth of the business format franchising occurred and emphasis was clearly laid on the development of domestic chains (Oxenfeldt & Thompson, 1968-69). Several US franchise systems introduced revolutionary concepts. However, they applied and enhanced the superiority of their franchise concepts in the external markets only in the early 1970s, after the clear success of domestic implementation (Love, 1986).

In the 1970s, competition was stronger in the North American market and maturity was evident in some areas where franchises prevailed (Hackett, 1976; Walker & Etzel, 1973). The 1980s was a period of rapid international expansion during which some 400 US franchisors increased their overseas units by more than 70 percent, to almost 39,000 (Preble & Hoffman, 1995). Business format franchising is predicted to be the dominant form of franchising internationally in the twenty-first century (Hoffman & Preble, 1993).

Business format franchising is an organizational form based on a legal agreement between a parent organization (the franchisor) and a local outlet (the franchisee) to sell a product or service using a brand name developed and owned by the franchisor. The franchisor typically sells the franchisee a right to use this intellectual property in return for a lump sum payment and

an annual royalty fee based on sales for a specified period of time (Klein, 1980; Klein & Leffler, 1981; Mathewson & Winter, 1985; Miller & Grossman, 1990; Norton, 1988a). This type of franchising, which is also known as package franchise, includes more than just providing the franchise with a product, service, and trademark (Hoffman & Preble, 1991).

The international Franchise Association, the major business format franchising trade association, defines franchising as “a continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organizing, training, merchandising and management, in return for a consideration from the franchisee” (U.S. Department of Commerce, 1994, p. ix). Similarly, Kostecka (1988, p. 3) defines business format franchising as “an ongoing business relationship between franchisor and franchisee that includes not only the product, service, and trademark, but the entire business concept itself – a marketing strategy and plan, operating manuals and standards, quality control, and a continuing process of assistance and guidance.”

In general, the franchisee usually agrees to adhere to franchisor requirements for product mix, operating procedures, and quality control. In return, the franchisor typically agrees to provide managerial assistance, training, marketing strategy and plan, advertising assistance, operating manuals and standards, and site selection heuristic, continuing process of assistance and guidance, and services that are to be delivered exactly as specified by the franchisor (Fladmoe-Lindquist & Jacque, 1995; I.F.A., 1990; Rubin, 1978; U.S. Department of Commerce, 1988). Types of business format franchises are especially prevalent in the restaurant industry, retailing, and a host of other business and personal services (Falbe & Dandridge, 1992; Preble & Hoffman, 1995). US fast food franchises are some of the best-known global franchise businesses (Khan, 1999) including McDonald's, Burger King, and Pizza Hut.

Hotel and restaurant chains distinguish themselves from others by their brand names, architectural designs, levels of service, reservation systems, and global logistics delivery. In the hospitality industry, therefore, franchise is an ongoing relationship rather than merely a matter of signing an arms-length contract and then passively raking in the royalties. The de facto organizational behavior is an evolving strategic partnership between franchisor and its franchisees (Contractor & Kundu, 1998). In this sense, business format franchises include strategic choices of operating technology as well as product/market and administrative structure (Hoffman & Preble, 1991).

Business format franchising is becoming an increasingly international activity (Shane, 1996b). From 1971 to 1985, U.S. franchisors added foreign outlets at a rate of 17% per year, almost twice as fast as they added domestic outlets. As a result, by 1990 more than 350 U.S. companies had more than 32,000 franchised outlets overseas (Aydin & Kacker, 1990). Moreover, this expansion is continuing. One-half of all franchise companies in the United States without international sales and nine-tenths of those with international sales plan to expand internationally over the next few years. By early 21st century, 60% of all franchisors in the United States are expected to have outlets overseas (Hoffman & Preble, 1993).

International Franchising

A study by Arthur Andersen and Company found that one-third of U.S. franchisors had overseas operations and among the firms without overseas operations as yet 50 percent indicated interest in operating overseas within the next five years (Tannenbaum, 1992). While franchisors who are older and have a larger number of units are more likely to operate internationally

(Huszagh, Huszagh, & McIntyre, 1992), all types and sizes of franchisors interested in becoming international franchisors (Aydin & Kacker, 1989).

Especially, the U.S. fast food industry plays a predominant role in international franchising. Franchising is an effective vehicle for international expansion for fast food restaurants (Khan, 1999). The growth rate of international units for the top 100 restaurant chains was 21.2 percent in 1997, while domestic units grew only 5 percent (Lombardi, 1996). This increase was mainly through franchising.

Franchising as an organizational form is gaining acceptance in many countries (Preble & Hoffman, 1995). Research has also explored strategies for international franchising as an organizational form. For example, Chan and Justis (1990) suggested master franchising, joint venture, licensing, direct investment, or governmental agreements as possible entry strategies for firms trying to enter the East Asian market.

International franchising also offers a strategic option for firms who do not franchise domestically. Ayal and Izraeli (1990) claim that for high tech products, an international market expansion through franchising could offer many advantages, including higher value accrued to the product due to the services provided by the franchising system coupled with the scale advantages of franchising.

Franchising is closely associated with service firms that have strongly identifiable trademarks that guarantee the customer of uniform product quality both across different service outlets and over time (Fladmoe-Lindquist & Jacque, 1995). Hymer (1976) argue that firms expand overseas because they possess a proprietary advantage that makes them able to outcompete local entrepreneurs. A franchisor's business system can be considered an example of a proprietary advantage, because the business system is unique to the franchisor (Calvet, 1981).

Caves (1971) demonstrated that companies with a proprietary advantage have an incentive to expand overseas, because they can use that advantage in foreign markets at little or no marginal cost over the cost of developing the advantage in the domestic market. Because foreign competitors would have to incur the total cost of developing that proprietary advantage, the firm has a cost advantage over competitors (Caves, 1982).

There are similarities between the international and domestic levels of analysis concerning the choice to own or to franchise for service firms. While the motivation to pursue global markets is likely to include a large number of the factors involved in domestic markets, the extent to which additional variables play a role in the decision to enter international markets is an important consideration in developing a broader understanding of this important business trend.

Some of the key considerations, as derived from the empirical literature such as Hackett (1976), Walker (1989), and Walker and Etzel (1973), play a role in the decision to franchise abroad. In their studies, companies receiving inquiries or proposals from prospective or existing franchisees were either ranked highly or cited by a large number of respondents in all three studies as a key motivator for foreign expansion. Initial involvement in expanding to foreign markets has followed a similar pattern, where firms received unsolicited export orders or requests by local customers for foreign shipment (Davidson & Harrigan, 1977).

Foreign market potential was a key reason for international expansion. Hackett (1976) found that the major motive for franchisors to move overseas was a desire to take advantage of markets with great potential and to establish a brand name. Many franchising firms were able to enter overseas markets without any change in their marketing strategy and experienced the same

level of profitability as they did at home (Elango & Fried, 1997). Proximity and similarity of markets were also a key consideration.

The movement towards cross-border franchising which began in the United States in the 1950s has been accelerating as an increasing number of franchise systems reach maturity in their domestic markets (Hackett, 1976; Hoffman & Preble, 1991; Sanghavi, 1991; Walker & Etzel, 1973). Domestic market maturity currently plays a key role in motivating service franchisors to pursue global expansion. For example, with the domestic market for fast food being mature and highly competitive, the relatively underdeveloped international quick service restaurant market is where companies will find much of their future expansion opportunity (Preble, 1992; Yu & Titz, 2000).

A trend towards cross-border franchising is also being reinforced by a small number of retailers who, although operating managed outlets in their domestic market, have preferred to utilize franchising as an entry mode into foreign markets either where population size or per capita expenditure may be insufficient to support a major programme of expansion, or in order to carry out market testing prior to establishing a full-scale operation (Burt, 1995; Whitehead, 1991). According to Whitehead (1991), international franchising provides an opportunity for firms to establish a presence in countries, where the population or per capita spending is not sufficient for a major expansion effort.

Hackett (1976) and Walker and Etzel (1973) noted that legal and governmental red tape were the major barriers to international entry by franchising firms. In contrast, Aydin and Kacker (1989) found that the large U.S. market, the lack of international management experience, and limited financial resources were reasons that franchisors remained domestic. The importance of perceptions in making this decision is Kedia, Ackerman, and Justis (1995), who found that firms

whose managers are favorably predisposed to internationalization are likely to pursue international opportunities.

Franchising has spread internationally in two stages. Initially it spread to countries characterized by high per capita income and a developed retail service sector; then to countries characterized by greater diversity in culture, income, and political systems (Welch, 1989). The literature on franchising has shown that franchisors prefer to expand by franchising in geographically distant locations (Brickley & Dark, 1987; Martin, 1988; Norton, 1988a). This preference has been explained as a function of relative agency and governance costs. The more remote the location of an outlet, the higher the costs of monitoring employees and the greater the preference for franchising (Brickley & Dark, 1987; Martin, 1988). Such explanations tend to focus on minimizing agency and governance costs while maximizing the ultimate returns to the franchisor (Kedia, Ackerman, Bush, & Justis, 1994).

Because franchisors prefer to expand to geographically distant locations by establishing franchised outlets and focus their expansion efforts geographically, most of the international expansion of American franchise systems occurs through the sale of franchises to foreign nationals (Shane, 1996b). In fact, the empirical evidence indicates that between 73% (Hackett, 1976) and 94% (U.S. Department of Commerce, 1987) of all foreign outlets of U.S. franchise systems are established through the sale of outlets to foreign franchisees.

On the contrary, because franchising is a highly standardized operation, the degree to which it can be successfully replicated across national markets is a daunting challenge (Fladmoe-Lindquist & Jacque, 1995). For example, McDonald has had to face some of the problems typical of international expansion via franchising such as foreign government's control over operation in entire countries and over media, site selection problems due to poor demographic

data, and difficulties in introduction of general concept of fast food (Smith, Arnold, & Bizzell, 1988).

While creative adjustments may be needed to adapt a franchise to a foreign location, franchisors must be careful to preserve, as much as possible, the product and market standardization that made their companies successful in the first place (Hoffman & Preble, 1991). Indeed, with multiple outlets operating in different national socio-cultural environments, the task of standardization is more complex and the cost of monitoring operations higher than it would be for a manufacturing firm operating one or more distributorships in foreign markets (Fladmoe-Lindquist & Jacque, 1995). In general, the closer the culture and values are between the home country of the franchisor and the franchisees' host countries, the easier it will be to preserve franchisor policies and modes of operation (Hackett, 1976; Rau & Preble, 1987; Welch, 1989).

Modes of Business Format Franchising

International franchising may occur on a unit-by-unit basis or use a master franchise concept. In the first case, the franchisor contracts for a single service unit with a franchisee. With direct franchising the franchisor directly establishes and runs individual franchisees in a foreign location from its domestic base. This method often requires a franchise packet that is carefully planned to suit the particular country involved.

Difficulties exist in managing individual unit operations from a distance, especially once the number of franchisees increases (Quinn, 1998). In the case of major social and cultural distances between the domestic and foreign market, direct franchising is less likely entry route

due to the problems of finding suitable franchisees and providing operational support and control (Mendelsohn, 1992a, 1992b).

The entry strategy most widely used in cross-border franchising has been the master franchise (Fulop & Forward, 1997). Under the master franchise arrangement, the overseas company (franchisor) contracts with an individual or domestic company (master franchisor) who will assume the rights and responsibilities of developing the concept and establishing franchises throughout a country or large territory, thereby creating a three-level franchise relationship (Justis & Judd, 1989; Queen, 1998b).

The use of master franchises is a more popular entry mode for international than for domestic franchise expansion. According to Hopkins (1996), the percentage of respondents who indicated that master franchises are used exclusively in international operations was five times greater (40 percent) than those being used only in domestic operations (8 percent). It appears that master franchises are perceived as additional means for dealing with the cultural differences and general complexities of less understood foreign markets.

The master franchisor is trained by the company and assumes the role of franchisor in their home country by subfranchising the units to other individuals depending on the terms of the contract or opening up stores for themselves. Under the subcontracting approach, the master franchisor acts as a local franchisor and format coordinator (Justis & Judd, 1989). Master franchisors usually assume the responsibility of selecting other franchisees, offering training, coordinating activities with local franchisees, monitoring performance, and implementing the strategies of franchisors. They charge local franchisees for the services provided and in turn compensate franchisors for the authority bestowed on them (Sashi & Karuppur, 2001).

Master franchises are likely to be preferred under certain circumstances. In developing countries where the commercial infrastructure is inadequate, reliable information for evaluating potential franchisees may not be available, e.g., credit information (Terpstra & Sarathy, 2000). Also, in some countries legal safeguards may be deficient and not permit franchisors to impose penalties on franchisees for violating agreements (Asheghian & Ebrahimi, 1991). In such circumstances, it is difficult for firms to collect the franchising and royalty fee from franchisees. Master franchisors with access to local information and familiar with local procedures may be better able to evaluate franchisees as well as collect payments. By selecting reliable master franchisors, firms are able to share the risks of conducting business, reduce adverse selection, franchisee moral hazard, and opportunistic behavior (Sashi & Karuppur, 2001).

Under the volatile markets, mainly due to the political-legal instability, firms may prefer master franchise arrangement instead of contracting several independent franchisees because franchisors can reduce coordination and communication costs and local master franchisors can cope with frequent political and regulatory changes (Sashi & Karuppur, 2001). In overall, the local partner is viewed therefore not only as a source of revenue for the company but also as a source of information about what aspects of marketing program may need to be altered to fit the values of the host country (Christiansen & Walker, 1990). Furthermore, the local partner has an investment in the business and, consequently, is more committed to seeing the business succeed (Chan & Justis, 1992).

Master franchises are frequently permitted in countries where government regulations are relatively restrictive. Because a large amount of the risk is shifted to the master franchisee, the level of resources needed would be low relative to other entry options and similarly, the franchisor's commitment to the host country could be minimal (Preble, 1992). Additionally,

when the level of economic/political risk in the host country is judged to be high, the master franchise is sound alternative to getting more deeply involved.

The potential danger to service franchisors of this type of strategy is the loss of control that might lead to a relaxation of the standards so critical to a franchisor's reputation (Lowell, 1991). Control of the quality of the network's operations is crucial and difficult to maintain. This threat in fact materialized in France when McDonald's was forced, in the early 1980s, to revoke its master franchise agreement because an inspection revealed stores that were not clean (Preble, 1992). Loss of direct access and control over local franchisees and markets also give rise to opportunism. In the long run, master franchisees may accumulate transaction-specific assets (e.g., reputation, marketing skills, systems and procedures, relationships with franchisees) and become indispensable. At this stage, the master franchisee might behave opportunistically. Subsequently, the arrangements with master franchisees may be terminated and direct relationships established with franchisees (Sashi & Karuppur, 2001).

Several additional factors should be considered by the franchisor before employing a master franchise in a foreign country. There is the possibility that the large, established international operator, which adds master franchising to its portfolio of entry methods, might in practice underestimate the social, economic and cultural differences of another country. As a result, this can often necessitate substantial adaptations and modifications to the original product, systems and marketing (Forward & Fulop, 1993, 1996).

A variation on the master franchise approach is to use an area franchise, whereby a single franchisee opens several outlets in a geographic area. The area concept is quite common in the fast food industry and is considered a desirable alternative for both the franchisor and the franchisee (Lowell, 1991).

It is apparent that franchising has emerged as an important strategy option that has numerous inherent advantages that facilitate franchisees' being successful in today's global marketplace. Franchising needs to be envisioned as more than just a method of distribution, particularly with the advent of the business format franchise and the explosive growth in the service sector of the economy (Cross & Walker, 1987).

Franchising: Hybrid Organizational Form

There has been renewed empirical research in the area of franchising. A central question in the research stream is why firms choose to franchise at all (Contractor & Kundu, 1998; Fong, 1987). Brickley and Dark (1987) looked at franchising as an organizational form choice using agency theory and found that the cost of monitoring store managers is an important issue in the choice between equity and franchising. Martin (1988) examines the incentives to franchise from a risk management perspective and found that uncertainty is a significant consideration in the equity or franchise choice.

A second line of investigation looks specifically at the nature of the franchise contract. Rubin (1978) examines the structure of the franchise contract and suggests that firms may choose to franchise for reasons other than failure to raise capital. None of these investigations, however, attempts to make a connection between the use of franchising and the service sector. The data used by Martin (1988) are completely service based. However, he does not mention the sectoral impact on his analysis. This is also the case in the research by Dark (1988) in which he examined franchising by U.S. firms within the domestic context.

The transaction cost (internalization) literature focused on the difficulties of negotiating an agreement that could effectively substitute for an extension of a company's own organization

(Williamson, 1979). These include selecting the right partner especially in foreign nations (Geringer, 1991). The transaction cost literature details the problems of bounded rationality, asset specificity, opportunism or shirking by the business partner, and the costs of monitoring the partner's activities and behavior (Erramilli & Rao, 1993; Fladmoe-Lindquist & Jacque, 1995; Mathewson & Winter, 1985; Williamson, 1979).

Williamson (1975, 1991a) identified three generic forms of economic organization – market, hybrid and hierarchy. The transaction cost literature was skeptical about the prospects of contractual relationships (market) being able to effectively substitute for a firm's own control and operation through ownership - hierarchy (in Williamson's terminology, 1979) or internalization (in Dunning's terminology, 1980).

Shane (1996a) argued that contractual relationships such as franchising are not mere arms of length contracts but long-term strategic relationships and may be a superior alternative to equity ownership. Business format franchising is a popular example of a hybrid organizational form that incorporates elements of both markets and hierarchies (Williamson, 1991a). It is a hybrid alternative since the franchisor both retains a procedure, and the locations of outlets and contracts with independent entrepreneurs to operate the units (Child, 1987).

Franchisors formulate overall business strategies and expect franchisees to function as integral parts of a system by implementing these strategies. However, franchisees may enjoy relative freedom in recruiting personnel, managing routine operations, and running local marketing programs. Franchising provides the flexibility required to implement hybrid strategies in which some elements of the marketing mix are standardized by the franchisor across global markets and other elements are locally determined by franchisees (Sashi & Karuppur, 2001).

Business format franchise serves as a significant alternative to both non-integration and full vertical integration (Norton, 1988a). Carney and Gedajlovic (1991) emphasize that franchising is frequently a means of achieving quasi-vertical integration. In this regard, firms may be able to overcome managerial limits to firm growth through the use of contractual organizational forms (Shane, 1996a). Larson (1992) found that new and growing firms, in general, tend to have a disproportionate preference for hybrid organizational forms. Teece (1986a) showed that hybrid organizational forms allow resource limited firms to gain control over co-specialized assets. This combination of features is likely to make franchising an attractive organizational form for competing in global markets.

Factors Influencing upon Foreign Market Entry Mode

The firm's choice of a particular foreign market entry mode is a function of a large number of diverse factors. It varies with product characteristics such as degree of differentiation, importance, age, and technological content (Davidson, 1982; Gatignon & Anderson, 1988; Goodnow, 1985; Stopford & Wells, 1972). It may depend upon certain firm characteristics such as size and resources, degree of diversification, and corporate policies (Davidson, 1982; Root, 1987; Stopford & Wells, 1972).

Entry mode choice by firms may also be determined by external environmental factors: host country trade and investment restrictions, host country market size, host country geographic and cultural distance, political stability, and exchange rate fluctuations (Aliber, 1970; Bauershmidt, Sullivan, & Gillespie, 1985; Gatignon & Anderson, 1988; Goodnow & Hansz, 1972; Root, 1987; Stopford & Wells, 1972). These product, firm, and environmental variables could be collectively referred to as non-behavioral determinants (Erramilli & Rao, 1990).

In another aspect of entry mode study, an emerging stream of literature (Aharoni, 1966; Cavusgil, 1980, 1982; Johanson & Vahlne, 1977) has been highlighting the role that behavioral factors play in a wide range of international marketing decisions, such as initial involvement in foreign markets, choice of country markets, and choice of foreign market entry modes. The focus of this literature, which could be called the behavioral theory approach, is on the decision maker's or the decision making unit's knowledge of foreign markets, and the perceptions, opinions, beliefs and attitudes born out of this knowledge or lack of it. Market knowledge can be defined as the knowledge relating to the market and the market influencing factors (Johanson & Vahlne, 1977).

Information Uncertainty

The limited amount of information available about international trade in services has assisted in the mystification of this importance and rapidly growing line of business. Unlike merchandise trade, the true volume of international services is not known (Wolfe, 1998). As a result, the management of service industries from a public policy and international trade and marketing perspectives remains complex and not well understood. Without this basic information, decision makers are handicapped in their deliberations, planning and negotiations to improve the global infrastructure for the entry mode decisions and marketing of services (Samiee, 1999).

International decision makers have to often make decisions in an unfamiliar environment characterized by paucity of reliable information (Mascarenhas, 1982). Lack of information and knowledge about a particular market creates uncertainty and heightens the risk perceived by decision makers in a given situation (Aharoni, 1966; Johanson & Vahlne, 1977). Under such circumstances, decision makers, who are seen as being risk averse, become cautious about committing substantial resources to the foreign market. On the other hand, familiarity of the foreign market reduces uncertainty, breeds self-confidence in decision makers, and consequently makes them more aggressive in their resource commitments (Cavusgil, 1982).

Proponents of the behavioral approach have suggested a generally positive relationship between the decision maker's knowledge of foreign markets and the level and pace of the firm's resource commitments to these foreign markets. Johanson and Vahlne (1977) postulate a direct relationship between market knowledge and market commitment (commitment of resources to a particular market). This relationship between market knowledge and resource commitment could be explained through the intervening variables of uncertainty and perceived risk.

Johanson and Vahlne (1977) make one further point by identifying two types of knowledge: objective and experiential knowledge. Objective knowledge is the one that could be taught through the indirect media and experiential knowledge is the one that could be acquired only through actual operational experience in the foreign market. The authors insist that it is experiential market knowledge that is critical in facilitating resource commitments. This, in fact, forms the basis for explaining the widely observed phenomenon of incremental internationalization, i.e., a gradual, step-by-step increase of a firm's involvement in a foreign market. It has been argued that firms increase their resource commitments in an individual foreign market not in large spectacular strides but in small incremental doses corresponding to each incremental increase in the firm's experiential knowledge (Cavusgil, 1982).

In addition to influencing the pattern of resource commitment, lack of market knowledge could lead to other kinds of behavior on the part of firms. Knowledge deficient firms may try to acquire experiential knowledge by teaming up with individuals and organizations outside the firm that possess such know-how. This means they will show a greater tendency to employ entry modes such as licensing, franchising, agent exports, and joint ventures.

In his study of foreign investment decisions in U.S. multinational corporations, Davidson (1982) empirically demonstrated how market uncertainty, caused by deficient market knowledge, could influence choice of entry modes by firms. In markets highly similar to the United States, i.e., markets about which U.S. firms can be expected to be very knowledgeable, such as Canada, United Kingdom, and Australia firms resorted to licensing and joint ventures to very little extent, preferring wholly owned subsidiaries instead. However, the usage rate of licensing and joint ventures rose dramatically for entries into countries that were less similar to the U.S.

Similarly, in their study of the foreign investment practices of American MNCs, Kogut and Singh (1988) found that cultural distance between the U.S. and the host country increased the probability of choosing a joint venture over an acquisition or a greenfield wholly owned subsidiary. Davidson (1982) also found licensing and joint ventures to be more strongly associated with firms that were inexperienced in a particular foreign market, that is, firms with little or no experiential market knowledge, compared to experienced firms.

A number of studies suggest that exporting is a less attractive option to gain access to foreign markets, especially for those firms that offer pure services, requiring some type of foreign direct investment to establish local presence quickly (Boddewyn et al., 1986; Vandermerwe & Chadwick, 1989; Zimmerman, 1999).

Environmental Uncertainty

Previous researches show that level of environmental uncertainty and risk in the host country affects the choice of entry modes (Brouthers, 1995; Contractor, 1990; Tse, Pan & Au, 1997). Pressures from external sources have crucial influences on the entry mode decisions and structures that firms pursue (Davis, Desai, & Francis, 2000). International service firms must deal with the environmental uncertainties and risks embodied in the contextual environment of the host country because the operations and decisions of organizations are inextricably bound up with the conditions of their environments (Pfeffer, 1972).

Environment can be defined as the network of individuals, groups, agencies, and organizations with which an organization interacts (Miles, Snow, & Pfeffer, 1974). Slattery and Olsen (1984) identified two set of environments - general and specific environment. The former

can be represented by a set of conditions such as economic, socio-cultural, political, and technological. The latter consists of customers, suppliers, competitors, and regulatory conditions.

In general, external environment makes it difficult to predict the future and increase the risk of performing business activities (Sashi & Karuppur, 2002). The international business environment has greater uncertainty than the domestic business environment. For example, the existence of two different government policies toward taxation or regulation lowers the stability of these regulations (Shane, 1996b). Currency misalignment, high rates of inflation, and transfer pricing make it difficult to measure performance across borders (Miller, 1992). Accordingly, firms commonly find international business opportunities to be inherently more risky than domestic ones (Ghoshal, 1987; Miller & Bromiley, 1990; Vernon, 1985; Werner, Brouthers, & Brouthers, 1996).

Often the international market environment can be very turbulent in regard to the acceptance and implementation of service concepts and goods. For example, as new goods and services are being introduced or developed, unanticipated anomalies invariably emerge. According to Hoskisson and Busenitz (2001), once they are released to the international market, the receptivity of an unfamiliar or a new product, concept, invention, or innovation is extremely difficult to predict; intended markets might reject a new product or alternative while unanticipated markets can emerge to adopt it. These issues suggest that environmental uncertainty has a substantial impact on the development, introduction and commercialization of international service firms' opportunities.

The term uncertainty as used in strategic management and organization theory refers to the unpredictability of environmental or organizational factors that have an impact on firm performance (Miles & Snow, 1978; Miller, 1993; Pfeffer & Salancik, 1978) or the inadequacy of

information about these variables (Duncan, 1972; Galbraith, 1977). Uncertainty can arise from exogenous shocks, unforeseeable behavioral choices, or combinations of the two (Lessard, 1988). Wilkinson and Nguyen (2003) particularly stress the firm's bounded rationality as a source of uncertainty, which limits its ability to anticipate all the consequences of its actions. Uncertainty is often described as a perceptual phenomenon derived from the inability to assign probabilities to future events, a lack of information about the cause and effect relationship and the inability to predict the outcome of a decision (Miller & Shamsie, 1999; Milliken, 1987). Miller (1992) states that uncertainty about environmental and organizational variables reduces the predictability of corporate performance, that is, increases risk.

Miller (1992, pp. 326-327) suggests that "the firm should attempt to establish an uncertainty exposure profile that optimizes its returns for the risk assumed." In relation with uncertainty, risk refers to variation and unpredictability in firm outcomes or performance variables that cannot be forecast *ex ante* (Miller, 1992). Managing risk is one of the primary objectives of firms operating internationally (Ghoshal, 1987). Managers generally associate risk with negative outcome variables (March & Shapira, 1987). Miller (1992) argued that risk, in fact, refers to a source of risk, e.g., political risk, since risk has frequently related to the factors either external or internal to the firm that impact on the risk experienced by the firm.

Noordewier, John, and Nevin (1990) described environmental uncertainty as the unanticipated changes in circumstances surrounding an exchange. There are different types of environmental uncertainties and risks according to the extent to which they can be controlled and managed by the firm through its organizational strategies (Shan, 1991). Root (1988) proposes to decompose the environment of the multinational enterprise into transactional (controllable) and contextual (uncontrollable) environments. Uncertainties and risks embodied in the contextual

environment might not be eliminated through expansion of the boundaries of the firm (Shan, 1991) since they are usually beyond the arm's length of firm's control (Root, 1988).

Transactional risks, on the other hand, arise internally from the opportunistic behavior of firms such as defaults on their obligations (Beamish & Banks, 1987). This research is concerned with both transactional and contextual type of environmental uncertainties and risks. The specific type of transactional uncertainties and risks is explained in chapter 3 from the agency theory and transaction cost economics perspective.

A contextual uncertainty related to foreign transactions includes the general stability risk (e.g., instability of political system), ownership/control risk (e.g., expropriation, intervention), operations risk (e.g., price control, local content requirements), and transfer risk (e.g., currency inconvertibility, remittance control) (Brewer, 1993; Root, 1994). General stability risk refers to management's uncertainty about the future viability of the host country's political system. Ownership/control risk is defined as management's uncertainty about host government actions affecting the entrant's ownership position. Operations risk refers to the possibility of sanctions that could constrain an investor's operations in the host country. Transfer risk is defined as limitations on the entrant's ability to transfer capital out of the host country (Root, 1994).

Miller (1992) viewed general environmental uncertainty as those variables that are consistent across all industries within a given country. Included in this factor are such as political risk, government policy uncertainty, economic uncertainty, social uncertainty, and natural uncertainty. Goodnow (1985) identified foreign market's opportunity, its economic development, political environment, geo-cultural environment, and comparative host country costs as external uncertainty factors. Herring (1983) described environmental uncertainty in terms of political instability, economic fluctuations, and currency changes of a country.

Reardon, Erramilli, and Dsouza (1996) examined the challenges and responses of service firms expanded internationally. They found that the most cited problems that consumer services face are host government restrictions, closely followed by cultural differences and marketing related problems. American firms, having sales of at least \$100 million and operating in two or more foreign countries regarded political stability as the most critical environmental factor, which is followed by foreign investment climate, profit remittances, and exchange controls (Kobrin, Bask, Blank, & Palombara, 1980). As such, general foreign market's characteristics are viewed as exogenous environmental factors (Goodnow, 1985; Root, 1994).

Previous research suggests that firms must select low ownership arrangements that provide flexibility when uncertainty is high (Anderson & Gatignon, 1986). In general, uncertainty can favor market relations (e.g., franchising) because they are more flexible mainly due to the fact that the ownership of productive assets may deprive the owner of the flexibility of low-cost exit from the market (Wilkinson & Nguyen, 2003). Kobrin (1982) also supports dependence on host country entity in the sense that the high switching costs associated with full ownership make this mode less flexible should change occur in host country conditions.

In the internationalization process, some firms perceive higher uncertainty and risk-levels and should enter via low control means or through those that involve relatively low resource commitments (Kim & Hwang, 1992). For example, Klein et al. (1990) found that Canadian firms were more likely use vertically integrated modes (e.g., full ownership) in the geographically and cultural close US market. Consistent with these findings, in his study on the international expansion of franchise systems, Hackett (1976) found that majority joint ventures were apparently formed in response to local laws, and minority joint ventures and 100 percent franchisee ownership were formed in order to reduce risk.

Gatignon and Anderson (1988), in the study of multinational corporation's degree of control over foreign subsidiaries, found that firms select low ownership arrangements (less integrated and less resource commitment) and take less control, or less risk entry modes that provide flexibility when uncertainty is high. Fladmoe-Lindquist and Jacque (1995) also found that higher levels of uncertainty in the host country contextual environment are difficult to control using wholly owned modes of entry.

Environmental uncertainty relates to the risks associated with entering less familiar markets and cultures (Wilkinson & Nguyen, 2003). Such risks are clearly difficult to control by the international service firm through traditional governance structures (Fladmoe & Jacque, 1995). In general, the contextual risks cause the firm to shy away from ownership because complete integration or full ownership exposes all the assets of the foreign investor to contextual risks (Shan, 1991). If such risks are unacceptable, the best the firm can do is to avoid them, as Williamson (1979) suggests. Firms should shun ownership and retain flexibility and shift risk to outsiders such conditions (Davis, Desai, & Francis, 2000).

To be flexible in response to unforeseeable future conditions firms use intermediaries (e.g., franchisees) rather than full integration (e.g., full ownership), as this converts the fixed costs of establishing internal operations into variable costs (Wilkinson & Nguyen, 2003). Also, it is easier to hire and fire intermediaries than it is to establish and de-establish an internal organization structure (Rindfleisch & Heide, 1997; Shelanski & Klein, 1995), which makes reliance on markets more efficient when uncertainty is high.

Service firms face different obstacles and uncertainties than manufacturing firms when expanding overseas. Control and logistical problems are inherent in services due to the natural inseparability and intangibility of services (Fryer, 1991). Since most services cannot be exported,

the home firm must work in close association with the subsidiary. While this is manageable in a domestic environment, it is difficult to achieve logistical and managerial support overseas. This truism exacerbates the managerial and administration problems encountered in international service firms (Reardon, Erramilli, & Dsouza, 1996).

Executives in international service companies have various ways of coping with an uncertain international business environment through the use of flexibility and control (Mascarenhas, 1982). There are possible trade-offs made by organizations in response to environmental uncertainty and dependence on host country entity (Koberg & Ungson, 1987). The literature suggests that teaming up with informed partners gives firms ready access to knowledge on local markets, and hence non-integrated and non-equity entry modes such as franchising are more efficient under conditions of high uncertainty (Anderson & Gatignon, 1986; Davidson, 1982; Hill, Hwang, & Kim, 1990; Johanson & Vahlne, 1977; Mascarenhas, 1982). Hence, service organizations facing high uncertainty resort to contractual arrangements (e.g., franchising) to ensure some stability in their planning process (Koberg & Ungson, 1987), especially when crossing a national border.

In going overseas, service firms face, in addition to domestic sources of environmental uncertainty, unfamiliar culture, political risk, and economic fluctuation. Unfamiliarity with operating in a new environment contributes to the uncertainty of the international environment that firm's face. In international operations, especially, environment uncertainty is a critical factor mainly due to the service characteristics. Services are people intensive, inseparable and perishable (Bowen & Jones, 1986; Erramilli & Rao, 1993). These attributes suggest that service firms require greater flexibility and control in order to deal with changes in the environment (Bowen & Jones, 1986; Habib & Victor, 1991).

Foreign firms may not realize value through an inter-firm transfer of their advantages, such as franchising, to indigenous firms, because the market sometimes fails to effectuate such transfers or because market transaction of these intangible assets frequently entails substantial cost (Teece, 1976, 1983). Therefore, in a country in which the cultural, political and economic systems differ greatly from its own, a foreign firm is more likely to cooperate with an indigenous firm which may have developed unique country and firm specific skills and advantages that are very costly, if not impossible, to duplicate by a foreign firm (Shan, 1991).

Foreign Market Entry Decisions in Service Sector

An internationalization strategy is often considered more risky for service firms than for manufacturers of goods (Carman & Langeard, 1980). One reason for this is that in many services the producer and the production facilities are part of service, which requires that the firm has greater control of its resources than would otherwise be the case (Palmer & Cole, 1995). Consistent with this view, according to Vandermerwe and Chadwick (1989), for services with a high consumer/producer interaction and a low involvement of goods, the underlying strategy is to gain high control through FDI, mergers, or acquisitions. Essentially, in these cases entry mode decisions are based on customer/market potential, country attractiveness, and risk factors, including political risk.

Several studies on the entry behavior of service firms have identified certain characteristics that are unique to service industry. The service sector is characterized by diverse patterns of internationalization (Boddewyn et al., 1986; Cowell, 1983; Shelp, 1981) due to the highly diverse nature of the services sector and inherent uniqueness of services. Delivery of services across national borders is dictated by the inherent nature of the service, the customer preferences, the attitudes of the host government, and the degree of control of operations (Zimmerman, 1999).

For example, in the service industry, advertising agencies, fast food chains, and software firms choose widely differing patterns of foreign market entry. Javalgi and White (2002) attribute results in widely differing trade and investment patterns to different degrees of service characteristics such as inseparability, intangibility, and standardization. As the corollary of that argument is that the decision of which mode of entry to use relies on the serviceness of the

offering and the degree of consumer/producer interaction (Clark & Rajaratnam, 1999; Ekeledo & Sivakumar, 1998; Erramilli & Rao, 1990; Vandermerwe & Chadwick, 1989).

Many international services are separable, meaning that their production and consumption occur independently and these services are exportable, whereas inseparable services are not exportable (Boddewyn et al., 1986; Erramilli & Rao, 1993; Sapir, 1982; Shelp, 1981). In this context, exporting of services is somewhat different from that of goods because services are intangible and inseparable. Bhagwati (1984), for example, contends that international trade in services is not all that different from merchandise trade. Storable, or hard services, are separable in that production and consumption may occur in different locations (Erramilli & Rao, 1993). More specifically, Erramilli (1990) proposes that hard services (e.g., software, engineering design, etc.) are producible in one country, storable in some tangible form, and exportable to another country.

At the international level of business, negotiations and operations become more complex (Carman & Langeard, 1980; Heskett, 1986). Such complexity can have a significant effect on the strategic ownership choices of international consumer service businesses. Carman and Langeard (1980) and Root (1987) contend that any form of export is impossible for service firms, presumably because production and consumption of services cannot be separated. Accordingly, service firms may engage in foreign production by producing and marketing their products within the host country. Many services are essentially location-bound, and can be provided to overseas customers only by producing them on foreign soil. In other words, consumer services are typically produced at the point of delivery that makes the actual exportation of a service difficult (Root, 1987).

While exporting of goods involves exporting an object to the target market, exporting of service requires embodying the service in a storage medium, such as cassettes or books that are tangible, and exporting the service-embedded object or using vehicle such as satellite stations or telephone wires to export the service to consumers in foreign locations (Ekeledo & Sivakumar, 1998). Knight (1999, p. 353) notes that “to the extent that tangibility component increases, it appears that the associated service, or critical element of it, can be physically exported to a distant buyer.”

Evidence suggests that the degree of tangibility and degree of involvement with clients in the service delivery are among the most salient features with which to consider the marketing of services internationally (Knight, 1999; Patterson & Cicic, 1995). Many services such as software, motion pictures, research and development, and architecture are exported in this fashion (Erramilli & Rao, 1990). The use of external agents and distributors is not uncommon for these services, although direct-to-customer export channels appear to be preferred modes. In markets with considerable export potential, the establishment of overseas sales and marketing subsidiaries is also common (Erramilli, 1992). However, these services are classed as hard services by Erramilli (1990) and fall outside the boundaries of this research.

Carman and Langeard (1980) and Root (1987) argue that service firms must choose from a more restricted set of modes made up only of contractual and investment entry. Erramilli (1990) also notes that soft services (e.g., health care, restaurant, car rental, etc.) are not exportable and therefore, are limited to entry modes such as franchising, joint ventures, and foreign direct investment. Sole ownership, joint venture, and franchising often require production in the host market, through either local partners or direct investment in production facilities in the local market (Ekeledo & Sivakumar, 1998).

For instance, many consumer services, e.g., fast food restaurants and hotels, are normally marketed to overseas customers through contractual methods such as franchising. Many kinds of professional services, e.g., management consulting, advertising, and accounting, are provided through foreign direct investment, which includes establishing joint ventures (also known as partnerships, consortia, or affiliates in the service sector) and wholly owned operations (which could be subsidiaries or branch offices) (Erramilli, 1992).

It is found that a firm's propensity to enter a foreign market through and owned subsidiary tends to increase with increases in the size of the market, the absence of possible partners in joint ventures or franchising, and the desire of the management to maintain control over foreign operations (Erramilli, 1991). Again, the viable entry mode for these types of services is some type of local presence that enables the firm to build some type of 'brick and mortar' facility through which services can be delivered (Erramilli & Rao, 1993; Knight, 1999; Vandermerwe & Chadwick, 1989). All in all, the greater the local presence of the service provider, the higher the propensity to respond to local demand swiftly and efficiently.

Foreign Market Entry Mode and Degree of Control

A mode of entry is a way of organizing and conducting international business transactions (Root, 1987). Firms entering new markets choose from a variety of different forms of entry, ranging from franchising, through exporting (directly or through independent channels), to foreign direct investment (joint venture, acquisitions, mergers, and new, wholly owned subsidiaries) (Erramilli, 1992; O' Farrell, Wood, & Zheng, 1998). Entry modes vary dramatically in the degree of control that the firm entering the market has over the resources, decision making, and rents associated with the business in the new market (Domke-Damonte, 2000). Franchising imply the lowest degree of control, and foreign direct investment with substantial equity participation, e.g., wholly owned subsidiaries, provides the most control (Erramilli & Rao, 1990).

Classical approaches to entry mode choice in relation with long-term strategic decisions emphasize choosing the option offering the highest risk adjusted return on investment in the feasible set (Anderson & Gatignon, 1986). Yet the literature on the entry mode choice makes little direct mention of risk or return. Instead, the issue is structured in terms of the degree of control each mode affords the entrant (Daniels, Ogram, & Radebaugh, 1982; Robinson, 1978; Robock, Simmonds, & Zwick, 1977; Vernon & Wells, 1976). Entry involves two interdependence decisions on location and mode of control. Exporting is domestically located and administratively controlled, foreign franchising is foreign located and contractually controlled, and FDI is foreign located and administratively controlled (Buckley & Casson 1998; Buckley & Pearce, 1979; Contractor, 1984).

Decision makers may compare the alternatives according to risk-return and cost-control trade-offs effect to evaluate factors influencing a foreign market entry mode choice (Anderson &

Gatignon, 1986; Goodnow, 1985; Root, 1987). Firms incur risks when entering a foreign market. For example, there exists a foreign market's business environmental risk caused by such changes as adverse political upheavals or unfavorable shifts in foreign exchange rate. The greater the business environmental risk, the higher the risk premium desired before entrance into a foreign market (Brewer, 1981; Shapiro, 1978).

The level of risk can be moderated by the type of control attained. Kwon and Konopa (1993) noted that there are two types of control. The first type of control is management control that is mainly a function of the ownership of the business entity. Management control is directly related to the ability and flexibility of decision making in the general area of management such as provision of service, marketing, administration, financing, research and development, and so forth. A second type of control is control of a market that is mainly a function of a firm's competitiveness. Hirsch (1976) suggested that if the cost of controlling and coordinating foreign operations is greater than the cost of controlling and coordinating domestic operations, and if that cost difference is correlated with the firm's intangible capital assets, it will retard foreign direct investment. In the realm of cost-control trade-offs, there also are additional studies which explain that the cost of doing business abroad is a major determinant of foreign market entry mode (Aliber, 1970; Buckley & Casson, 1981).

The literature has placed emphasis on the degree of control and cost of resource commitments preferred by organizations within each of these arrangements, with the general consensus that firms balance their choices between control and cost of resource commitment in deciding upon entry modes (Anderson & Gatignon, 1986) and that preserving flexibility is of paramount importance (Mascarenhas, 1982). Furthermore, Hill et al. (1990) contended that these

choices are really a tradeoff between preferences and link this tradeoff to a consideration of several environmental variables.

Entry modes differ from each other on key dimensions such as the amount of resource commitment, extent of risk, potential for returns, and degree of control (Root, 1987).

Traditionally, researchers have perceived control as flowing from ownership through resource commitment, even though there is growing recognition of non-equity or contract-based methods of acquiring control (Dunning, 1988; Dunning & McQueen, 1982). Thus the greater the firm's level of ownership, the greater the control it enjoys over its international transactions (Anderson & Gatignon, 1986). For this reason, company-owned channels, wholly owned foreign subsidiaries and branches are designed as full-control modes in our study. On the other hand, contractual transfers and joint ventures are termed shared-control modes.

Control refers to the ability to influence systems, methods, and decision and has a critical impact on the future of a foreign enterprise, while involvement refers to the level of market-specific managerial and financial resources committed to a foreign subsidiary by a firm (Anderson & Gatignon, 1986; Erramilli & Rao, 1990). Usually, there is a very strong correlation between a firm's level of involvement in a foreign subsidiary and the firm's control of the subsidiary (Anderson & Gatignon, 1986). Therefore, involvement is used interchangeably with control in the study of international entry mode (Ekeledo & Sivakumar, 1998). As a consequence, the higher a firm's level of involvement in the foreign subsidiary, the higher the firm's participation in, or the firm's closeness to, the foreign market.

Without control, a firm finds it more difficult to coordinate actions, carry out strategies, revise strategies, and resolve the disputes that invariably arise when two parties to a contract pursue their own interests (Davidson, 1982). Further, international firms can use its control to

obtain a larger share of the foreign enterprise's profits. In this vein, control is a way to obtain a higher return. Meanwhile, control carries a high price, while obviously desirable (Vernon, 1983). To take control, the entrant must assume responsibility for decision making, responsibility a firm may be unwilling or unable to carry out in an uncertain foreign environment (Anderson & Gatignon, 1986).

Control also entails commitment of resources, including high overhead. This in turn creates switching costs, reducing the firm's ability to change its institutional arrangement should its choice turn out to be sub optimal. Resource commitment also increases firm's exposure, i.e., the possibility of losses due to currency changes (Davidson, 1982). Thus, to assume control is also to assume some forms of risk.

It is useful to conceptualize firms as seeking entry modes that allow them to exercise maximum possible control over their foreign operations (Stopford & Wells, 1972; Vernon & Wells, 1976). Entry modes differ in the amount of control they provide the firm (Anderson & Gatignon, 1986; Calvet, 1984; Caves, 1982; Davison, 1982; Root, 1987). Typically, amount of control increases as a firm's resource commitment, and hence level of involvement, increase. Although exceptions to this observation could be found (Anderson & Gatignon, 1986), it is still a valid generalization to make (Root, 1987).

Generally speaking, firms preferring to maintain control over their foreign operations may have to choose entry modes with high involvement levels. But when faced with an unacceptable level of uncertainty and risk, decision makers try to reduce their involvement by cutting back on amount of resources, and/or by teaming up with outside agents, distributors, and partners, especially in the host country market (Aharoni 1966; Mascarenhas, 1982). In other words, they are willing to give up some of their control in return for lower uncertainty and risk.

Hence, focusing on control is consistent with the classical risk-adjusted return perspective (Agarwal & Ramaswami, 1992; Anderson & Gatignon, 1986).

There are many ways to gain control and many variations within any one form of entry mode (Hayashi, 1978; Kindleberger, 1984). For example, minority partner might exercise influence out of proportion to ownership, due to such factors as a special contractual arrangement, expertise, or status as a government body. Although there is no tested, accepted theory as to how much control each mode affords, both the management (Root, 1987) and the economic (Calvet, 1981; Caves, 1982) streams of research offer information as to the clustering of entry modes. Anderson and Gatignon (1986) grouped foreign entry modes into 17 levels in terms of the amount of control (high, medium, low) an entrant gains over the activities of a foreign business entity. Later, Erramilli and Rao (1990) further reduced foreign modes of entry into 9 groups according to the degree of control an international service firm can exercise over the operations of a foreign business unit.

Sampson and Snape (1985) contend that service businesses do not have the export option. Consequently, services businesses must focus on the decision of the firm's level of involvement in, or control of, the operations of the foreign subsidiary rather than the determination of the location of production facilities in the selection of entry mode – choosing between full-control or high-involvement modes and shared-control or low-involvement modes. Inability to use the export option has a significant impact on how services enter foreign markets because each entry mode is associated with a certain level of risk-return tradeoff.

Dominant equity interests such as company-owned subsidiary are expected to offer the highest degree of control to the entrant (Bivens & Lovell, 1966; Davidson, 1982; Friedman & Beguin, 1971; Killing, 1982; Root, 1987). In the case of a wholly owned subsidiary, control over

day-to-day operations and certain strategic decisions may be delegated to the foreign subsidiary, but ultimate control always resides at the firm's corporate office. In the case of a joint venture, the level of control is dependent on the ownership split and the number of parties involved. In any event, control must be shared with venture partners. Thus, the level of control will fall somewhere between that consistent with franchising and that consistent with a wholly owned subsidiary (Hill, Hwang, & Kim, 1990).

Balanced interests such as equal partnership are shown as medium-control modes based on the notion of a credible commitment (Williamson, 1983) or hostage. Friedman and Beguin (1971) assert that forming a venture with a high likelihood of trouble such as equal partnerships will have difficulty locating a suitable partner. To attract a partner, the entrant may need to put up something to lose, a sort of good-faith collateral, known as credible commitment. For example, in a slightly unbalanced venture, the over 50% partner may concede favorable contract clauses such as veto power. These clauses can be so favorable that a firm may have more control with a 49% share than a 51% share.

Or the commitment may be the most critical positions in the foreign entity; the exposed partner can demand to fill them with its own personnel, a method preferred by Japanese multinationals (Hayashi, 1978). In a 50-50 relationship, the hostage is a peculiar one – the venture itself. Friedman and Beguin (1971) point out that equality in equity capital can “lend a special feeling of partnership to the two partners” (p. 372), adding “the risk of deadlock itself acts as a powerful incentive to the partners, encouraging them to find solutions to disagreements by discussion and compromise” (p. 377).

In certain nonequity modes, moderate control comes from daily involvement in the operation and from expertise (Anderson & Gatignon, 1986). In the case of franchising, control

over operations and strategy is granted to the franchisee in exchange for a lump-sum payment, a per-unit royalty fee, and a commitment to abide by any terms set out in the franchising contract (Hill, Hwang, & Kim, 1990). The terms of the contract may impose some limit on the operating and strategic decisions of the franchisee, but given the nature of contracting and bounded rationality, these are unlikely to be all-embracing (Williamson, 1985). It offers lowest degree of control comparing to joint venture and wholly owned subsidiary. Meanwhile, in contract management, the entrant performs specified functions and has representation on the management committee that oversees the venture's activities.

In sum, entry modes differ from each other on dimensions such as amount of resource commitment, extent of risk, potential for returns, and degree of control (Anderson & Gatignon, 1986; Kotler, 1988; Root, 1987). One characteristic that encompasses all of these attributes is the degree of vertical integration associated with the modes of entry. Many studies (Anderson & Coughlan, 1987; Anderson & Gatignon, 1986; Gatignon & Anderson, 1988) have viewed the choice of entry mode as a problem of choosing the degree to which international business transactions are vertically integrated. Integration implies ownership of the export channel or foreign operation (Erramilli, 1992). Export modes such as direct-to-customer channels and overseas sales subsidiaries, and foreign production modes such as branch offices and wholly owned subsidiaries represent integrated entry modes.

On the other hand, exporting through intermediaries, contractual transfers and joint ventures, represent nonintegrated modes of entry. Other authors have used similar classifications (Anderson & Coughlan, 1987; Anderson & Gatignon, 1986; Davidson & McFetridge, 1985; Gatignon & Anderson, 1988). Generally speaking, integrated modes entail higher degree of

control, which require a greater commitment of resources and carry bigger risk but promise higher returns to the firm.

The viewpoint adopted in this study is that international entry mode choices are most usefully and tractably viewed as a tradeoff between control and the cost of resource commitments, often under conditions of considerable risk and environmental uncertainty. Preserving flexibility should be a major consideration of most firms in making the tradeoff (Mascarenhas, 1982). Flexibility, the ability to change systems and methods quickly and at a low cost, is always an important consideration, particularly in lesser-known foreign markets, where the entrant is likely to change systems and methods as it learns the new environment. This view is consistent with Holton (1971), who argues that control, risk, and flexibility are principal considerations.

Foreign Market Entry Mode and Firm Performance

The performance of entry mode selection to a firm's competitive advantage in a new international market has been studied widely, yet the majority of these studies have not examined mode performance. Comparative entry mode research explicitly measuring performance in international settings has been sparse, owing to the difficulty associated with collecting valid and reliable data for a firm's international subsidiary performance.

Among previous researches, in manufacturing sector, relating equity modes (e.g., acquisition, joint venture, new venture) of foreign ownership and control strategies to performance, Woodcock, Beamish, and Makino (1994) found that different equity-based entry modes have different performance levels, suggesting that joint ventures and greenfield ventures reduce the impact of acquisition risk. They also found that the new venture mode outperforms the joint venture mode and the joint venture mode outperforms the acquisition mode. These results support previous studies that have attempted to assess the relationship between performance and entry mode by Li and Guisinger (1991) and Simmonds (1990) in a domestic setting.

Suggesting the same cost/risk relationships as in Woodcock, Beamish, and Makino (1994), Nitsch, Beamish, and Makino (1996), and Anand and Delios (1997) found that, on average, joint ventures and greenfield ventures provided better performance than did acquisitions. Pan, Li, and Tse (1999) examined foreign firms in China, and found that equity joint ventures performed better than contractual joint ventures, but wholly-owned subsidiaries did not. Using similar data sets and arguments to Pan, Li, and Tse (1999), Pan and Chi (1999) found that equity joint ventures had higher performance than contractual joint ventures or wholly-owned modes.

Brouthers, Brouthers, and Werner (2000) attempted to use multiple measures of perceived environmental uncertainty (hereafter, often abbreviated as PEU) to determine the entry mode choices of firms and link these risk-adjusted mode choices to managerial satisfaction with firm performance. They found that MNCs are substantially more satisfied with their internationalization performance outcomes by taking multiple dimensions of international risk into account when selecting their entry mode strategy. Their findings also reinforce the idea that entry mode choice has both a significant direct and an indirect influence on satisfaction with firm performance. These empirical studies, however, did only examine performance differences between equity-entry modes in manufacturing industry.

The franchise system might be considered as a portfolio of operating units (Markland & Furst, 1974) that constantly attuned to reflect changing costs and revenue opportunities (Anderson, 1984). Seeing that resource scarcity (Carney & Gedajlovic, 1991) explains, as capital and management constraints are relaxed, franchisors would become more concerned with the profitability and managerial control of a maturing organization through the processes involving adjustments in the quantity and quality of establishments that are company owned (Anderson, 1984).

Oxenfeldt and Kelly (1968-1969) conjectured that company-owned establishments would tend to dominate performance in the more mature business areas. As a successful franchise mature, the company has increased opportunities and resources to exercise organizational and financial changes that redefine its share of establishments to maximize its best interests. Greater ownership is thought to accomplish this by giving the company higher profits and greater control.

In the franchise system, several empirical studies have investigated the relationship between organizational form and performance based upon the resource scarcity perspective, in which franchise development was that successful franchise systems would tend toward complete company ownership (Dahlstrom & Nygaard, 1994; O' Hara & Thomas, 1986; Thomas, O' Hara, & Musgrave, 1990). Support for resource scarcity is provided by Thomas, O' Hara, and Musgrave (1990), who found that high unit sales, which spread monitoring costs over more sales dollars, cause units to be converted company-owned status.

Martin (1988) supports some of the conjectures and conclusions of earlier works regarding the growth of company-owned shares of franchise establishments. Franchising life-cycle functions are estimated using firm-specific data on 949 organizations in 16 sectors during the period from 1969 to 1986. Although Martin found that the company-owned units outperformed the franchised units in three-to-one ratio including restaurants and hotels, the proportion of company-owned outlets is found to decline in the long run.

Using aggregate time series data covering more than a decade and 17 different business areas, Anderson (1984) empirically tested performance difference between company owned and franchisee owned subsidiaries and conclude that there is little evidence to support contentions that comprehensive performance differentials exist between company and franchise establishments. He also stated that although there are some mature business areas, such as automotive services and soft drink bottlers, where company-owned establishments have superior performance, there are others, such as restaurants and convenience stores, where they do not.

Rubin (1978) and Wattel (1968) contend that because of the owner profit incentive, franchisees are more likely to be sensitive to the day-to-day usage of resources, costs, and specific market conditions that affect unit performance. Their studies are further supported by

Marquardt and Murdock (1986) who argue that franchised establishments outperform company-owned units because independent franchisees are more motivated to work, mainly due to their equity investments being at risk. Shelton (1967) found this to be true in a study of restaurants, where he concluded that the establishments of independent franchisee-owners outperformed those supervised by company managers, even when their compensation was linked to unit profits.

On the contrary, a study conducted by Huo (1994) reveals different results from the previous studies. He investigated the relationship between internal environment, organizational form, and financial performance in hotel chains using contingency framework. The result shows that hotel chains operating under different organizational form do not differ in their financial performance. The other findings of this study indicate that hotel chains that showed a match between the monitoring cost of their internal environmental factors and organizational form perform better than if those elements do not match. However, capital scarcity and asset specificity prove to be no effect on firm's performance measured in terms of return on investment and growth in unit sales.

Research evidence appears inconclusive regarding which organizational form has better performance. Moreover, despite this evidence, few researchers have explicitly measured and compared the performance of the various international entry modes, and fewer still have attempted to develop a parsimonious theoretical argument for performance differences in an international setting.

The extant research on international entry modes has examined the contingent relationship between environment and selected entry mode, and focused on explaining the fit between the environment and its organizational form. Contingency theory suggests that the

selected entry mode must conform to the particular industry, firm and the country factors faced by the entering firm. The contingency perspective also delineates relationships not only the influence of the selection of entry modes, but also their performance and profitability. In line with contingency theory, it has been predicted that the firm's international performance will be higher when the firm's organizational form matches its environmental factors such as firm characteristics, industry specific factors and country factors.

To date, however, no study has explicitly investigated the relationship between international ownership structure and performance in the hospitality industry. The objective of this study is to discern which international entry mode in general outperforms others in terms of degree of control exercised, given that the firms have selected the entry modes based on specific contingent positions. This study develops a generalized theoretical argument applicable to international environments, and then tests the arguments with an international sample based upon three entry modes, company-owned subsidiary, joint venture, and franchising.

