

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 the models of franchising and brand licensing. The analysis covers the main theories that support business 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 way to leverage brand value and intellectual property. The choice of the optimal strategy depends on a complex interaction between the company's resources, market conditions, and long-term strategic objectives.

Keywords: Business Expansion, Franchising, Brand Licensing, Growth Strategies, Internationalization.

Introduction

The pursuit of 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, ranging

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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 for expansion with different levels of investment and control. Franchising, in particular, has established itself as a powerful engine for growth, enabling 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 equity capital (Combs & Ketchen, 2003).

In parallel, brand licensing represents another strategic avenue for expansion, in which the owner of an intellectual property (the brand) grants third parties the right to use it on products or services for a specified period, in exchange for royalty payments (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 support 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 from management and economics. Understanding these foundations is crucial for



analyzing the underlying logic 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). 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 interest between principal and agent, and (2) information asymmetry, which makes it difficult for the principal to fully monitor the agent’s actions (Eisenhardt, 1989).

Franchising is often analyzed through the lens of Agency Theory as a solution to mitigate these problems. By turning the manager of a unit into a franchisee, who is the residual claimant 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 company-owned units, where managers are salaried and may not have the same level of motivation, franchising can reduce agency costs, especially in geographically distant and difficult-to-supervise units (Brickley & Dark, 1987).

Transaction Cost Theory

Transaction Cost Theory (TCT), developed from the work of Coase and popularized by Williamson, focuses on the costs of conducting economic transactions in the market (Anderson & Gatignon, 1986). The theory posits that firms decide to internalize activities (vertical growth) or resort to market contracts (such as franchising and licensing) based on a comparison of transaction costs



with internal governance costs. Transaction costs include search and information costs, negotiation and bargaining costs, and monitoring and enforcement of contracts.

Under TCT, franchising can be seen as a hybrid form of organization, situated between hierarchy (company-owned units) and the pure market. The decision to franchise rather than own and operate units directly 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 agreement can be the most efficient governance structure (Hennart, 2010).

Resource-Based View (RBV)

The Resource-Based View (RBV) argues that a firm's competitive advantage derives from its valuable, rare, inimitable, and non-substitutable (VRIO) 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 RBV perspective. Franchising allows a company with a successful business model and a strong brand (valuable resources) to expand rapidly without needing to possess all the financial and managerial resources required for growth (Combs & Ketchen, 2003). The franchisor contributes the brand, system, and 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 that 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 (owner of the brand and business model) and the franchisee (who invests in 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 established brand and a tested system.

Advantages of Franchising

The literature points to a robust set of advantages that explain the popularity of franchising, mainly from the franchisor's perspective. 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 a significantly lower direct investment (Combs & Ketchen, 2003). This resolves what is often 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, quickly establishing brand presence and gaining market share before competitors (Shane, 1996). This rapid expansion is particularly important in industries where 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 profits generated (Lafontaine, 1992). This reduces monitoring costs for the franchisor, a benefit that is especially relevant for geographically dispersed networks (Brickley & Dark, 1987). Furthermore, franchisees often bring valuable local market knowledge, which can help adapt operations and marketing strategies to the specific conditions of the region.



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 agreements establish strict standards, the franchisor has less direct control over the day-to-day management of a franchised unit compared to a company-owned one (Bradach, 1997). Maintaining brand consistency and service quality across the entire network becomes a complex managerial challenge, and the inappropriate behavior of one franchisee can have negative repercussions for the entire brand.

The potential for conflict 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 renewals, 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% of the profits from a successful unit, the franchisor receives only a percentage in the form of royalties. In highly profitable markets, operating company-owned units may be more financially advantageous in the long run.

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

Table 1: Summary of the 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 whereby 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, usually 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 from the licensor. The licensee company assumes all costs of production, distribution, and marketing of the licensed product (Chasser & Wolfe, 2010). This allows the licensor to generate a new revenue stream and increase brand visibility and reach 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 its own operations or a franchise network, a company can license its brand to a local partner who already has the production capacity and market knowledge, thus overcoming cultural and regulatory barriers more effectively (Papageorgiadis, Alexiou, & Nellis, 2016).



Challenges and Disadvantages of Licensing

The biggest risk in brand licensing is the dilution of or damage to the brand image. If the licensed product is of low quality or if the licensee engages in questionable business practices, the licensor's brand reputation can be severely harmed (Cao, Ren, & Du, 2022). The choice of the licensing partner and quality control over the products are therefore of critical importance.

Similar to franchising, the licensor has limited control over the licensee's activities. 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 licensee 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 producing and marketing a type of product under the licensed brand and, at the end of the contract, may decide to launch its own competing brand using the knowledge gained.

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

Table 2: Summary of the 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 business growth. The choice of entry mode into a foreign market is a complex strategic decision, which can range from direct exporting to foreign direct investment (FDI) with the creation of wholly-owned subsidiaries. Franchising and licensing are contractual entry modes that are situated at an intermediate point on this spectrum (Schellenberg, Harker, & Jafari, 2018). The literature on international business offers several 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. The central premise of the model is that the 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 establishing 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 procedural 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 full 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” instead of “liability of foreignness”. 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 the 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 between control, risk, capital investment, and the desire to leverage key resources such as 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, 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 equity. The main risk lies in the potential dilution of the brand image, which makes 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 partnering with local entities, facilitating a learning process and gradually increasing commitment to the market.

For future research, it is suggested to investigate more deeply the use of hybrid models, where companies combine company-owned, franchised, and licensed units in their expansion strategies. Comparative studies that analyze the financial performance and long-term sustainability of each model in different sectoral and geographical 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 summary, the decision to expand through franchising or licensing must be carefully considered, taking into account the company’s strategic objectives, available resources, and 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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