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Abstract

In the last 25 years, many U.S. food franchisors have ventured into foreign markets, commonly with local partners as master franchisees. Many international master franchising contracts include development commitments that specify a number of outlets that the franchisees must develop in exchange for exclusive rights to an assigned market (often, their entire nation). Based on a sample of 142 ventures of 53 U.S. food franchisors in 37 countries, the inescapable conclusion is that the development commitments in most master franchise agreements are excessively large relative to the number of units actually built by the master franchisee.

Keywords

restaurant, food franchisors, international markets, development commitments

Disciplines

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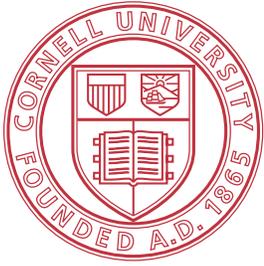
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☆☆☆☆☆ *Biting Off More than They Can Chew:*

Unfilled Development Commitments in International Master Franchising Ventures



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by Arturs Kalnins, Ph.D.

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BITING OFF MORE THAN THEY CAN CHEW:

UNFULFILLED DEVELOPMENT COMMITMENTS IN INTERNATIONAL MASTER FRANCHISING VENTURES

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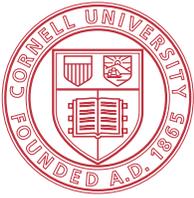
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T H E C E N T E R F O R H O S P I T A L I T Y R E S E A R C H . O R G

Biting Off More than They Can Chew:

Unfulfilled Development Commitments in International Master Franchising Ventures

by Arturs Kalnins, Ph.D.

IN THE LAST 25 YEARS, many U.S. food franchisors have ventured into foreign markets, commonly with local partners as master franchisees. Many international master franchising contracts include development commitments that specify a number of outlets that the franchisees must develop in exchange for exclusive rights to an assigned market (often, their entire nation).

Based on a sample of 142 ventures of 53 U.S. food franchisors in 37 countries, the inescapable conclusion is that the development commitments in most master franchise agreements are excessively large relative to the number of units actually built by the master franchisee.

Specifically, a regression analysis found the following:

- Ventures with larger development commitments have a lower probability of survival than those with smaller commitments.

- With a development commitment size at the 25th percentile of those in the data (\$8.2 million), the probability of a venture's survival is 49 percent. The probability goes down to 33 percent with a larger development commitment at the 75th percentile (\$40 million).

Surprisingly, factors other than development commitment size, such as the experience level of franchisors and franchisees, did not significantly affect survival rates.

About the Author



Arturs Kalnins, Ph.D., is an associate professor at the Cornell University School of Hotel Administration (atk23@cornell.edu). His research has focused on hospitality, franchising, and small business strategy with an emphasis on geographical issues. Specific projects include analysis of impact, agglomeration and immigrant-entrepreneur business groups in the lodging industry, franchisee selection and intrabrand competition within fast food chains, and (in this report) development commitments in master franchising ventures. His has been published in such journals as *Management Science*, *Marketing Science*, *RAND Journal of Economics*, *Strategic Management Journal*, *Academy of Management Journal*, *Journal of Economics and Management Strategy*, and the *Journal of Law, Economics, and Organization*.

Other key findings include:

- Of the 142 ventures in the sample, only 55 (39%) survived until the end of the development commitment periods, typically five years.
- The median development-commitment size is 34 units, or \$19.2 million when normalized across chains by average investment per unit for each franchisor's brand.
- Development commitments are usually not fulfilled or enforced. Master franchisees operated a median of only three units at the end of the development-commitment period in the 55 surviving ventures. That figure is less than 10 percent of the median commitment size of 34 units. Additionally, the franchisees completely fulfilled the development commitment in only six (11%) of the surviving ventures.

As a consequence, franchisors and franchisees should realize that aggressively large development commitments do not yield larger or more successful ventures. They do not help franchisors develop foreign markets. Further, excessive development commitments are not without cost. Large commitments generate unrealistic expectations and a misallocation of resources that lower venture survival rates.