Summary

In summary, the research into the strategic management of service units by international service companies is limited. Existing research tends to either examine the impact of the role of service production on the economy, or describe the international experiences of specific service industries. General research on services focuses on conceptual frameworks or on normative discussions of the internal management of a service providing organization. This thesis will attempt to advance the research by developing and testing a model that will explain the differences in the pattern of usage among company-owned, joint venture, and franchising agreements by international service companies.

CHAPTER 3

THEORETICAL FRAMEWORKS AND PROPOSITIONS

Introduction

A conceptual framework is a logically developed, described, and elaborated network of associations among concepts that have been identified through theoretical and empirical research, in which the relationships between the independent and dependent concepts are elaborated, usually with an indication of whether the relationships would be positive or negative (Sekaran, 1992). A conceptual framework indicates how a researcher perceives the phenomena being investigated, and which factors and how they influence the phenomena (Anderson, 1997).

On the other hand, a theory is a systematically related set of statements, including some lawlike generalizations, that is empirically testable (Bacharach, 1989; Fry & Smith, 1987). The purpose of theory is to increase scientific understanding through a systematized structure capable of both explaining and predicting phenomena (Hunt, 1991). Anderson (1997) contends that a theory can be represented by various conceptual frameworks.

Hobbs (1996) states that a theoretical framework enables predictions to be made about the likely outcomes of different business strategies and observed business behavior to be evaluated. Therefore theoretical framework need to provide better explanations of the motivations for firms' behavior and the consequences for efficiency. In this regard, when undertaking any analysis, it is helpful to have a framework within which to work and from which testable hypotheses can be drawn.

Porter (1990) claimed "...little is known about international competition in services" (p. 240). Porter's statement reflects the fact that for international services, theory lags practice by a considerable degree. The nature of international services is so diverse that no single, all-

encompassing theory will likely emerge (Clark et al., 1996). This is plausible since no all-explaining theory exists for products either.

In particular, Anderson (1997) states concerning the phenomena of foreign ownership strategies and control modes in international service distribution, “there is also no general agreement on what should be labeled as theory, conceptual framework, or paradigm” (p. 30). This phenomenon can be explained by the fact that intangible, perishable, heterogeneous, inseparable and culturally sensitive aspects of services are all likely to pose special problems in relation with the foreign market entry question in service industry as scholars attempt to define and operationalize appropriate constructs and construct measures.

Services theory is likely to be complex and can benefit from investigation into the literature of several domains (Knight, 1999) since services encompass such a wide range of activities that they would seem to defy generalization. As Clark et al. (1996) argued this may partially account for why marketing scholars have been relatively slow to devise externally valid theories on international services. Given that much of the work to date in international services regarding institutional arrangements has been devoid of theory and conceptualizing, it is appropriate to investigate the explanatory value of existing theories.

When a firm seeks to perform a business function outside its domestic market, it must first choose the best entry mode into the foreign market. The choice of entry mode into a foreign market has a significant impact on the success of a firm’s international operations. The existing literature on the entry mode decision has either presented a list of considerations without identifying underlying constructs or treated each entry mode decision in isolation.

Obviously, there could exist for each firm a corporate governance adequate for each entry mode, as well as, an environment particular for a determined choice. Van de Ven (1989)

recommends adoption of multiple independent thought trials to improve our theorizing. Aspects of marketing, economics, and organizational study are all important for developing insights into how different organizational arrangements in international services distribution emerge and for understanding the consequences of these arrangements for industry efficiency and competitiveness (Hobbs, 1996). Though there are many existing factors to consider in this decision, Palenzuela and Bobillo (1999) state that “one should to seek a simplified theory with sufficient explicative strength concerning the entrance of the firm into the foreign markets” (p. 62).

Based on control as the central factor in the entry mode choice and given its relationship with the contingency factors and performance, it seems appropriate to build a simplified theory by unifying different theoretical explanation, which coincides with a great number of explicable factors. A unifying framework is developed in which three underlying constructs that influence the entry mode decision are identified. Especially, the proposed framework conceptualizes optimal level of ownership and control mode as a response by the firm to the interplay of three level of environments (firm, industry, and national) and as a determinant of firm’ s performance.

This chapter discusses a theoretical framework for the study of the relationships among environmental factors, foreign ownership and control modes, and firm’ s performance. According to Anderson (1997), the selection of frameworks will be based of the author’ s perception of the most important contributions to explain entry modes. The author addresses this suggestion and four theoretical frameworks are used in this research. Three-tiered theoretical approach captures the impact of firm, industry, and national context on entry mode and its relationship with performance.

Agency framework is used to test issues at the firm context. Especially agent framework is concerned with the relationships between the principal (i.e., the firm) and the agent (i.e., the service provider). The transaction cost framework is used at the industry context to examine the pattern of differences in ownership strategies that may be a result of differences in asset specificity. At the national context, a resource dependence framework is used to test the impact of country level effects. To encompass all the factors that could influence foreign ownership and control modes, and thereby to increase the explanatory power, the contingency theory is likely to be preferred.

The proposed model suggests different perspectives from previous frameworks of entry mode choice in several important ways. First, proposed model treats foreign ownership strategies and control modes as an important mediating factor influencing firm's performance. The suggested model also examines not only direct effects of internal and external factors on entry mode choice but also treats industry factors as an important contingency factor in influencing entry mode choice.

The second distinguishing feature of the proposed model is that it investigates further division of each service class. For example, internationally traded services can be divided into hard services (separable services, e.g., music cassettes) and soft services (inseparable services, e.g., restaurant and hotel services), as explained by Erramilli (1990). While hard services are represented by services embedded in goods or delivered through technological vehicles, it is extremely difficult or even impossible to decouple production and consumption for soft services such as restaurants and hotels. As Shelp (1981), Sapir (1982), and Boddewyn et al. (1986) have shown, some services can be tradable or exportable. This is possible because production and

consumption of these services can be separated. Such subcategories of a product are likely to influence entry mode strategies also.

The third salient feature of the proposed model is that it accommodated service characteristics. The entry choice models by Douglas and Craig (1995), Goodnow (1985), and Root (1994) suggest that the same variables apply equally to goods and services. Hence, the boundaries between goods and services are not always clear; many goods have a significant service component, and many services have a significant goods component (Bhagwati, 1984). However, researchers broadly agree that there are important differences between goods and services (Zeithaml, Parasuraman, & Berry, 1985). That point is captured by Shostack's intangible dominant entities. In other words, a product whose source of core benefit is intangible is a service (Berry & Parasuraman, 1991; Zeithaml & Bitner, 2000).

The extent of information asymmetry also varies with the characteristics of a service. This effect can be examined by differentiating services in terms of the mix of three attributes: search, experience, and credence qualities (Darby & Karni, 1973; Holmström, 1985; Nelson, 1970, 1974; Wilde, 1981; Zeithaml, 1981). Nayyar (1993) classifies fast-food restaurants as search services and hotels as experience services. Search qualities are attributes that potential buyers can determine prior to purchase and experience qualities are determinable only after the purchase of a service or during its consumption.

In hospitality services, the output appears less difficult to isolate or quantify, which make it less difficult compared to majority of intellectual services, if not impossible, for the customer to measure it from the elements attributed by relatively highly standardized essential evidence and service. Thus we can say that the hospitality services will be located in the category of search or experience qualities, insofar as the customer is not faced with a strong asymmetry of

information as in the case of highly customized or professional services (customer has less information and knowledge of the problem than the service provider).

Agency Theory

The classical agency theory problem was posed by Berle and Gardiner (1932), who observed that ownership and control had become separated in larger corporations as a result of the dilution in equity positions. Jensen and Meckling (1976) paper was expressly concerned with the separation of ownership from control. They defined an agency relationship as the principals' delegation of decision-making power to others (agents) who are charged with acting on their behalf. An agency relationship is present whenever one party (the principal), who are in control of a set of economic functions or assets in some form of ownership or property rights, depends on another party (the agent) to undertake some action on the principal's behalf (Ross, 1973).

Principle-agent theory arises in a business management context associated with behavioral studies of employer-contractor or employer-employee interactions (Harris & Raviv, 1978). Hence, any employment relationship is an agency relationship. Day-to-day control of business functions or assets has been delegated, by the principals, to agents who operate them on their behalf (Jensen & Meckling, 1976). The agency problem arises when agents will not have exactly the same objectives and motivation as principals and will be tempted to divert resources away from their principals to themselves (Hutchinson, 1999). This situation provided an opportunity for professional managers, as those in control, to act in their own best interest (Walsh & Sward, 1990).

Early work in agency theory centered on dilemmas of dealing with incomplete information in insurance industry contracts (Ross, 1973; Spence & Zeckhauser, 1971). The theory was generalized to dilemmas associated with contracts in other contexts (Harris & Raviv, 1978; Jensen & Meckling, 1976). The central dilemma investigated by principal-agent theorists is how to get the employee or contractor (agent) to act in the best interests of the principal (the

employer) when the employee or contractor has an informational advantage over the principal and has different interests from the principal.

Centered on this dilemma, given virtually any transaction can be viewed as being governed by an implicit and explicit contract (Leitzel, 1989), agency costs are a type of transaction cost, reflecting the fact that without cost, it is impossible for principals to ensure agents will act in the principals' interest (Arrow, 1985; Williamson, 1988). Agency costs include the costs of investigating and selecting appropriate agents, gaining information to set performance standards, monitoring agents, bonding payments by the agents, and residual losses (Jensen & Meckling, 1976).

The central issue for agency theory is how to resolve the conflict between owners and managers over the control of corporate resources (Jensen, 1989) through the use of contracts which seek to allocate decision rights and incentives (Rumelt, Schendel, & Teece, 1994). On the other hand, marketers heavily rely on independent agencies whose services are contractual basis to perform some of the work involved in unit operations. Each of these contractual arrangements involves an agency relationship (Bergen, Dutta, & Walker, 1992).

Agency relationships are pervasive in business transactions and the agency relationship is a significant component of almost all transactions (Arrow, 1985). This is particularly true because most of goods and services are distributed through intermediaries such as wholesalers, retailers, or franchisees who act as agents of the franchisor (Bergen, Dutta, & Walker, 1992).

In this study, the theoretical framework in the firm context that will be used to develop testable hypotheses is principal-agent theory. Principal-agent theory is concerned with the ability of the principal (e.g., a service corporation) to evaluate and control the behavior of an agent (e.g., a service unit) (Eisenhardt, 1989; Levinthal, 1988). The general problem of evaluation arises

when such evaluation is difficult or expensive to conduct and there is a lack of goal congruence and asymmetry of risk preferences between the principal and agent (Jensen & Meckling, 1976). Under these conditions, agents may engage in deceptive behavior such as shirking or misrepresentation of skills and abilities (Brickley & Dark, 1987).

Moreover, efficient agency relationships can be even more difficult to achieve in international markets than in domestic markets because cross-cultural disparities magnify the problems of uncertainty, asymmetric information, and monitoring (Bergen, Dutta, & Walker, 1992). As service firms cross the national borders, such opportunistic behavior by the service units can magnify the risk for the service company, and the design of appropriate control mechanisms and compensation packages takes on added importance. As a result, the control of potentially opportunistic behavior of foreign agents or moral hazard of firm's employees is a central concern of international service companies.

This framework is useful for testing the relationship between a company and its service units because the value of a service company's intangible assets can be adversely affected by the behavior of service units (Hutchinson, 1999). Asset intangibility is a particular feature of the service sector, with its trademark, product brands, business formats and managerial technology, goodwill, reputation, research and development, and advertising, all of which are embedded information (Doherty & Quinn, 1999). Another particular major benefit of agency framework in the international service distribution context is its emphasis on the significance of the information transfer process, the information asymmetry problem and ensuing monitoring costs. These factors are regarded as central to foreign entry mode choice decision (Doherty, 1999).

The principal-agent framework focuses on the contract between principal and agent and assumes that principals and agents will choose the most efficient contract alternative, given

assumptions about people (e.g., self-interest, bounded rationality, risk aversion), organizations (e.g., goal conflict among members), and information (e.g., information as a commodity) (Eisenhardt, 1989; Jensen & Meckling, 1976). This framework has been extended to include the relationship between employer-employee, buyer-supplier, and other agency relationships (Harris & Raviv, 1978).

In addition, the ultimate customer also can be viewed as engaging in an agency relationship as he or she attempts to gain accurate product information and desired product benefits from a supplier who may be viewed as his or her agent (Coughlan, 1988; Devinney, 1988). Specially, the crux of the framework is on determining more efficient governance of relationship between behavior-oriented contract (e.g., hierarchical governance) and outcome-oriented contract (e.g., transfer of property rights, market governance) (Eisenhardt, 1989).

The theory assumes that there is at least partial goal incongruence and disparity in risk preference between principal and agent. Under conditions of incomplete information and uncertainty, which characterize most business settings, at least two agency problems arise; adverse selection and moral hazard (Shane, 1998b). The following are the key dimensions of agency theory: 1) information asymmetry; 2) behavioral uncertainty; 3) differing attitudes toward risk; and 4) information as a commodity (Eisenhardt 1989; Levinthal, 1988).

As Jensen and Meckling (1976) argued, agency problems arise from the information asymmetry that results from the division of labor between the principal and the agent and from the potential goal conflict and risk preferences of the two parties. Information asymmetries arise when one party has information the other desires but does not have.

For example, the information asymmetry problem exists in the principal-agent relationship because agents, being in day-to-day control of a company, have detailed knowledge

of its operations. The principals have neither access to this knowledge, nor, in many cases, the ability to interpret information, if access was perfect. The problem is that self-interest makes the agent unwilling to share the information with the principal, or may induce the agent to provide the principal with false information (Bergen, Dutta, & Walker, 1992; Doherty & Quinn, 1999).

Doherty (1999) has asserted that the simplicity or complexity of the information transfer process, with its corollary for the information asymmetry problem, has a central role to play in explaining foreign market entry mode. The complex regulatory, economic, social, cultural boundaries which characterize the international service context, coupled with the profusion of specific intangible assets, can either ease or complicate the information transfer process, thus attenuating or accentuating the information asymmetry problem.

Agency theory partitions behavioral uncertainty into two parts, moral hazard (hidden action) and adverse selection (hidden information) (Arrow, 1985). Moral hazard arises through a lack of effort (shirking) on the part of the agent and the inability of the principal to adequately monitor an agent's actions. Moral hazard is the potential for agents to operate in their own self-interests against the objectives of the principals (Doherty & Quinn, 1999). Managers cannot completely substitute for owners because their lack of ownership incentives leads them to shirk (Alchian & Demsetz, 1972). As a result of insufficient information, it is possible for the agent to perform at less than the promised level of competency.

Consequently, principals require an effective mechanism to control agent behavior before entering into a principal-agent relationship. One effective mechanism involves monitoring agent behavior. When a firm grows from a simple structure to a professional management structure, the ratio of monitors to production workers increases, raising the cost of monitoring (Silver &

Auster, 1969). This means that, as the opportunities for moral hazard increase, the firm must expend greater resources on monitoring to deter it.

Agents can engage in two types of moral hazard: sub-optimal effort and misdirected effort (Shane, 1996a). Since employees are paid a fixed wage, they have an incentive to put forth only as much as effort as is necessary to ensure that they get paid. They also have an incentive to misdirect effort to personal goals like obtaining perks or leisure time (Shane, 1996a). This behavior is partly based on the assumption of self-interest, i.e. that agents shirk responsibility when it is difficult or costly to evaluate the agent's efforts.

Adverse-selection refers to intentional misrepresentation of skills and abilities by the agent and/or the principal to the other (Eisenhardt, 1988). The problem of adverse-selection arises partly as a result of the difficulty of verifying statements by either party. Potential new employees have different training and innate abilities and so differ in their capabilities. Therefore, firms face uncertainty about the quality of potential new employees (Coyte, 1984) and adverse selection requires firms to incur costs to differentiate more qualified applicants from the less qualified (Levinthal, 1988). Potential new employees have an incentive to cause the firms to believe that they have the appropriate skills, training, and backgrounds for the most desirable jobs even if they do not. Given this incentive for adverse selection, the firms must incur costs in gathering information to determine which jobs are appropriate to which new employees (Prescott & Visscher, 1980).

The cost of gathering information to overcome this adverse selection problem grows greater in international level mainly because the monitoring cost of owned units increases with unit dispersion (Carney & Gedajlovic, 1991). As the franchising contract makes franchisee wealth largely dependent on the residual income at individual outlets, it has been argued that

franchising is a screening device to weed out applicants who lack the necessary managerial skills (Norton, 1988a). Thus the use of franchising helps firms attract the requisite human capital for its outlets (Sen, 1998).

In contrast, when firms seek to overcome managerial limits to firm growth through the use of contractual organizational forms (market contracts) such as franchising, in the absence of adequate information and costly monitoring, agents may present a more positive image of themselves or their financial position than is actually true. At the international level, adverse-selection can be a concern for firms (Fladmoe-Lindquist & Jacque, 1995). As a result of local financial laws and cultural norms, it can be complicated to verify the accuracy of the information provided by the potential franchisee.

Risk preference can be thought of as the degree of an individual's or firm's preference for adventure rather than security (Arrow, 1974a; Pratt, 1964). There is a considerable disparity in risk preferences and goal congruence between principal and agent, which lead them to take disparate courses of action. A risk-averse party favors security and thus seeks some assurance of the attainment of desirable effects or insurance against the occurrence of adverse outcomes. A risk-neutral party is indifferent to adventure or security (Bergen, Dutta, & Walker, 1992).

The theory presumes that in general, an agent is risk averse or at least more risk averse than the principal-whereas the principal is risk neutral or at least more neutral than the agent (Harris & Raviv, 1979; Picard, 1987). This rationale is based on belief that principals can more easily decrease risk through diversification of investments than the agents, who are less able to diversify their employment (Bergen, Dutta, & Walker, 1992). The assumption of principal risk neutrality may be modified, however, to define the principal as risk averse (Eisenhardt, 1989). A risk averse principal is likely to transfer risk to the agent and, if the risk averse behavior of the

agent remains constant or also increases, it may lead to increased goal conflict between principal and agent as each tries to transfer risk to the other (Fladmoe-Lindquist, 1991).

Information, the fourth point, is viewed as a purchasable commodity that has a cost and may be used by the principal to control the opportunistic behavior of an agent (Eisenhardt, 1989). Such information systems include, but are not limited to, budgeting methods, reporting procedures, and management methods. It is suggested that such information systems are more likely in an internalized relationship (hierarchical governance) due to monitoring problems than under a market-based contract (market governance) that can only focus on performance outcomes (Fladmoe-Lindquist, 1991).

Since franchisees are compensated through residual claimancy on the profits of a firm and employees are compensated through wages, each is motivated by different goals and may, therefore, behave different ways (Eisenhardt, 1988, 1989). As a result, under conditions of uncertainty, firms (principals) cannot be sure that employees are acting in their interests without incurring monitoring costs to do so. This situation gives rise to intrinsic agency problems of adverse selection and moral hazard (Jensen & Meckling, 1976).

An ideal organizational design would eradicate problem of adverse selection and moral hazard. There are three solutions to these problems. First, the compensation package in principal-agent theory is considered to be the most important tool to align the behavior of the agent with the preferences of the principal (Arai, 1989; Eisenhardt, 1988; John & Weitz, 1989). Second, the principals tend to increase the amount of information about the agents' behavior by monitoring the agent. The more information the principal has, the harder it becomes for agent to shirk or misrepresent abilities (Eisenhardt, 1988).

Agency theory proposes another solution to agency problems such as moral hazard, which is to replace wage contracts with hybrid organizational arrangements like franchising that provide residual claimancy to employees. Residual claimancy aligns the employees' goals with those of the principal and reduces the problems of moral hazard and adverse selection (Jensen, 1983). Previous studies (e.g., Brickley & Dark, 1987; Mathewson & Winter, 1985; Norton, 1988a) identified the monitoring of managers to be a central motivation to franchise. For instance, Brickley and Dark (1987) suggest franchising is more efficient than using company-owned outlets when there is environmental uncertainty and when it is difficult for the firms to monitor the behavior of individual outlets.

Contract arrangements such as franchising are intended to achieve goal alignment by placing the primary risk of failure from shirking or moral hazard on the financial shoulders of the franchisee by tying the profits of the service outlet to the performance of the agent-franchisee (Justis & Judd, 1989; Martin, 1988); Monitoring costs in the form of royalty payments and fees which try to account for the potential for moral hazard. Given transaction specific assets invested by franchisees which cannot be redeployable for other business purposes, non-performance penalties and franchise cancellation clauses also are used as tools to align agent behavior with principal preferences (Fladmoe-Lindquist, 1991).

Agency theory provides a theoretical context in which to examine the effect of hybrid organizational arrangements (i.e., franchising) on firm growth since it examines the relative efficiency of hiring employees and making them owners (Alchian & Demsetz, 1972). Thus, franchising provides firms with a hybrid form of organization that minimizes the cost of effectively monitoring operations under certain circumstances (Klein, Crawford, & Alchian, 1978; Mathewson & Winter, 1985; Rubin, 1978).

As Norton (1988b) argues, contractual organizational forms deter moral hazard and adverse selection at a lower monitoring cost than is incurred when company-owned retail outlets are used. Larson (1992) found that new and growing firms, in general, tend to have a disproportionate preference for hybrid organizational forms. Teece (1986a) showed that hybrid organizational forms allow resource limited firms to gain control over co-specialized assets.

Agency theory can help identify conditions in which franchising leads to greater channel efficiency than do other alternatives, such as a wholly-owned subsidiary (Bergen, Dutta, & Walker, 1992). Especially, business format franchising is a hybrid organizational form that incorporates elements of both markets and hierarchies (Williamson, 1991a). It is a hybrid alternative since franchising combines decentralized ownership and control at the production stage of a service, together with the centralized provision of operating procedures and know-how, promotion of a brand name, locations of outlets and contracts with independent agents to operate the units (Child, 1987). Such an institutional arrangement is of paramount and growing importance in the service sector vis-à-vis intangible properties and idiosyncratic nature of inseparable production and consumption process (Thompson, 1992).

Extant empirical work uses ownership choice issue to identify the apparent sources of monitoring and agency costs. Agency theory interprets franchising as a response to agency problems associated with the geographic dispersion of units in a retail chain (Brickley & Dark, 1987; Brickley, Dark, & Weisbach, 1991; Castrogiovanni & Justis, 1998; Caves & Murphy, 1976; Combs & Castrogiovanni, 1994; Dant, Kaufmann, & Paswan, 1992; Hopkinson & Hogarth-Scott, 1999; Lafontaine 1992; Lal, 1990; Martin, 1988; Mathewson & Winter, 1985; Minkler, 1990; Norton 1988a, 1988b; Rubin 1978; Sen, 1993; Thompson, 1992).

Brickley and Dark (1987) and Sen (1998) found that the propensity to franchise restaurants increased with distance from company headquarters to outlet location, which makes personal monitoring so much more difficult. Norton (1988a) also found rural location and local establishment size and labor intensity to promote franchising, but he reported substantial inter-industry variation. Minkler (1990) found that franchising dominated where the owner would otherwise be vulnerable to manager opportunism, while Krueger (1991) investigated the difference in compensation between company-owned and franchisee-owned fast food restaurants and reported that it was associated with higher supervisory wage costs.

Empirical analyses of ownership structure in franchising typically rely on the agency-theory approach (Brickley & Dark, 1987; Lafontaine 1992; Norton 1988b). Analyses focus on risk sharing and efficient reduction of monitoring costs arising from moral hazards as primary considerations shaping ownership structure. Franchising enables the principal to share the risk inherent in an unfamiliar foreign environment and to take advantage of the franchisee's greater information about local conditions (Bergen, Dutta, Walker, 1992). In addition, franchisees are more likely to control unit variable costs tightly and are more highly motivated than company managers who receive most of their incomes as a fixed salary (Carney & Gedajlovic, 1991).

According to agency framework, managers of owned units have less than a strong incentive to perform efficiently because a substantial proportion of their compensation is a fixed salary (Brickley & Dark, 1987). Due to moral hazard, which arises through intentional lack of effort on the part of the agent and inability of the principal to adequately monitor the agent's performance, this form of compensation constitutes a low powered incentive (Williamson, 1985). While a principal can gauge the financial performance of a unit by reviewing periodic accounting data, it cannot reliably know whether to attribute performance levels to managerial effort or to

other factors beyond its agent's control. Consequently, unit managers must be directly monitored by field staff to ensure that managers are performing in line with agreed upon standards which is a costly administrative burden to the principal. Shirking is an inevitable cost of fixed wage contracts and costly monitoring, and thus an argument for the existence of franchising (Minkler, 1990).

In contrast, franchising provides an aligned incentive system since franchisees are compensated by residual claims on their own unit. Though company-owned outlets do not necessitate sharing profit with an intermediary, such profit sharing provides strong incentives for franchisees to operate efficiently (Bergen, Dutta, & Walker, 1992). As a result, the franchisee has a dual incentive to maximize revenues through effective management and promotion of the franchise concept while minimizing variable costs (Fladmoe-Lindquist & Jacque, 1995). The franchisor has a symmetrical incentive to promote gross sales through appropriate promotion as royalties are based on a percentage of gross sales rather than tied to residual net income.

Viewed from the perspective of agency theory, the franchise contract is designed to maximize the relational qualities of the exchange. Contract provisions are the means of ensuring goal congruence, or align mutual interests that would otherwise diverge (Hopkinson & Hogarth-Scott, 1999). The franchisor's rights of termination which is typical in franchise contract thwart the potential for cost-saving quality deterioration by the franchisee and so control the externality problem of local damage to the brand's reputation by enforcing quality standards (Thompson, 1992). Hopkinson and Hogarth-Scott (1999) depict franchise contract as a "sleeping mediator" in that the contract provides for the control and resolution of conflict that can be anticipated.

The fee payments of franchising help incentive compatibility. Thompson (1994) points out that the upfront fixed costs help to guarantee pre-operational dedication from the franchisee.

In addition, the franchisee's initial fees in the franchise or brand are only recovered over time (Hopkinson & Hogarth-Scott, 1999). Thus the franchisee's sunk costs function as a hostage to secure performance (Williamson, 1984). In this regard, the need to remain within the relationship with the intention of attaining the deferred benefits provides an incentive to fulfill contractual obligations. Consequently, the need for monitoring is reduced as the franchisee's effort is largely self-enforced.

While the availability of both financial and human capital inputs for the establishment of an outlet, the system-wide success of the chain only be assured if the unit managers maintain the operational norms stipulated by the company (Sen, 1998). If managers fail to maintain these guidelines, it is unlikely that the company can provide the chain-wide consistency that customers expect in their search process (Rubin, 1990).

Within a vertically integrated system, the only way a company can attain consistency beyond country boundaries is by strictly monitoring activities at all outlets. This is particularly onerous in the service industry, which requires a greater degree of human interface with its customers to overcome the intangibility problem (Berry & Clark, 1986; Zeithaml, Parasuraman, & Berry, 1985). Thus, the system expansion by adding outlets might be thwarted because of the inherent monitoring costs to ensure system-wide uniformity of the entire chain.

In an international setting such monitoring costs are increased by two unique variables, geographical and cultural distance (Alon & McKee, 1999a). As a consequence of monitoring problem caused by geographical and cultural distance, the opportunity for moral hazard and adverse selection increase in foreign operation. Employees tend to act opportunistically by shirking and providing less than the appropriate level of effort, because their compensation is independent of their output (Hennart, 1982).

Employees are not residual claimants on the output of the firm and have an incentive to do no more than the amount required by management, which requires managers need to monitor employees to ensure that they perform at a minimum acceptable level (Hennart, 1986). Hence, unless the company is able to monitor the behavior of managers in foreign units effectively, the increase in margin gained by ownership is not sufficient to offset the greater efficiency of franchisees (Bergen, Dutta, & Walker, 1992).

In contrast, franchisee opportunism tends to take other forms. Effective monitoring mechanisms for franchisees are different from those for employees. Franchisee opportunism is most likely to take one of two forms: inefficient investment and free riding off the efforts of others. Franchisees underinvest in assets that have spillover effects to other foreign outlets, because these spillovers cannot be fully appropriated (Carney & Gedajlovic, 1991). Franchisees shirk on product quality, because the gains from shirking accrue solely to the shirker and the costs are borne by all members of the franchise system (Klein, 1980; Norton, 1988a). Therefore, franchisors need to monitor franchisees to prevent inefficient investment and free riding.

The difference between effective mechanisms for monitoring employees and franchisees means that firms must develop particular unique mechanisms for monitoring employees and franchisees behavior. Following proposition was derived from the agency theory perspective:

Proposition 1:

The costs of monitoring effort of the firm are related to the choice of ownership and control modes of foreign affiliates.

Transaction Cost Theory

Much research conducted in internationalization area has sought economic rationale behind entry mode decisions. This approach considers the firm as an efficiency seeking entity that chooses governance forms that minimize its costs of coordinating transactions. Accordingly, the selection of foreign entry mode has been theorized to be a cost minimizing choice between alternate forms of organization ranging from contracts to internalized business methods (Contractor, 1990). Quinn and Doherty (2000) note that the economics-based theoretical frameworks that have been developed for conceptualizing domestic service distribution have yet to be developed in an international context.

The second level of the model examines the effect of industry-wide concerns on the ownership and control alternatives from the perspective of transaction cost analysis (TCA). One of the Coase's (1937) initial propositions was that firms and markets are alternative governance structures that differ in their transaction costs. Specifically, Coase proposes that under certain conditions, the costs of conducting economic exchange in a market may exceed the costs of organizing the exchange within a firm. In this spirit, TCA (Williamson, 1975, 1979, 1981a) concerns the question of when a function is more efficiently performed within a firm (vertical integration) versus across independent entities (market contracting). In recent years, TCA is concerned with the contractual relations between firms and each of their (internal and external) constituencies with respect to economizing transaction costs (Rumelt, Schendel, & Teece, 1994).

Arrow (1969) has defined transaction costs as the "cost of organizing the economic system." Consistent with Arrow (1969), transaction costs can also refer to the "costs of running the system" (Rindfleisch & Heide, 1997) or simply "the costs of carrying out any exchange" (Hobbs, 1996), whether between firms in a marketplace or a transfer of resources between stages

in a vertically integrated firm. Stated more precisely, transaction costs refers to such ex ante costs as drafting and negotiating a contingent claims contract, and such ex post costs as monitoring and enforcing agreements to ensure against immoral pursuit of self-interest (Hill, 1990; Jones & Hill, 1988; Rindfleisch & Heide, 1997). Thus, transaction costs include actual and opportunistic costs of transacting under various governance structures (Anderson, 1985). If the potential transaction costs associated with carrying out safeguarding, adaptation, and evaluation processes incurred in the course of market exchange outweigh the bureaucratic costs of managing an exchange within a hierarchy, it is more efficient to coordinate the exchange within a hierarchy (Heide, 1994; Jones & Hill, 1988; Williamson, 1985).

The particular ownership structure or control modes (governance structure, a term used in TCA) depend on the comparative transaction costs rather than production costs. The TCA views the firm as a governance structure. The term governance has been defined very broadly as a mode of organizing transactions (Williamson & Ouchi, 1981). A more precise delineation of the concept is offered by Palay (1984), who defines it as “a shorthand expression for the institutional framework in which contracts are initiated, negotiated, monitored, adapted, and terminated” (p. 265).

Moe (1984) and Williamson (1985) have used similar definitions of governance. Palay (1984) viewed contract as a very broad sense, and does not necessarily describe a formalized, legally binding document. Stated differently, governance encompasses the initiation, termination and ongoing relationship maintenance between a set of parties (Heide, 1994). Essentially, governance includes elements of establishing and structuring exchange relationships as well as aspects of monitoring and enforcement.

The TCA approach begins with the assumption that under competitive markets, market-contracting arrangements, or low-control modes, are favored because threat of replacement forces suppliers to perform efficiently. Under restricted bargaining market, however, wholly-owned operations or full-control modes are favored because the firm can significantly reduce its transaction costs by replacing external suppliers with its own employees, whose behavior it can monitor and control more effectively (Hennart, 1989). Thus, market failure is the primary antecedent to the firm's decision to integrate and assume greater control. In TCA, market failure means that integration is more efficient than market contracting, not that the market mechanism cannot be used (Anderson, 1985). From the transaction-cost perspective, the most important determinant of market failure is the presence of transaction-specific assets (Klein, Frazier, & Roth, 1990; Williamson, 1986).

According to Williamson (1975), the preference for hierarchical governance over independent market agents becomes more pronounced when two sets of moderating factors broadly termed as environmental and human factors co-exist in the marketplace. The environmental factors are uncertainty and small numbers of market agents, while human factors are the bounded rationality of the firm's managers, which limits their ability to foresee all future contingencies and potential opportunistic behavior by foreign agents (Beamish & Banks, 1987). This risk is greater when there exists a small numbers bargaining problem (Williamson, 1979).

The sources of negotiating, monitoring, and enforcement costs are the transaction difficulties that may be present in the exchange process (Klein, Crawford, & Alchian, 1978; Williamson, 1975). The key concepts to this framework producing transaction difficulties are two behavioral assumptions about transacting parties: bounded rationality and opportunism.

Williamson and others have focused on the role of opportunism and the bounded rationality (limited capability of individuals, i.e., cognitive limitations) in processing information.

Bounded rationality argues that although people may intend to make a rational decision, their capacity to evaluate accurately all possible decision alternatives is physically limited (Simon, 1961). It is difficult to identify, gather and analyze all of the information necessary to be able to make a fully informed choice. Thus bounded rationality poses a problem only in situations of complexity or uncertainty where the ability of people to make a fully rational decision is impeded (Hobbs, 1996).

The second behavioral assumption is opportunism. One of the central assumptions underlying this theory is the belief that the risk of opportunism is inherent in many transactions. This assumption suggests that neither contracting party can be relied upon to voluntarily provide complete information or to bargain fairly. Opportunism has been defined by Williamson (1979) as “self-interest seeking with guile” (p. 234). Williamson (1985) further explains that “this includes but is scarcely limited to more blatant forms, such as lying, stealing, and cheating... More generally, opportunism refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse” (p. 47). In other words, it recognizes that businesses and individuals will sometimes seek to exploit a situation to their own advantages. This does not imply that all those involved in transactions act opportunistically all of the time, rather, it recognizes that the risk of opportunism is often present (Hobbs, 1996).

Opportunism plays a key role in the choice of cost minimizing governance structure because without it cooperation will be the norm between parties to an exchange and promise will suffice to safeguard market transactions (Williamson, 1985). In other words, without

opportunism the economic rationale for coordinating an exchange within a hierarchy would be substantially reduced. However, Williamson assumed that if asset specificity is high, the risk of opportunism is often great enough to warrant replacing the market with a hierarchy. Such opportunism is considered by Williamson (1985) to create a strategic type of uncertainty that acts as an exogenous disturbance on the transaction. The concept of strategic refers to intentional, ex ante behavior. As a result of strategic self-interested actions, contract renegotiations become costly as each party attempts to hide information from the other.

Along with behavioral factors producing transaction difficulties, Williamson (1979) describes four key determinants of the cost of a transaction, which affect the choice of institutional alternative. These key characteristics of transactions are: 1) the degree of uncertainty surrounding the transaction; 2) the degree of asset specificity; 3) the frequency of the transaction (small numbers of bargaining); 4) information asymmetry (information impactedness). Of these four dimensions, asset specificity is considered to be the most critical determinant of transaction costs and is referred to as the engine that drives the entire system of transaction cost analysis (Williamson, 1991b).

Klein, Crawford, and Alchian (1972) and Williamson (1979) suggest that market failure (hence integration) is mainly caused by the presence of valuable transaction specific assets. Transaction-specific assets refers to nonredeployable physical and human investments in assets that are specialized and unique to the requirements of a particular exchange relationship and thus are valuable only in a narrow range of alternative uses: the higher the redeployability of the asset, the lower the specificity (Anderson, 1985; Anderson & Gatignon, 1986; Jones & Hill, 1988).

Idiosyncratic nature of asset specificity gives rise to safeguarding problem, in the sense that systems should be organized to minimize the risk of ensuing opportunistic exploitation (Klein, Crawford, & Alchian, 1978; Williamson, 1985). The low specificity reduces the risk associated with any given transaction, and theoretically, it should lead to more efficient transactions. On the other hand, for assets with low redeployability (high specificity), such as highly specialized production equipment, or highly skilled workers, or investments in R&D and marketing, the knowledge within the factor markets concerning the present and future value of the assets will be very limited, thus increasing the cost of the transaction (Simerly & Li, 2000).

As the potential for asset specificity rises, the possibility of a bilateral trading relationship increases along with the resultant costs primarily due to opportunism by either negotiator. At this point it may become more efficient for a firm to shift those activities from the marketplace to the hierarchy of the firm, and internalize those functions. However, if levels of asset specificity are low, it is more efficient for organizations to contract in the marketplace. The fundamental issue in TCA is whether a particular transaction is more efficiently undertaken within a hierarchy of organization or by the marketplace. In essence, the question of TCA rests on the most efficient governance structure for a set of activities (Williamson, 1985).

Asset specificity may occur in four different ways: physical, site, dedicated, and human (Williamson, 1985). Physical assets include those assets that are mobile but highly specialized for a particular transaction. Such assets include investment in equipment necessary for the provision of a particular company's business format, but not used commonly by other service firms in the same business. Physical asset specificity might also exist if the service company utilizes some type of advance technology that is not used by others in the same business.

Site-specific assets are immobile assets that are located in close proximity to each other in an attempt to economize on inventory and transportation expenses. In the area of services, site-specific assets would include a geographic location that is an important part of the service. This type of asset specificity is of lesser concern to consumer services than it is to professional services that attempt to locate near their primary client.

Dedicated assets refer to capital investments made based on a belief that a current arrangement with a specific party will continue into the future. Such assets in services might include the expansion of the physical plant to comply with new design standards (e.g., the redesign of the McDonald's restaurants) or the purchase of specialized equipment to expand a corporate mandated menu (e.g., addition of a breakfast line or salad bar to a fast-food menu).

Less attention has been paid to the role of human assets since discussions of TCA typically have been centered on manufacturing (Anderson & Schmittlein, 1984). Transaction specific assets are also relevant to human nature (Monteverde & Teece, 1982a; Williamson, 1981a). Human assets involve special-purpose skills and knowledge as well as working relationships, which are procured through a learning process and create specific human capital (Anderson, 1985). Human assets are key to the production of a goods or the provision of a service. Such skills and knowledge would include specific procedures for preparing and serving food that are part of the business format. In business format services, personnel management and training methods are often part of the overall format package and must be adhered to or the franchise risks the loss of its contact.

Another dimension causing difficulties in a transaction is uncertainty. A low level of uncertainty lends itself to market transactions. In contrast, highly uncertain transaction such as quality characteristics may result in a more formal type of vertical co-ordination, where one

party has more control over the outcome of the transaction (Hobbs, 1996). As uncertainty increases, it becomes more costly for the contracting parties to pursue a transaction with a fully specified contract, particularly under the behavioral assumption of bounded rationality.

Williamson highlights two forms of uncertainties – environmental (1979) and internal (1981a) uncertainty. Consistent with Williamson (1979, 1981a), TCA specified the circumstances surrounding an exchange as *ex ante* (i.e., environmental uncertainty), and *ex post* (i.e., internal uncertainty). Environmental uncertainty is a result of the impact of the external environment on the transactions. This dimension is a property of the decision circumstance within which transaction takes place (Heide, 1994). This complicates negotiating and enforcing contingent claims contracts since the environment shifts in unpredictable ways. The market contract is advantageous unless transaction assets are specific to a considerable degree (Anderson & Schmittlein, 1984). Williamson (1979) also suggests that firms should react to volatility in their environment by avoiding ownership and retaining flexibility by shifting risk to outsiders.

The primary consequence of external uncertainty is an adaptation problem. An adaptation problem arises because relevant contingencies are unpredictable to be specified *ex ante* in a contract (Rubin, 1990). Modifying agreements to shifting circumstances is onerous since even the best contracts are curtailed (Rindfleisch & Heide, 1997). Within a TCA framework, the key determinant of a firm's governance decision is the interaction between environmental uncertainty and specific assets. Hence, the likelihood of vertical integration is expected to increase, given significant transaction specific assets, with increasing uncertainty because adaptation can be made without revision of agreements between transacting parties (Anderson & Schmittlein, 1984; Williamson, 1979).

In contrast, internal uncertainty (Williamson, 1981a) refers to the problems of behavioral opportunism. The effect of behavioral uncertainty or performance ambiguity is intricacy of performance evaluation, that is, difficulties in verifying whether compliance with established agreements has taken place (Alchian & Demsetz, 1972; Rindfleisch & Heide, 1997). Alchian and Demsetz (1972) call the difficulty with which individual productivity can be gauged. Although monitoring performance can be done by contracting to provide service to other parties, output measures of the contractor's performance is often inadequate. Consequently, the hierarchical control procedures available through internal organization are assumed a priori to have evaluation capabilities (Anderson & Schmittlein, 1984).

Frequency, the third dimension of TCA, involves the number of discrete interactions involved in a particular activity. The transaction cost theory is based on the notion of market imperfections that result in integrated structures being a more preferred form of organization than relying on market mechanisms. However, a specialized governance mechanism can be costly, which involves significant setup and maintenance costs. As transactions become more infrequent, the incentive to act opportunistically and to exploit any information asymmetries increases. For rarely occurring transactions, losses from opportunism and inflexibility are likely to be lower than the incremental overhead costs of internalization (Anderson & Schmittlein, 1984).

According to Williamson (1985), higher levels of transaction frequency provide an incentive for firms to employ hierarchical governance, because "the cost of specialized governance structures will be easier to recover for large transactions of a recurring kind" (p. 60). Therefore, the cost of specialized governance structures becomes more desirable and is easier to recover if the transactions recur with considerable frequency since potential losses from not

integrating outweigh the overhead costs of integration (Anderson & Schmittlein, 1984; Klein, 1989).

To date, only a few TCA studies (e.g., Klein, 1989) explicitly address transaction frequency. Several studies have failed to confirm the hypothesized effects of frequency and find any positive association between transaction frequency and hierarchical governance (Anderson, 1985; Anderson & Schmittlein, 1984; Maltz, 1993, 1994). Hobbs (1996) contended that when transactions are carried out frequently, both buyer and seller will probably value repeat business and will not wish to tarnish their reputations by acting opportunistically. Frequent transactions also provide buyers and sellers with information about one another. For these reasons, frequent and repeated transactions tend to be carried out in the spot market.

Drawing on the economics of information literature (Akerlof, 1970; Stigler, 1961), TCA recognizes that many business exchanges are characterized by incomplete, imperfect or asymmetrical information. Information asymmetry (information incompleteness or impactedness) refers to the situation where all parties to a transaction face the same, but incomplete, levels of information. Therefore, they all face the same uncertainty. Information asymmetry arises when there is public private information available to all parties but also private information which is only available to selected parties, so that all parties to the transaction no longer possess the same levels of information (Jones & Hill, 1988).

Information asymmetries can lead to opportunistic behavior in two ways. The first involves ex ante opportunism where information is hidden prior to a transaction. This is known as “adverse selection” and was first defined by Akerlof (1970) in his seminal paper on the market for “lemons.” Akerlof suggested that in a situation of asymmetric information, a seller may possess information about defects in a product (e.g., a faulty second-hand car or “lemons”) that is

not available to the potential buyer. As a result, the seller can act opportunistically by failing to reveal these defects to the buyer prior to the transaction.

Hidden information can lead to adverse selection and problems of opportunistic behavior. In some countries, contract law mitigates the problem of adverse selection, providing some protection to the buyer. Moral hazard also arises from information asymmetry. This is *ex post* opportunism which occurs after a transaction because of the hidden actions of individuals or firms. These parties may have the incentive to act opportunistically to increase their economic welfare because their actions are not directly observable by other parties.

The joining effects of different combination of sources of transaction costs give rise to specific transaction difficulties. When joined with bounded rationality, external uncertainty, and asset specificity, the risk of opportunism suggests that participants to an exchange may attempt to expropriate the quasi rent that persuaded others to enter the exchange in the first place (Alchian & Woodward, 1988). A quasi rent is the excess above the returns necessary to maintain a resource in current operation. It can be the means to recover sunk costs, such those that result from investments in specific assets.

The combination of opportunism with small numbers bargaining conditions makes market transaction dicey to perform efficiently (Williamson, 1979). When a small numbers condition prevails it can be presumed that one or the other of the transacting parties will act opportunistically, such as by demanding a higher price than that previously agreed. The proclivity of opportunism will be more likely if transaction specific assets is involved or information asymmetry is substantial. Arrow (1974b) suggests that such possibility could be insured against if both trading parties signed a comprehensive contingent claims contract.

However, as Jones and Hill (1988) contended, bounded rationality in an uncertain environment makes safeguarding unfeasible or costly to achieve.

According to the original framework of TCA, firms can organize their business transactions through a discrete choice between market exchange (no integration) and internal organization (full integration). Expanding on Williamson's initial description of markets versus hierarchies, TCA has been extended in recent years to cover a range of control rather than the extremes of integrate or market contract (Anderson & Gatignon, 1986; Williamson, 1985); the governance features of internal organization can be achieved without ownership or complete vertical integration by some other mode reflecting an intermediate degree of integration within the context of interfirm relationships (Heide, 1994).

Drawing on Macneil (1978), Williamson (1985) has suggested that governance structures can be arrayed on a continuum of relationalism, anchored by the market and hierarchy at the polar extremes. As suggested by Stinchcombe (1985), unilateral provisions can be built into contracts that are essentially the functional equivalents of an organizational hierarchy. Macneil (1980) made the general assumption that bilateral elements are required for a set of parties to project their exchange into the future. The extant models of bilateral governance applied the basic concept to relations between firms (Barney & Ouchi, 1986).

In Macneil's (1978, 1980) typology of discrete versus relational exchange, discrete exchange is consistent with the concept of market and hierarchy proposed by TCA, in which individual transactions are assumed to be independent of past and future relations between the contracting parties (Goldberg, 1976). Put in different way, individuals pursue their interests vigorously (opportunism in TCA), and depend on economic and lawful sanctions for the purpose of enforcing contractual obligations.

Relational exchange, in contrast, views enforcement of obligations as following from the mutuality of interest that exists between a set of parties within the historical and social context in which transactions take place (Dwyer, Schurr, & Oh, 1987; Kaufmann & Stern, 1988).

Relational exchange appears to capture the spirit of a bilateral power system (Bonoma, 1976), in which individual goals concern for the long-run benefit of the system serves through joint accomplishments as a restraint on individual tendencies to pursue their self-interest in an opportunistic fashion. For instance, Thorelli (1986) contends that reciprocal interdependence and trust are at the nucleus of most successful franchise systems based on standing relationships and a complete network of linkages between system members.

Implicitly, the theory of relational contracting (i.e., bilateral contracting) is based on a recognized need for adapting relationships to changing circumstances (Heide, 1994), and as such parallels some of the adaptation arguments proposed in TCA. In addition, bilateral trading relationships can be crafted that minimize potential governance problems in the first place (Williamson, 1991a).

The importance of bilateral governance is emphasized in Ouchi's (1979) hypothesis that bilateral structures are superior in their ability to deal with performance ambiguity. In addition, bilateral governance is efficient for the purpose of dealing with certain forms of uncertainty (Noordewier, John, & Nevin, 1990). This research stream focuses on how governance problems can be handled without common ownership (i.e., complete integration).

There are a number of in-between ownership and control modes (hybrid mechanisms) at either end of the spectrum of market and hierarchy. As several studies have shown, firms may use a wide range of transaction forms in implementing cooperative strategies (Anderson & Gatignon, 1986; Contractor & Lorange, 1988). Joskow (1987) investigates the role of asset

specificity in determining the length of contracts between coal suppliers and electric utilities. Other important contract-based TCA studies include Leffler and Rucker (1991) and Palay (1984).

Following the analysis of Thorelli (1986), Osborn and Baughn (1990) separated various forms of cooperation into quasi-market (market dominated) and quasi-hierarchy (hierarchy dominated) forms. Contractual agreements to sell or provide service or products (e.g., franchising) are market-dominated. Joint venture, on the other hand, can be viewed as quasi-hierarchies. The hybrid governance mechanisms have been ranged from formal mechanisms, such as contractual provisions and equity arrangements (Joskow, 1987; Osborn & Baughn, 1990), to more informal mechanisms, such as information sharing and joint planning (Noordewier, John, & Nevin, 1990; Palay, 1984).

As the primary alternative to vertical integration as a solution to the general problem of opportunistic behavior, the use of contractual arrangements has been explored and provided important applications of TCA by investigating long-term, bilateral exchange relationships (e.g., franchising). According to Klein, Crawford, Alchian (1978), a main building block of the contractual alternative to hierarchy is the goodwill market-enforcement mechanism, namely, the imposition of a capital loss by the withdrawal of anticipated future business. Macaulay (1963) provides evidence that transactions are generally performed based upon an implicit type of long-term contract that employ a market rather than explicitly stated legal enforcement mechanism since contingencies cannot be easily identified or even inexpensively specified and legal redress is costly.

The international business aspect of the debate started with Hymer's seminal thesis (1976), wherein he contended that for foreign investment to take place, a firm needed to have a

source of monopoly power that enabled it to bear the higher cost of operating and competing against a local firm in a foreign market. The entry mode literature has been enriched by the contributions of Anderson and Gatignon (1986), and Gatignon and Anderson (1988). They have proposed a theoretical framework, transaction cost analysis, which combines elements of industrial organization, organizational theory, and contract law. Since this theory forms the one of the basis for the present study, it is highlighted below.

Anderson and Gatignon (1986) treat the choice of entry modes as a question of choosing the degree to which international business transactions are vertically integrated. On the one hand, there are several types of contractual entry modes that represent little or no integration. At the other extreme lie modes such as wholly owned subsidiaries that represent full integration. In between these two extremes lie many intermediate modes of entry, representing different degrees of integration. The authors attempt to recognize the degree of integration that is most efficient in the long run for a firm in a particular setting. They propose that integration is favored when certain transaction specific assets accumulate, when the external and internal uncertainty is low, and when there exists a potential for free riding by agents and intermediaries.

Gatignon and Anderson (1988) empirically demonstrated that the propensity to integration increases with increasing proprietary content of products, advertising expenditures, and company's experience abroad. On the other hand, firms' proclivity to lower degree of integration increase with increasing host country risk, host country's cultural distance from the US, and scale of operations of foreign business entity.

Anderson and Gatignon (1986) postulate that, in choosing foreign entry modes, firms make trade-offs between control (benefit of integration) and cost of resource commitments (cost of integration). TCA predicts that firms integrate when asset specificity is high and firms restrain

from integration when specificity is low because the benefits of integration (control) fall short of the costs of attaining it. In this context, the benefits of integration under market failure must be compared with the costs of integration because establishment of an integrated operation entails significant internal organization or bureaucratic costs. High overhead costs caused by integration process also results in high switching costs. As such, control is assumed to carry a high price.

The TCA also predicts a positive relationship between asset specificity and propensity for high-control foreign ownership and control modes. The strength of relationship is, however, contingent upon the influence of moderating factors that affect the relative costs and benefits of integration, such as external uncertainty (Anderson & Gatignon, 1986, Kogut & Singh, 1988, Erramilli & Rao, 1993), internal uncertainty (Anderson & Gatignon, 1986), and firm size (Erramilli & Rao, 1993).

Erramilli and Rao (1993) contend that the asset specificity of transaction increases as the service becomes more idiosyncratic, being characterized by high levels of professional skills, specialized know-how, and customization. For inseparable services, especially when service variability or heterogeneity arises, high-specificity firms would likely source services internally (full integration) because of the unique training required for providing the service, and the necessity to control quality for potential service variability during service encounters (Murray & Kotabe, 1999).

As a consequence, for those services that have high asset specificity, they should be sourced internally (integrated). As the service requires major investments in providing training to employees for skills and specialized know-how, the source of supply is limited and the terms for securing the supply of such services are unfavorable (Williamson, 1985). Indeed, transactions of this kind pose a greater risk to the service firm if the supplier does not deliver the service

according to the specification or render the service on time, because alternative sources of supply are either limited or unavailable.

Meanwhile, for inseparable services providing a more standardized service, the firm can rely on market governance because the firm would not need to be stuck with the current supplier since locating alternative suppliers who would invest in specific assets for the services immediately is not relatively difficult (Murray & Kotabe, 1999).

High costs of integration may not be strictly true in the case of many (although no all) service firms, especially in the professional and business services sector (e.g., advertising agencies and management consultants) (Erramilli and Rao, 1993). It must be also emphasized that there are service firms for which integration entails large-scale investments in physical facilities (high transaction specific assets) such service industries as hospitals, hotels, and airlines. Thus, when considering moderating factors, control can be acquired at comparatively low expense.

TCA is an analytical paradigm whose primary subject matter is the design of efficient governance mechanisms for supporting transaction. At the core of the paradigm are the axioms that certain exchange characteristics give rise to transaction difficulties and that different governance mechanisms exist that have different cost-minimizing properties (Williamson, 1985).

For the purposes, the key dimension of transaction is the presence of transaction specific assets. They are assets dedicated to a particular relationship and involve sunk costs that would be nonredeployable in the event of termination. As argued by Klein, Crawford, and Alchian (1978), transaction specific investments create a significant hold-up potential, which would be exploited opportunistically unless appropriate safeguards are designed. The most prominent safeguard in

TCA is vertical integration, which attenuates opportunistic appropriation of quasi-rents by virtue of the employment relation that is created (Levy, 1985).

The economic framework underlying TCA provides considerable insights for foreign ownership strategies and control modes of service firms. A proposition regarding choice of entry modes and their relationships with firms' performance was devised using the theoretical framework of TCA.

Proposition 2:

The transaction specific assets of the firm have an impact on the choice of ownership and control modes of foreign affiliates.

Resource Dependence Theory

In the management literature, the external environment can be broadly defined as “the totality of physical and social factors that are taken directly into consideration in the decision-making behavior of individuals in organizations” (Duncan, 1972, p. 314). Kreiser and Marino (2002) note that while the individual components that constitute each researcher’s conception of the environment are not always the same, each conception agrees that the diverse environmental elements act to spawn uncertainty for the firms.

The environment may be viewed as a multidimensional construct (Child, 1972; Dess & Beard, 1984; Duncan, 1972; Hrebiniak & Joyce, 1985; Lawrence & Lorsch, 1967a; Milliken, 1987; Mintzberg, 1979; Thompson, 1967), which includes complexity (referred to as ‘heterogeneity’ by Thompson, 1967), dynamism, and hostility (referred to as ‘munificence’ by Dess & Beard, 1984 and as ‘illiberality’ by Child, 1972). To form a more comprehensive view of uncertainty, multidimensional operationalizations of uncertainty were developed (Boyd, 1990; Boyd & Fulk, 1996; Dess & Beard, 1984; Duncan, 1972; Gerloff, Muir, & Bodensteiner, 1991; Lawless & Finch, 1989; Sharfman & Dean, 1991; Tan & Litschert, 1994; Tung, 1979).

Environmental complexity and dynamism have been closely linked to the information uncertainty perspective (Lawrence & Lorsch, 1967a; Thompson, 1967), while hostility has been tied to the resource dependence perspective (Aldrich, 1979; Pfeffer & Salancik, 1978). According to these authors, the concepts of dynamism, hostility, and complexity could be utilized in order to measure the level of uncertainty present in a given environment. High levels of dynamism, hostility, and complexity all acted to create high levels of uncertainty.

The literature on organizational environments reflects two prominent perspectives. The first perspective is that of information uncertainty, which suggests that the environment is the

source of information (Duncan, 1972, Lawrence & Lorsch, 1967a; Thompson; 1967; Tung; 1979). The information uncertainty perspective is delivered directly from Barnard (1938) and is built on the assumption that uncertainty arises from a lack of perfect information about the environment. He argued that the primary reason for this uncertainty is the inability of managers to comprehend all the information present in a given environmental situation.

Based upon the work of Barnard (1938) several researchers (e.g., Cyert & March, 1963; March & Simon, 1958; Simon, 1957) contended that managers were forced to make decisions under conditions of “bounded rationality.” Bounded rationality refers to organizational processes related to the “choice of courses of action in an environment which does not fully disclose the alternatives available or the consequences of those alternatives” (Thompson, 1967, p. 9). A logical consequence of bounded rationality is that decision makers are not able to completely understand intricate environments, and forced to make decisions while possessing curtailed information about their strategic options (Kreiser & Marino, 2002).

A key focus of research based on this perspective is emphasis on perceived uncertainty and the subjective rather than objective data generated by participants in organizations (Tan & Litschert, 1994). Regarding perceived uncertainty, Duncan (1972) argued, “Uncertainty and the degree of complexity and dynamics of the environment should not be considered as constant features in any organization. Rather, they are dependent on the perceptions of organization members and thus can vary in their incidence to the extent that individuals differ in their perceptions” (p. 325).

