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An Encouraging Factors for Entrepreneur in Franchising: A Malaysia Experience

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Abstract

As a result of an encouraging competitive franchising business worldwide the Government of Malaysia has taken initiatives to pursue local entrepreneurs into such business to boost the small business sector. Malaysia is second in Asia and 21st in the world in franchising development considering its inception in 1994. Under the Franchise Development Programme, the franchise business system has embarked on the business system as smart, systematic, efficient and effective. By the 2000 there were 756 franchisees registered as compared to only 54 in 1995. Franchising has been described as a form of “business cloning” (Hoffman and Prebles, 1993) and has advocated as a business format franchisers seek to have franchisees replicate in their local community an entire business concept, including product or services, trade name and methods of operations. Previous studies have indicated that business format franchising is the fastest growing business and have identified that the failure rate of the business using franchising is generally lower than those of the conventional startups. This paper thus attempts to investigate the success factors towards incorporating franchising and problems of failure that entrepreneurs seriously faced. A semi-structured questionnaire was designed and interviews were conducted with twenty-five on going business franchisees, however, the problems with failure, interviews were conducted by telephone to twelve franchisers and with three available franchisees, who has ceased operation. The success factors addressing full support and training; continuous communication; excellent franchise image; and factors contributed to their failures such as mismanagement and lacks of experiences are identified.



OVERVIEW

It is now widely accepted that franchising plays an important role in furthering the development of the Small Medium Sized Enterprises (SME) sector. Franchising as a business concept is fully established in the USA, indeed nowhere else is it actually found to be developed so intensively in a number of industry sub-sectors comprising of food, non-food, financial and other service businesses. Even outside the USA growth rate of franchising is impressive. As far as Europe is concerned, franchising made its first appearance as early as 1929 in France and has been on the increase ever since (Sang havi, 1998)

Franchising is already well known and has an increasing role in national economies, being also assisted by divestment programmes in the state and publicly owned enterprises. In some developing countries, franchising has been adopted by national governments as one of the strategies for faster economic development and is considered a major tool for providing faster job creation and new incomes in the SME sector where micro enterprises are the prevailing entities.

Various research studies have identified that the failure rate of businesses using franchising is generally lower than those of the “conventional” startups. However, it has also been proven that the development of franchising depends on the overall economic circumstances and that its growth can be significantly impacted by the performance of the economy as a whole. It should be also be pointed out that the failures in franchising are possible and that franchising is not “a panacea” to cure ailments in the SME development process.



All these issues highlight the need to understand the benefits as well as limitation in using franchising as a tool to open business in a small and medium scale. It is also vital to identify which measures/tools should be used and how, for facilitating and promoting franchising with a purpose of optimizing its benefits. It is also important to understand the ways to build up franchising into a successful small and medium business into an overall economic development.

Interestingly, Malaysians have long practiced a concept almost similar to the franchise system known as “*pawah*”. The system is normally exercised by giving the right to utilize agriculture or breeding farms. Through this system, the landowner gives the right to farm the agricultural land or to breed livestock. As a reward, both parties will enjoy the profit, based upon an informal understanding. Normally this “*pawah*” system does not rely on any written agreement.

The development of modern home-grown franchises started in the early 1980s, mainly in the food sector (Sate Ria, Marrybrown), automotive sector (EON), petrol stations (Petronas) and crafts/gifts (Royal Selangor). Initially Majlis Amanah Rakyat (MARA) was given the task by the Government to facilitate the development of home-grown franchises (Noraini, 2000).

Franchise Development Programme (FDP), was established by the Government at the end of 1992 under the supervision of Ministry of Entrepreneur Development (MED) and was the major turning-point in stimulating the growth of franchising in Malaysia. The FDP was adopted to produce more Bumiputra franchisees as one of the main agendas of the National Development Plan (Awalan, 1999). The objectives were to



increase the number of entrepreneurs as franchisor, master franchisees and franchisees and to develop home-grown products and services into franchise businesses.

However, its implementation is no easy task as franchising is relatively new in Malaysia. Therefore, the MED, with the co-operation of the Malaysian Franchise Association and other related agencies, actively promoting educational programmes such as seminars, conferences, and courses on developing and managing franchise. As of 31st December 2001, there were 84 franchises registered with the programme, with a total 620 franchisees being developed. Under the 8th Malaysia Plan (8MP), the Malaysian government has allocated RM100 million for the FDP with a target to develop 1,000 new franchisees.

