

# **Entrepreneurial Orientation and the Franchise System: Organisational Antecedents and Performance Outcomes**

## **Introduction**

Entrepreneurial orientation (EO), with its three core dimensions of risk-taking, proactiveness and innovativeness (Keh et al., 2007), is said to be a key ingredient for firm success (Wang, 2008). EO describes how a firm operates (Lumpkin and Dess, 1996), capturing “specific entrepreneurial aspects of decision-making styles, methods, and practices” (Wiklund and Shepherd, 2005, p.74). Indeed, Rauch et al. (2009) suggest that the entrepreneurial strategy-making processes that key decision makers employ are central to achieving their firm’s purpose, sustaining its organisational vision and creating competitive advantage. The EO concept is relevant to any firm irrespective of its size and type (Knight, 1997), and with over 100 studies having been conducted on EO, its relevance for enhancing firm performance is widely accepted (Rauch et al., 2009).

Empirical studies have examined the EO construct in various ‘entrepreneurial’ organisational settings, such as in small and medium-sized enterprises (SMEs) (Avlonitis and Salavou, 2007; Keh et al., 2007; Moreno and Casillas, 2008), in technological start-ups (Lee et al., 2001), and in spin-offs (Walter et al., 2006). But only a few published studies have examined issues relating to EO in franchised firms (e.g. Falbe et al., 1998), and even in a retail context (e.g. Griffith et al., 2006) where franchising is common. Although authors such as Maritz (2005) and Maritz and Nieman (2008) have explored whether franchise systems exhibit an EO, the potential impact on system performance – in essence the desirability of an EO – has not been explored extensively.

In the context of franchising, the likely relationship between EO and franchise system performance is debatable. The fact that franchising is built upon realising standardisation, in differing local market environments, has led to much controversy on how entrepreneurial behaviours can thrive within this organisational form (Dada et al., 2011; Ketchen et al., 2011). Although EO at the franchisor level is not disputed (see e.g. Maritz and Nieman, 2006, 2008), enabling an EO amongst the franchisees within a franchise system could be damaging, as the dimensions (such as franchisee innovations) can be harmful to the system rather than beneficial. While pursuing their individual entrepreneurial interests, franchisees may depart from the franchisor's proven procedures (Baucus et al., 1996; Gassenheimer et al., 1996) and this may pose a risk for the franchise system (Boulay, 2008). As Cox and Mason (2007, p.1056) noted, "If franchisees deviate from the system's standard model in pursuit of their own self-interest this will lead to trademark erosion and quality deterioration". Controversy therefore surrounds the extent to which an EO can be fostered amongst the franchisees within a franchise system (see e.g. Maritz and Nieman, 2006, 2008) and also whether franchisees can in fact be regarded as entrepreneurs (see e.g. Falbe et al., 1998; Lindsay and McStay, 2004). However, the differing local market environments in which franchisees operate mean that some flexibility and opportunity to innovate may be important for them to meet local market needs (Falbe et al., 1998), and this can provide a source of competitive advantage (Baucus et al., 1996). Given the important role of franchising in global wealth creation (Hoy et al., 2000), understanding the extent to which an EO is desirable in franchise systems is an area which merits attention. Studying this research area also enables us to fill this gap in the literature.

This study therefore aims to understand the extent to which an EO is germane to franchised firms. In particular, we examine the organisational antecedents and performance outcomes of EO in franchise systems. Although several key dimensions of the EO construct

have been proposed in the literature (Wang, 2008), there is consensus amongst several researchers that risk-taking, innovativeness and proactiveness are the core dimensions (Wiklund and Shepherd, 2005). As noted by Wiklund and Shepherd, this conceptualisation largely follows from the argument that EO is revealed through the characteristics of an entrepreneurial firm– undertaking innovations, acting proactively, and taking risks. Therefore, our focus in this study will be on the overall EO construct, comprising these three core dimensions. It should also be stressed that given EO is an organisational level construct (Covin and Lumpkin, 2011) this paper explores EO at system level, rather than by exploring the actions of individual franchisees.

