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EFFECT OF FINANCING IN BUSINESS FORMAT FRANCHISING ON PERFORMANCE OF SAROVA HOTELS LIMITED

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Abstract: **Organizational performance continues to be a primary concern for players in the hospitality industry considering the current competitive environment that hotels operate in. in as much as it is never clear to what extent a specific strategy adopted by an organization affects its long-term performance, firms still need to consider ways in which they can attain a superior strategic position in the industry. Previous trends within the hospitality industry have indicated major brands pursuing business format franchising as a strategy to attain a strategic position thus enhancing their organizational performance. This study sought to investigate the effect of financing in business format franchising on performance of Sarova hotels limited. The research adopted a descriptive exploratory research design where the focus was Sarova Hotels Limited. This study used primary which was collected using questionnaires that had open ended and closed ended questions. The primary data was gathered from the management staff from three departments across the hotel including operations, accounting and finance and marketing where stratified random sampling was used to come up with the sample size. The collected data was analyzed using quantitative techniques which included descriptive statistics and inferential statistics which were presented in tables, figures and reports. The findings of this study indicated that financing had a positive effect on the performance of Sarova Hotels Ltd. the study recommended that more hotels need to consider pursuing business format franchising strategy as a way of entering new markets**

Keywords: **Financing, Franchising, Organizational Performance.**

1. INTRODUCTION

Organizations are continuously experiencing pressure from their operating environment which is pushing them to pursue strategies that will ensure efficiency and effectiveness of operations as well as accomplishing more with the limited resources available to them, and the same is very evident in hospitality establishments (Alon, 2004). In their effort to pursue these ideal strategies, hotels establish goals and measures which provide guidance towards the chosen path, assist in measuring performance as well as to control the activities carried out by the organization. In the past few decades, franchising has grown to be one of the most popular ways to participate in a variety of businesses (Ramirez- Hurtado, Guerrero-Casas & Rondan-Cataluna, 2011). As well, it has been considered a vital strategy by those firms looking for business expansion (Rajagopal, 2007).

Hotels, like many organizations, operate in very dynamic and competitive environment, and therefore to ensure that it performs as required, it needs to adopt business strategies that will enable them tap on the opportunities presented in the environment (Barney, 2010). Hotels that have already established their brands have had to deal with the heightened competition thus finding ways to manage and improve their performance (Mani 2016). Business format franchising,

especially in the hospitality industry, is used where production and consumption are difficult to separate and thus the establishments must locate their outlets geographically to sell their products or services. (Felício, Couto & Caiado, 2014,; Combs, Michael & Castrogiovanni, 2004).

The adoption of business format franchising as a growth strategy by hotels has been evident within the hospitality industry with many international brands opening branches in the country. Through franchising, financial burdens are eased by securing scarce financial resources, while administrative burdens are augmented by leveraging the administrative expertise of franchisees. Lewandowska (2014) suggests that incentives such as 'a successful business model', 'reputation of the franchisor', 'trademark of the franchisor', and 'a network-wide advertising program of the franchisor' are offered to encourage franchise purchases. Therefore, franchising is regarded as a fast and safe way of entering a market and gaining superior benefits (Aydin & Kacker, 1990).

Business format franchising has been adopted by hotels as a strategy to create a sustainable existence of the firm in the market. This has especially been so for hotels that pursues growth, firm stability and development as well as a robust system for marketing and distribution through a network distribution of independent business relationships (Andrew et al., 2008). The environment that Sarova hotels operate in is characterized by high competition and rapidly evolving customer tastes and preferences. Sarova hotels has managed to maintain their position as market leaders in the industry by providing customers with standardized and consisted quality service in a diversified environment across all their chain establishments. Yet like many establishments both locally and internationally, Sarova Group of Hotels has been bound to pursue business format franchising in an effort to create a competitive advantage against other similar players and align itself strategically to the drastic changes that rock the operating environment.

As defined by Griffin (2006), organizational performance is a company's capability of acquiring and exploiting resources in order to achieve its goals. A firm's performance is measured by the extent to which it meets its goals (Venkatraman and Ramanujam, 2006). A firm's performance is measured by both the firm's competencies and whether the company has achieved its objectives, as per Robbins and Coulter (2002). Similarly, Daft (2000) and Ricardo and Wade (2001) tell us that firm performance is a function of achieving organizational goals and objectives within a given period of time, which equates to efficiency, effectiveness, stability, consistency in behavior, and normative measures. Balanced scorecards can also be used to measure firm performance, which measures the performance of internal business processes, financial results and customer relations (Kaplan and Norton, 2001). In addition to focusing on economic performance, the triple bottom line method measures environmental, social and governance performance (Norman & MacDonald, 2004). Competitive strategies are key factors affecting performance, but other factors, including information systems and other management functions, can also play a role.