Resource dependence theory, building on the work in social exchange theory (Emerson, 1962), views interfirm governance as a strategic response to conditions of uncertainty and dependence (Pfeffer & Salancik, 1978). Given the underlying assumption that few organizations

are internally self-sufficient with respect to their critical resources, two potential problems are created. First, a lack of self-sufficiency creates potential dependence on the parties from whom the focal resources are obtained (Emerson, 1962). Second, it introduces uncertainty into a firm's decision making, to the extent that the resource flows are not subject to the firm's control, and may not be predicted accurately (Heide, 1994).

The main premise of resource dependence theory is that firms will seek to reduce uncertainty and manage dependence by purposely structuring their exchange relationships by means of establishing formal or semiformal links with other firms (Ulrich & Barney, 1984). A variety of such links has been suggested, including contracting (Miles, Snow, & Pfeffer, 1974), joint ventures (Pfeffer & Nowak, 1976), and complete merger (Pfeffer, 1972). The establishment of an interfirm link is viewed as dealing with the problems of uncertainty and dependence by deliberately increasing the extent of coordination with the relevant set of exchange partners or creating negotiated environment (Cyert & March, 1963).

Resource dependence theory views market environment as a set of organizations that engage in exchange relationships with one another (Child, 1972; March & Simon, 1958; Pfeffer & Salancik, 1978). Child (1972) attributes environmental uncertainty primarily to organizational dependence on resources and argues that uncertainty arises as firms attempt to manage critical resource flows from partners who have varying degrees of power. As the environment becomes less munificent or more hostile, firms are subjected to greater uncertainty (Tan & Litschert, 1994).

Within the resource dependence view, the environment is considered as the source of scarce resources that are critical to a firm's survival. Resource scarcity refers to the degree of environmental munificence or the availability of vital resources (Pfeffer & Salancik, 1978). It

was the lack of control over these critical resources that give rise to environmental uncertainty. In order to reduce the impact of this environmental uncertainty on organizational performance, it is necessary for organizations to develop and sustain effective relationships with their external environment (Kreiser & Marino, 2002). Management's ability to cope with these conditions by reducing the firm's dependence on or increase its control over these resources will affect organizational effectiveness (March & Simon, 1958).

As claimed by Koberg (1987), in an environment where information is lacking, uncertainty may appear as numerous short-range fluctuations in external conditions requiring modest adjustments on the part of an organization. An environment where adequate resources are lacking, however, can pose a far greater and longer lasting threat to an organization. Changes in available resources may require broad changes in the structure of an organization.

Although most researchers would accept some combination of the two separate but related perspectives (Hrebiniak & Joyce, 1985; Lawrence & Dyer, 1983; Yasai-Ardekani, 1986), most research has investigated the effects of only one of the two. Some researchers have critically examined both theoretical and methodological approaches to examining the theory (Hrebiniak, 1981; Koberg & Ungson, 1987; Pennings, 1975; Van de Ven & Drazin, 1985).

Koberg and Ungson (1987), for instance, investigated the joint effects of perceived environmental uncertainty and dependence on resources on organizational structure and performance. They argue that managing the eventual supply of resources in the external environment may be more crucial than predicting the environment with utmost accuracy. They also suggest that dependence may be managed through long-term contracts and institutional arrangement. In doing so, it is likely that managers may view their environments as highly uncertain, but may find solace in their ability to control them.

As Yasai-Ardekani (1986) suggests, industry environmental uncertainty and risk influence management perception which, in turn, leads to an influence on the organizational structure. Carman and Langeard (1980) have contended that service firms face far greater uncertainties and risks in international expansion than do product firms. They further state that: (1) the inseparability of production and consumption for services eliminates certain entry mode choices, (2) the intangibility increases the time needed to diffuse service innovation, and (3) service providers may be perceived by host governments as contributing little to the national economy while draining resources, precipitating regulations that favor domestic service providers over foreign providers.

In contrast to the traditional view of inverse relationship of dependence and autonomy, a number of scholars have advocated the coexistence of high dependence with high autonomy in social systems (Baliga & Jaeger, 1984; Garnier, 1982; Pfeffer & Salancik, 1978; Thompson, 1967). Pfeffer and Salancik (1978), for example, contend that even in asymmetrical exchange relationships, asymmetries tend to be resource specific; put another way, asymmetries seldom place one party in a beneficial position over the other party to create unilateral-dependency structures.

Franchise management involves the reconciliation of the franchisor's desire for standardization, consistency, and control for the preservation of its goodwill and brand equity and the franchisee's quest for autonomy. The empirical study of Dant and Gundlach (1999) in fast food restaurants reveals the emergence of four combinations of dependence and autonomy domains. Authors support that because franchisee-franchisor relationships encompass several domains, both parties feel dependent on the other party in domains, and simultaneously, autonomous in other domains.

Organizational capabilities for filtering information uncertainty and managing problematic resources affect the dependence of firms on long-term contracts (Pfeffer & Salancik, 1978). As Pfeffer (1972) and Guetzkow (1966) observed, long-term contracts (e.g., franchising) may be used to reduce some environmental uncertainty and to stabilize interorganizational relationships. More long-term relationships are expected when resource flows are particularly problematic and environmental uncertainty is high (Pfeffer & Salancik, 1978). Shane (1996a) concluded that “the use of franchise contracts appears to be an important long-term strategic choice in its own right for international service firms” (p. 86).

Resource dependence theory views market governance (e.g., franchising) as a response to environmental uncertainty and dependence. In examining the concurrent effects of environmental uncertainty and resource dependence on organizational structure, the author attempted to provide a theoretical synthesis of these perspectives. To cope with increased environmental uncertainty and instability of resource flows in international expansion, hospitality companies may resort to long-term contracts such as franchising that is one type of coordinating activity. The following proposition is consistent with the theoretical synthesis of environmental uncertainty and resource dependence on control strategies of foreign operations.

Proposition 3:

The environmental uncertainty perceived by firms’ decision makers affects the choice of ownership and control modes of foreign affiliates.

Contingency Theory

Most previous work in foreign ownership and control modes has focused on relationships between environmental and organizational variables or between organizational and performance outcome variables rather than on the linkages among all three sets of variables (Keats & Hitt, 1986). Especially, the importance of entry mode selection to a firm's competitive advantage in a new international market has been studied widely, yet the majority of these studies have not examined mode performance. Few studies have explicitly measured and compared the performance of the various organizational forms.

Van de Ven and Drazin (1985) suggested that the ability to understand the behavior of organizations depends on the ability to address sets of contingencies, structural alternatives, and performance criteria simultaneously. There are no conceptual and empirical studies in the hospitality industry that attempted to develop a parsimonious theoretical argument for the relationship of environment-structure-performance in international perspective.

The contingency theory can be attributed partly to a fundamental assumption that there is no one best way to organize, and that any one way of organizing is not equally effective under all conditions (Galbraith, 1973). In strategic literature, there is a belief that no universal set of strategic choices exists that is optimal for all business, irrespective of their resource positions and environmental context (Ginsberg & Venkatraman, 1985).

As observed by Harvey (1982), "the contingency approach to strategy suggests that, for a certain set of organizational and environmental conditions, an optimal strategy exists" (p. 81). Further, as pointed out by Schoonhoven (1981), "when contingency theorists assert that there is a relationship between two variables...which predicts a third variable..., they are stating that an interaction exists between the first two variables" (p. 351).

Contingency is any variable that moderates the effect of an organizational characteristic on organizational performance (Donaldson, 2001). Within a contingency framework, there is an association between contingency and the organizational structure and contingency determines the organizational structure. Contingency theory sees maximum performance as resulting from appropriate level of the structural variable that fits the contingency (Ekeledo & Sivakumar, 1998). Put another way, some combinations of the environmental dimensions and organizational structure will lead to better organizational performance (Covin & Slevin, 1989; Huber, O'Connell, & Cummings, 1975).

A critical review of the research connecting structure and performance has been provided by Dalton, Todor, Spadolini, Fielding, and Porter (1980). They commented that despite the importance of performance there was a paucity of research, weakness in methods, and inconsistencies in findings, both regarding the main effects of structure and the contingent effects of structure. For example, two early studies of the relationship between contingency fit and performance failed to find a positive relationship (Mohr, 1971; Pennings, 1975). Donaldson (2001) pointed out that some of the earlier studies might have failed to find the relationship because of methodological limitations.

However, Woodcock, Beamish, and Makino (1994) argue in favor of a contingency approach. They propose that, although each entry mode is associated with different degrees of control, resource commitment, risk management, flexibility, and performance characteristics, the optimal mode of entry is often contingency driven. Canonical analyses by Pennings (1987) of branches of a large commercial bank show that the relationship between environmental contingency and structural variables is stronger for the high performing than for the low performing branches, which is consistent with their structures fitting the contingencies.

Subsequent to Mohr (1971) and Pennings (1975), there have been other studies that have found a positive impact of consonance between contingency and structure on performance and so support contingency theory (e.g., Dewar & Werbel, 1979; Donaldson, 1987; Drazin & Van de Ven, 1985; Gresov, 1989; Hoskisson, 1987; Jennings & Seaman, 1994; Pennings, 1987; Powell, 1992).

The traditional line of research on international entry modes has examined the contingency relationship between firm characteristics, environment, and selected entry mode (Woodcock, Beamish, & Makino, 1994). Stopford and Well (1972) developed one of the first international entry mode models when they argued that entry mode selection was contingent upon the firm's international experience and product diversification. A case study conducted by Johanson and Vahlne (1977) along with empirical studies by Dubin (1975) and Davidson (1980) provide further support for this contingent, incremental entry mode relationship. The latter studies also found that cultural and other national differences between the host and home countries appear to influence entry mode decisions.

Other studies have compared different ownership and control strategies. Gatignon and Anderson (1987) found that locational factors, the degree of multinationality, and research and advertising intensity influence the selection decision between joint ventures or wholly owned entry modes. Kogut and Singh (1988) found that industry, firm, and country-specific factors influence the selection decision between the joint venture, acquisition, and new venture.

A wide variety of foreign ownership and control modes was examined by Kim and Hwang (1992) and Agarwal and Ramaswami (1992) using eclectic framework. They found that locational, ownership and internalization advantages contingently influenced all of the different

entry modes. The preponderance of research on international entry modes provides theoretical and empirical support for the contingency entry mode argument.

Many of the studies in manufacturing sector that examine entry mode performance contend that equity-based modes such as acquisition, joint ventures and new venture perform below par. For example, Porter (1987) found evidence of poorly performing acquisitions. Various joint venture studies concluded that joint ventures are intrinsically inefficient because of the inherently complex management relationships (Janger, 1980; Killing, 1983). New venture research described the new venture mode as risky, having highly variable performance outcomes (Burgelman, 1983; Drucker, 1974; Hill & Jones, 1989).

A handful of studies have been done in the hospitality industry to examine environment-ownership strategy relationship and its performance implications. Huo (1994), using a contingency framework, proposed linkages among internal environment, organizational form, and financial performance in hotel chains operating in the U.S. This study investigated consonance between contingencies (capital scarcity, monitoring cost, and asset specificity) and organizational structure (company owned, franchised, and combination of both) that has a positive effect on performance. He found that hotel chains that showed a fit between the monitoring cost of their organizational factors and organizational form performed better than hotel chains if those elements did not match. This study also indicated that hotel chains operating under different organizational forms did not show differences in their level of financial performance.

Ginsberg and Venkatraman (1985) suggested that to develop a powerful, yet parsimonious, contingency framework, it is important to determine which factors have a generally important influence on the strategic choice of organizational structure for international

operations and also have performance implications. Many studies have considered country, industry, and firm-specific factors and their contingent influence on entry mode decisions. Caves and Mehra (1986) found that entry mode selection was influenced by a variety of industry and firm-specific factors, including firm size, advertising intensity, research intensity, industry growth, and industry concentration. A subsequent study by Zejan (1990) confirmed the results of Caves and Mehra's study.

Contingency theory necessitates having a basis for classifying competitive settings – hence the need for contingency variables. Country or societal factors such as cultural and social environment, political and legal environment, and economic environment are usually identified as contingency variables; organizations have little or no control over such variables (Biggadike, 1981). However, Hambrick and Lei (1985) argue that organizational variables such as product differentiability, asset mix, and cost-effectiveness that are relatively fixed in the short run can also be considered contingency variables. Therefore, researchers have adopted a broader meaning of contingency by considering factors responsible for differences in performance outcomes as contingency variables.

On the basis of that broader interpretation of contingency framework, proposed conceptual model incorporated factors responsible for variations in ownership structure and control modes offered by different entry modes. Environmental factors are examined in the context of firm specific, industry specific, and country specific context. Ultimately, this study investigates the relationships among environmental factors, foreign ownership and control modes, and performance.

Four major links of contingency relationships were identified in Figure 3-1: link (I) indicating the influence of internal environment on ownership structure and control mode; link

(II) illustrating the influence of firm level environment on ownership structure and control mode; link (III) highlighting the influence of external environment on ownership structure and control mode; link (IV) depicting the influence of the chosen organizational arrangements on firms' performance.

This study extends the traditional model of foreign ownership and control modes and suggests that organizational structures and environmental factors are highly interdependent and must be complementary in many ways to ensure good performance under challenging conditions. There is a trivariate relationship among contingency, structure, and performance.

Proposition 4:

There is a causal relationship among environmental factors, ownership structure and control modes, and organizational performance.

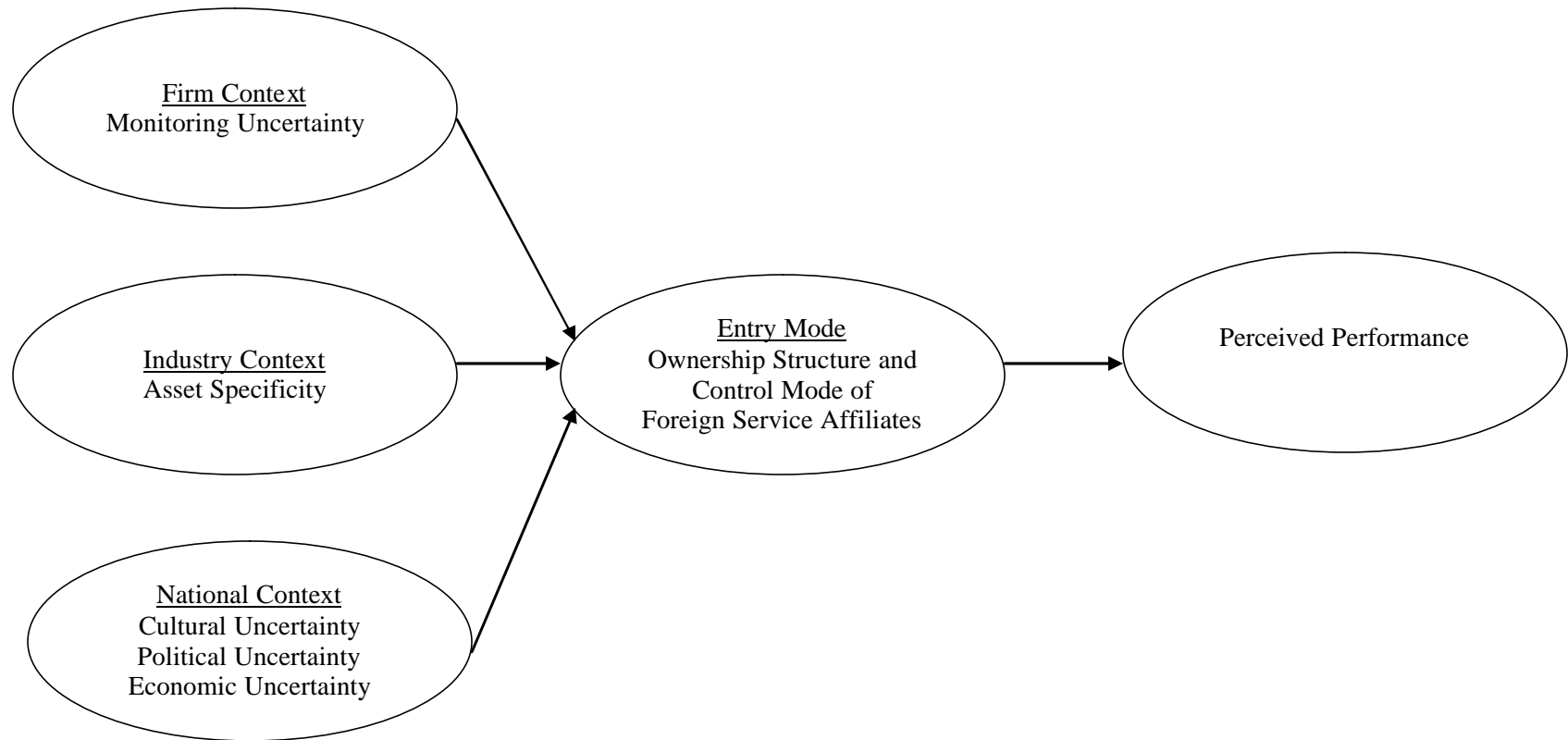


Figure 3-1. Three Tier Contingency Model of Foreign Market Entry Mode

Summary

The main purpose of this study is to assess the effects of ownership structure and control mode on performance with an appreciation of the factors that lead transactors to adopt one form of organization over another and optimal level of control exerted within the system. This chapter describes the theoretical frameworks and builds propositions that are utilized to develop hypotheses in the following chapter.

Agency theory is applied at the firm context vis-à-vis ownership structure and control modes beyond country boundary. This is supplemented by transaction cost economics at the industry context. At the national context, a resource dependence framework is used to test the impact of country level effects on foreign ownership structure. To encompass all the factors in each level of environment that could influence foreign ownership structure and control modes, and thereby to increase the explanatory power and explain the relationship of organizational form to performance, the contingency theory is likely to be preferred.

The next chapter relates these theoretical frameworks to the research question of how each level of environmental factors at firm, industry, and national context impinges on the foreign ownership structure and control modes of international hospitality companies and how governance choices have an effect on firm performance.

CHAPTER 4

DEVELOPMENT OF RESEARCH HYPOTHESES

Introduction

The initial internationalization efforts of service firms were directed toward Canada, Britain, and Australia, countries that are culturally, politically, and economically similar to the United States (Alon & Mckee, 1999b). As markets matured in these countries, profit potential decreased because of increasing domestic and international competition (Welch, 1992). Therefore, companies had to seek growth avenues in less developed or developing, culturally dissimilar or politically unstable countries. These environments presented a new set of challenges which often required changes in the product/service mix, contractual arrangements or methods of operation (Alon & Mckee, 1999b).

With the increased diversity of countries in which service firms sought potential outlets came the need to develop a systematic way to evaluate potential host countries. The standardized nature of goods and services in hospitality industry necessitates a high degree of cooperation and control by the firm, but this is complicated in a multicultural context. This research develops a model that judges the investment climate of a host country from an international perspective. This model considers three factors important to country analysis including (1) economic, (2) cultural, and (3) political factors.

The previous chapter described the theoretical frameworks that form the basis of the three-tier model that is the core of this study. This chapter begins with a discussion of the research hypotheses at the firm context. The author describes the building blocks of the model and how they interact with entry mode choices of service firms and impact on firm's performance.

Firm Level Hypothesis

Agency theory provides a framework for evaluating ownership and control alternatives at the firm level. Agency theory addresses relationships in which one party (i.e., the principal) delegates work to another (i.e., the agent) (Jensen & Meckling, 1976). The theory focuses on determining the most efficient contractual relationship given assumptions about principals, agents, organizations, information, and uncertainty (Bergen, Dutta, & Walker, 1992; Eisenhardt, 1989).

Monitoring Uncertainty

The central dimensions in the agency theory framework are uncertainty and risk (Eisenhardt, 1989; Levinthal, 1988). Uncertainty exists when the firm cannot accurately assess its agents' performance by objective, readily available output measures (Anderson & Gatignon, 1986). This may occur when good measures of output are not available, or when the relationship between inputs and outputs is ill-understood, making it difficult to specify what performance level to expect (Ouchi, 1977). Especially, entrants new to the international setting are unlikely to know how to overcome uncertainty. Further, firms that operate in competitive industries and try to exert control before they know how to use it will make serious errors that should depress efficiency (Teece, 1976).

Uncertainty gives rise to two behavioral problems, moral hazard and adverse selection (Jensen, 1983; Jensen & Meckling, 1983). Moral hazard arises through intentional lack of effort on the part of the agent (e.g., shirking) and the inability of the principal to adequately monitor the agent's actions, which leads to internal uncertainty by the principal regarding the actions of the agent (Alchian & Demsetz, 1972; Eisenhardt, 1988). Adverse selection involves the

misrepresentation of skills and abilities by agent to the principal and produces internal uncertainty for the principal as to the true capability of the agent (Levinthal, 1988; Prescott & Visscher, 1980). Both of these aspects have the effect of producing outcomes that are not in the best interests of the principal.

Uncertainty by the principal regarding an agent's actions can be a major issue in service firms. Services are generally characterized by the high degree of inseparability and heterogeneity. As Palmer and Cole (1995) note, producers of services are an integral part of their product and require greater control over the production process to reduce heterogeneity of service. The inseparable nature of many services makes it possible for each interaction to be unique (Grönroos, 1990). However, this uniqueness provides a level of independence that provides an opportunity for agents to behave opportunistically. Such types of customer interactions are difficult to monitor and evaluate by objective output measures, and create uncertainty for the principal as a result of incomplete information.

The problem of incomplete information regarding agent behavior is further exacerbated by the very nature of a decentralized service delivery system whose geographical scope extends beyond national boundaries. In international operations, distance and time boost the level of uncertainty by broadening the information gap (Fladmoe-Lindquist & Jacque, 1995). It is argued that geographic expansion makes central control of unit operations difficult and costly mainly due to the physical distance (Castrogiovanni & Justis, 1998; Mathewson & Winter, 1985; Rubin, 1978). If the organization cannot bear those monitoring costs, it may experience agency problems (Fama & Jensen, 1982; Jensen & Meckling, 1976; Mathewson & Winter, 1985) as unit managers serve self-interests or exert less than maximum effort toward company interests.

The high degree of interaction between customer and service provider and the decentralized system of service creation and delivery create a situation in which monitoring is costly to acquire. Further, customer interactions occur on a one-to-one basis in relatively unsupervised business settings. For instance, at a fast food restaurant, the unit manager cannot adequately monitor the behavior of the counter clerks at all times. Corporate investigators (i.e., field representatives) have even fewer opportunities to monitor the interactions of the service personnel in foreign operations and are likely to generalize from random inspection visits. Despite technological improvements of facilitating data transmission, it is still difficult and costly to gather and receive complete information about foreign operations in a timely manner. Indeed, objective information may not provide an accurate picture of the condition of the service delivery and may even be misleading.

The development of complete integration (e.g., wholly-owned subsidiary) in a foreign market is expensive because of the need to coordinate the interdependent activities of organizational members in a distance (Jones, 1983, 1984). The use of full ownership involves some loss of control in the system since the delegation of control to local unit operators (i.e., foreign unit manager) inside the organization may allow them to develop subgoals to further their own interests (Jensen & Meckling, 1976). In response to this problem, firms can hire professional managers (i.e., field representatives) for investigating and monitoring the behavior of foreign unit operators to relieve some of this burden, or to apply bureaucratic controls (rules and procedures) but this imposes costs upon the firm (Jones, 1983; Perrow, 1979).

As hired professional managers (i.e., field representatives) are not residual claimants on the proceeds of the firm, they, too, have an incentive to shirk. As a result, professional monitors need to be monitored by firms. Therefore, even if they hire professional managers, firms face

finite limits to their monitoring capability. Thus, if these bureaucratic costs are greater than the benefits that will accrue to the firm by reducing monitoring costs, then company ownership will not emerge and market exchange such as franchising will be the norm (Bowen & Jones, 1986). As a result, in deciding upon a foreign ownership structure and control mode, the relative costs of market and hierarchy are constantly traded off against one another.

According to agency theory, the advantage of franchising is that by transforming outlet managers into owners, franchising induces franchisees to maximize outlet profits and greatly reduces the need for direct monitoring by the franchisor. A common alternative to franchising is to offer managers a salary supplemented by a bonus tied to outlet performance (Bradach, 1997). However, a firm's decision makers still cannot know whether an outlet's performance is attributable to managerial effort or to factors outside the outlet manager's control (Carney & Gedajlovic, 1991). Thus, the firm's decision makers cannot be sure that managers are adhering to quality standards and considerable direct monitoring remains necessary (Bradach, 1997).

It is suggested that franchising exists to ameliorate agency problems inherent in fixed wage contracts when there is diffuse production and distribution, and costly monitoring (Mathewson & Winter, 1985; Rubin, 1978). Krueger (1991) found that wages are higher in company-owned chains, and he argued that chain-unit managers seem less concerned about maximizing unit profit. If outlet operators are instead compensated with profit-sharing, they have reduced incentives to shirk or engage in opportunistic behavior because they must pay a portion of the cost (Minkler, 1990). An explanation for profit-sharing, therefore, is an explanation for franchising and franchisees are just profit-sharing managers.

Brickley and Dark (1987) illustrate how franchisors make retail ownership decisions in effort to economize on monitoring costs while simultaneously maintaining product and service

quality. Because franchisees have considerable financial investment at stake and receive unit profits, they are likely to be more motivated than managers of company-owned units. Thus, franchising is said to enhance the entrepreneurial capacity of the organization (Norton, 1988b), making unit monitoring less costly than in company-owned chains.

Norton (1988b) found that franchised units tend to be larger than company-owned units, and he presented arguments that this was due to fewer agency problems. This approach attempts to shift the costs of moral hazard and self-selection to the foreign agent. Effectively, international franchising creates financial incentives for the foreign franchisees to monitor themselves by making them bear the cost of shirking through the reduction of net income.

When the costs of direct monitoring are relatively high, the ownership incentive accompanying franchising becomes particularly attractive (Combs & Ketchen, 1999). Prior research has identified important conditions that raise direct monitoring costs: (1) availability of managerial talent, (2) the amount of learning about local conditions needed to effectively evaluate managers, (3) distance of units from headquarters; the distance monitoring personnel must travel to observe an outlet, (4) local population density, and (5) the relative proximity of locations to one another (Brickley & Dark, 1988; Carney & Gedajlovic, 1991; Caves & Murphy, 1976; Martin, 1988; Minkler, 1992; Norton, 1988a, 1988b; Rubin, 1978, 1990).

The need for long distance travel and local market study are perhaps most pronounced when firms embark upon foreign expansion (Sashi & Karuppur, 2002). According to Combs and Castrogiovanni (1994), franchising can eliminate or reduce many of these costs because a local franchisee has two strong incentives for maximizing the present value of his/her franchise, thereby linking his/her interest to the franchisor's. First, a franchisee often risks a large proportion of personal wealth in a single unit. Second, in exchange for a franchise fee and sales

royalties, the franchisor relinquishes residual claim on profits to the franchisee. Hence, the franchisee is highly motivated to maximize the present value of the franchise because effective management is the only way to recover the investment with an acceptable long-run return (Alchian & Demsetz, 1972; Carney & Gedajlovic, 1991; Norton, 1988b). Because of these incentives, the franchisor can spend less effort insuring these units are managed properly.

In brief, franchising helps to prevent moral hazard and adverse selection without requiring site visits with their accompanying travel difficulties and the need for regional monitoring facilities in global markets. Firms can reduce monitoring costs by involving local partners as franchisees in distant markets. The ownership of residual claims by the franchisee reduces the possibility of shirking even if some monitoring is still required to prevent free riding and debasing of quality. Free riding problems may be attenuated by requiring the franchisee to pay a higher initial fee, making it costlier for the franchisee to acquire the residual claims to unit profits in distant markets and by increasing the franchisee's share of these profits by lowering the royalty rate in distant markets (Sashi & Karuppur, 2002).

Expansion into foreign markets should exacerbate direct monitoring problems and render the ownership incentive found in franchising attractive. As a result of the high cost of information incurred in international monitoring, firms will favor franchising to align the behavior of foreign agents with theirs (Fladmoe-Lindquist & Jacque, 1995). Therefore, firms are more likely to favor franchising, because franchisees are more motivated and there is always a chance of problem of shirking and opportunistic behavior on the agents (i.e., employees).

Accordingly, I expect that:

Hypothesis 1:

As the monitoring cost of a unit manager in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Industry Level Hypotheses

Most services have the potential of being internationally marketed. Like products, the development of capabilities and competencies drives competitiveness in services trade. It is evident that the nature of services varies widely. Each service industry has its own infrastructure, requires specific competencies and may be governed by a comprehensive set of regulations and laws.

The firm's competitive advantage within a service sector, on the other hand, may be through the development of proprietary equipment, patented processes, and/or trademarks. For instance, restaurant and hotel industry developed strong brand name and expand into international market based on operational know-how and patented processes.

Previous research in the transaction cost study typically has concentrated on the manufacturing sector and been applied to inter-firm comparisons (Anderson, 1982; Gatignon & Anderson, 1988). The previous research investigating the entrance of service firms into foreign markets has been to apply transaction cost analysis to identify the circumstances under which service firms entering individual foreign markets would accept shared control of the venture (Carmen & Langeard, 1980; Cowell, 1983; Domke-Damonte, 2000; Erramilli; 1991; Erramilli & Rao; 1990; Sharma & Johanson, 1987).

It is to be noted that industry factor needs to be considered because the heterogeneity of the service sector suggests that the differences between the different service industries may be substantial (Lovelock, 1983). Within the industry, even though transaction specific assets such as both product propriety and marketing expertise are firm-related variables, it is quite evident that firms operating in the same service industry do tend to possess the same characteristics

(Fladmoe-Lindquist, 1991; Hu & Chen, 1993). In this context, this research applies the transaction cost framework to industry rather than the firm level of analysis.

The transaction cost framework describes the ownership and control modes of corporate equity and franchise contract as the choices among governance structures for the creation and delivery of international services. Transaction cost analysis approaches the entry mode question with the following promise: a low level of ownership is preferable until proven otherwise, which accords with an assumption fundamental to economics, that is, that market outcomes tend to be efficient when competition is strong (Williamson, 1979, 1981b). Competitive pressures drive parties to perform effectively at low cost and to deal with each other in fairness, honesty, and good faith lest they be replaced (Anderson, 1985; Anderson & Gatignon, 1986).

Integration or full ownership is, however, justified when the market mechanism no longer encourages performance, i.e., when competitive pressure is low. Williamson (1979) argues that most transactions begin when competition is intense but some degenerate into lock in small number of bargaining when the contract partner becomes irreplaceable. Then the partner may extract new contract terms, become inflexible, and otherwise violate the letter and spirit of the agreement with relative impunity such as opportunistic behavior, i.e., self-interest seeking with guile (Williamson, 1979).

Degeneration into lock in occurs when transaction specific assets of considerable value accumulate (Anderson & Gatignon, 1986). These are human and physical investments that are valuable only in a narrow range of transactions, which is specialized to one or a few users or uses (Williamson, 1981b). When transaction-specific assets are likely to become valuable, transaction cost analysis suggests that firms are better off either integrating the function (exerting maximum control) or redesigning tasks so that general purpose assets will suffice.

Transaction Specific Assets (Asset Specificity)

Transactions specific asset is an important issue for service businesses that employ a specific business format. The use of business format in service distribution involves clearly defined materials and service techniques that are a part of the brand name and contract. Business formats are an integral part of the competitive strategy of many service industries such as hotels and fast-food restaurants.

Transaction specific asset varies by service industry. Transaction specific assets are highly specialized investments that have little or no general purpose outside of specific relationships between firms (Williamson, 1981b). Such transaction specific assets transform an initial large numbers of buyers or suppliers to a small numbers condition with scope for opportunistic behavior (Sashi & Karuppur, 2002). Small numbers or opportunism will not by themselves cause markets to be replaced by hierarchical arrangements, but in conjunction with each other give rise to a situation where one firm might appropriate the quasi-rents earned by another firm (Klein et al., 1978). A quasi-rent is the value of an asset over its salvage value (Carney & Gedajlovic, 1991; Hobbs, 1996). It can be the means to recover sunk costs, such as those that result from investments in specific assets (Hill, 1990).

The quasi-rent appropriation is particularly relevant to franchising. If quasi-rents are high, the franchisee risks appropriation by the franchisor (Carney & Gedajlovic, 1991). By its very nature, much of the investment a franchisee makes is in physical (e.g., a uniquely designed building for McDonald's with its golden arches) and dedicated assets (e.g., equipment required for a newly added breakfast menu). These assets may be tangible (e.g., structural design) or intangible (e.g., management know-how). Such resource commitment as physical and dedicated assets has low salvage value and cannot be redeployed to alternative uses without cost (loss of

value) (Hill et al., 1990). In other words, these structural design and equipment cannot be easily transferred to another restaurant firm. That is, franchisees should demand higher rates of return, or returns that permit them to fully depreciate the value of their franchisee specific assets over the duration of a contract (Carney & Gedajlovic, 1991).

Brickley and Dark (1987) suggest the risk of quasi-rent appropriation is likely to be greatest when there is a high initial investment required to establish a franchise. Scott (1995) evidenced positive effect of physical asset specificity such as unit size on company ownership based on the fact that franchisors find it more costly to rely on franchising when franchisees are required to make large relation-specific investments.

The practical implication is a franchisor who will have difficulties attracting franchisees under such circumstances. Therefore, high initial investments will lead to greater company ownership of service outlets. In the case of a company owned subsidiaries, the company has to bear all of the costs of opening up and serving the foreign markets. Thus, the company owns all of the revenue generating assets (Hill et al., 1990). In global markets, when high physical and dedicated asset specificity might lead to small numbers condition and opportunistic behavior, franchising is unlikely to be the preferred mode of operation (Sashi & Karuppur, 2002).

The role of intangible assets is of critical importance to the competitive posture of service firms. The capabilities of a firm which set it apart from the competition are based on intangible business processes rather than capital equipment (Samiee, 1999). Human asset is the integral part of the firm's intangible assets in virtually every service industry. Human asset is another important type of transaction specific assets, which includes skills and knowledge of the idiosyncrasies of firm's activities (Fladmoe-Lindquist & Jacque, 1995). Employee and

management education in the light of firm's specific assets contribute to organizational learning and knowledge, which in turn enhance the competitive position of the firm (Samiee, 1999).

The knowledge of business procedures and customers is an example of a human transaction specific asset. One of the firm's important inputs for outlet success is operational knowledge about how to manage day-to-day activities, improve efficiency, and promote products and services (Combs & Ketchen, 1999; Rubin, 1990). Operational knowledge can be defined as specific asset when it is "knowledge that is costly to transfer to agents" (Jensen & Meckling, 1995, p. 4). For service firms, it can be time consuming and thus costly to effectively communicate a large repository of detailed knowledge to outlet managers (Shane, 1998b). For example, according to Luby's Cafeterias' 1993 annual report, it takes the company approximately seven years to train (that is, transfer knowledge to) an outlet manager.

Franchising raises the cost of distributing human specific knowledge system wide because franchisees cannot be forced to undergo additional training and are under no obligation to communicate to the franchisor any knowledge generated in their outlets (Bradach, 1997; Darr, Argote, & Epple, 1995). Such assets are not easily transferable to other service industries and contribute to performance, the partner who acquires them becomes hard to replace.

By the nature of customization of service distribution, the entrant must work actively with the local entity that has considerable local knowledge to tailor the product to the customer. Accordingly, working relationships must be developed between franchisor and franchisee. Those working relationships will include knowledge of what to expect from individuals and of how to communicate and constitute an asset specific to the franchisor-franchisee transactions (Anderson & Gatignon, 1986). There is a strong reliance of decision-makers on such relationships when assessing other foreign opportunities, which underscores their importance (Holton, 1971; Keegan,

1974; Kobrin et al., 1980). Since these relationships exist only with the current franchisee, the entrant is locked in.

In essence, human specific knowledge flows more easily within firms than between them (Darr et al., 1995), leading company ownership to be preferred when extensive training and support is needed in new outlets (Lafontaine, 1992; Scott, 1995). According to Williamson (1981b), team effects have been created, and control is needed to preserve them. Thus, human specific knowledge should discourage expansion through franchising.

A major product related transaction specific asset influencing foreign market entry strategies is the proprietary nature of a firm's assets (Kim & Hwang, 1992). Proprietary knowledge is a firm specific asset and is not freely transferable outside the organization (Anderson & Gatignon, 1986). Firms may use proprietary knowledge to create unique product that differentiate their product in the foreign market. Proprietary asset includes the technological content of the product, innovation, information, and operational knowledge (Anderson & Gatignon, 1986; Buckley, Pass, Prescott, 1992; Ekelodo & Sivakumar, 1998; Hill, Hwang, & Kim, 1990; Kim & Hwang, 1992).

The transfer of complex proprietary knowledge to several franchisees located in different parts of the world may involve hazards of valuation and transmission problems (Calvet, 1981). Such knowledge is often ill codified and difficult to transmit across organizational boundaries (Sarkar & Cavusgil, 1996). Differences in idiosyncratic dimensions, e.g., organizational culture of franchisor and franchisees, may increase the costs of transfer through the modes such as franchising (Contractor, 1990). Calvet (1981) points out that proprietary knowledge is also subject to hazards of valuation. For instance, the buyer cannot know what the knowledge is worth unless the knowledge is disclosed, at which point the acquirer need not pay for it (Calvet,

1981). This obliges information-holders to exploit it themselves, resulting in high levels of ownership, and hence control, of a foreign business entity. Ownership has the added advantage of encouraging teamwork and keeping the team (employees) together (Williamson, 1981b).

While franchising the brand names of products based on proprietary knowledge looks very appealing, authorizing the use of brand names for products based on proprietary knowledge could lead to severe control problems in the long run (Sashi & Karuppur, 2002). For instance, after acquiring the proprietary knowledge, franchisees may exhibit opportunistic behavior. If a franchisor grants a right to a foreign franchisee to use firm-specific know-how to operate foreign outlets, it runs a franchisee disseminating that proprietary knowledge or using it for purposes other than those originally intended (Hill & Kim, 1988). Franchisees may make minor modifications in product attributes to circumvent patent infringement laws and regulations, and even compete with the franchisor in global markets (Sashi & Karuppur, 2002).

A service firm is more likely to adopt the company ownership when it wants to reduce the risk of dissemination of firm specific knowledge and protect its proprietary assets because copyrights laws may not be enforced in some countries when the product is of foreign origin (Ekelodo & Sivakumar, 1998; Hill, Hwang, & Kim; 1990; Rosenbaum, 1995; Specter, 1995). In order to retain control over the proprietary knowledge and the resulting product differentiation, service firms entering into a foreign market do exert more control as proprietary content increases (Sashi & Karuppur, 2002). One reason for this is that internal organization fosters an atmosphere conducive to congruence of goals and values between members of the organization (Hill, Hwang, & Kim, 1990).

As transaction asset specificity reaches low levels, franchising becomes an attractive mode. Sashi and Karuppur (2002) point out that firms are likely to consider franchising a suitable

mode of foreign operation particularly for product categories based on technologies available in the public domain for which physical attribute/format standardization leads to customer satisfaction and value (e.g., fast food restaurants).

In the service industry, the intangible asset of reputation and brand name is of great concern than are the traditional types of assets described above (Martin, 1988). The value of brand names increases for product categories that are difficult for customers to evaluate, e.g., services (Hill & Kim, 1988). The reputation of the service firm is especially important due to the service characteristics of inseparability and heterogeneity; the quality of the product or service can not be examined before it is actually consumed and services are unique with each interaction between customer and provider.

The service becomes just another store, hamburger stand or lodging facility without the reputation of the service firm. From the customer's perspective, brand names ensure uniform quality and simplify selection. Brand names provide identity to products and allow firms to differentiate their offerings in the crowded marketplace (Sashi & Karuppur, 2002), e.g., McDonald's arches and Holiday Inn's log. In order to conserve resources to estimate the value of products, consumers' choice of a particular service firm is based on previous personal experience and some proxy measures such as the seller's reputation, brand name, warranty, etc. (Fladmoe-Lindquist, 1991). As a consequence, brand names assist firms in retaining loyal customers and in attracting new customers. Thus, brand names are firm-specific assets that facilitate transactions.

Successful brand names can transcend national boundaries and extend the reputation earned in one market to several global markets (Sashi & Karuppur, 2002). Global media and communication systems facilitate the introduction of brand names and diffusion of product and service information globally (Levitt, 1983). The owners of successful brand names can enter

global markets by authorizing franchisees to offer products and services with their brand names. The use of reputed brand names enables franchisees to draw customer attention as well as achieve economic efficiencies (Caves & Murphy, 1976).

However, like other firm specific assets, brand names are not freely transferable. Authorizing franchisees to use reputable brand names can create a free-rider problem. The fundamental service task of serving food or providing a hotel room is vulnerable to imitation and the problems of free-riding (Caves & Murphy, 1976). In order to appropriate the benefits of the brand name reputation and extract short-term gains, franchisees can dilute the quality of inputs or service by not upholding the standards himself if the gains from such activities can be internalized and the costs externalized (Klein, 1980; Klein & Saft, 1985; Norton, 1988b).

The actions of free riding erode the value of the brand name and may pass a burden on to other system outlets in the form of devalued brand reputation. As a result of shirking by one franchisee, it is likely that customers will shift their purchases to a close substitute rather than risk disappointing experience. Since salaried managers in company owned outlets have no incentive to shade quality, firms will incline to opt for high control entry modes (Anderson & Coughlan, 1987; Kim & Hwang, 1992; Norton, 1988b).

Research suggested that service firms vary with respect to the asset specificity of their service; these variations may result in differences in entry mode selection (Contractor & Kundu, 1998b; Erramilli & Rao, 1993; Fladmoe-Lindquist & Jacque, 1995; Murray & Kotabe, 1999). This scholarship suggests that, because services tend to be people intensive, service firms' competitive advantage tends to be derived from idiosyncratic assets such as investments in training and knowledge. Entry Mode choice will vary with the degree of idiosyncratic asset investment (Erramilli & Rao, 1993).

When the specificity of the assets is low (low idiosyncratic asset investment), low control modes such as franchising are preferred. However, when the service being provided requires high levels of idiosyncratic asset investment, wholly owned modes are preferred (Brouthers & Brouthers, 2003; Contractor & Kundu, 1998b; Erramilli & Rao, 1993).

In the service industry, both Fladmoe-Lindquist and Jacque (1995), and Erramilli and Rao (1993) found strong empirical support for the relationship between asset specificity and mode choice, with high specificity being related to the use of wholly owned modes of entry. Contractor and Kundu's (1998b) measure of asset specificity in terms of importance of training was also significantly related to mode choice, thus providing additional support.

Studies have concluded that asset specificity is positively related to high control entry modes. This is in line with transaction costs theory which proposes that when transaction specific assets are valuable, firms prefer to integrate the function to avoid being locked into a degenerative relationship with an external supplier where they might be vulnerable to opportunism (Anderson & Gatignon, 1986; Williamson, 1981a). Based on this discussion, I expect that:

Hypothesis 2:

As the level of asset specificity invested in a foreign market increases, firms are more likely to rely on expansion through integrated entry mode (e.g., company-owned subsidiary).

National Level Hypotheses

The resource dependence view of the firm (Penrose, 1959; Pfeffer & Salancik, 1978; Wernerfelt, 1984) conceives of organizational choices as being predicated on the forces of environmental uncertainty and limited firm-specific resources. Within resource dependence perspective, organizations are viewed as coalitions, altering their structure and patterns of behavior to acquire and maintain needed external resources (Pfeffer & Salancik, 1978).

Thompson (1967) has postulated that organizations attempt to manage their external dependencies or to control the environment. Resource based explanations suggest that resource availability and utilization figure in choices among modes of entry if there are cost distinctions (Chang, 1995). Viewed in a context that treats an environment as a source of information and resources (Koberg, 1987), the perspectives adopted in this study reflect an increase in environmental uncertainty (McCann & Selsky, 1984) in foreign business milieu and a growing dependence of organizations on outside resources (Ansoff, 1979).

Uncertainty associated with the host country environment is a critical factor that can potentially influence entry mode choice (Erramilli, 1992). Environmental uncertainty can be viewed as the state of not knowing or a lack of knowledge about the future direction of a host market situation (Hoskisson & Busenitz, 2002). Since the managers of international firms contemplate the future strategically, they often face many complexities with regard to political, cultural, and economic environment, making it very difficult to discern in advance what the appropriate reaction should be in regard to entering a given market (Leifer & Mills, 1996).

When environmental uncertainty is high, a larger degree of ownership potentially entails greater switching costs should undesirable events occur (Shan, 1991). Williamson (1979) hypothesized that firms should react to uncertainty by avoiding full ownership and control mode,

since it commits them to one operation that may not be appropriate when the next environment shift occurs. In particular, in extreme market volatility, excessive integration often overexposes firms to demand uncertainty (Harrigan, 1986). Similarly, several organization theorists (e.g., Lawrence & Lorsch, 1976a; Pfeffer & Salancik, 1976) argued that less vertically integrated structures are more effective under high external uncertainty conditions.

Gatignon and Anderson (1988) state that environmental uncertainties are “generally understood to mean the extent to which a country’s political, legal, cultural, and economic environment threatens the stability of a business operation” (p. 315). Kotler and Armstrong (1991) also pointed out the magnitude of economic, political-legal, cultural, and business environment, which impinge on a nation’s readiness to make or import different products and services and its attractiveness as a market to foreign firms.

In this study, the national investment context is concerned with the uncertainty and restiveness of the international investment climate for the international hospitality firm. The problem of exposure arises when there is the possibility that an outcome will be less favorable than expected, but some action must be implemented before the actual outcomes can be precisely forecast (Herring, 1983) especially due to the inseparable characteristics of service provision. At the national context, such exposure becomes less controllable by the individual firm.

This research examines the effect of environmental uncertainty in the national context on the mode of operation in global markets by decomposing such environmental risk into political, cultural, and economic dimensions. By analyzing the levels of three dimensions – political, economical, and cultural - present in the foreign environment, firms will be able to formulate and implement foreign ownership and control strategies to match these environments (Kreiser & Marino, 2002).

Viewed in a context that treats an environment as a source of information and resources (Lawrence & Dyer, 1983), perspectives adopted in this study reflect an increase in environmental uncertainty (McCann & Selsky, 1984) and a growing dependence of organizations on outside resources (Ansoff, 1979).

Cultural Distance

First, the potent form of external uncertainty is created by cultural distance. The study of culture is vital to the management of international business. Although in the early years of international expansion, service firms, following a similar pattern to manufacturing firms, expanded only to culturally similar countries, since then international investments have extended to less developed and less culturally similar countries (Davidson, 1980).

Culture can be viewed as a learned, shared, compelling, interrelated set of symbols whose meanings provide a set of orientations for members of a society (Terpstra & David, 1985). Jeannet and Hennessey (1988) also viewed culture as the human aspect of a persons' environment; it consists of beliefs, morals, customs, manners, and habits learned from others. Culture is embedded in elements of the society and thus cultural distance encompasses differences in language, religion, education, work ethic, gender role, social structure, ideology, time orientation, and so on between the home country and the host country, which affect consumers' selection of goods and services (Goodnow, 1985; Jeannet & Hennessey, 1988).

Cultural distance stems from the heterogeneous and multicultural world of international business and increases the problems of communication and misunderstandings among market participants (Wilkinson & Nguyen, 2003). For example, interaction with the people of different cultures differ greatly as each culture assigns its own meaning and expression to such gestures as

body movement, eye contact, body touch, etc. A lack of understanding of such simple and obvious gestures may cause problems and produce unsuccessful results (Javalgi & White, 2002).

Different cultures have varying effects on the marketing of services internationally. According to Dahringer (1991), "... difficulties in marketing services internationally are due largely to close cultural relationships between a society and the services offered in that society" (p. 7). Managing business in the service sectors with people from different cultures will never be as clear and simple as conducting business in the domestic market. Consequently, researchers and practitioners alike have begun to investigate cultural differences and international business practices (Hofstede, 1993, 2001; Samiee, 1999).

Culture affects not only the attitudes and beliefs of the potential consumers but may also impact their response to certain products and services (Brouthers, 1995). Variations in cultural norms can affect local implementation (Hofstede, 2001; Hofstede & Bond, 1988) due to the customer involvement of production process. Cultural differences are likely to require modification of product and promotion decisions. For instance, Pizza Hut added fish as a topping to its pizzas in Russia, and Swensons reengineered its product to use vegetable protein instead of dairy products in Saudi Arabia (Bucher, 1999).

The components of culture have an impact on the acceptability and adoption pattern of services in foreign markets (Javalgi & White, 2002). As evidenced by international studies, sociocultural difference is an important determinant of the foreign market entry mode and the critical part of the requirement for the success of the operation (Anderson & Gatignon, 1986; Brouthers; 1995; Chow, Inn, & Szalay, 1987; Erramilli & Rao, 1993; Goodnow, 1985; Goodnow & Hansz, 1972; Kogut & Singh, 1988; Root, 1994).

Sociocultural distance makes external uncertainty very high since the foreign business environment is unfamiliar or unknown (Anderson & Gatignon, 1986). This makes the monitoring and controlling of foreign counterparts more difficult and costly (Rosson, 1984). Kogut and Singh (1988) suggest that choice of entry mode needs to be qualified by factors stemming from institutional and cultural contexts since “differences in national cultures have been shown to result in different organizational and administrative practices and employee expectations” (p. 144).

Hofstede’s (1983, 2001) five key cultural dimensions provide the background to better understanding national differences in management practices. These dimensions, which have been extensively used as a way of understanding cultural differences, are as follows; power distance (expectations regarding equality among people); individualism/collectivism (the relationship between the individual and the group in a society); masculinity/femininity (expectations regarding gender roles); uncertainty avoidance (reactions to situations); and long-term orientation/short-term orientation (which focused on goal orientation toward time) (Bond et al. 1987). Kogut and Singh (1988) found that the effect of cultural distance and uncertainty avoidance is to increase the likelihood of favoring less integrated entry mode over sole ownership.

Since any relationship between the service-provider and the customer typically involves a degree of social interaction, Hofstede’s dimensions seem relevant to any study of relationships in service settings across cultures (Patterson & Smith, 2001). A growing challenge for international service firms is the development of trusting relationships with customers, especially for those firms that directly involve customer contact. Clark and Rajaratnam (1999) note that the effects of

culture are most conspicuously seen in contact-based services, where people must interact and communicate directly.

Hofstede's (2001) five perceptual dimensions of culture can contribute to explain the service gap between customers' expectations and management perceptions in the foreign business soil, which finally lead to personnel gap during the service delivery process. In other words, perceptions and specification of service quality bounded by rationales rooted in home culture can give rise to the perceptual discrepancies toward different service quality standard. Cultural distance between home country and foreign country where the firm intended to enter may also bring the gap between service quality specification and service delivery. In consequence, the service gap exists when the service provider that is based overseas does not show the level of competence or assistance that domestic customers expect.

For example, customers who want to avoid risks, due to the high uncertainty avoidance of their cultural orientation, might look for a more tangible sign of service quality. Customers might hold service providers responsible for assuring a certain quality, even under uncommon and less favorable conditions because of achievement oriented cultural idiosyncrasy. Contacts between customers from cultures characterized by high uncertainty avoidance and service providers accustomed to low uncertainty avoidance can cause considerable gaps and service encounter problems (Mattila, 1999; Stauss & Mang, 1999). Foreign firm is more likely to cooperate with an indigenous firm (e.g., franchisees) which may have country knowledge to avoid cultural uncertainties and finally to suit cultural imperatives.

Frequently, modifications may be needed not just in the recipes and menu selections, but in the operations as well (Sadi, 1994). The business concept and its management system are extensions of the cultural roots of the firm's home country (Huszagh et al., 1992). The

transferability of the system becomes a function of the cultural distance between the foreign and domestic cultures as well as of the service's unique cultural attributes (Fladmoe-Lindquist, 1996). Embedded in the operational routines and processes are assumptions about how work should be done. Thus, cultural distance affects internal managerial and operational business practices, communication and performance evaluations, as well as providing an attractive service to local consumers (Alon, & Mckee, 1999b; Eroglu, 1992).

Sociocultural distance also creates high information costs. Transferring home management techniques and values is difficult where the operating environment is very dissimilar to that of the home country (Root, 1987). Anderson and Gatignon (1988) note that cultural distance cause firms to avoid full ownership because distance increases information costs and difficulty in transferring management skills. Cultural distance also erodes the applicability of firms' competencies and investments in culturally distance countries are more likely to fail (Li & Guisinger, 1991; Lorange & Roos, 1991).

An entrant transferring its operating procedures and methods to a very different setting will have to train its agents heavily (Anderson & Gatignon, 1986). Firms may avoid high information costs by transferring risk to external agents. Franchising may be preferred because it enables franchisors to transfer responsibility for managing local operations to franchisees, but at the same time allows franchisors to retain control of local operations, implement format standardization, and ensure product quality as in high ownership arrangements (Sashi & Karuppur, 2002).

From the standpoint of service characteristics, cultural distance is a critical factor in the evaluation of intangible services because customers tend to focus on the tangible accouterments or peripherals of the service as symbolic indicators or surrogates of the service itself (Shostack,

1977). Different sets of appropriate tangibles emerge in each culture for a given service product because a different universe of symbols is encountered.

As Nicoulaud (1989) explains, "...in international marketing, effort must be made to ensure that the service product or its representative (i.e., tangibles) falls into a frame of reference common to both parties" (p. 62). Root (1987), in the same context, contends that the "...message...outside the receiver's perceptual field...cannot transmit the sender's meaning, although it may well transmit a meaning not intended..." (p. 265).

Extending the notion of cultural distance, Edvinsson (1981) argued that service providers, lacking any legitimacy and identity in the foreign market, require some kind of platform and local support environment to operate successfully. Although this is true for goods manufacturers operating abroad, the intangibility of services means that uncertainty about performance is higher and thus greater demands are placed on service firms to win the confidence of the consumer through strong referent promotion and a good local image (Buckley et al., 1992). Edvinsson (1981) suggests that this is best achieved through co-operation with a local firm known and trusted by consumers.

Another attribute of simultaneity exhibited by many services may be defined as the condition that producers and consumers have to communicate directly in the service transaction. While domestic service providers usually share a common cultural framework, international service providers may have significant cultural differences to contend with. Where culture distance is large, production-consumption barriers arise because the difficulty of achieving effective interpersonal communication increases. Thus, effective interpersonal communication is a critical success factor for international service distribution (Crosby, Evens, & Cowles, 1990).

Considering the simultaneous characteristics of services and ensuing problem of interpersonal communication, management of the service quality gap (Parasuraman, Zeithaml, & Berry, 1985), especially gap between service quality specifications and service delivery, will be more difficult where the amount of person-to-person communication between service producers and consumers is large or high degree of customization is needed because efficiency here requires good interpersonal communication.

In relation with addressing the implications of the inseparability of production and consumption characteristics of services, Dahringer (1991) commented that because most services require frequent and close interaction between supplier and consumer, cultural factors are likely to have greater impact on the choice of less integrated entry mode. Lifflander (1970) also presented the advantages of franchising abroad with relation to sociocultural factors.

Firms are most likely to adopt entry modes that require high resource commitment when the cultural gap between their domestic market and the local market is minimal (Ekeledo & Sivakumar, 1998; Reardon, Erramilli, & Dsouza, 1996). This can be evidenced by Davidson and McFetridge (1985) who found that firms favour foreign production as an entry mode when the host country's culture is similar to that of the home country.

Faced with the uncertainty that arises from the unknown, however, a firm may be unwilling to commit substantial resources to a foreign operation since such a commitment would substantially reduce the firm's ability to exit without cost if the host market should prove unattractive (Hill, Hwang, & Kim, 1990). Root (1994) argued that the preference for equity investment characterized by high degree of control by U.S. firms in Canada is partly the result of similarity in culture between Canada and U.S.

As indicated by previous entry mode studies, as sociocultural distance increases, or market knowledge decreases, management's desire for control decreases (Anderson & Gatignon, 1986; Erramilli & Rao, 1990; Kogut & Singh, 1988). In highly different cultures, management will perceive increased levels of control risk because of their lack of market knowledge and will select entry mode strategies that minimize management control (Anderson & Gatignon, 1986; Brouthers, 1995). This is further explained by the fact that not knowing, being comfortable with, or even agreeing with the values and operating methods of the host country, executives may shy away from the involvement that accompanies ownership in favor of non-equity arrangements (Davidson, 1980, 1982; Hill, Hwang, & Kim, 1990; Root, 1987).

Goodnow and Hansz (1972) supported less integrated foreign market entry strategy, i.e. franchising, in an empirical study of how much control large U.S. firms exert when going overseas. Via cluster analysis, they sorted 100 countries into three groups that roughly correspond to increasing cultural distance from the United States. Goodnow and Hansz also grouped entry modes into three types: strong control/high investment, moderate control/modest investment, and weak control/low investment. They found firms reduce their control and investment as they move away from culturally similar countries.

