

# Problems Faced by Franchise Model Business Expansion in Rural India

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## Abstract

The Indian urban market has transformed from the normal way of doing business to other means so as to create value for the customers. One area which has seen drastic growth is the franchise model of business. The franchise model has grown well, and the franchisees are able to get better returns for their investments. Franchises are available in the product and service sectors. This study looks into the rural areas where the franchises have not developed, as in the case of urban areas. The study was done with peers in the rural areas as well as the established franchises in the urban area. Franchises in the area of education have seen some success in the rural areas, but the other sectors are lacking. The reasons for the factors were the growth potential of the franchise, affordability of the customers in the rural area, value creation by the franchise to the rural customers, and profitability of the franchise. The analysis gives a direction that the franchises can take for a successful expansion in rural areas by achieving profitability with value creation and affordability to customers and growth of the franchise. Expansion of franchises in rural areas can develop quality service to customers and, create employment, and bring in economic growth for the nation.

**Keywords:** Challenges, Rural, Franchise, Business, Expansion

## Introduction

Franchising has developed a new business strategy wherein the investment is taken care of by the franchisee, and the knowledge and, training and running of the profitable model is given by the franchisor. Worldwide, this business model has been successful, and it employs

10-15% of the workforce in certain countries. Also, it is a major player in economic development. It can also help governments improve economic development: Lanchimba, Porras, Salzar and Windsperger (2021). Franchising involves a proven model with a customer base created in a particular area, and it is replicated with the same set of amenities, ambience and experience for the customer, which creates a unique impression in the customer's mind. There is a vast difference between a franchise and a dealership or agency. A franchise normally has only one company's product, and it is run as per the instructions of the franchisor. The franchise also decides the decor, training, and advertisement of the product or service. The franchisee will run the business with the help of the franchisor but in an area very well known to the franchisee. There are certain fees to be paid to the franchisor, like the franchisor's royalties for the knowledge and a certain percentage from the sales and advertising fees. In spite of the various expenses and the initial investment, franchisees are able to see profits.

## Indian Franchise Sector

Franchised outlets in India have built such a massive consumer base mainly by focusing on Indianisation or customisation of products or services, thus connecting with the customer segment and catering to their specific needs. The demographic shift that India is experiencing with its middle class has led to an increase in their disposable income. Due to this shift, there has been a consistent growth in the number of consumers for branded products and franchised names. However, there are multiple other factors influencing the franchising

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model to become such a huge success, such as an easy-to-start entrepreneurship and a proven model. Lower failure rate. Apart from the international brands, Indian brands have also started franchising and are quite successful, like Kid Zee, Euro Kids, VLCC, and Naturals, to name a few. Challenges that are faced by businesses based on the situation, as indicated by franchisors, can also overcome and exploit the rural market. Customers identify themselves with the franchise brand. Because of this, it is necessary to preserve a brand reputation and franchise system reputation, with the aim of retaining existing and obtaining new customers. Trajkovic and Stankovic (2017) The activities of franchises have been in urban, metro cities where the population is concentrated and there is easy access to the outlets for the customers and the customers are aware of the benefits and the experiences, they get from the franchise outlets of firms.

### **Aim and Problem Statement**

Franchising is a well-proven business model in developed countries. Also, it has developed in major cities in India in the fields of food, education, automotive business, and travel, and it has developed into a major entrepreneurship activity in the process of providing employment and entrepreneurial development in the country. In spite of the success, the franchise model has not developed in rural areas; hence, the researcher has undertaken the concept of the reasons for it. The non-development of franchise businesses in rural areas with reference to the state of Tamil Nadu, India. Tamil Nadu is a southern state in India. The total area of Tamil Nadu is 1,30,060 km<sup>2</sup>, including 1,16,424.47 km<sup>2</sup> rural area and 13,635.53 km<sup>2</sup> urban area. The population in the 2011 census was 72.14 million. The urban population is 34.91 million, which is 48.38 per cent of the total population, and the rural population is 37.22 million, which is 51.59 per cent of the total population. The Gross State Domestic Product (GSDP) of Tamil Nadu for 2019-20 was \$246 billion. Franchise business started with the arrival of KFC and McDonalds, the major Multinational franchising firms in India. There has been reasonable development of a franchising business, and it has grown in the form of foreign franchises and Indian-grown franchises, and it has been working successfully in the cities and urban areas. The customers are able to experience the facilities and the service from the franchises with good ambience and

