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## International hotel development: A study of potential franchisees in China

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### Abstract

Franchising is a strategic partnership formed by the franchisor and the franchisee, and consequently partner selection between the franchisor and the franchisee is critical to the long-term success of a franchise. However, the literature has primarily taken the viewpoint of franchisors, but failed to explore the perspective of the potential franchisees. As China represents a significant growth opportunity for international hotel franchisors, this study examines the perspective of China's domestic hotel operators regarding franchising and analyzes a mix of factors that may affect such perspective. The study of 182 Chinese hotel general managers shows that China's hotel practitioners have considerable interest in franchising and are knowledgeable about the concept as it pertains to hotels. The findings indicate that the length of work experience and educational background of Chinese hotel operators may influence their franchising preferences. Hotel chains that have strong brand awareness, supportive centralized reservation systems, and offer relatively high returns on investment at relatively low franchise fees, are most attractive to potential Chinese franchisees.

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### 1. Introduction

Franchising is globally one of the most rapidly growing business strategies because it enables a franchisor to develop with minimal capital involvement (Cherkasky, 1996). 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 10 most franchised industries in the United States (e.g., Cruz, 1998; International Franchise Association, 2006). As multinational franchisors, including hotel chains, are actively seeking growth in expanding international markets such as China and India, international franchising has received increasing attention in academic research.

As an important type of non-equity strategic alliance, a franchise is essentially a long-term strategic partnership formed between a franchisor and franchisee. Literature regarding strategic alliances suggests that partners with complementary resources are most likely to achieve long-term partnership success (e.g., Chathoth and Olsen, 2003). Consequently, the importance of the partner-selection process cannot be underestimated. While the partner-selection literature has traditionally investigated joint ventures, a few recent studies have sought to focus exclusively on the context of international franchising. Fladmoe-Lindquist (1996) proposed that the capabilities needed for a franchisor to sell franchises internationally are different from those required in a domestic context. It has been revealed that prior knowledge of the franchisor is critical to a successful franchise partnership (Altinay and Wang, 2006), and a potential franchisee's personal characteristics have been suggested to be among the most important franchisee-selection criteria applied by franchisors (Clarkin and Swavely, 2006). Moreover, based on a comprehensive and in-depth case study regarding a leading

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international hotel franchisor, Altinay (2006) revealed that franchisee selection is a substantial, multidimensional organizational activity rather than a straightforward process, and different types of selection criteria play different roles at different stages during this complex practice.

Although the literature has provided valuable insights regarding various aspects of international franchising, previous research has focused only on the perspectives of franchisors. While Altinay and Wang (2006) suggest that, in the franchisor–franchisee relationship, there is a “mutual evaluation” between the franchisor and the franchisee to assess the possibility of a long-term successful partnership, little, if any, research has been done from the perspective of franchisees or potential franchisees. Particularly, little is known regarding how potential international franchisees select franchisors. Therefore, Altinay (2006) advocated that research on franchisees’ franchisor-selection process is needed. This study aims to narrow this gap by studying the perspectives of potential franchisees.

Specifically, we focus on the hotel market of China, potentially one of the world’s largest franchise markets for many service industries, including hotels. Realizing the significant growth potential of China’s hotel market, most major international hotel companies are implementing aggressive growth strategies there (e.g., Liu and He, 2006; Shellum, 2003). However, until recently, hotel franchising has not been employed in China. While China’s hotel industry has been a popular subject of many studies (e.g., Pine, 2002; Pine and Phillips, 2005; Pine et al., 2000; Tang et al., 2006), many factors that may affect the development of hotel franchising in China have been only generally described in the literature and without rigorous analysis using primary data. As franchising is becoming an increasingly effective tool for business expansion in China’s many other industries in recent years, more and more hotel owners, executives, and potential investors are collectively beginning to demonstrate a willingness to embrace the franchise concept. However, these industry practitioners’ perspectives regarding franchising remain a topic to be explored by academic research.

We believe that a greater understanding of China’s potential franchisees’ perspectives concerning the major factors that may affect the future growth of hotel franchising will not only contribute conceptually to the literature regarding international franchising, but also be practically valuable to potential hotel franchisors and franchisees. By conducting a survey of 182 general managers (GMs) of China’s state-owned hotels, a significant potential target market for hotel franchising, we examine respondents’ perceptions and preferences. A range of factors was analyzed, including the preferred hotel operation models, favored franchisors, important concerns in choosing a franchisor, and benefits attracting franchisees. Moreover, certain factors that might affect the hotel operators’ such perceptions were examined.

## 2. Review of literature

### 2.1. *Franchising as a strategic partnership: the process of partner selection*

Franchising is a specific business format, where a franchisor lends its trade name and business system to a franchisee in return for a fee (Connell, 1997; International Franchise Association, 2006). Started as early as 1863 (Rosenberg, 1969), franchising has become globally one of the most rapidly growing business strategies (Cherkasky, 1996). By 1998, there were 8600 franchisors worldwide, including 400 multinational ones (Yang, 2001). According to the International Franchise Association (2006), in the United States, more than 760,000 franchised businesses in 75 industries account for more than 40% of all US retail sales, and on average, a new franchise outlet opens every 8 min.