Whereas equity ownership requires the service firm to fully bear the onerous modification of its business format package, franchising allows the principal to shift the responsibility for cultural adaptation to its foreign franchisee who then bears the risk of financial failure if the service is not adequately adapted to the host country cultural context (Fladmoe-Lindquist & Jacque, 1995). Sashi and Karuppur (2002) postulates that franchising allows franchisors to intermingle their strengths with the country-specific knowledge and management

skills of franchisees. Franchisees familiar with the local culture will be better able to modify products and promotional strategies to suit domestic requirements.

In addition to political uncertainty, increased cultural differences or geographic distance, may create a situation where service firms incur internal organizational costs that exceed transaction cost savings when using wholly owned modes (Brouthers & Brouthers, 2003). It is contended that the greater the cultural difference between home and host countries, the lower the degree of control an entrant should and does demand (Alon & Mckee, 1999b; Kwon & Konopa, 1993). When cultural distances are significant, even firms that prefer high ownership arrangements in domestic markets may adopt low ownership arrangements in global markets (Sashi & Karuppur, 2002).

Because of cultural distance, service firms tend to avoid wholly owned modes of entry as behavioral uncertainties increase (Erramilli & Rao, 1993). Empirical studies of service firm mode choice suggest that, as behavioral uncertainties increase, service providers reduce the use of wholly owned modes of entry (Agarwal & Ramaswami, 1992; Erramilli & Rao, 1993; Fladmoe-Lindquist & Jacque, 1995). Uncertainty due to cultural distance may also lead investors either to undervalue or to shy away from making foreign investments (Davidson, 1980, 1982; Root, 1987). Empirically this position is supported by Gatignon and Anderson (1988).

The manager of a service for business can adapt to the cultural differences and business practices and thereby improve the chances of success of cross-cultural business interactions. In brief, as sociocultural distance increases, or market knowledge decreases, management's desire for control decreases (Anderson & Gatignon, 1986; Erramilli & Rao, 1990; Hu & Chen, 1993; Kogut & Singh, 1988). For this reason, cultural difference discourages equity mode market entry

(e.g., wholly owned subsidiary) in favour of franchise. In consequence, the following hypothesis is developed.

Hypothesis 3:

As the cultural distance between a firm's home country and the host country increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Political Uncertainty

Relationships with host governments largely remain contextual (uncontrollable) for the foreign investor in market economies (Beamish & Banks, 1987; Pan, 1996). In the terminology of Root (1988), contextual uncertainties are those external uncertainties and risks embodied in the market environment and usually beyond the control of the firm. Contextual uncertainty and ensuing risks are viewed in terms of the host country's political stability and the host country's policies/regulations related to transnational business activities (Root, 1988).

Kobrin (1982) defines political uncertainty as unexpected changes in government structures (instability of political system) and policies from a "friendly" to a "hostile" attitude. Both political stability and government policy changes are subject to national social influences and sovereign choice, and, as such, were expected to differ across countries, but not across industries (Miller, 1993). Political uncertainties are concerned with the problems of international firms operating in a host country (Fladmoe-Lindquist, 1991). While political risk management has been a crucial component of multinational strategy, it takes on special meaning and complexity in foreign ownership and control strategies (Shan, 1991) and influences a firm's entry mode decision (Kwon & Konopa, 1993).

Political stability refers to a political system that allows representation of major elements of its people, has the confidence of its people, has the stable governments, creates conditions for continuity and growth of businesses, and encourages private enterprises (Goodnow & Hansz, 1972). Such a political system attracts foreign equity investment. Political instability, in contrast, refers to the form and stability of government, especially unpredictability of changes in political regimes and the direction of that change, and the attitude of government toward foreign investment (Anderson & Gatignon, 1986; Falbe & Dandridge, 1992; Goodnow, 1985; Goodnow & Hansz, 1972; Kobrin, 1976; Shubik, 1983; Ting, 1988). Local political instability is often reflected in frequent government changes, military coups, riots, insurrections, worker strikes against the national authority, and so forth (Goodnow & Hansz, 1972). Political instability deters foreign investment. For instance, a government that frequently reverses previous decisions discourages investment from abroad.

Political instability is likely to have a greater impact on the entry decision of services because of the need for physical proximity between service provider and consumer (Ekeledo & Sivakumar, 1998). Fatehi-Sedeh and Safizadeh (1988) argued that certain social and political events, such as elections, influenced the flow of direct foreign investment. Their conclusion suggested a negative relationship between political instability and the flow of foreign direct investment. Similarly, Brouthers (1995) found that international risk increased entry mode choices that shifted risks to other firms. Thus, in nations where political risks are perceived to be high, it is unlikely that a high resource commitment entry mode (e.g., FDI) will be undertaken (Kwon & Konopa, 1993). It was found that political instability discouraged complete integration or full ownership (Davidson & McFetridge, 1985; Green & Cunningham 1975).

The government instability or structure risk that in the past has led to the confiscation, expropriation, or domestication of a firm's resources, however, actually accounts for very little of a firm's risk to financial returns (Kobrin, 1982) and has been of a lesser concern for consumer service firms (e.g., hospitality firms) than it is for professional services or for some goods producing industries (Fladmoe-Lindquist, 1991). Very few of the services provided would be considered to have strategic importance from a national sovereignty perspective. For instance, expropriation in the case of consumer service businesses is rare because consumer services are not regarded as producing strategic goods or politically sensitive products which might threaten from a national sovereignty perspective of host countries (Fladmoe-Lindquist & Jacque, 1995).

The concept of political uncertainty involves the changes that occur in governmental policy and regulation (Fladmoe-Lindquist, 1991). Political instability can lead to frequent changes in government policies and industrial regulations and thus increase the risk of performing business operations in a country (Sashi & Karuppur, 2002). For example, restrictions on trade and direct foreign investment, repatriation of profits, restrictions on ownership, discriminatory licensing, copyright violations, and tax structure can affect the entry mode and economic performance of firms (Reardon, Erramilli, & Dsouza, 1996).

Along with the issue of instability of political system, policy uncertainty has impact on the choice of foreign market entry mode and economic performance of firms (Reardon et al., 1996). Policy uncertainty indicates instability in government policies that have an impact on the business community (Ting, 1988). Typical of national government policy uncertainties are the full range of regulations to which international service firms are subject. Firms need to deal with host country policies and regulations as they cross national borders (Herring, 1983).

Policy uncertainty includes legislative requirements and restrictions such as foreign ownership restrictions and transfers the extent of restrictions towards local currency convertibility, local content requirements, local hiring requirements, imported inputs, price control, and repatriation of profit including interest, royalties, and principal repayments (Dunning, 1980; Goodnow, 1985; Goodnow & Hansz, 1972; Root, 1987). Another policy uncertainty bearing on the entry mode is the nature of trade policy such as the number and type of import quotas, tariff protection, tax rates and trends towards taxation (Caves, 1971; Goodnow & Hansz, 1972; Horst, 1971; Lipsey & Weiss, 1981; Root, 1987; Smith, 1987).

Governments that object to international service firms may severely hinder foreign firms from entering the market with their services (Grönroos, 1999). The major impediment related with host country policies and regulations that international service firms encounter centers on the government requirement for local participation of host country entity in ownership; restrictions concerning the ownership and control of corporate assets – the maximum percentage of ownership that the entrant may hold (Aydin & Kacker, 1990; Falbe & Dandridge, 1992; Fladmoe-Lindquist, 1996; Herring, 1983; Lafili & Van Ranst, 1990). These national policies and regulations vary from country to country, including the home country, and affect the choice of ownership and control strategies (Fladmoe-Lindquist, 1996). As a consequence, the ability to evaluate local policy uncertainty is of paramount importance for international service firms.

Changes in host country policy and regulation will impinge on the type of entry for international service firm and have an effect on the level of profitability of the firm and its ability to provide a consistent level of service (Falbe & Dandridge, 1992; Fladmoe & Jacque, 1995; Kobrin, 1979). Investments become riskier as national regulations become increasingly uncertain. For example, at the time of an initial investment, a firm may be permitted to import

certain inputs to services. However, a shift in governmental policy may later forbid importation of additional inputs and permit to use local contents. Such policy changes may make the continuation of business difficult or expensive, and would not have been acceptable at the start of the project (Kobrin, 1979).

Governmental regulations such as local content requirements and health regulations may require hospitality firms to modify the menu offered and to use local raw materials. These types of governmental regulations may have a negative impact on quality standardization. For example, Hobson's, a California based gourmet ice cream franchising chain, was prohibited from importing raw material from the U.S. by the Korean government, and give up importing raw materials to stay in business (Eroglu, 1992). This issue is particularly important for business format services that rely on a very specific set of inputs for their business operations. Changes in governmental policy regarding personnel, training, or service inputs can affect the ability of the local service outlet to perform as specified in the standardized business format.

The host country policies and regulations concerning protection of intellectual property such as trademark rights and contracts are of central importance to service firms (Lafili & Van Ranst, 1990). Since the general concept of business formatted services such as details of management approaches, designs, recipes, or processes that constitute core elements of the system may be easily imitated, firms that are involved in such service industry (e.g., hotel and restaurant industry) should be precautionary when entering into foreign markets to protect the brand name and reputation of the firm (Justis & Judd, 1989). The protection of brand name and reputation, however, is not easily managed in countries where intellectual property laws vary or are not enforced (Fladmoe-Lindquist, 1996). For example, Japanese law does not allow service marks (Abell, 1990; Lafili & Van Ranst, 1990). In this regard, as service firms continue to move

to countries with significantly different legal traditions, the issue of intellectual property rights will increase in impact on the ownership and control modes of the firm.

International service firms are less likely to make a resource commitment when host governments impose onerous legislative restrictions of the prospective foreign entrants (Kwon & Konopa, 1993). According to Agarwal and Ramaswami (1992), host countries with greater probability of restrictive policies impede foreign investment and encourage non-equity modes (e.g., franchising). For example, if the host country has extensive foreign exchange control, Davidson and McFetridge (1985) found the probability of using a high resource commitment entry mode such as FDI is low. Conversely, foreign direct investment increases when local legislation provides foreign investment incentives (Contractor, 1984).

Services generally require some level of interaction between producers and consumers. For international services, this requires bringing producers and consumers together across national boundaries through some type of establishment or collapsing space and time to allow interaction despite separation (Clark & Rajaratnam, 1999). As Nicolaides (1991) explains, “in many service sectors trade is either not technically feasible or cost effective. Because the supply of these services requires close contact between their providers and consumers, foreign firms which want to supply non-tradable services need to establish a permanent presence in local markets” (p. 126). In deed, in most cases, hospitality services cannot be traded without this permanent presence in local markets. All too often, however, governments often impose restrictions on foreign ownership and on foreign direct investments flows (investment barriers).

Depending on the degree of political uncertainty, different organizational forms may be employed by multinational service firms. When the degree of political uncertainty is high, firms can consider franchising as an entry mode. Aydin and Kacker (1990) presented the benefits of

franchising in relation with the political risk involved in international market expansions. They argued that costs resulting from failure risk and political risk are much less because franchising relies mostly on ownership by franchisees. The benefits of franchising is further evidenced by the fact that firms should react to volatility in their environment by avoiding ownership and retaining flexibility by shifting risk to outsiders (e.g., franchise agents) (Davis, Desai, & Francis, 2000).

Franchising may not be favored because royalty payments can be affected by political uncertainty (Fladmoe-Lindquist & Jacque, 1995). However, Sashi and Karuppur (2000) suggest that firms can reduce the risk by setting a high initial fee followed by low royalty payments and franchisors will then be able to retain control of franchisees as well as reduce risk. Firms may also enter into franchise agreements with an option to purchase in the future (Sashi & Karuppur, 2000). Frequent changes in government policies may require firms to frequently adjust their practices. For instance, policies relating to the use of foreign brand names or imported raw materials may be altered. The modifications ensued as a consequence to comply with local regulations may be made more easily by involving local franchisees.

In order to protect their investment, firms will be compelled to gather information and monitor political changes on a continuous basis (Reardon et al., 1996; Sashi & Karuppur, 2002). Investors are likely to undervalue investments made in markets where political uncertainty is high since full ownership control would entail high switching costs and undesirable events might occur (Fladmoe-Lindquist & Jacque, 1995). Contractor and Lorange (1988) maintained that one of the strategic rationales for forming cooperative relationships (e.g., franchising) over wholly owned ventures was risk reduction. Cooperative ventures have the advantage of lower capital investment risk, lower risk of return due to faster entry, and lower political risk.

Hypothesis 4:

As the political uncertainty in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Economic Uncertainty

To the extent that national product and financial markets are segmented, managers operating in different countries should experience distinct levels of economic uncertainty (Miller, 1993). Economic uncertainty manifests itself in terms of the stage of economic activity and demand fluctuations (Sashi & Karuppur, 2002). Economic uncertainty also encompasses fluctuations in the level of prices (Oxelheim & Wihlborg, 1987).

Prices fluctuations may take the form of general price inflations or movements in the relative prices of inputs (such as raw materials or labor) and consumer goods (Oxelheim & Wihlborg, 1987). Often associated with the movements in aggregate production and prices are uncertain movements in exchange rates and interest rates (Miller, 1992), which can affect the cost of conducting business operations in global markets and adversely impact returns (Sashi & Karuppur, 2002).

Currency uncertainty is the unpredictability of the value of domestic currency vis-à-vis the major international currencies (Terpstra & Sarathy, 2000). Currency risk arises from fluctuating exchange rates between the entrant (reference) currency and the host country (local) currency which may result in lost income for the international service firm (Fladmoe-Lindquist & Jacque, 1995). Currency fluctuations are likely to affect the value of the investments as well as the repatriation of earnings (Sashi & Karuppur, 2002).

Firms may prefer to avoid investing in countries where the currency uncertainty is high since swings in foreign exchange rates are expected to affect the decision to use corporate equity as an ownership strategy (Sashi & Karuppur, 2002). In particular, location dependent services which involve substantial investment in physical resources to operate (e.g., restaurants and hotels) may be hesitant to commit to full equity positions and to expand to countries under conditions of volatile exchange rates and the resulting translation exposures on the balance sheet of their parent (Fladmoe-Lindquist & Jacque, 1995).

Since the site dependency of consumer services eliminates the export option, contractual arrangements such as franchising may provide an alternative approach to mitigate economic exposure to exchange risk (Fladmoe-Lindquist & Jacque, 1995). By employing franchising as the mode of operation, firms will be able to enter global markets without committing their own financial resources. Sashi and Karuppur (2002) argued that foreign exchange risk can be reduced by receiving a higher initial fee from franchisees. Franchisors can gather information from franchisees and retain control of these markets as well as preserve the scope for realizing a regular flow of returns.

Another economic factor alluded to in the literature of entry mode and economic uncertainty was demand conditions and foreign market opportunity potential in the host country (Alon & Kckee, 1999b; Caves, 1974; Caves & Mehra, 1986; Goodnow, 1985; Goodnow & Hansz, 1972; Kwon & Konopa, 1993; Root, 1987). Host country's market potential has been found to be among the most important determinants of foreign entry decision (Aharoni, 1996). Typically, where an extensive market opportunity exists, firms tend to choose a high resource commitment over a low resource commitment to increase the rate of return (Agarwal, 1994).

On the contrary, when future host country demand for an international firm's product is uncertain, existing works indicate that international firms tend not to commit substantial resources in the market (Harrigan, 1983). In markets where future demand is expected to be low market risks are perceived as high, since the firm must command a large share of a small market to be profitable (Brouthers, 1995). Extensive resource commitments may limit the firm's ability to reduce excess capacity, effectively adjust to oscillating conditions, or exit altogether from the host country without incurring substantial sunk costs if demand should fail to reach a significant level (Hill, Hwang, & Kim, 1990). In such a market, they appear to favor entry modes that require low involvement, such as franchising (Harrigan, 1983; Kim & Hwang, 1992).

The next component of economic risk factors is economic infrastructure. Economic infrastructure refers to the methods available within a market to sell, advertise, promote, and distribute a firm's goods or service (Brouthers, 1995). Brouthers (1995) argues that economic infrastructure can cause economic uncertainty through the lack of familiar infrastructure components or the lack of a structured infrastructure. These economic infrastructure effects management decision on the entry mode and amount of resources they are willing to commit to a particular market.

Good performance of production and marketing tasks requires not just a commercial infrastructure but also a physical infrastructure (Douglas & Craig, 1995). A poor physical infrastructure may lead to a substantial impact on the choice of entry mode. In some countries the physical component of the infrastructure are different from the home market or poorly maintained and are inadequate to support the firm's preferred strategy (Brouthers, 1995).

Service firms, because they must be present in the local market, may have to adapt their operations to available facilities and supporting services, adopt a contractual mode (e.g.,

franchising) or avoid the market altogether (Ekeledo & Sivakumar, 1998). They may elect to stay out of the market if the non-equity mode (e.g., franchising) is not feasible. In general, a poor economic infrastructure is likely to reduce the number of equity based ownership and control modes in favor of franchising (Terpstra & Sarathy, 2000).

As with physical infrastructure, commercial infrastructure effects risk perception in a number of ways. Firms used to advertising and selling in a specific infrastructure may find another market's commercial too restrictive, limited, unresponsive or unusual due to the lack of familiar infrastructure components or lack of structured infrastructure (Brouthers, 1995). For instance, a firm that primarily uses television advertising in the U.S. may find this form of advertising limited or unavailable in other countries, such as Eastern European countries (Wierenga, Pruyn, & Waarts, 1996). Ricks (1983) cites a number of examples where marketing infrastructure decisions had adverse effects on international expansion. In these examples, firms used incorrect marketing channels or methods based on home market experience without adjusting for differences in the targeted foreign market.

The economic infrastructure of a host country is a significant factor affecting ownership and control decision of international service firms. Due to the intangible characteristics of services, consumers look for tangible signs of service quality to reduce uncertainty. The service provider's task is to make the service tangible through the right channel of communication, i.e., commercial infrastructure.

The service company gains entry into the market at little risk without incurring excess expenses in the creation of a new learning curve through franchising. The franchisees provide market information to choose appropriate communication channels; franchisors can reduce the

gap between service delivery and external communication by selecting accurate and appropriate communication channels, which are essential to delivering high quality service.

These economic risks effect management's decision on the amount of resources they are willing to commit to a particular market. A service firm must adjust its entry mode strategy based on management's perception of economic uncertainty in the foreign market. For markets where economic risk is perceived as being low, firms will use strategies that involve a high level of resource commitment. However, in markets that have high economic risks, management must adjust its strategy to minimize the effect of the risks on the firm's performance and will likely use low resource commitment strategies.

Multinational service firms may prefer to shun investing their own capital by involving local partners willing to invest and adopt franchisor strategies and operating procedures. Of the several low ownership alternatives, franchising will be preferred when there is a need for higher value addition in host country markets (Sashi & Karuppur, 2002). As Norton (1988a) found in the domestic context, franchisees will be able to assess market demand frequently and alter production to meet changing requirements.

Hypothesis 5:

As the economic uncertainty in a foreign market increase, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Entry Mode Hypothesis

As entry modes have a major impact on the firm's overseas business performance, their choice is regarded as a critical international business decision (Anderson & Gatignon, 1986; Root, 1987; Terpstra, 1987; Hill et al., 1990; Wind & Perlmutter, 1977). Woodcock, Beamish, and Makino (1994) point out that for entry mode (i.e., ownership and control mode) selection research to be of use to firm managers, the relationship between entry mode selected and performance must be considered. Entry mode theory assumes that firms will select the mode that provides the best return on investment (Brouthers, Brouthers, & Werner, 1999; Woodcock et al., 1994).

Degree of Ownership and Control

Many forms of market entry are available to firms to enter international markets. One classification first distinguishes between equity and non-equity modes. Equity modes involve firms taking some degree of ownership and control of the market organizations involved, including wholly owned subsidiaries and joint venture. Non-equity modes do not involve or represent relatively low degree of ownership and control. Non-equity modes include exporting or some form contractual agreements such as franchising (Pan & Tse, 2000).

Because of nature of our empirical study, of empirical interest in this research are the three international entry modes of franchising, joint venture, and wholly-owned subsidiaries. Although something of a simplification, much of the international business literature focuses on these three distinct modes and suggests that each of these entry modes is consistent with a different level of control (Calvet, 1984; Caves, 1982; Davidson, 1982; Root, 1987) and resource commitment (Vernon, 1983).

A review of the literature suggests that while wholly owned subsidiaries can be characterized by a relatively high level of control and resource commitment, the opposite can be said of franchising agreements (Hill et al., 1990; Kim & Hwang, 1992). High-control modes (e.g., wholly-owned subsidiary) can increase return and risk. Low-control modes (e.g., franchising) minimize resource commitment and hence risk, but often at the expense of returns (Anderson & Gatignon, 1986). With respect to joint ventures, although the levels of control and resource commitments admittedly vary with the nature of the ownership split, their extent can nevertheless be said to lie between that of wholly owned subsidiaries and franchising agreements (Kim & Hwang, 1992).

Each entry mode is associated with a certain level of investment risk and resource commitment, and thus different entry modes imply a different level of organizational control over the foreign operation. Previous researches have suggested that entry modes having different ownership levels are associated with specific control capabilities and capacities (Anderson & Gatignon, 1986; Calvet, 1981; Caves, 1982; Davidson, 1982; Gatignon & Anderson, 1988; Root, 1987). Anderson and Gatignon (1986) postulated that, in choosing entry modes, firms make trade-offs between control (benefit of integration) and cost of resource commitments (cost of integration). Especially, for the firm based in foreign markets, organizational control is the central factor in the organizational and financial pattern (Palenzuela & Bobillo, 1999).

Hence, the basic criterion used to evaluate entry modes is the level of control or involvement each mode affords the entrant because it is the single most important determinant of both risk and return (Erramilli & Rao, 1990). Control and integration are closely related, since integration gives a firm legitimate authority to direct operations (Anderson & Gatignon, 1986). Control refers to authority over operational and strategic decision-making and resource

commitment means dedicated assets that cannot be redeployed to alternative uses without loss of value (Kim & Hwang, 1992). Woodcock et al. (1994) defined organizational control as the efficient and effective management of the relationship between the parent and entry entity that enables the parent to best meet their overall goals and objectives (i.e., goal congruence).

Stopford and Wells (1972) suggest that firms choose entry modes which allow them maximum control over foreign activities. As control is often assumed to be proportionately related to the degree of resource commitment, this suggests that firms will follow high-involvement strategies, investing a large amount of resources in the foreign operation (Buckley et al., 1992). The TCA approach suggests that most efficient transactions are governed by complete integration because it solves many of the problems associated with opportunistic behavior by the parties through maximum control (Ring & Van-de-Ven, 1992).

Poppo and Zenger (1998) maintain that transaction cost based mode choices may lead to better performance because transaction cost theory provides managers with a method “to maximize performance by matching exchange, which differ in attributes, to governance structures, which differ in performance” (p. 854). Hill (1990) suggested that transaction cost solution compare transaction costs with “bureaucratic costs of managing an exchange” (p. 501). As a consequence, entry modes based on transaction cost perform better because they consider both transaction costs and the costs of internal coordination and control (Brouthers, 2002; Shrader, 2001).

However, the influence of transaction efficiency and asset specificity on the choice of foreign market entry for service firms is contingent on other factors that affect the benefits and costs of integration (Erramilli & Rao, 1993; Murray & Kotabe, 1999; Palenzuela & Bobillo,

1999). Such a decision is weighted against the amount of perceived risk and uncertainty associated with the venture as well as the available resources of the firm (Brouthers, 2002).

Agarwal and Ramaswami (1992) suggest choosing the entry mode offering the highest risk-adjusted return on investment from the feasible entry options. Anderson and Gatignon (1986) contend that “firms trade various levels of control for reduction of resource commitment in the hope of reducing some forms of risk while increasing their returns” (p. 3). They also state that firms are interested in subsidiary control as a means of controlling risk and improving performance.

Since risk and control are related to a firm’s costs and returns of doing business in a foreign market, the risk-return/cost-control trade-offs model is offered as an explanation of a firm’s behavior of maximizing profit by choosing the optimal entry mode for a desired foreign market (Grosse, 1985). Ekeledo and Sivakumar (1998) contend that relationship among risk, entry mode, and performance may be reflected by the level of control and resource commitment associated with each entry mode alternative.

Although previous studies suggest that franchising offers lowest degree of control comparing to joint venture and wholly owned subsidiary (Hill & Hwang, 1990), franchising presents certain degree of control because the typical agreement includes incentives to adhere to the system’s rules and allows a high degree of monitoring of the franchisee’s activities (Anderson & Gatignon, 1986).

Baroncelli and Manaresi (1997) argue that franchising substitutes the loss of ownership by an increase of external relationships and it takes without losing control on retail operations. According to Leblebici and Shalley (1996), in franchising, firms accomplish dual objectives of

gaining control over resources that are needed to capitalize on opportunities and to achieve effectiveness and growth by the use of contracts.

Franchising, in terms of control, represents an intermediate case between contractual transactions among equity holding independent parties in markets and the employment relations in hierarchical organizations (Baroncelli & Manaresi, 1997). As Williamson (1985) has pointed out, a “greater attention to transactions of the middle range will help illuminate an understanding of complex economic organization” (p. 84). Thus, franchising arrangements provide a unique setting in which the franchisor and the franchisee establish and maintain quasi-firm arrangements to create value (Carney & Gedajlovic, 1991).

Although paucity of theoretical and empirical research provides substantial support for making predictions pertaining to the relationships between the various environmental uncertainties, entry mode choice and firm performance in service sector, previous literature suggests that industry type and mode type may have an effect on performance since service sector is characterized by diverse patterns of internationalization (Cowell; 1983; Boddewyn et al., 1986; Shelp, 1981). For example, advertising agencies, fast food chains, and software firms choose widely differing patterns of foreign market entry (Erramilli, 1990). Brouthers, Brouthers, and Werner (2000) found that satisfaction with performance is increased when firms take into account environmental uncertainty and industrial sector in their entry mode decisions.

Erramilli and Rao (1993), in their study of service firms, employed a modified version of TCA to investigate the determinants of the choice of entry modes, in which industry type was considered as a mediating factor. They argue that capital intensity, inseparability and environmental uncertainty (e.g., cultural distance and host country risk) raise the costs of integration and encourage firms to employ shared control modes. In this regard, further

considerations should be taken in the light of the nature of industry type, service characteristics (e.g., intangibility, inseparability, heterogeneity), and standardization of goods and service.

With respect to industry type, Brouthers et al. (2000) state that “service firms may have several advantages over manufacturing in achieving (at least) short-term performance goals” mainly due to the less capital intensity (p. 187). Capital intensity is the level of investments on fixed assets to generate sales revenue (Erramilli & Rao, 1993; Kim & Lyn, 1987). Service organizations can be established at lower resource commitment in a shorter period of time than can manufacturing operations and the economies of scale for services are much lower, in general, than for manufacturing operations (Campbell & Verbeke, 1994; Erramilli & Rao, 1993). Therefore, in foreign markets, service firms may launch their operations utilizing relatively less corporate assets, yet providing good performance in relation to its resource and time commitment (Brouthers et al., 2000).

Ownership of overseas service facilities entails considerably less resource commitment than manufacturing sectors. Thus, concerning the high costs of integration, high resource commitment may not be true for many service firms, if not all, especially in the professional and business services sector (e.g., advertising agencies and management consultants), which frequently involves little fixed overhead such as plants, machinery, buildings, and other physical assets (Erramilli & Rao, 1993). According to Sharma and Johanson (1987), Swedish technical service firms bypassed the incremental chain establishment followed by manufacturing firms, because of minor resource commitments.

Although service firms may be generally less capital-intensive than manufacturing firms, the level of capital intensity can range from extremely low to extremely high across service industries (Erramilli & Rao, 1993). As noted by Erramilli and Rao (1993), it must be emphasized

that low capital intensity may not be true for some service firms (e.g., hotels and airlines), in which integration entails large scale investments in physical facilities. Similar to manufacturers, hospitality firms require a minimum efficient size and longer time to establish and certain intensity of facility utilization to reach certain level of performance satisfaction. For hospitality firms, satisfactory performance levels may not be accomplished in the short term because demand for output has yet to reach a breakeven or profitable level.

“Since the level of capital intensity represents the relative magnitude of fixed investment, increasing capital intensity signifies rising resource commitments and escalating costs of resource integration” (Erramilli & Rao, 1993, p. 24). In this regard, other things being equal, the higher the capital intensity, the more difficult it is for hospitality firms to exploit internal sourcing through vertical integration. In consequence, control can be attained at relatively high expense by hospitality firms. In order to reduce risks and increase level of performance, hospitality firms may resort to shared control modes (e.g., franchising) when entering uncertain foreign markets.

Another type of mediating factor affecting on the choice of foreign entry modes and performance is the inseparable feature of services. Zeithaml et al. (1985) state that inseparability is a feature that distinguished many service firms from manufacturing. For instance, close physical proximity of service providers and consumers is required for the provision of services by hotels and restaurants. Inseparability demands close buyer-seller interactions (Grönroos, 1983) and “forces the buyer into intimate contact with the production process” (Carman & Langeard, 1980, p. 8).

Carman and Langeard (1980) suggest that service firms providing inseparable services face special risks because they must begin full operations within the host country without being

able to export and learn first. Inseparability may impinge on the discrepancy between service performance standards and actual service delivered by service providers (service gap suggested by Zeithaml et al., 1985). In particular, lest service firms should train foreign customers' tastes prior to marketing their goods and services, inseparability may exacerbate another gap between service delivery and external communications in foreign market because of cultural differences and adaptation difficulties to local tastes.

Erramilli and Rao (1993) postulate that inseparability imposes considerable added costs and risks on service firms operating in foreign soil mainly due to the cultural distance. Many previous empirical studies have contended that cultural distance encourages deployment of shared control modes (e.g., franchising) (Davidson & McFetridge, 1985; Gatignon & Anderson, 1988; Kogut & Singh, 1988). Shared control entry modes offer some pooling of risk caused by inseparability, while also providing flexibility and control (Domke-Damonte, 2000).

Along with inseparability of services, high degree of customization and ensuing heterogeneity of the end service place extra demands upon the entry modes and performance of the service firm (Domke-Damonte, 2000). The loss of direct control over foreign operations compounds the problem of quality control due to the natural heterogeneity in the scale of highly people-supplied services (Buckley et al., 1992). Anderson and Gatignon (1986) suggest that researchers have found no need for the entering firm to own the factors of production and that adequate control could result from lower control modes such as franchising.

Given the labor intensity of many service operations, the output of service operations is often less standardized than the outputs of manufacturing operations. Service uniformity and quality may vary substantially over differing demand levels (Sasser, Olsen, & Wyckoff, 1978). People intensity attribute of the service firm (because of the simultaneous production and

delivery of the service product and heterogeneous provision of end service) results in greater difficulty in managing foreign operation and incurs higher internal organizational costs than manufacturing firms (Bowen & Jones, 1986; Carney & Gedajlovic, 1991; Erramilli & Rao, 1993; Fladmoe-Lindquist & Jacque, 1995).

In order to overcome problems of heterogeneity by maintaining quality and uniformity of services, as recommended by Parasuraman and Varadarajan (1988), service firms need significant human investments for securing a highly trained and motivated staff. However, these skills may not be prevalent in foreign labor markets. Thus international service firms are encountering problems, not only in obtaining local staff with the needed expertise, but also with the motivation of expatriates from the home office (Reardon et al., 1996).

Therefore it might be unreasonable for services firms to take on so much uncertainty in the output of their services, especially in the unfamiliar foreign market. In this regard, as suggested by Domke-Damonte (2000), services firms may have to rely more heavily on the development of codified standards and processes, and the cooperation through franchising. Within service industry, moreover, hospitality firms offer relatively higher degree of standardized services, operations and goods than professional services. Thus highly codified standards and processes through franchising reduce the risk of heterogeneity problems.

Another critical condition affecting entry mode choices in service exchange is the intangibility of services. With products, there is an exchange that yields physical ownership; with services the object of exchange is often an experience that can be neither touched nor possessed (Shostack, 1977). As a consequence, the customer may have difficulty envisioning what has been obtained when receiving a service. As intangibility increases, performance ambiguity increases because the customer has less evidence available to assess the service (Bowen & Jones, 1986).

The performance ambiguity is one principle source of transaction costs and gives rise to difficulty of reducing the costs of negotiating, monitoring, enforcing and evaluating exchanges between parties to transaction (Bowen & Jones, 1986). Service firms can increase the ability of both parties to measure the performance of one another through the development of standardized services and operation process.

With respect to intangibility of services, Darby and Karni (1973) described services and goods as some combination of three different qualities that customers use to evaluate them: search qualities, experience qualities and credence qualities. Search qualities are attributes that a customer can determine prior to purchase (Darby & Karni, 1973; Holmström, 1985; Nelson, 1970, 1974). These traits are generally related with tangible components of services (Normann, 1984), such as the physical features and layout of facilities for providing services, the quality of equipment, service providers' attire, and facilitating goods (Sasser, Olsen, & Wyckoff, 1978). Also included are consulting reports, structural plans, and presentation material. Search qualities are not necessarily linked with tangible features of services, including attributes like the interest rate, approval time, and monthly payments associated with a mortgage plan (Nayyar, 1993).

Experience qualities are attributes that can be discerned only after purchase or during consumption (Darby & Karni, 1973; Holmström, 1985; Nelson, 1970, 1974). Examples of experience qualities are features such as taste, purchase satisfaction, convenience, level of comfort, safety, security, speed, reliability, and service providers' attention to the needs and feelings of customers (Nayyar, 1993). Credence qualities are intangible characteristics that the consumer may find impossible to evaluate, even after purchase and consumption of a service (Darby & Karni, 1973; Holmström, 1985; Zeithaml, 1981). For instance, degree of service providers' professionalism and knowledge are the features of credence qualities.

Although each service consists of combination of different qualities, for most services one type of attribute dominate. Nayyar (1993) classifies fast-food restaurants and hotels as search and experience services, respectively. Since hospitality services primarily are composed of search and experience qualities, they are comparatively less difficult to control than professional services. Given the highly standardized services and relatively high tangible aspects involved, hospitality firms (e.g., fast food restaurants) provide a service that is far easier to evaluate performance than the professional service (e.g., teaching provided in a university). Thus it might be implausible for hospitality firms to control foreign subsidiaries through complete integration, considering this entails high resource commitment and exit costs.

Referring to consumer services, including hospitality services, Anderson and Gatignon (1986) suggest that researchers have found no need for the entering firm to own the factors of production and that adequate control could result from shared entry modes such as franchising. Erramilli and Rao (1990) also suggest that service firms are prepared to relinquish some of their control over the operation in return for lower uncertainty and risk. By teaming up with host-market intermediaries they are able to overcome the problem of lack of market knowledge, lack of business contracts and distribution structures (Buckley et al., 1992). Based on the empirical study of service firms' entry mode choice, Domke-Damonte (2000) reported that there is "the close proximity to zero probability for choosing high control entry modes for service firms in both the lodging and restaurant industries" (p. 54).

To obtain the control service firms desire, at a lower cost, they prefer to use practices like shared value systems and contractual arrangements via franchising which shift the costs of monitoring and controlling activities to the local market entities, reducing internal organizational costs (Carney & Gedajlovic, 1991; Fladmoe-Lindquist & Jacque, 1995). From the perspectives

of modified (extended) TC-based entry mode choices, contingency factors, and characteristics of hospitality services, this study develops hypothesis predicting circumstances under which firms establish shared control modes.

Hypothesis 6:

As the expected performance level in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Summary

Given the high levels of uncertainty and risk often associated with foreign market entry, it seems reasonable to expect firms to adopt more risk-averse modes when they possess certain degree of control to adopt resource deployment patterns. Rather than being constrained by resource intensive hierarchical arrangement, firms have the overall strategic flexibility to choose modes of entry that best allow them to respond to exogenous factors in the international environment.

The more adaptive modes include non-equity (equity free) of entry, using highly motivated outside entities or distributors such as franchisees. Although this entry mode is accompanied by a partial loss of internal control, this loss is offset by an increased ability to adapt to the local market needs. In particular, given the simultaneous production and consumption of service provision and ensuing impediments of lack of organizational learning time, firms will tend to adopt an entry mode more amenable to conformity with conditions in the host country market.

CHAPTER 5

RESEARCH METHODOLOGY

Introduction

This study develops and tests an initial integrative, systematic model of the environment–organization interface and associated performance outcomes. From a statistical standpoint, it is important to examine complex trivariate relationship between environmental contingency, ownership structure and control mode of foreign affiliates, and performance rather than simple bivariate. The methodology employed, structural equation analysis, allows simultaneous examination of systemic relationships among environmental and organizational variables as well as of their joint and separate influences on performance. This approach provides for the integration of cross-sectional data and for the consideration of multiple dependent variables.

In this chapter, the theoretical model previously designed was tested empirically. Structural Equation Modeling (from hereon, often abbreviated as SEM) technique was utilized, requiring a redefinition, known as “specification,” of the theoretical model. Once the general model was specified (in chapter 3), hypotheses were then developed (in chapter 4) in order to address specific aspects of the model and the relationships of the variables. A survey instrument was designed in agreement with the model and in order to collect the data necessary to test the hypotheses. The chapter concludes with a discussion of the survey and its administration.

Research Framework

From the statistical view point, Kelloway (1998) viewed the term ‘theory’ at two levels; “a theory can be thought of as an explanation of why variables are correlated (or not correlated). Most theories go far beyond the description of correlations to include hypotheses about causal relations. A necessary but insufficient condition for the validity of a theory would be that the relationships (i.e., correlations/covariances) among variables are consistent with the propositions of the theory” (p. 5).

Structural equation modeling has been widely applied in a number of disciplines, including cross-cultural research (Riordan & Vandenberg, 1994), channel management (Schul & Babakus, 1988), international marketing (Han, 1988), services marketing (Brown, Churchill, & Peter, 1993; Cronin & Taylor, 1992; Price, Arnould, & Tierney, 1995), and strategic management (Goll & Rasheed, 1997). The primary purpose of SEM is the explanation of the pattern of inter-related dependence relationships between a set of latent (unobserved) variables and in particular the analysis of causal links between latent variables, each measured by one or more manifest (observed) variables (Reisinger & Turner, 1999).

In this study to test the hypothesized model, the SEM technique was used since they were best suited for causal models with multiple indicators. This statistical methodology uses theoretically defined variables and examines how matrix equations are able to represent their relationships (Hayduk, 1987). In addition, it is the difference between the measured and predicted covariances that receive attention, rather than differences in measured and predicted individual observations (Bollen, 1989b).

As Bollen (1989b) states, the basic premise of structural equation procedures is to examine the covariance matrix formed by the sample in comparison with the population

covariance matrix as specified in the theoretical model. The sample provided by the data is compared with the relationships specified in the model, and the degree to which the data fit the model reflects the adequacy of the causal assumptions within the model.

The SEM allows simultaneous examination of systemic relationships among environmental and organizational variables as well as of their joint and separate influences on performance. The use of structural equation modeling should be of great use to identify the direct and indirect effect of various levels of environmental variables (exogenous constructs) on the two important dependent latent variables (endogenous constructs), foreign market entry modes and performance. This approach provided for the consideration of multiple dependent latent variables.

The descriptive theoretical model developed from the literature in the second chapter and the theoretical frameworks reviewed in the third chapter has been redrawn in the fourth chapter to facilitate its testing. These redrawn models can be tested with LISREL, version 8.30, a program designed for the analysis of multivariate causal models (Jöreskog & Sörbom, 1993). Figure 6-4 illustrates the models actually tested with LISREL. They were developed from the theoretical model arrived at in chapter two and three, but are unique in their presentation of the variables and the relationships within the model.

The measurement model is specified and shown in Figure 6-2. In this figure, the actual variables used to measure the latent variables are indicated. All of the latent variables have more than one indicator as shown by the multiple arrows from the latent variable to the measured variables. The model presented in Figure 6-3 is the proposed structural model, which includes both manifest variables and the latent variables as well as their relationships.

These models are presented in a format that is in accordance with that of structural equation modeling techniques. As has been illustrated, the causal relationships between the latent variables, as derived from the theoretical model, are tested through data collected from the observed variables. The degree to which this model is correct depends upon the degree to which it can be represented in the empirical data and the degree to which the proposed theoretical model adequately reflects the relationships of the latent variables. Also, the degree to which the latent variables are adequately measured by the observed variables also affects the fit of the model. The degree of fit indicates that the data collected have a covariance matrix similar to the matrix specified in the model.

Research Hypotheses

The testable hypotheses from the theoretical model were developed in the fourth chapter and restated below in examining the causal linkages between environmental factors, foreign ownership/control modes, and performance. Several different hypotheses were identified in order to further investigate and test the model. Each hypothesis is presented and a direction is specified in Figure 6-3. The following is a listing of the hypotheses that are presented in the theoretical model to be empirically tested in this study.

Hypothesis 1:

As the monitoring cost of a unit manager in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Hypothesis 2:

As the level of asset specificity invested in a foreign market increases, firms are more likely to rely on expansion through integrated entry mode (e.g., company-owned subsidiary).

Hypothesis 3:

As the cultural distance between a firm's home country and the host country increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Hypothesis 4:

As the political uncertainty in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Hypothesis 5:

As the economic uncertainty in a foreign market increase, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Hypothesis 6:

As the expected performance level in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Research Design

Study Population

Population can be defined as any complete group of entities such as people, organizations, institutions, or like that share some common set of characteristics in agreement with the purpose of the study under investigation and about which researchers want to be able to draw conclusions and plan to generalize (Babbie, 1995; Boyd, Westfall, & Stasch, 1989; Zikmund, 1997).

As previously defined in the first chapter, referring to hotel and restaurant firms (NAICS sector 72) as hospitality industry, the target population includes international service companies in the NAICS categories of accommodation (NAICS code 721X) and food services & drinking places (NAICS code 722x). The ‘accommodation’ and ‘food services’ sector (NAICS sector 72) comprises establishments providing customers with lodging and/or prepared meals, snacks, and beverages for immediate consumption (U.S. Census Bureau, 2001b). These service industries were selected because they have a longer history of international operations and a higher rate of international involvement.

Sampling Frame

Sampling is the process of selecting observations using a small number of units of a larger population to draw conclusions about the whole population, while a sampling frame is the actual list or quasi-list of elements (sampling units) from which a probability sample may be selected (Babbie, 1995; Gall, Borg, & Gall, 1996; Zikmund, 1997).

Despite much effort, no sampling frame for the study could be obtained from any source in its entirety: government agencies, trade groups, or commercial vendors. The need for

generalizing research findings has led me to select and collect data from a variety of sources. Therefore, the sampling frame for each of the two hospitality industries known to be engaged in international operations was constructed from relevant professional business directories. A systematic sample of international hospitality firms were identified and drawn from the Directory of Chain Restaurant Operators (2003), Directory of Hotel & Lodging Companies (2004), International Hotel Groups Directory (1992), International Directory of Corporate Affiliations (1991), and Franchise Opportunities Guide (2002).

Sample Size

It is generally understood that SEM is very much a large sample technique because both the type of estimation methods (e.g., maximum likelihood) and tests of model fit (e.g., the χ^2 test) are based on the assumption of large samples (Kelloway, 1998). Several authors have presented different guidelines on the definition of “large” (e.g., Anderson & Gerbing, 1984; Bentler & Chou, 1987; Marsh, Balla, & MacDonald, 1988).

Although there is no correct sample size in the absolute sense, in general, recommendations are for a size ranging between 100 to 200 to ensure the appropriate use of maximum likelihood estimation (MLE) (Dillon, Kumar, & Mulani, 1987). For example, it is commonly recommended that models incorporating latent variables require at least sample size of 100 observations and samples of size 200 observations or greater are preferred to increase the accuracy of parameter estimates (Boomsma, 1983; Marsh, Balla, & MacDonald, 1988).

In contrast, Geweke and Singleton (1980) showed that a focus on absolute sample size was inappropriate without a specification of other factors such as the model size, including the number of measured and latent variables included in a model. In the same logic, Kline (1998)

suggests that sample size of with less than 100 cases may be untenable unless a very simple model is evaluated. More complex models entail the estimation of more statistical effects, and thus larger samples are required in order for the results to be reasonably stable (Kline, 1998). Taking a somewhat different approach, it has been suggested that the ratio of subjects to estimated parameters be between 5:1 and 10:1 (Bentler & Chou, 1987; Hair, Anderson, Tatham, & Black, 1995; Hatcher, 1994).

A number of conflicting recommendations exist in the literature regarding the minimum sample size required for appropriate statistical inference. Small samples require more careful considerations of the conditions for valid statistical power and inference. With regards to statistical power, hypothesis testing strategy for SEM models entails accepting the null hypothesis for the best model fit. It will be simple to draw conclusions about model fit when samples are small and tested models are likely to fit (Matsueda & Bielby, 1986; Saris, Satorra, & Sörbom, 1987).

In contrast, when samples are too large tested models are unlikely to fit data and thus it will be difficult to draw conclusions about model fit. From the view point of statistical inference, Tanaka (1987) argues that positive relation exists between the quality of inference made from a sample of data and its size. Thus when limited information is available, an appropriate degree of conservatism accompanies interpretation of findings and weaker inferential statements about the data should be made (Tanaka, 1987).

It may not have been obvious up until this point concerning how big sample size is big enough. In accordance with the sample size suggested by previous studies, minimum of 100 observations is minimally acceptable and a more appropriate level of 200 observations are preferred for this study in order for testing proposed hypotheses under investigation.

According to Crawford-Welch (1990), the response rates of previous research conducted in hospitality industry range from approximately 10 percent (Dev, 1988) to 30 percent (Tse, 1988; West, 1988). Base upon the conservative response rate of 10 percent, a total of 1,309 survey questionnaires were mailed out to the target population.

Survey Administration

The unit of analysis used was an individual foreign market entry decision made by a hospitality firm. The data for this research were obtained from a random sample of hospitality firms that had at least one foreign subsidiary outside United States. Data for this investigation was collected through a mail survey of hospitality firms in the United States engaged in international operations.

Survey questionnaires, accompanied by personalized cover letters and directions for completion, were mailed to managers most likely to be involved in the foreign market entry decision process in their firms. Accordingly, key informants for the information needed for this study were designated to be corporate level directors in charge of international operations, vice presidents, presidents, and CEOs (Campbell, 1955; Siedler, 1974).

In line with the logic of John (1984), who suggests for selecting knowledgeable informants, the choice of this respondent group is based upon the belief that respondents in these positions are most conversant with international expansion ventures and the dynamics of the entire foreign entry decision process. Agarwal and Ramaswami (1992) also argues that only the people in these positions have complete knowledge required for the decision process of foreign ownership and control strategies. The use of these key informants is consistent with the practices

of previous researchers who have examined organizational strategies (Nayyar, 1993; Shortell & Zajac, 1990; Snow & Hrebiniak, 1980; Zajac & Shortell, 1989).

In responding to the questionnaire, managers were asked to reflect back to a foreign entry mode decision they were involved during the recent five years in current company and to answer questions according to the logic utilized in reaching that decision. Such a period reflects a reasonable planning horizon of the organizations studied (Keats & Hitt, 1988). Also, a five year window is viewed as adequate to capture the growth of even the slow moving firms (Combs & Ketchen, 1999).

The surveys were printed in such a fashion so as to allow ease of completion and return. A double column format, with a visual separation device, was used for the questions. Inside envelope were a letter stating the purpose of the research and survey questionnaires. The envelope also contained the business reply envelope. This allows the respondents to simply fill out the questionnaire, fold in half, seal it, and then drop it in the mail, without incurring any postage or other cost. A phone number and an e-mail address were provided for respondents to contact in case of problems with the survey.

Operationalization of Constructs

Managing international risks can be accomplished through the choice of appropriate strategies germane to organizational structure. Perception of these risks, however, may vary firm to firm and country to country, and accordingly if risk varies, strategic choice of ownership and control mode may also vary (Brouthers, 1995). This study attempts to link a contingency model of entry mode selection to firm's performance.

To assess validity, Gerbing and Anderson (1988) argue for the use of all possible scales within a single analysis so that an assessment of internal consistency can be made. As suggested by Gerbing and Anderson (1988), in this study, multiple measures of perceived environmental uncertainty at each level of firm, industry, and national context were applied to predict the entry mode strategy of international hospitality firms and link these risk-adjusted entry mode choices to multiple measures of satisfaction with firm performance.

In a study of the joint effects of environmental uncertainty and resource dependence, Koberg and Ungson (1987) claimed that "consistent with the argument that perceptions of organizational contingencies and not objective properties determine decision-making behavior, two perceptual measures of environment were employed. One was measure of environment uncertainty... the other was a measure of environmental resource dependence" (p. 279). Although organization and environment are both important for understanding organizational adaptation to external environment, changes in managers' perceptions of uncertainty and changes in available resources may generate different types of organizational adjustments (Koberg, 1987).

In the study of organizational environment, Scott (1992) notes that there is a controversy in the literature concerning the relative virtues of subjective, perceptual measures versus

objective measures of dimensions of the environment. The study of managerial perceptions is a major issue of theoretical and empirical concern in organizational analysis, studies of strategic management, and the measurement of performance (Fable & Welsh, 1998).

Some researchers have treated the environment as an objective fact independent of firms (Aldrich, 1979), while others have treated this construct as perceptually determined and enacted (Weick, 1969). This issue has been a source of equivocal empirical results. Bourgeois (1980), however, has concluded that the issue is not whether measures should be objective or perceptual; rather, he suggested that both objective and perceptual environments are real and relevant from a strategic management standpoint.

One theoretical argument is that perceptual measures are more appropriate since only perceived factors enter into decision making and influence subsequent actions (Dill, 1958; Duncan, 1972; Lawrence & Lorsch, 1967a; Pfeffer & Salancik, 1978). The decision maker's perception of international environmental factors which influence the firm's entry mode choice determines how firms actually behave, not how ought to behave, with regard to the foreign market entry mode decision (Kwon & Konopa, 1993).

Previous studies in organizational environment have supported argument in the significance of managers' perceptions, interpretations, and their effect on strategic decision making (Gould & White, 1986; Huff, 1990; Reger & Huff, 1993; Senge, 1990). Agarwal and Ramaswami (1992) suggest that a critical determinant in the choice of entry mode and of the decision to internationalize is managerial perceptions and attitudes.

Gould and White (1986) argue that "human behavior is affected by only that portion of the environment that is actually perceived; our views of the world and the people in it are formed from a highly filtered set of impressions and our images are strongly affected by the information

we receive through our filters” (p. 28). Such perceptions and attitudes are important to understanding the decision-making process within a firm (Kedia, Ackerman, Bush, & Justis, 1994).

Managers cope with a myriad of events, and must interpret or make sense of these events and then sort them into patterns that influence future actions (Daft & Weick, 1984; Weick, 1995). Research findings indicate that managerial perceptions have an effect on choices, actions, and organization performance (Hambrick & Mason, 1984; Starbuck & Milliken, 1988; Thomas, Clark, & Gioia, 1993; Waller, Huber, and Glick, 1995; Walsh, 1988).

Tversky and Kahneman (1974) and Kahneman and Tversky (1979) examined strategic heuristics under uncertainty, noting that beliefs, attitudes and perceptions influence the interpretation of information by decision makers. The beliefs and perceptions of the top management team may influence the way in which information is filtered, potentially blinding decision makers to significant opportunities in the environment (Hambrick & Mason, 1984). Daft and Weick (1984) suggest that the perceptions, beliefs and assumptions of top managers significantly influence the manner in which organizations seek out and interpret information available to them. In short, the attitudes, beliefs and perceptions of managers influence their assessment of the availability and desirability of opportunities in their environment.

Consistent with their argument that managerial perceptions ultimately decide degree of ownership and control in the operation of foreign affiliates, in this study, the author assumes that managerial perception of the factors that decide a successful (or unsuccessful) foreign operation is a central issue because these factors would influence managerial decisions in a number of areas. By examining the attitudes of managers of firms which operate internationally, this research not only seeks to understand the factors that affect the strategic decisions on entry mode

that involve ownership and control modes in foreign markets by navigating domain constraints in firm, industry, and national context but also investigates influences of entry mode on firm performance.

Monitoring Uncertainty (Exogenous Construct)

Behavioral uncertainty is one of the critical components of firm-specific uncertainties manifested by Miller (1992) who argues that employees and managers may act out of their own individual self-interest. Agency theory addresses relationships in which the principal delegates work to the agent (e.g., employees) who agrees to perform the task (Bergen, Dutta, & Walker, 1992; Eisenhardt, 1989; Jensen & Meckling, 1976). As described by Eisenhardt (1985), agency theory is an analytic, normative microeconomics/accounting approach to the question of how principals can control the activities of the agents.

A central premise of this theory is that principals and agents have divergent goals. Goal incongruence places principals and agents in conflict. For example, the principal (e.g., the company) desires increased profit whereas the agent (e.g., the foreign unit manager) desires increased personal income (Anderson & Oliver, 1987). The agent may not expend the effort needed to perform the delegated task and may act out of their own individual self-interest, giving rise to the problem of moral hazard. The principal may also be unable to ascertain if the agent is capable of performing the delegated task, giving rise to the problem of adverse selection (Arrow, 1963; Jensen & Meckling, 1976).

While behavioral uncertainty exists in the domestic operations as well as internationally, the nature of international operations exasperate this uncertainty in two unique ways. First, because the firm must perform these functions in different cultures where the relationships may

vary significantly from the home market (Alon & McKee, 1999a; Brouthers, 1995; Doherty & Quinn, 1999; Huszagh, Huszagh, & McIntyre, 1992; Teece, 1977) and second, international operations are by their very nature more difficult to structure and control mainly due to the physical distance (Alon & McKee, 1999a; Fladmoe-Lindquist, 1996; Fladmoe-Lindquist & Jacque, 1995; Terpstra & Yu, 1988).

The major agency problem associated with company-owned unit is moral hazard (e.g., shirking and perquisite consumption) by employees (e.g., foreign unit managers) (Bergen, Dutta, & Walker, 1992; Brickley & Dark, 1987; Eisenhardt, 1989; Jensen & Meckling, 1976; Martin, 1988). For example, a manager of a company-owned unit in the foreign country has an incentive to substitute low-quality inputs if he gets a kickback from a supplier who charges a high price for a low-quality input (Brickley & Dark, 1987). Also, the manager has an incentive to substitute low-quality inputs if a large fraction of his income is incentive-based (Brickley & Dark, 1987). Such an arrangement, however, would be expected to occur in a different foreign business environment mainly due to the difference in culture and business practices.

A primary method of controlling the problem of moral hazard is monitoring the employees (Brickley & Dark, 1987). Because of monitoring costs, however, the increase in potential income generally associated with direct ownership may be insufficient to offset the greater efficiency of the franchisee (Bergen, Dutta, & Walker, 1992). Thus the difficulty the principal faces in monitoring the agent affects ownership structure and control modes (the extent of vertical integration) of foreign affiliate (Lafontaine & Slade, 1997).

Researchers in management (Arrow, 1964; Galbraith; 1977; March & Simon, 1958; Ouchi, 1978) support the notion that organizational structure represents a control mechanism and view the control system as a process of monitoring. Given that formal control consists of

attempts by the organization to influence the behavior of individuals or groups, organizational structure is, by definition, a control mechanism (Jaworski, 1988). As suggested by Jaworski (1988) and Anderson and Oliver (1987), agent control systems (process of monitoring) can be classified into those monitoring the final outcomes of a process (in their terminology, output control and outcome-based control respectively) and those monitoring individual stages (e.g., behaviors) in the process (in their terminology, process control and behavior-based control respectively).

Agency theory is a major theoretical approach pertinent to the agent control problem and suggests control systems (i.e., organizational structure) that monitor behavior processes versus those that measure outcomes (Anderson & Oliver, 1987). Forms of control systems based on the monitoring of outcomes or of behaviors are germane to the agency theory perspective in the notion that agency theory is concerned with the design of control systems that realign the incentives of both principal and agent so that both parties desire the same outcome (i.e., incentive compatibility) (Lafontaine & Slade, 1997). Researchers sought to develop indicators of latent construct of behavior and outcome control and empirically tested the effect of types of controls on agent relationships (Aulakh & Gencturk, 2000; Bello & Gilliland, 1997; Celly & Frazier, 1996; Challagalla & Shervani, 1996; Jaworski & MacInnis, 1989; Jaworski, Stathakopoulos, & Krishnan, 1993; Oliver & Anderson, 1994; Ramaswami, 1996).

Finding appropriate proxies for monitoring costs tends to be difficult (Lafontaine & Slade, 1997). For measuring costs of output control, researchers asked managers to respond to various statements. Anderson (1985), Anderson and Schmittlein (1984), and John and Weitz (1988) obtained information on the difficulty of relating sales results to the performance or effort of individual agent. For example, in Anderson and Schmittlein (1984), managers responded to “it

is very difficult to measure equitably the results of individual agents” (p. 391). Using scores obtained as measures of monitoring costs, these researchers found that the higher their measures of monitoring cost, therefore, the poorer are sales data as a measure of effort. Consequently, companies tend to rely less heavily on output-based compensation: thus the increased degree of vertical integration (e.g., the company-owned subsidiary). In other words, lower costs were associated with less integrated organizational form (e.g., franchising).