well-trained employees and entrepreneurs. The industry is expected to contribute approximately 4% to the GDP of India in the year 2022. Franchising not only encourages self-employment but is also a huge employment generator. The franchising industry is estimated to have employed over 14 million people, which is almost 10% of the total estimated Indian workforce. The share of India's rural population is around 66%. The expansion of the franchise is very limited to Amul and Patanjali. In this study, the researcher attempts to study the present situation of the problems faced by the franchisors by expanding more rapidly to the rural areas. The need for the study is to find the factors that are restricting the expansion of franchises to rural areas, which can solve the problems of making quality products and services available to rural India. Rural franchise expansion will lead to increased employment, and training of the rural youth will also stop the migration of workers from rural areas to urban areas. There is evidence that franchising firms create more market and economic value than non-franchising firms in the US public restaurant sector (Aliouche & Schlenrich, 2009). The main objective is to identify the level of various challenges faced by the franchisors in expanding their business model to rural areas.

### **Review of Literature**

#### **Profitability**

Business organisations develop products and services to suit the customer's needs and satisfaction; year after year, they innovate to stay in the market by creating a favourable image in the minds of the customers. Rural markets also require products and services to their liking. The franchise expansion happens when the franchisor sees there is a market for their product, and an outlet in the rural area can provide profitability to the franchisee of that area. Profitability is influenced by the price of the product, Quantity sold, and Fixed and variable cost control. These variables are used under the profitability construct. A study states that the current and prior year's growth rates had a negative impact on the current year's profitability. This outcome implies that in the restaurant industry, profit creates growth, but growth impedes profitability (Jang & Park, 2011); in any business, fairness in dealing with the partners and the customers leads to better performance. Donghun (2021), this is applicable in the financial and

non-financial areas as well. Franchising has developed several economies in the world.

## Growth of the Business

Business development involves the growth of the business in the area that is located in the growth involves the customer acceptance of its products or services and the increase in the sales of the business year on year, which also leads to further expansion and additional employment opportunities to the local area. Franchising also requires reasonable growth for the business to sustain in rural areas. Business growth depends on the existence of the firm and the survival in the rural market, followed by the acceptance by the customers, which marks the takeoff of the franchise followed by success; these variables are taken under the growth construct. Franchise success in the metros and urban areas depends on the intensity of the population and the location of the franchise, which is reiterated by Kendall and Singh (2007). The differences are likely in the services provided by the franchises; if monitored by the franchisor, client satisfaction can bring franchise success. Gidwani (2010). It is also be noted that companies with moderate growth in earnings (sales) exhibit the highest rates of return and value creation for their owners: Ramezani, Soenen and Jung (2002) during the growth phase, franchise restaurants engage more actively in earnings management than non-franchise restaurants. Further, the deterrence effect of financial leverage on earnings management is weaker for franchise restaurants than non-franchise restaurants. Overall, this study suggests that franchise restaurants are generally more inclined towards earnings management (Gim, Choi & Jang, 2019). There are also problems with getting finance and power in underdeveloped areas (Donga, 2017).