Malaysia is proud to have achieved in this format business system as the second in Asia and 21st in the world in franchising development considering its inception a few decade only. Report in the year 2000 has revealed the development of franchise programme as very encouraging and an increase of about 78 local franchise in December 1999 compared to only 19 in 1995. Please refer exhibit Table 1.

Table 1
Number of Franchisee and Franchiser Registered

Year	Number of Franchisees	Number of Franchisers
1995	54	19
1996	144	18
1997	126	14
1998	146	20
1999	105	7
2000	181	64
2001*	185	73
2002*	191	79
Total	756	142



Source: Malaysian Franchise Association Report, 3rd Ed. 2000.

* Estimated from the International Franchising Seminar 2002.

However, in reality the government has not achieved its target to produce 1,200 franchisees in the Seventh Malaysia Plan that ended in the year 2000 because a total of 756 franchisees or 63 per cent were accomplished. Unfortunately about 152 franchisees amounting to about 20 per cent have to closed down their operations due several factors that have jeopardize the development in addition to economic slump since 1997. The above problem has initiated researchers to investigate the factors of success and failure in this format business system franchise.

This study will try to investigate the critical factors that contributed to the success of the format business system franchise considering the critical success factors. The study will then lead to investigate the factors that contributed to the failure and problems that franchisees faced and later ceased their operation.

LITERATURE REVIEW

The essence of franchising is capitalizing on both the economies of scale associated with large systems and the benefits derived from small. Localized operations. The franchise entrepreneur, as the creator, builder, and guardian of a unique business format, is responsible for efficiently managing a complex system of independent business owners. Of the many types of management issues faced by franchisers, perhaps one of the most difficult is defining the appropriate boundaries of their format, i.e. maintaining the



required level of uniformity for the system to obtain economies of scale, while avoiding the danger of stifling efficient local market adaptation (Kaufman and Eroglu, 1998).

Studies of franchised systems suggest that franchise owners are more motivated than branch managers or non-franchised businesses, as they are effectively self employed but faces less risk than occurs in this latter form of ownership. Coupled with this, franchisee turnover tends to be lower than branch manager turnover incomparable businesses. It should be pointed out that many entrepreneurs who start their own conventional small business in order to preserve their independence find in reality that this independence is whittled away by various external constraints to a fraction of what was originally anticipated. Every existing and potential entrepreneur who is thinking about becoming a franchisee should first undertake self-evaluation of his/her suitability as a potential franchisee in comparison with starting and managing an entirely independent business. For example, if he/she is too autonomously minded, he/she may need to think hard before entering into such commitment, as the price to join a well-established franchising system is “subordination compliance” to the already existing rules and conditions determined in the operating manuals as stipulated in the franchise contract. The decision by prospective franchisee to “buy into a franchise system” is not enough; he/she has to be also selected by the franchisor, especially well established ones, who are particularly concerned about the suitability of those wanting to join the system in terms of their resources and capabilities, personality, professional background and experience, family background and even health condition. These issues are equally applicable to single entrepreneurs as well as to SMEs



Franchising has been defined as a “type of business arrangement in which one party (the franchiser) grants a license to another individual, partnership or company (the franchisee) which gives the right to trade under the trade mark and business name of the franchiser” (Clarke, 1997). This form of franchise system is commonly found among fast-food service restaurants such as A&W, KFC, and McDonald’s; among oil companies and their petrol retailers and expanded rapidly in the country. It is also used selling cars, pharmaceutical, specific products or services and educational services.

On the other hand, such business format franchising has been described as a form of “business cloning” (Hoffman and Prebles, 1993). As Hoffman and Prebles (1993) advocate, business format franchisers seek to have franchisees replicate in their local community an entire business concept, including product or services, trade name and methods of operations. Franchisees are provided with details of the franchiser’s trade secrets, as well as everything else necessary to establish a previously untrained person in their own legally separate business, running it with continuing advice and support on a predetermined basis for a specific period of time (Clarke, 1997). Furthermore, the franchiser also normally provides the franchisees with information systems, through training programmes and a detailed operations manual so that “each franchisee operates within the franchiser’s corporate image, offering customers consistency in product and or services. Consistency day in day out from every location in the network is expected” (Clarke, 1997). The franchiser’s control over the franchisees’ activities may extend over products sold, price, hours of operations, condition of plant, inventory, insurance, personnel and accounting and auditing (Rubin, 1978).