Rather than overcommit resources, a better approach would be for franchisors to set modest initial development commitments—not exceeding a total required investment of \$10 million. This number allows the franchisees to allocate resources appropriately without overdeveloping. If they fulfill this initial commitment, they can renegotiate a larger commitment with the franchisor in exchange for a larger geographic territory.

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IN THE LAST 25 YEARS, many U.S.-based food franchisors have expanded into international markets, typically signing master franchise agreements with local partners. Many of those international master franchising contracts include development commitments, also referred to as

“development schedules.” These clauses specify the number of outlets that master franchisees must develop in exchange for exclusive rights to an assigned market (typically, their entire home nation). Using a sample of 142 ventures of 53 U.S. food franchisors in 37 countries, this report, based on an article appearing in

the *Journal of Economics and Management Strategy*, is the first to present systematic information about international master franchising ventures.¹

¹ See: Arturs Kalnins, “Overestimation and Venture Survival: An Empirical Analysis of Development Commitments in International Master Franchising Ventures,” *Journal of Economics and Management Strategy*, Vol. 14, No. 4 (Winter 2005), pp. 933–953.

I collected the 142 international restaurant master franchising contract announcements from press releases, newspaper articles, and trade journal articles in the Dow Jones News Retrieval and the ASAP General Business File databases. These announcements, made between 1982 and 1999, all stated specific development commitments. I included only announcements where the end of the development commitment period was no later than 2004, so that I could assess whether the venture had fulfilled its stated commitment. I excluded from the dataset 28 announcements that did not list a specific development commitment and also those where the franchising contract had not yet actually been signed. The franchisors found in the sample include large firms experienced in international expansion, such as Arby's, Burger King, Domino's Pizza, Popeye's, and Wendy's, along with small franchisors, such as Higby's Yogurt and Taco Time.

The data collection and analysis described here add substantially to our knowledge about international restaurant master franchising ventures. Despite their ubiquity, little systematic information exists about these ventures and their development commitments. Previous studies found that master franchising is the most common entry mode for U.S. franchisors in foreign markets. In a survey of 35 food franchisors, master franchising was used for 227 of 333 (68%) foreign market entries. Of these 227, 164 allowed the master franchisee to sub-franchise to others. The remaining 63 were area development agreements in which the master franchisees agreed to develop all units themselves.² In another survey, 50 percent of 152 franchisors used sub-franchising contracts internationally compared to only 15 percent domestically.³

² Dixie Zietlow and Jean-Francois Hennart, "The International Distribution of Franchises by U.S. Franchisors," Working Paper 96-102, University of Illinois Center for International Business Education (1996).

³ Bruce Walker, "A Comparison of International vs. Domestic Expansion by U.S. Franchise Systems," International Franchise Association, Washington, D.C. (1989).

Based on the sample collected for this study, I have learned that most master franchisees are native to the territory assigned them. In 122 of the 142 ventures, franchisors contracted with native franchisees. Of the 20 master franchises that did not involve local citizens, 12 were based in the United States. Among the remaining eight, Israeli franchisees operated ventures in the Netherlands and the Philippines, a Canadian franchisee operated in Poland, and a Cypriot franchisee in Saudi Arabia. Ten franchisees had previous experience with a different U.S. franchisor in their native country, and four had signed with the same franchisor but in a different country.

Despite the apparently popularity of master franchises, the survival rate for the international master franchising ventures that I studied was low. Only 55 of the 142 ventures (39%)

Despite the popularity of master franchises, the survival rate for international restaurant master franchising ventures is low.

survived until the end of their development commitment periods. In 66 of the 87 ventures that did not survive, franchisees built units and then shut them down. In the remaining 21 failed ventures, the franchisees signed the contract and paid the fees, but never built any units. Even with those failures, the franchisee investments studied here may well be profitable on average. Surviving ventures yielded 806 functioning units representing an approximate total investment of \$285 million. In contrast, the defunct ventures involved at least 407 closed units (worth approximately \$189 million, not including fixed fees). Those figures may well imply a positive net present value for each franchisee *ex ante* at an acceptable discount rate, and a net welfare gain for the host countries.