Another explanation of measuring monitoring costs can be assessed by the costs of process (behavior-based) control. Process control is exercised when the firm monitors the agents’ behavior or attempts to influence the means used to achieve desired ends whereas output control refers to the extent to which the firm monitors the results or outcomes produced by the agents (Aulakh & Gencturk, 2000; Jaworski, 1988). Unlike output control, it focuses on behavior and/or activities rather than the end results. In process control mechanism, therefore, relatively considerable monitoring of agent’s activities by management is involved; relatively high levels of management direction of and intervention in the activities of agents are involved (Anderson & Oliver, 1987).

This process control system may be expensive because of significant management overhead involved and increasingly costly as the physical distance increases. With measure of distance or dispersion, researchers are aiming to capture the cost of monitoring the unit manager’s effort directly. Frequently used measure of monitoring difficulty is some notion of distance or dispersion from a monitoring headquarters. Needless to say, the cost of separation in space and time are exacerbated in global markets that span continents and time zones, and despite recent improvements in transportation and communication technology, present challenges to frequent, direct, on-site monitoring of agents’ behavior in foreign subsidiaries

(Sashi & Karuppur, 2002). When monitoring costs are measured directly by distance, higher monitoring costs have a negative effect on the fraction of company-owned outlets (Lafontaine & Slade, 1997).

Previous studies, in domestic settings, empirically support for monitoring cost explanation of agency theory. Rubin (1978) suggests that the cost of monitoring is likely to be high when the unit is geographically distant from the monitoring headquarters, i.e. main or regional headquarters of the company. Studies in domestic markets suggest that franchised units tend to be located farther away from monitoring headquarters (Brickley & Dark, 1987; Norton, 1988a). Norton (1988a) cites the example of Waffle House, which chose company-owned outlets for the southeast where its corporate operations were located, and for the southwest where it had some company operations, but opted for franchisee-owned operations in the rest of the US.

Brickley and Dark's (1987) study is the first systematic attempt to test the monitoring hypotheses for franchising. The authors obtained data on the ownership structure of 36 different firms belonging to nine different industries including lodging, restaurant, specialty-food shops, travel services, and recreation services. They find that distance is related to ownership structure tenure; outlets located further from company-headquarters are more likely to be franchised with the increase of employee-monitoring costs. They used the distance from the nearest monitoring headquarters for owned and franchised units to measure monitoring costs. Using U.S. Department of Commerce data, which summarized the proportion of franchising in 15 industries in 1985, Brickley and Weisbach (1991) found statistical support for agency theory assumptions.

Norton (1988a) uses 1977 U.S. census data for the restaurant, refreshment places, and motel industries to test hypotheses that there is a direct relationship between increases in monitoring costs and increases in the number of franchising contracts a firm would be willing to

undertake. The two variables Norton (1988a) used as proxies for monitoring costs – population dispersion and labor intensity – were found to be positively associated with the percentage of establishments categorized as franchise-holders. His main result is that outlets in rural areas are more likely to be franchised due to monitoring problems of unit managers. This result holds for all three industries.

Shane (1996a) proposed that franchising is a mechanism of minimizing agency problems of growth. He found support for the hypotheses that franchising spurs growth and that it increases a firm's likelihood for survival. Kuga (1989) and Minkler (1990), in the study of McDonald and Taco Bell restaurants respectively, found support for the hypotheses that the proportion of franchising units increases with employee-monitoring costs.

The cost of direct monitoring effort is accomplished by sending in a company representative or a pretend customer in order to obtain additional information (e.g., product quality, friendly service, and on cleanliness) that complements sales data (Lafontaine & Slade, 1997). In the lodging industry, Huo (1994) utilized costs of management overhead involved in monitoring behavioral uncertainty of unit managers as a proxy of monitoring costs rather than using distance measure because of distance variation with each unit. Three variables - number of field representatives, frequency of travel, and length of stay - were employed to access the cost of monitoring a unit. The result indicated that while high monitoring cost organizations tended to feature franchising, low monitoring organizations tended to feature company ownership.

Although control considerations are important for any organization, they are especially so when managing business transactions across diverse national environments (Aulakh & Gencturk, 2000). Geographical distances and cultural differences increase the cost of monitoring and coordination geographically dispersed operations (Alon & McKee, 1999a; Hennart, 1991b).

Since monitoring is more difficult internationally than it is domestically, the opportunity for moral hazard and adverse selection increases (Sashi & Karuppur, 2002). In international service provision, intangible and inseparable attributes of services hamper the lower cost of monitoring agent behavior and make process control costly. Thus, in global markets, the costs of communication, coordination, and supervision are likely to be high when units are dispersed across many different countries.

In the case of international service firms, Fladmoe-Lindquist and Jacque (1995) and Terpstra and Yu (1988) measured the distance by utilizing air travel time or air distance between a U.S. city (Houston, New York, or San Francisco, whichever is the closest) and the capital city of the host countries where the firms operated. The study results evidenced that franchising seems to be preferred when monitoring difficulty increases due to the distance. The evidence from previous studies offers support for the monitoring hypothesis. It seems, therefore, in domestic and international settings, that empirical evidence favors agency theory's explanations of franchising

Considering the possibility that the firms can use not only outcome information to infer something about the agent's effort, but also a direct signal of the agent's behavior, it should be clear that the different control measures that are applied in the empirical literature capture different types of monitoring costs (Lafontaine & Slade, 1997). In other words, direct supervision or monitoring of the agent's behavior provides the firms with an expanded signal of agent effort that supplements the information contained in the sales data.

In this study, the author explored control considerations from the viewpoint of the firm (principal) and examined these considerations for business transaction relationships that cross national borders. As suggested by Jaworski (1988) and Khandwalla (1972, 1973a), the author

took different control mechanisms into account and focus on the simultaneous use of multiple controls to limit the distortion of the true magnitude of management controls to monitoring costs.

As a consequence, monitoring costs were measured by principal's perceptions of three different types of control exercised: output control, process control, and management overhead control. Multi-item scales were used to operationalize three different types of control variables. The individual questions were measured by using seven-point semantic differential scales anchored by 1 (disagree) and 7 (agree). Taken together, twelve items formed three composite indicators (Table 5-1).

Process control was measured by five items, adapted from studies by Aulakh and Gencturk (2000), and Jaworski and MacInnis (1989), which captures the degree to which a principal firm specifies and monitors the procedures used by its foreign agents. For output control, three items, adapted from studies by Anderson and Schmittlein (1984) and Anderson (1985), were used to assess the information on the difficulty of relating outcomes and the extent to which the firm monitors outcomes of foreign agents. Management overhead control was measured by four items, adapted from studies by Huo (1994) and Cravens et al. (1993), which describe management overhead cost of direct monitoring effort incurred by sending the company representative to the subsidiaries located at diverse places in the foreign countries.

Table 5-1. Measures of Monitoring Uncertainty

Process Control Ó

1. It is difficult to closely monitor the extent to which the foreign agent follows established procedures.
2. It is difficult to frequently monitor the marketing reports of the foreign agent.
3. It is difficult to regularly monitor the quality control maintained by the foreign agent.
4. It is difficult to update our foreign agents about changes in technology, product, or service concept.
5. It is difficult to directly monitor foreign agents' activities by field representatives.

Output Control Ó

1. It is difficult to measure equitably the results of individual level.
2. Sales and cost records tend to be inaccurate at the individual level.
3. Mere sales volumes and cost figures are not enough to make a fair evaluation.

Management Overhead Control Ó

1. It is costly to maintain optimal number of field representative to monitor foreign agents.
2. Cost for visiting or traveling the foreign unit is too high.
3. It is costly to collect information about the foreign agent's behavior.
4. Distance from a monitoring headquarters to foreign units is a major impediment to close monitoring of foreign agents.

Note: Respondents were asked to rate all items on a 7 point semantic differential scale, where 1 = disagree and 7 = agree.

© denotes variables that used composite means of responding items.

Transaction Specific Asset (Exogenous Construct)

One of the central tenants of TCA theory is that the specificity of the assets employed in a transaction has a significant impact on the efficiency (transaction costs) of alternative governance structures. Asset specificity refers to a firm's investments that are dedicated to a trading relationship and cannot be redeployed to alternative uses (Williamson, 1991a). Thus specific assets are investments made that have less value outside the specific transactional relationship (Bello & Lohtia, 1995; Rindfleisch & Heide, 1997). Firms make such investments when they provide specialized technical, operational and sales training as well as commit managerial and physical resources (Rosson & Ford, 1982). Because these assets are dedicated to a particular business transactions their value to the firm would be lost if the relationship was terminated.

Empirical research in an international context provides partial support for a relationship between the transaction specificity of assets and ownership structure and control modes in foreign markets (Anderson & Coughlan, 1987; Gatignon & Anderson, 1988). The research has not fully explored the effect of asset specificity because studies tend to examine only one type of specific investment at a time (Bello & Lohtia, 1995).

For example, Anderson (1985), Anderson and Coughlan (1987), and John and Weitz (1988) analyzed dedicated human investments in training in terms of overall level of skill needed, rather, only the nontransferable component is measured. Gatignon and Anderson (1988) examined a product specificity indicator reflecting the proprietary content of technological products. Combs and Ketchen (1999), Klein (1989), and Klein, Frazier, and Roth (1990) employed a single indicator that combines human and physical investments.

A paucity of empirical research has been conducted in the service sector to investigate the relationship between asset specificity and governance structure. In international service provision, Erramilli and Rao (1993) measured asset specificity represented by the degree of idiosyncrasy that characterized a service. They defined an idiosyncratic service as “one which is characterized by ‘high’ levels of professional skills, specialized know-how, and customization” (Erramilli & Rao, 1993, 23). Murray and Kotabe (1999) replicated the same scales of idiosyncratic services to measure transaction specific asset in international and domestic service industries.

In the restaurant industry, Combs and Ketchen (1999) assessed asset specificity by averaging two attributes of human (using specific knowledge) and dedicated asset specificity in which each dimension comprised four items respectively. Huo (1994) assessed physical, human, and location assets by using related eight variables to measure the construct of asset specificity in the lodging industry and they were summed and averaged to arrive at a single measure of asset specificity.

Because these studies treat each asset type in isolation, the various specific investments have not been simultaneously examined and little is known about their relative importance on the choice of ownership structure and control modes of foreign affiliate. Rindfleisch and Heide (1997) suggest that asset specificity is a multifaceted attribute. By itself, thus, no one variable covers the domain of transaction specific asset. By combining different attributes into a scale with reasonable internal consistency, a more accurate measure of asset specificity can be derived (Anderson & Coughlan, 1987).

To understand the salience of different specific investments, this study examined the contribution of four attributes of transaction specific assets toward the ownership and control

strategy of foreign subsidiaries. The four attributes of asset specificity are product, human, physical, and brand name asset specificity (Table 5-2).

For product specificity, seven semantic differential items were adapted from following prior researches: Anderson (1985), Bello and Lohtia (1995), Gatignon and Anderson (1988), and Palenzuela and Bobillo (1999). For example, the level of firm specific technology may influence mode choice, since firms with greater technology may incur higher transaction costs in safeguarding their technology from misappropriation (Hennart, 1991a; Gatignon & Anderson, 1988; Williamson, 1985). This Operationalization is appropriate because the proprietary content of sophisticated products is associated with product-based asset specificity (Gatignon & Anderson, 1988). Transaction cost analysis also reveals that product attributes such as customization could have an impact on entry mode choice (Anderson & Gatignon, 1986). This appears to hold true for the service sector, as firms marketing customized services have been observed to be more willing to integrate than firms providing standardized services (Erramilli & Rao, 1988).

For human specificity, six items were adapted from the following previous studies: Anderson and Coughlan (1987), Bello and Lohtia (1995), Brouthers, Brouthers, and Werner (2003), Combs and Ketchen (1999), Erramilli and Rao (1993), Huo (1994), John and Weitz (1988), Klein, Roth, and Frazier (1990), and Murray and Kotabe (1999). The items applied to this study mostly tap the investments in specific product and operational knowledge related attributes gained through training and education: knowledge about firm specific goods, customer idiosyncrasies and tacit nature of operations, necessitated by the learning requirements of the foreign selling situation (Anderson & Gatignon, 1986).

Specialized human assets are present to varying degrees in distribution of goods and services. The time and effort used to acquire firm specific knowledge needed for downstream activities is perhaps the most common form of these investments found in foreign business transaction (Heide & John, 1988). Dunning (1989) argues that knowledge as a service (e.g., management consultancy, legal service) is not necessarily perishable and can be repeatedly used by the producer at little or no cost. When the knowledge is invested in the personnel of the firm, the knowledge can be produced and sustained for specific uses (Buckley et al., 1992). The firm capitalizes on its innate firm-specific knowledge because the knowledge is specialized or nonredeployable investments to support an exchange (John & Weitz, 1988) and thus is costly to transfer to agents (Jensen & Meckling, 1995).

As contended by Erramilli and Rao (1993), idiosyncratic services characterized by high levels of professional skills and specialized know-how are attained only through several years of education and training, which cannot be easily transferable to other situations. Therefore, as the service becomes more idiosyncratic and the time and effort spent training a foreign partner in different business environment, the asset specificity of transactions increases and firms economize on transaction costs by self-performing as many tasks as feasible (Anderson, 1985).

The five physical specificity items were adapted from Bello & Lohtia (1995), Brouthers et al. (2003), Combs & Ketchen (1999), Heide and John (1990), Huo (1994), and Klein, Roth, and Frazier (1990). A unique national circumstances (e.g., aesthetics or customs) and existing foreign infrastructures may lead the firm to invest in specialized facilities, unique building designs, signage, décor, and other capital items within their foreign outlets needed to support the foreign marketing of its brand (Dnes, 1993; Scott, 1995; Ward, 1984). Firms committing physical and capital investments risk being held hostage because these nonredeployable assets

make it difficult to dismiss an opportunistic partner (Williamson, 1985). These items adopted in this study assess the firm's investment in facility, equipment and other capital items needed to support the foreign operation.

Four items for measuring the brand name asset specificity were adapted from Fladmoe-Lindquist and Jacque (1995), Gencturk and Aulakh (1995), Hennart (1991a), Krishnan and Hartline (2001), Levy (1985), and Sashi and Karuppur (2002). Asset specificity of brand names was measured by assessing R&D intensity, advertising intensity, trademark registration, and intensity of marketing research. For example although there may be some variation within industry, the service firms' index of advertising intensity vary more across industries (Fladmoe-Lindquist & Jacque, 1995). Recognizing the functions of brand names, firms usually spend considerable amounts on persuasive advertising (Krishnan & Hartline, 2001). Firms formulate promotional strategies with the objective of creating a high degree of awareness and establishing a positive brand image in the minds of a target audience. Firms that consider their brand names to be valuable assets attempt to protect themselves from illegal competition by registering brand names with international regulatory organization (Sashi & Karuppur, 2002).

Four attributes of asset specificity served as indicators of one construct (i.e., asset specificity) in the model. Each of four attributes of asset specificity was measured by multiple items derived from previous researches using seven point semantic differential scales anchored by 1 (low) and 7 (high). Each item was designed to capture one facet of the four attributes of asset specificity; taken together as a scale, they formed a composite indicator of each attribute of asset specificity.

The empirical study of service firms' international entry mode choice by Erramilli and Rao (1993) revealed that using 'standardization' and 'formalization' is less ambiguous for

respondents to interpret and describe in lieu of using customization and tacit nature of knowledge. The author addressed this suggestion and reverse-code those two items as 'standardization' and 'formalization' respectively. Finally each item assessed the measurement quality and psychometric properties of the specificity indicators.

Table 5-2. Measures of Asset Specificity

Human Asset Specificity Ó

1. Level of training, in number of months and intensity, provided to handle your product.
2. Level of training, in number of months and intensity, provided and to learn customer needs.
3. Level of education, in number of years, required to be qualified to handle your product and customer.
4. Level of difficulty for an outsider to learn your systems and operational procedures.
5. Extent to which the process of work is formalized. ®
6. Degree to which knowledge acquired in your firm is useful in only a narrow range of applications and cannot be easily put to use elsewhere.

Product Asset Specificity Ó

1. Degree of goods standardization. ®
2. Degree of service standardization. ®
3. Level of proprietary content of goods/services.
4. Degree of technical content of goods/services.
5. Degree of goods/service complexity.
6. Level of difficulties for an expert to know the specific goods/service qualities.
7. Level of difficulties to an outsider to learn the firm's technical content of goods/services.

Physical Asset Specificity Ó

1. Degree of facility specialization for your brand.
2. Degree of equipment customization for your brand.
3. Degree of décor specialization for your brand.
4. Degree of special investment needed for your brand.
5. Level of capital expenditures required.

Brand Name Specificity Ó

1. Advertising expenditures as a percentage of sales
2. R&D expenditures for goods and services as a percentage of sales.
3. Marketing research expenditures as a percentage of sales.
4. Degree of trademark registration.

Note: Respondents were asked to rate all items on a 7 point semantic differential scale, where 1 = low and 7 = high.

® denotes items that were reversely coded.

© denotes variables that used composite means of responding items.

Cultural, Political, and Economic Uncertainty (Exogenous Constructs)

Managers operating in the international business context confront a variety of uncertain environmental factors. International risk management researchers have focused primarily on the assessment of political, economic and cultural uncertainties, and appropriate organizational responses. These uncertainties reflect international management researchers' interest in the country level of analysis. This perspective differs from the risk management discussed in the strategy field, where industry dynamics is viewed as the central issue of giving rise to managerial uncertainties (Miller, 1993).

Environmental uncertainty refers to the extent to which organizational decision makers perceive unpredictable changes in their external (national) environment (Koberg, 1987). Miller (1993) conjectured that managers' characterizations of their countries may not reflect disparate dimensions of uncertainties regardless of the existence of objective differences in political, economic stability, and sociocultural similarity. Managers may portray current uncertainties with respect to their own past experience (Tversky & Kahneman, 1973). Managers also seem to have different tolerances for ambiguity across countries (Hofstede, 2001). Differences in managerial perspective toward current environmental components may exaggerate or moderate perceived uncertainty discrepancies across countries relative to some objective measure of environmental uncertainty (Miller, 1993).

Managerial perceptions of environmental uncertainty can be influenced by the importance managers assign to certain environmental variables (Kreiser & Marino, 2002). Thus, Environmental uncertainty is often described as a perceptual phenomenon derived from the inability to assign probabilities to future events, a lack of information about the cause and effect relationship and the inability to predict the outcome of a decision (Miller & Shamsie, 1999;

Milliken, 1987). Additionally, a number of studies use a general international risk perception measure based on managerial opinion (Bonaccorsi, 1992).

As Hitt, Ireland, and Palia (1982) explained, “the recognizable pattern of organizational responses to environmental conditions is determined not so much by the objective characteristics of the organization-environment interactions as by managerial perceptions of the strategic importance of the critical areas contained within different organizational functions” (p. 270). They believed that the overall amount of uncertainty present in the environment was determined by managerial perceptions of that environment. In the same logic, Sawyerr (1993) also claimed that “the firms also respond to the environment perceived and interpreted by the decision makers and that the environmental conditions that are not noticed do not affect management’s decisions nor actions” (p. 290).

On another aspect of environmental research, most of the researches examining risk in international studies have been limited to only one risk area at a time (Agarwal & Ramaswami, 1992; Bonaccorsi, 1992; Howell & Chaddick, 1994; Kim & Hwang, 1992; Luehrman, 1990). Miller (1992) argues that the emphasis on a specific uncertainty, rather than on multiple risk indicators is a significant shortcoming in most existing literature on international risk. This approach, which is labeled the ‘particularist’ view, isolates specific uncertainties which lead to the exclusion of other interrelated uncertainties (Miller, 1992).

Given the large number of different types of international risks, actions taken to avoid one type of risk may actually increase exposure to another type of risk (Brouthers, 1995; Miller, 1992). Since decisions in one risk area affect the magnitude of risks and the decisions on other risk areas, a single global measure of risk may not be appropriate (Werner, Brouthers, Brouthers,

1996). Therefore management must be cognizant of the overall risk management package (Brouthers, 1995).

Vernon (1985) and Miller (1992) have suggested that the perception of a more comprehensive international risk and the strategic choice of entry mode may be related. They suggest that looking at individual international risk variable, such as studies of political risk (Robock, 1971; Simon, 1982) or financial risk (Stone, 1989), in isolation of the other international risks results in an incorrect analysis of the international question and may lead to an incorrect entry mode decisions because other related risks, such as sociocultural uncertainties, have been ignored. For this reason, it appears to be important to incorporate a number of international risk variables into investigations of national environment (Brouthers, 1995; Miller, 1993; Shan, 1991).

Political and Economic Uncertainty

Miller (1993) addresses the multidimensionality of perceived environmental uncertainty (PEU) in international aspect based on earlier work by Dill (1958), Katz and Kahn (1978), Lawrence and Lorsch (1967a), Miles and Snow (1978), and Thompson (1967). The proposed six dimensions are consistent with the typology developed by Miller (1992), which decomposes uncertainty perceptions into general environmental, industry and firm uncertainties. The PEU measure developed by Miller (1993) was later tested for validity by Miller (1993) and reliability by Werner et al. (1996).

Thus, logical flow of the perceptual uncertainty view for current research is that the entry mode responds to environmental factors pertinent to national context that managers judge them as having a high degree of importance to firm performance. Jackson, Schuler, and Vredenburg

(1987) noted that economic, political, and sociocultural events may be sources of uncertainty. Based on the importance of environmental uncertainties uncovered in the previous researches, this study decomposes the national environment into three elements of political, economic and sociocultural dimension, and uses multidimensional scales when measuring uncertainty perceptions.

Werner et al. (1996) investigate dimensionality and internal consistency of Miller's (1993) measure by comparing scales with ones determined by factor analysis and test the reliability of scales. They find that conceptualized scales have generally high internal consistency in samples of both manufacturing and service firms. However, the findings also suggest that several changes in the PEU measure are warranted, resulting in a refinement of Miller's measure, which they have labeled PEU2. The PEU2 measure represents each of the constructs of the areas of PEU more parsimoniously, which consists of five dimensions and reduced number of 28 indicators.

A recent research by Brouthers et al. (2000) provided multiple measures of perceived environmental uncertainty (PEU2) to determine the entry mode choices of firms and link these risk-adjusted mode choices to managerial satisfaction with firm performance. They found that firms which make PEU risk-adjusted entry mode choices are significantly more satisfied with their firm's performance than firms whose entry mode choices cannot be predicted using multiple PEU risk measures. Their findings reinforce the idea that entry mode choice has both a significant direct influence on satisfaction with firm performance and an indirect effect.

This research adapted multidimensional measure of PEU2 developed by Werner et al. (1996) for accessing 'political' (Table 5-4) and 'economic' uncertainty (Table 5-5). The five dimensions of PEU2 measure access managers' perceptions of environmental uncertainty when

doing business in different countries. The nine indicators and sub-items selected from PEU2 measure were supplemented with the environmental scales posited by previous international entry mode studies conducted by Alon and McKee (1999a), Fable and Dandridge (1992), Gencturk and Aulakh (1995), Goodnow (1985), Goodnow and Hansz (1972), Kim and Hwang (1992), and Miller (1992, 1993).

Cultural Uncertainty

In addition to political and economic risks, cultural disparities give rise to the uncertainty against national context. Brouthers and Brouthers (2000) suggest that the “cultural context helps to define profit potential and/or the risks associated with a specific market entry” (p. 91). However, the link between the various components of culture gives it an all-encompassing perception since culture is understood as the sum of all behavioral norms and patterns collectively shared by a social group (Usunier, 1993). As depicted in the work of Hall (1959), Hofstede (2001) and Trompenaars (1994), cultural distance comprises differences in national culture and includes differences in language, customs, business practices, and psychological and subjective characteristics.

Culture has been seen as a ‘determinant of preferences’ or ‘collective subjectivity’; the subjectivity being revealed in individual preferences that are not directly measurable, and in the attachment of probabilities (Casson, 1993). Triandis (1973) distinguishes ‘subjective’ culture from its expression in ‘objective’ artifacts and defined the former as a cultural group’s characteristic way of perceiving the man-made part of its environment. Hofstede (2001) treats subjectivity as the programming of the mind, which stands for beliefs, attitudes, and skills.

Culture, as a consequence, affects not only the attitudes and beliefs of the potential consumers but may also influence their response to certain goods and services (Brouthers, 1995). Not only the interactions with the staff, but all contacts with different elements are also part of the service encounter: physical facilities, service systems, and other customers (Stauss & Mang, 1999). In times of globalization, quality perception of service encounter differs among customers from different cultures due to culture-bound expectations and perceptions (Mattila, 1999). Therefore the service provider is likely to have more problems than manufacturers when interacting with customers from diverse cultures (Reardon, Erramilli, & Dsouza, 1996).

As suggested by Dunning and Bansal (1997), culture needs to be described in terms of the particular attribute being studied. Based on their argument, this study describes the culture as a critical component of perceived quality of service encounter that has an impact on entry mode decision since service customers perceive quality in the moment of interaction with the service provider. In highly different cultures, management will perceive increased levels of control risk because of their lack of market knowledge and will select entry mode strategies that minimize management control (Brouthers, 1995).

The relationship between national culture and entry strategy is explicitly examined by Kogut and Singh (1988) and Shane (1994), who used a reductionist version of Hofstede's (1980) cultural classification. Cultural barriers are utilized in an examination of foreign market entry by Bakema, Bell, and Pennings (1996), and a cultural learning process is invoked by Benito and Gripsrud (1992) to help explain the entry mode strategy. The works of Hofstede (1983, 1993, 1995, 2001) examined five characteristics that are used to make meaningful comparisons about the ways that national differences among 40 countries may affect management styles: power

distance, uncertainty avoidance, individualism/collectivism, masculinity/femininity (gender role differentiation), and long-term/short-term orientation (goal orientation).

In this research, the measure of culture was derived from the indices postulated by previous studies (Table 5-3). First, the choice of indicators for cultural uncertainty is mainly based on the 'subjectivity' considerations of culture posited by Casson (1993) and Triandis (1973), which is accessed by recent version of Hofstede's (2001) five indicators of cultural distance and his argument about the cultural implication of global management (Hofstede, 1988, 1999). The subjectivity measure of cultural distance was supplemented with cultural values suggested by Hall (1976), Riddle (1986), Cateora (1996), and Reardon, Erramilli and Dsouza (1996): language, aesthetics (e.g., symbols), customs or social practices (e.g., heroes and rituals), business practices (e.g., time orientation and context orientation).

In sum, environmental dimensions, singly or in combination, explain multinational managers' proclivities toward one or another entry mode strategy (Ross, 1999). It has been posited that the application of multidimensional measures to environmental study is highly consistent with the PEU construct (Buchko, 1994; Tosi & Slocum, 1984). In accordance with their suggestions, this study employed multidimensional scales with multi-items for measuring the national environment constructs.

Finally, the instrument applied in this study contains 14 scales, composed of 52 items, which measure the perceived uncertainty in three major dimensions - political, economic and cultural environment - toward firm's national environment. Managers were requested to evaluate the predictability of political and economic dimension and similarity of cultural dimension of each item at the time of entry mode decision in the primary countries company entered in the past five years on a seven-point semantic differential scale.

Table 5-3. Measures of Cultural Uncertainty

Custom

Language

Aesthetics

Business Practice

Value System ^Ó

1. Power distance: the degree of inequality among people which the population of a country considers as normal.
2. Uncertainty avoidance: the degree to which people in a country prefer structured over unstructured situations. Structured situations are those in which there are clear rules as to how one should behave.
3. Gender role differentiation: the degree to which a culture defines vastly different social roles for the sexes (masculinity vs. femininity).
4. Individualism: the degree to which people in a country prefer to act as individuals rather than as members of groups.
5. Goal orientation: long-term values are oriented towards the future, like thrift and persistence, while short-term values are oriented towards past and present, like respect for tradition and fulfilling social obligations.

Note: Respondents were asked to indicate similarities between home and host country and rate all items on a 7 point semantic differential scale, where 1 = few and 7 = many.

© denotes a variable that used a composite mean of responding items.

Table 5-4. Measures of Political Uncertainty

Business Restriction Ó

1. Import restrictions
2. Public service provision
3. Local content requirements
4. Attitude towards foreign firms
5. Price controlled by the government
6. Permitted remittance and repatriation funds

Policy Change Ó

1. Monetary policy
2. Foreign business tax policies
3. Enforcement of existing laws
4. Foreign ownership policies
5. Government policies towards foreign business
6. Legal regulations affecting the business sector

Political Stability Ó

1. Social unrest
2. Threat of terrorism
3. Risk of expropriation
4. Threat of armed conflict
5. Changing social concerns
6. Political ideologies of government officials
7. Ability of the party in power to control the government

Note: Respondents were asked to rate all items on a 7 point semantic differential scale, where 1 = unpredictable and 7 = predictable.

© denotes variables that used composite means of responding items.

Table 5-5. Measures of Economic Uncertainty

Macroeconomic Change Ó

1. Interest rate
2. Inflation rate
3. Economic conditions
4. Foreign exchange controls

Infrastructure Ó

1. Banking systems
2. Transportation networks
3. Technological capability
4. Communication facilities
5. Power and water supplies

Market Opportunity Ó

1. Purchasing power
2. Population growth
3. Level of urbanization
4. Extent of the middle class
5. Proportion of female labor

Market Demand Ó

1. Customer needs
2. Industry growth rate
3. Customer preferences
4. Stage of industry life cycle
5. Prospects for future profits
6. Average industry gross margin

Market Change Ó

1. Product changes
2. New product introductions
3. Changes in goods/services quality
4. Availability of substitute goods/services

Resource Availability Ó

1. Availability of trained labor
2. Prices of inputs and raw materials
3. Quality of inputs and raw materials
4. Availability of inputs and raw materials

Note: Respondents were asked to rate all items on a 7 point semantic differential scale, where 1 = unpredictable and 7 = predictable.

© denotes variables that used composite means of responding items.

Ownership and Control Modes (Mediating Endogenous Construct)

Doing business in international markets is a difficult challenge for any firm (Cavusgil, 1980; Root, 1987). Especially, it is difficult to decide what levels of integration the firm should use in various foreign markets, whereby integration is a continuum anchored by the options of market and hierarchy (Williamson, 1985). At one extreme, the firm can perform all business functions itself. At the other extreme, the firm can choose to use outside agents who take title to provide firm's goods and services. Between these extremes, a continuum of market hierarchy options is available (Anderson & Gatignon, 1986; Gatignon & Anderson, 1988; Klein, Frazier, & Roth, 1990)

For this study, measures of entry mode included integrated (wholly owned subsidiaries), cooperative arrangements (joint ventures), and independent entry (franchising). This classification appears to be consistent with other researchers in the area of entry mode options (Brouthers, 1995; Brouthers et al., 2000; Contractor, 1984; Erramilli & Rao, 1993, Minor, Wu, & Choi, 1991; Root, 1987). Previous research has suggested that entry modes having different ownership levels are associated with specific control capabilities and capacities (Anderson & Gatignon, 1986; Calvet, 1981; Caves, 1982; Davidson, 1982; Gatignon & Anderson, 1988; Root, 1994). The entry modes decision involves determining the level of control that the parent company should have in the foreign subsidiary's management.

Previous entry mode research has identified a firm's ability to control an operation and resource commitment as the two primary dimensions of entry mode selection (Anderson & Gatignon, 1986; Kogut & Singh, 1988; Erramilli & Rao, 1990; Hill, Hwang, & Kim, 1990). Control refers to authority to influence or direct the activities, operations of a foreign subsidiary, or strategic decision-making (Anderson & Gatignon, 1986; Erramilli & Rao, 1990).

Thus by exerting control, firms attain the efficient and effective management of the relationship between the parent and entry entity that enables the parent to best meet their overall goals and objectives (Woodcock et al., 1994).

Each of these modes of entry provides management with a trade off. First, management can retain full control of the operation through a high commitment of resources to either start a new operation from the beginning or to acquire an existing operation, which means bearing total risk (integrated modes). This complete ownership gives the firm the ability to manage the daily activities of the operation without the interference or consent of other parties. Second, management can share control and resources with another firm, and avoid some of the risk (cooperative arrangements). Cooperative arrangements, such as joint venture, require fewer resources on the part of the firm, but they reduce the control that management has over the foreign operation.

Finally, independent entry, such as franchising, requires the least commitment of resources on the part of the firm. Management can shift control, especially certain degree of daily operation, and resource commitment to another firm and avoid most of the risks in that particular market (independent modes) (Buckley & Mathew, 1980; Contractor, 1990; Erramilli & Rao, 1990). Franchising provides control possibilities for the entering firm, but it offers relatively lowest degree of control among three entry modes used in this study (Brouthers, 1995). In franchising, certain degree of control comes from daily involvement in the operation and from expertise because the typical agreement includes incentives to adhere to the system's rules and allows a high degree of monitoring of the franchisee's activities (Anderson & Gatignon, 1986).

Many times management feels that if they have the ability to directly control the foreign operation they can also manage and reduce risk (Cyert & March, 1963; Mascarenhas, 1982).

However, at some point the perception of risk gets so high that management wish to minimize the risks associated with international expansion and relieve itself of some portion of the control, sharing responsibility for control and shifting the risk management to another firm or individual, such as franchisee, who they conceive is better qualified to perform the tasks (Brouthers, 1995). In the normal transaction of international business these control risks are not simple black and white issues.

Control problems, by nature, are inherent in services due to the inseparability, intangibility and heterogeneity of services (Fryer, 1991). Since most services cannot be exported due to customer involvement during service production, the home must work in close association with foreign subsidiary (Erramilli & Rao, 1993). While this is manageable in a domestic environment, it is difficult to achieve logistical and managerial support overseas (Reardon, Erramilli, & Dsouza, 1996). This truism exacerbates the managerial and administration problems encountered in international service firms.

Anderson and Gatignon (1986) demonstrated the feasibility of a mapping from entry modes to the degree of control they afford the entrant and provided propositions about the relationship between control and governance structure (i.e., entry mode). They clustered 17 entry modes into three groups in terms of the amount of control (high, medium, low) an entrant gains over the activities of a foreign business entity. They contended that the most appropriate entry mode is a function of the trade-off between control and the cost of resource commitment.

Hill et al. (1990) also proposed a framework of choice of entry modes by clustering entry modes into three modes – wholly owned subsidiary, joint venture and licensing – based upon the degree of control (high, medium, low) the mode provides the entrant. They argue that different

variables often suggest different entry modes and that resolving these differences involves the acceptance of trade-offs between control and amount of resource commitment.

Erramilli and Rao (1990) attempted to explain the variation of foreign market entry mode choice in the service sector by taking into account the unique characteristics of service firms. They have tried to place entry mode choices on a continuum by arranging the entry modes based on level of managerial involvement and financial resources commitment. The nine-point scale included values ranging from 1 (lowest involvement and resource commitment) for franchising to 9 for a wholly owned subsidiary (highest involvement and resource commitment). The analysis shows that the service firms exhibits significantly different level of involvement in choosing entry modes. For example, a fast-food chain chooses to lower level of involvement and prefers to team up with outsiders by appointing a franchisee in a foreign market to serve the local customers.

Firms may take plural forms of entry modes for controlling foreign subsidiaries rather than depending on one organizational form. Unlike conventional dichotomous selection of entry mode choices, this study measures foreign market entry modes based on a continuum where entry modes are arranged by degree of control and inherent financial resources commitment. Our analysis builds on the existing literature (Anderson & Gatignon, 1986; Erramilli & Rao, 1990, 1993; Gatignon & Anderson, 1988; Gencturk & Aulakh, 1995; Hill, Hwang, & Kim, 1990; Hu & Chen, 1993; John & Weitz, 1988) that viewed entry modes as a continuum by mapping from governance structure (i.e., entry mode) to control.

A firm's level of control over subsidiaries in a foreign market depends upon a level of involvement of managerial operation and financial resources commitment. The mediating endogenous construct, entry modes, was measured by and slightly adapted from the foreign

market involvement scale developed by Erramilli and Rao (1990, 1993) and the entrant's equity ownership percentage of foreign subsidiaries utilized by Gatignon and Anderson (1988).

The survey used in this present study asked managers within the respondent firms to indicate level of control over foreign subsidiaries which best describe the entry mode they used to move into a foreign market (Table 5-6). At one extreme, the variable entry mode assumes a value of 1 if the entry mode is limited operational involvement and lowest financial resources commitment (i.e., franchising). At the other extreme, a value of 7 is assigned to highest managerial involvement and financial resources commitment (i.e., wholly owned subsidiary). A value of 4, in the middle, is assigned to shared control and involvement with another firm or individual (i.e., joint venture) in foreign market. The procedures standardize and compute the composite mean of four scales.

Table 5-6. Measures of Entry Mode

Managerial Involvement \bar{O}

1. Involvement in pricing activities
2. Involvement in promotion activities
3. Involvement in production activities
4. Involvement in quality maintenance for goods and services

Financial Involvement

ratio of investment per foreign unit to average investment per foreign equity unit
(total amount of foreign investment / total number of foreign units)
/ (total amount of foreign equity investment / total number of foreign equity units)

Equity Involvement

ratio of number of foreign equity unit to total number of foreign unit
(total number of foreign equity units / total number of foreign units) $\times 100$

Note: Respondents were asked to rate all items on a 7 point semantic differential scale, where 1 = low and 7 = high.

© denotes a variable that used a composite mean of responding items.

Performance (Ultimate Endogenous Construct)

Performance is a difficult concept, both in terms of definition and measurement (Keats & Hitt, 1988). Organizational performance can be defined as the achievement of an enterprise with regard to some criterion (Lenz, 1980). Thompson (1967) suggested that regardless of the basis for organizational assessment, the importance issue for organizations is preparedness for future action. Both internal and external constituencies judge preparedness, and because of uncertainty, typically measure it in ‘satisficing’ terms, often based on economic-financial information (Keats & Hitt, 1988).

As Simerly and Li (2000) contended, measuring firm performance has been a major challenge for scholars and practitioners as well. There is substantial disagreement concerning the measurement of performance (Lenz, 1980). Some suggest the use of multiple measures while others assert that various aspects of performance may be captured in a single measure (Kirchhoff, 1977). There is also controversy about the use of performance measures that are of primary importance to the organization studied versus that are of importance to society in general (Parsons, 1960; Price, 1972; Steers, 1975).

One logical argument is that performance is a multidimensional construct (Chakravathy, 1986; Stern, El-Ansary, & Brown, 1989), thus any single index may not be able to provide a comprehensive understanding of the performance relationship relative to the constructs of interests (Simerly & Li, 2000). Therefore, as applied in the current research, it is important to look at multiple indicators.

On another aspect, what little has been done on international entry mode choices and firm performance tends to be exclusively rely upon financial performance measures and ignore other measures of firm performance, e.g., non-financial performance (Nitsch, Beamish, & Makino,

1996; Pan & Chi, 1999; Pan, Li, & Tse, 1999; Simmons, 1990; Woodcock et al., 1994). Non-financial measures are included because firms often have objectives in addition to financial ones (Anderson, 1990; Geringer & Hebert, 1991; Kim & Hwang, 1992). Roth and Morrison (1990) suggested that a firm may pursue both the non-financial (i.e., strategic) and financial (i.e., operating) dimensions of market performance as the objectives of its business operation in addition to financial ones. Based on their recommendation, for the present integrative model, market performance consists of two composite measures; financial market performance and non-financial market performance, both of which provide indications of preparedness.

Inclusion of both financial and non-financial measures of performance is important for this study for several reasons. Financial performance provides valuable insights on achieving firm level economic goals as an evaluative referent and indication of past and present organizational adaptation (Brouthers, 2002; Keats & Hitt, 1988). Accordingly, financial performance is considered an important outcome variable by both practitioners and strategy researchers (Bettis, 1981; Rumelt, 1974). In this study, financial performance not only includes profit-based but also productivity-based measurements since the success of internationalization has been reflected in both measures of financial performance (Bloodgood, Sapienza, & Almeida, 1996).

Meanwhile, non-financial or market performance provides information about a firm's strategic and competitive goals (Anderson, 1990) and thus future oriented consideration of an organization's ability to adapt itself at the time of environmental challenges (Brouthers, 2002; Keats & Hitt, 1988). Several researchers, especially in the discipline of finance, argue that market performance is the ultimate criterion of firm effectiveness (Johnson, Natarajan, & Rappaport, 1985; Reilly, 1979; Weston & Brigham, 1978).

Another issue concerning firm performance is the application of subjective measures. Dess and Robinson (1984) postulate that subjective measures can be used to measure performance against multiple, financial and non-financial criteria. In particular, subjective measures are preferred when non-financial performance is involved or when objective financial measures are not available (Dess & Robinson, 1984; Geringer & Hebert, 1991). In this regard, In addition to perceived financial performance measures, the author uses several other non-financial perceptual measures of managerial satisfaction with the firm's performance.

The subjective performance measures were applied for this study based on three reasons. First, previous empirical studies have found that firms tend to be unwilling to provide objective measures of performance for specific countries entered and suggested that subjective measures be employed (Brouthers, Brouthers, & Werner, 1999; Woodcock et al., 1994). In addition, reconciling cross-national differences in accounting procedures and financial reporting practices makes cross-national comparisons of quantitative financial performance very difficult (Brouthers et al., 1999). Subjective performance approach can solve this problem. Last, in several previous studies (e.g., Dess & Robinson, 1984; Geringer & Hebert, 1991) researchers found that objective performance measures correlate well with subjective performance measures.

Thus, Brouthers et al. (1999) point out that subjective and objective measure are assessing the same construct empirically as well as theoretically, and little information is lost by using subjective performance measures. Empirical studies also evidence positive association of measures of perceived organizational performance with objective measures of firm performance (Delaney & Huselid, 1996; Dollinger & Golden, 1992; Powell, 1992).

It should be noted that the criterion of success can be measured differently by the various respondents (Hopkins, 1996) because managers tend to judge the success or failure of a venture

based on the achievement of preset goals and objectives (Anderson, 1990). Hence, perceived performance measured by multiple financial and non-financial indicators should provide valuable information on the progress of the new foreign subsidiary toward meeting parent firms' goals and objectives (Brouthers, 2002). Although each reflects a different dimension of performance, previous research has shown them to be interrelated.

To gather subjective measures of mode performance for the purpose of current research, respondents were requested to rate five financial measures of mode performance (sales level, sales growth, net profit, profitability, and unit growth rate), five non-financial measures (market share, market acceptance, reputation, brand loyalty, and competitive position) and overall firm performance and success (Table 5-7).

Financial and non-financial measures were mainly adopted from Brouthers (2002) and Tan and Litschert (1994), which were supplemented by other previous studies: Brignall, Fitzgerald, Johnston, & Silvestro, 1991; Brouthers et al., 1999, 2000, 2003; Chowdhury, 1992; Dess & Robinson, 1984; Gencturk & Aulakh, 1995; Geringer & Hebert, 1991; Hopkins, 1996; Murray & Kotabe, 1999. Respondents were asked to evaluate each mode performance measure on a seven-point semantic scale ranging from 1 (dissatisfied) to 7 (satisfied) regarding the question of 'how satisfied are you with the performance of the foreign activity, as measured with ...' the various performance dimensions.

Table 5-7. Measures of Performance

Financial Performance ©

1. Net profit
2. Sales level
3. Profitability
4. Unit growth rate
5. Sales growth rate

Nonfinancial Performance ©

1. Market share
2. Competitive position
3. Reputation of your brand
4. Market acceptance of your brand
5. Brand loyalty of foreign customer

Overall Performance

Note: Respondents were asked to rate all items on a 7 point semantic differential scale, where 1 = dissatisfied and 7 = satisfied.

© denotes variables that used composite means of responding items.

CHAPTER 6

ANALYSIS AND RESULTS

Introduction

This chapter describes the analyses used to test the conceptual model and reports the results of this research. The first section examines the characteristics of the sample that was used for this study. The next section introduces measurement instruments for all the constructs and presents analytical procedures to check instrument reliability and validity. The third section provides the results of the hypothesis tests for each of the relationships between constructs. Finally, the last section summarizes the findings of this study.

Sample and Data Collection

The study involved a questionnaire survey of decision makers of the hospitality firms that has at least one foreign subsidiary outside United States and engaged in international operations. The study drew a random sample of 1,309 corporate level directors, vice presidents, presidents, and CEOs who were involved in international operations and knowledgeable to assist with information regarding their respective firms.

After eight weeks of the survey mailing, 164 returned questionnaires were received, among which 148 contain complete data on all survey questions required for testing a model hypothesized in this study. The author planned to test the conceptual model with the structural equation modeling (SEM) method using LISREL 8.3 (Jöreskog & Sörbom, 1993). It has been recommended that a sample range of 150 would be adequate for testing a SEM model (Anderson & Gerbing 1988; Dillon, Kumar, & Mulani, 1987; Hair et al. 1995).

Given that the number of usable questionnaires satisfied the initial plan for this study, a

second-round mailing was deemed unnecessary, and the survey was concluded. Although the overall response rate was not high (12.5%) comparing with previous surveys of similar target population (e.g., Tse, 1988; West, 1988) in hospitality industry, these data were considered adequate for the research issue at hand because responding firms constituted a diverse group of dyads from foodservice and lodging companies. Furthermore given the length of the questionnaire – four full pages in small font – and the fact that no pre-mailing notice and second-round mailing were made, it was judged to be acceptable.

Since some companies had multiple key informants who were asked to respond a survey questionnaire, the possibility existed for more than one person to respond concerning a given company. This did not occur, however, and the 164 respondents represented 164 different companies.

Non-Response Bias

The mail survey has been criticized for nonresponse bias (Armstrong & Overton, 1977). The determination of whether a particular set of mail returns is or is not representative of the population sampled is certainly an important step before the sample is generalized to the population. The most commonly recommended approach to the nonresponse problem is to sample nonrespondents (Hansen & Hurwitz, 1946). For example, Reid (1942) chose a 9% subsample from his nonrespondents and obtained responses from 95% of them.

The high cost and frequent impracticability of follow-ups, however, have led researchers to estimate the effects of nonresponse without using success waves of a questionnaire to determine if persons who respond differ substantially from those who do not: wave refers to the response generated by a stimulus, e.g., a follow-up postcard (Ferber, 1948-1949; Daniel, 1975).

Many researchers have argued that it is not possible to obtain valid estimates (Ellis, Endo, & Armer, 1970; Hochstim & Athanasopoulous, 1970; Ognibene, 1971). Filion (1976), on the contrary, reanalyzed data from Ellis et al. (1970) and concluded that, in fact, extrapolation did help; furthermore, Erdos and Morgan (1970) favor estimation where judgment warrants.

In this study, the evaluation of nonresponse bias was completed using time trends extrapolation method (Ferber, 1948-1949) to peruse possible non-response bias. Time trends procedure is based on the assumption that subjects who respond less readily are more like non-respondents than those responding more readily (Pace, 1939). Consequently, “any differences on a certain issue between mail respondents and non-respondents would be reflected in the replies of the early respondents as compared with those of the later ones” (Ferber, 1948-1949, p. 671). Late respondents are, in effect, more similar to non-respondents. The method of time trends has an advantage over the use of waves in that the possibility of a bias being introduced by the stimulus itself can be eliminated (Armstrong & Overton, 1977).

The possibility of nonresponse bias was addressed in this research by comparing characteristics of early 90% ($n = 146$) and late 10% ($n = 18$) respondents on demographic, entry mode, and performance variables. The two sample *t*-test showed no significant differences at the .05 level between early and late respondents in terms of demographic variables including annual sales, total number of units, number of countries, number of continents, and business experience (*p* values ranged from .070 to .644). In addition, two sample *t*-test results for three entry mode variables evidenced that there were no statistically significant differences at the .05 level between early and late respondents: *p* values were .209, .169 and .904 for managerial involvement, financial involvement, and equity involvement, respectively. At last, a comparison of the early and late respondents revealed that two groups did not differ on three performance

variables – financial performance, nonfinancial performance, and overall performance: *p* values were found to be .601, .887 and .914, respectively. The results of statistical tests suggested that there were not statistically significant differences between the early and late respondents. Thus the two groups were combined in subsequent analysis.

Profile of the Sample

Table 6-1 summarizes some general characteristics of the sample. Of the respondents providing demographic information, about eighty three percent were top executives (CEO, president, chairman, or vice president) and the rest of the respondents (17%) were directors and other positions who were directly involved in the foreign market operations and decision making process, especially foreign market entry mode choices. More than half of the respondents in the sample (58%) were engaged in foodservice industry, which can be explained by the fact that sampling frame of the restaurant industry was twice as large as that of lodging industry.

The size of the firms varies in terms of number of units, number of employees in headquarters, annual sales, and annual international sales. In terms of total number of units, a large amount firms were found in the range of 100 to 999 (43.6%) followed by the range of 10-99 (28.2%). More than half of the firms in the sample reported that number of employees in the headquarters fell into the category of 10 to 100 (54.9%). The majority of the firms in this survey reported that they had sales volume between 100 and 1,000 million dollars (45.1%) and international sales of less than 100 million dollars (75%).

The international experience of the firms can be depicted not only by the firm's age and number of years in international operation but also by the number of foreign countries and continents they entered to establish foreign subsidiaries. As the table indicates, about eighty two

percent of the responding firms (81.6%) were less than 50 years old and had less than 30 years of international business experience (82.3%). Of the companies responding to this survey, seventy three percent provides their goods and services in less than 10 foreign countries and 58% in more than 2 continents. Fifty eight percent of the responding firms have their operations in North America followed by South America (57%), Asia (52%), Europe (48%), Australia/Oceania (31%), and Africa (24%).

Finally, to explore differences between lodging and restaurant firms, the composite mean was calculated for each of seven conceptual constructs included in the proposed structural model. The results of analyses using *t*-test demonstrated that there were no statistically significant differences at the .05 level between lodging and restaurant firms in terms of firm performance, degree of foreign ownership and control, and five constructs pertinent to environmental uncertainty including monitoring uncertainty, asset specificity, political uncertainty, cultural uncertainty, and economic uncertainty (*p* values ranged from .080 to .780).

Table 6-1. Demographic Characteristics of Respondents

Items	Frequency	Percent
Position		
CEO/President	57	34.8
Vice President	79	48.1
Director	21	12.8
Other	7	4.3
Nature of Business		
Lodging	66	40.2
Foodservice	95	57.9
Both	3	1.9
Firm Size		
Number of Units		
Less than 10	9	5.5
10 – 99	46	28.2
100 – 999	71	43.6
1000 – 9,999	32	19.6
More than 10,000	5	3.1
Sales Volume (in \$ million)		
Less than 10	13	9.1
10 – 99.99	41	28.9
100 – 999.99	64	45.1
1,000 – 4,999	22	15.5
More than 5,000	2	1.4
International Sales Volume (in \$ million)		
Less than 10	51	31.1
10 – 99.99	72	43.9
100 – 999.99	21	12.8
More than 1,000	20	12.2
Number of Employees in Headquarters		
Less than 10	7	4.3
10 – 99	90	54.9
100 – 999	45	27.4
1,000 – 4,999	15	9.1
More than 5,000	7	4.3

Table 6-1. Demographic Characteristics of Respondents (continued)

Items	Frequency	Percent
Firm's International Business Experience		
Business Experience (in years)		
Less than 10	15	9.2
10 to 29	67	41.1
30 to 49	51	31.3
50 to 69	22	13.5
More than 70	8	4.9
International Business Experience (in years)		
Less than 10	42	25.6
10 to 29	93	56.7
30 to 49	22	13.4
More than 50	7	4.3
Number of Foreign Countries in Operation		
Less than 5	90	55.6
5 to 9	28	17.3
10 to 29	23	14.2
30 to 49	7	4.3
More than 50	14	8.6
Number of Continents in Operation		
One Continent	68	41.5
Two Continents	27	16.5
Three Continents	19	11.6
Four Continents	13	7.9
Five Continents	10	6.1
Six Continents	27	16.5
Foreign Operations by Continent		
North America	95	57.9
South America	93	56.7
Asia	86	52.4
Europe	79	48.2
Australia / Oceania	51	31.3
Africa	39	23.8

Factor Analysis

Analysis of the measures for this study was performed through a two step process. First, exploratory factor analysis (EFA) was used to construct unidimensional scales. Some analysts like to perform a factor analysis on the data before doing anything else in the hope of determining the number of dimensions underlying the construct. Factor analysis can indeed be used to suggest dimensions. Much less prevalent is its use to confirm or refute components isolated by other means (Churchill, 1979).

In this study, EFA has been used before the confirmation steps suggested hereinafter identifying items which do not have the common core but which do produce additional dimensions and/or theoretical common grounds that might not have been detected through the review of literature; factor analysis was used to confirm whether the number of dimensions conceptualized can be verified empirically.

Next, the reliability and internal consistency of the multiple items constituting each construct was estimated by the item-total correlation analysis. Beyond the examination of the loadings for each indicator on a relevant factor, composite reliability and variance extracted for a latent construct was calculated separately for each multiple item construct in the model. Finally, the convergent and discriminant validity of the measures was assessed through confirmatory factor analysis (CFA) with intercorrelated factors. The model was specified using LISREL 8.30 (Jöreskog & Sörbom, 1993).

Assumptions in Factor Analysis

Since one of the goals of EFA is to obtain a set of common underlying dimensions (factors) that help explain the structure of the interrelationships (correlations) among variables,

the variables should be related to each other for the factor model appropriate (Hair, Anderson, Tatham, & Black, 1995). Inspection of the correlation matrix reveals that almost 70% of the coefficients are greater than .30 in absolute values (Hair et al., 1995; Norušis, 1994). All variables have a large correlation with at least one of the other variables in the set (Appendix B). This provides an adequate basis for proceeding to the next level of examination of adequacy of factor analysis on both an overall basis and for each variable.

The correlations among variables can also be analyzed by computing the partial correlations among variables. If variables share common factors, the partial correlation coefficients between pairs of variables should be small when the linear effects of the other variables are eliminated (Hair et al., 1995; Norušis, 1994). Inspection of off-diagonal anti-image correlations, the negative of the partial correlation coefficient, reveals that among 354 correlations over 313 (88.4%) anti-image correlations are close to zero, indicating a data matrix perhaps well suited to factor analysis.

Another test of factorability is to assess the overall significance of the correlation matrix with Bartlett's test of sphericity. In this study, the chi-square value of the Bartlett's test statistic for sphericity is large (2232.64) and the associated significance level is small (.00). Thus it appears unlikely that the population correlation matrix is an identity. Lastly, Kaiser-Meyer-Okin (KMO) measure of sampling adequacy of .897 is meritorious based upon the guidelines by Kaiser (Kaiser, 1974). A measure of sampling adequacy for each individual variable was also assessed through the examination of the diagonal values of anti-image correlation matrix. Reasonably large values, ranged from .679 to .940, provided an evidence for a good factor analysis (Norušis, 1994).

As for the necessary conditions for both EFA and CFA, it is recommended that the variables be examined for substantial multicollinearity because multicollinearity acts as a weighting process not apparent to the observer but affecting the analysis nonetheless (Hair et al., 1995). On initial examination, the correlation matrix showed no high correlations as defined by Hair et al. (1995) as .90 and above, and at the very least strong correlations above .80 (Hatcher, 1994). Lack of any high correlation values of .90 and above (actual correlations ranged from 0 to .728), however, does not ensure a lack of collinearity because collinearity may be due to the combined effect of two or more variables.

Multicollinearity was diagnosed by examining both tolerance and variance inflation factors (VIF) for the variables to assess multiple variable collinearity. The small tolerance values and large VIF values denote high collinearity. A common cutoff threshold is a tolerance value below .10, which corresponds to VIF values above 10.00 and multiple correlation of .95 (Hair et al., 1995; SPSS, 1996). The tolerance and VIF values for the variables ruled out the possibility that multicollinearity is a serious problem in this study: the tolerance values range .280 for to .660 and its inverse of VIF values range 3.568 to 1.515 respectively, which are considered acceptable (Hair et al., 1995; Norušis, 1994).

An important assumption underlying SEM is that the distribution of the observed variables is multivariate normal (Bollen, 1989b; Byrne, 1995, 1998; Hair et al., 1995; Kline, 1998). Departure from multivariate normality can introduce potential problems in estimation of structural equation models (West, Finch, & Curran, 1995). For example, violation of this assumption can seriously invalidate statistical hypothesis testing such that the normal theory test statistic may not reflect an adequate evaluation of the model under study (Browne, 1982, 1984; Hu, Bentler, & Kano, 1992). A lack of multivariate normality particularly inflates the Chi-square

statistic, rejecting over 5% true model and generates upward bias in critical values for determining coefficient significance of all parameter estimates (Hair et al., 1995; West, Finch, & Curran, 1995).