Franchising has become increasingly popular because, if it is properly managed, it is mutually beneficial to both parties. Franchising may be seen as a business relationship, whereby a franchiser must depend on the franchisee to undertake some action on the franchiser's behalf (Dant and Nasr, 1998). In a franchise system, franchisers must depend on their franchisees to run their businesses efficiently. In return franchisers not only offer their support and advice in the form of information system, training and an operational manual, but they also monitor their activities to ensure that the reputation of the franchises system is not being damaged in any way by the activities of any one of them (Rubin, 1978). It is therefore, in the interest of both the franchisers and the franchisees to optimize their efforts to make the franchise a success.

In considering the pace of development of franchising as a means for establishing small and medium businesses, one must also examine the reasons why the franchise system was an attractive proposition to companies seeking to expand a particular businesses format. In terms of control and profitability, the decision to franchise a new business concept not, at first sight seem the ideal way to achieve growth. However, as has been noted, the franchiser is able to keep his capital investment relatively low in comparison with acquisition methods of business expansion. By utilizing the capital and hard work of the franchisees, the franchiser is able to generate profits from a relatively low cost base. The decision to franchise will often be justified by the successful working relationship between the franchiser and the franchisee.

There are a number of disadvantages to business format franchising which can affect both the franchiser company and the franchisee. As with any form of business,



friction can occur between the parties to a contract. In franchised systems, however, since the franchiser is largely devolved from the daily operation of the business, lack of communication between the parties can frequently be the cause of the problems. Close attention to the nature and spirit of the franchise agreement will often prevent occurrence of disputes in an effective franchising formula (Sang havi, 1998).

Business format franchising is the process of licensing the rights and obligations to copy a unique retail positioning that profitably serves a need for a viable customer segment (Kaufmann and Eroglu, 1998). It may contain products and/or service and may or may not be location-specific. Including the support systems to implement and operate it, the format typically also involves access to sources to supply, as well as specified equipment and detailed operating instructions. Overall, therefore, the business format is comprised of various elements that manifest four distinct components: product/service deliverables, benefit communications, system identifiers, and format facilitators.

Product/service deliverables are those elements sometimes referred to collectively as the concept, and reflect the unique features of the format franchise. For example, a key product/service deliverables for a particular franchise may be the quick preparation of consumers' income taxes. The product/service deliverables also include differentiating features, such as a unique menu and the quality of the food in a restaurants franchise, or the convenience of being able to have our oil changed seven days a week in an automobile service franchise. To sum, the product/service deliverables are the collection of features that comprises the franchise format and defines its unique competitive niche.



Benefit communicators are those elements referred to quality, durability, and elegance are other examples of attributes that are not readily observable or measurable by consumers. It also should be noted that the benefits implied and the form of such implications vary across format types. For instance, clean uniforms in a fast-food outlet suggest cleanliness in the preparation and handling of the food, whereas clean uniforms in an automotive service center imply care and professionalism.

System identifiers are the set of visual and auditory elements i.e. the trademark or logo that also includes color schemes, and characters (McDonalds) among others. While format facilitators are the policies and procedures that form the foundation both for format's efficient functioning into the operation of the total system. These would cover a wide spectrum such as equipments, layout and design, as well as financial reporting requirements, royalty payment procedures, and data collection. This is the most critical element because it defines the organization, operation and governance of the franchise system.

Another encouraging factors to consider this business format franchising is the advantage of costs and the benefits of standardization. One of the primary motives for standardizing across markets is the desire to reduce cost. These cost savings are scale of economies due to purchasing (Douglas and Wind, 1987), marketing (Buzzell, 1968; Onkvisit and Shaw, 1987), and research and development (Buzzell, 1968), as well as savings due to easier implementation and management of programmes. As organization go into international market, cost minimization is also an important rationale for standardization across domestic market. Therefore, a standard format is effective in



reducing cost relates to monitoring. However, the central concern of the operations function in franchising systems is quality control and the ability of the franchiser to identify poor performance by franchisee. Again standardization takes it form to ensure quality assurance to the customers' satisfaction and possibly minimize the cost.