Development Commitments

Development commitments in international master franchising ventures range from a few units to thousands of them. Practitioner observers suggest that franchisors use large commitments to protect themselves against insufficient development of a market by the master franchisee.⁴ Franchisors are likely to view as optimal a larger number of units than would the franchisees, for at least three reasons. First, franchisors are typically less risk averse (especially since their money is not at risk). Second, franchisors receive royalties from franchisees based on sales rather than profits, causing franchisors to prefer higher sales at the expense of margins. Third, once they understand the

Franchisors have shown a preference for franchisees who agree to large development commitments.

franchise system's operations some franchisees may wish to develop similar, "knock-off" units that do not use the franchisor's brand name. More generally, some franchisees may view the initial exclusive contract and fees as nothing more than an option, a situation that franchisors can mitigate with a development commitment.

Consistent with the desire for full market development, franchisors have shown a preference for franchisees who agree to large development commitments. For example, Subway considered three bids for a Japanese master license and accepted the proposal with the largest commitment.⁵ When Burger King sought an Argentine master franchisee, the franchisor discarded many bids from potential fran-

⁴ See, for example: G. Estes, "Having It Their Way: Burger King Enters Chilean Market," *Latin American Law and Business Report*, Vol. 3, No. 6 (1995).

⁵ R. Chaudhry, "Room to Grow in Japan," *Restaurants & Institutions*, January 9, 1991, p. 108.

chisees unwilling to consider sufficiently large commitments.⁶

Another likely reason that franchisors think big is that the number of units actually built rarely equals the number proposed. This study found that even surviving ventures typically come nowhere near to building the number of units specified by the development commitments. Only six of the 55 ventures still extant at the end of their development periods fulfilled or exceeded the stated commitment size. More telling, among the 87 failed ventures, only five were accompanied by news of lawsuits regarding nonfulfillment of the commitments. These findings suggest that franchisors and franchisees initially overestimate their markets' potential, but that the parties seem willing to renegotiate their contracts.

My study found substantial within-country and within-franchisor variations in commitment size. The commitments for Japan, for example, ranged from 20 units to 2,000 units (\$5 million to \$300 million when normalized across chains by the per-unit cost). Few obvious franchisor or country characteristics, however, explain any of the variation in development-commitment size. Regressions of development-commitment size on several franchisor and country attributes found no franchisor attributes (including age and size) that were even remotely significant in predicting development-commitment size. Among country attributes, only country population had a significant but unsurprising effect on development-commitment size. These independent variables are described in detail below.

Regressions to Explain Venture Survival

Venture survival. Venture survival is a coarse dependent variable, but if a venture does not survive until the end of the development period, its goal clearly has not been fulfilled. To tally the survivors and failures, I used reports of a market exit in the trade journals and the lack of units in operation in the country as

⁶ G. Estes, *op.cit.*

per franchisor websites, annual reports, or press releases as indicators that a venture did not survive.

I analyzed survival with Chamberlain's binary logit model to ensure unbiased estimates in the presence of country and franchisor fixed effects.⁷ The regressions with country and franchisor fixed effects are important because they remove country- and franchisor-level variations in the data from the coefficients of the independent variables. For example, if ventures in a certain large country are particularly unlikely to survive because of the poor local economy, a false relationship between large development commitments and low probability of survival may emerge from a sample that includes observations from this country. The development commitments in this case are large only because the country is large. The low survival rate comes from the poor economy, but a simple regression might nonetheless show a misleading direct relationship between the development commitment size and the low likelihood of survival. Including country fixed effects ensures that international master franchising ventures from each country are compared only to others from the same country when determining the relationship between survival and an independent variable such as the development commitment. The coefficient for the independent variable can be viewed as a weighted average across countries of these many within-country comparisons. Needless to say, only countries with at least two ventures with different outcomes (i.e., at least one survivor and one nonsurvivor) can be included in this particular analysis. The same holds true regarding franchisors in the franchisor fixed effect analyses.