*Hypothesis 1 (H1) Growth has a positive effect on Profitability.*

## Value Creation

A customer purchases a product or a service based on the value realised of it; as the value increases, it is demanded more and consumed more. Franchisors in urban areas have created value for the customers in the form of the ambience of the outlet purchase experience, service

quality and providing options for recreation. Rural areas' commutability is limited, and the need for creating value in the form of doorstep delivery, providing it hot and fresh in case of food, can create value for the customer. Value creation can be achieved by innovating the product or service, quality of service provided, increasing returns for the shareholder, and Local employment creation. Empirical evidence is provided that market orientation facilitates a firm's business strategy, which, in part, positively influences its business performance Lee, Kim, Seo and Hight (2015). Traditional format (product distribution) franchising is better suited to frontier markets than business format franchising (Beck, Deelder & Miller, 2010).

*Hypothesis 2 (H2) There is a significant positive correlation between Value creation and Profitability.*

## Affordability

Companies produce products and services for the customer, and different levels of products are available as per the market it is marketed. It can be for lower-income customers, average-income customers, or high-income customers. Rural population income depends on the monsoon and the crop cultivation for the landowners and the labourers. Franchisors need to provide the products and services at different rates than the one applied in the urban areas. The variables taken under the affordability construct are the income of the rural population, expenses incurred, disposable income available for extra spending, and willingness to accept the franchise products or services. Another study found franchise minimart to have a sustainable competitive advantage in franchise retail business, using the lean systems or workplace organization or 5S. Astuty and Sinaga's (2021) customer retention perspective reveals a greater depth to the franchisee–customer relationship with local customers; both should co-create local marketing initiatives (Bodey, Shao & Ross, 2017). Franchising firms can manage system expansion by weathering the economic effects of a location (i.e. country-level economic cycles) by shifting their resources. Alon, Madanoglu and Shoham (2017) state that the presence of modern retail stores provides a decrease in turnover and customer impact for traditional retail stores vicinity (Masruroh, 2017).

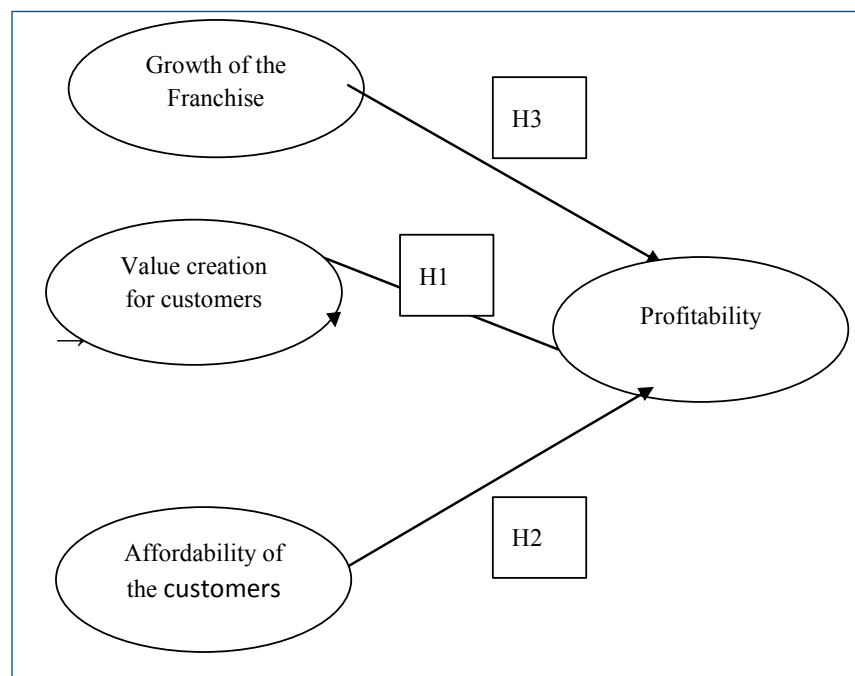
*Hypothesis 3 (H3) There is a significant positive correlation between Affordability and Profitability.*