Standardization also permits image continuity and stability across markets (Jain, 1989; Levit, 1983). Within the context of formal franchising, a consistent image is obtained through close adherence to the system's rules and standards by all franchisees and the unequivocal of all franchisees to the system (Kaufmann and Oroglu, 1999). In fact this image represents the total expected reinforcement that a consumer associates with patronizing the outlets, consumers' experience and rewarding, but importantly, consistent image.

The Success Factors

Managers are interested in results. They are interested in identifying specific factors by which the success of their action may be gauged. They take comfort when knowing, and agreeing with, their defined responsibilities and expected results. They are interested in information that helps them achieve their goals. Therefore a technique known as critical success factor (CSF) approach is employed. As the name implies, the pivotal characteristics of CFS methodology is the determination of the set of factors that the manager considers critical for his or her success. Once identified, these factors are stated as objectives and the information required to monitor their performance is then identified.



In other word, CSF is a key area where satisfactory performance is required for the organization to achieve its goals. In this study researchers have identified twenty-one key success factors that entrepreneurs may consider in their critical success factors that contributed their success in format business systems more than five years.

The CSF method is not new. It is based on the concept of ‘success factors’ introduced by Ronald Daniel in 1961. However, Rockart of MIT was first to apply the concept in the information system areas. Because CFSs indicate the few key areas of activities in which favorable results are absolutely necessary for the manager to succeed, the manager should have appropriate information to allow her to determine whether events are proceeding sufficiently well in each area. However, the CFSs differ among industries and for individual firms within a particular industry. It may also vary some from year to year, but remain fairly constant for periods of time shorter than several months.

A variety of factors determine the success or failure of a particular projects or business in terms of objectives set. The identification of the critical success factors (CFSs) for a particular objective will enable limited resources of time, manpower and money to be allocated appropriately. Some researchers have been conducted to identify CFSs for project success using quantitative measures of various factors (Jaselskis and Ashley, 1991; Chua et al., 1997; Kog et al., 1999). Alternatively, CFSs can also be identified based on expert opinions. The impact of experience possessed by key personnel towards outcomes has been widely recognized. It would be legitimate then to



assume that experienced practitioners would have composed a set of CFSs after testing against their experience.

METHODOLOGY

Given the lack of empirical research in this area especially in Malaysia, an exploratory investigation was considered the most justifiable approach (Churchill 1991). The research method was adopted from the combination of quantitative and qualitative approached as suggested by Miles and Huberman (1994). The sampling plan was designed by using judgment and snowball sampling. The major advantage of these samplings is that it substantially increases the likelihood of locating the desired characteristic in the population (Malhotra 1999).

This study has selected a total number of 25 franchisees in the city of Johor Bahru, the third largest city in Malaysia, located at the southern tip, neighboring Singapore. The respondents were form varies range of sectors from food (4), cleaning services (6), photo shops (7), product (2), retail (30, pharmacy (1) and education (2). They were interviewed face to face to answer the questionnaires. The structure of questionnaires follows the five-point Likert scale ranging from strongly agree to strongly disagree was used to measure the critical success factors experience by them.

A questionnaire was developed in five phases. Phase one includes the respondent background. Second phase were factors why respondents choose to venture into the format business franchise and rank them accordingly. Third phase was the 21 success factors that perceived by the respondents for the past five year they were in business



using the Likert scale from strongly important to strongly not important. The fourth phase was exclusively for the respondents who failed for the past 5 year with 8 factors for them to rank according. To identify the respondents who failed in their operation, researchers was only able to interview three franchisees and have decided to interview through telephone the franchiser head office that are mostly located at the capital city of Malaysia. The last phase was recommendation by the respondents (those who fail) towards the Ministry of Entrepreneur Development, the Malaysian Franchise Association (MFA) and the financial institutions.