In accordance with Brown and Dant's (2008) criteria for making a significant contribution to the literature, the main contributions of this paper are threefold: (1) we delve into the dimensions of potential antecedent variables (franchise system structural support and franchise contract clauses) and outcome variables (e.g. a range of non-financial performance outcomes) of EO that have been usually ignored in existing franchising studies. Moreover, issues relating to performance have generally received minimal attention in the franchising context (Barthélemy, 2008); (2) we address key limitations of the few existing studies on EO and the franchise system such as the reliance on a small number of case studies, the focus on a single industry and on the franchisee perspective (see e.g. Nelson and Coulthard (2005) and Sul and Khan (2006)); and (3) by presenting an empirical study of EO, drawing on a sample of franchise systems from the UK, the present paper broadens the scope of prior franchising studies. In a recent paper, Dant (2008) called for researchers to look beyond the North American contexts for data as most franchising research has focused virtually exclusively on the US. Although both the UK and the US have reasonably well developed franchising sectors, the UK market is less mature than the US, thereby enabling us to provide new insights into the phenomenon being considered.

In the next section we review the relevant background literature on EO and franchising; the related hypotheses are then developed. This is followed by a discussion of the research methodology, prior to presenting the research results. We conclude by highlighting the implications of the study, its limitations and the future research directions.

## **Literature review and hypotheses development**

### *The EO construct*

The concept of EO emanated from the research of scholars such as Miller (1983, p.770) who defined an entrepreneurial firm as one that “engages in product market innovation, undertakes somewhat risky ventures and is first to come up with ‘proactive’ innovations, beating competitors to the punch”. Although some authors (e.g. Hughes and Morgan, 2007; Lumpkin and Dess, 1996) have suggested there are five dimensions of EO, namely autonomy, competitive aggressiveness, innovativeness, proactiveness, and risk-taking, there is consensus amongst researchers (Wiklund and Shepherd, 2005) around the latter three dimensions. Wiklund et al. (2009) stressed that even in recent studies scholars have decided to use the original and well validated scale of Miller (1983), with innovativeness, risk-taking, and proactiveness as the underlying dimensions of EO. Therefore, this paper will focus on the overall EO construct, comprised of these three dimensions.

The innovativeness dimension involves the search for novel, unusual, or creative solutions to challenges facing a firm (Morris et al., 2002). This includes the development of new products and services (Walter et al., 2006), as well as new administrative techniques, technologies, and practices for the firm’s operations (Knight, 1997). Risk-taking involves a firm’s propensity to support projects in which the expected results are uncertain (Walter et al., 2006) such as moving into unfamiliar new markets and committing substantial resources

to ventures with vague outcomes (Lumpkin and Dess, 2001). These behaviours are usually motivated by high returns (Li et al., 2008, 2009). Proactiveness has been linked with aggressive posturing relative to the firm's competitors (Knight, 1997). It relates to efforts associated with being the first mover (Li et al., 2008).

Extant research suggests that firms can exhibit varying degrees of EOs, which can be grouped on opposite extremes of a continuum (Avlonitis and Salavou, 2007). For example, at the one end are the entrepreneurial organisations that include as part of their product market strategies an agenda to undertake aggressive, regular and extensive innovations while taking considerable related risks (Miller and Friesen, 1982). In contrast, positioned at the other end are the conservative organisations that innovate infrequently and reluctantly while taking little risks (Miller and Friesen, 1982). Understanding the divergent EO profiles of firms is particularly vital as these can have different performance outcomes for organisations (Atuahene-Gima and Ko, 2001; Avlonitis and Salavou, 2007). While in franchising there is some evidence to suggest that franchisees may lack EO (Maritz and Nieman, 2006) a number of authors have suggested that EO is important for system performance (Falbe et al., 1998; Lindsay and McStay, 2004; Maritz and Nieman, 2008). But there is only limited empirical evidence to support this (Sul and Khan, 2006). Thus, it is important to consider the potential link between EO and performance.

As highlighted earlier, standardisation and uniformity are typically imposed as the foundations of franchising (Cox and Mason, 2007) given the franchisor's interest in protecting the trade name and public image (Stanworth, 1991). Thus, the advantages of achieving system integrity may limit system EO. However, as Lindsay and McStay (2004) suggest, this may be costly from a performance perspective. Further, Zachary et al. (2011, p.632) believe that "... experienced, high-performing franchisors afford franchisees the autonomy to act on and resolve issues as they arise within certain bounds". Kaufmann and

Eroglu (1999) suggest that it is generally the franchisees who, through their local adaptation efforts, develop new market offerings and transform existing ones. Thus, it would seem that despite the standardisation which characterises franchise systems, EO can exist, although its relationship with system performance is less clear. Besides, as Falbe et al. (1998, p. 137) suggest, in an increasingly competitive environment, “the need for entrepreneurial activity in franchising is likely to increase dramatically”.