Franchises can be defined as business relationships in which a franchisor provides a franchisee with a right to use a trademark of the franchisor in conducting business pursuant to a contract that specifies the terms and conditions of doing business. According to Hoffman & Preble (2004), the franchisor is expected to provide training and guidance in organization, management, and marketing of the franchise. A proven and tested model is used in franchise systems to distribute both products and services. Due to the support structure provided by the franchisor, the franchisee would have a greater opportunity to succeed (Luangsuvimol & Kleiner, 2004).

The components that make up business format franchising include financing, management expertise, marketing and standardization. Capital is a key factor in the hotel industry, requiring considerable financial outlay up front. The franchise system lowers a hotel's risks and investment requirements when it expands. Franchises also permit franchisees to share in the expansion costs with their franchisors, who pay upfront fees, initial fees, and ongoing royalties as costs are incurred. Annon (2007) argues that franchising provides hotel and motel franchisors a more efficient way to expand. As a result, franchisees benefit from brand recognition, economies of scale, marketing benefits, and managerial expertise from franchisors. Franchising is seen as a business model characterized by standardization and consistency, creating a sense of oneness (Terry & Huan, 2012). As characteristic to the franchise model, Terry and Huan (2012) contend that standardization with regards to brand uniformity, quality control and incurred costs, fully link to the characteristic of and criteria for the success and survival of business format franchises in the hotel industry.

The hospitality sector is made up of diverse establishments which are graded in accordance with the star classification system whereby the establishments range from small town hotels to five star town and beach1hotels. The size and decor of hotel rooms, the scope of the services, the quality of food, recreational facilities offered, and the location of the

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hotel play a role in its classification (www.safariweb.com). In the Ministry of Tourism, the Hotels and Restaurants Authority (HRA) is responsible for the classification of hotels and restaurants as well as the supervision of the qualityof their services. In addition to hotels categorized by their natural environment (Ng'ang'a, 2013), hotels may also be classified based on their government-approved status.

The tourism industry has been Kenya's main source of foreign exchange earnings since independence. Kenya and many other developing economies view the growth of tourism as a quick and reliable way to generate foreign exchange receipts, jobs, and economic growth in the short term. Although the evolution and development of Kenya's tourism industry has been positive, a critical evaluation indicates that the industry faces some socio- economic problems and structural deficiencies that limit its utility as a tool for local, regional and national sustainable development (Akama, 1999). Several hotel chains in Kenya are expected to grow their business significantly in 2017- 2021, according to PwC's African Insights Hotel Outlook: 2017-2021 report. In the next five years, Kenya is expected to add 13 new hotels. Consequently, Kenya's hotel capacity will grow by 13 percent as a result of these new properties, which will add 2,400 rooms. From 18,600 in 2016 to 21,000 in 2022, PwC predicts a 2.5% increase in the number of available rooms.

STATEMENT OF THE PROBLEM

Hospitality industry is one of the main contributors of revenue for the country thus characterized by a diverse, dynamic, and complex business environment (Achola 2016).

Consumers of hospitality products and services also enjoy a range of options on where they can source for value considering the increased globalization of business that continues to be experienced in the hospitality industry. Examining the influential factors that affect the performance of hospitality establishments is important since it provides insights on the strategies that hospitality establishments can adopt to enhance their performance. Some of the environmental factors that continue to affect the performance of hospitality establishments with regards to occupancy, market share, revenues and customer satisfaction include safety and security issues, technological advancements, and economic instability (Baena, 2012).

Like many prominent hotels around the world, Sarova Hotels have been forced to pursue strategies that can enable deliver value to the customer through their products and services as well as help them to grow and be sustainable. The chain has preferred to get into business through franchise agreements with the expectation that they will perform better in their activities and incur much less costs and failure risks considering their already well- established brand (Michael and Moore, 1995). Business format franchising is one of the strategies that has been adopted by hotels in their effort to respond strategically to the rapid changes in external business environment and enhance their performance.

