

BUSINESS EXPANSION: A LITERATURE REVIEW ON FRANCHISING AND BRAND LICENSING

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Abstract: This article presents a literature review on business expansion strategies, with a special focus on franchising and brand licensing models. The analysis covers the main theories that underlie corporate expansion, including Agency Theory, Transaction Cost Theory, and the Uppsala Model of internationalization. The objective is to consolidate existing knowledge, identify the advantages and disadvantages of each model, and point out directions for future research. The review demonstrates that, while franchising is a robust strategy for rapid market penetration and geographic growth with limited capital, brand licensing offers a flexible pathway to leverage brand value and intellectual property. The choice of the optimal strategy depends on a complex interaction among company resources, market conditions, and long-term strategic objectives. The research concludes that both strategies are vital for sustainable growth in competitive global markets.

Keywords: business expansion. franchising. brand licensing. growth strategies. internationalization.

Introduction

The search for growth is a fundamental driving force in the business world. Companies of all sizes and sectors continuously seek ways to expand their operations, increase their market share, and ensure long-term sustainability. The strategies to achieve this expansion are varied,

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ranging from organic growth, through the development of new products and penetration into new markets, to inorganic growth, through mergers, acquisitions, and strategic alliances (BARRINGER; GREENING, 1998).

Among the various strategic options, franchising and brand licensing emerge as prominent models that allow expansion with different levels of investment and control. Franchising, in particular, has consolidated itself as a powerful engine of growth, allowing companies to replicate their business models in different locations through independent partners (franchisees) (GILLIS; CASTROGIOVANNI, 2012). This model is based on a contractual relationship where the franchisor grants the right to use its brand and know-how in exchange for fees and royalties, enabling rapid geographic expansion with less need for proprietary capital (COMBS; KETCHEN, 2003).

In parallel, brand licensing represents another strategic pathway for expansion, in which the holder of an intellectual property (the brand) grants third parties the right to use it on products or services for a determined period, upon payment of royalties (CAO; REN; DU, 2022). This strategy allows companies to extend the reach of their brands to new product categories or geographic markets without the need to invest directly in production or distribution (PALFREY, 2011).

This article aims to conduct an in-depth review of the academic literature on these two important expansion strategies. We will analyze the theoretical foundations that underpin franchising and licensing, the contractual and relationship dynamics, and the factors that influence the choice and success of each model. Finally, we will discuss the implications for managers and researchers, consolidating current knowledge and suggesting paths for future investigations in this dynamic and relevant field of strategic management.

Theoretical Foundations of Business Expansion

The decision to expand a business and the choice of the strategy to be adopted are informed by various theories of administration and economics. Understanding these foundations is crucial to

analyze the underlying logics of franchising and brand licensing. In this section, we review three of the most influential theories: Agency Theory, Transaction Cost Theory, and the Resource-Based View.

Agency Theory

Agency Theory, formalized by Jensen and Meckling (1976), analyzes contractual relationships where one party (the principal) delegates work to another (the agent) (JENSEN; MECKLING, 1976). In the context of expansion, the company (principal) delegates the operation of a new unit to a manager or franchisee (agent). The core of the theory lies in the “agency problem”, which arises from two main sources: (1) conflict of interests between principal and agent and (2) information asymmetry, which makes it difficult for the principal to fully monitor the agent’s actions (AGENCY PROBLEM DEFINITION, [s.d.]).

Franchising is frequently analyzed from the perspective of Agency Theory as a solution to mitigate these problems. By transforming a unit manager into a franchisee, who is the residual claimant (holder of residual profit) of their operation, the model aligns incentives. The franchisee, as the business owner, has a strong stimulus to work efficiently and maximize profits, reducing the need for direct monitoring by the franchisor (LAFONTAINE, 1992). Compared to maintaining proprietary units, where managers are salaried and may not have the same level of motivation, franchising can reduce agency costs, especially in geographically distant units that are difficult to supervise (BRICKLEY; DARK, 1987).

Transaction Cost Theory

Transaction Cost Theory (TCT), developed from the works of Coase and popularized by Williamson, focuses on the costs of carrying out economic transactions in the market (ANDERSON;

GATIGNON, 1986). The theory postulates that companies decide to internalize activities (vertical growth) or resort to market contracts (such as franchising and licensing) based on the comparison of transaction costs with internal governance costs. Transaction costs include search and information costs, negotiation and bargaining, and contract monitoring and enforcement.

Under TCT, franchising can be seen as a hybrid form of organization, situated between hierarchy (proprietary units) and the pure market. The decision to franchise instead of owning and directly operating units is influenced by factors such as asset specificity, uncertainty, and the frequency of transactions (ANDERSON; GATIGNON, 1986). When the operation of a unit requires investments in specific assets (local know-how, for example), but not to the point of justifying full vertical integration, a long-term franchise contract may be the most efficient governance structure (HENNART, 2010).

Resource-Based View (RBV)

The Resource-Based View (RBV) argues that a company's competitive advantage derives from its valuable, rare, inimitable, and non-substitutable (VRIN) resources and capabilities. Expansion is seen as a way to explore and leverage these resources in new markets or domains (BARRINGER; GREENING, 1998).