RESULTS AND ANALYSIS

Overall as shown in Table 2, the respondent (franchisees) more than 85% have five years experience in the operation; most of them are area franchisee and are running a format business system; they rent their premises; and less than ten employees. This shows that they a small time retailers and are looking forward for a better business. However, the franchisers are mostly are in operation more than ten years and are very established locally and internationally. The failure companies, however, are not easily located, whereby the authority are reluctant their disclose address and researchers could only locate three respondents as exhibited in Table 2.

Table 2
Profile of companies

Number of years in operation	N (25)	N (12)*	N (3)**
< 5 years	10		3
6 – 10 years	13	2	
11 – 15 years	1		
> 15 years	1	10	



Franchise status			
Master franchisee	1		
Area franchisee	24		3
Type of franchise			
Format business	23	12	3
Distribution franchise	2		
Type of outlet			
Self ownership	6		
Rent	19		3
Number of employees			
< 10	16		2
11 – 25	5		1
26 – 35	1		
36 – 45	2		
> 45	1		

*Franchiser

** Franchisees has ceased operation

Table 3

Respondents' mean importance factors scores in franchise business selection

Factor	Ranking
Practical and profitable	1
Less capital requirement to introduce the product	2
Higher success rate and low risk rate	3
Win-win relationship	4
Recognition by the society of franchise business	5
Implementation of R&D	6
Support from franchiser	7
Support from the Government, MFA and financial institution	8

The franchisees ranking importance for selecting franchise business are presented in Table 3. Eight selection variables are ranked by franchisees why they choose to go into franchise business. Franchisees has rated franchise business as practical and profitable the



highest, followed by less capital requirement to introduce the product, and higher success rate and low risk rate. These variables are very critical for any entrepreneurs to venture into the business world considering its profitability, less capital requirement and furthermore high success rate and low risk rate. The variables that ranked from 4 to 8 represent the importance of implementation when entrepreneurs are already in the business. In other words once an entrepreneurs have invested into the business the next stage is for the entrepreneur to establish and build a good relationship with franchiser for win-win situation and get their full support, plus ensure that the business are recognized by the society and conduct continuous product innovation (R&D) for the business to stay in business. And last but not least is to relied with the Government agencies for continuous support and with the financial institutions.

Table 4
Successful Respondents in Franchise Business (more than 5 years)

Selection factor	Mean
Sufficient financial resources/capital	4.88
Excellent customer service	4.88
Ideal customer target	4.88
Strong employee commitment	4.84
Clear mission and goals of business	4.76
Franchisee should hold characteristic of an entrepreneur	4.72
Product / Services that are popular or recognize by public	4.72
Continuous communication between franchisee and franchiser	4.68
Trust between franchisee and franchiser	4.68
Support from Government, franchise association, and financial institutions	4.68
Full support and training from franchiser	4.64
Impartial agreement between franchisee and franchiser	4.64
Close relationship between franchisee and franchiser	4.64



Franchisee secure various markets	4.52
Accurate selection by franchiser /excellent record of success	4.44
Franchisee has substantial sales and marketing background experiences	4.40
Operate franchise business without the help of manager in daily operation	4.36
Excellent franchise image	4.27
Package for franchise are provided	4.20
Experience in other businesses	4.20
Franchisee are free to do business at outlet level without much interference from the franchiser	4.08

Twenty-one selection variables are ranked from the most important to least important, based on the mean. The highest possible mean was 5, and the lowest possible mean was 1. The means ranged from a high of 4.88 (sufficient financial resources/capital, excellent customer service and ideal customer target) to a low of 4.08 (franchisee are free to do business at outlet level without much interference from the franchiser). To determine the group of respondents among franchisee, factor analysis was performed. Factor analysis is a data reduction technique that can help determine a smaller number of underlying dimensions of a large set of inter-correlated variables. The principal component options coupled with a VARIMAX rotation were selected for the factors analysis. According to VARIMAX criteria, factors retained after rotations have eight values of greater than one. The variables with commonalities below 0.45 were dropped from consideration. A summary of the dropped factor analysis variables found in the present study is presented in Table 5.