### Social Franchising in Rural Areas

Franchising can be done on the social front as well (Lyne, 2020). Franchising can have a different effect depending on the area where it is implemented. Regional differences exist (Hoffman & Preble, 2004). The least developed countries can resort to social franchising in rural areas to develop an entrepreneurial ecosystem. In certain cases, education is more socially franchised than commercial franchising by Warraich (2017). Social sector franchising is emerging and is promising (Starbird, Wilson & Aliouche, 2021). Franchisors rely more on company-owned outlets for expansion when the threat of entry from competitor firms in adjacent markets increases. Nishida and Yang (2020) Franchisors need to address areas of disadvantage that have been raised in prior Indigenous entrepreneurship and small business studies. Weaven, Frazer, Brimble, Bodle, Roussety and Thaichon (2019) franchisees are able to add value to the supply chain by combining hybridising, which has made the chain much stronger and more productive than its components (Anderson & Lent, 2019).

The analysis part of the collected primary data has been tabulated. The questionnaire was distributed among the franchise owners in the urban area and the business owners in the rural areas of Tamil Nadu. The research is empirical in nature. In 300 franchise outlets with a business working for 3 years, ranging from fast food, travel, and retail stores to salons. Also, about 150 business owners in the rural areas on the basis of a minimum 3 years of existence. About 450 questionnaires were distributed, and 432 questionnaires have been reverted. Out of these, 22 questionnaires were found to be incomplete, and 10 were biased. The collected primary data has been analysed using the software package called JASP open-source statistical package. Four constructs with their indicators were analysed for correlation. SEM Analysis was performed. Franchisees are able to add value to the supply chain by combining hybridising, which has made the chain much stronger and more productive than its components (Anderson & Lent, 2019). Companies that take care to build competitive advantage at each stage of their expansion will enjoy higher profitability, even if growth may be slower at times. The pay-off is that they will have the resources to sustain continued growth into new markets and win the struggle to create value for investors (Jackson, 2008).

### Research Methodology



**Chart 1: Conceptual Model**

Hypothesis 1 (H1): Growth has a positive effect on Profitability.

Hypothesis 2 (H2): There is a significant positive correlation between Value creation and Profitability.

Hypothesis 3 (H3): There is a significant positive correlation between Affordability and Profitability.

**Table 1: Variables and Indicators**

<i>Variables</i>	<i>Indicators</i>
Value creation	Innovation
An indicator of acceptance of the products by the customer	Service provided
	Increasing returns
	Employment
Profitability	Price
An indicator of the business prosperity	Quantity
	Fixed cost
	Variable cost
Business Growth	Existence
An indicator of the sustainability of the business	Survival
	Take off
	Success
Affordability	Income
An Indicator of the customer ability to purchase	Expenses
	Disposable income
	Willingness

Table 1 gives the variables and what they indicate with reference to the franchise business expansion, like affordability indicates the purchasing power of the rural population and is dependent on the Income, Expenses, Willingness and the availability of disposable Income.

### Reliability Tests

**Table 2: KMO and Bartlett's Sphericity Test for Economy**

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	0.904	
Bartlett's Test of Sphericity	Approx. Chi-Square	4559.306
	df	120
Sig	< 0.00	
Cronbach's Alpha	0.707	

Table 2 demonstrates the questionnaire's internal consistency was checked with Cronbach's Alpha, which gives a value of 0.7, indicating a good internal consistency of the instrument. Sampling adequacy was checked with the KMO test, which was found to be in range. A KMO value over 0.5 and a significance level for the Bartlett's test below 0.05 suggests there is a substantial correlation in the data.

**Table 3: Composite Reliability and Convergent Validity**

<i>Constructs</i>	<i>Items</i>	<i>Parameter Significance Estimation Reliability</i>				<i>Factor Loading Validity</i>	<i>Item Reliability</i>	<i>Composite CR</i>	<i>Convergent AVE</i>
		<i>UnStd</i>	<i>S.E</i>	<i>T-Value</i>	<i>P</i>	<i>Std</i>	<i>SMC</i>		
Value creation	VC1	1.000				0.737	0.543	0.750	0.652
	VC2	1.244	0.128	9.689	<0.001	0.735	0.540		
	VC3	0.832	0.089	9.389	<0.001	0.612	0.375		
	VC4	0.700	0.073	9.533	<0.001	0.523	0.274		
Growth	G1	1.000				0.738	0.545	0.868	0.826
	G2	1.273	0.056	22.567	<0.001	0.971	0.943		
	G3	1.245	0.066	18.758	<0.001	0.855	0.731		
	G4	1.122	0.071	15.733	<0.001	0.739	0.546		