Independent variables. As mentioned above, the main independent variable of interest is the development-commitment size, as negotiated and reported in press releases before the initiation of the venture. Commitment sizes are normalized to U.S. dollars, based on the

investment per unit for each franchisor's brand. The per-unit investment ranged from a low of \$90,000 for sandwich shops such as Subway and Blimpie to \$1.5 million for full-service restaurants such as Chili's and TGI Friday's.

Three important franchisor attributes are included as control variables, those being the size of U.S. operations, the size of international operations, and number of years in business, all measured at the time each contract was signed. The operations variables are also normalized in U.S. dollars. These variables potentially capture effects of a franchisor's reputation, quality, experience, and scale economies. Two additional franchisor characteristics are included: the number of years the franchisor firm operated its brand before taking on franchisees and the investment per unit of the franchisor's brand. These variables were gathered from the *Bond's Franchise Guide* (1985–1999) and the *Nation's Restaurant News* "Top 50 International Chains" issues (1990–1999).

Some regressions include franchisor fixed effects to eliminate the possibility that unobservable static attributes of each franchisor might affect the coefficients of interest. These attributes include the quality of the franchisor's brand, minimum efficient scale requirements for the brand, any tendency of the franchisor to overestimate markets, and any tendency towards opportunism at the franchisees' expense.

The contract announcements frequently offer little information about the franchisee. As a consequence, I could control for only one franchisee characteristic in the regressions, namely, experience. I set this variable to 1 if the franchisee company had previous food-service experience or experience as a franchisee (0, otherwise). About half of the franchisees are large conglomerates, and most of those have a food-service division. In 25 cases, announcements listed nothing more than names of individuals (15 cases) or the term "investors" (10 cases), along with some indication of nationality. These franchisees are treated as inexperienced.

⁷ W. Greene, *Econometric Analysis*, 4th Ed. (Upper Saddle River, NJ: Prentice-Hall, 2000), p. 680.

To control for country-level effects, I used each nation's GDP per capita and population in the year that the contract was signed (collected from the Euromonitor database), and, in some regressions, country fixed effects. I collected other country-level variables more specific to the demand for and supply of fast-food restaurants, but these were highly correlated with GDP. For example, per-capita spending at restaurants (from Investext) was correlated 0.91 with GDP per capita.

Country fixed effects are included to eliminate the possibility that static attributes of each nation (e.g., legal regimes, cultural distance from the United States) are influencing the coefficients of interest. The fixed effects also eliminate any influence of country-specific variations in minimum efficient scale requirements, which could plausibly result in differences in desire for large development commitments.

Regression Results

Results of logit analyses. Exhibit 1 contains the results of four logit regressions where the dependent variable is venture survival. The first column presents a full-sample regression, the second uses a sub-sample with country fixed effects, and the third uses a sub-sample with franchisor fixed effects. The country-fixed-effects

The probability of a venture's survival diminishes as the size of the development commitment increases.

regression uses only 114 observations because seven observations are the sole observation for a country, and 21 observations are from seven countries with only surviving ventures or only non-surviving ventures. The franchisor-fixed-effects regression uses 91 observations because 21 franchisors only have one observation in the sample, and 30 observations are from 11 franchisors with only surviving ventures or only

nonsurviving ventures. As shown in Exhibit 1, the probability of a venture's survival diminishes as the size of the development commitment increases. This result is robust to the inclusion of country or franchisor effects.