2. LITERATURE REVIEW

Theoretical Literature Review

The concept of franchising was advanced by Oxenfeldt and Kelly (1969) for the purpose of allowing firms to access scarce resources, particularly financial and managerial (local decision-making and market knowledge) resources, thus permitting rapid expansion. The management talent and local market knowledge required to grow a franchise is difficult to develop when the company is young and small (Katz & Owen, 1992). When the company is small, raising money for expansion requires access to traditional financial markets (e.g., through public stock offerings). Hence, franchisors attempt to gain access to franchisees' capital and managerial resources when building and managing outlets, even though franchised outlets may yield higher returns (Oxenfeldt & Kelly, 1969).

Oxenfeldt and Kelly (1969) proposed the resource scarcity model, which explains how firms turn to franchising to achieve economies of scale by expanding at a faster rate than would otherwise be possible with resource generated internally. Within the setting, Oxenfeldt & Kelly's suggestion is debatably correct. Businesses experiencing financial problems may turn to franchising as a means to borrow money from franchisees who participate in the enterprise and unload some of the costs that the franchisor would otherwise incur in distributing the product to a large number of consumers. By repeating a tried-and-true strategy in many locations, the franchisor may leverage franchisee investment to reach millions of customers.

When considering this theory from the perspective of the franchisor, it would seem that the franchisee has an endless supply of resources to invest in, which may not always be the case. However, the fact that the franchisor diversifies his business by working with numerous smaller investors is what gives the franchisee a resource base. Obviously, the resource scarcity

argument put out by Oxenfeldt and Kelly does not concentrate on performance based on the business structure franchising but instead makes the unwarranted assumption that franchisees have larger financial resources than the franchisor.

Empirical Literature Review

As Spinelli and Birley (1996) contend, business format franchising promotes business processes by limiting financial constraints to growth. Franchisees in business format franchises are considered a reliable source of expansion capital from a franchisor's perspective by Caves and Murphy (1976). Furthermore, Dant (1995) argues that franchising allows franchisees to overcome informational barriers by providing them with management training, site selection guidance, and pricing information, as well as information about the many aspects of owning a business.

Michael (2000) after examined the restaurant industry in USA on factors that lead to greater bargaining power in a business format franchise agreement, found that access to adequate capital resulted to greater bargaining power and compliance of standards which was necessary for ensuring the goals of the business relationship were achieved. Wu (1998) analyzed the price differential between franchises and independent motels and found that high fee franchises charged more than independently run establishments, thus giving franchises a price advantage. Lafontaine & Shaw (1999) provides evidence on how the key monetary terms in franchising contracts such as royalty rates and fees are adjusted. The findings indicate that little trade-offs exist between royalties and upfront fees paid in a franchise contract

3. RESEARCH METHODOLOGY

The research adopted a descriptive exploratory research design where the focus was Sarova Hotels Limited. This study used primary which was collected using questionnaires that had open ended and closed ended questions. The primary data was gathered from the management staff from three departments across the hotel including operations, accounting and finance and marketing where stratified random sampling was used to come up with the sample size. The collected data was analyzed using quantitative techniques which included descriptive statistics and inferential statistics which were presented in tables, figures and reports.

4. FINDINGS

The descriptive statistics results of financing in business format franchising are presented in Table 1.

Table 1: financing in business format franchising

	N	Mean	Std. Deviatio n
Capital is an important factor in the franchising agreement	88	3.4659	1.33863
There is cost sharing arrangement between the franchises	88	3.1364	1.39936
The supplies for all outlets are sourced centrally	88	3.3068	1.41712
The hotel has generally been able to secure adequate resources to run its operations	88	3.2614	1.30863
The resources and capabilities acquired as a result of franchising match the market needs	88	2.6932	1.41712
Aggregate		**3.17274**	**1.376172**

The findings in the table 1 illustrate that the respondents are in agreement regarding the significance of capital as a factor in the franchising agreement M= 3.4659; SD=1.3386. This suggests that on average, respondents consider capital to be an important factor in franchising. The aggregate mean is close to the individual mean at 3.1727, indicating a consensus among the respondents. Furthermore, the aggregate standard deviation suggests that there is minimal variability with a value of 1.3761. This is in line with the sentiments of Kidwell & Nygaard (2011), who highlighted that franchisees require sufficient capital to not only acquire the franchise license but also to cover initial setup costs, such as leasing or purchasing a suitable location, purchasing equipment and inventory, and conducting necessary renovations or branding activities. This ultimately shows that capital plays a vital role in the overall success and viability of a franchising agreement by providing the necessary resources for sustained operations and growth.