Franchising is regarded as an important type of strategic alliance that provides competitive advantage to both partners when effectively established (e.g., Baucus et al., 1996; Chathoth and Olsen, 2003). Distinguished from equity alliances, such as joint ventures, franchising enables a franchisor to enter an international market and achieve large economies of scale with minimal capital investment and relatively low levels of risk, and therefore, is among the most effective and attractive vehicles with which multinational corporations expand internationally (e.g., Chathoth and Olsen, 2003; Contractor and Kundu, 1998; Pizanti and Lerner, 2003) (The benefits for franchisees will be detailed in Section 2.2.) Consequently, it is not surprising that, among the limited number of studies regarding international franchising, franchisors have received primary attention. A notable study by Eroglu (1992) proposed a conceptual model of the determinants of franchise internationalization. This model suggests that a franchisor’s intention to internationalize is the result of the benefits perceived by top management as well as perceived risks, both of which are significantly influenced by a number of organizational and environmental factors, including firm size, firm operation experience, top management’s characteristics (international orientation, risk tolerance and perceived competitive advantage), domestic competitive pressure, external change agents, and perceived favorability of the target country. Building on the resource-based view of the firm, Fladmoe-Lindquist (1996) suggested that the capabilities needed for a franchisor to sell franchises internationally are different from those required in a domestic context, and the specific capabilities include distance management, cultural adaptability, host country policy evaluation, and exchange rate management.

While the goal of a franchise as a strategic partnership is to achieve competitive advantage for both partners, based on the agency theory, it is widely recognized that franchisors and franchisees do not always share the same views regarding goals, values and competitive methods (e.g., Baucus et al., 1996; Contractor and Kundu, 1998;

Chathoth and Olsen, 2003; Galen and Touby, 1993). Because the franchisor receives the “first cut” of cash flow collections through revenue-based royalties regardless of the operation’s profitability, franchisees only have residual profit claims on the remaining net cash flow of the franchised operation. Literature reveals that franchisees’ opportunistic behaviors may include ignoring franchisors’ goals in pursuit of their own entrepreneurial interests, refusing to participate in marketing activities, deviating from the franchisor’s standards, and/or resisting changes needed to keep the system competitive (Galen and Touby, 1993). Since consensus on values, goals, and competitive methods between franchisors and franchisees were found positively related to better business performance and more competitive franchise systems, compatible franchisees are critical to the long-term success of franchisors (Baucus et al., 1996). Therefore, a few franchisor-oriented studies focus exclusively on the topic of franchisee selection, i.e., how franchisors select franchisees. It is suggested that an efficient partnership between a franchisor and franchisee could be established by use of franchisee-selection criteria based on prospective franchisees’ likely future outcomes desired by franchisors (Jambulingham and Nevin, 1999). Jambulingham and Nevin (1999) examined the relationship between several franchisee-selection criteria, such as franchisees’ financial capability, experience and management skills, demographic characteristics, attitude toward business dimensions and outcomes desired by franchisors. Their findings show that the use of specific franchisee-selection criteria can be applied as an effective input control strategy by franchisors because it had a positive effect on the franchisees’ outcomes desired by franchisors, such as cooperation. Moreover, recent research conducted by Clarkin and Swavely (2006) studies the relative importance of six franchisee-selection criteria including financial net worth, general business experience, specific industry experience, formal education, and psychological profile. This study reveals that financial and professional qualifications, although important, are indeed not the most critical criteria; it is a potential franchisee’s personal characteristics that rank the most important criteria by the franchisors.

While little research regarding the topic of franchisee selection has been done in the context of the hotel industry, two notable exceptions are recent work by Altinay (2006) and Altinay and Wang (2006). Altinay and Wang (2006) focused primarily on the significant effects of prior knowledge of franchisors and franchisees on the franchisor–franchisee partnership, while Altinay’s (2006) case study regarding a leading hotel firm is the most comprehensive and in-depth regarding the process through which an international hotel franchisor chooses its franchisees. It was revealed that three contextual factors are important for implementing franchisee-selection criteria: the strategic context of the organization itself, the target country market, and the nature of the franchise partnership. Since the task-related selection criteria (the operational skills and

resources) and partner-related criteria (the effectiveness of cooperation between the franchisor and the franchisee) both play important roles and such roles vary at different stages of the selection process, international franchisee selection is not a straightforward organizational activity. Rather, it is a substantial, multidimensional process in which a cooperative environment essential for a successful partnership develops gradually rather than overnight (Altinay, 2006; Altinay and Wang, 2006).

While franchisee selection is important for franchisors, it is indisputable that potential franchisees are selecting franchisors simultaneously, as well, because from a franchisee’s perspective, their potential risks include their franchisors encroaching on the franchisees’ market, failing to disclose information, providing a misleading indication of the likelihood of success, and misrepresenting costs or revenues. (Galen and Touby, 1993). Phan et al. (1996) suggest that franchisees should consider that franchisors’ actions are not always congruent with the franchisees’ best interests. Baucus et al. (1996) found significant differences between franchisees’ emphasis on competitive methods (i.e., product/brand development, efficiency, and customer service) and those they attribute to their franchisors. Chathoth and Olsen (2003) also indicate that in a hospitality franchise agreement, the franchisor usually has the “upper hand” because the franchisor is exposed to lower risks than the franchisee. Particularly, in the context of hotel industry, studies by Altinay (2006) and Altinay and Wang (2006) suggest that the interactions between franchisors and prospective franchisees are critical because both parties evaluate each other to assess the potential of reaching a successful long-term partnership. It has been suggested that the long-term success of a strategic partnership is the result of strategic fit and cultural fit involving complementary resources, trust, and appropriate governance mechanisms, all of which are significantly affected by both partners (Chathoth and Olsen, 2003). Therefore, the perspectives of potential international franchisees are equally important for any successful international franchising. However, the international franchising literature regarding partner selection has been dominated by a franchisor focus, and little attention has been paid to potential international franchisees. Previous research has indicated that studies are necessary to fill this gap and take a franchisee viewpoint (Altinay, 2006).