### *EO and performance outcomes*

The theoretical linkage between EO and performance has long been implied in the literature (Zahra and Covin, 1995). Firms with EO display behaviours that are stimulated by the search for high returns (Li et al., 2008) in order to promote and sustain corporate competitive postures (Knight, 1997; Covin and Miles, 1999). Being a pioneer in an industry, through introducing new products or technologies to the market first, has many benefits (Zahra, 1993; Zahra and Covin, 1995). Pioneers are able to command high prices, target the most lucrative market segments, control distribution channels, launch their products as benchmarks in the marketplace or industry (Zahra and Covin, 1995) and establish a reputation as technological leaders (Walter et al., 2006). Such actions, which significantly rejuvenate organisations, their markets, or industries (Covin and Miles, 1999), can strengthen their market share (Zahra and Covin, 1995) and enable them to capture high profits (Walter et al., 2006). It is no surprise that several empirical studies have justified the EO-performance theoretical proposition by reporting that an EO positively influences firm performance (see e.g. Lee et al., 2001; Wiklund and Shepherd, 2005; Keh et al., 2007). It is worth noting, however, that not all studies have found a positive relationship between EO and performance. For example, Walter et al. (2006) did not find a direct relationship between EO and sales growth, sales per

employee, or profit attainment, while Tang et al. (2008) found a curvi-linear relationship between EO and performance.

Previous studies have used various measures of performance to examine the relationship between EO and firm performance. These include financial measures such as profit growth, sales growth, and market share growth (De Clercq et al., 2009). For each of these financial measures, some studies have used objective indicators such as information from the firms' annual accounts (Moreno and Casillas, 2008). Other studies have employed subjective indicators by asking respondents to assess their perceptions of the firm's performance relative to its main competitors over a period of time (Wang, 2008; Tang et al., 2008; De Clercq et al., 2009). Although there are limitations to perceptual data with regards to increased measurement error and possibility for mono-method bias (Keh et al., 2007), prior research suggests that subjective performance measures can accurately reflect objective measures (Lumpkin and Dess, 2001). Moreover, respondents are often very reluctant to give (objective) figures relating to firm performance (Walter et al., 2006), providing justification for the use of alternative subjective measures. Researchers have also included non-financial performance measures in their studies (Keh et al., 2007).

In spite of the indication that EO positively influences firm performance, there is little evidence to suggest that such a relationship extends to the franchising context. Miller (2011) has also called for more EO research to embrace the larger issue of context-specific studies in order to enhance application and generate more fine-grained and more empirically valid knowledge. Using both financial and non-financial measures of performance outcomes, we therefore hypothesise that:

***H1: EO is positively related to the performance outcomes of franchise systems***

### *Antecedents of EO*

The literature has emphasised the internal environment of the firm as the defining factor of entrepreneurship within an existing organisation (Antoncic and Hisrich, 2001). When a firm is committed to an entrepreneurial strategic vision, senior management bears much of the responsibility for developing and communicating cultural norms for fostering entrepreneurial processes and behaviours among organisational members (Ireland et al., 2009). Top-level managers create a philosophical *modus operandi* for the type of firm they look forward to leading in the future – “an organisation that is opportunity-focused, innovative, and self-renewing” (Ireland et al., 2009, p.25). Considerable attention has been devoted to identifying the organisational antecedents of entrepreneurship in an established organisation. Some of the most consistently cited internal factors that influence firm-level entrepreneurial behaviours include management support, autonomy/work discretion, rewards/reinforcement and organisational boundaries (Hornsby et al., 1993).

In the case of franchising, Falbe et al.’s (1998) study suggest that support for entrepreneurial activity by franchisees may be embedded into the system from the franchisor’s perspective. Certainly from the franchisees’ perspective, the internal patterns of communication between franchisor and franchisee “play a primary role in the franchisors’ entrepreneurial strategy” (Sul and Khan, 2006, p.446). Gillis and Combs (2009) suggest that knowledge-sharing routines, such as franchise councils and local and regional meetings which celebrate franchisee innovations, are important to achieve innovation while maintaining standardisation. Indeed, Lawrence and Kaufmann (2011, p. 14) argue that franchisee based communities (such as franchise associations) can be “rich repositories of institutional knowledge” which can be exploited. Falbe et al. (1998) found that the most frequently mentioned methods by which franchisors supported entrepreneurial activity were the use of a franchise council, the recognition of new ideas at the annual meeting of the



franchise system, and the presence of a champion for innovation at franchisor headquarters. Dada et al.'s (2011) study further demonstrates the importance of the franchisor's perspective in creating an environment that enables franchisees to set up new ideas to develop the business (i.e. to be innovative), to differentiate themselves in the marketplace (i.e. to be proactive), and to implement new ideas with unknown outcomes (i.e. to take risks). Thus it is hypothesised that:

*H2: Franchisor support will be positively related to EO in franchise systems*

In addition to these measures of franchisor support, we posit that franchise contract clauses may demonstrate the franchisor's desire for entrepreneurial behaviours amongst franchisees. Although contracts play a major role in managing relationships with franchisees, franchising research has largely taken them for granted (Cochet and Garg, 2008). Indeed, while there is extensive research which has explored the role of the franchise contract, this has tended to focus on contract uniformity within the system (Lafontaine and Oxley, 2004; Blair and Lafontaine, 2005) and monetary terms within the contract (e.g. franchise fees, royalty rates and advertising fees). Although non-monetary contract clauses have received some attention, these have tended to explore issues such as contract length, allocation of territories, tying arrangements and the circumstances around which the franchisor or franchisee may terminate the agreement (Blair and Lafontaine, 2005). Thus, the focus of research has been on ensuring franchisee compliance with system procedures, rather than exploring the contract as a means of enabling entrepreneurial activity within the system. Chaudey and Fadairo (2008) found that more constrained franchise contracts improved network performance, due to reduced franchisee opportunism. Contract provisions which provide clear procedures, by which entrepreneurial behaviours on the part of franchisees will be managed within the system, could perhaps enable franchisors to obtain high levels of

system compliance without thwarting franchisee entrepreneurial orientation. Thus, although franchise contracts are potentially an important tool in enabling franchisors to encourage entrepreneurial behaviour within the confines of the system, their role has not previously been explored. Our premise is that entrepreneurial franchise systems may have explicitly stated (entrepreneurially focused) contract clauses to govern the franchisee's operations. This leads us to the following hypothesis:

***H3:** The presence of entrepreneurially focused clauses in the franchise contract will be positively related to EO in franchise systems*

The hypothesised causal relationships from the above discussion are depicted in the path model presented in Figure 1. We controlled for franchise age and franchise size (in both domestic and overseas markets) which might significantly affect the research results (Rhee et al., 2009).

**Insert Figure 1 about here**

## **Research methods**

### *Sample and data collection*

The sampling frame for this study comprised the franchisors listed in a major UK franchise publication, the *British Franchise Directory and Guide* (2009). This contains comprehensive listings of franchises in the UK. Although over 1,100 franchises were listed in the directory, some franchisors operate multiple brands and some may no longer be in operation. The recent Annual NatWest/British Franchise Association Survey (2008) reported that there are an estimated 809 active franchisors in the UK. A cross-sectional research design, involving a mail questionnaire survey, was employed for data collection.

In order to ensure face and content validity, the questionnaire was reviewed and pre-tested (Hughes and Morgan, 2007) by sending copies to ten franchisors who participated in a previous related research project conducted by the authors. Following this, the final version of the questionnaire was mailed to all the franchisors listed in the *British Franchise Directory and Guide* (2009). The mailing also included a postage-paid reply envelope and a personalised cover letter to the franchisor. We believe franchisors “are well suited as key informants because they are expected to possess sufficient knowledge and have an adequate level of involvement with regard to our study’s focal constructs” (Simsek et al., 2007, p.1407). In particular, our constructs of interest are the (1) EO of the franchise system – which should reveal how the franchisor operates (see Lumpkin and Dess, 1996) and capture specific entrepreneurial aspects of the franchisor’s decision-making styles, methods, and practices (see Wiklund and Shepherd, 2005), (2) franchisor’s perspective, notably franchisor support and franchise contract clauses, and (3) performance of the franchise system. Therefore, as owners of the franchise system, we believe franchisors were the most appropriate key informants to provide the required information.

We employed several strategies in an attempt to increase response rate. First, prior to the survey, we endeavoured to publicise the study by sending the details to (a) the Director General of the British Franchise Association (BFA), the only independent accreditation body promoting ethical franchising in the UK, and (b) the Head of Franchising at a leading legal firm in the UK. Second, in line with Morris and Jones (1993), we offered to send a copy of the results of the complete study to interested respondents. Seventy four percent of the franchisors expressed an interest in this and provided their full contact details. This initiative may also improve the conscientiousness and reliability of responses (Hambrick et al., 1993).