There are no clear cutpoints as to when scores may no longer be regarded as normally distributed and how much non-normality is problematic (Curran, West, & Finch, 1996; Kline, 1998). Curran et al. (1996), following the pattern used in Monte Carlo (computer simulation) studies of estimation methods applied for SEM, suggested thresholds for the categorization of distributions as normal, moderately nonnormal, and extremely nonnormal. According to Curran et al. (1996), scores are considered to be nonnormal if they demonstrated absolute values of univariate skew indexes ranging from 2.0 to 3.0 and kurtosis values from 7.0 to 21.0; extreme nonnormality was defined by absolute values of the univariate skew indexes greater than 3.0, and kurtosis values greater than 21.0.

In conjunction with the univariate normality test, the validity of the assumption of multivariate normality test was also performed through LISREL's companion package, PRELIS 2.3 (Jöreskog 1988; Jöreskog & Sörbom, 1996b). For single tests of zero skewness and kurtosis, the categories suggested by Curran et al. (1996) were used as guidelines. As reported in Table 6-2, with absolute values of mean skewness and kurtosis index of .04 and .32, respectively, for all practical purposes, the scores can be considered as generally approximating a univariate normal distribution (Curran et al., 1996); absolute values of univariate skewness indexes ranged a low of .00 to a high of .15 and kurtosis varied from .14 to .56. Chi-square values for the test of univariate normality varied from .143 to 3.682 and associated *p* values ranged from .159 to .931, supporting univariate normality hypothesis of zero skewness and zero kurtosis (Jöreskog & Sörbom, 1996b).

Results of omnibus tests of skewness and kurtosis in combination are provided in Table 6-3; the single skewness and kurtosis tests are reported as z -statistics, and the omnibus test as a χ^2 statistic (D'Agostino, 1986; Mardia, 1970, 1974, 1985; Mardia & Foster, 1983). Tests for multivariate normality related to the present data revealed that z -scores for skewness and kurtosis were $-.68$ ($p = .50$) and $-.08$ ($p = .94$) respectively. The Chi-square value for multivariate normality was $.46$ and associated p value for the test of multivariate normality was not significant ($p = .79$), which were collectively the indications of the underlying assumptions of multivariate normality (Jöreskog & Sörbom, 1996b).

Finally, along with the preceding necessary conditions, James, Mulaik, and Brett (1982, pp. 56-57) describe a number of “conditions pertaining to the appropriateness of theoretical models for confirmatory analysis.” Their prerequisites include the requirement of a formal statement of theory in terms of a structural model and providing a theoretical rationale for each causal hypothesis (Kelloway, 1998). The current study model has been sufficiently developed through the review of related literature and underlying theories, which have been fully described in chapter 2, 3, and 4.

Evidence of Theoretical Dimensions from EFA

Confirmatory factor analysis requires a priori designation of plausible factor patterns from previous theoretical work (Mueller, 1996). Prior to the application of CFA, as a preliminary step EFA was conducted in a data matrix to discover that some of the instruments did not measure the factors as expected and uncover further underlying dimensions and/or theoretical structures that might not have been identified through the development of theoretical model (Hatcher, 1994). In order to obtain theoretically meaningful constructs rather than simply

Table 6-2. Test of Univariate Normality

Indicator	Skewness	Kurtosis	Skewness & Kurtosis	
	Score	Score	Chi-Square	P-Value
Output control	-.058	-.143	.144	.930
Monitoring cost	.021	-.484	2.154	.341
Process control	-.040	-.192	.191	.909
Product asset	.018	-.185	.143	.931
Physical asset	-.040	-.229	.297	.862
Brand-name asset	.046	-.387	1.189	.552
Human asset	.116	-.254	.697	.706
Custom	.050	-.333	.812	.666
Language	.000	-.329	.720	.698
Aesthetics	.068	-.327	.828	.661
Business practice	.058	-.309	.691	.708
Value system	.100	-.306	.851	.653
Business restriction	.012	-.229	.259	.878
Policy change	-.006	-.307	.595	.743
Political stability	.028	-.307	.615	.735
Macroeconomic change	.099	-.158	.336	.845
Infrastructure	.040	-.302	.606	.739
Market opportunity	-.010	-.477	2.051	.359
Market demand	.023	-.375	1.056	.590
Market change	.049	-.416	1.456	.483
Resource availability	.095	-.308	.836	.658
Managerial involvement	.152	-.508	3.061	.216
Financial involvement	.134	-.557	3.682	.159
Equity involvement	.153	-.422	2.062	.357
Financial performance	.060	-.277	.538	.764
Nonfinancial performance	-.048	-.242	.362	.835
Overall performance	-.011	-.195	.161	.923

Table 6-3. Test of Multivariate Normality

Skewness		Kurtosis		Skewness & Kurtosis	
Z-Score	P-Value	Z-Score	P-Value	Chi-Square	P-Value
-.676	.499	-.082	.935	.464	.793

reducing the number of variables, a Promax oblique rotational approach was utilized on an initial factor solution (Hair et al., 1995). Before acceptance, the emerging factors were checked against the following criteria:

1. The value of each eigenvalue greater than 1.0 should be included (Norušis, 1994).
2. The factor loadings after rotation are greater than 0.3 (Zaltman & Burger, 1975).
3. The variance explained by all factors is greater than 40 percent (Zaltman & Burger, 1975).
4. No variable has significant loading on more than one factor (Zaltman & Burger, 1975).

As reported in Table 6-4, the results of the factor analysis of the 27 entry mode indicators show Promax rotated loadings, eigenvalue analysis, percentages of the variance extracted, and factor names and the items comprising each factor. The analysis has been conducted with the Statistical Package for the Social Sciences (SPSS) version 12.0 factor analysis procedure. As contended by Tucker and Lewis (1973), the number of factors to accept appears to depend on meaningfulness of factoring results. On examination, the initial analysis of six factors did not appear to be a good solution in the sense of how simple and thus how interpretable factor pattern matrix is; for example, three variables – managerial involvement, financial involvement, and equity involvement - displayed significant loadings on all six factors.

Therefore, user specified seven factor solution was applied based upon a priori criterion to arrive at the best representation of the data and to extract more interpretable theoretical pattern matrix. Hair et al. (1995) noted that “a priori criterion approach is useful if the analyst is testing a theory or hypothesis about the number of factors to be extracted....if theoretical or practical reasons necessitate each variables communality being sufficient, then the researcher will include as many factors as necessary to adequately represent each of the original variables” (p. 377-378).

Table 6-4 shows that almost 73% of the total variance is attributable to the first seven factors. The remaining 20 factors together account for only 27.3% of the variance. The factor analysis revealed significant loadings on all scale items (ranged from 0.596 to 0.933). The first six dimensions account for variances greater than 1 (eigenvalue greater than 1); the eigenvalue of the seventh dimension was less than 1. Although using the eigenvalue greater than 1 (Browne, 1968; Linn, 1968), especially when the number of variables is between 20 to 50, is one of the reliable procedures for establishing a cutoff to determine the number of factors (Hair et al., 1995), it is not always a good solution (Tucker, Koopman, & Linn, 1969). In viewing the eigenvalue for the seventh factor, it was determined that its high value (.744) did not preclude its possible inclusion.

It is recommended to employ a combination of criteria in determining the number of factors to retain (Hair et al., 1995). According to Cattell (1966b), at least one and sometimes two or three more factors are considered significant than does the latent root criterion (eigenvalue) as a result of scree test. The scree analysis displayed Figure 6-1 indicated that seven factors be retained because the scree, i.e., gradual trailing off, begins at the 7th factor (Cattell, 1966a). In combining all the criteria considered, including a priori criterion, factor loadings, total variance explained, eigenvalue and scree plot, it appeared that a seven-factor model should be sufficient for the analysis of current study; in other words, a model with seven factors may be adequate to represent the data.

Table 6-4. Exploratory Factor Analysis – Seven Factor Solution

Factors	Loadings	Eigenvalue	Percent of Variance Explained
Economic Uncertainty		8.780	32.519
Macroeconomic change	.824		
Infrastructure	.818		
Market opportunity	.817		
Market demand	.806		
Market change	.806		
Resource availability	.858		
Cultural Uncertainty		3.275	12.130
Custom	.695		
Language	.790		
Aesthetics	.933		
Business practice	.860		
Value system	.798		
Monitoring Uncertainty		2.080	7.704
Output control	-.835		
Monitoring cost	-.870		
Process control	-.895		
Asset Specificity			
Product asset	.860	1.682	6.230
Physical asset	.716		
Brand-name asset	.596		
Human asset	.790		
Political Uncertainty			
Business restriction	.866	1.587	5.877
Policy change	.821		
Political stability	.869		
Performance			
Financial performance	.796	1.476	5.468
Nonfinancial performance	.870		
Overall performance	.853		
Entry Mode			
Managerial involvement	.717	.744	2.755
Financial involvement	.825		
Equity involvement	.797		
Total Variance Explained			72.683

Scree Plot

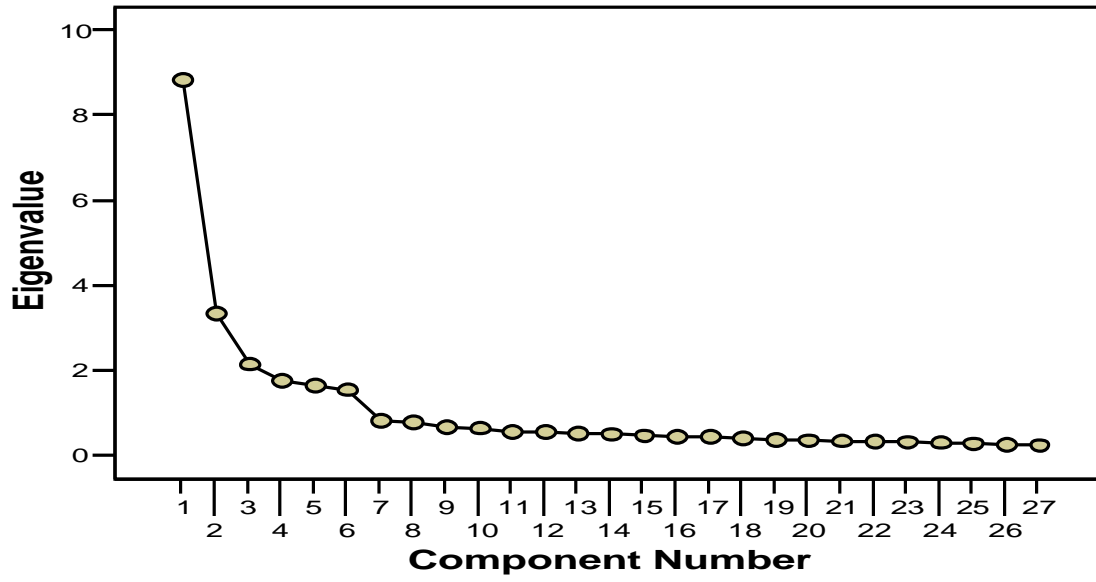


Figure 6-1. Eigenvalue Plot for Scree Test Criterion

Structural Equation Modeling Approach

*He who loves practice without theory is like the sailor who boards ship
without a rudder and compass and never knows where he may be cast.*

--- LEONARDO DA VINCI

Introduction

Scientific theory is a complex spatial network in which theoretical constructs are correlated (or not correlated) and hypotheses about causal relations link theoretical constructs one to another (Feigl, 1970). Correspondence rules connect hypothetical constructs to derived and empirical concepts and each concept is defined by operational definitions; that is, hypothetical constructs are given meaning through specification of the dimensions of each construct (Hempel, 1952). As a corollary, a key implication of the structure of theory is that the integration of theory construction and theory testing is of critical importance (Hughes, Price, & Marrs, 1986).

The empirical testability (Popper, 1959), verifiability (Dodd, 1968), or conformability (Clark, 1969) is a major criterion to evaluate the adequacy of theoretical constructions. Tests of substantive theory, i.e., hypothesized relationships among theoretical constructs, necessarily involve an “auxiliary measurement theory” concerning relationships among theoretical constructs and their indicators (Blalock, 1982, p. 25). Since the theoretical constructs are not observable, a set of observable indicators must be defined for each dimension of each construct prior to the direct and empirical test of a theory (Jöreskog & Sörbom, 1993). There must be clear rules of correspondence between the indicators and the constructs, such that each construct and dimension is distinct (Costner, 1969).

Structural equation models, frequently referred as LISREL (LInear Structural RELations) models, recognize and test a theory about relationships between theoretical constructs that are not directly observable and measurable but must instead be estimated from multiple observable indicator measures (Jöreskog, 1973; Jöreskog & Sörbom, 1993, 1996a). Technically, the structural equation models benefit from using the structural and measurement models simultaneously (Byrne, Baron, & Campbell, 1993; Loehlin, 1992). The structural equation part of the model formulates the pattern of the intercorrelations between the unobserved constructs as defined by the theory on which the instrument is based, while the measurement part of the model represents the correspondence rules by which the unobservable theoretical constructs are related to the observed indicators (Jöreskog & Sörbom, 1993). Conceptually, the use of structural equation models entails a mode of thinking about theory construction. Data analysis serves as describing theory more accurately, testing theory more precisely, and producing a more thorough understanding of the data (Hughes, Price, & Marrs, 1986).

Preliminary Analyses

One of the limitations of confirmatory factor analysis and path analysis with latent variables involves the optimal number of manifest indicator variables. Though no theoretical limit on the number of variables in the model exists, in practice, researchers are advised to have four or five indicators for each latent factor, as it is often necessary to drop some of the indicators in order to arrive at a well fitting measurement model (Hatcher, 1994). It is also recommended that each construct be assessed with at least three indicators (Anderson & Gerbing, 1988; Bentler & Chou, 1987; Lomax, 1982).

Another necessary condition for the application of structural equation modeling involves the maximum number of indicator variables that can be effectively studied. Bentler and Chou (1987) and Mislevy (1986) advised that researchers who lack a great deal of knowledge about the variables of interest should work only with relatively small data sets of perhaps 20 indicator variables or less, whereas a maximum of 30 indicator variables are recommended by Hatcher (1994). Hair et al. (1995) stress the benefits of parsimonious and concise theoretical models, but they advise not to omit a concept solely because the number of variables is becoming large. The number of indicators included in the current research for each construct varied from 3 to 6, totaling 27 observed indicators, which numbers are considered appropriate considering the complexity of the model.

Because the variables in the study actually had a 7-point semantic differential scaled data, it behooves me to take this ordinality into account in analyses of the data, given that the use of maximum likelihood (ML) estimation assumes that the scale of the observed variables is continuous and the distribution of the observed variables is multivariate normal (West, Finch, & Curran, 1995). Multivariate normality has already been checked in previous section of this chapter and proved to be appropriate in terms of relevant Chi-square values.

In the light of practical application, when the number of categories is large, researchers support treatment of ordinal variables as if they were continuous (Atkinson, 1988; Babakus, Ferguson, & Jöreskog, 1987; Muthén & Kaplan, 1985). Indeed, Bentler & Chou (1987) have argued that, given normally distributed categorical variables, “continuous methods can be used with little worry when a variable has four or more categories” (p. 88). Byrne (1998) reviewed SEM applications and revealed most to be based on Likert-type or semantic differential scaled data with estimation of parameters using ML procedures. Consequently, the robustness of the

estimators to violations of assumptions was not considered as a serious issue for this empirical study.

Two-Stage Analysis

In the current study, the postulated relationships in a conceptual model were analyzed with the software program of LISREL 8.30 (Jöreskog & Sörbom, 1993) with the sample covariance matrix as the input matrix as Cudeck (1989) recommended. LISREL recognizes the maximum likelihood estimation method as default and this study employed ML as a method of parameter estimation primarily because ML performs reasonably well under a variety of less-than-optimal analytic conditions such as small sample size (Hoyle & Panter, 1995). For the treatment of missing data, listwise deletion was utilized as this method is usually recommended rather than pairwise deletion when working with SEM (Byrne, 1995).

Analysis of the measures for this study was performed through a two-stage process of structural equation modeling recommended by Anderson and Gerbing (1988): the measurement model is first estimated, and then the measurement model is fixed in the second stage when the structural model is estimated (Kenny, 1979; Williams & Hazer, 1986). Anderson and Gerbing (1988) argued that with a two-stage process, more accurate representation of the reliability of the indicators can be achieved, whereas a single-stage analysis with simultaneous estimation of both measurement and structural models will suffer interpretational confounding (cf. Burt, 1973, 1976). According to Burt (1976, p. 4), interpretational confounding “occurs as the assignment of empirical meaning to an unobserved variable which is other than the meaning assigned to it by an individual a priori to estimating unknown parameters.” Two-step approach is advised by

Anderson and Gerbing (1988) on the belief that interpretational confounding is minimized by prior separate estimation of the measurement model.

Selection of Model Fit Criteria

An important aspect of CFA modeling is the determination of the extent to which a hypothesized model fits the observed data. Historically, goodness-of-fit testing in CFA has been based on the Chi-square statistic. Although the Chi-square statistic is a global test of a model's ability to reproduce the sample variance/covariance matrix, one critical limitation of this statistic, however, is its known sample-size dependency (Bollen, 1989b). The Chi-square statistic must be interpreted with caution in most applications (Jöreskog & Sörbom, 1996). Thus, statisticians have proposed alternative indices of fit that evaluate the extent to which covariation in the observed data can be explained, a focus that is considered to be a more practical mode of assessment. Overall, the CFA literature has emphasized the use of multiple criteria that reflect statistical, theoretical, and practical considerations (Hayduk, 1987; MacCallum, 1986; Marsh, Balla, & McDonald, 1988). In this study, I addressed this call and the model fit to the data was basically assessed with:

1. The Chi-square Likelihood Ratio (Jöreskog, 1969),
2. The Goodness-of-Fit Index (GFI; Jöreskog & Sörbom, 1984)
3. The Tucker-Lewis index (TLI/NNFI; Tucker & Lewis, 1973),
4. The Comparative Fit Index (CFI; Bentler, 1990),
5. The Incremental Fit Index (IFI; Bollen, 1989a),
6. Root Mean Square Error of Approximation (RMSEA; Steiger, 1990)
7. The t values and modification indices (MIs), all provided by the LISREL program

8. The substantive meaningfulness of the model (MacCallum, 1986; Silvia & MacCallum, 1988).

On the decision of acceptable level of fit, Bollen (1989b, p. 275) addressed that “overall, selecting a rigid cutoff for the incremental fit indices is like selecting a minimum R^2 for a regression equation. Any value will be controversial. Awareness of the factors affecting the values and good judgment are the best guides to evaluating their size.” Similarly, Marsh and Hocevar (1985) noted that “most applications of confirmatory factor analysis require a subjective evaluation of whether or not a statistically significant χ^2 is small enough to constitute an adequate fit” (p. 567) and that “this issue will continue to be an important one in the future development of this statistical procedure” (p. 568).

Although the subjectivity somewhat undermines some of the rigor that is possible with CFA, Hair et al. (1995) stated that the ultimate decision of whether the fit is acceptable depends on the research purposes established by the researcher. Sobel and Bohrnstedt (1985) also contended that “scientific progress could be impeded if fit coefficients are used as the primary criterion for judging the adequacy of a model” (p. 158). Furthermore, in many instances guidelines have been suggested, but no absolute test is available. As Gerbing and Anderson (1992, p. 134) point out, there is not one best fit index and, “there never be a single index that should always be used to the exclusion of others.” For aforementioned reasons, assessment of model adequacy was based on multiple criteria throughout the model testing process that took into account theoretical, statistical, and practical considerations.

Measurement Model Development

In this study, the first stage of a two-stage process (Anderson & Gerbing, 1988) for the development of structural model involved utilizing confirmatory factor analysis to develop an acceptable measurement model. At this phase, with the intention of curtailing potential for interpretational confounding, measurement model did not specify any causal relationships between the latent constructs included in the conceptual model and each latent variable is allowed to correlate freely with every other latent variable. Further, as recommended by Jöreskog & Sörbom (1993), measurement model tested by CFA was accessed through three steps: first, each construct was tested separately, then constructs were taken two at a time, particularly for evaluating discriminant validity of conceptual constructs by means of Chi-square difference tests, and then all constructs were considered simultaneously in the measurement model.

The purpose of CFA was to evaluate to what extent an observed data set validates what is theoretically believed to be its underlying constructs and assess whether the observed data fits a prespecified theoretically-driven model (Mueller, 1996). In the following section, confirmatory factor analysis was performed at each level of construct to test a measurement model stipulating the relationships between the latent factors and their indicator variables. All analyses were conducted using LISREL 8.3 (Jöreskog & Sörbom, 1993). These analyses employed the ML method of parameter estimation, and all analyses were performed on the variance-covariance matrix.

Since the hypothesized model in the current study included a total of seven priori specified constructs, seven separate CFAs were performed. As presented in Table 6-7, the number of indicators for each construct ranged a low of 3 to a high of 6, totaling 27 observed

indicators, in which 20 out of 27 indicators were composite scales. Goodness-of-fit indices for the seven single-construct models are presented in Table 6-5. The chi-square statistic included in this table provides a test of the null hypothesis that the reproduced covariance matrix has the specified model structure, i.e., that the model fits the data. Table 6-5 also provides four additional goodness-of-fit statistics: GFI, NNFI, CFI, and IFI.

Goodness-of-fit statistics reported in Table 6-5 were selected primarily based on recommendation by Kelloway (1998), Hoyle and Panter (1995), and Medsker, Williams, and Holahan (1994). The NFI (Bentler & Bonett, 1980) has been widely used as the practical criterion of choice for the last decade (Byrne, 1998). The practical criterion of the choice of four goodness-of-fit indexes reported in Table 6-6 over Bentler and Bonett's (1980) NFI has been a reflection of evidence that the NFI has shown a tendency to underestimate fit in small samples (in the current study, where $N = 148$); the NNFI and CFI are variations on the NFI that have been shown to be less biased in small samples (Bentler, 1995; Marsh et al., 1988); estimation-specific indexes (e.g., GFI) are more appropriate than estimation-general fit indexes (e.g., NFI) in finite samples (Tanaka & Huba, 1989); IFI address the issues of parsimony and sample size that were known to be associated with the NFI (Byrne, 1995).

CFA Results for Monitoring Uncertainty (MU)

Three composite indicators were utilized for the measure of 'monitoring uncertainty.' Estimation of this single factor model reported in Table 6-5 revealed that the model was saturated and the fit was perfect. The factor loadings were reviewed to assess the significance of parameters. The obtained t values for three loadings were 12.31, 13.13, and 13.24, providing evidence of statistical significance at .001 level. The standardized loadings were .78, .82, and .83

for process control (MU3), monitoring cost control (MU2), and output control (MU1), respectively. It can be said that all loadings were moderately large and can be retained in the model (Hatcher, 1994). The analysis revealed coefficient of determination (R^2) values of .61 for MU3, .68 for MU2, and .69 for MU1. The largest squared correlation coefficient (R^2) value of .69 can be interpreted as indicating 69% of its variance can be accounted for by the latent construct 'monitoring uncertainty (MU).'

CFA Results for Asset Specificity (AS)

The measurement scale for the construct 'asset specificity (AS)' was comprised of 4 composite variables. Goodness of fit indices presented in Table 6-5 show that a single factor model for AS provided a very good fit to the data. The model Chi-square statistic was nonsignificant, $\chi^2_{(2)} = 1.40$, $p = .49$, and the GFI (1.00), NNFI (1.01), CFI (1.00), and IFI (1.00) all exceeded .99, indicating acceptable level of fit.

All factor loadings were significant at the significance level of .001 and associated t values ranged in size from 8.15 to 10.70 (Table 6-6). The standardized loadings ranged in size from .60 to .77. It can be said that all loadings were above .60 and at least quite large (Hatcher, 1994), which can be regarded as important to the model. The analysis revealed R^2 values ranged from a low of .36 to a high of .59. None of the normalized residuals exceeded conservative level of 2.0 (Cuttance, 1987) in absolute magnitude, and the largest normalized residual was 1.15 for the relationship between 'physical asset specificity (AS2)' and 'brand name asset specificity (AS3).' None of the modification indexes exhibited significant value of 5 (Kelloway, 1998) for reparameterization or deletion from the model.

CFA Results for Cultural Uncertainty (CU)

The measurement model of ‘cultural uncertainty (CU)’ consisted of 5 manifest variables, among which one indicator was a summated scale. As shown in Table 6-5, the goodness-of-fit measure for a single factor model of CU indicated a very good fit to the data, as evidenced by a significantly small Chi-square value ($\chi^2 = 8.89$, $df = 5$) and by the level of statistical significance ($p = .11$). In reviewing the criteria of model fit statistics, the values of GFI (.98), NNFI (.99), CFI (.99), and IFI (.99) exceeded the suggested level of .90 (Bentler & Bonett, 1980; McDonald & Marsh, 1990; Tucker & Lewis, 1973).

The t statistics were reviewed for evaluating proper representation of the parameter estimate. The obtained t scores ranged from 12.45 through 13.51, indicating that all factor loadings were significant ($p < .001$) and the estimates were statistically different from zero (Table 6-6). Standardized factor loadings of five manifest variables ranged from a low of .76 for ‘aesthetics (CU3)’ to a high of .86 for ‘business practice (CU4)’, which values are indicative of being reasonably large and significant to the model (Hatcher, 1994). A review of R^2 values provided information regarding the variance of each indicator accounted for by the ‘cultural uncertainty (CU).’ The R^2 values ranged from a low of .58 to a high of .74 for CU3 and CU4, respectively. Standardized residuals were investigated and found to be smaller than 2.58 (Byrne, 1998; Jöreskog & Sörbom, 1988) in absolute magnitude: the largest normalized residual was -2.48 for the relationship between ‘business practice (CU4)’ and ‘value system (CU5).’

CFA Results for Political Uncertainty (PU)

Three composite indicators were used to estimate the single factor model of ‘political uncertainty (PU).’ Estimation of this single factor model presented in Table 6-5 revealed that the

model was saturated and the fit was perfect. The factor loadings were tested to prove that the estimate is statistically different from zero. Based on a level of .001, then, the obtained t statistics were greater than 3.29 and the hypothesis of zero parameter estimate was rejected: t values were 10.51, 12.34, and 13.61 and the standardized loadings were .70, .80, and .87 for business restriction (PU1), policy change (PU2), and political stability (PU3), respectively. It can therefore be said that all loadings were large and should be retained in the model (Hatcher, 1994). The analysis revealed R^2 values of .49 for PU1, .64 for PU2, and .76 for PU3.

CFA Results for Economic Uncertainty (EU)

The measurement scale of economic uncertainty (EU) contained six summated indicators. In reviewing the goodness-of-fit indexes in terms of their optimal values, they are consistent in their reflection of a well-fitting model; GFI = .98, NNFI = .99, CFI = .99, and IFI = .99. All of these indices exceeded the recommended level of .90 (Bentler & Bonett, 1980; McDonald & Marsh, 1990; Tucker & Lewis, 1973). As reported in Table 6-5, goodness-of-fit measure provided an evidence of a good fit to the data, as indicated by a small Chi-square value ($\chi^2_{(9)} = 13.85, p < .001$).

A review of factor loadings evidenced that all coefficients were significant at .001 level and associated t values were as low as 11.89 and as high as 14.03 (Table 6-6). The analysis revealed R^2 values ranged from a low of .54 to a high of .68 for six indicators. LISREL output showed that the standardized loadings ranged in size from .74 to .82., indicating that values are larger than .60 and are moderately large (Hatcher, 1994). On examination, one of the standardized residuals exceeded recommended level of 2.0 (Cuttance, 1987) except the

relationship between the ‘infrastructure (EU2)’ and ‘macroeconomic change (EU1)’, indicating trivial misfit in the model with a value of 3.09 in absolute magnitude.

Evidence of misfit is also captured by the modification indices (MIs). The value of MIs represents the expected drop in overall χ^2 value if the parameter were to be freely estimated in a subsequent run (Sörbom, 1989). A review of the MIs indicated that model respecification could yield a substantially better fit if the error covariance between ‘macroeconomic change (EU1)’ and ‘infrastructure (EU2)’ were freely correlated (MI = 9.58). Typically, modification indices smaller than 7.882 (Jöreskog & Sörbom, 1993) provide an insignificant improvement in fit relative to the loss of one degree of freedom from estimating the additional parameter; for the threshold value, Byrne (1988) and Kelloway (1998) suggested 5 and Medsker, Williams, & Holahan (1994) recommended 4. An error covariance between EU1 and EU2 was greater than recommended level of 7.882 (Jöreskog & Sörbom, 1993), and associated expected parameter change value (Saris, Satorra, & Sörbom, 1987) yielded a negative value (-.11). The reestimation of a parameter between error terms produced a smaller differential ($\Delta\chi^2_{(1)} = 9.40$) than MI value between the hypothesized model with no correlated error and the respecified model with an error correlation.

From a substantive standpoint, Byrne (1998) points out that the negative value of expected parameter change makes little sense. More importantly, no previous studies provided theoretical and empirical rationale for the specification of error terms between EU1 and EU2. Jöreskog (1993) admonished “every correlation between error terms must be justified and interpreted substantively” (p. 297). On the same logic, Hatcher (1994) comments that the data-driven modification will fit data only from that specific sample and cannot be generalized to other samples or to the population because modifications are not based upon the predetermined

theoretical ground. Thus, the hypothesized model having no error covariance was considered optimal in representing the construct 'economic uncertainty (EU).'

CFA Results for Entry Mode (EM)

A mediating endogenous construct, entry mode (EM), was measured by three indicators. Table 6-5 presents that estimation of this single factor model was saturated and the fit was perfect. As reported in Table 6-6, the obtained t values for the associated factor loadings were 14.75, 13.32, and 13.77 for managerial involvement (EM1), financial involvement (EM2), and equity involvement (EM3), providing evidence that all factor loadings were significant at .001 level and these parameters can be considered important to the single factor measurement. The standardized loadings were .88, .81, and .83 for EM1, EM2, and EM3, respectively, indicating that all loadings were above .60 and can be considered moderately large (Hatcher, 1994). The R^2 was reviewed to examine the extent to which the measurement model is adequately represented by the observed measures. Examination of the R^2 values revealed all three indicators were moderately strong: scores were .77 for EM1, .66 for EM2, and .69 for EM3.

CFA Results for Performance (PP)

Three indicators were derived from previous studies to measure a performance of a firm in relation with firm's ownership and control mode of foreign affiliates. As presented in Table 6-5, estimation of this single factor model was saturated and the fit was perfect. The parameter estimates and associated t statistics were examined to evaluate how responding indicators are important to the model and whether or not they should be retained in the model. The t values for all factor loadings (13.34, 10.08, and 12.42) were statistically significant at .001 level and all

three standardized factor loadings (.86, .71, and .80) were moderately large (Hatcher, 1994) for three variables of financial performance (PP1), nonfinancial performance (PP2), and overall performance (PP3), respectively. For these reasons, none of the existing parameters should be deleted from the single factor model. The R^2 values reported for each observed variable in the LISREL output was examined to measure the adequate representation of manifest variables to the responding 'performance (PU)' construct. The examination revealed R^2 values of .74 for financial performance, .51 for nonfinancial performance, and .64 for overall performance. The largest R^2 value of .74 can be interpreted as 74% of variance in financial performance (PP1) can be explained by the latent factor 'performance (PP).'

Table 6-5. Goodness-of-Fit Indexes for the Single-Construct Measurement Models

Construct	Chi-square (df)	P - Value	GFI	NNFI	CFI	IFI
Monitoring Uncertainty	The model is saturated and the fit is perfect.					
Asset Specificity	1.42 (2)	.49	1.00	1.01	1.00	1.00
Cultural Uncertainty	8.89 (5)	.11	.98	.99	.99	.99
Political Uncertainty	The model is saturated and the fit is perfect.					
Economic Uncertainty	13.85 (9)	.13	.98	.99	.99	.99
Entry Mode	The model is saturated and the fit is perfect.					
Performance	The model is saturated and the fit is perfect.					

Note: Goodness-of-fit statistics are selected primarily based on recommendation by Hoyle and Panter (1995) and Medsker et al. (1994).

Table 6-6. Parameter Estimates for Single Construct Measurement Models

Construct	Indicator	Standardized Loading *	t – Value	Indicator Reliability
Monitoring Uncertainty (MU)	Output control (MU1)	.83	13.24	.69
	Monitoring cost (MU2)	.82	13.13	.68
	Process control (MU3)	.78	12.31	.61
Asset Specificity (AS)	Product asset (AS1)	.77	10.70	.59
	Physical asset (AS2)	.65	8.90	.42
	Brand-name asset (AS3)	.60	8.15	.36
	Human asset (AS4)	.61	8.27	.37
Cultural Uncertainty (CU)	Custom (CU1)	.80	13.30	.64
	Language (CU2)	.77	12.50	.59
	Aesthetics (CU3)	.76	12.45	.58
	Business practice (CU4)	.86	14.86	.74
	Value system (CU5)	.81	13.51	.65
Political Uncertainty (PU)	Business restriction (PU1)	.70	10.51	.49
	Policy change (PU2)	.80	12.34	.64
	Political stability (PU3)	.87	13.61	.76
Economic Uncertainty (EU)	Macroeconomic change (EU1)	.80	13.29	.63
	Infrastructure (EU2)	.75	12.25	.57
	Market opportunity (EU3)	.82	14.03	.68
	Market demand (EU4)	.82	13.88	.67
	Market change (EU5)	.82	14.03	.68
	Resource availability (EU6)	.74	11.89	.54
Entry Mode (EM)	Managerial involvement (EM1)	.88	14.75	.77
	Financial involvement (EM2)	.81	13.32	.66
	Equity involvement (EM3)	.83	13.77	.69
Performance (PP)	Financial performance (PP1)	.86	13.43	.74
	Nonfinancial performance (PP2)	.71	10.80	.51
	Overall performance (PP3)	.80	12.42	.64

* p < .001

Table 6-7. Descriptive Statistics of Measurement Scales

Construct	Indicator**	Number of Items*	Mean	SD
Monitoring Uncertainty (MU)	Output control (MU1)	3	4.28	1.44
	Monitoring cost (MU2)	4	4.49	1.45
	Process control (MU3)	5	4.41	1.39
Asset Specificity (AS)	Product asset (AS1)	7	3.92	1.38
	Physical asset (AS2)	5	4.39	1.45
	Brand-name asset (AS3)	4	4.30	1.37
	Human asset (AS4)	6	3.64	1.41
Cultural Uncertainty (CU)	Custom (CU1)	1	3.90	1.64
	Language (CU2)	1	4.28	1.49
	Aesthetics (CU3)	1	3.90	1.53
	Business practice (CU4)	1	3.84	1.62
	Value system (CU5)	5	3.82	1.54
Political Uncertainty (PU)	Business restriction (PU1)	6	4.11	1.50
	Policy change (PU2)	6	4.09	1.57
	Political stability (PU3)	7	3.95	1.61
Economic Uncertainty (EU)	Macroeconomic change (EU1)	4	3.41	1.45
	Infrastructure (EU2)	5	3.66	1.61
	Market opportunity (EU3)	5	3.79	1.75
	Market demand (EU4)	6	3.66	1.70
	Market change (EU5)	4	3.64	1.77
	Resource availability (EU6)	4	3.41	1.60
Entry Mode (EM)	Managerial involvement (EM1)	4	3.89	1.47
	Financial involvement (EM2)	1	3.99	1.49
	Equity involvement (EM3)	1	3.82	1.36
Performance (PP)	Financial performance (PP1)	5	3.84	1.51
	Nonfinancial performance (PP2)	5	4.40	1.46
	Overall performance (PP3)	1	4.13	1.41

* Number of items = Number of questions to measure corresponding indicators (see Appendix B).

** Indicator: Twenty out of twenty seven indicators are summated scales of corresponding items.

Note: Respondents were asked to rate all items on a 7 point semantic differential scale, where 1 = disagree and 7 = agree for scales of Monitoring Uncertainty, where 1 = low and 7 = high for scales of Asset Specificity and Entry Mode, where 1 = few and 7 = many for scales of Cultural Uncertainty, where 1 = unpredictable and 7 = predictable for scales of Political Uncertainty and Economic Uncertainty, where 1 = unsatisfied and 7 = satisfied for Performance scales

Overall Measurement Model

After estimating each construct as described in the previous section of this chapter, the measurement model for all the constructs without constraining the covariance matrix of the constructs was estimated. In other words, a covariance is estimated to connect each latent construct with every other latent construct. In Figure 6-2, the estimation of a covariance between each construct is depicted by a curved, two-headed arrow connecting each latent construct (ξ) to every other latent construct (ξ).

Overall measurement model contained seven constructs with a minimum of three indicators per factor: entry mode (EM), performance (PP), monitoring uncertainty (MU), and political uncertainty (PU), were measured by 3 indicators per construct, asset specificity (AS) by 4 indicators, cultural uncertainty (CU) by 5 indicators, and economic uncertainty (EU) by 6 indicators. Twenty out of total 27 indicators were summated scales that were measured by a 98-item questionnaire and remaining 7 indicators were measured by a 7-item questionnaire (Appendix B). The Figure shows that the 'EM (entry mode)' construct (ξ_1) is measured by manifest variables EM1, EM2 and EM3, the '(PP) performance' construct is measured by manifest variables PP1, PP2 and PP3, and so forth.

Offending Estimates

As a final phase of three-step approach for the estimation of measurement model (Jöreskog & Sörbom, 1993), the unidimensionality of a measure was assessed through the estimation of a model containing oblique factors by freeing correlations among latent variables included in the hypothesized model of this study. The initial step in assessing the fit of individual parameters in a model was to determine the viability of their estimated values by

examining ‘offending estimates’: offending estimates are estimated parameter coefficients in either the structural or measurement models that exceed acceptable levels (Hair et al. 1995). In particular, parameter estimates should demonstrate the right sign and size, and be in agreement with the underlying theory (Byrne, 1998).

The most common examples of parameters demonstrating unreasonable estimates are standard coefficients exceeding 1.0, negative error variances (also known as Heywood cases), and standard errors that are excessively large or small (Bentler, 1995; Hair et al. 1995; Jöreskog & Sörbom, 1996a). Standard errors, for example, close to zero (Bentler, 1995; Hatcher, 1994) or extremely large (Jöreskog & Sörbom, 1989) may indicate an estimation problem. It needs to be noted that no definite criterion of small and large value of standard error has been established due to the fact that standard errors are affected by the units of measurement in manifest variables, latent variables, or both, as well as magnitude of the parameter estimate itself (Byrne, 1998).

Table 6-8 shows the LISREL estimates, standard error, and error variances of each indicator used for the measurement model. On examination, none of the indicators included in the measurement model exhibited offending estimates that are theoretically inappropriate and must be corrected before the model was to be interpreted and the goodness-of-fit assessed: the values of standard coefficient were moderate in size, ranged from a low of .50 to a high of .88; all error variances showed positive signs and ranged between .23 and .65; standard errors ranged from .10 to .12 and there were no near-zero standard errors such as .0003 (Hatcher, 1994).

Analysis of Overall Measurement Model

The assessment of model fit for the overall measurement model was done to portray the extent to which the hypothesized constructs included in the current model is adequately

represented by specified manifest indicators. An omnibus test of the measurement model was first conducted prior to the decision on the significance of individual parameters composing the model as suggested by Jöreskog (1993). Along with the goodness-of-fit indices that have been used to test the measurement model for individual construct (e.g., GFI, NNFI, CFI, and IFI), additional fit indexes that are generated by LISREL 8.3 were considered in the assessment of overall measurement model. The fit indexes presented in Table 6-9 are consistent with the most widely adopted dimensions for classifying fit indexes (Bollen, 1989a; Gerbing & Anderson, 1993; Hu & Bentler, 1995; Marsh et al., 1988; Tanaka, 1993).

Table 6-9 provides the results of goodness of fit statistics for overall measurement model analysis. The model provided a reasonably good fit to the data for overall measurement model. Estimation of this model revealed a nonsignificant model Chi-square value, $\chi^2_{(303)} = .99$, $p > .05$, suggesting that hypothesized model is entirely adequate. Although the criterion of normed Chi-square is subjective or arbitrary (Kelloway, 1996; Medsker et al., 1994), model may be acceptable if the Chi-square value is less than twice the size of the degrees of freedom. The Chi-square/df ratio (.84) met the recommended criterion of being less than 2 (Wheaton, Muthén, Alwin, & Summers, 1977), indicating acceptable fit to the data.

The value of standardized root mean square residual (standardized RMR) was .046 and can be interpreted as meaning that the model explains the correlations to within an average error of .046, which is less than the suggested value of .05 (Byrne, 1998; Kelloway, 1998). The root mean square error of approximation (RMSEA) value for the hypothesized model is .00, with the 90% confidence interval ranging from .00 to .00 and the p-value for the test of closeness of fit equal to 1.00. The RMSEA point estimate is less than suggested value of .01 for outstanding fit to the data (Steiger, 1990), the value of upper bound of the 90% interval is below the value

suggested by Browne and Cudeck (1993), and the probability value associated with this test of close fit is larger than suggested value of .50 (Jöreskog & Sörbom, 1996a), evidencing that the model fits the data well.

As shown in Table 6-9, both the GFI (.89) and AGFI (.86) were slightly below the suggested value of 1.00 (Byrne, 1998; Hair et al., 1995; Jöreskog & Sörbom, 1984; Kelloway, 1998) and both values were marginally acceptable. Kelloway (1998), however, warned that this guideline of GFI is based on the experience and highly arbitrary, and thus should be treated with caution; in other words, the current GFI score might be downwardly biased. As with the CFI, coefficient values range from zero to 1.00, with higher values indicating superior fit. The value of IFI falls beyond the normed range and can be greater than 1. Based on the CFI and IFI values reported in Table 6-9 (1.00 and 1.02, respectively), it can once again be concluded that hypothesized model fits the sample data fairly well. The NFI value (.89) was identified as slightly less than the suggested value of .90 (Bentler, 1992). However, given that NFI has shown a tendency to underestimate fit in small samples (Bentler, 1990), the NFI value was reasonably acceptable (in the current study, $N=148$).

The t scores obtained for the coefficients in Table 6-8 ranged from 6.96 to 13.17, indicating that all factor loadings were significantly different from zero ($p < .001$) and considered important to the model. Examination of standardized loadings revealed that only one out of 27 loadings was below the value of .60 suggested by Hatcher (1994), being a sign of at least moderately large loadings.

Another coefficient estimated in the measurement model was the correlation among the seven constructs (ϕ). The t value for 18 obtained correlations out of 21 proved to be statistically significant at the significance level of .01. Three correlations between constructs, however, fell

below the critical value for the .05 significance level; this indicated that there might be weak support at best for believing that the constructs are correlated. Further information on inter-factor correlation coefficients, their standard deviations, and t values was provided in Table 6-10, while more specific information on the intercorrelations, means, and standard deviations for the study's 27 manifest variables are presented in Appendix C.

Information of R^2 was reviewed to determine the extent to which the measurement model is adequately represented by the observed measures. Results of R^2 values reported in Table 6-8 evidenced moderately strong measures at least, with the strongest indicators being the three measures of EM (EM1-EM3) and with the weakest indicators being the four measures of AS (AS1-AS4). The highest R^2 values (.78) for the variable 'EM1' and 'PP1' can be interpreted, for example, as indicating that 78% of its variance can be accounted for by the latent factor EM and PP.

Inspection of the LISREL-produced modification indices suggested six (5 error covariances and 1 factor loading) likely additional parameters greater than 5 (Kelloway, 1998). Typically, modification indices smaller than 7.88 (Jöreskog & Sörbom, 1993), 5 (Kelloway, 1998) or more conservative level of 3.84 (approximately 4) (Hair et al., 1995; Medsker et al., 1994) provide an insignificant improvement in fit relative to the loss of one degree of freedom from estimating the additional parameter (Jöreskog & Sörbom, 1988). The largest modification index (6.59) suggested freeing the path from the PU construct to EU6 indicator, which was initially estimated from EU to EU6 for the hypothesized model.

The modification index suggested that a substantial improvement in fit in terms of χ^2 difference ($\Delta\chi^2_{(1)} = 9.31, p < .005$) could be obtained from making this modification that assign a path from EU construct to EU6 as well as a path from PU construct to EU6. No change has been

made, however, because (a) no substantial improvement achieved for other fit areas (e.g., GFI, NNFI, CFI, and IFI), (b) the indicator EU6 did not demonstrate large negative normalized residuals with other indicator variables (EU1 through EU5) that were correctly assigned to EU construct and did not display large positive residuals for the variables (PU1 through PU3) that were correctly assigned to PU construct (Anderson & Gerbing, 1988), (c) of the dangers of empirically generated modifications, i.e. capitalization on chance characteristics of the sample data (MacCallum, Roznowski, & Necowitz, 1992), (d) there is no theoretical justification for the change, and (e) the item is clearly not designed to assess the PU construct.

Overall, based on the analysis of goodness-of-fit statistics, parameter estimates, standardized residuals, and MIs, the most that can be concluded from these results is that hypothesized seven-factor measurement model provided a meritorious fit to the model. Finally, in the following section, structural model was built on the measurement model by introducing causal relationships with latent variables and incorporating those connections that were hypothesized by theoretically driven model.

Table 6-8. Parameter Estimates for Overall Measurement Model

Construct	Indicator	Standardized Loading*	Standard Deviation	t Value	Indicator Reliability	Error Variance
MU	MU1	.84	.10	11.65	.70	.30
	MU2	.82	.11	11.26	.67	.37
	MU3	.77	.10	10.45	.60	.40
AS	AS1	.73	.11	8.94	.53	.47
	AS2	.66	.12	7.98	.44	.56
	AS3	.65	.11	7.76	.42	.58
	AS4	.59	.12	6.96	.35	.65
CU	CU1	.81	.11	11.66	.66	.34
	CU2	.77	.11	10.71	.59	.41
	CU3	.75	.11	10.39	.57	.43
	CU4	.85	.11	12.48	.72	.28
	CU5	.81	.11	11.65	.66	.34
PU	PU1	.69	.12	8.89	.48	.52
	PU2	.81	.12	10.83	.66	.34
	PU3	.86	.12	11.68	.74	.26
EU	EU1	.79	.10	11.22	.63	.37
	EU2	.75	.12	10.38	.56	.44
	EU3	.83	.12	11.97	.68	.32
	EU4	.82	.12	11.87	.68	.32
	EU5	.83	.12	12.05	.69	.31
	EU6	.73	.12	9.94	.53	.47
EM	EM1	.88	.10	13.17	.77	.23
	EM2	.82	.10	11.81	.67	.33
	EM3	.82	.10	11.72	.67	.33
PP	PP1	.88	.11	12.35	.77	.23
	PP2	.70	.11	9.12	.49	.51
	PP3	.79	.10	10.67	.62	.38

* p < .001

Note: MU (monitoring uncertainty) MU1 (output control) MU2 (monitoring-cost control) MU3 (process control)

AS (asset specificity) AS1 (product asset) AS2 (physical asset) AS3 (brand-name asset) AS4 (human asset)

CU (cultural uncertainty) CU1 (custom) CU2 (language) CU3 (Aesthetics) CU4 (business practice) CU5 (value system)

PU (political uncertainty) PU1 (business restriction) PU2 (policy change) PU3 (social stability)

EU (economic uncertainty) EU1 (macroeconomic change) EU2 (infrastructure) EU3 (market opportunity) EU4 (market demand) EU5 (market change) EU6 (resource availability)

EM (entry mode) EM1 (managerial involvement) EM2 (financial involvement) EM3 (equity involvement)

PP (performance) PP1 (financial performance) PP2 (nonfinancial performance) PP3 (overall performance)

Table 6-9. Goodness-of-Fit Statistics for Overall Measurement Model

Fit Measures	Goodness-of-Fit Statistics
<u>Absolute Fit Measures</u>	
Chi-Square	$\chi^2_{(303)} = 240.89, p = .996$
RMSEA	.00
Standardized RMR	.046
Critical N	210.69
GFI	.89
AGFI	.86
<u>Comparative Fit Measures</u>	
NFI	.89
NNFI	1.03
CFI	1.00
IFI	1.02
RFI	.88
<u>Parsimonious Fit Measures</u>	
PNFI	.77
PGFI	.71

Note: Chi-square likelihood ratio (Jöreskog, 1969); RMSEA = Root Mean Square Error of Approximation (Steiger, 1990); RMR = Root Mean Square Residual; Critical N (CN; Hoelter, 1983); GFI = Goodness-of-Fit Index (Jöreskog & Sörbom, 1984); AGFI = Adjusted Goodness-of-Fit Index (Bentler, 1983); NFI = Normed Fit Index (Bentler & Bonett, 1980); NNFI = Non-Normed Fit Index (Tucker & Lewis, 1973); CFI = Comparative Fit Index (Bentler, 1990); IFI = Incremental Fit Index (IFI; Bollen, 1989a); RFI (RNI) = Relative Fit (Noncentrality) Index (McDonald & Marsh, 1990); PNFI = Parsimony Normed Fit Index (James, Mulaik, & Brett, 1982); PGFI = Parsimony Goodness of Fit Index (James, Mulaik, & Brett, 1982)

Table 6-10. Correlations among Constructs for Overall Measurement Model (*t* values in Parentheses)

Construct	Construct						
	EM	PP	MU	AS	CU	PU	EU
EM	1.00						
PP	.65 (10.08)	1.00					
MU	-.58 (-8.58)	-.45 (-5.53)	1.00				
AS	.60 (8.18)	.45 (5.15)	-.41 (-4.59)	1.00			
CU	.77 (17.27)	.47 (6.10)	-.45 (-5.85)	.53 (6.76)	1.00		
PU	.34 (3.90)	.20 (2.19)	-.08* (-.86)	.14* (1.43)	.20 (2.14)	1.00	
EU	.48 (6.47)	.28 (3.16)	-.28 (-3.24)	.29 (3.13)	.43 (5.74)	-.10* (-1.06)	1.00

* $P > .05$

Note: EM (entry mode) PP (performance) MU (monitoring Uncertainty)
AS (asset specificity) CU (cultural uncertainty) PU (political uncertainty)
EU (economic uncertainty)

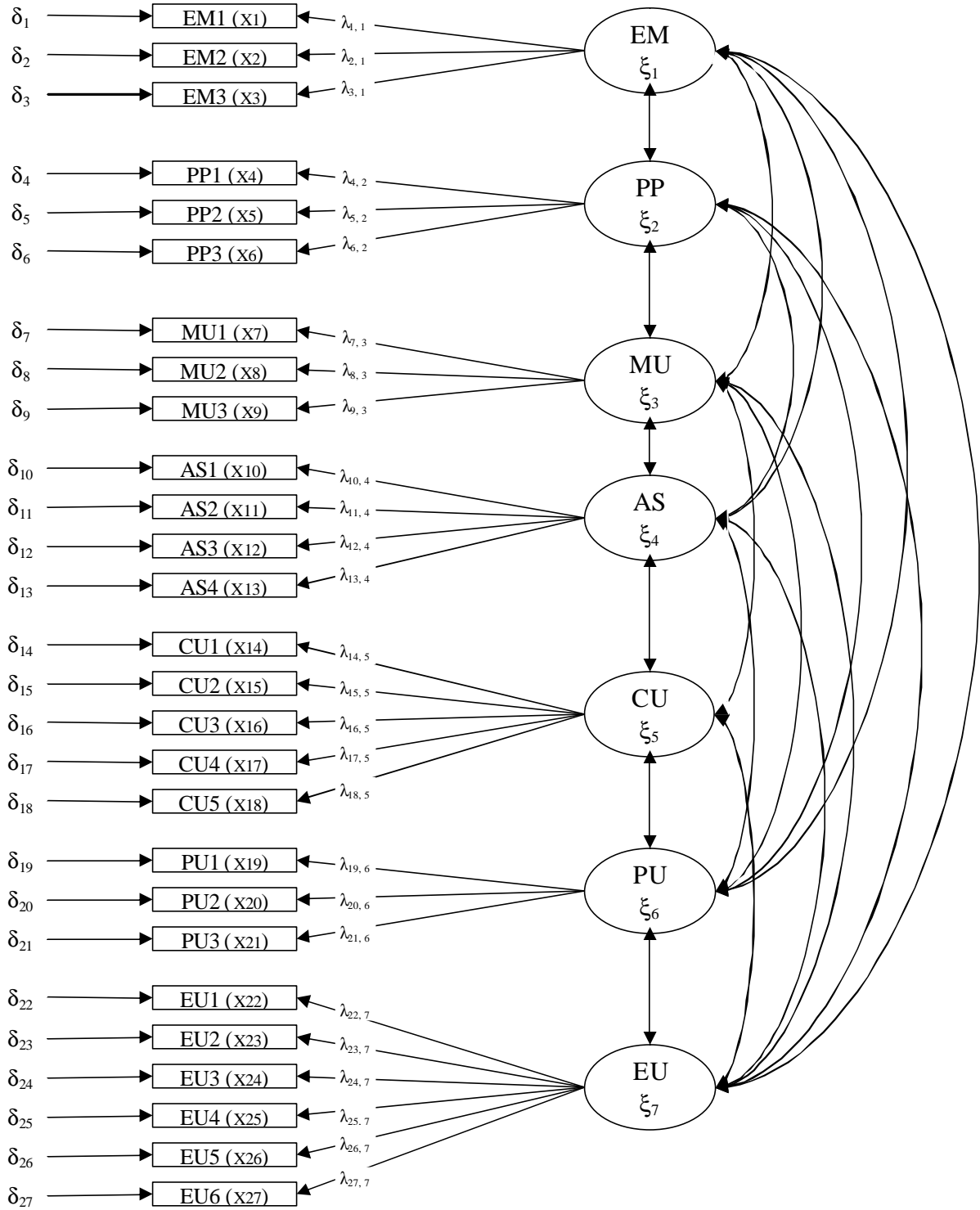


Figure 6-2. Overall Measurement Model

Table 6-11. Description of Constructs and Indicators Contained in the Model

Constructs	Indicators	Description	
MU		Monitoring Uncertainty	
	MU1	Output control	
	MU2	Monitoring cost control	
	MU3	Process control	
AS		Asset Specificity	
	AS1	Product asset specificity	
	AS2	Physical asset specificity	
	AS3	Brand-name asset specificity	
CU		Cultural Uncertainty	
	CU1	Custom	
	CU2	Language	
	CU3	Aesthetics	
	CU4	Business practice	
PU		Political Uncertainty	
	PU1	Business restriction	
	PU2	Policy change	
	PU3	Political stability	
	EU		Economic Uncertainty
EU1		Macroeconomic change	
EU2		Infrastructure	
EU3		Market opportunity	
EU4		Market demand	
EU5		Market change	
EM		Entry Mode	
	EM1	Managerial involvement	
	EM2	Financial involvement	
	EM3	Equity involvement	
	PP		Performance
		PP1	Financial performance
PP2		Nonfinancial performance	
	PP3	Overall performance	

Construct Validation

The purpose of measurement model in this study was to describe how well the observed indicators serve as a measurement instrument for the latent variables; the key concepts are measurement, reliability, and validity (Jöreskog & Sörbom, 1993). The measurement model estimated in the previous step is one which fits the data of the sample reasonably well and in which all parameters are meaningful and substantively interpretable. The review of findings obtained from CFAs in previous section provided good support for the measurement model applied in the current research. As many researchers indicated, however, most measures employed in social and behavioral sciences contain sizable measurement errors (e.g., Bryant & Yarnold, 1995; Stevens, 1996). Before acceptance of the final measurement model, a few additional tests have been performed to assess the reliability and validity of the constructs and indicators.

By definition, measurement error is “the degree to which the observed values are not representative of the true values” in the population (Hair et al., 1995, p. 8). The major source of error within a test or measure is the sampling of items (Churchill, 1979). Researchers can follow several paths to reach the goal of reducing measurement error and may choose to develop composite scales, also known as summated scales. Hatcher (1994) contended that “ideally, each of the indicator variables should be a different composite scale of known reliability and validity” (p. 262).

In an effort to reduce measurement error and enhance the true level of observed value obtained, this study developed composite scales, where several items are combined to represent a composite variable. The majority of items on the survey instrument were either taken directly or adapted for use from existing measures. This was to ensure that these measures have face

validity that provides sound logic and information for the related construct. For example, in Table 6-7, the first three indicators –MU1, MU2, and MU3 - have composite scales, each consisting of multiple items (3, 4, and 5 items, respectively), and all designed to measure the MU construct. The objective was to avoid using only a single variable to represent different facets of the concept and to obtain a more well-rounded perspective and more precisely specified responses. More specific information and full description on summated scales are given in the last part of chapter 5 and Appendix B.

The next step of investigation was the assessment of the construct validation of the measures employed for the proposed structural model. The construct validity of a measurement refers to the extent to which an operationalization of a construct actually measures what it purports to measure (Zaltman, Pinson, & Angelmar, 1973). Three key dimensions that are considered for the assessment of construct validation are (1) internal consistency and reliability, (2) convergent validity, (3) discriminant validity.