## 2.2. *Hotel franchising: franchise benefits and concerns of franchisees*

In the hotel industry, it is generally agreed that franchising was launched in the 1960s as an expansion strategy for Holiday Inn and other brands (Pine et al., 2000; Rushmore and Baum, 2001). In 1997, Rushmore found that more than 65% of the US hotel room supply was franchised. According to International Franchise Association (2006), the number of franchised hotels has been increasing in each of the past 5 years, which makes the

lodging industry the tenth largest franchised industry in the United States. However, franchising is much less popular outside the United States. In Europe and Asia/Pacific, branded hotel rooms (including both management contracts and franchises) account for only 18% and 15%, respectively, of all hotel rooms (Altinay and Altinay, 2003). Consequently, franchising is regarded by most international hotel chains as a potentially important growth strategy in the near future (e.g., Altinay and Altinay, 2003; Hong et al., 2000; Walsh, 2004).

In addition to broadly discussed benefits for a franchisor, a large body of literature also examines a number of benefits of a franchise that are attractive from a franchisee's point of view. First, since an established brand provides an instant quality identity, recognition, and image, it is not surprising that brand name is regarded as one of the most important benefits that encourage independent hotel owners to become franchised (Rushmore and Baum, 2001; Temling, 1987). In addition, operating systems, reservation systems, and marketing programs are key technologies that could enable a franchised hotel to distinguish itself from its competitors (e.g., Rushmore and Baum, 2001). Moreover, franchising could significantly smooth the complicated opening process of a hotel (Temling, 1987). Compared to independent operation, a franchisee can obtain significant pre-opening assistance from a franchisor, therefore making it relatively less risky to develop a new hotel.

Literature has also revealed various factors associated with different franchise brands that may affect a potential franchisee's decision regarding first, whether to choose the franchise model; and second, if deciding to utilize a franchise, which brand to choose. In addition to brand name (as discussed earlier), from the viewpoint of a franchisee, franchise fees and return on investment are among the most important factors in the franchise-selection decision (Rushmore and Baum, 2001; Temling, 1987). Regardless of the percentage of revenue charged by franchisors, it was reported that a US franchised hotel benefits by an average of approximately \$2000 per room after the cost of franchise, and the same level of profitability could even be maintained after a hotel terminates the franchise term, mostly due to strong repeat business (Temling, 1987).

On the other hand, compared with independent operation, lack of operational freedom and flexibility, which are reflected by the operational requirements and the duration of the franchise term, has been cited as a disadvantage of franchising (Temling, 1987).

### 2.3. *Franchising in China's hotel industry*

In China, the hotel industry has grown significantly from only 137 hotels in 1978 to 10,888 hotels in 2004 (China National Tourism Administration (CNTA), 2005). To satisfy the nation's dramatic economic and tourist growth, the Chinese government has invested significantly in developing new hotels since late 1970s. In the meantime,

developing upscale/luxury hotels with joint ventures and management contracts has become the primary model for international hotel chains to take advantage of the business opportunities in China (Pine, 2002; Xiao, 1999). However, Chinese hotel executives historically have been slow to embrace the chain concept. By 2003, only 16% of Chinese hotel rooms were chain operated, of which most were 4-star or 5-star international brands. Notably, the international hotel chains have realized the highest occupancy, profit, and brand awareness (e.g., Pine and Phillips, 2005; Xiao, 1999).

As a result of the Chinese government's considerable investment, state-owned hotels, which accounted for 53.4% of China's hotel room inventory by 2004, compose the dominant hotel group in terms of room supply. However, the state-owned hotels are the least competitive in the market. For example, in 2000, the RevPAR of the state-owned hotels was less than half of the foreign-funded properties' (CNTA, 2001). The state ownership system is widely criticized as one of the major problems of China's hotel industry. As the state-owned hotels' GMs are appointed by the Chinese government (which might be national, provincial, or regional), they generally play a dual role in the hotels: the GM and the asset manager, i.e., representative of the owner (government). Specifically, such a dual role requires not only expertise in operating hotels but also in dealing with complex ownership and government-related issues. Consequently, on the one hand, a large number of the state-owned hotels' GMs had substantial work experience in various government agencies; and on the other hand, because the GM of a state-owned hotel is usually the only hotel expert of the owner (the respective government), the GM plays a key role in shaping the owner's (government's) strategic policies and decisions regarding the hotel, including buying/selling/leasing the hotel, branding, and choosing the operational model (franchising, management contract, or independent operation). (e.g., Wu, 2001; Xiao et al., 2003). However, it has been recognized that the failure to separate general management and asset management has caused some serious complications and has reduced effectiveness in hotel operations (e.g., Pine, 2002; Pine et al., 2000; Wu, 2001; Xiao et al., 2003). In addition, the exclusive control of the state-owned hotels' GMs and the complicated state ownership system has obstructed the development of China's domestic hotel chains. By the end of 2000, among approximately 40 domestic hotel-management companies, only one company had managed more than 10 properties (Wu, 2001).

Chinese hotels are currently experiencing a significant shift of ownership, capital, and market restructuring. First, as the government has gradually realized the disadvantages of state ownership, more and more previously state-owned hotels have been or are being reformed to joint-stock ownership through selling a certain percentage of hotel stock to outside investors. The involvement of the external profit-driven shareholders is forcing the managers to

change from a more government-oriented to a more market-oriented operating model, and therefore, they are actively seeking new strategies to compete with their international rivals (Xiao et al., 2003). In addition, the Chinese government is transferring the assets of some state-owned hotels to publicly held companies to make them instant hotel chains (Dai, 2003). Another effort of China's hotel industry is exploring additional capital sources, such as the private capital market (Dai, 2003). Furthermore, the saturating upscale hotel markets in China's gateway cities are pushing both global and domestic hotel chains to expand into smaller cities with lower priced products. As a result, the limited-service segment is becoming a new highlight of China's hotel development (Wang, 2002).