Constructs	Items	Parameter Significance Estimation Reliability				Factor Loading Validity	Item Reliability	Composite	Convergent
		UnStd	S.E	T-Value	P	Std	SMC	CR	AVE
Profitability	PR1	1.000				0.555	0.308	0.717	0.621
	PR2	1.489	0.240	6.197	<0.001	0.733	0.537		
	PR3	1.108	0.205	5.406	<0.001	0.540	0.292		
	PR4	1.446	0.241	5.987	<0.001	0.654	0.428		
Affordability	AF1	1.000				0.848	0.719	0.954	0.913
	AF2	1.188	0.038	31.682	<0.001	0.992	0.984		
	AF3	0.994	0.058	17.059	<0.001	0.816	0.666		
	AF4	1.207	0.048	25.038	<0.001	0.995	0.990		

The Composite reliability CR measures the internal consistency of indicator variables loading on the latent variable. If the Composite reliability is greater than 0.7, then the indicator variables loading on the latent variable have shared variance among them; all the latent variables have CR above 0.7. Convergent validity, or the average

value extracted, refers to how closely a test is related to other tests that measure similar constructs. A construct is a behaviour, attitude, or concept, particularly one that is not directly observable. If a correlation with an instrument measuring the same construct is >0.50, it is considered to be good. All constructs have a convergent validity >0.5.

**Table 4: Showing the Correlation between the Latent Constructs**

Construct scales	Mean	SD	Value creation	Growth	Profitability	Affordability
Value creation	3.651	0.903	1			
Growth	3.100	1.120	0.714**	1		
Profitability	3.512	1.152	0.638**	0.876**	1	
Affordability	3.756	1.076	0.699**	0.791**	0.785**	1

Descriptive statistics and correlations among variables. \*\*Correlation is significant at the 0.01 level, N=400 the correlations between the constructs are >0.5 and significant.

**Table 5: Average Variance Extracted**

Construct	AVE	Value Creation	Growth	Profitability	Affordability
Value creation	0.652	<b>0.807</b>			
Growth	0.826	0.648	<b>0.909</b>		
Profitability	0.621	0.930	0.638	<b>0.788</b>	
Affordability	0.913	0.798	0.645	0.844	<b>0.955</b>

The results of discriminant validity. Diagonals (in bold) represent the square root of the average variance extracted, while the other entries represent the correlation. The square root of AVE is >0.4, which is accepted.

**Structural Model Assessment**

Initially Chi Square ratio is checked for the model fit.

**Table 6: Model Chi-Square Ratio**

	df	χ <sup>2</sup>	p
Model	346.67	293	<.001

The chi-square test can measure the fit in SEM. The chi-square value and model degrees of freedom can be used to calculate the ratio. This tests the null hypothesis that

the predicted model and observed data are equal. This predicts to match the actual data as closely as possible; the Chi-Square ratio = 1.18, a value less than 5, is a good fit.

**Table 7: Model Output Index**

<i>User Model Versus Baseline Model</i>	
	<i>Model</i>
Comparative Fit Index (CFI)	0.990
Tucker-Lewis Index (TLI)	0.989
Bentler-Bonett Non-normed Fit Index (NNFI)	0.989
Bentler-Bonett Normed Fit Index (NFI)	0.939
Parsimony Normed Fit Index (PNFI)	0.847
Bollen's Relative Fit Index (RFI)	0.933
Bollen's Incremental Fit Index (IFI)	0.990
Relative Noncentrality Index (RNI)	0.990

Comparative Fit Index Compares the fit of a target model to the fit of an independent, or null, model. It should be  $> .90$ , which is 0.990. An NFI of 0.939 indicates the model of interest improves the fit by 95 NNFI, and TLI is preferable to be  $> .90$  is 0.989. Relative Fit Index nearing 1 is a good fit, Incremental Fit Index over 0.9 is a good fit, and overall all the results show a good fit.