To confirm that the statistically significant effect of development commitment size on survival is meaningful, I used the coefficients from the first column of Exhibit 1 to estimate the probabilities of survival for hypothetical ventures. All variables were held at their means except for development commitment size. With a development commitment size at the 25th percentile of those in the data (\$8.2MM), for instance, the probability of survival is 49 percent. With a commitment size at the 50th percentile (\$19.6MM), the probability goes down to 42 percent, and further decreases to 33 percent with a development commitment at the 75th percentile (\$40MM). From those calculations, I conclude that increasing the development commitment size has the economically meaningful effect of diminishing the likelihood that master franchisees are still operating their ventures at the end of the development period.

Robustness tests. I conducted several tests of robustness. First, I investigated the possibility that outliers—that is, ventures unrepresentative of the sample as a whole, with exceptionally large development commitments—are driving the results. The Higby's Yogurt example discussed below falls into this category. The regression with franchisor-specific fixed effects in the third column of Exhibit 1 addresses this issue to some degree. I had to omit five of the six observations with the largest commitments from this regression (Higby's among them), because the associated franchisors only had one contract in the sample. To further evaluate the role of outliers, I estimated regressions without the 12 observations that had commitments greater than \$90 million when normalized. The resulting findings for the equivalent of columns 1 and 2 in Exhibit 1 remained significant. These results suggest that outliers are not the source of the negative relationship between survival and commitment size.

EXHIBIT 1**Logit regressions predicting survival of international master franchising ventures**

Independent Variables	Binary Logit		
	Full Sample	22 Country Fixed Effects	18 Franchisor Fixed Effects
Development Commitment	<i>-.016*</i>	<i>-.019+</i>	<i>-.025+</i>
International Operations	-.073	-.069	
U.S. Operations	.028	.035	
Years in Operation	-.004	.029	
Years before Franchising	-.015	-.054	
Average Investment per Unit	.001	.001	
Experienced Franchisee	.423	.255	.238
Host Country Population	.069		-.003
Host Country GDP Per Capita	-.041		-.002
Year Contract was Signed	.045	.072	.013
Number of Observations	142	114	91
Number of Survivors	55	47	48
Number of Failures	87	67	43
Log Likelihood	-84.4	-37.5	-34.9

Notes: Positive coefficients indicate a greater likelihood of survival. Statistical significance at the 5% level is shown in red type; **statistical significance at the 10% level is shown in red boldface italic**. Significance is based on two-tailed tests.

Second, I replaced the dollar-normalized “development commitment” and “investment in operations” variables with nonnormalized counts of units. Regressions equivalent to those in Exhibit 1 with these nonnormalized variables yield the same levels of significance for the commitment variable with the exception of the franchisor fixed-effects regression. As with the normalized case, the findings remain significant when all observations with development commitments greater than one standard deviation above the mean are dropped.

Third, I estimated regressions with additional variables not shown. These include company-owned and -franchised U.S. operations variables, percentage of U.S. operations company owned, percentage of total operations that are international, growth rate of the franchisor domestically and internationally, and dummies for nonnative franchisees and franchisees that are existing firms or individuals. None of these variables yielded any significant results nor did they change significance levels of the development-commitment variable.

Interpretation of the Results: Living Large

Why are development commitments so large? The analysis presented here leads me to conclude that franchisors clearly demand development commitments that are infeasible in most cases. Yet, based on trade press reports and my

Franchisors frequently demand development commitments that are simply infeasible.

own interviews with the former CEO and with the general counsel of one of the largest U.S. food franchisors, the franchisors view those development commitments seriously. The top managers with whom I spoke showed great surprise when I presented them my findings that the development commitments are rarely fulfilled, even among large, reputable, experienced franchisors. A further dissonant note came in a trade-press article, in which the CEO of a large franchisor stresses that development commitments are taken seriously at his company but that occasionally he allows development shortfalls of up to 30 percent from the commitment due to economic downturns. That assertion does not seem to square with the finding presented here that surviving ventures typically fulfill only 10 percent to 20 percent of the development commitments. That finding is not consistent with a small accommodation due to economic shortfalls.⁸

The analysis raises the following question: Why do so many franchisors insist on development commitments that are far too large? First, all franchisors will estimate imperfectly, even those that expend great effort to achieve accuracy. Some will overestimate the potential of

⁸ Both the former CEO and general counsel with whom I spoke in November 2004 wished that their names and company identity not be used in this report. The archival interview comes from: R. Martin, "Futures Shock," *Nation's Restaurant News*, Sept. 14, 1998, p. 1.

new markets, while others will underestimate market potential. The overestimating franchisors are likely to insist on development commitments that are too large because of their desire for a high level of market development.