While franchising remained an essentially unknown concept in China until the 1990s, the development of franchising has surpassed that of other business models in China since then. By the end of 2000, there were more than 400 franchisors with over 1000 outlets in more than 30 industries (Yang, 2001). However, China's hotel industry appears to have accepted the franchising concept much later than other industries. Due to the lack of domestic human resources, joint ventures associated with management contracts were encouraged by the Chinese government to import international operational standards and management expertise (Pine, et al., 2000; Xiao, 1999). Starting from late 1990s, when more domestic management staff and private capital became available, many hotel chains began to promote the franchise model. For example, Jin Jiang Inn, a domestic budget brand launched by Jin Jiang, attracted 21 franchisees within 3 months after it announced its new franchise program in 2003 (Fen, 2003). Most recently, Super 8 has grown to 37 properties in 24 Chinese cities since it entered China in 2004 (Super 8 China, 2006).

Among the previously discussed benefits of a franchise, it is believed that, due to the lack of brand penetration in China, brand name can particularly bring competitive advantages to Chinese franchisees (Wang, 2002; Yang, 2001). In addition, previous studies suggested that most Chinese hotels were desperate to strengthen their marketing capabilities and to expand their distribution channels. Therefore, a well-developed international reservation system would be expected to be among the most welcomed features to future Chinese hotel franchisees (Pine, 2002; Xiao et al., 2003). Indeed, much evidence could be found in the current success stories of franchising. Ramada attributes its franchise achievement in China to two core competencies: brand name and reservation system (Xiao, 2002). Similarly, the major reason behind the rapid franchise development of Home Inn, the second largest domestic economy hotel chain, is its centralized reservation system, which is backed up by [www.ctrip.com](http://www.ctrip.com), China's largest hotel room and air ticket distributor (Zhang, 2003). Moreover, pre-opening assistance from franchisors is also attractive to the increasing number of Chinese private real

estate investors who may be interested in, but are relatively new to the hotel business (Zhang, 2003).

#### 2.4. Factors affecting a potential franchisee's preference and hypotheses

Literature also suggests several factors that may affect potential hotel franchisee's perceptions regarding franchising. First, previous research has established the link between top managers' personal demographic characteristics and their strategic perceptions. Hambrick and Mason (1984) suggested that executives' level of education and tenure in the subject industry influence the environmental elements to which they are sensitive and the strategic responses they propose. This upper echelon theory has been supported in general business research (Walsh, 1988); however, it has not been linked either to the franchising strategies, or to the franchising preferences of hotel executives. To study its validity in the context of the hotel industry, we hypothesize as follows:

**H1.** Chinese hoteliers' preference regarding a hotel operating model is affected by their (a) educational background and (b) tenure in the hotel industry.

**H2.** Chinese hoteliers' preference regarding brand with which to franchise, if they were to purchase a franchise, is affected by their (a) educational background and (b) tenure in the hotel industry.

Researchers have revealed that the operating model, i.e., franchise or management contract, is associated with the hotel quality level, which could be measured by AAA's diamond rating, Mobil's star rating, or similar scales. Dev et al. (2002) revealed that the likelihood of choosing a management contract over a franchising arrangement increases when quality of the hotel rises. Moreover, it is recognized that most brands specialize in their respective quality level and few brands exist in more than two different quality levels (Zhang, 2003). Because hotel GMs typically have considerable experience in their hotels' specific quality type, GMs would be expected to be more familiar with the brands competing at the same or close quality level than the ones at different quality levels. Thus, we propose the following hypotheses:

**H3.** Chinese hoteliers' preference regarding a hotel operating model is affected by their hotel's quality level.

**H4.** Chinese hoteliers' preference regarding brand with which to franchise, if they were to purchase a franchise, is affected by their hotel's quality level.

Similarly, people's choice regarding a hotel operating model is likely associated with hotel service type, such as full-service, limited-service, extended-stay suites, etc. In the United States, market segmentation makes the industry so diverse that the direct correlation between certain quality levels and service types is somewhat ambiguous. It is recognized that different qualities exist in competing hotel

types, so select-service hotel brands like Courtyard by Marriott may be categorized as upscale, while full-service hotel brands like Holiday Inn may be classified in the lower mid-scale category (Smith Travel Research, 2005). While it is common for most types and brands of hotels in the United States to employ franchising, a widely cited notion in China is that franchising is more attractive for certain hotel types, particularly limited-service types (e.g., Wang, 2002). Full-service hotels are currently predominant in China, with over 8000 properties, while limited-service is a quickly expanding concept, but with fewer than 1000 hotels (Zhang, 2003). In addition, although rare, other hotel types, including all-suites and resorts, are becoming conceptually familiar to the Chinese hotel industry. While the GMs who are the subjects of our research are currently working in a certain type of hotel, their most desired hotel type for which they would like to work may affect their preferred hotel operation. Thus, we propose this final hypothesis:

**H5.** Chinese hoteliers' preference regarding a hotel operating model is affected by their preferred hotel type.

### 2.5. Summary of literature and research questions

Previous literature regarding international franchising has primarily taken the perspectives of franchisors. While franchisees are equally important to the success of the franchisor–franchisee partnership, little is known regarding how franchisees select franchisors. As discussed in Section 2.2, literature reveals essentially five benefits for franchisees purchasing a franchise, as well as approximately five concerns of franchisees in choosing a franchisor. Nevertheless, most previous research regarding franchisees is composed of merely general descriptions, and no rigorous research with a systematic design, primary data, and qualitative analysis has focused on the topic of franchisor selection. Particularly, in the hotel industry, regardless of the significant interest in international hotel chains regarding the growing China market, perspectives held by China's potential hotel franchisees truly remain unexplored.