**Table 10: Hypothesis Path**

<i>Hypothesis/Path</i>	<i>Estimate</i>	<i>S.E</i>	<i>C.R</i>	<i>P</i>	<i>Std. Estimate (<math>\beta</math>)</i>	<i>Hypothesis Testing Results</i>
H1. Value creation $\rightarrow$ Profitability	0.654	0.072	9.08	$<.001$	0.600	Supported H1
H2. Affordability $\rightarrow$ Profitability	0.265	0.065	4.08	$<.001$	0.220	Supported H2
H3. Growth $\rightarrow$ Profitability	0.335	0.081	4.14	$<.001$	0.373	Supported H3

Results of the significance test of the model and hypothesis testing. Estimate=Unstandardized regression weights; Std. Estimate ( $\beta$ )=standardized regression weights; S.E.=Standardized error; C.R.=Critical ratio ( $>|1.96|$ ). \*\*\*=Significance at the 0.001 level.

The Hypothesis results in Table 10 show that the influence of value creation for customers on profitability is significantly positive, indicating a franchise creating value for its customers can see profitability in rural areas. The influence of affordability on profitability is significantly positive, indicating that affordability of the

rural population leads to the profitability of the franchise. The influence of the growth of the rural franchise on profitability is significantly positive, indicating a growing franchise will see profitability. The results are depicted in the path diagram chart 2. Table 4 provides the correlation between the constructs.