Second, franchisors may insist on large development commitments because they are subject to decision-making biases and, again, desire full market development. A firm's level of confidence in a new venture is likely to be reflected in the development commitment. Confidence may be an unbiased reflection of the franchisor's actual ability, but it may also be systematically unrealistic. The well-accepted findings in the academic psychology, economic, and business literatures that individuals are overconfident in their abilities would, if applied to franchisors, lead to initial overestimation and large development commitments. The magnitude of the difference between the development commitment and the actual number of units built in most of the sample here strongly suggests overconfidence.

Third, franchisors may insist on large development commitments for opportunistic reasons. Forcing an overcommitment by the master franchisee may help ensure that franchise development absorbs all the master franchisee's available resources, thus diminishing the likelihood that the franchisee will build a knock-off chain.

Alternatively, an opportunistic franchisor may wish to fool its franchisees into believing that the market potential is greater than it is. One result of that belief is that the franchisee might be willing to pay larger upfront fees. Moreover, the franchisor may then be able to generate some journalistic hype by announcing a large agreement. That seems to be the case with the long-bankrupt Higby's Yogurt chain.⁹ J Higby's, a small yogurt franchisor from Sacramento, had fewer than 100

⁹ The information regarding Higby's comes primarily from the following two sources: Larry Hicks, "Higby's Two Routes to Recovery," *The Sacramento Bee*, Dec. 25, 1988, p. B1; and Lynn Graebner, "J. Higby's Inc. Moves into a New Era," *The Business Journal-Sacramento*, March 19, 1990, p. 3.

shops in the United States in 1987. However, that did not stop the firm that year from signing an agreement to open 2,000 units in Japan by 1992. The chairman of the firm unabashedly called the deal “the largest single franchise agreement ever signed nationally or internationally.” Even Wall Street approved of the deal, pushing Higby’s stock to a high of \$11.50. Yet the Japanese master franchisee managed to open only 20 units, and quickly shut these down. Higby’s was likely behaving opportunistically and telling the local franchisee whatever it wanted to hear to sign the deal. Higby’s attitude towards its franchisees in Asia reveals this as a possibility. “Any money the company makes in Asia is gravy, given it is the responsibility of the licensees to pay for sites, equipment, and other operating expenses,” the chairman boldly said.

Nonetheless most of the franchisors in this sample are experienced and established, and they likely care about their reputation. For these franchisors, such as Arby’s, Burger King, Domino’s Pizza, and Wendy’s, reputation-ruining opportunism such as that of Higby’s would be far costlier than it is worth in the long run. For these reasons I conclude that sincere managerial overconfidence is the most likely explanation for the franchisors’ insistence on development commitments that are too large.

Regardless of restaurant franchisors’ reasons for insisting on large development commitments in foreign markets, rational franchisees should prefer no development commitment (or a minimal one), because they incur most of the costs related to the venture. Nonetheless, franchisees agree to large commitments, likely due to overconfidence in their own abilities or due to overconfidence in their estimation accuracy. A telling quote comes from a vice president of the large Charoen Pokphand (CP) conglomerate in Thailand.¹⁰ When asked why CP’s quick-service chain, Chester’s, had avoided the fate of many U.S. franchisors and their local fran-

chisees that failed in Thailand, he replied: “We do not expect our fast-food store to become a billionaire overnight.”