The purpose of this study is to investigate the perspectives and views of China's domestic hoteliers, perceived as the potential future hotel franchisees, concerning the factors that affect the development of hotel franchising. Moreover, as proposed in the hypotheses, several factors that may affect such perspectives of Chinese hoteliers are studied. Specifically, a questionnaire was developed to answer the following four questions: (1) What is the respondents' most preferred hotel operating model? (2) If the respondents would consider purchasing a franchise, what are the most desirable brands? (3) Among the factors discussed in Section 2.2, what are the most important concerns in choosing a franchisor and what are the most valued benefits for franchisees? (4) How do the respondent-specific characteristics as identified in the hypotheses (i.e., education, industry tenure, and hotel

quality level) affect the respondents' preferences regarding hotel operating model and franchise brands?

## 3. Methodology

### 3.1. Sample

Literature reveals that the state-owned hotels are the dominant segment in China's hotel industry and are considered to be among the most likely future franchisee candidates (Xiao et al., 2003). While franchising decisions are normally made by the hotel owner, as previously discussed, the GMs of Chinese state-owned hotels also function as both asset manager and representative of the hotel owner (government), and consequently, play a key role in making franchising decisions (i.e., whether to choose the franchising model and which franchisor/brand to choose) on behalf of the owner (government) (Xiao et al., 2003). Since the GMs are the identifiable hotel representatives of the Chinese government, we believe focused research regarding the GMs of Chinese state-owned hotels could help to reveal China's potential franchisees' perceptions towards the concept of franchising. The questionnaire employed in our research was pre-tested on a sample of 34 hotel GMs serving on the China Hotel Professional Managers Committee. The questionnaire was modified and then a total of 450 copies were distributed to the GM participants of two national conferences of the China Hotel Association (CHA) as part of a larger survey administrated by the CHA. The GM participants were identified with assistance of the CHA, and all participants of the second conference were notified to not repeat this study if they had participated earlier. A follow-up reminder with a copy of the original questionnaire was faxed to the non-respondents approximately 2 weeks after each conference. Among the 206 questionnaires returned, 182 were useable, resulting in a 40.4% response rate. To reduce the non-response bias, 10 GMs who did not return the questionnaires were randomly selected by CHA and were contacted via phone. A short survey was completed by those 10 GMs. Their responses regarding franchising benefits and concerns were compared to the answers of the sample via *t*-tests, and no statistical differences were found.

### 3.2. Measurements

*Operating models:* Respondents were asked to select their single favorite operating model from three options: (1) purchasing a franchise and operating the hotel independently (labeled as "franchising"); (2) operating the hotel independently without having a franchise (labeled as "independent operation"); and (3) operating the hotel with an external branded management company (labeled as "management contract").

*Preferred franchise brands:* An open-ended questionnaire was developed for the respondents to freely name their

favorite franchise brands in the order of level of preference (e.g., the first brand is the respondent's most favorite brand).

*Valued benefits of franchising:* Five benefits that were believed to be particularly attractive to the franchisees were adopted from the literature—brand name, reservation system, operating system, marketing and promotion support, and support in opening a hotel. The respondents were asked to evaluate each item in terms of the perceived value of a future franchise with a 5-point scale, in which 5 indicated “extremely valuable” and 1 indicated “not valuable at all”.

*Franchisees' concerns in choosing a franchisor:* Five potential concerns were adopted from the literature—brand name, franchise fee, return on investment, operational requirements, and length of the franchise term. The respondents were asked to rank these five items in terms of the perceived importance of buying a franchise with a 5-point scale, in which 1 indicated “most important” and 5 indicated “least important”.

*Hotel quality level:* Each respondent was asked to provide his/her current hotel's star level, which ranges from 1-star to 5-star and is officially awarded by China National Tourism Administration.

*Hotel type:* Each respondent was asked to choose his/her most preferred hotel type to work, from “full-service hotel”, “limited-service hotel”, and “others, such as resort, suite, etc.”

To answer research questions 1, 2, and 3, the data were analyzed with descriptive statistics. Because all data regarding the proposed hypotheses were categorical, our statistical choices were limited. Therefore, to answer research question 4,  $\chi^2$ -tests were applied to test the proposed hypotheses. Due to the fact that all independent and dependent variables in the hypotheses were categorical, a correlation matrix would not be informative, and consequently is not provided.

## 4. Results

### 4.1. Descriptive statistics

The sample's characteristics are summarized in Table 1. Among the 182 GMs, 49.5% indicated that if they could choose an operating model for their hotels, they would prefer to buy a franchise and to manage it themselves. Only 24.2% and 26.4% of the respondents chose independent operation and management contract, respectively. In terms of the respondents' favorite hotel type to operate, full-service was supported most (44.0%), followed by limited-service (35.2%), and then others, including resort and suites (20.8%).