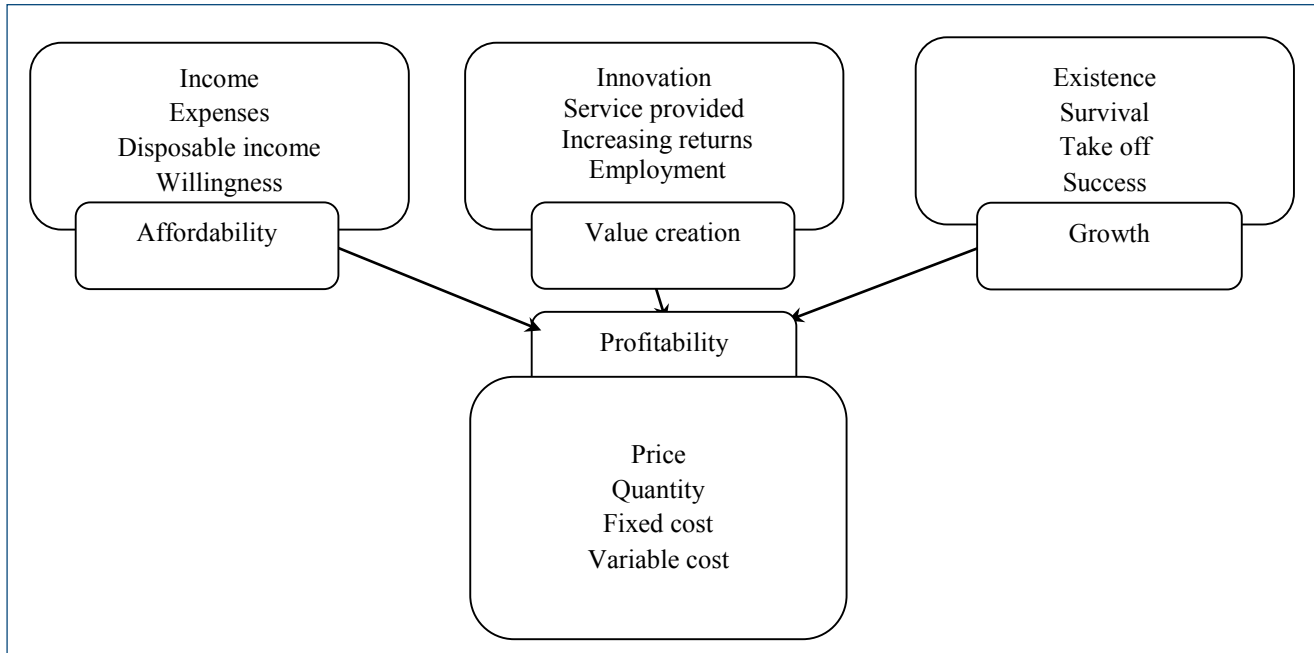
**Table 8: RMSEA Output**

<i>Root Mean Square Error of Approximation</i>	
	<i>Model</i>
RMSEA	0.021
Upper 90% CI	0.030
Lower 90% CI	0.010
p-value RMSEA $\leq 0.05$	1.000

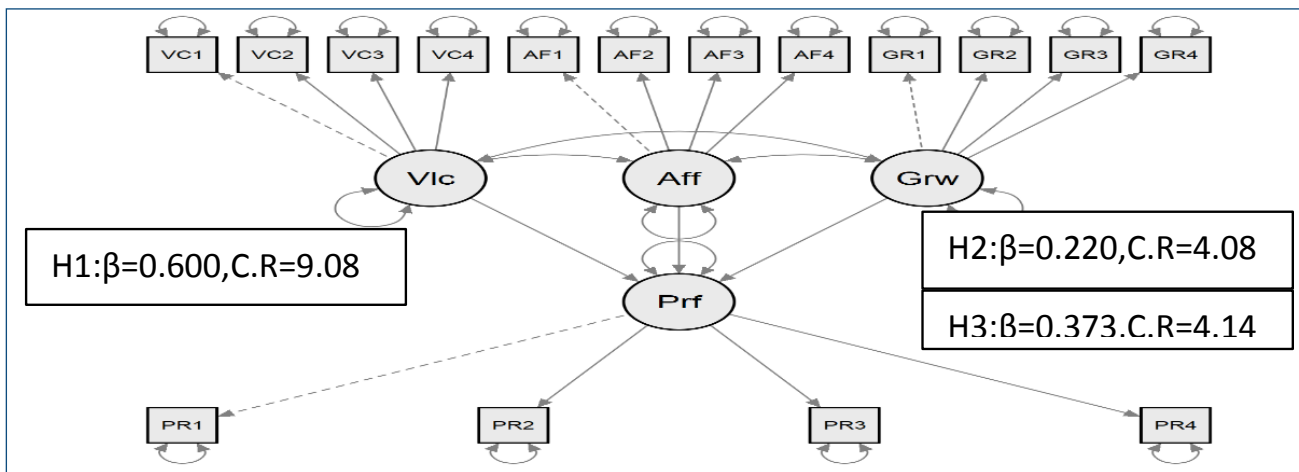
The conceptual model was tested through SEM analysis, and the corresponding results are listed in the tables. Table 6 gives the Chi-square ratio=1.8, well within the standard limit of  $< 3.0$ . Output indexes CFI= .990 and TLI= .989 are  $>.95$  shown in Table 7. RMSEA = 0.021 and GFI = 0.997, indicated in Tables 8 and 9, respectively, indicate that the model is a good fit.

**Table 9: Goodness of Fit Index**

<i>Other Fit Indices</i>	
	<i>Model</i>
Hoelter Critical N (CN) alpha=0.05	387.245
Hoelter Critical N (CN) alpha=0.01	408.430
Goodness of Fit Index (GFI)	0.997
Parsimony Goodness of Fit Index (GFI)	0.996
McDonald Fit Index (MFI)	0.935



**Chart 2: Constructs Effect and Relationships**



Prf: Profitability Vlc: Value creation Aff: Affordability Grw: Growth.

