# 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. *International Journal of Hospitality Management*. Vol.27, pp 478-487

**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 (1 = Franchise) | - | - | .307** | .104 | .320** | .090 | .480** | - |

**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*** |
| $\Delta R^2$ | | .191 | | .000 | | .112 |
| F for $\Delta R^2$ | | 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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