Reliability and Internal Consistency of Measurement Scales

Reliability of a measuring instrument means low measurement error and indicates the extent to which it yields consistent and stable results over repeated observations (Eagly & Chaiken 1993; Nunnally, 1978). In other words, reliability can be interpreted as the proportion of the observed variable that is free from error (Lord & Novick, 1968). According to DeVellis (1991), “scale reliability is the proportion of variance attributable to the true score of the latent variable” (p. 24). In practice, reliability is typically defined in terms of the consistency of the scores that are obtained on the observed variable because it is not possible to obtain true scores on a variable (Hatcher, 1994). Coefficient alpha is, therefore, often referred to as an internal

consistency index of reliability because with other factors equal, alpha coefficient will be high if the various items on a scale intercorrelate with one another: “internal consistency is the extent to which the individual items that constitute a test correlate with one another or with the test total” (Hatcher, 1994, p. 132).

According to Carmines and Zeller (1988), coefficient alpha may be interpreted conceptually as an estimate of the correlation between a given scale and an alternate form of the scale that includes the same number of items. In the social sciences, Cronbach’s (1951) alpha (α) is one of the most widely-used indexes of internal consistency reliability of a set of items and the basic statistic for assessing the reliability of a scale composed of multiple items based on internal consistency, especially for Likert and semantic scales (Churchill, 1979; Hatcher, 1994).

Assessing scale reliability with coefficient alpha “absolutely should be the first measure to assess the quality of the instrument” (Churchill, 1979, p. 68) when conducting questionnaire research.

Cronbach’s Alpha

In the current study, internal consistency reliability was assessed in four separate procedures. First, to assess the reliability of all the scales that are based on reflective indicators, Cronbach’s alpha (Cronbach, 1951) was estimated for each factor comprising multiple items. Computation of alpha is based on the reliability of a test relative to other tests with same number of items, which could be constructed from a hypothetical universe of items that measure the same construct of interest (Hatcher, 1994; Norušis, 1994). As shown in Table 6-12, on all occasions, Cronbach’s alpha was higher than the suggested minimum acceptable level of .70; increasingly large coefficient alphas beyond .80 may not significantly increase overall reliability (Nunnally, 1978). The majority of scales had high reliabilities, ranged from .75 to .91, which

indicate the sample of items performs well in capturing the construct which motivated the measure. The acceptable level of Cronbach's alpha values found in this study implied that respondents answered the items within each scale in a somewhat uniform manner and unidimensional scales were likely to be extracted.

Squared Multiple Correlation

Along with the coefficient alpha reliability estimate for the scale, the reliability of a single measure for each indicator variable (indicator reliability) was assessed by squared multiple correlation. Squared multiple correlation is a measure of the strength of the linear relationship. This proportion of variance in the observed variable that is accounted for by its corresponding latent variable is used as an indicator of each item's common factor reliability (Bollen, 1989a; Jöreskog & Sörbom, 1993; Long, 1983). In other words, R^2 serves as a reliability indicator of the extent to which each adequately measures its respective underlying construct (Bollen, 1989a; Long, 1983). The reliability of each measure in a single factor model can be shown to be:

$$\text{Squared multiple correlation} = \frac{L_j^2}{L_j^2 + e_j}$$

Where, L_j = the standardized factor loadings for that factor

e_j = the measurement error associated with the individual indicator variables,

which is $1 - L_j^2$ (reliability of the indicator).

Examination of the R^2 values provided by LISREL 8.3 output revealed measures of moderate to high strength. Indicator reliabilities varied from a low of .35 (AS4) to a high of .78 for (EM1). For example, EM (a mediating endogenous construct) was measured by three indicators, and the R^2 for these indicators are .78, .67, and .67. On the other hand, one of the

exogenous constructs, AS, was assessed by indicators with relatively low R^2 : AS was assessed by four indicators, and the reliabilities for these indicators were only .53, .43, .42, and .35.

Composite Reliability Index

Beyond examination of the squared multiple correlation of each indicator, the composite reliability index was computed separately for each latent factor included in the model in order to reflect the internal consistency of multiple indicator construct. A composite reliability measure is analogous to coefficient alpha and estimates the internal consistency of a latent variable (Bagozzi, 1981a); the evaluation of this measure is critical for the reason that tests of conceptual model specified by hypothesized causal relationships involve latent constructs rather than their respective manifest indicators (Hughes, Price, & Marrs, 1986). The formula for this composite reliability index (adapted from Fornell & Larcker, 1981) was calculated as:

$$\text{Composite reliability} = \frac{(\sum L_j)^2}{(\sum L_j)^2 + \sum e_j}$$

Where, L_j = the standardized factor loadings for that factor

e_j = the measurement error associated with the individual indicator variables,
which is $1 - L_j^2$ (reliability of the indicator).

A commonly used threshold value for an acceptable level of reliability for instruments is .70 or .60 (Hatcher, 1994). Computation for each measurement on seven constructs revealed that construct reliability values ranged from a low of .75 for AS, to a high of .91 for EU. Clearly, the composite reliability for the constructs included in the model exceeded the recommended upper level of .70 (Hair et al., 1995; Hatcher, 1994). Table 6-12 provides the reliabilities for all variables included in the final measurement model.

Despite the fact that squared multiple correlation indicated the reliability of a single measure and the computed value of composite reliability evidenced the reliability of the construct, neither one measures the amount of variance that is captured by the construct in relation to the amount of variance due to measurement error. Additionally, on the basis of composite reliability alone, it may be concluded that the reliability of the construct is sufficient, albeit more than half of the variance is due to error (Fornell & Larcker, 1981).

Average Variance Extracted

As a final step of testing composite reliability, the average variance extracted was utilized to reflect the overall amount of variance in the manifest variables accounted for by the latent factor; it is a more conservative measure than composite reliability and used as a complementary measure to the construct reliability value (Fornell & Larcker, 1981; Hair et al., 1995). The average variance extracted provides information regarding “the amount of variance that is captured by the construct in relation to the amount of variance due to measurement error” (Fornell & Larcker, 1981, p. 45). The formula for this average variance extracted (adapted from Fornell & Larcker, 1981) can be shown to be:

$$\text{Variance Extracted} = \frac{\sum L_j^2}{\sum L_j^2 + \sum e_j}$$

Where, L_j = the standardized factor loadings for that factor

e_j = the measurement error associated with the individual indicator variables,

which is $1 - L_j^2$ (reliability of the indicator).

Table 6-12 presents variance extracted estimates for seven-construct model proposed in this study. All the indexes exceeded the .50 criteria substantially recommended by Fornell and Larcker (1981), except for asset specificity (AS), for which the variance extracted estimate

was .44. Hatcher (1994) cautioned, however, that this test is quite conservative and stringent; “very often variance extracted estimates will be below .50, even when reliabilities are acceptable” (p. 331). Variance extracted measures for the rest of six constructs varied from .63 for PU to .71 for EM, meaning that 71% of the variance is captured by EM construct, and only 29% is due to measurement error. Overall, test statistics show that most of these measures employed in the current research exhibited adequate reliability.

Convergent Validity of Measurement Scales

The preceding steps produced an internally consistent or internally homogenous set of items. Nunnally (1967, p. 92) contends that “consistency is necessary but not sufficient for construct validity.” Reliability may or may not produce a measure which has construct validity. Construct validity, “which lies at the very heart of the scientific process, is most directly related to the question of what the instrument is in fact measuring – what construct, trait, or concept underlies a person’s performance or score on a measure” (Churchill, 1979, p. 70).

Construct validity is first examined by assessing the convergent validity of measures applied to the test of current model. Convergent validity is demonstrated when multiple attempts are used to measure the same concept and different methods are in agreement; the more dissimilar the method, the more stringent the test (Campbell & Fiske, 1959). Evidence of the convergent validity of the measure is provided by the extent to which it correlates highly with other methods designed to measure the same construct (multitrait-multimethod, MTMM); in short, the correlation shows that both instruments were measuring the same construct.

In the present study, on the other hand, convergent validity is assessed instead by reviewing the *t*-tests for the factor loadings and factor loading only, as the different constructs were not assessed by multiple methods. If all factor loadings for the indicators measuring the

same construct are statistically significant (greater than twice their standard error) this is viewed as evidence supporting the convergent validity of those indicators. The fact that all t tests are significant shows that all indicators are effectively measuring the same construct (Anderson & Gerbing, 1988).

The standardized factor loadings and the t tests for these loadings are presented in Table 6-12. The results showed that the t values for all indicators range from 6.96 to 13.17. These t values were all significantly different from zero at significance level of .001 because all t values exceeded the critical t of 3.29. These results supported the convergent validity of all indicators as a measure of its respective underlying constructs. The internal structure of the measures was also evaluated using absolute value of factor loadings. Within the measurement model, all path coefficients from latent constructs to their corresponding indicators (ranging from .83 to 1.47) were greater than the suggested criteria of .60, indicating convergent validity for the constructs (Bagozzi & Yi, 1988).

Discriminant Validity of Measurement Scales

The measure should have not only convergent validity, but also discriminant validity. Discriminant validity refers to the degree to which a given construct is different from other constructs and the measure for a given construct is not a reflection of some other variable but noble (Churchill, 1979; John & Reve, 1982). Discriminant validity is indicated by “predictably low correlations between the measure of interest and other measures that are supposedly not measuring the same variable or concept” (Heeler & Ray, 1972, p. 362). Quite simply, scales that show too high correlations may be measuring the same rather than different constructs.

Table 6-12. Convergent Validity & Reliability of Measures

Construct	Indicator	Convergent Validity		Reliability			
		Standardized Loading*	t Value	Indicator Reliability	Construct Reliability	Variance Extracted	Cronbach Alpha
Monitoring Uncertainty	MU1	.83	13.24	.69	.85	.66	.85
	MU2	.82	13.13	.68			
	MU3	.78	12.31	.61			
Asset Specificity	AS1	.77	10.70	.59	.75	.44	.75
	AS2	.65	8.90	.42			
	AS3	.60	8.15	.36			
	AS4	.61	8.27	.37			
Cultural Uncertainty	CU1	.80	13.30	.64	.90	.64	.90
	CU2	.77	12.50	.59			
	CU3	.76	12.45	.58			
	CU4	.86	14.86	.74			
	CU5	.81	13.51	.65			
Political Uncertainty	PU1	.70	10.51	.49	.83	.62	.83
	PU2	.80	12.34	.64			
	PU3	.87	13.61	.76			
Economic Uncertainty	EU1	.80	13.29	.63	.91	.63	.91
	EU2	.75	12.25	.57			
	EU3	.82	14.03	.68			
	EU4	.82	13.88	.67			
	EU5	.82	14.03	.68			
	EU6	.74	11.89	.54			
Entry Mode	EM1	.88	14.75	.77	.88	.71	.88
	EM2	.81	13.32	.66			
	EM3	.83	13.77	.69			
Performance	PP1	.86	13.43	.74	.83	.62	.83
	PP2	.71	10.80	.51			
	PP3	.80	12.42	.64			

* p < .001

Note: MU1 (output control) MU2 (monitoring cost control) MU3 (process control)
AS1 (product asset specificity) AS2 (physical asset specificity) AS3 (brand-name asset specificity)
AS4 (human asset specificity) CU1 (custom) CU2 (language) CU3 (Aesthetics)
CU4 (business practice) CU5 (value system) PU1 (business restriction) PU2 (policy change)
PU3 (social stability) EU1 (macroeconomic change) EU2 (infrastructure) EU3 (market opportunity)
EU4 (market demand) EU5 (market change) EU6 (resource availability)
EM1 (managerial involvement) EM2 (financial involvement) EM3 (equity involvement)
PP1 (financial performance) PP2 (nonfinancial performance) PP3 (overall performance)

The multitrait-multimethod (MTMM) approach provides a relatively strong test of discriminant validity; MTMM is also a useful way of assessing the convergent validity of a measure (Campbell & Fiske, 1959). The MTMM tests were not performed for the present model study, as multiple methods were not used to assess the different constructs. Nonetheless, some evidence regarding discriminant validity can still be obtained from the present analysis. This paper addressed the issue of discriminant validity through application of three procedures: Chi-square difference test, confidence interval test, and variance extracted test.

Chi-square Difference Test

First, discriminant validity was assessed by comparing the Chi-square difference statistic ($\Delta\chi^2$) for two estimated constructs on the values obtained for the constrained (uncorrelated) and unconstrained (correlated) models (Jöreskog, 1971). While the unconstrained model (standard measurement model) was estimated in which all factors are allowed to correlate, the estimated correlation parameter (ϕ_{ij}) between two estimated constructs was constrained to 1.0 for the constrained model (unidimensional model), as suggested by Bagozzi (1981b) and Anderson and Gerbing (1988). According to Bagozzi and Phillips (1982, p. 476), “a significant lower χ^2 value for the model in which the trait correlations are not constrained to unity would indicate that the traits are not perfectly correlated and that discriminant validity is achieved.”

Anderson (1987) argues that a nonsignificant value for one pair of factors can be obfuscated by being tested with several pairs that have significant values. In the present study, I addressed this call and pairwise Chi-square difference test was performed to test the discriminant validity for every possible pair of constructs, rather than as a simultaneous test of all pairs; this resulted in 21 different models and consequently 21 difference tests, as there are 21 separate

covariances between the seven constructs in the model. Performing such a large number of Chi-square tests for assessments of discriminant validity, however, creates problems involving the maintenance of the true overall significance level for the family of tests (cf. Finn, 1974). A Chi-square difference ($\Delta\chi^2$) value with an associated p value less than .05 supports the discriminant validity hypothesis (Jöreskog, 1971). The significance level for each test should be adjusted in order to avoid an unacceptable actual significance level higher than the standard level of .05. To deal with this problem, Hatcher (1994) recommends employing a relatively small p value for the individual tests.

The summary of Chi-square difference tests between the constrained and unconstrained model on each pair of factors is presented in Table 6-13. The observed Chi-square difference values ranged from a low of .65 to a high of 66.06, among which difference values of 13 pair of factors were significant at .001 level, 3 pair of factors at .01 level, and 2 pair of factors at .05 level, supporting the discriminant validity hypothesis that constructs were unique dimensions (Jöreskog, 1971). In other words, the unconstrained model in which the factors were viewed as distinct but correlated constructs provided a fit that was significantly better than the fit provided by the constrained model (Bagozzi & Phillips, 1982).

The observed Chi-square difference values for three pair of constructs, however, were less than 3.84 and associated p values less than .05: MU-PU ($\Delta\chi^2_{(1)} = .65$), EU-PU ($\Delta\chi^2_{(1)} = 1.01$), and AS-PU ($\Delta\chi^2_{(1)} = 2.01$). For that reason, further investigation was conducted through application of two complimentary procedures – confidence interval test and variance extracted test - with regard to three pair of factors that showed small Chi-square difference values and associated large probability values, consequently providing lack of substantial evidence of discriminant validity.

Table 6-13. Discriminant Validity: Chi-Square Difference Test

Construct		Parameter	Constrained Model		Unconstrained Model		$\Delta\chi^2$	Δdf
			χ^2	df	χ^2	df		
MU	AS	MU-AS	23.68	14	8.71	13	14.91 ^{***}	1
MU	CU	MU-CU	39.32	20	17.09	19	22.23 ^{***}	1
MU	PU	MU-PU	5.89	9	5.24	8	.65	1
MU	EU	MU-EU	28.86	27	20.22	26	8.64 ^{**}	1
MU	EM	MU-EM	43.45	9	6.42	8	37.03 ^{***}	1
MU	PP	MU-PP	27.06	9	6.70	8	20.36 ^{***}	1
AS	CU	AS-CU	45.73	27	20.39	26	25.34 ^{***}	1
AS	PU	AS-PU	12.25	14	10.24	13	2.01	1
AS	EU	AS-EU	36.62	35	28.52	34	8.10 ^{**}	1
AS	EM	AS-EM	44.33	14	11.79	13	32.54 ^{***}	1
AS	PP	AS-PP	32.48	14	15.14	13	17.34 ^{**}	1
CU	PU	CU-PU	20.80	20	16.61	19	4.19 [*]	1
CU	EU	CU-EU	53.29	44	31.58	43	21.71 ^{***}	1
CU	EM	CU-EM	87.25	20	21.19	19	66.06 ^{***}	1
CU	PP	CU-PP	44.92	20	21.03	19	23.89 ^{***}	1
PU	EU	PU-EU	32.78	27	31.77	26	1.01	1
PU	EM	PU-EM	22.42	9	10.14	8	12.28 ^{***}	1
PU	PP	PU-PP	6.78	9	2.55	8	4.23 [*]	1
EU	EM	EU-EM	49.11	27	22.88	26	26.23 ^{***}	1
EU	PP	EU-PP	26.16	27	17.30	26	8.86 ^{**}	1
EM	PP	EM-PP	50.57	9	4.26	8	46.31 ^{***}	1

* $p < .05$; ** $p < .01$; *** $p < .001$

Note: MU (monitoring uncertainty) AS (asset specificity) CU (cultural uncertainty)
 PU (political uncertainty) EU (economic uncertainty) EM (entry mode) PP (performance)

Confidence Interval Test

One of the complementary assessments of discriminant validity is to determine whether the confidence interval (\pm two standard errors) around the correlation estimate between the two factors includes 1.0 (Anderson & Gerbing, 1988). As presented in Table 6-14, the confidence interval for three pair of factors ranged from -.28 to .12 for MU-PU, from -.28 to .08 for EU-PU, and from -.06 to .34 for AS-PU. In all three cases, the correlation coefficients between two constructs were significantly different from 1: the correlation coefficients plus or minus two times of standard errors did not include the value of 1, meaning that it is unlikely that the actual

population correlation between two estimated constructs in all three cases is 1.0 (Anderson & Gerbing, 1988). This finding supports the discriminant validity measures.

Table 6-14. Discriminant Validity: Confidence Interval Test

Construct		Parameter	Estimate	Standard Error	Confidence Interval	
					Lower	Upper
MU	PU	MU-PU	-.08	.10	-.28	.12
EU	PU	EU-PU	-.10	.09	-.28	.08
AS	PU	AS-PU	.14	.10	-.06	.34

Note: MU (monitoring uncertainty) PU (political uncertainty)
 EU (economic uncertainty) AS (asset specificity)

Variance Extracted Test

Finally, discriminant validity was evaluated with a variance extracted test (Fornell & Larcker, 1981; Netemeyer, Johnston, & Burton, 1990) for three-pair of factors that had small Chi-square difference values ($p > .05$). With this test, the variance extracted estimates for the four factors (MU, EU, PU, and AS) were compared to the corresponding square of the correlations between the two factors in three cases of paired factors: correlation between MU and PU; EU and PU; AS and PU. To fully satisfy the requirements for discriminant validity, both variance extracted estimates should be greater than corresponding squared correlation (Fornell & Larcker, 1981).

In the present study, the variance extracted estimate was .66 for MU and .62 for PU and the squared correlation between factors MU and PU was .0064 as presented in Table 6-8. Variance extracted estimates were calculated earlier and appeared in Table 6-12. Because the variance extracted estimates for both MU and PU were greater than the square of the interfactor correlation (the ϕ matrix), this test supports the discriminant validity of the two factors. For the

next pair of factors, the squared correlation between EU and PU was .01. The variance extracted estimates for both EU (.63) and PU (.63) were larger than the .01, indicating the discriminant validity of the two factors. For the final pair of factors, AS and PU, the correlation between factors was .14 and the square of this correlation was approximately .02, which was less than the variance extracted estimate of each factor, .43 and .63. As reviewed in Table 6-15, the average variance extracted for the factors were all superior to the correlation coefficients between factors, thus providing evidence for the discriminant validity.

Table 6-15. Discriminant Validity: Variance Extracted Test

Construct	Variance Extracted	Construct	Variance Extracted	Parameter	Estimate	Square of Estimate
MU	.66	PU	.62	MU-PU	-.08	.0064
EU	.63	PU	.62	EU-PU	-.10	.0100
AS	.43	PU	.62	AS-PU	.14	.0196

Note: MU (monitoring uncertainty) PU (political uncertainty)
 EU (economic uncertainty) AS (asset specificity)

In summary, analyses provided mixed support for the discriminant validity of the construct measures. The confidence interval test and the variance extracted test suggested that indicators were measuring two distinct constructs for each pair of factors in the present model study, while the Chi-square difference test did not support three cases among 21 interfactor correlations (the ϕ matrix). Anderson and Gerbing (1988) pointed out that although Chi-square difference test is “a necessary condition for demonstrating discriminant validity, the practical significance of this difference will depend on the research setting” (p. 416). Collectively, the above procedures ensured the reliability, convergent validity, and discriminant validity of all the construct scales. Taken as a group, the constructs in the model performed very well.

Structural Model Development

In the previous three sections, the measurement model was estimated for each construct separately, then for each pair of constructs by combining them two by two, particularly for the purpose of construct and indicator validation. Then overall measurement model was estimated for all the constructs without constraining the covariance matrix of the constructs as recommended by Jöreskog & Sörbom (1993). Figure 6-3 identifies the seven latent constructs investigated in this study and shows the theoretical frameworks incorporated in the conceptual model and the expected direction of relationships between latent constructs.

In this section, as a second step of two-stage process suggested by Anderson and Gerbing (1988), the structural equation model was estimated for the constructs jointly with the measurement model. The structural model assessed in this stage is not identical to the measurement model in Figure 6-2 because the structural model in Figure 6-3 posits directional causal relationships between the latent constructs.

Offending Estimates

Before evaluating the structural model, the results are first examined for offending estimates (Byrne, 1998; Hair et al., 1995; Hatcher, 1994). Offending estimates were assessed to see if there were any unreasonable values, i.e., nonsensical or theoretically inconsistent estimates or other anomalies by examining the standardized parameter estimates exceeding 1, very large standard errors, and negative error variances for the path coefficients (Bentler, 1995; Jöreskog & Sörbom, 1989, 1993). The results revealed that parameter estimates for the relationships between latent variables had the right sign and size. The parameter estimates were in consistent with the underlying theory and a priori specifications: the largest value of standardized parameter

estimate (.43) was less than 1; the largest standard error in size was .11; all error variances showed positive signs.

Nomological Validity

Having met the acceptable limits of feasibility of parameter estimates, structural part of the overall model fit was evaluated. According to Anderson and Gerbing (1988), the nomological validity of a theoretical model can be tested by performing a Chi-square difference test in which the theoretical model is compared to the measurement model. A finding of no significant difference indicates that the theoretical model is successful in accounting for the observed relationships between the latent constructs (Anderson & Gerbing, 1988). Therefore, the Chi-square difference test between measurement model and theoretical model was performed. The result was proved to be statistically nonsignificant ($\chi^2_{(5)} = 2.01$), given that the critical Chi-square value with 5 df is 11.07 at .05 significance level. This finding evidenced that the theoretical model was successful in accounting for the relationships between the latent constructs.

Analysis of Overall Structural Model

The global measures of model fit (Brannick, 1995) available in structural equation modeling techniques often are used as an omnibus test of the model whereby global fit can be assessed before proceeding to a consideration of the individual parameters composing the model (Jöreskog, 1993). Three categories of goodness-of-fit statistics were considered along with other model fit indexes such as parameter estimates, standardized residuals, and modification indexes. Three types of goodness-of fit statistics are presented in Table 6-16 and include (a) absolute fit,

(b) comparative (incremental) fit, and (c) parsimonious fit (Bollen, 1989a; Gerbing & Anderson, 1993; Marsh et al., 1988; Tanaka, 1993).

Gerbing and Anderson (1992, p. 134) describe the ideal properties of such indices to (a) indicate degree of fit along a continuum bounded by values such as 0 and 1, where 0 represents a lack of fit and 1 reflects perfect fit, (b) be independent of sample size...and, (c) have known distributional characteristics to assist interpretation and allow the construction of a confidence interval. Kelloway (1998) argued that none of the fit indices satisfy all three of these criteria, with the possible exception of the RMSEA. As explained in the previous section, the goodness-of-fit indices in this research have been primarily judged by χ^2 , GFI, NNFI, CFI, IFI, and RMSEA for the evaluation of hypothesized model following the suggestions by Medsker, Williams, and Holahan (1994), Hoyle and Panter (1995), Hatcher (1994), and Kelloway(1998). Along with these criteria, other goodness-of-fit indices produced by LISREL 8.3 were examined closely as complements in the following analyses.

Evaluation of Goodness-of-Fit Indexes

As indicated by the goodness-of-fit values reported in Table 6-16, the hypothesized seven-factor structural model represented a reasonably good fit to the data. The Chi-square test simultaneously tests the extent to which each parameter specification for model under study is valid (Jöreskog & Sörbom, 1993). The Chi-square test of the current model yielded a $\chi^2_{(308)}$ value of 242.90 ($p = .95$) thereby suggesting that the hypothesized model is adequate. Interpreted literally, this test statistics indicates that the hypothesis bearing on relations of seven conceptual construct represents a likely event and should not be rejected. Given that the sensitivity of the likelihood ratio test to sample size, the result of Ch-square test was not unexpected.

Even if all the assumptions of the Chi-square test hold, it may not be realistic to assume that the model holds exactly in the population (Jöreskog & Sörbom, 1993). In this case, Chi-square should be compared with a non-central rather than a central Chi-square distribution (Browne, 1984). The noncentrality parameter (NCP) serves as a measure of the discrepancy between population covariance matrix and model covariance matrix and can be regarded as a “natural badness-of-fit of a covariance structure model” (Steiger, 1970, p. 177). The hypothesized model produced a NCP of 0.0. As a means to establishing the precision of the NCP, Steiger (1990) has suggested that it be framed within the bounds of confidence intervals. The review of confidence interval revealed that over all possible randomly sampled NCP values, 90% of them would range from 0.0 to 1.14, indicating an acceptable range.

Another fit of the model was assessed by taking the ratio of the χ^2 and its degrees of freedom, i.e., normed Chi-square, (Wheaton, Muthén, & Alwin, 1977). When calculated, the result (.79) revealed that the value of normed χ^2 was below the acceptable level of 5 (Wheaton, Muthén, & Alwin, 1977). It should be noted, however, that this criterion for model fit has conflicting standards of interpretation (Medsker et al., 1994); for instance, normed χ^2 of less than 2 or 3 have been interpreted as indicating a good fit to the data (Carmines & McIver, 1981) as have ratios between 2 and 5 (Kelloway, 1998), with ratio less than 2 indicating being overfitted thereby capitalizing on chance (Hair, 1995). It has also shown that normed χ^2 is affected by sample size, and that the same model may generate significantly different ratios with small samples than with large samples (Marsh et al., 1988); the sample size of current analysis is not large enough ($N = 148$), which might impinge on the value of normed χ^2 . Wheaton (1987) later advocated that this ratio not be used. In this regard, interpretative standards for the normed χ^2 have little justification and use of the index appears to be in decline (Kelloway, 1996). For this

reason, this criterion was supplemented with other criteria and used only as a very rough rule of thumb.

As indicated by the NNFI (1.03), GFI (.89), CFI (1.00), and IFI (1.02) values reported in Table 6-15, the hypothesized seven-factor structural model represented a reasonably good fit to the data. For an acceptable value of GFI, Kelloway (1998, pp. 27-28) claimed that “rules about when a GFI index indicates a good fit to the data are highly arbitrary and should be treated with caution.” Among the four fit indexes reviewed above, GFI value of .89 was acceptable level, given that the guideline of acceptable value exceeding .90 is based on experience (Kelloway, 1998). Unlike CFI and GFI, values of NNFI and IFI can fall outside the normed range, i.e., zero to one (Hoyle & Panter, 1995). The NNFI (Bentler & Bonett, 1980) and the CFI (Bentler, 1989) are generally preferable to the GFI or NFI as they are less likely to produce biased estimates in small samples (Bentler, 1995; Marsh et al., 1988).

As shown in Table 6-16, the NFI (.89), RFI (.88), and AGFI (.87) were slightly less than suggested level of .90; however, the result was consistent in suggesting that the hypothesized model represented an adequate fit to the data, albeit marginally acceptable. The NFI value of .89 may be underestimated in this study due to the fact that as Bentler and Bonett (1980) point out, the NFI has a tendency to underestimate fit of the model in small samples (in this study, $N = 148$). An NFI of .89 means that the model was 89% better fitting than the null model. The discrepancy between the GFI and AGFI (.02) may be caused by the inclusion of trivial parameters (Kelloway, 1998).

The PGFI addresses the issue of parsimony in SEM (James, Mulaik, & Brett, 1982). Typically, parsimony-based indices have lower values than the acceptable level of cutoff points for other normed fit indexes. Mulaik et al. (1989) suggested that nonsignificant χ^2 statistics and

goodness-of-fit indices in the range of .90, accompanied by parsimonious-fit indices in the range of .50, are not unexpected. A PGFI value of .73 would seem to be consistent with fit statistics examined in the previous section. As was the case for the PGFI, the PNFI takes the complexity of the model into account in its assessment of goodness-of-fit (James, Mulaik, & Brett, 1982). A PNFI of .78 presented in Table 6-16 fell in the range of expected values.

The RMSEA represents a close approximation of fit relative to the degrees of freedom that could be expected if the model were estimated in the population, not just for the sample drawn for the estimation (Steiger, 1990). Steiger (1990) suggests that values below .10 indicate a good fit to the data, values below .05 a very good fit to the data and values below .01 indicate an outstanding fit to the data. On the other hand, Browne and Cudeck (1993) suggest that values less than .05 indicate good fit and values as high as .08 represent reasonable errors of approximation in the population. MacCallum et al. (1996) suggest midrange cutpoints: RMSEA values ranging from .08 to .10 indicate mediocre fit and those greater than .10 indicate poor fit.

The RMSEA has been recognized as one of the most informative criteria in covariance structure modeling (Byrne, 1998) and satisfies all three ideal properties of fit indices suggested by Gerbing and Anderson (1992). Following the guidelines proposed by Steiger (1990), the point estimate of RMSEA of .00 represented a good fit to the data. One possible limitation of the RMSEA, as noted by Byrne (1994), is that it ignores the complexity of the model. Instead of applying point estimation of RMSEA, MacCallum et al. (1996) strongly urged the use of confidence intervals in practice for the decision of imprecision of the estimate. A very narrow confidence interval would argue for good precision of the RMSEA value in reflecting model fit in the population. A 90% confidence interval ranged from .000 to .005 in this study, presenting possibility to determine accurately the degree of fit in the population.

LISREL 8.3 also provides a test of the significance of the RMSEA by testing whether the value obtained is significantly different from .05: it tests the hypothesis that the error of approximation has an associated probability of less than .05 ($p < .05$). The result showed that the p -value for the test of closeness of fit equal to 1, which was greater than the threshold value of .50 suggested by Jöreskog & Sörbom (1996a). Jöreskog & Sörbom (1993) suggested that the lower bound of interval should be less than .05 and upper bound of interval less than .08. Interpretation of the confidence interval for the current study indicates that, over all possible randomly sampled RMSEA values, 90% of them will fall within the bounds of .00 and .005, which represents an exact degree of precision. Thus, it can be concluded that the degree of approximation in the population is extremely small and the model fits the data well.

Another indication that current model fits well is provided by the cross-validation index (ECVI) value. The ECVI was proposed as a means to estimating the expected value of the cross-validation index using only data from a single sample (Browne & Cudeck, 1989). The ECVI is thought to measure the discrepancy between the actual covariance matrix in the analyzed sample and the expected covariance matrix over all possible calibration samples. The model having the smallest ECVI value exhibits the greatest potential for replication (Byrne, 1998).

In assessing the hypothesized seven-factor model, the comparison of ECVI value of 3.05 has been made with that of both the saturated model (ECVI = 5.14) and the independence model (ECVI = 16.65). Given the lower ECVI value for the hypothesized model, compared with both the independence and saturated model, it can be concluded that the current model represented the best fit to the data and a reasonably close approximation in the population. The 90% confidence interval for ECVI suggested that precision of the estimated ECVI value ranged from 3.05 to 3.06.

Taken together, these results suggested that the hypothesized model was well fitting, represented a reasonable approximation to the population, and revealed great potential for replication.

As with the ECVI, the Akaike's (1987) information criterion (AIC) and Bozdogan's (1987) consistent version of the AIC (CAIC) are used in the comparison of two or more models with smaller values representing a better fit of the hypothesized model (Hu & Bentler, 1995). These indices also reflect the extent to which parameter estimates from the original sample will cross-validate in future samples (Bandalos, 1993). The output showed that both the AIC and CAIC statistics for the hypothesized model (382.90 and 662.70, respectively) are substantially smaller than they are for either the independence (2447.54 and 2555.46, respectively) or the saturated models (756.00 and 2266.95, respectively).

Lastly, adequate model fit is also evidenced by Hoelter's Critical N (CN). Specifically, the purpose of the CN is to estimate a sample size that would be sufficient to yield an adequate model fit for a χ^2 test (Hu & Bentler, 1995). Hoelter (1983) proposed that a CN value in excess of 200 is indicative of a model that adequately represents the sample data. As shown in Table 6-16, the CN value of 211.94 for the hypothesized model provided an evidence to conclude that the size of current sample ($N = 148$) used in this study was sufficiently large as to allow for an adequate fit to the model, presuming that it was correctly specified.

Evaluation of Parameter Estimates

Shown in Figure 6-4 are standardized parameter estimates for the factor loadings, along with their respective t values in parentheses; as such, both the observed and unobserved variables in the model are scaled to have a variance of 1 and a mean of 0 (Jöreskog & Sörbom, 1993). For purposes of statistical identification, a reference variable was used for which the measure having

the highest reliability is fixed to 1 (Byrne, 1998), thus t values were not reported for these parameters.

As illustrated in Figure 6-4 and Table 6-17, all causal path coefficients linking two latent constructs and the associated t values for six path coefficients proved to be statistically significant at .05 level: t values ranged from 2.3 to 7.64 in absolute magnitude, indicating that correlation is non-zero and significant to the model. The completely standardized loadings ranged from .18 to .65 in absolute magnitude. The modification indices suggested that there were no particular path that should be introduced in the model.

Inspection of the standardized residual matrix revealed that absolute value of one element out of 351 slightly exceeded threshold value of 2.58 suggested by Byrne (1998): the negative residual between PU3 and CU5 (-2.62) indicates that these two manifest variables correlated more than the model accounted, i.e., overestimated the covariances between the variables, indicating possible misfit in the model, albeit it was not serious. On visual inspection of the stem-leaf plots shown in Appendix D, standardized residuals were symmetrically clustered around zero point, with most being in the middle of distribution and only a few in the tails, indicating residuals being neither underestimated nor overestimated. Finally, a review of the Q-plot (Appendix E) showed that all points fell approximately on a 45 degree line, suggesting that the hypothesized model is reasonably well-fitting (Jöreskog, 1993; Jöreskog & Sörbom, 1993).

Although standardized residual shows where the lack of fit is, it does not tell how the model should be modified to fit the data better. Modification indices detect specification errors in the model that cannot be identified through the inspection of standardized residuals; in other words, MI values pertain only to fixed parameters, and indicate the expected decrease in Chi-

square given the relaxation of imposed constraints (Jöreskog & Sörbom, 1993); the decrease, however, may actually be higher (Byrne, Baron, & Campbell, 1993).

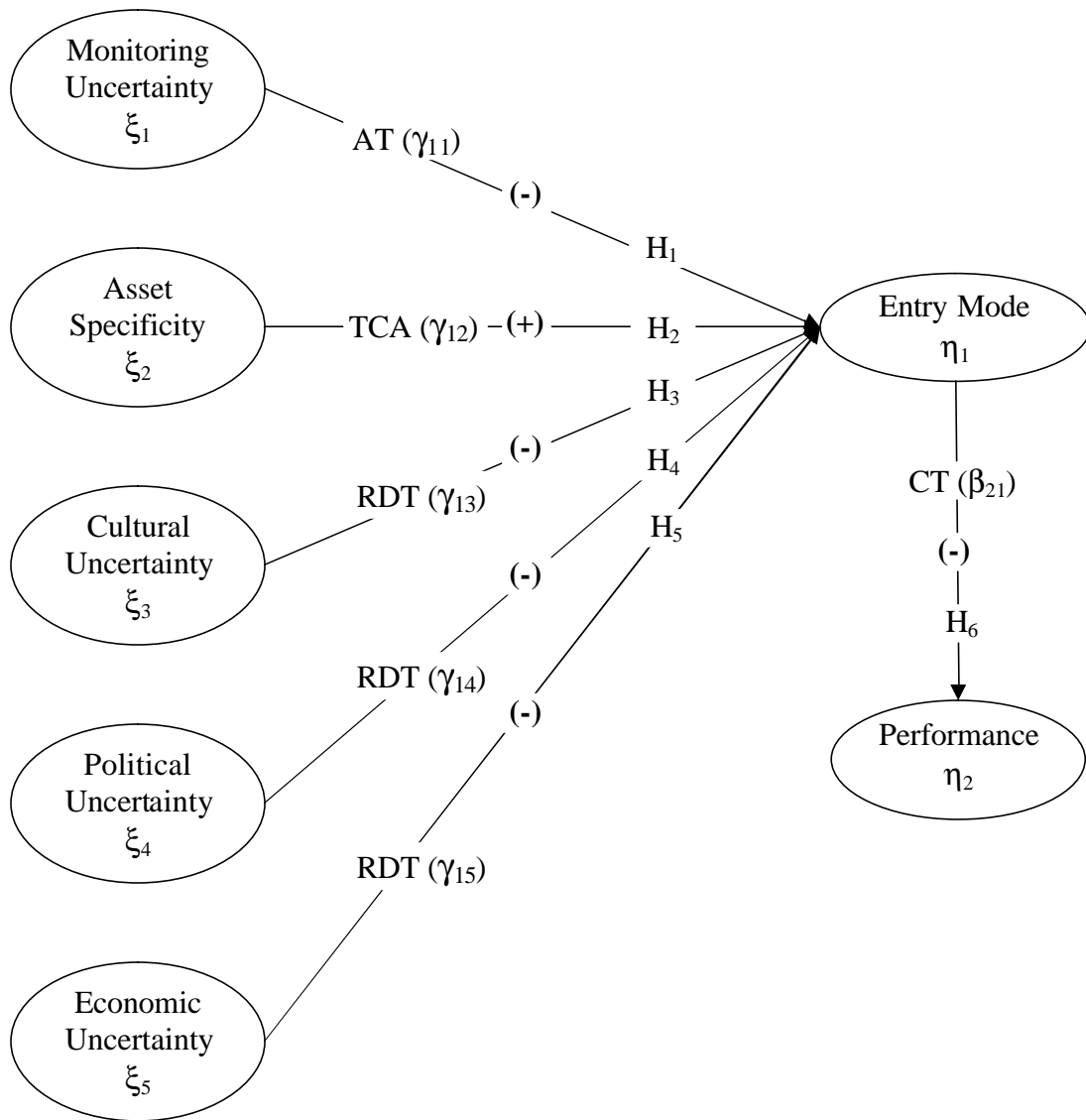
LISREL 8.3 uses a threshold value of 7.882 to identify the largest MI which would lead to largest drop in χ^2 values if set free. The modification indices larger than 7.882 is the significance level (α) of .05 for the Chi-square distribution with one degree of freedom (Jöreskog & Sörbom, 1993); in other words, only large modification indices were of interest and thus provided in the LISREL output file and written in the diagram. In examining the number of values larger than 7.882, there were no MI values indicative of possible misspecification in the hypothesized model, evidencing a reasonably well-fitting hypothesized model.

Further analyses of MI values have been conducted based on conservative threshold value of 5 suggested by Byrne (1998) and Kelloway (1998). In the present study, the parameter showing the largest value was path from the PU construct to EU6 indicator ($\lambda_{27,6}$ in Figure 6-2) with an MI value of 6.62, indicating that value is slightly above the restrictive cutoff point of 5 (Byrne, 1998; Kelloway, 1998); the reparameterization of this path was discussed in the measurement model section and thus respecification has not been made. Five MI values identified from error covariance matrix were larger than conservative threshold value of 5: two values in θ_{δ} matrix and three in $\theta_{\delta\epsilon}$ matrix. The respecification of these error terms has not been made because (a) the initial model fit well (MacCallum et al., 1992), (b) specification of correlated error terms for purposes of achieving a better fitting model is not an acceptable practice (Jöreskog, 1993), and (c) there was no strong substantive and theoretical rationale (Jöreskog & Sörbom, 1996b).

Typically, the misuse in overfitted model arises from the incorporation of correlated errors into the model purely on the basis of statistical fit and for the purpose of achieving a better

fitting model (Jöreskog, 1993). MacCallum et al. (1992) cautioned “when an initial model fits well, it is probably unwise to modify it to achieve even better fit because modifications may simply be fitting small idiosyncratic characteristics of the sample” (p. 501). Taken together, aforementioned reasons, and values of selected fit indexes (e.g., CFI value of 1.00) for overall model fit, led me to conclude that any further incorporation of parameters into the model would result in an overfitted model.

The examination of goodness-of-fit indexes provided acceptable size of values, which were indicative of good fit for the hypothesized model. A brief point needs to be addressed before I draw any safe conclusions. Sobel and Bohrnstedt (1985) posited that exclusive reliance on goodness-of-fit indices is unacceptable. Indeed, fit indices provide no guarantee whatsoever that a model is useful and can in no way reflect the extent to which the model is plausible. In this sense, Byrne (1998, p. 119) contended that “assessment of model adequacy must be based on multiple criteria that take into account theoretical, statistical, and practical consideration.” Adhering to this caveat, combined with theoretical considerations and statistical implications, I concluded that the findings generally provided support for hypothesized model tested. The hypothesized model schematically portrayed in Figure 6-4 was therefore retained as this study’s final model.



Note: AT (agency theory) TCA (transaction cost theory)
 RDT (resource dependence theory) CT (contingency theory)

Figure 6-3. Hypothesized Structural Model

Table 6-16. Goodness-of-Fit Statistics for Hypothesized Structural Model

Fit Measures	Goodness-of-Fit Statistics
<u>Absolute Fit Measures</u>	
Chi-Square	$\chi^2_{(308)} = 242.90, p = .945$
RMSEA	.00
Standardized RMR	.047
Critical N	211.94
GFI	.89
AGFI	.87
<u>Comparative Fit Measures</u>	
NFI	.89
NNFI	1.03
CFI	1.00
IFI	1.02
RFI	.88
<u>Parsimonious Fit Measures</u>	
PNFI	.78
PGFI	.73

Note: Chi-square likelihood ratio (Jöreskog, 1969);
 RMSEA = Root Mean Square Error of Approximation (Steiger, 1990);
 RMR = Root Mean Square Residual;
 CN = Critical N (Hoelter, 1983);
 GFI = Goodness-of-Fit Index (Jöreskog & Sörbom, 1984);
 AGFI = Adjusted Goodness-of-Fit Index (Bentler, 1983);
 NFI = Normed Fit Index (Bentler & Bonett, 1980);
 NNFI = Non-Normed Fit Index (Tucker & Lewis, 1973);
 CFI = Comparative Fit Index (Bentler, 1990);
 IFI = Incremental Fit Index (IFI; Bollen, 1989a);
 RFI (RNI) = Relative Fit (Noncentrality) Index (McDonald & Marsh, 1990);
 PNFI = Parsimony Normed Fit Index (James, Mulaik, & Brett, 1982);
 PGFI = Parsimony Goodness of Fit Index (James, Mulaik, & Brett, 1982)

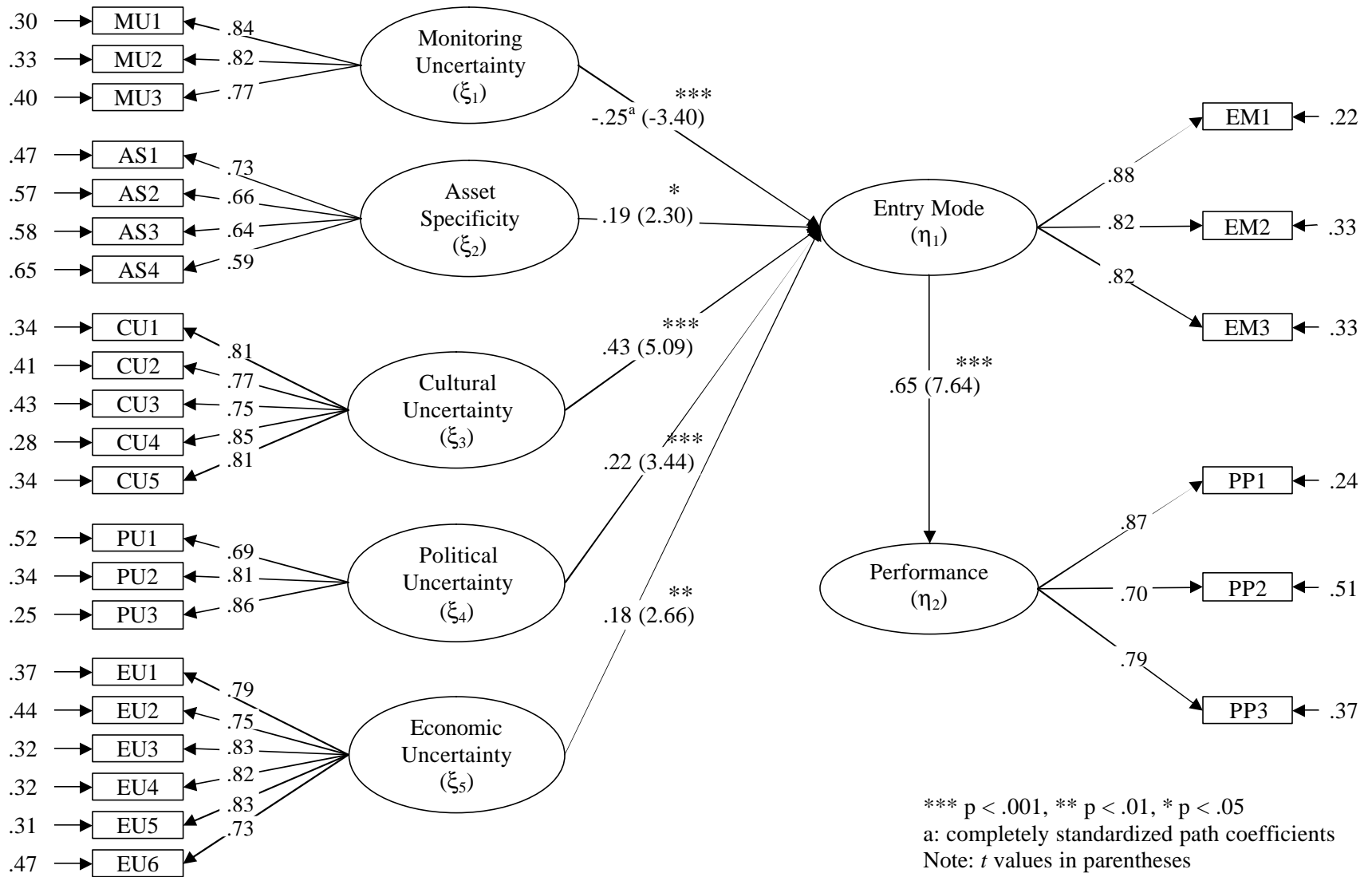


Figure 6-4. Empirical Results of Hypothesized Structural Model

Hypotheses Testing

The proposed conceptual model was analyzed with the software program of LISREL 8.3 and its companion program of PRELIS 2.3 (Jöreskog & Sörbom, 1993). The data used in testing the hypotheses were in the form of a correlation matrix and were embedded into the LISREL input file. The standard deviations were included thereby enabling the analyses to be based on the covariance matrices. In other words, the models tested were covariance structure models with multiple indicators for all latent constructs. All model tests used ML estimation as implemented in LISREL 8.3 (Jöreskog & Sörbom, 1993). The SEM method allows for simultaneous testing of all hypothesized relationships and provides coefficients representing both direct and indirect effects. This method also minimizes the impact of measurement errors on the estimation of model parameters.

The present analysis followed a two-stop procedure based in part on an approach recommended by Anderson and Gerbing (1988). In the first step, as recommended by Jöreskog & Sörbom (1993), measurement model being developed and tested by CFA was accessed via three steps and finally demonstrated an acceptable fit to the data. In step two, structural relationships between constructs have been added to the measurement model so that it came to represent the theoretical (causal) model of interest. This theoretical model was then tested and investigated until a theoretically meaningful and statistically acceptable model was found.

Table 6-17 summarizes the results of the hypotheses and Figure 6-4 presents a final model based on the empirical results. As reported in Table 6-4, the model investigated in this study consisted of seven latent constructs. Each of the seven constructs was measured by at least three manifest indicator variables. A total of 20 out of 27 indicators were composite based on their observed items. Although not all hypothesized relationships between conceptual constructs were

supported (1 out of 6), each hypothesis was proved to be significant and the results provided strong support for the conceptual framework proposed in chapter 4 (Figure 5-1): the hypothesized relationship (H_6) between ‘entry mode (EM)’ and ‘performance (PP)’ was found to be significant but did not support the expected sign of negative relationship.

Hypothesized Effects of Monitoring Uncertainty on the Choice of Foreign Market Entry Mode

Hypothesis 1: As the monitoring cost of a unit manager in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

Agency theory provides a framework for evaluating ownership and control alternatives at the firm level. This hypothesis predicts that the existence of an agent’s behavioral uncertainty results in less integrated institutional arrangement (e.g., franchising). In fact, the problem of incomplete information vis-à-vis agent behavior is further exacerbated by the heterogeneous and inseparable nature of many services as well as the very nature of a decentralized service delivery system whose geographical scope extends beyond national boundaries. The development of complete integration (e.g., wholly-owned subsidiary) in a foreign market is expensive because of the need to coordinate the interdependent activities of organizational members in a distance (Jones, 1982, 1984). By transforming outlet managers in remote distance into owners, franchising induces franchisees to maximize outlet profits and greatly reduces the need for direct monitoring by the franchisor (Bradach, 1997).

The LISREL test revealed that the path coefficient from ‘monitoring uncertainty (MU)’ to ‘entry mode (EM)’ was statistically significant ($\gamma_{1,1} = -.25$, $t = -3.40$, $p < .001$) and supported expected direction of relationship. Thus, as the level of monitoring uncertainty increases in a foreign market, firms prefer less integrated organizational structure, i.e., non-equity mode of

entry such as franchising, by exerting low degree of control and reducing level of ownership on their foreign subsidiaries.

Hypothesized Effects of Asset Specificity on the Choice of Foreign Market Entry Mode

Hypothesis 2: As the level of asset specificity invested in a foreign market increases, firms are more likely to rely on expansion through integrated entry mode (e.g., company-owned subsidiary).

Transaction cost theory provides theoretical backbone on the choice of ownership and control modes of foreign subsidiaries in the industry context. Transaction costs are partially created by the asset specificity of the investment required when making a new foreign entry. Because transaction specific assets are employed to complete a specific task and may be lost value in another use, firms degenerate into lock in small number of bargaining when the contract partner (e.g., a franchisee) becomes irreplaceable, i.e., the market mechanism no longer encourages performance (Klein et al., 1990; Williamson, 1979, 1985; Williamson & Ouchi, 1981). Further, asset specificity may create switching costs when initial foreign agents do not perform well (Erramilli & Rao, 1993; Klein et al., 1990; McNaughton & Bell, 2001).

When asset specificity is high, the loss of foreign intermediary such as a franchisee can prove to be very costly. Foreign agents have access to proprietary knowledge and can become competitors or form ventures with competing organizations, using the knowledge they previously acquired (Anderson & Gatignon, 1986). Specific assets may also require extensive training and investment in service industries, both of which are lost if a firm is required to switch foreign agents (Contractor, 1984). Hence, previous researches tend to indicate that firms prefer equity

modes of entry (e.g., company-owned subsidiary) with high asset-specific investments (Delios & Beamish, 1999; Erramilli & Rao, 1993; Gatignon & Anderson, 1988).

The LISREL test revealed that the path coefficient from ‘asset specificity (AS)’ to ‘entry mode (EM)’ was statistically significant ($\gamma_{1,2} = .19$, $t = 2.30$, $p < .05$) and supported predicted sign of relationship. Thus, as the level of transaction specific asset increases, firms prefer integrated organizational structure, i.e., equity mode of entry such as company-owned foreign units, by exerting high degree of control and increasing level of ownership on their foreign subsidiaries.

Hypothesized Effects of Cultural Uncertainty on the Choice of Foreign Market Entry Mode

Hypothesis 3: As the cultural distance between a firm’s home country and the host country increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

The cultural uncertainty has been viewed from a resource dependence theory that treats an environment as a source of information and resources (Lawrence & Dyer, 1983). One of the potent forms of external uncertainty in national context is created by sociocultural distance. Sociocultural difference is an important determinant of the foreign market entry mode and the critical part of the requirement for the success of the operation (Brouthers; 1995; Kogut & Singh, 1988) mainly due to the fact that variations in cultural norms can affect local implementation (Hofstede, 2001; Hofstede & Bond, 1988). Especially, perceptions and specification of service quality bounded by rationales rooted in home culture can give rise to the perceptual discrepancies toward different service quality standard.

In highly different cultures, management perceives increased levels of control risk because of their lack of market knowledge and selects entry mode strategies that minimize management control (Anderson & Gatignon, 1986; Brouthers, 1995). Edvinsson (1981) argues that service providers, lacking any legitimacy and identity in the foreign market, require some kind of platform and local support environment to operate successfully. Whereas equity ownership requires the service firm to fully bear the onerous modification of its business format package, franchising allows the firm to shift the responsibility for cultural adaptation to its foreign franchisee who then bears the risk of financial failure if the service is not adequately adapted to the host country cultural context (Fladmoe-Lindquist & Jacque, 1995).

The LISREL test revealed that the path coefficient from ‘cultural uncertainty (CU)’ to ‘entry mode (EM)’ was statistically significant ($\gamma_{1,3} = .43$, $t = 5.09$, $p < .001$) and supported expected direction of relationship. Thus, as the level of cultural uncertainty increases in a foreign market, firms prefer less integrated institutional structure, i.e., non-equity mode of entry such as franchising, by exerting low degree of control and decreasing level of ownership on their foreign subsidiaries.

Hypothesized Effects of Political Uncertainty on the Choice of Foreign Market Entry Mode

Hypothesis 4: As the political uncertainty in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

The resource dependence view of the firm (Penrose, 1959; Pfeffer & Salancik, 1978; Wernerfelt, 1984) provides theoretical explanation of the relationship between political uncertainty and organizational form of a service firm in a given foreign market. Along with the issue of instability of political system, policy uncertainty has impact on the choice of foreign

market entry mode and economic performance of firms (Reardon et al., 1996). The major impediment related with host country policies and regulations that international service firms encounter centers on the government requirement for local participation of host country entity in ownership (Falbe & Dandridge, 1992; Fladmoe-Lindquist, 1996). Governmental regulations such as local content requirements and health regulations may require hospitality firms to modify the menu offered and to use local raw materials.

Brouthers (1995) found that international risk increased entry mode choices that shifted risks to other firms. Thus, in nations where political risks are perceived to be high, it is unlikely that a high resource commitment entry mode (i.e., FDI) will be undertaken (Kwon & Konopa, 1993). It was found that political instability discouraged complete integration or full ownership (Davidson & McFetridge, 1985; Green & Cunningham, 1975). International service firms are less likely to make a resource commitment when host governments impose onerous legislative restrictions of the prospective foreign entrants (Kwon & Konopa, 1993). Contractor and Lorange (1988) maintained that one of the strategic rationales for forming cooperative relationships (e.g., franchising) over wholly owned ventures was risk reduction.

The LISREL test evidenced that the path coefficient from 'political uncertainty (PU)' to 'entry mode (EM)' was statistically significant ($\gamma_{1,4} = .22$, $t = 3.44$, $p < .001$) and supported predicted sign of relationship. Thus, as the level of political uncertainty increases in a foreign market, firms prefer less integrated organizational arrangement, i.e., non-equity mode of entry such as franchising, by exerting low degree of control and avoiding high level of ownership on their foreign subsidiaries.

Hypothesized Effects of Economic Uncertainty on the Choice of Foreign Market Entry Mode

Hypothesis 5: As the economic uncertainty in a foreign market increase, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

The resource dependence theory also explains the relationship between political uncertainty and the choice of governance structure of international hospitality companies. To the extent that national product and financial markets are segmented, managers operating in different countries should experience distinct levels of economic uncertainty (Miller, 1993). In particular, location dependent services which involve substantial investment in physical resources to operate (e.g., restaurants and hotels) may be hesitant to commit to full equity positions and to expand to countries under venerable economic conditions such as price fluctuation, uncertainty demand conditions, lack of market opportunity potential and volatile exchange rates (Fladmoe-Lindquist & Jacque, 1995).

The service company gains entry into the market at little risk without incurring excess expenses in the creation of a new learning curve through franchising. The franchisees provide market information to choose appropriate communication channels; franchisors can reduce the gap between service delivery and external communication by selecting accurate and appropriate communication channels, which are essential to delivering high quality service. As Norton (1988a) found in the domestic context, franchisees will be able to assess market demand frequently and alter production to meet changing requirements. International service firms may prefer to shun investing their own capital by involving local partners willing to invest and adopt franchisor strategies and operating procedures.