Eight international and two domestic hotel chains were named by the respondents as the favorite franchisors (See Table 2). InterContinental, the parent company of Holiday Inn, was chosen by 94.8% of the respondents, of which 30.8% picked it as their favorite franchisor. Jin Jiang,

Table 1  
Characteristics of respondents

Variables	Respondents (%)
Gender	
Male	61.5
Female	38.5
Age	
Younger than 40	44.0
40 and older	56.0
Quality level	
5 star or equivalent	4.4
4 star or equivalent	18.7
3 star or equivalent	52.7
2 star or equivalent	18.7
1 star or less	5.5
Work experience in the hospitality industry	
Less than 10 years	56.0
10 years and above	44.0
Educational background	
Did not receive bachelor's degree	39.6
Bachelor's degree and above	65.5

Note:  $N = 182$ .

Table 2  
Respondents' favorite franchisors

	Favorite franchisor	One of the favorite franchisors
	Frequency (%)	Frequency (%)
InterContinental	56 (30.8)	165 (90.7)
Jin Jiang	48 (26.4)	95 (52.2)
Marriott	30 (16.5)	88 (48.4)
Hilton	24 (13.2)	90 (49.5)
Capital Hotels	12 (6.6)	65 (35.7)
Starwood	4 (2.2)	68 (37.4)
Best Western	4 (2.2)	8 (4.4)
Hyatt	2 (1.1)	9 (4.9)
Cendant	2 (1.1)	60 (33.0)
Accor	0 (0.0)	13 (7.1)
Total	182 (100.0)	–

Note:  $N = 182$ . All respondents chose more than one favored brand.

China's largest domestic hotel chain, gained over half of respondents' support (52.2%), and was selected by 26.4% as their first pick. Hilton and Marriott achieved similar overall brand awareness among the respondents (49.5% and 48.4%, respectively). Starwood (37.4%), Cendant (33.0%), and another domestic China firm, Capital Hotels (35.7%) were also considerably desirable, while Hyatt, Accor, and Best Western were only occasionally mentioned.

The ranks of the respondents' concerns in choosing a franchisor are shown in Table 3. Franchise fee, brand name, and return on investment were the top three concerns. On the other hand, length of term and operational requirements were less serious concerns expressed by the GMs.

Table 3  
Most important concern in choosing a franchisor

Variable	Mean	Std. Dev.
Franchise fee	2.30	1.140
Brand name	2.41	1.085
Return on investment	2.49	1.377
Operational requirements	3.68	1.255
Length of the franchise term	4.00	1.274

Note:  $N = 182$ , 1 = most important concern, 5 = least important concern.

Table 4  
Most recognized benefits of franchising

Variables	Mean	Std. Dev.
Reservation system	4.42	.746
Brand name	4.33	.746
Operating system	3.84	.969
Marketing and promotion support	3.70	1.016
Support in opening a hotel	3.53	.821

Note:  $N = 182$ , 1 = not valuable, 5 = extremely valuable.

Table 4 represents the most recognized benefits of buying a hotel franchise. Reservation system was the most attractive factor according to respondents, among whom 57.1% agreed that it is extremely important. Brand name also received strong emphasis as 49.5% of the respondents considered it to be extremely important. Comparably, the importance of operating system, marketing and promotion support, and support in opening a hotel were less valued.

#### 4.2. Hypotheses testing

Hypothesis 1a is supported by the data. Respondents' education level has a significant effect on preference regarding hotel operating model ( $\chi^2 = 19.956$ ,  $p < 0.05$ ). Among the GMs who do not have a bachelor's degree, 61.6% prefer non-franchising operations, whereas 59.3% of the college graduates favor franchising as the operating model.

Hypothesis 1b is marginally supported. The GMs' preference regarding whether to purchase a franchise is marginally affected by their tenure in the hotel industry ( $\chi^2 = 3.366$ ,  $p < 0.10$ ). More respondents with fewer than 10 years hotel experience prefer franchising (56.9%), while more respondents who have worked over 10 years in the industry prefer management contract and independent operation (62.5%).

Hypothesis 2a is not supported. The GMs' preferred franchise brands are not significantly affected by their education levels ( $\chi^2 = 7.614$ ,  $p > 0.10$ ).

Hypothesis 2b is marginally supported. Respondents' tenure in the industry has a marginally significant effect on their favorite franchise brands ( $\chi^2 = 14.791$ ,  $p < 0.10$ ). Among the respondents with fewer than 10 years hotel

experience, 37.2% would prefer to purchase a Holiday Inn franchise while only 15.6% would choose Jin Jiang as their favorite franchise brand. Comparably, 40.0% of the GMs with more than 10 years hotel experience would select Jin Jiang, while only 22.5% list Holiday Inn as their first franchise choice.

Hypothesis 3 is supported by the data. Respondents' preference regarding hotel operating model is affected by their current hotels' quality level ( $\chi^2 = 15.838$ ,  $p < 0.05$ ). 62.5%, 41.1%, and 50.0% of GMs of 3-, 2-, and 1-star hotels, respectively, would prefer to purchase a franchise and operate the hotel themselves, while only 23.5% of 4-star hotel managers and none of the 5-star hotel general managers would like to do so.

Hypothesis 4 is supported. A hotel's quality level significantly affects its GM's preference regarding favorite franchise brand ( $\chi^2 = 67.274$ ,  $p < 0.01$ ). Marriott (60.0%) is the favorite, followed by Hilton (20.0%) and Starwood (20.0%) among the 5-star hotels' GMs, while Holiday Inn is most desirable brand according to the GMs of 4-star hotels (64.7%). For the operators of 3-star hotels, domestic brand Jin Jiang is most favored (39.6%), followed by Holiday Inn (22.9%), Hilton (16.7%), and Marriott (12.5%). A total of 38.1% of the 2- and 1-star hotels' GMs would like to purchase a Holiday Inn franchise, and Jin Jiang is also a favored brand (19.0%).