The analysis indicates that the respondents generally agree on the presence of a cost- sharing arrangement between the franchises M=3.1364 and SD=1.3993. This is supported by the fact that the aggregate mean and standard deviation closely align with the individual mean and standard deviation. The small difference between the aggregate and individual values suggests a high level of consensus among the respondents. This implies that there is distribution of financial burdens and resources among the franchises, ultimately promoting efficiency and mutual benefits. This therefore supports the arguments by Michael & Combs (2008) that franchises operating within the same business format can leverage cost sharing to pool their financial resources, enabling them to access economies of scale, negotiate better deals with suppliers, and invest in shared marketing campaigns. By spreading costs across multiple franchises, each individual unit can achieve cost savings, improve profitability, and enhance competitiveness which can lead to improved overall performance across the franchise network.

The respondents' agreement, as indicated by the aggregate mean and standard deviation, suggests that there is a consensus among them regarding the central sourcing of supplies for all outlets M=3.3068 and SD=1.4171. The close proximity between the aggregate mean and the individual mean, along with the similarity in the aggregate standard deviation to the individual standard deviation, indicates that the respondents' opinions are relatively consistent and centered around a common viewpoint. This implies that the majority of the respondents perceive the central sourcing of supplies as a prevailing practice across the outlets. This is linked to several factors including allowing for economies of scale, enabling franchises to benefit from bulk purchasing and negotiating better pricing and terms with suppliers. Also, the aspect of consistency and standardization for franchisees is highlighted as a reason for central sourcing of supplies. Further, this also highlights on the aspect of enabling better inventory management and supply chain coordination, as well as reducing the risk of stockouts, overstocking, and inefficiencies as discussed by Shane et al (2006).

The findings also indicated that the respondents agreed that the hotel had generally been able to secure adequate resources to run its operations (M=3.2614; SD=1.3086), and that the resources and capabilities that have been acquired as a result match the market needs, M=2.6932; SD=1.4171. As established in the previous chapters, franchises require resources such as financial capital, skilled personnel, technology, and marketing expertise to establish and operate their businesses effectively. Furthermore, matching market needs is vital as it ensures that the franchise's offerings are relevant, attractive, and responsive to customer demands and preferences. These findings thus imply that by acquiring resources and capabilities that are aligned with market needs, franchises can better differentiate themselves from competitors, enhance customer loyalty, and ultimately drive long-term profitability and growth (Sorenson &Sorensen, 2001).

Results of Inferential Analysis

Correlation Analysis

Table 2: Correlation Analysis

		Financing	Performance
Financing	Pearson Correlation	1	.985**
	Sig. (2-tailed)		.000
	N	88	88
Performance	Pearson Correlation	.985**	1
	Sig. (2-tailed)	.000	
	N	88	88

The table 2 represents a Pearson correlation matrix, which provides information about the correlation coefficients between different variables. The matrix shows the correlation values and their statistical significance for financing and performance. These findings indicate that higher levels of financing is associated with better performance outcomes.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.805[a]	.647	.630	.49501

The findings in table 3 indicate that R squared is 0.647 which implies that 64.7 % variation in organizational performance in Sarova hotels can be explained by changes in the predictor variable which is financing. The remaining 35.3% change in performance is influenced by other factors not covered in the study. The results further show that organizations performance can be predicted up to 80.5% by the predictor variables under research with a standard error of 0.4950.

Table 4: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0.013	.414		0.032	.000
	Financing	0.172	.149	.190	1.155	.042

Following the illustrated output, the regression model will therefore be represented as follows;

$$Y = 0.013 + 0.172\ (\text{financing})$$

From the table above it can be seen that, Financing (t=1.155, p=0.042) is positively related to organizational performance and statistically significant at 95% confidence level as (0.042<0.05).

5. CONCLUSIONS

The variable of financing is the least impactful factor on organizational performance among the variables mentioned with a t-value of 1.155, indicating a positive relationship with performance. The p-value of 0.042 is slightly above the threshold of 0.05, but it is still considered statistically significant at the 95% confidence level. Although the impact is relatively lower than the other variables, financing still has some influence on performance and implies that securing appropriate financing can support various organizational initiatives and investments, which can, in turn, influence performance outcomes.

6. RECOMMENDATIONS

Considering the heightened competition present in the hospitality sector, understanding the key drivers in a business format franchising strategy are crucial in enabling Sarova Hotels to further enhance their performance. Further in order to establish a competitive position, Sarova Hotels need to embrace the flexibility that is necessary to navigate the changing environment, as well as understand the business drivers needed to achieve high productivity levels in business format franchise setup. For instance, by strictly adhering to standardization, the organization might miss out on the opportunity to serve clients whose tastes and preferences change due to changes in the operating environment.

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