The LISREL test evidenced that the path coefficient from ‘political uncertainty (PU)’ to ‘entry mode (EM)’ was statistically significant ($\gamma_{1,5} = .18$, $t = 2.68$, $p < .01$) and supported

predicted sign of relationship. Thus, as the level of economic uncertainty increases in a foreign market, firms prefer less integrated institutional arrangement, i.e., non-equity mode of entry such as franchising, by exerting low degree of control and decreasing level of ownership on their foreign subsidiaries.

Hypothesized Effects of Foreign Market Entry Mode on Firm Performance

Hypothesis 6: As the expected performance level in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).

A modified version of TCA is employed to investigate the relationship between the choice of entry modes and performance, in which industry type is considered as a mediating factor on the decision of ownership structure of a foreign affiliate. Anderson and Gatignon (1986) postulated that, in choosing entry modes, firms make trade-offs between control (benefit of integration) and cost of resource commitments (cost of integration). As control is often assumed to be proportionately related to the degree of resource commitment, this suggests that firms will follow high-involvement strategies, investing a large amount of resources in the foreign operation (Buckley et al., 1992).

As noted by Erramilli and Rao (1993), it must be emphasized that low capital intensity may not be true for some service firms (e.g., hotels and airlines), in which integration entails large scale investments in physical facilities. Similar to manufacturers, hospitality firms require a minimum efficient size and longer time to establish and certain intensity of facility utilization to reach certain level of performance satisfaction. In consequence, control can be attained at relatively high expense by hospitality firms. They argue that, inseparability, intangibility, and

high degree of customization with ensuing heterogeneity raise the costs of integration and encourage firms to employ shared control modes.

On the contrary, Domke-Damonte (2000) argues that there is “the close proximity to zero probability for choosing high control entry modes for service firms in both the lodging and restaurant industries” (p. 54). In order to reduce risks and increase level of performance, hospitality firms may resort to shared control modes (e.g., franchising) when entering uncertain foreign markets. According to Leblebici and Shalley (1996), in franchising, firms accomplish dual objectives of gaining control over resources that are needed to capitalize on opportunities and to achieve effectiveness and growth by the use of contracts.

The LISREL test evidenced that the path coefficient from ‘entry mode (EM)’ to ‘performance (PP)’ was statistically significant ($\gamma_{1,5} = .65$, $t = 7.64$, $p < .001$) but did not show expected sign of relationship. Thus, when the firm expects higher performance, firms prefer integrated organizational form, i.e., equity mode of entry such as a company-owned subsidiary, by exerting high level of control and enhancing degree of ownership on their foreign affiliates.

Table 6-17. Summary of Structural Path Estimates & Hypotheses Tests

Relationships	Hypothesis	Estimate	t-value	Result	(No) Support
Monitoring Uncertainty → Entry Mode	H ₁ As the monitoring cost of a unit manager in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).	-0.25	-3.40***	Significant Negative	Supported
Asset Specificity → Entry Mode	H ₂ As the level of asset specificity invested in a foreign market increases, firms are more likely to rely on expansion through integrated entry mode (e.g., company-owned subsidiary).	0.19	2.30*	Significant Positive	Supported
Cultural Uncertainty → Entry Mode	H ₃ As the cultural distance between a firm's home country and the host country increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).	0.43	5.09***	Significant Negative	Supported
Political Uncertainty → Entry Mode	H ₄ As the political uncertainty in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).	0.22	3.44***	Significant Negative	Supported
Economic Uncertainty → Entry Mode	H ₅ As the economic uncertainty in a foreign market increase, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).	0.18	2.68**	Significant Negative	Supported
Entry Mode → Performance	H ₆ As the expected performance level in a foreign market increases, firms are more likely to rely on expansion through less integrated entry mode (e.g., franchising).	0.65	7.64***	Significant Positive	Not Supported

*** $p < .001$, ** $p < .01$, * $p < .05$

Note: Items for the measure of monitoring uncertainty were negatively worded; a high score denotes high uncertainty.

Items for the measure of asset specificity were positively worded; a high score denotes high asset specificity.

Items for the measure of cultural uncertainty were positively worded; a low score denotes high uncertainty.

Items for the measure of political uncertainty were positively worded; a low score denotes high uncertainty.

Items for the measure of economic uncertainty were positively worded; a low score denotes high uncertainty.

Items for the measure of entry mode were positively worded; a high score denotes high integrated mode.

Summary

In this chapter, the results from the data collection were tabulated and analyzed using various statistical methods. Descriptive results were presented, and the survey instrument was examined for its reliability and validity through application of manifold procedures. Six hypotheses were examined in order to test the theory of foreign market entry mode developed in chapter three and four. The main framework was borrowed from contingency theory for developing hypothesized relationships between constructs included in the model.

The analyses supported five hypotheses connecting environmental factors at firm, industry, and national context to foreign market entry mode, which were conceptualized by agency theory, transaction cost theory, and resource dependence theory. The hypothesized relationship between foreign market entry mode and performance developed from the modified transaction cost theory was found to be significant and positively related instead of having an expected sign of inverse direction of relationship. The next chapter briefly describes summary of findings, draws inferences from the results reported in this chapter, presents suggestions for future research, and makes concluding remarks.

CHAPTER 7

CONCLUSIONS AND IMPLICATIONS

Summary of Findings

It is well recognized that service firms play an important role in international business, yet previous international research and international mode of entry research tend to ignore the determinants of international entry mode choice of service firms (Contractor, 1984; Clark et al., 1996; Davidson & McFetridge, 1985; Erramilli & Rao, 1990). Furthermore, few studies have examined the performance implications of using a theoretically predicted mode of foreign market entry (Brouthers et al., 1999). The corollary of these statements is that a paucity of research has been done on the mechanism of trivariate relationships among environmental contingency, market entry mode, and firm performance.

This study set out to develop a conceptual model that explains the linkages between environmental factors and the ownership and control strategies offered by different entry modes, and its relationship with performance. The choice of entry mode was explicated by three types of environmental factors, including firm-specific factors (Erramilli, 1992; Jensen & Meckling, 1983), industry-specific factors (Anderson & Gatignon, 1986; Erramilli & Rao, 1993; Williamson, 1981b), and country-specific factors (Anderson & Gatignon, 1986; Gatignon & Anderson, 1988; Javalgi & White, 2002; Kobrin, 1982; Miller, 1993; Sashi & Karuppur, 2003).

The overall model has been explained by contingency framework that conceptualizes optimal level of ownership and control mode as a response by the firm to the interplay of five environmental factors and as a determinant of firm's performance. To this core can be added complementary theories which are borrowed from agency theory, transaction cost theory, and

resource dependence theory. These theories explain the linkages between mode of market entry and each type of environmental factors.

In order to empirically test the hypotheses, data were collected from international hospitality firms regarding the ownership structure of subsidiaries located in foreign countries. As a whole, the conceptual model developed in the study received adequate support from the empirical study. The LISREL software program suggested minor modifications to each of the measurement model and structural model. However, there was no theoretical and statistical foundation to accept the modifications as suggested. Most modifications suggested were correlations between various error terms. The modifications proposed crossed the entry mode (i.e., mediating endogenous construct), requiring a correlation of error terms for dependent and independent variables. In addition, the increase for variance and increase of values (in some case, decrease in values) in fit indices explained by these proposed modifications were not significant. Given these reasons, the modifications were hence rejected (this is fully explained in chapter 6).

Impact of Contingency Fit on Performance

The results of structural equation model presented in Table 6-17 clearly indicate that contingency theory is a useful framework to explain the trivariate relationships between environment, mode of entry, and firm performance. This study found a positive impact of fit between environmental uncertainty and organizational structure on performance and so support contingency theory in which some combinations of the environmental dimensions and organizational structure will lead to better organizational performance (Covin & Slevin, 1989).

Consistent with the original hypotheses, the results suggest that hospitality firms will choose less integrated entry modes (e.g., franchising) in risky foreign environments to maximize

performance. International franchising holds certain unique advantages over other types of international business such as direct foreign investment. It is much less prone to economic and political risks and requires fewer financial resources since the host country entity (e.g., franchisees) bear most of these burdens. Consequently, these results should serve as evidence that nonequity-based mode of entry requiring less resource commitment (e.g., franchising) can be a viable alternative for international growth to minimize risk and reduce uncertainty in foreign markets.

Effects of Environmental Uncertainty on the Choice of Market Entry Mode

The relationship of market environment with organizational structure was examined through three different perspectives. Market environment influences not only conditions prevailing outside the firm as a whole, but also include conditions within the firm that are external to organizational subunits (e.g., a division operating in a particular country). The influence of organizational subunits operating in different countries on one another can thus be represented as environmental influences. Market environment was investigated at firm, industry, and national context, which includes five factors – monitoring uncertainty, asset specificity, cultural uncertainty, political uncertainty, and economic uncertainty.

The model is suggestive of a picture in which all five environmental factors vie for affecting the choice of market entry modes. All five environmental factors were found to be significantly related to firms' organizational structure and did not have direct links to performance. Collectively, these results suggest that the choice of an ownership and control strategy for international hospitality firms involves a complex balance of firm, industry, and country level factors. Managers may be able to make better mode choice decisions using the

theory-driven criteria examined in this study, increasing their chances for financial and non-financial success.

Among five environmental factors, cultural uncertainty has the largest effect on the choice of entry modes followed by monitoring uncertainty, political uncertainty, asset specificity, and economic uncertainty. In times of globalization, quality perception of service encounter differs among customers from different cultures due to culture-bound expectations and perceptions (Mattila, 1999). In highly different cultures, management will perceive increased levels of control risk in monitoring each unique interaction because of incomplete information and will select entry mode strategies that minimize management control (Brouthers, 1995; Grönroos, 1990).

Monitoring Uncertainty

First, agency theory provided a framework for evaluating ownership and control alternatives at the firm level. The monitoring (internal) uncertainty was hypothesized to influence the international franchising decision positively. The results of this study indicated that firms with more developed internal control systems preferred equity modes of entry, while those with less-developed systems preferred non-equity modes. This may be the case because firms with developed systems for controlling international operations can control geographically disperse sub-units at a low cost. However, firms without these systems of control prefer to shift control responsibility to target market-based organizations (e.g., franchisees). Thus, all internal uncertainty dimensions, e.g., difficulty of output and process control of agents in foreign countries, increase the likelihood of less integrated entry mode such as franchising in global markets.

The findings support previous research (e.g., Brickley & Dark, 1987; Castrogiovanni & Justis, 1998; Mathewson & Winter; Rubin, 1978) that pointed out that difficulty of central control of remote unit operations was a factor in the choice to use franchising. The issue of physical distance and central control is of concern for hospitality services considering the critical importance of adherence to the business format. The specific style of service and operations is central to the firm's strategy and competitive position, and the details of the service may make the differences between success and failure.

The agency problem arises when there is a lack of goal congruence and agents will be tempted to divert resources away from their principals to themselves (Hutchinson, 1999). For instance, restaurant and hotel services can be easily reproduced by foreign agents who are hired for the local unit operations. As service firms move from the domestic to the international environment, such opportunistic behavior or moral hazard of firm's employees can increase the risk for the service company because cross-cultural disparities magnify the problems of uncertainty, asymmetry information, and monitoring (Bergen, Dutta, & Walker, 1992). Deviation from the business format in hospitality services increases the problems of quality control and standardization.

The business format operation is intrinsically embedded in brand names. The power (value) of the brand name could itself discourage franchisees from behaving opportunistically. Franchisees may also recognizing the importance of international brand names in achieving personal goals and the need for continued marketing support from franchisors (Sashi & Karuppur, 2002). Besides, franchising presents certain degree of control because the typical agreement includes incentives to adhere to the system's rules and allows a high degree of monitoring of the franchisee's activities (Anderson & Gatignon, 1986). For instance, the legal and financial

penalties triggered by violations of franchise agreements can deter opportunistic behavior such as free riding by franchisees.

Transaction Specific Asset

Second, this study applied the transaction cost theory to explain the relationship between asset specificity and organizational alternatives in global markets. As in previous manufacturing sector studies, the findings of this study supported the conventional view of transaction cost in which as asset specificity increases, hierarchical (e.g., company owned subsidiary) rather than market alternatives (e.g., franchising) are preferred (Williamson, 1975, 1981a). Hospitality firms making greater asset-specific investments tended to prefer equity modes of entry, while firms making less asset-specific investments tended to prefer non-equity modes. This does not mean that firms have more innovative products/services or proprietary knowledge, but merely shows that firms make different mode choices contingent on the level of specific investment required.

Comparatively speaking, asset specificity is one of two dimensions to which less weight was assigned for the evaluation of relationship with ownership structure, although the weight was statistically significant. In other words, asset specificity is one of the least important factors in hospitality industry among five environmental factors that affect firms' decision on the choice of market entry modes. One possible explanation for this relatively low significance might lie in the idiosyncrasies of hospitality industry. Industry-specific assets and characteristics of hospitality firms can be featured by low asset specificity, especially compared to professional services, which could contribute to the popularity of franchising in hospitality industry as a mode of entry. Low asset specificity allows adoption of franchising that offers lowest degree of control comparing to joint venture and wholly owned subsidiary (Hill & Hwang, 1990).

There are several signs of low asset specificity in hospitality industry. For example, Erramilli and Rao (1993) contend that the asset specificity of transaction increases as the service is characterized by high levels of professional skills, specialized know-how, and customization. As evidenced by Reardon, Erramilli, and Dsouza (1996), however, consumer services including restaurant and hotel industry usually require only the most rudimentary of skills of most employees, which encourage highly standardized business-format operations that have been implied to the franchising distribution.

Another signs of low asset specificity and its propensity to franchising is found in physical asset specificity for hotel industry. By definition, transaction specific assets are highly specialized investments that have little or no general purpose outside of specific relationships between firms (Williamson, 1981b). Lafontaine and Slade (1997) argue that the value of assets or up-front investment in some industries should not be significantly lower outside of the relationship. This is true in business-format franchising. Within this group, the hotel industry requires the largest level of investment. This investment, however, is not relationship specific: hotel banners are routinely changed with little effect on property value (Lafontaine & Slade, 1997).

On another issue of asset specificity, the brand-name asset specificity should be interpreted in a different way in hospitality industry. Langeard et al. (1981) has noted that heterogeneity is an important aspect of many people-supplied services and quality variation is common. Consequently, service branding can be an important tool in creating and sustaining a strong brand image and goodwill amongst customers. Coupled with this, the brand image can provide important expectations, which help to minimize customer uncertainty stemming from the intangibility of the service.

It has been said that hospitality industry is people-intensive but this does not necessarily mean high degree of intangibility, heterogeneity, or customization because fast-food restaurants and hotels are classified as search services and experience services, respectively, by Nayyar (1993). Search qualities are attributes that potential buyers can determine prior to purchase and experience qualities are determinable only after the purchase of a service or during its consumption (Darby & Karni, 1973; Holmström, 1985; Nelson, 1970). In other words, brand image in hospitality industry has not been created by services but by tangible goods and related tangible component of service provision. Services might not be a core strategy but be peripheral part of strategy. In addition, as described previously, high degree of customization and information asymmetry, and ensuing high degree of heterogeneity are not the core component of the brand image of hospitality companies.

With aforementioned reasons, many hospitality firms with reputable brand names (e.g., McDonalds) can employ them as an asset to enter global markets using less integrated entry mode such as franchise agreement. Notwithstanding they have externalized the selling arm of their operations, they are able to maintain control over the quality of the provided service mainly due to the low level of customization. Pushing the limits even further, the brand-name specificity might have been built on product image rather than service characteristics. Should the core components of brand image comprise service characteristics rather than tangible components, the importance of brand image should lead to the firm internalizing operations in order to protect the quality of the delivered service and avoid the potentially damaging effect on corporate image caused by underperformance by the franchisee.

Cultural, Political, and Economic Uncertainty

Third, at the national context, resource dependence theory was used to exam the impact of national environments on ownership and control alternatives. All the external uncertainty dimensions are hypothesized to influence the global franchising positively. Increases in cultural distance favor less integrated entry mode such as franchising and higher degrees of uncertainty in the market environment (country risk) such as political and economic uncertainty increase the likelihood of adopting franchising as the mode of operation in global markets. This suggestion is in conformance with research recommending market alternatives in uncertain environments (Williamson, 1975).

Previous research by Aydin and Kacker (1990) uncovered that the major reason for firms' reluctance to pursue growth opportunities offered by international markets was lack of local market expertise. Their finding is further supported by Barnard's argument (1938) that the primary reason for uncertainty is the inability of managers to comprehend all the information present in a given environmental situation. The findings of this study demonstrated that firms entering markets where environmental uncertainties were perceived to be high tended to prefer non-equity modes of entry such as franchising, presumably to reduce or shift risks to target market organizations such as franchisees as well as exploit franchisees' local market knowledge. When target market uncertainties were perceived to be low, hierarchical mechanisms (e.g., company owned subsidiary) were normally employed. The results are consistent with the logic of resource dependence theory that views interfirm governance as a strategic response to conditions of uncertainty and dependence (Child, 1972; Pfeffer & Salancik, 1978).

Although all three factors significantly related to the choice of ownership structure of foreign affiliates, cultural dimension was considered the most significant factor at the time of

decision-making followed by political uncertainty and economic uncertainty. Previous research revealed that the relatively less weight has been assigned to economic uncertainty in assessing country risk and its impact on the choice of entry mode. Aydin and Kacker (1990) found that lack of demand in overseas markets was not a major barrier to expansion abroad.

Effects of Market Entry Mode on Performance

In the current study, it was hypothesized that market contracts such as franchising featured by lower degree of ownership and control on firms' foreign units would lead to the increased level of performance. The hypothesized relationship was grounded on belief of the efficiency of the risk-return/cost-control trade-offs model suggested by TCA and advantages of franchising. As Roberts and Greenwood (1997) note, the transaction cost explanation is a comparative-efficiency one. It is important to note that transaction cost theory does not suggest that equity modes of entry (e.g., company-owned units) are always superior to markets (Hennart, 1989). As Baroncelli and Manaresi (1997) argue, franchising substitutes the loss of ownership by an increase of external relationships and it takes without losing control on retail operation.

In studying the relationship between internationalization strategy and firm performance in manufacturing and professional service industry, previous studies identified a strong connection between entry mode type and performance (e.g., Lu & Beamish, 2001; Nitsch et al., 1996; Pan, Li, & Tse, 1999; Woodcock et al., 1994). The direction of relationship, however, was inconclusive and none of the study included franchising as a mode of entry.

The data in the current research contradicted the hypothesis, albeit the strong relationship has been identified: the negative relationship was hypothesized but the relationship proved to be positive. This suggests that relatively higher performance stems from integrated organizational

form by exerting higher level of control and enhancing degree of ownership of foreign affiliates (e.g., company-owned subsidiaries). In absolute sense, i.e., departure from the concept of fit between contingency and structure, the increased level of ownership and control will result in enhancing the level of perceived performance mainly due to the fact that company-owned outlets do not necessitate sharing profit with an intermediary; firms do not need to relinquish residual claim on profits to the franchisee.

There has always been a contradictory arguments regarding performance in the research of foreign market entry mode. Brouthers et al. (1999) and Brouthers (2000), however, point out that previous studies ignore the decision-specific nature of entry mode selection. These scholars suggest that instead of examining performance differences for different entry mode types, researchers should focus on how contingency model-based mode of entry choices may differ in performance from non-contingency model-based mode choices. This additional step is important because there is not one best performing mode choice, but managers hope to make contingency model-based mode choice decisions that they expect will provide them with the best (optimal) performing mode choice.

Implications

For Theory

This study has important implications for both researchers and managers, although it does have a number of limitations. First, it needs to be noted that a theory that is based on a unified framework could go a long way toward clarifying and perhaps resolving the debate in the literature on the appropriate choice of entry mode in the global market (Contractor, 1984; Davidson & McFetridge, 1985). This research addresses an important issue in response to their calls on the optimal choice of ownership and control strategies in the foreign market. The rationale of selection process starts with a development of an integrated framework within which contingency theory of strategic alignment is extended to the internationalization of service firms. Caves (1980) suggests that the formulation of strategy and the selection of structure are interconnected and influence firm performance. Specifically, the contingency model in this study hypothesizes that the international performance of service firms depends on the combined effects of environmental factors and entry mode. The general results support the basic contingency theory that it is the interaction between environmental factors and organizational structure that has significant implications in predicting firms' performance in international market.

Further, contingency theory is supplemented with two economic models of organizations (agency theory and transaction cost theory) and a political model of organizations (resource dependency theory) by highlighting the significance of broad characteristics of services in entry mode selection. As Dalton et al. (1980) and Donaldson (2001) indicate, despite the importance of performance implication, early studies have failed to find the effects of contingency fit between structure and environments on firm performance because of methodological limitations. This research empirically tests each hypothesis drawn from conceptual foundations in organizational

theory with the help of structural equation modeling technique. Research findings reveal a relationship between contingency fit and performance as well as relative magnitude of each theory-driven constructs on the choice of entry mode.

For Management

Owners and managers of service firms involved in or considering international expansion may benefit from the findings of this study in several ways. First, research findings tend to indicate that selecting an international mode of entry that conforms to the predictions of current model will result in more successful international activity than if the firm uses another entry mode. In general, study findings provide strong support for applying the contingency model to international entry mode choice in hospitality industry. This indicates that the contingency model of mode choice can be used by hospitality managers and provides a useful tool for making international business decisions. This reinforces the need for making rational, theory-based mode choice decisions. Firms that make theory predicted mode choices perform better both financially and strategically.

Second, most firms have limited resources that restrict search and analysis activities. These restrictions tend to influence the decision of optimal choice of foreign market entry modes. Examination of the three key environmental issues discussed in this study can help managers make more successful mode choice decisions. Managers need to evaluate (1) the level of specific-asset investment required in a new market, (2) the environmental uncertainty of the potential target country, and (3) the status of internal control systems and processes. Managers can maximize performance by aligning entry mode strategy with external contextual circumstances as well as internal resources. For instance, higher degrees of uncertainty

associated with the foreign market encourage external dependence of the venture, in which the operation depends more heavily on local relationships. Resource exploitation depends on the local market for either inputs or outputs for better performance.

If an entry requires high specific-asset investment, then equity modes of entry (e.g., joint ventures or wholly owned modes) should be considered; if the specificity of investment is low, non-equity modes (e.g., franchising) should be used. If the firm is thinking about doing business in a country where the economic, political, and social system is relatively stable and certain, equity modes of entry should be preferred. When there is volatility in the economic, political, and/or social environment, non-equity modes may provide a more effective way of dealing with these uncertainties. Finally, managers need to evaluate their own internal control systems and processes. Firms that possess strong internal control processes may be in a better position to take advantage of equity modes of entry compared to firms with weak internal control systems. Firms without strong control systems may benefit from relying on the control systems of partner organizations and can utilize non-equity modes of entry. Hence, by evaluating these three criteria, managers can make better entry mode decisions.

Another implication of this research is the inclusion of franchising as an actual management strategy and competitive business practice that is related to international ownership and control strategy. In order to achieve superior performance, firms should adopt administrative mechanisms that are fully compatible with international strategies (Roth, Schweiger, & Morrison, 1991). The proposed framework of this study links internal control variables, firm-specific asset variables, and market environmental variables to the likelihood of franchising in global market. Understanding the fit between the each set of contingent variables and the elements of ownership

and control strategy will allow marketers to determine when franchising is the suitable mode of operation in global markets.

In summary, I found that theory-driven relationships identified in this study appeared to be applicable to service firms. For managers, the advantage of such a unified framework is that it allows them to combine a set of insightful as well as often partial analyses to better address the totality of the multidimensional and complex decision on foreign market entry mode. In consequence, firms that use contingency predicted international entry modes tend to report higher performance than do firms using other modes of entry. This indicates that the integrated framework can be used to help firms make better decisions on entry mode.

Limitations of Research

This study is not without limitations. The interpretation of the findings should take into account the limitations of the study. Probably the most limiting factor in the study, as already mentioned, is the sample size. The sample size covered only 148 companies in two industries. Although the sample size satisfied minimum number of 100 observations (Marsh et al., 1988), it was not large enough for the recommended number of 200 or more for models of moderate complexity (Boomsma, 1983). The size of sample is even far below the suggested ratio of observations to estimated parameters of being 5:1 to 10:1 (Bentler & Chou, 1987), which leads to the range between 350 and 700. Consequently, the results of this study might be limited by the data set from which they drive because the final model might capitalize on chance variations in the data. Given the sample size limitation, it is not explicit to draw any safe conclusions until after the model will be tested with a validation sample. Accordingly, the model should be regarded as tentative until the results are replicated in other samples; in other words, the results may not generalize to all service industries or to even all firms in hotel and foodservice industry.

While it is impossible to control for every source of variance, or sacrifice response rate by forcing the survey instrument to an unmanageable size, it might have been advantageous to include other questions pertinent to control variables. The inclusion of control variables could help researchers to better understand the precise effects of factors included in the model. For example, previous studies have concluded that the firm size and experience have a positive effect on international expansion, choice of market entry mode and propensity to franchising (e.g., Alon, 2001; Alon & Mckee, 1999a; Lafontaine & Kaufmann, 1994; Li, 1994; Martin, 1988; Shane, 1996b, 1998b; Simerly & Li, 2000; Terpstra & Yu, 1988). Differences in size and experience begin to suggest that firms may have had vastly different perceptions of their choice

of entry modes. The effect of control variables has not been tested mainly due to the estimation problem related with limited sample size and excess parameterization. Without data for these elements, it is impossible to do more than present supposition as to how they may have affected the data and the hypotheses testing process.

In addition, most of the firms in the sample are, or have been recently been, of American origin. This research primarily surveyed U.S.-owned multinational corporations, which restricts the generalizability of the findings. As a result, there may be ethnocentric bias in the results based on cultural attitudes towards ownership and control issues. Indeed, national differences in levels of 'trust' influence the desirability of internationalization and the choice of entry mode (Shane, 1994). Kogut and Singh (1988) claimed that characteristics of national cultures, especially managements' attitude towards uncertainty avoidance, have influenced the selection of entry modes. Recent research by Brouthers and Nakos (2004) also suggests that nationality was significantly related to mode choice as a control variable. Their findings tend to indicate that Dutch firms preferred more non-equity modes of entry, compared to Greek firms.

Lastly, perceptual data may have been a contributing factor. The results of the study may also be limited by the use of a single respondent from each company and assuming they represent corporate-level knowledge. Even though concerns cannot be totally eliminated, the care used in developing the instrument suggests that the data of this study should be reliable. There is support for the position that managers at headquarters are knowledgeable about the dynamics of decision process (Agarwal & Ramaswami, 1992) and most conversant with international expansion ventures (Campbell, 1955; John, 1984; Siedler, 1974). In addition, top managers' perceptions towards firms' performance strongly correlate with objective measures of performance (Dess & Robinson, 1984), and top managers' perceived environments coincide with

objective environments (Dess & Beard, 1984). However, additional studies are needed to continue developing our understanding of the effectiveness of each strategic alternative.

Directions of Future Research

From Research Perspective

It is hoped that future research can clarify many aspects of this study, and possibly overcome some of the limitations already discussed. One immediate need is replication of the model with a larger sample. Control variables could also be included; ultimately, control variables would play a critical role to portray the relative significance of factors and contingency fit when they are integrated into a model. Thus, such control variables, while not elements in the original theory, will be relevant for future studies. Control variables are recommended to be composite scales.

There are several important directions that could extend this research. First, the existing data set should be expanded to include more firms in the hotel and foodservice industry. Some service businesses, such as tourist hotels, secure their business from foreign clients (Shan, 1991). Their dependence on local market is likely to be smaller than that of a Kentucky Fried Chicken restaurant. This suggests that insights can be obtained by further studies that will examine the level of operating dependence on the local network of relationships in hospitality industry.

The model could also be extended to firms in other service industries with different service characteristics. These might include professional services that have more credence qualities rather than search and experience qualities (Darby & Karni, 1973). These services do use alternative contractual arrangements such as partnerships and joint ventures (Terpstra & Yu, 1988) rather than franchising. An empirical research by Powell (1990) suggests that these organizational arrangements may be stable alternatives to the traditional market or hierarchy arrangements. This expansion would allow for additional testing of the ownership and control

strategies within each service industry and between industries and permit a more thorough testing of the model.

Future research may wish to examine within sector differences (e.g., differences between exporting, licensing, and franchising or differences between joint venture and wholly owned modes) or between sector differences (comparing multiple mode types such as exporting, licensing, joint ventures, and wholly owned modes). This can be accomplished using multinomial logit analysis, but would require a larger sample size than in the present study. Studies like these would add to our understanding of choice of entry mode and performance.

Another direction for further research would involve a detailed examination of the time dependence of internationalization process of services, particularly in franchising. This would involve a look at the time when each firm entered each geographic market. There has been an increase in the popularity of franchise arrangements and this contractual evolution may be an issue in understanding the different choices that hospitality firms make regarding their international ownership and control strategies.

Finally, a detailed examination of geographic dependence of entry mode would be useful. This direction of research would look at the geographic evolution of the foreign outlets. For example, it would attempt to determine the effect of specific geographic expansion patterns on the ownership and control strategies. It is possible that some service firms initially developed foreign operations in areas where there exists cultural distance between home and host countries rather than areas where market entrants are familiar with host country's culture.

From Theoretical Perspective

On important issue of model development and theory building, Cudeck and Browne (1983) proposed that any given hypothesized model “be regarded as one of many formations for describing behavioral theory, some of which are reasonable” (p. 50). Multiple theories can be explored in settings in which different theories from various disciplines appear to have greatest relevance. Hirsch, Michaels, & Friedman (1987) argued that strength of organizational research is its polyglot of theories that yields a more realistic view of organizations.

Consistent with Hirsch et al. (1987) arguments, the recommendation here is to develop plausible models with complementary theories to capture the greater complexity of organizations. Theoretical variety permits researchers to view phenomena through multiple lenses and thus gain a richer understanding (Allison, 1971). Firms’ foreign market entry behavior that remains unexplained could better be explained by introducing relevant theories into the integrated model.

For example, most notably, franchising appears to influence growth and survival as predicted by resource scarcity (also known as ownership redirection theory), and the propensity to franchise is influenced by the costs of monitoring as predicted by agency theory which is applied in this research. Both traditional theories, however, present a partial view of the world that, although it is valid, ignores a bit of complexity of organizations. Candidates that have not yet widely used in the study of market entry mode and franchising could be upper echelons theory, resource-based theory, institutional theory, signaling theory, and political-economy framework.

From Statistical Perspective

While the data set begins to support the model, the hypothesized model in this study can be rejected if the sample size is large enough due to the sensitivity of the likelihood ratio test to sample size. If the model fits the data, it does not mean that it is the correct model or even best model (Jöreskog & Sörbom, 1993). Corollary of this statement is that hypothesized models are best viewed as approximation to reality rather than exact statements of truth (Marsh, Balla, & McDonald, 1988). In this sense, Cudeck and Browne (1983) recommend that it is preferable to depart from the unrealistic assumption of the hypothesis-testing approach that any model will exactly fit the data.

The SEM technique in this study was to test a single model with a limited sample size, rather than to compare one model to another. In fact, there can be many equivalent models to access the firms' decision on mode of entry, all of which can fit the data equally well as judged by any fit indexes. To draw a safe conclusion that the hypothesized model is the best fitted model, it is urged by many scholars that additional models equivalent to hypothesized model be generated from a strong theoretical base and be able to be excluded on logical or substantive grounds (Hair et al., 1995; Jöreskog & Sörbom, 1993; Kelloway, 1996). Therefore, future study needs to compare competing or nested models, in order to draw stronger conclusions about the appropriateness and stability of the model.

Conclusion

The service sector has become a major part of both the national and international economy. However, until recently, most researches on the topic of strategy and structure of business have concentrated on firms in the goods-producing sectors, particularly in international research. This study was able to develop a theoretical model designed to understand how service firms organize its system-wide structure in an unfamiliar foreign business milieu to attain institutional equilibrium and eventually to gain higher performance. This model effectively demonstrated trivariate relationships between environment-structure-performance in international perspective.

Through developing and testing a theoretically integrated model, this research has attempted to contribute to the area of international service research by focusing on the ownership and control strategies of international hospitality firms. The empirical evidence indicates that the incremental internationalization and traditional international life cycle theory of strategy and structure may not be as applicable to service industry. The use of franchise contracts appears to be an important long-term strategy by international service firms, if not all at least hospitality firms, rather than a temporary arrangement on the way to full corporate ownership.

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APPENDIX A

SURVEY COVER LETTER



September 15, 2004

Dear Participant:

I need your help!!! My name is Seehyung Kim and I am a doctoral student in Hospitality and Tourism Management at Virginia Tech. I am working on my dissertation and this survey is part of my graduate research. Your answers are of critical importance for the results of this study. The completion of seven years of my Ph.D. study depends on your participation and completing this survey in its entirety.

This study has been designed to improve the understanding of relationships between environmental factors and the pattern of foreign market entry mode, and its performance implication by seeking the information from decision makers in hospitality industry. I am conducting this study under the guidance of Dr. Mahmood A. Khan. I appreciate your help by filling out the survey and returning it to me.

The questionnaire has been coded for response tracking purposes only, and your anonymity will be protected. I give you my words that your individual answers will never be divulged in any way that could be traced to you. Your answers will be reported only in the form of statistical summaries. Please read all directions and consider your answers carefully. When done, please put your complete questionnaire in the postage-paid envelope and place it in the mail.

Your kind participation could help me more than you can imagine. Please complete and return the survey as soon as possible. Should you have any questions, please feel free to contact me at (540) 961-9107 (phone/fax) or sekim6@vt.edu (e-mail). I would be happy to answer any questions. I know your time is valuable, and therefore I would like to thank you in advance for your participation.

Best regards,

Seehyung Kim
Ph.D. Candidate

Dr. Mahmood A. Khan
Professor

APPENDIX B

SURVEY QUESTIONNAIRE

APPENDIX B

SURVEY OF INTERNATIONAL ENTRY MODE AND PERFORMANCE

SECTION 1

Please: **Circle the number** best describing the **level of control** your firm has exerted on your **foreign agents** in the past five years.

↗ **Foreign agents:** managers of subsidiaries located in foreign countries.

↗ **Field representatives:** managers who visit a foreign unit to supervise or monitor all activities of foreign agents and inspect a quality standard of a foreign unit.

1 = Disagree, 4 = about middle, 7 = Agree

Disagree

Agree

1. It is difficult to measure equitably the results of individual foreign agent. 2. Sales and cost records tend to be inaccurate at the individual level of foreign agent. 3. Mere sales volumes and cost figures are not enough to make a fair evaluation of individual foreign agent.	1 2 3 4 5 6 7 1 2 3 4 5 6 7 1 2 3 4 5 6 7
1. It is costly to maintain optimal number of field representatives to monitor foreign agents. 2. Costs for visiting or traveling the foreign unit are too high. 3. Distance from a monitoring headquarters to foreign units is a major impediment to close monitoring of foreign agents. 4. It is costly to collect information about the foreign agent's behavior.	1 2 3 4 5 6 7 1 2 3 4 5 6 7 1 2 3 4 5 6 7 1 2 3 4 5 6 7
1. It is difficult to directly monitor foreign agent's activities by field representatives. 2. It is difficult to regularly monitor the quality control maintained by the foreign agent. 3. It is difficult to frequently monitor the marketing reports of the foreign agent. 4. It is difficult to update our foreign agents about changes in technology, product, or service concept. 5. It is difficult to closely monitor the extent to which the foreign agent follows established procedures.	1 2 3 4 5 6 7 1 2 3 4 5 6 7 1 2 3 4 5 6 7 1 2 3 4 5 6 7 1 2 3 4 5 6 7

SECTION 2

Please: **Circle the number** best describing the **similarities** of **sociocultural environment** in the countries your company entered in the past five years.

1 = Few, 4 = about middle, 7 = Many

Few
↓

Many
↓

Sociocultural Environment							
<u>Similarities in following features between home and foreign country</u>							
1. Custom	1	2	3	4	5	6	7
2. Language	1	2	3	4	5	6	7
3. Aesthetics	1	2	3	4	5	6	7
4. Business practice	1	2	3	4	5	6	7
5. <u>Power distance</u> : degree of inequality among people which the population of a country considers as normal	1	2	3	4	5	6	7
6. <u>Individualism</u> : degree to which people in a country prefer to act as individuals rather than as members of groups (collectivism)	1	2	3	4	5	6	7
7. <u>Gender role differentiation</u> : degree to which a culture defines vastly different social roles for the sexes (masculinity vs. femininity)	1	2	3	4	5	6	7
8. <u>Uncertainty avoidance</u> : degree to which people in a country prefer structured over unstructured situations. Structured situations are those in which there are clear rules as to how one should behave	1	2	3	4	5	6	7
9. <u>Goal orientation</u> : long-term values are oriented towards the future, like thrift and persistence, while short-term values are oriented towards past and present, like respect for tradition and fulfilling social obligations	1	2	3	4	5	6	7

SECTION 2

Please: **Circle the number** best describing the **predictability** of **political environment** in the countries your company entered in the past five years.

1 = Unpredictable, 4 = about middle, 7 = Predictable

Political Environment	Unpredictable ↙ ↘							↙ ↘ Predictable
1. Import restrictions	1	2	3	4	5	6	7	
2. Public service provision	1	2	3	4	5	6	7	
3. Local content requirements	1	2	3	4	5	6	7	
4. Attitude towards foreign firms	1	2	3	4	5	6	7	
5. Prices controlled by the government	1	2	3	4	5	6	7	
6. Permitted remittance and repatriation funds	1	2	3	4	5	6	7	
1. Monetary policy	1	2	3	4	5	6	7	
2. Foreign ownership policies	1	2	3	4	5	6	7	
3. Foreign business tax policies	1	2	3	4	5	6	7	
4. Enforcement of existing laws	1	2	3	4	5	6	7	
5. Government policies of foreign business	1	2	3	4	5	6	7	
6. Legal regulations affecting the business sector	1	2	3	4	5	6	7	
1. Social unrest	1	2	3	4	5	6	7	
2. Threat of Terrorism	1	2	3	4	5	6	7	
3. Risk of expropriation	1	2	3	4	5	6	7	
4. Threat of armed conflict	1	2	3	4	5	6	7	
5. Changing social concerns	1	2	3	4	5	6	7	
6. Political ideologies of government official	1	2	3	4	5	6	7	
7. Ability of the party in power to control the government	1	2	3	4	5	6	7	

SECTION 2

Please: **Circle the number** best describing the **predictability** of **economic environment** in the countries your company entered in the past five years.

1 = Unpredictable, 4 = about middle, 7 = Predictable

Economic Environment	Unpredictable							Predictable
1. Interest rate	1	2	3	4	5	6	7	
2. Inflation rate	1	2	3	4	5	6	7	
3. Economic conditions	1	2	3	4	5	6	7	
4. Foreign exchange controls	1	2	3	4	5	6	7	
1. Banking systems	1	2	3	4	5	6	7	
2. Transportation networks	1	2	3	4	5	6	7	
3. Technological capability	1	2	3	4	5	6	7	
4. Communication facilities	1	2	3	4	5	6	7	
5. Power and water supplies	1	2	3	4	5	6	7	
1. Purchasing power	1	2	3	4	5	6	7	
2. Population growth	1	2	3	4	5	6	7	
3. Level of urbanization	1	2	3	4	5	6	7	
4. Extent of the middle class	1	2	3	4	5	6	7	
5. Proportion of female labor	1	2	3	4	5	6	7	
1. Customer needs	1	2	3	4	5	6	7	
2. Industry growth rate	1	2	3	4	5	6	7	
3. Customer preferences	1	2	3	4	5	6	7	
4. Stage of industry life cycle	1	2	3	4	5	6	7	
5. Prospects for future profits	1	2	3	4	5	6	7	
6. Average industry gross margin	1	2	3	4	5	6	7	
1. Product changes	1	2	3	4	5	6	7	
2. New product introductions	1	2	3	4	5	6	7	
3. Changes in goods/service quality	1	2	3	4	5	6	7	
4. Availability of substitute goods/service	1	2	3	4	5	6	7	
1. Availability of trained labor	1	2	3	4	5	6	7	
2. Prices of inputs and raw materials	1	2	3	4	5	6	7	
3. Quality of inputs and raw materials	1	2	3	4	5	6	7	
4. Availability of inputs and raw materials	1	2	3	4	5	6	7	

SECTION 3

Please: **Circle the number** best estimating **transaction specific assets**, which consist of human, physical, product, and brand name assets, **invested in foreign affiliates** in the past five years.

1 = Low, 4 = about middle, 7 = High

	Low						High
1. Degree of goods standardization	1	2	3	4	5	6	7
2. Degree of service standardization	1	2	3	4	5	6	7
3. Degree of goods/service complexity	1	2	3	4	5	6	7
4. Level of difficulties for a expert to know the specific qualities of goods/service	1	2	3	4	5	6	7
5. Degree of technical content of goods/service	1	2	3	4	5	6	7
6. Level of proprietary content of goods/service	1	2	3	4	5	6	7
7. Level of difficulties to an outsider to learn the firm's technical content of goods/service	1	2	3	4	5	6	7
1. Level of capital expenditures required	1	2	3	4	5	6	7
2. Degree of décor specialization for your brand	1	2	3	4	5	6	7
3. Degree of facility specialization for your brand	1	2	3	4	5	6	7
4. Degree of equipment customization for your brand	1	2	3	4	5	6	7
5. Degree of special investment needed for your brand	1	2	3	4	5	6	7
1. Degree of trademark registration	1	2	3	4	5	6	7
2. Advertising expenditures as a percentage of sales	1	2	3	4	5	6	7
3. Marketing research expenditures as a percentage of sales	1	2	3	4	5	6	7
4. R&D expenditures for goods and services as a percentage of sales	1	2	3	4	5	6	7
1. Level of training, in number of months, provided to handle your product	1	2	3	4	5	6	7
2. Level of training, in number of months, provided to learn customer needs	1	2	3	4	5	6	7
3. Level of difficulty for an outsider to learn your systems and operational procedures	1	2	3	4	5	6	7
4. Extent to which the process of work is formalized	1	2	3	4	5	6	7
5. Level of education, in number of years, required to be qualified to handle your product and customer	1	2	3	4	5	6	7
6. Degree to which knowledge acquired in your firm is useful in only a narrow range of applications and cannot be easily put to use elsewhere	1	2	3	4	5	6	7

SECTION 4

Please: **Circle the number** best representing your firm's level of **managerial and financial involvement in foreign affiliates** in the past five years.

Instructions to respondents: In answering the question number 5 & 6, please count two units of Joint Venture as a one unit of Full-Equity Ownership

1 = Low, 4 = about middle, 7 = High

	Low						High
	1	2	3	4	5	6	7
1. Involvement in pricing activities	1	2	3	4	5	6	7
2. Involvement in promotion activities	1	2	3	4	5	6	7
3. Involvement in production activities	1	2	3	4	5	6	7
4. Involvement in quality maintenance for goods and services	1	2	3	4	5	6	7
5. Financial Involvement ratio of investment per foreign unit to average investment per foreign equity unit (total amount of foreign investment / total number of foreign units) / (total amount of foreign equity investment / total number of foreign equity units)	1	2	3	4	5	6	7
6. Equity Involvement ratio of number of foreign equity unit to total number of foreign unit (total number of foreign equity units / total number of foreign units) × 100	1	2	3	4	5	6	7

SECTION 5

Please: **Circle the number** best describing how satisfied your firm is with the **performance of the foreign activity** in the past five years.

1 = Dissatisfied, 4 = about middle, 7 = Satisfied

	Dissatisfied				Satisfied		
	1	2	3	4	5	6	7
1. Net profit	1	2	3	4	5	6	7
2. Sales level	1	2	3	4	5	6	7
3. Profitability	1	2	3	4	5	6	7
4. Unit growth rate	1	2	3	4	5	6	7
5. Sales growth rate	1	2	3	4	5	6	7
6. Market share	1	2	3	4	5	6	7
7. Competitive position	1	2	3	4	5	6	7
8. Reputation of your brand	1	2	3	4	5	6	7
9. Market acceptance of your brand	1	2	3	4	5	6	7
10. Brand loyalty of foreign customer	1	2	3	4	5	6	7
11. Overall Performance	1	2	3	4	5	6	7

SECTION 6**Demographic Information****❖ Position**President/CEO/Chairman Vice President Director Other **❖ Nature of Business**Lodging: First class Mid-priced class Economy class Other Foodservice: Full-service restaurant Quick service restaurant Specialty foodservice Other **❖ Firm's Experience**

1. Please state the year your company began to operate. ⇨ _____
2. Please indicate the year your company first start foreign sale of your product. ⇨ _____
3. Please indicate number of foreign countries in which your products are provided. ⇨ _____
4. Please indicate continents in which your goods and services are provided (check all that apply).
Africa Asia Australia/Oceania Europe North America South America

❖ Firm Size

1. Number of total units ⇨ _____
2. Worldwide annual sales (in millions of dollars) ⇨ _____
3. Foreign sales (in millions of dollars) ⇨ _____
4. Number of full time employees in headquarters ⇨ _____

THANK YOU VERY MUCH**I really appreciate your time and efforts in filling out this questionnaire.**

If you would like to make any comments or suggestions, please indicate them below.

APPENDIX C

CODE USED FOR ANALYSIS OF THE HYPOTHESIZED MODEL
&
MEANS, STANDARD DEVIATIONS, & CORRELATION MATRIX

APPENDIX C

Code used for Analysis of the Hypothesized Model

The following lines were read from file C:\LISREL83\EM-PRELIS\EM-RA.PSF:

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DA NI=27 NO=148
LA
EM1 EM2 EM3 PP1 PP2 PP3 MU1 MU2 MU3 AS1 AS2 AS3 AS4 CU1 CU2 CU3 CU4 CU5 PU1 PU2 PU3 EU1 EU2 EU3
EU4 EU5 EU6
RA=C:\LISREL83\EM-PRELIS\EMPRELIS
KM
1.000
.710 1.000
.728 .675 1.000
.517 .513 .423 1.000
.403 .387 .327 .610 1.000
.444 .463 .399 .689 .571 1.000
-.443 -.442 -.432 -.364 -.172 -.290 1.000
-.383 -.391 -.412 -.336 -.124 -.286 .681 1.000
-.322 -.340 -.409 -.344 -.177 -.305 .646 .642 1.000
.414 .302 .295 .268 .255 .117 -.217 -.252 -.172 1.000
.371 .308 .280 .305 .282 .250 -.263 -.240 -.228 .494 1.000
.422 .403 .297 .311 .237 .259 -.295 -.296 -.210 .445 .420 1.000
.304 .253 .208 .200 .239 .095 -.143 -.118 -.147 .485 .368 .354 1.000
.585 .601 .538 .316 .278 .287 -.344 -.277 -.325 .290 .294 .324 .324 1.000
.522 .473 .502 .370 .317 .324 -.319 -.324 -.260 .275 .242 .316 .248 .575 1.000
.524 .417 .425 .325 .273 .237 -.287 -.255 -.246 .159 .198 .294 .177 .600 .572 1.000
.550 .492 .505 .309 .285 .225 -.305 -.249 -.228 .309 .310 .393 .291 .714 .661 .661 1.000
.548 .544 .513 .312 .339 .362 -.383 -.329 -.268 .248 .274 .312 .235 .645 .661 .631 .663 1.000
.220 .154 .221 .142 .048 .105 -.151 -.058 -.076 .210 .043 .092 .086 .169 .174 .137 .182 .113
1.000
.304 .255 .258 .158 .071 .120 -.115 -.055 -.047 .113 .038 .069 .066 .159 .213 .156 .189 .129 .558
1.000
.264 .192 .141 .193 .060 .125 -.076 .010 .015 .068 .040 .114 .034 .109 .161 .061 .101 .010 .606
.696 1.000
.310 .338 .325 .181 .172 .212 -.203 -.134 -.131 .257 .139 .198 .202 .305 .313 .204 .316 .337 .072
.052 -.006 1.000
.270 .246 .310 .131 .142 .218 -.197 -.125 -.159 .094 .127 .133 .200 .253 .290 .180 .302 .280 .015
-.039 -.097 .528 1.000
.283 .310 .369 .155 .112 .186 -.226 -.189 -.161 .152 .091 .186 .191 .285 .281 .163 .305 .309 -
.084 -.129 -.174 .661 .634 1.000
.306 .344 .342 .165 .156 .236 -.258 -.239 -.227 .197 .106 .186 .200 .310 .235 .205 .298 .347 -
.036 -.093 -.187 .672 .615 .663 1.000
.354 .355 .438 .212 .180 .219 -.241 -.147 -.191 .165 .122 .104 .239 .312 .284 .215 .309 .340 .000
-.061 -.127 .652 .649 .679 .681 1.000
.281 .285 .264 .181 .111 .235 -.143 -.077 -.060 .092 .016 .101 .117 .246 .254 .163 .221 .221 .106
.064 052 .627 .581 .605 .585 .573 1.000
SD
1.471 1.496 1.365 1.506 1.460 1.416 1.447 1.450 1.399 1.383 1.450 1.378 1.415 1.640 1.493 1.537
1.625 1.546 1.508 1.573 1.613 1.457 1.619 1.758 1.701 1.777 1.603
ME
3.892 3.993 3.818 3.845 4.399 4.128 4.277 4.486 4.412 3.919 4.392 4.304 3.635 3.899 4.277 3.899
3.838 3.842 4.108 4.088 3.953 3.412 3.655 3.791 3.662 3.635 3.405
MO NX=21 NY=6 NK=5 NE=2 LY=FU,FI LX=FU,FI BE=FU,FI GA=FU,FI PH=SY,FR PS=DI,FR TE=DI,FR TD=DI,FR
LE
EM PP
LK
MU AS CU PU EU
VA 1.00 LY(1,1) LY(4,2) LX(1,1) LX(4,2) LX(11,3) LX(15,4) LX(20,5)
FR LY(2,1) LY(3,1) LY(5,2) LY(6,2) LX(2,1) LX(3,1) LX(5,2) LX(6,2) LX(7,2)LX(8,3) LX(9,3)
FR LX(10,3) LX(12,3) LX(13,4) LX(14,4) LX(16,5) LX(17,5) LX(18,5) LX(19,5) LX 21,5)
FR BE(2,1) GA(1,1) GA(1,2) GA(1,3) GA(1,4) GA(1,5)
OU EF SC RS MI AD=OFF

```

```

Number of Input Variables 27
Number of Y - Variables 6
Number of X - Variables 21
Number of ETA - Variables 2
Number of KSI - Variables 5
Number of Observations 148

```

APPENDIX D

STEM-LEAF PLOTS OF STANDARDIZED RESIDUALS

APPENDIX D

Stem-leaf Plots of Standardized Residuals

Summary Statistics for Standardized Residuals

Smallest Standardized Residual = -2.62
Median Standardized Residual = 0.00
Largest Standardized Residual = 2.44

Stemleaf Plot

```
- 2 | 6  
- 2 | 4441111  
- 1 | 9977665  
- 1 | 44444333332222222221111111100000000000  
- 0 | 999999988888888888888888877777777777666666666666665555555  
- 0 | 4444444444444444433333333333333222222222222222222211111111111000000000+27  
0 | 111111111111122222222333333333333344444444444444  
0 | 555555555555555556666666666777777777778888888888999999999  
1 | 000000001111111111112222344444  
1 | 55555566677889  
2 | 000002344
```

Largest Negative Standardized Residuals

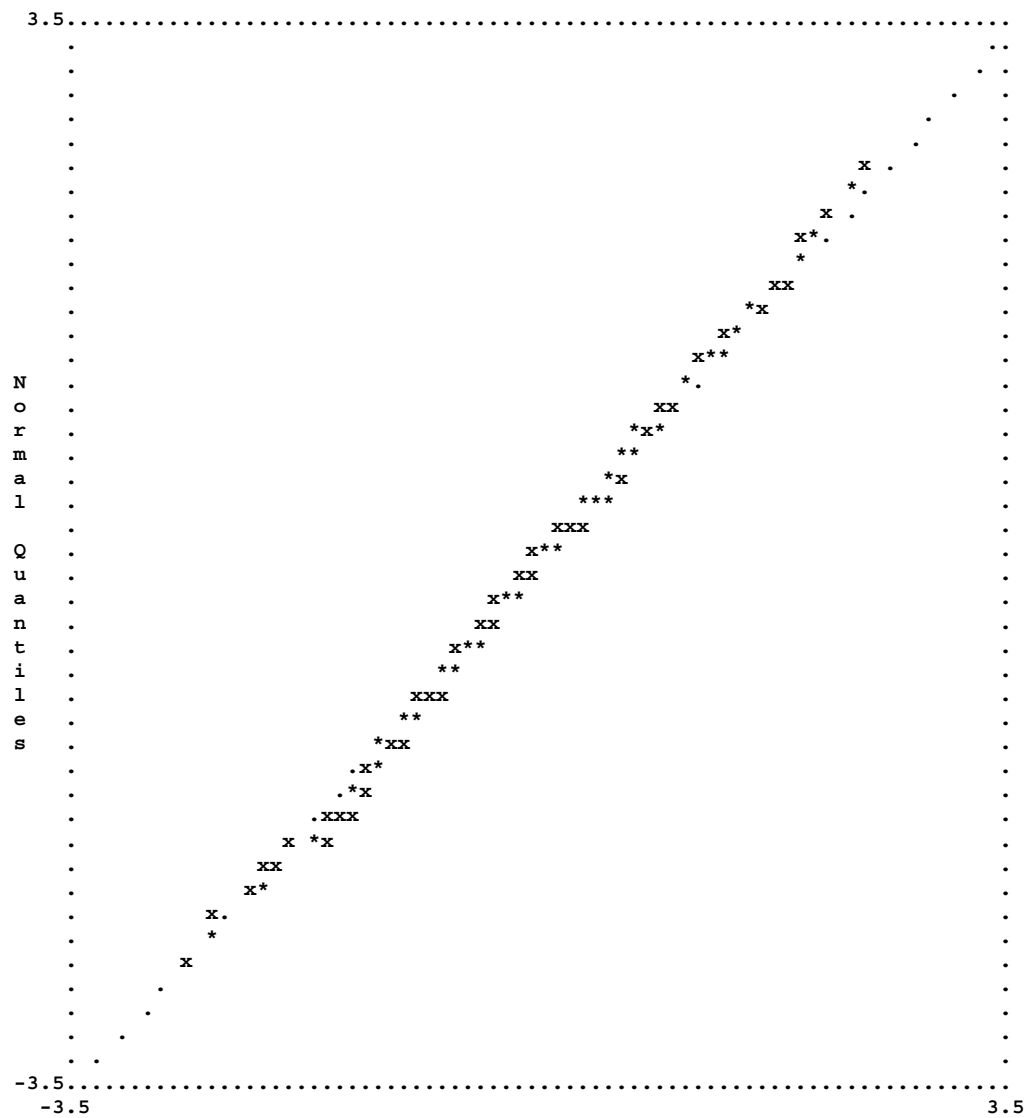
Residual for **PU3** and **CU5** **-2.62**

APPENDIX E

Q-PLOT OF STANDARDIZED RESIDUALS

APPENDIX E

Q-plot of Standardized Residuals



V I T A

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EDUCATION

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HONOR & AWARD

Martin Oppermann Memorial Award, March 2004
Best Article of the Year 2003, Journal of Travel & Tourism Marketing

PUBLICATIONS

Kim, S., Clemenz, C., & Weaver, P. (2002). Segmenting golfers by their attitudes toward food and beverage service available during play. Journal of Hospitality and Leisure Marketing, 9(3/4), 67-82.

Kim, S., & Yoon, Y. (2003). The hierarchical effects of affective and cognitive components on tourism destination image. Journal of Travel & Tourism Marketing, 14(2), 1-22.

(has been selected by the JTTM Editorial Board as the “Martin Oppermann Memorial Award –Best Article of the Year 2003”)

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PRESENTATIONS

Kim, S., & Khan, M. A. (2001). International franchising opportunities for restaurant companies in Pan-Pacific countries. Pan-Pacific Conference XVII (refereed), Vina del Mar, Chile.

Kim, S., & Kwock, Y. (2001). Determinants of firm's performance and its relationship to usage level and customer satisfaction in the organization market of hospitality. 1st CU Joint Conference in Hospitality and Tourism (refereed), Hong Kong, Hong Kong.

Clemenz, C., Weaver, P., and Kim, S., (2001). Sponsored research: Par for the course in hospitality education - Profiling golfers per their attitudes toward food and beverage service offered during play. 6th Annual Graduate Education and Graduate Students Research Conference in Hospitality and Tourism (refereed, poster session), Atlanta, Georgia.

Kim, S. (2001). A market segmentation study based on golfers' service attitudes. 4th Annual CHRE College Graduate Student Research Day, Blacksburg, Virginia.

Yoon, Y., & Kim, S. (2002). An assessment and construct validity of destination image: A use of second-order factor analysis. 33rd Annual TTRA Conference (refereed), Arlington, Virginia.

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The End.