Hypothesis 5 is also supported. The GMs' preference regarding the hotel operating model is affected by their preferred hotel type ( $\chi^2 = 20.681$ ,  $p < 0.01$ ). A total of 78.1% of the GMs who would prefer to operate a limited-service hotel would like to purchase a franchise, while franchising, management contract, and independent operation are almost equally supported by the GMs who would prefer to operate full-service hotels (30.0%, 35.0%, and 35.0%, respectively). Among the GMs who would prefer to operate other types of hotels such as resorts and all-suites, 47.4% would prefer independent operation and 36.8% would choose to purchase a franchise but operate independently.

## 5. Discussion

### 5.1. Franchisor selection

This study makes valuable contributions to the theory and practice of international franchising. Our findings indicate that, while franchisors select franchisees with certain criteria, franchisor-selection criteria are also employed by prospective franchisees. Strategic alliance literature has indicated that not all resources can bring competitive advantage to the partnership; only complementary resources can contribute to the strategic fit of partners in a strategic alliance (Chathoth and Olsen, 2003). According to the resource-based view of the firm, previous research on partnership selection, although not specifically regarding the context of the franchising partnership, has indicated that the more resources a party could bring to a

partnership, the more likely it would be selected as a partner by the other party (Awadzi et al., 1988; Altinay, 2006). The findings of this study have confirmed such a notion. While literature regarding hotel franchising has suggested a number of perceived benefits of a franchise, this study suggests that franchisees do not weigh them equally. From the perspective of a potential franchisee, a strong brand name and a supportive reservation system are regarded as more valuable resources of franchisors than operating systems, marketing and promotion support, and support for hotel openings. In addition, when choosing a franchisor, the potential franchisees have ranked brand name, financial costs such as franchisee fee, and the corresponding return of the franchise as significantly more important issues than operational standards and the length of the franchise term required by the franchisors, which indicates that China's potential franchisees place greater value on profit than on flexibility.

It is important to note that the relative importance of the franchisor-selection criteria should be interpreted taking into consideration of the current characteristics of China's hotel industry. The findings support the previously discussed views that Chinese hotels are desperately in need of globally recognized brand names and effective reservation systems because both have been shown to directly assist hoteliers with the generation of occupied room nights. On the other hand, the lack of concern regarding the franchisor's expertise in terms of operating systems and support for hotel openings may prove a popular, although questionable assumption that China has accumulated an adequate number of qualified domestic managers who have mastered hotel operational skills (e.g., Xiao, 1999). Such confidence in hotel operations may also explain why the management contract model has become less attractive in China than it was 20 years ago. As competition exceeds operational standards to become the major concern of the industry, branded hotels show competitive advantage over independent ones because they not only have well-known brand names but also have centralized reservation systems that have the ability to generate guests from all over the world (Pine et al., 2000; Xiao, 1999). Therefore, while the management contract model is a less valuable one and independent operation may not be competitive, franchising becomes a reasonable alternative.

In addition, while this study clearly indicates the complementary resources that are currently most valued by potential Chinese franchisees, literature suggests that the strategic alliance is a learning process in which both partners continuously learn from each other, reevaluate each other, and readjust themselves (Doz, 1996). Therefore, another possible explanation to the relatively low value or concern given to the operational standards and flexibility might be that franchising is still in its infant stage in China's hotel industry, and consequently, many benefits and limitations of franchising have not been fully realized by Chinese hoteliers. The scope of this study does not enable us to investigate the evolving process of the

franchise partnership. However, it is reasonable to expect that, as franchising becomes more widely adopted by Chinese hoteliers, and additional cases of success and failure emerge, more resources of the franchisors (such as the operating standards and expertise in opening new hotels) will be increasingly appreciated by the future franchisees. In the meantime, with more experience in franchising, more future franchisees may also realize the franchise-related limitations and tradeoffs, such as the lack of flexibility in hotel operations, and consequently increase their concerns regarding the relevant franchise terms.

### 5.2. *Franchisor and brand preference*

This study also provides specific information regarding the franchisors and brands currently favored by potential Chinese franchisees. There are apparently four tiers regarding franchisor and brand preference. First, it is not surprising that InterContinental, the parent company of Holiday Inn, which is the earliest and most prevalent international hotel brand in China, is the favorite franchisor when potential franchisees consider purchase a franchise. The "second tier" consists of Marriott, Hilton, and Jin Jiang. Interestingly, although two global brands, Marriott and Hilton, have overall equally strong brand awareness as does the domestic hotel chain—Jin Jiang, Jin Jiang is more attractive to prospective Chinese franchisees than the other two in terms of franchise selection. One of the reasons may be that Jin Jiang is well known as a multi-tier hotel chain that has properties ranging from 2-star to 5-star, while Marriott and Hilton are mostly categorized into the luxury segment in China. Thus, the potential franchisees who would like to invest in mid-scale or limited-service hotels may not consider Marriott and Hilton as suitable franchisors. Less mentioned hotel franchisors, including Cendant, Starwood, and another domestic company, Capital Hotels, constitute a "third tier." These brands possess considerable awareness in China, but are not at the top of the list according to hotel GMs. "Fourth tier" brands, such as Best Western, Hyatt, and Accor, are only occasionally named, which suggests that China's potential franchisees are not very familiar with them. Overall, the findings suggest that hotel chains that have established their brand names by previously managing hotels in the China market are more favorable than the new players to China.

### 5.3. *Factors affecting franchising preference*

This study further reveals that educational background, industry tenure, current hotel's quality level, and preferred hotel type in which to work may influence a potential hotel franchisee's preferences regarding franchising in various ways.