Explanations for the Development Commitment-Survival Relationship

A too-large development commitment alone is unlikely to kill off a venture if (1) the commitment can be easily renegotiated or simply ignored and (2) if there are no ongoing effects of biased decision making. If new information indicates that the original commitment size is infeasible, for instance, the master franchisee and the franchisor should be willing to negotiate a smaller commitment to facilitate the venture’s survival. Even if a franchisee has incurred set-up costs due to a large commitment, it should be able to write these off as sunk costs and revert to a cost structure and strategy used by franchisees operating at a smaller scale in the same market. That franchisee should have an equal likelihood of survival as those franchisees that did not initially agree to an overly large development commitment.

Initial overestimates of feasible development-commitment size may mean lower survival rates due to the ongoing effects of biased decision making. In particular, initial estimates such those reflected in a development commit-

One Thai restaurateur warns that too many local licensees of American chains expect instant riches.

ment act as an “anchor,” and any subsequent adjustments will be smaller than optimal.¹¹ For this reason, an initial overestimate may cause the venture’s principals to insist that more of the commitment be fulfilled than is feasible. In particular, managers may misallocate resources

¹⁰Y. Qingchuan and H. Yong, “Thai Fast-food Chain Challenges International Giants.” *Xinhua News Agency*, June 18, 2000.

¹¹A. Tversky and D. Kahneman, “Judgment under Uncertainty: Heuristics,” *Science*, Vol. 185 (1974), pp. 1124-1131.

away from more productive tasks to develop too many new units if the development commitment is too large. Eventually, survival of the venture will be jeopardized. Even as an unenforceable motivational goal, the commitment may act as an anchor that franchisees take into account inappropriately when making resource-allocation decisions.

Implications for Franchisors and Franchisees

The conclusions of this study are straightforward and powerful. At least in an international setting, large development commitments do not help restaurant franchisors fully develop a market, regardless of what the franchisors may

Large development commitments do not help restaurant franchisors fully develop a market.

believe. Large commitments also appear to be ineffective as a possible means of discouraging knock-off units, because they are so rarely fulfilled. Furthermore, a franchisor's principals should not believe that setting the commitments too high is costless, simply because they do not have to enforce those commitments. Large commitments generate unrealistic expectations and a misallocation of resources that decrease the likelihood of a venture's survival.

Even large franchisors that are experienced in large international markets may be subject to managerial biases such as overconfidence and anchor effects. They too need to curb their appetite for large development commitments in

foreign markets, and enter with reasonable size commitments. To maximize the likelihood of venture survival (approximately 50%), I recommend that initial development commitments not exceed an investment of \$10 million. At that level, a chain like Subway or Domino's Pizza could enter with a 50-unit development commitment, while a hamburger chain could reasonably enter with a 20-unit development commitment. Full-service restaurants should initially restrict themselves to five units or less. If the franchisors remain worried about full development, they can initially give their master franchisees exclusivity only in the municipal region where the units are to be built, rather than for the entire country. If the franchisee succeeds in fulfilling the initial commitment, the parties can then negotiate a larger development commitment in exchange for exclusivity in the entire nation.

Finally, while U.S. franchisors can clearly add much knowledge and value to support the efforts of foreign franchisees in their home markets, would-be food-service operators should also consider the option of opening restaurants on their own in their home market. Several potential franchisees have stated that the image of Americana is all they need from the franchisor. If that is in fact all they need, they can create that image themselves without paying for trade dress. For example, TT Resources Bhd., a Malaysian food and beverage concern,¹² successfully developed and operates "Stars Super Sandwiches" and "San Francisco Steak House" restaurants in Malaysia without paying any American firm a nickel. ★★★★★

¹² A. Ganguli, "TTRB Unveils RM50m Expansion Plan," *New Straits Times*, March 7, 2001, p. 2.

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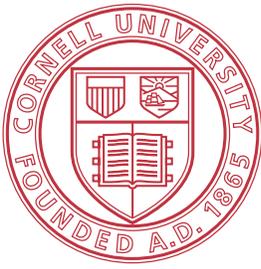
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