**Chart 3: Path Diagram**

The Chart 3 illustrates the path diagram generated by JASP open source statistical software.

**Table 11: Mediation Analysis**

Path	Direct Effect	Indirect Effect	Total Effect
Value creation → Profitability	0.600	–	0.600
Affordability → Profitability	0.220	–	0.220
Growth → Profitability	0.373	–	0.373

Table 11 mediation analysis of the Direct and Indirect Effects of Growth and Profitability H3 is confirmed as Value creation has a positive impact on profitability, and Affordability also has a positive impact on profitability; hence, H1 and H2 are also accepted. The results showed that there was a significant total effect between value creation and profitability ( $\beta = 0.600$ ,  $p < .001$ ), and path affordability and profitability ( $\beta = 0.22$ ,  $p < .001$ ) and Growth and Profitability ( $\beta = 0.373$ ,  $p < .001$ ) were significant. In addition, the indirect effect is not prominent; therefore, it was concluded that a partial mediation has not occurred.

## Results and Discussion

### Theoretical Implications

The results from this study indicate that factors like the growth of the business, affordability of the products by the customers, value creation by the franchise, and profitability for the franchise are the reasons due to which the expansion of the franchise model has seen less growth. As the rural areas are mostly dependent on agriculture, the income is highly seasonal; even though mixed farming and drip irrigation are used, the monsoon season plays an important role in the income of the customers. The affordability is also linked to the income as well as the knowledge of the customers to get such a service and experience. The rural population always look for better value for the money spent. There is a comparison between the normal product and the service, and compared with that of the franchised goods, services for better value, long-lasting value and additional benefits are expected. The rural population is not concentrated; they are scattered because of the fields and farms. People going shopping every day, eating out, or other aspects are limited, which curtails the walk-ins to the outlets, and the maintenance of stock and transportation costs is likely to increase in return, profitability is likely to reduce. The recommendations for the franchisors are if their product or service is required by the rural area and it does not require continuous replenishment of stock; pricing could be subsidised more than the price in the cities. As for the survival of the franchise business, Sangamitra Ramachander (2018) finds that those who have family assistance have better chances of survival, which illustrates that more assistance is needed for the franchisee from the franchisor to take a

different approach to rural franchising. The results state that factors like the value creation of the franchise for the customers and, the affordability of the customers, growth of the franchise contribute significantly to the profitability of the franchise, which can help in the expansion of the franchise to rural areas.

### Managerial Implications

Franchise model expansion has been successful in developed countries to rural areas in certain sectors like fast food. Indian rural areas comprise an agriculture-dependent population, and the dependency for business growth profitability entirely depends on the labour population who need the purchasing power and knowledge of the products or services provided by the franchises. Value creation can, to a certain extent, bring in better growth prospects with the limited scope of application areas of franchising. Expansion of franchises in the known regional food outlets can be successful, and educational franchises to develop language and computer skills can have growth prospects.

### Limitation

The study is based on information gathered from the geographic area limited to Tamil Nadu, India. All conclusions derived may be applied to other areas as well with further study and also the type of franchises that are expanding to the rural areas.

### Conclusion

Franchisors provide quality service and ambience for the customers, which comes at a price which is normal for the city dwellers and is acceptable and affordable for them. The customers are also ready to try new products and services. In the rural areas where agriculture is the major source of revenue and depends on the season, at times, the produce may not even get the minimum support price. In this scenario, for the expansion of the franchise outlets, products need a reassessment of their model in terms of royalty fees and profit sharing so that the franchisee does not get affected and the franchisor also makes a reasonable profit. Pricing will be an issue as affordability comes with earning capacity, which is low in rural areas. Franchisors will have to have a subsidized approach to the rural areas

with the same quality and can bring in the expansion much more easily and successfully. Value creation for the customers holds the key to the customers preferring the franchise outlets in rural areas.

*Funding:* This study did not receive any funding from any agency or institution.

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