Table 5
Identification of Factors and Factor Loadings

Selection Factor	1	2	3	4	5	6	7
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Full support and training from franchiser	0.912	
Continuous communication between franchisee and franchiser	0.901	
Excellent franchise image	0.880	
Impartial agreement between franchisee and franchiser	0.842	
Accurate selection by franchiser /excellent record of success	0.658	
Ideal customer target	0.920	
Excellent customer service	0.834	
Experience in other businesses	0.791	
Franchisee should hold characteristic of an entrepreneur	0.922	
Franchisee are free to do business at outlet level without much interference from the franchiser	0.893	
Package for franchise are provided	0.671	
Franchisee has substantial sales and marketing background experiences	0.915	
Franchisee secure various markets	0.863	
Operate franchise business without the help of manager in daily operation	0.671	
Support from Government, franchise association, and financial institutions	0.820	
Clear mission and goals of business	0.774	
Close relationship between franchisee and franchiser	0.726	
Sufficient financial resources/capital	0.859	
Strong employee commitment	0.562	
Product / Services that are	0.737	



popular or recognize by public Trust between franchisee and franchiser	0.599
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Seven distinct factor groups were identified by factors analysis. Factor one franchisees are called *strong establishment*. These franchisees should obtain full support and training from franchiser, continuous communication between franchisee and franchiser, excellent franchise image, impartial agreement between franchisee and franchiser, and accurate selection by franchiser /excellent record of success. These items represent the factors contributed to the successful franchise business system.

Factors two franchisees are called *customer focus*. Franchisees should focus on its target ideal customer, excellent customer service, and experience in other businesses. This criterion is vital for the survival in any business environment.

Factors three franchisees are called *entrepreneurship skill*. The franchisees in this group should hold characteristic of an entrepreneur, franchisee are free to do business at outlet level without much interference from the franchiser, and package for franchise are provided.

Factor four franchisees need to possess *strong personnel*. Franchisees should possess a substantial sales and marketing background experiences, franchisee secure various markets and operate franchise business without the help of manager in daily operation.

Factor five franchisees need was to establish a *good relationship*. These include support from Government, franchise association, and financial institutions, and obviously



to set up a clear mission and goals of business, and close relationship between franchisee and franchiser.

Factor six franchisees need was the availability of *strong resources*. These include sufficient financial resources/capital and strong employee commitment.

The seventh factor is associated with *well known*. Product / services that are popular or recognize by public and the need of trust between franchisee and franchiser

The Failure Factors

Table 6
Ranking the Reasons for Failure in Franchising

Factors for failure	Franchiser	Franchisee
Intense competition with other franchise /other competitors	7	8
High rental on premises	8	4
Problem with employees	2	7
Lack of training or experience in business	3	5
Conflict/problem and communication with franchiser	5	1
Product or service are not well accepted by public	6	6
Lack of management expertise	1	2
Unstrategic outlet/premise location	4	3
Total	12	3

As mentioned earlier due to the difficulty in locating the failure franchisees, the Table 6, above have identify the ranking the reasons of failure from the perspectives of franchisers and franchisees. Franchisers have identified lack of management expertise, problems in managing employees, lack of training and experience in business and unstrategic location as the main reasons for failure. Contrary, franchisees have identified conflict/problem and communication, lack of management expertise, unstrategic outlet/premise location and high rental on premises as the main reasons to cease



operation. However, both respondents have concluded that lack of management expertise as the common main reasons for failure.

CONCLUSION AND DISCUSSION

For a successful format business franchise the initial criteria is a need for a strong establishment between franchiser and the franchisee by providing excellent training and support, in continuous communication with impartial agreement, image and proven track of excellent record business. As indicated by Dant and Nasr (1998) and Rubin (1978) franchising is a business relationship, whereby franchisers must depend on their franchisee, offer support and advice, training and also monitor their activities continuously to ensure reputation of the franchise system to make the franchise a success.

To succeed in today's competitive marketplace, the franchise business system to be customer focus, winning customers from competitors and keeping excellent customer service by delivery greater value. Therefore it is an advantage to franchisees that has previous business experience that would assist them to careful analysis the target customer.

The success criteria above mentioned are critical, however, franchisees lack management expertise would then results in failures. Thus the lack of training should incorporate the essential element of managing an organization, which include, finance (cash flow), managing human, motivating and continuous self-evaluation of performance franchisees' operation.



This research and recent research in the area of franchising has identified that from the respondents perspective, majority consider selecting a format business franchising as profitable, less capital layout, and consider it as a high rate success with low risk rate.



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