Franchising and licensing are effective strategies from the perspective of the RBV. Franchising allows a company with a successful business model and a strong brand (valuable resources) to expand rapidly without the need to possess all the financial and managerial resources necessary for growth (COMBS; KETCHEN, 2003). The franchisor contributes the brand, the system, and the know-how, while the franchisee provides local capital and market knowledge. Similarly, brand licensing is a direct way to generate revenue from the brand resource, allowing other companies to apply this brand to their own products and distribution channels (PALFREY, 2011).

The Franchising Model as an Expansion Strategy

Franchising represents one of the most popular business expansion strategies, characterized by a contractual partnership between two legally independent parties: the franchisor (holder of the brand and business model) and the franchisee (who invests and operates one or more units of the business) (MELO; ANDREASSI, 2010). This relationship allows the franchisor to expand its market presence rapidly, while the franchisee operates a business with an already established brand and a tested system.

Advantages of Franchising

The literature points out a robust set of advantages that explain the popularity of franchising, primarily from the perspective of the franchisor. The main one is access to capital for growth. The franchisee provides most of the capital needed to open and operate a new unit, allowing the franchisor to expand its network with significantly lower direct investment (COMBS; KETCHEN, 2003). This resolves what is frequently called the “capital scarcity hypothesis” as one of the main drivers of the decision to franchise (CASTROGIOVANNI; COMBS; JUSTIS, 2006).

Another crucial advantage is the speed of market penetration. With franchisees financing the expansion, companies can open a large number of units in a short period, rapidly establishing brand presence and gaining market share before competitors (SHANE, 1996). This rapid expansion is particularly important in industries where the first-mover advantage is significant.

From a managerial standpoint, franchising offers a solution to the agency problem. Franchisees, as owners of their businesses, are more motivated than salaried managers to ensure operational efficiency and unit profitability, as they are the main beneficiaries of the generated profits (LAFONTAINE, 1992). This reduces monitoring costs for the franchisor, a benefit especially relevant for geographically dispersed networks (BRICKLEY; DARK, 1987). Furthermore, franchisees

generally bring valuable local market knowledge, which can help adapt operations and marketing strategies to specific regional conditions.

Challenges and Disadvantages of Franchising

Despite its advantages, the franchising model also presents significant challenges. The most cited disadvantage is the loss of control over operations. Although franchise contracts establish rigorous standards, the franchisor has less direct control over the day-to-day management of a franchised unit compared to a proprietary unit (BRADACH, 1997). Maintaining brand consistency and service quality across the entire network becomes a complex managerial challenge, and inappropriate behavior by a franchisee can have negative repercussions for the entire brand.

The potential for conflicts in the franchisor-franchisee relationship is another inherent disadvantage. Disputes can arise over a variety of issues, including the value of royalty and marketing fees, contract renewal, the imposition of new operational standards, and market cannibalization when new units are opened too close to each other (DANT; KAUFMANN, 2003).

Financially, although franchising reduces the need for initial investment, it also means that the franchisor shares the profits of the operation. Instead of retaining 100 percent of the profits from a successful unit, the franchisor receives only a percentage in the form of royalties. In highly lucrative markets, operating proprietary units can be financially more advantageous in the long run.

| Advantages | Disadvantages |
|--|----------------------------------|
| Access to expansion capital | Loss of operational control |
| Rapid market penetration | Potential for conflicts |
| Reduction of agency costs (motivated managers) | Profit sharing |
| Local market knowledge by franchisee | Risk to brand reputation |
| Lower financial risk for franchisor | Complexity in network management |

Table 1: Summary of advantages and disadvantages of franchising for the franchisor.

Brand Licensing as an Expansion Strategy

Brand licensing is an expansion strategy that involves a contractual agreement by which the owner of a brand (licensor) grants another company (licensee) the right to use that brand on its products or services, in exchange for payments, generally in the form of royalties (CAO; REN; DU, 2022). Unlike franchising, which involves the replication of a complete business model, licensing focuses primarily on the use of intellectual property, such as the brand name, logos, and characters (PALFREY, 2011).

Advantages of Brand Licensing

One of the main advantages of licensing is the ability to extend the brand to new product categories or markets with low or no capital investment by the licensor. The licensed company assumes all production, distribution, and marketing costs of the licensed product (CHASSER; WOLFE, 2010). This allows the licensor to generate a new revenue stream and increase the visibility and reach of the brand without deviating from its core business.

Licensing can also strengthen brand equity. By associating the brand with new quality products, consumer perception of the main brand can be reinforced and expanded. For example, a luxury car brand that licenses its name for watches or leather goods can reinforce its image of sophistication and quality (CHASSER; WOLFE, 2010).

Furthermore, licensing offers a way to enter international markets with reduced risk. Instead of establishing proprietary operations or a franchise network, a company can license its brand to a local partner who already possesses production capacity and market knowledge, overcoming cultural and regulatory barriers more effectively (PAPAGEORGIADIS; ALEXIOU; NELLIS, 2016).