While educational background was found to have no significant effect on the favorite franchise brands, it does affect the hotel operators' preferred operating model.

Although it is not easy to explain why more highly educated hotel GMs prefer franchising while less-educated ones tend to favor traditional non-franchised operations, one possible reason is that franchising is a fairly new and complex business format in China, and consequently the hotel GMs with higher levels of education may have more knowledge about franchising and feel more comfortable dealing with the complexities of franchising. Moreover, highly educated hotel GMs may also be more confident in their abilities to manage hotels than less-educated ones. Therefore, it is important for hotel chains desiring to expand their franchise operations in a relatively new market, such as China, to first improve the target market's understanding regarding franchising. This conclusion is consistent with the literature indicating that franchisors should continuously "educate" the prospective franchisees (e.g., Altinay and Wang, 2006). As domestic hotel operators become more knowledgeable regarding franchising, we can expect more industry practitioners to favor the expansion of franchising in China.

Industry tenure remains a question mark regarding its effect on China's hotel GMs' preference regarding franchising. Although it is implied that GMs with fewer than 10 years of hotel employment experience tend to favor franchising as the operating model and are more likely to choose an international brand with which to franchise, the magnitudes of the statistics are not strong enough to draw conclusions regarding such relationships. While one could argue that GMs with more experience prefer franchising because they are more confident in their operating skills and consequently would rather save the "rent" (i.e., management fee), more research is needed to further explore the effect of industry tenure on franchising preference.

Although industry tenure as part of people's work experience was not found to indicate the GMs' franchising preferences, on the other hand, the level of work experience may have been revealed through the quality level of the operators' current hotels. It is recognized that the management contract model is the most effective operating model to maintain quality and consistency and therefore is most preferred by luxury hotel chains. Such notion is therefore reflected by the perspectives of China's hotel operators of luxury hotels. While most operators of the lower quality hotels (i.e., 3-, 2-, and 1-star) tend to favor franchising as the operating model, very few GMs of 4- and 5-star hotels indicated they would like to acquire a franchise. Similarly, when considering the preferred brands with which to franchise, the operators of the higher quality hotels would more likely consider Marriott, Hilton, and Starwood, while Holiday Inn and Jin Jiang are most favored by the operators of lower quality hotels.

In addition, it has been suggested that hotel quality plays an important role in the GMs' franchising preferences. Specifically, limited-service hotels might represent the biggest market for selling franchises. This finding is supported by the recent success of limited-service brands,

such as Jin Jiang Inn and Super 8, both of which sold a relative large number of franchises in a short period of time (Fen, 2003; Super 8 China, 2006). Taking into consideration the fast growth of the limited-service segment in China, the future of franchising in China appears to be promising.

## 6. Conclusions and limitations

To our knowledge, this research is the first quantitative study focusing on potential international franchisees' perspective regarding the concept of franchising, particularly regarding their perceived franchisor-selection criteria. This study extends the literature regarding strategic alliance and international franchising by revealing that franchise partnership is a result of a two-way selection process between franchisors and franchisees. For a successful long-term strategic franchise partnership, the perspectives and expectations of the franchisee may be equally as important as those of the franchisor. Although franchisors and franchisees may employ different selection criteria, the ultimate goal of both parties usually is to identify the most suitable partner and to achieve the best strategic fit between each other. Particularly, from a potential franchisee's perspective, this study has revealed that China's hotel market is prepared to apply the franchising business format. China's prospective franchisees have shown considerable knowledge and interest in franchising, and such knowledge and interest in franchising may be affected by their educational background, industry experience (i.e., tenure and quality of hotels), and preferred hotel types of the prospective franchisees. Specifically, this study indicates that the more highly educated hoteliers and those operating 1-, 2-, and 3-star hotels are most likely to become future franchisees. Moreover, international hotel brands, such as Marriott, Hilton, and Holiday Inn, are the favorite upscale hotel brands, while domestic Chinese brands, including Jin Jiang, are the most attractive mid-scale hotel brands in China. Furthermore, this study contributes to the literature regarding strategic alliance by identifying the currently most valuable complementary resources of potential Chinese franchisees. The global hotel firms that have succeeded in managing Chinese hotels and have built their brand images in China should have significant competitive advantage in selling franchises. In particular, a franchisor that has a strong brand name and a supportive centralized reservation system, and offers a relatively high return on investment at a relatively low franchise fee will be most attractive to potential Chinese franchisees.

As an early study regarding hotel franchising in China, several important limitations should be noted. As literature has suggested, partner-selection criteria can be affected by various factors, such as the context of the franchisor and the characteristics of the target country market, and consequently should be determined on a contingency basis (e.g., Gerringer, 1991; Altinay, 2006). Therefore, the

specific franchisor-selection criteria indicated in this study should only apply to China's hotel industry but not to be generalized to other industries or to other countries. A future study comparing the franchisee-selection criteria across different countries may shed further light on this topic. In addition, as previously indicated, the sample of this study only consists of China's state-owned hotels' GMs, while many other stakeholders, such as investors, lenders, and hotel guests are all critical to the development of a franchise market (Pine et al., 2000; Rushmore and Baum, 2001). Moreover, although state-owned hotels are the majority of China's hotel supply, independent properties with other ownership types, such as privately owned hotels, are also potential franchisee candidates. Therefore, the results of this study should be applied with caution. The investors and other types of hotel owners may have different perspectives regarding hotel franchising than the GMs examined in this study. A future study analyzing the major concerns of investors and other types of owners, and then combining the results with this study's findings, could provide a more accurate and complete picture reflecting the perceptions of China's hotel industry regarding the concept of franchising.

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