

Are Franchising Systems Beneficial for Lodging Industry in terms of Profitability and Intangible Value?

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ABSTRACT

Franchising plays a significant role in the rapid growth of its retail sales. To identify whether franchising can influence lodging firms' financial performance, this study investigates the profitability and intangible values of both franchised and non-franchised restaurant firms. The collected data is the lodging companies' annual reports from 2001 to 2009. The variables include ROA (Return on Assets), ROE (Return on Equity), intangible value, firm size, leverage, and franchising dummy. The results of the hierarchical regression model, independent t-test, and descriptive statistics support the positive association between ROA, intangible value and franchising. The results of this study show that franchised lodging firms have higher profitability and intangible value than non-franchised firms, and indiscriminate expansion and low financial leverage can lead to poor financial performance.

Keywords: Franchising, Profitability, Return on Assets, Return on Equity, Intangible Value

INTRODUCTION

Franchising is a system in which the franchisor grants a license, trademark, and service mark, as well as advice, and assistance in organizing, merchandising, and managing the business as a long-term business relationship (Andrew, W. et al., 2007). This system is a major expansion strategy for the hotel industry because of its advantages (Koh, Y. et al., 2009). Actually, the annual retail sales of business-format franchising were about \$246 billion in 1992 (Huber, 1993). In the lodging industry, franchising has contributed so significantly to the growth of major hotel chains since the 1960s that it has made lodging one of the ten most franchised industries in the United States (Cruz, 1998; International Franchise Association, 2006).

Naturally, franchising systems have gained the interest of researchers and scholars thanks to this rapid growth speed and large scale business (Elango, B. & Fried, V. 1997). Although there has been considerable interest in franchising, the present research considers whether this system is beneficial for the lodging industry in terms of profitability and intangible value (Combs et al., 2004; Watson et al., 2005).

Based upon prior research, the resource scarcity theory is the most appropriate theory to explain the motivation of franchising companies (Hsu, L. & Jang, S., 2009). The resource scarcity theory suggests that the franchising system can grow more quickly because others' funds are used to finance the construction of the franchised units and other people manage those facilities (Andrew, W. et al., 2007; Hsu, L. & Jang, S., 2009).

However, there is some debate as to whether franchising is more beneficial for the hospitality firms' financial performance than owning in terms of business operation (Koh, Y et al., 2009). Some research compares the financial performance of franchised restaurants with the financial performance of non-franchised restaurants (Hsu, L. & Jang, S., 2009). The results reveal that franchised restaurant performance is better. However, it is rare to find a

study which compares the franchised lodging industry's financial performance with that of non-franchised lodging firms. Therefore, the purpose of this research is to compare the financial performance of franchised-lodging industry firms with the financial performance of those which are non-franchised. Moreover, this study is conducted from the franchisors' perspective.

TABLES AND FIGURES

Table.1 Lodging Industry's Profitability Record

	1990-1992	1996-1998	2002-2004	1990-2004
ROA	0.022	0.025	-0.019	0.010
ROE	0.418	0.130	-0.154	0.117

Sources: Jang,S., Tang,C.,& Chen,M. (2008). Financing Behavior of Hotel Companies.
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Table 2. Measurements of Variables

Variables	Type	Description
ROA	DV	Net Income/Average Total Assets
ROE	DV	Net Income/Average Total Owners' Equity
Tobin's Q	DV	(MVE+PS+DEBT)/TA
Franchise Dummy	IV	Dummy Variable: 1=franchised; 0=non-franchised
Financial Leverage(DEBT)	CV	Total Debt/Total Equity
Firm Size(SIZE)	CV	Total Assets

Table 3. Descriptive Statistics of Franchised and Non-franchised Lodging Firms

	ROA(%)	ROE(%)	Q	Size (Million \$)	Debt
Mean					
All	5.22	12.33	1.15	5504	35.52
Franchised	7.40	18.42	1.68	7888	60.02
Non-franchised	2.11	3.43	0.41	2116	0.71
Minimum					
All	-13.00	-101.00	-0.24	121	-9.50
Franchised	-11.00	-101.00	0.12	169	-5.89
Non-franchised	-13.00	-34.00	-0.24	121	-9.50
Maximum					
All	39.00	529.00	13.65	37860	3117
Franchised	39.00	529.00	13.65	37860	3117
Non-franchised	17.00	26.00	1.81	9494	3.85
S.D					
All	8.54	71.06	1.97	5953	324.82
Franchised	10.15	92.33	2.41	6595	423.88
Non-franchised	3.91	8.49	0.48	2185	1.87

Table 4. Difference in Probability and Intangible Value between Franchised and Non-franchised Lodging Firms

Variables	Franchised	Non-franchised	Mean difference	t-Statistics	Sig
ROA	7.44	2.11	5.33	3.056	.000
ROE	18.42	3.43	14.99	.996	.020
Tobin's Q	1.68	0.41	1.27	3.200	.002

Table 5. Means, standard deviations, and correlations

	Mean	SD	1	2	3	4	5	6
1. ROA	.052	.085	-					
2. ROE	.122	.711	-.065	-				
3. Tobin's Q	1.157	1.972	.427**	-.071	-			
4. Debt	5504	5953	.033	.772**	-.008	-		
5. Size	35.521	324.82	-.160	.033	-.199	-.026	-	
6. Franchise	-	-	.307**	.104	.320**	.090	.480**	-

(1 = Franchise)

Notes: Two-tailed tests; ** $p \leq .01$

Table 6. Effect of Franchising on ROA, ROE, and Tobin's Q

Variables	ROA		ROE		Tobin's Q	
	β	β	β	β	β	β
Step 1						
Debt	.029	-.023	.773 ***	.772***	-.024	-.064
Size	-.159	-.401***	.053	.047	-.135	-.369**
ROA					.406***	.238*
Step 2						
Franchise Dummy		.501***		.012		.429***
ΔR^2		.191		.000		.112
F for ΔR^2		21.451***		.024		14.235***
Overall R^2	.026	.217	.599	.599	.200	.313
Overall F	1.210	8.142***	66.421***	43.803***	7.355 ***	9.905***

Notes: Entries represent standard coefficient estimates; (* $p \leq .05$, ** $p \leq .01$, *** $p \leq .001$)

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