Challenges and Disadvantages of Licensing

The greatest risk in brand licensing is the dilution or damage to the brand image. If the licensed product is of low quality or if the licensed company engages in questionable business practices, the licensor's reputation can be severely harmed (CAO; REN; DU, 2022). The choice of the licensed partner and quality control over the products are, therefore, of critical importance.

Similar to franchising, the licensor has limited control over the activities of the licensee. Control is generally restricted to the use of the brand and product quality, as stipulated in the contract, but does not extend to the general operations of the licensed company. Managing multiple licensing agreements in different product categories and geographic regions can also become administratively complex (TOMAR, 2009).

Another disadvantage is the potential to create a future competitor. The licensee acquires experience in the production and commercialization of a type of product under the licensed brand and, at the end of the contract, may decide to launch its own competing brand, utilizing the acquired knowledge.

| Advantages | Disadvantages |
|--------------------------------------|---|
| Low capital investment | Risk of brand dilution or damage |
| New revenue source (royalties) | Limited control over licensee |
| Increased brand visibility and reach | Risk of poor product quality |
| Strengthening of brand value | Potential to create a future competitor |
| Entry into markets with low risk | Administrative complexity |

Table 2: Summary of advantages and disadvantages of brand licensing for the licensor.

Internationalization Strategies: The Uppsala Model

Expansion into international markets represents one of the most significant forms of corporate growth. The choice of entry mode into a foreign market is a complex strategic decision,

which can range from direct export to foreign direct investment (FDI) with the creation of wholly-owned subsidiaries. Franchising and licensing are contractual entry modes situated at an intermediate point on this spectrum (SCHELLENBERG; HARKER; JAFARI, 2018). The international business literature offers various models to explain how companies expand globally, with the Uppsala Model being one of the most influential.

Developed by Johanson and Vahlne (1977), the Uppsala Model describes internationalization as a gradual and incremental process (JOHANSON; VAHLNE, 1977). The central premise of the model is that a lack of knowledge about foreign markets is the main obstacle to international expansion. Companies tend to overcome this barrier incrementally, starting with markets that are psychologically close (in terms of culture, language, political system, etc.) and with low-commitment entry modes, such as exporting.

As the company acquires more knowledge and experience in the foreign market, it increases its commitment, moving to entry modes that require more resources and involve greater risk, such as the establishment of sales agents, licensing, franchising, and, eventually, direct investment to create production or sales subsidiaries (VAHLNE; JOHANSON, 2017). This process is driven by a learning cycle: market knowledge leads to commitment decisions, which in turn lead to new activities and experiences, generating more knowledge.

Franchising and licensing fit perfectly into this processual model. For a company that already exports to a certain country, the next logical step to increase its commitment may be to find a local partner for a licensing agreement or to become the first franchisee in the country. These strategies allow the company to deepen its market presence without immediately assuming the total risks and costs of direct investment (HILAL; HEMAIS, 2003).

In a later revision of their work, Vahlne and Johanson (2017) updated the model to reflect the reality of a more globalized and connected world, placing greater emphasis on the importance of relationship networks and the concept of “liability of outsidership” rather than “liability of foreignness” (VAHLNE; JOHANSON, 2017). In this more recent view, a company’s position in relevant business

networks is crucial for acquiring knowledge and opportunities, and franchising and licensing are effective ways to build these networks in foreign markets.

Conclusion

This literature review has consolidated academic knowledge on franchising and brand licensing as central strategies for business expansion. The analysis of theoretical foundations — Agency Theory, Transaction Cost Theory, and the Resource-Based View — reveals that the choice between these models is not trivial, but rather a complex strategic decision, influenced by a balance among control, risk, capital investment, and the desire to leverage key resources such as the brand and operational know-how.

Franchising emerges as a powerful strategy for companies seeking rapid growth and broad market penetration with limited capital resources. By aligning the franchisee's incentives with the franchisor's objectives, the model offers an effective solution to the agency problem, promoting motivation and local market knowledge. However, the challenges related to maintaining brand consistency, the loss of operational control, and the potential for conflict require robust management and support systems from the franchisor.

Brand licensing, in turn, presents itself as a flexible and low-investment alternative for the monetization of intellectual property. It allows companies to extend the reach of their brands to new product domains and geographic markets, generating incremental revenue and strengthening brand value. The primary risk lies in the potential dilution of the brand image, making careful partner selection and rigorous quality control imperative for success.

In the context of globalization, both strategies function as important entry modes into international markets, aligning with the incremental logic of the Uppsala Model. They allow companies to reduce the “liability of foreignness” by associating with local partners, facilitating a learning process and gradually increasing commitment to the market.

For future research, further investigation is suggested into the use of hybrid models, where companies combine proprietary, franchised, and licensed units in their expansion strategies. Comparative studies analyzing the financial performance and long-term sustainability of each model in different sectoral and geographic contexts would also be of great value. Finally, digitalization and new technologies are transforming how networks are managed, opening a new field of research on the future of franchising and licensing in the digital age.

In sum, the decision to expand through franchising or licensing must be carefully considered, taking into account strategic objectives, available resources, and the company's risk tolerance. There is no one-size-fits-all solution, and success lies in the company's ability to choose and manage the model that best aligns with its reality and growth ambitions.

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