Following two reminders, a total of 97 completed questionnaires were received. Two questionnaires were excluded because they were not sufficiently complete, bringing the total

number of usable questionnaires to 95. These comprised 70 questionnaires received from the original mailing, 25 from the first round of reminders, and none from the second round of reminders. Thus, the overall response rate was 11.74 percent of the total number of active UK-based franchisors. This response rate is consistent with “the 10 to 12 percent typical for mailed surveys to top executives in large American firms” (Hambrick et al., 1993, p.407). Similar response rate has also been reported in mailed surveys to CEOs of SMEs (e.g. Simsek et al., 2007). Our sample size is reasonably comparable with those of many prior studies that have examined issues on, or related to, EO in different contexts (see Gupta and Moesel, 2009). For example, Zahra and Covin (1995) had 108 firms, Falbe et al. (1998) had a sample size of 50 participants, Zahra and Garvis (2000) had 98 firms, Green et al. (2008) had 110 firms, and Gupta and Moesel (2009) had 100 firms. In addition, our response rate is offset to some extent by the fact that many potential respondents were unable to participate for different reasons (Hughes and Morgan, 2007) that were attached to the uncompleted returned questionnaires. The reasons included notes/letters explaining that it was against the organisation’s policies to take part in external research. Also, about 100 questionnaires were returned undelivered due to reasons such as addressee not found, addressee has gone away, and addressee has closed down.

We assessed the possibility of non-response bias by comparing early respondents with late respondents; the latter are assumed to be similar to non-respondents (Simsek et al., 2007). This approach, ensuing from Armstrong and Overton (1977), has been used in several studies, e.g. Simsek et al. (2007) and Witt et al. (2008). We divided our sample into two groups (1) early respondents being questionnaires received before the first round of reminders, and (2) late respondents being questionnaires received after the first round of reminders. T-test comparisons of the two groups on age of the franchise system, defined as the number of years the company has been franchising in the UK ( $t=0.650$ ,  $p=0.517$ ), and the

size of the franchise system, defined as the number of franchise outlets that the company has in the UK ( $t=0.661$ ,  $p=0.510$ ), did not reveal statistically significant differences. Therefore, we concluded that non-response bias is not likely to be a concern in the interpretation of the findings from this study.

The average age of respondents' systems in the UK was approximately 10 years and the average size in the UK was approximately 79 outlets. We were unable to conduct any statistical significance tests to ascertain the representativeness of the sample because there is no complete information on the age and size dimensions of the franchise systems operating in the UK. The characteristics of the sample are presented in Table I. Respondents were from 12 industry sectors. The highest percentage of respondents were from the Retailing sector (18%), followed by Catering and Hotels (11%). The sample included both well established and young franchise systems, with very large as well as very small franchised outlets. Although we do not claim to have a random sample, "the broad representation of types and sizes of businesses, ..., [suggests that] these ... findings should have a high degree of generality" (Miller and Friesen, 1982, p.7).

Insert Table I about here.

### *Measurement of constructs*

In Table II we present all the measurement items of the constructs used in this study as well as their associated standardised factor loadings (SFL), alphas ( $\alpha$ ), composite reliability (CR), and average variance extracted (AVE). We used SPSS Version 18 and AMOS Version 19 for the analysis. Consistent with Sapienza et al. (2005) and many others, we employed previously validated measures wherever possible, and most were re-worded to fit the franchising context; where there were no prior scales, we developed measures based on inferences from the literature. All the SFLs are in acceptable ranges and significant at the  $p=.001$  level,

indicating convergent validity (Walter et al., 2006). The minimum SFL was .48 and all other SFLs exceeded .50 with the maximum being .89 (Atuahene-Gima and Wei, 2011; Meek et al., 2011; Rhee et al., 2009). All the critical ratios exceeded 1.96 (Garson, 2011). Further evidence of convergent validity is provided with the AVE estimates, which indicate that all constructs have an AVE greater than .50 (Bagozzi and Yi, 1988). The minimum AVE was .76 and the maximum was .82. The AVE estimates of the constructs all exceed the squared correlations between the corresponding pairs of constructs (Fornell and Larcker, 1981), indicating discriminant validity among the constructs (De Clercq, 2009). Test for reliability was done using alpha and composite reliability. The alphas were above .60 (Shi and Wright, 2001), the recommended minimum standards (Bagozzi and Yi, 1988; Baker et al., 2002). Also, the values of the CRs were all above the recommended benchmark of .60 (Bagozzi and Yi, 1988). To assess the constructs' validity further, the confirmatory factor analysis (CFA) results for the measurement models for each construct indicate that the fit indices are appropriate (De Clercq et al., 2009; Weerawardena and O'Cass, 2004), as shown in the footnotes of Table II.

(1)**Entrepreneurial orientation.** As highlighted earlier, we questioned the franchisors on their system's EO. Given that EO is an organisational level construct, and that franchisors have a strong strategic influence on the system, we believe they are the most appropriate informants. Undertaking a system level analysis also enables the relationship between EO and performance to be explored at a level in keeping with the EO literature (e.g. Avlonitis and Salavou, 2007; Hughes and Morgan, 2007; Keh et al., 2007; Li et al., 2009, and many others) which has explored the relationship between EO and company performance, enabling comparisons between franchising and other organisational forms. EO was computed as the average of all the scales for items relating to innovativeness,

proactiveness and risk-taking (Walter et al., 2006). The measures of EO were adapted from Keh et al. (2007) and were originally extracted from Covin and Slevin (1989) and Miller and Friesen (1982). A 5-point Likert scale (1: *Strongly disagree* to 5: *Strongly agree*) was used.

(2) **Performance outcomes.** Following Wiklund and Shepherd (2005, p.80) we “... ascribe to the view that performance is multidimensional in nature, and it is therefore advantageous to integrate different dimensions of performance in empirical studies”. Therefore, both financial and non-financial measures of performance outcomes were employed subjectively according to the perception of the respondent (Keh et al., 2007). Financial performance was measured using items that asked respondents to compare their franchise systems to that of their competitors in the last 3 years. A 5-point Likert scale (1: *Much weaker* to 5: *Much better*) was used. While a 5-point Likert scale (1: *Strongly disagree* to 5: *Strongly agree*) was used to assess respondents’ degree of agreement with each of the items relating to non-financial performance. The performance measures were adapted from Keh et al. (2007).

(3) **Franchisor support.** This was measured through the use of items relating to methods instituted to encourage entrepreneurial activity in franchised outlets. A 5-point Likert scale (1: *Not at all* to 5: *To a large extent*) was used to assess respondents’ degree of agreement with each of the items. The measures were adapted from Dada et al. (2011) and Falbe et al. (1998).

(4) **Franchise contract clauses.** Measures for entrepreneurially focused franchise contract clauses were developed based on inferences from Schumpeter (1934) and Keh et al. (2007). The items relate to the inclusion of procedures for entrepreneurial activity (such as the introduction of new products/services, new methods of production/operation, and new

sources of supply) in franchise contracts. A 5-point Likert scale (1: *Not at all* to 5: *To a large extent*) was used to assess respondents' degree of agreement with each of the items.

(5) **Control variables.** We included a set of control variables in order to make sure that the model was properly specified and allow for likely alternative explanations for variations in performance and EO (De Clercq et al., 2009; Rhee et al., 2009; Zachary et al., 2011). Wiklund and Shepherd (2005), for instance, note that firms of different size and age may demonstrate different organisational and environmental characteristics that may in turn influence performance. Falbe et al. (1998) also argue that franchise age and size may influence the franchisor's entrepreneurial strategies. Consistent with previous EO research we therefore controlled for age and size of the franchise system. Measurement/definition of each of these variables was explained earlier in this section. We also included both the age and size of the franchise system's overseas operations.

**Insert Table II about here.**

### *Assessing common method bias*

Since we relied on single respondents to assess all of the study constructs, this approach may introduce a common method bias (Simsek et al., 2007) which can threaten the psychometric properties of questionnaire measures (Tepper and Tepper, 1993). In order to address concerns relating to common method biases, response anonymity and confidentiality was guaranteed to reduce respondents' evaluation apprehension; this procedural technique was suggested by Podsakoff et al. (2003) and adhered to in studies such as Wang (2008). We also employed an additional statistical technique. This involved the use of the Harman one-factor (or single-factor) test (Podsakoff and Organ, 1986; Podsakoff et al., 2003) that has been used in several studies (e.g. Avlonitis and Salavou, 2007; Wang, 2008; Li et al., 2008; Rhee et al., 2009). As



described in Podsakoff et al. (2003), all items from all of the constructs in our study were included in a factor analysis. The results yielded multiple factors with eigenvalues greater than 1 (Sapienza et al., 2005). These factors accounted for 69.86% of the total variance, with the first factor accounting for only 19.02% of the variance. Therefore, no single factor emerged from the factor analysis and no one factor accounted for the majority of the variance. These results demonstrate that common method variance is unlikely to be a major problem in our data, and provide support for the validity of the measures used in this study (Stam and Elfring, 2008; Rhee et al., 2009).

## **Results**

The means, standard deviations, and correlations of the variables are displayed in Table III. We tested the hypotheses simultaneously using a path model via AMOS Version 19. Estimating the path model produced a non-significant chi-square statistic (Chi-square=1.020,  $p=.600$ ) (Weerawardena and O’Cass, 2004) indicating a good model fit (Garson, 2011). Other fit indices were also appropriate ((normed fit index (NFI) = .99, incremental fit index (IFI) = 1.0, comparative fit index (CFI) = 1.0), with all exceeding the recommended guideline of .90 (De Clercq et al., 2009; Tang et al., 2008; Walter et al., 2006; Wang, 2008), demonstrating that the model specified fits the sample data very well (Tsai and Li, 2007; Vardy et al., 2002). Model fit was also assessed by examining whether the root mean square error of approximation (RMSEA) was .10 or less (Atuahene-Gima and Wei, 2011). The RMSEA=.000, which indicates a very good fit (Vardy et al., 2002). The fitness of the measurement model was further confirmed with the ratio of Chi-square to degrees of freedom (df) which was lower than the specified guideline of ‘less than 5’ (Tang et al., 2008): ratio of Chi-square to df =  $1.020/2 = .510$ .

Table IV provides the standardised path coefficients of the model. As predicted in H1, the path from EO to PERFORMANCE was significant and positive ( $\beta = .233, p < .05$ ). This indicates that the existence of an EO in the franchise system has a significant effect on performance outcomes (i.e., higher franchise system performance is associated with greater EO). Our results also provide support for H2: SUPPORT was a significant predictor of EO ( $\beta = .302, p < .01$ ). In other words, franchise firms that implement structural support systems for franchisee entrepreneurial activity are more likely to possess an EO. Although the relationship between CONTRACT and EO was positive as predicted, it was not statistically significant ( $\beta = .156, p > .10$ ). Therefore only H3 was not supported. We also analysed the effects of the control variables, i.e. franchise size and franchise age, on EO and performance, although none of their paths was addressed by our hypotheses (Rhee et al., 2009). These results revealed that neither franchise size nor franchise age exerted a statistically significant positive influence on both EO and performance. Therefore, the hypothesised relationships were confirmed irrespective of franchise size and franchise age (Rhee et al., 2009). The percentage of variance explained was 14.7% for EO and 14.8% for performance, providing additional support for the path model (Weerawardena and O’Cass, 2004). The  $R^2$  value of 14.8% for the relationship of EO to franchise system performance is consistent with those of prior findings in a non-franchising focused context (e.g. Hughes and Morgan, 2007; Short et al., 2010). “These results represent some of the strongest relationships of entrepreneurial orientation to firm performance to date” (Short et al., 2010: 340).

Although no hypothesis was specified for a non-linear relationship between EO and performance outcomes, we tested for the possibility of an inverted U-shaped relationship, i.e. whether higher levels of EO initially produce increases in performance outcomes, but after a while, additional EO decreases performance outcomes. We found no evidence of an inverted U-shaped relationship thereby supporting our hypothesis that there is a linear relationship

between EO and the performance outcomes of franchise systems as confirmed by the results of this research.

Insert Table III about here.

Insert Table IV about here.

## **Discussion and conclusion**

In spite of the increasing interest on EO (Rauch et al., 2009), only a few studies have been published in academic journals on issues relating to EO in franchise systems. Our study attempted to fill this void in the literature by examining the role of EO on the performance outcomes of franchise systems and the organisational antecedents of EO.

The results indicate that for franchise organisations, EO is positively related to performance. These findings are consistent with the results of prior studies that have examined the EO-performance relationship in the context of the so called ‘entrepreneurial’ firms. For example, Wiklund and Shepherd (2005) investigated the EO of small businesses; their findings suggested that EO is positively associated with small business performance. Furthermore, our findings are consistent with prior studies that used similar EO scales to examine the EO-performance outcomes relationship in firms operating in different countries, such as in the US (Zahra and Covin, 1995), Sweden (Wiklund and Shepherd, 2005) and Singapore (Keh et al., 2007). The recent meta-analysis conducted by Rauch et al. (2009) also demonstrates that the correlation of EO with performance is fairly large ( $r=0.242$ ). This correlation is consistent with the significant value reported in our study of 0.234.

Despite the apparent positive impact of EO on performance, it was interesting to find that the franchise companies surveyed tended to have a low EO, with a mean score of 2.296 (out of a possible 5). This low degree of EO is perhaps unsurprising given the standardisation inherent in the franchise concept. However, the results suggest that franchise systems could benefit from having higher EO.

In addition, prior studies (e.g. Lumpkin and Dess, 1996) have suggested that contextual factors may advance our knowledge of the EO concept. We found franchisor support to be positively and significantly related to EO. Although standardisation is the keystone of franchising (Cox and Mason, 2007; Kidwell et al., 2007), our findings suggest that the development of a system which allows for flexibility to foster EO may improve the performance outcomes of franchise systems. Nevertheless, preserving the level of standardisation required for the system (without stifling efficient local market adaptation) is considered to be one of the most difficult management challenges faced by franchisors (Kaufmann and Eroglu, 1999). It would seem that through appropriate support structures this balance can be found using what Gillis and Combs (2009) term 'knowledge sharing routines' such as franchise councils and regional meetings. Through these means, franchisors can encourage an EO among their franchisees whilst keeping control over implementation, and thus, standardisation.

In spite of the positive and significant relationship between franchisor support and EO, there was no significant relationship between franchise contract clauses and EO. Possible explanations for the lack of significance in the latter could be attributed to the fact that franchise contracts are usually written to reinforce the uniformity expected in the franchise operations and to ensure franchisee compliance with system procedures, rather than designing the contract as a means of enabling entrepreneurial behaviours. This can also explain why the mean value for the contract construct is low (2.723 out of a possible 5), signifying the low

extent to which franchise contract clauses explicitly include procedures for entrepreneurial activity. In a recent study, Dada et al. (2011) emphasised that many franchisors tend to have the impression that entrepreneurial behaviours would be damaging to the franchise system, as these go against the whole essence of the franchise concept, which requires standardisation and uniformity. However, given the positive and significant relationship between EO and franchise system performance reported in the present study, it is worth including more explicit entrepreneurial clauses in franchise contracts as a formal institutional measure for managing franchisee entrepreneurial behaviours. Indeed Dada et al.'s (2011, p.19) findings suggest that "entrepreneurial behaviours amongst franchisees can be fostered and managed, without jeopardizing standardisation and uniformity".

Overall, though, the findings reported in this study suggest that EO in franchise organisations does impact system performance, and that the franchise system support structures are important in fostering EO within the organisation.

As with all studies (Wiklund and Shepherd, 2005), ours is not free from limitations. First, since the questionnaires were self-completed, the results from the measurement instruments may depend on the extent to which respondents were able to accurately report their level of agreement or feelings with regards to the survey items (Weaven et al., 2009). Second, because our sample was drawn across several industry sectors, this might increase generalisability but eliminate significant differences. However, our interest was to investigate the role of EO in multiple industry sectors in order to address some of the limitations of prior studies (e.g. Sul and Khan, 2006). In addition, we did not focus on a single industry sector given the nature of the data available on the UK-based franchisors which may generate few respondents within each sector.

Although size and age of the franchise systems were controlled for, further studies drawing on a larger sample, could explore more fully the effect of (1) different industries; (2)

different systems (new versus mature); (3) different governance structures (plural form, master franchising, area development); and (4) different ownership structures, areas identified by Grace and Weaven (2011) as valuable points of comparison in franchise research. Whilst this paper has focused on EO at system level, it would be interesting to investigate how franchisees respond to system EO. Blut et al. (2011) suggest that franchisees may place a different value on autonomy at different stages of their lifecycle, and therefore an exploration of how system EO influences franchisee satisfaction during their lifecycle, and how EO manifests itself at unit level, are all interesting areas for future research. Future studies could also consider including other dimensions of EO, notably competitive aggressiveness and autonomy (Lumpkin and Dess, 1996). Further, it would be interesting to also examine the long-term effect of EO on the performance of franchise systems which would entail a longitudinal analysis (see Zahra and Covin, 1995).

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