

# The Internationalization Path of Brazilian Franchisors

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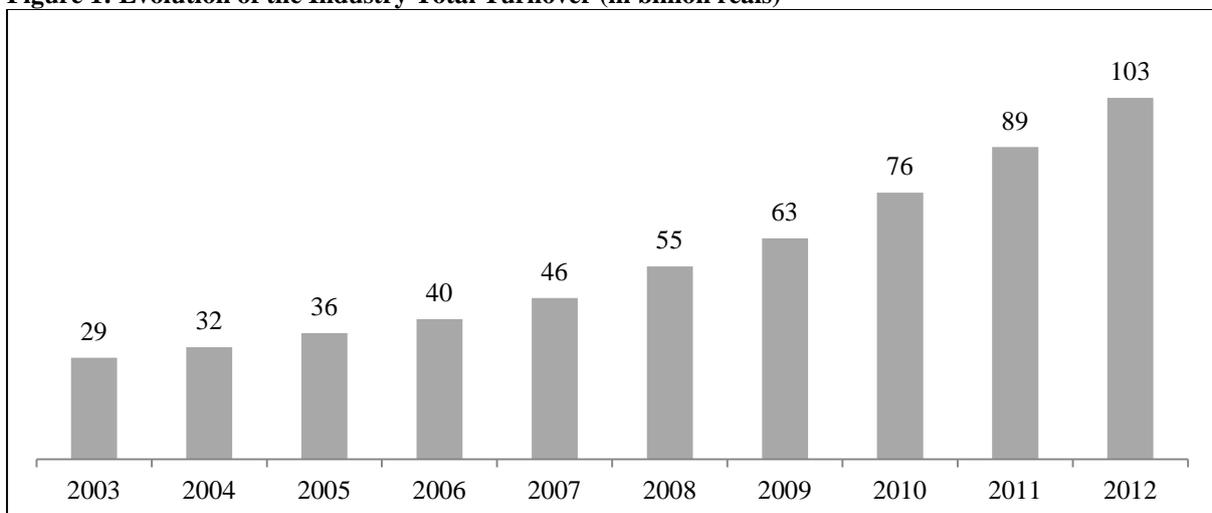
## Abstract

This study aimed at describing the internationalization path of Brazilian franchisors. To achieve this objective we have used secondary data from 106 Brazilian franchise firms that had international operations, complemented by in-depth interviews with executives from the industry. The results showed that Brazilian franchisors have several characteristics in common, although they operate in a number of different industries.

## Introduction

During the period from 2003 to 2012, Brazilian franchises have shown a steadily average growth of 15.2% per year. Their 2012 turnover represents 2.35% of Brazilian GDP: an increase in comparison to 1.71% in 2003. At the same time that Brazilian franchisors grew domestically, they also increased their presence abroad. More than one hundred Brazilian franchisors were operating in foreign markets in 2013. These firms had franchisees in 53 foreign countries and more than 700 units abroad: an average of 3.1 franchise units per country. Due to the importance of this sector for the growth of Brazilian economy and because of the increase of international presence, this study aimed to analyze the internationalization path of Brazilian franchisors. Figure 1 shows the evolution of total industry turnover and Table 1 presents the growth rates of Brazilian franchising from 2004 to 2012.

**Figure 1: Evolution of the Industry Total Turnover (in billion reais)**



Source: ABF ([www.portaldofranchising.com.br](http://www.portaldofranchising.com.br))

**Table 1: Yearly Growth Rates of the Industry**

2004/03	2005/04	2006/05	2007/06	2008/07	2009/08	2010/09	2011/10	2012/11
8.9%	13.2%	11.1%	15.6%	19.5%	14.7%	20.4%	16.9%	16.2%

Source: ABF ([www.portaldofranchising.com.br](http://www.portaldofranchising.com.br))

After a review of the literature on the internationalization of franchising, we investigated the internationalization path of Brazilian franchisors using secondary data available in the internet, in specialized press and publications of the Brazilian franchising association. The understanding of franchising operations abroad was also obtained by means of primary data collected using in-depth interviews. The information from both primary and secondary sources was used to present a portrait of the internationalization path of Brazilian franchisors.

This paper is organized as follows: after this introduction, we summarize the extant literature relevant to the study. Then we present the methodology adopted in the study. In the following section we present and discuss the findings of the study. Finally, we present the conclusions and managerial implications.

## **Literature Review**

In this section we present the main findings in the literature regarding the motivations that drive the choice of franchising as a mode of international expansion, the criteria used to choose the market to install a franchise operation, and the main difficulties encountered by franchisors when expanding abroad.

### **Motivations to internationalize**

When undertaking an international expansion, firms would not always have the financial, or human resources necessary to enter in a large number of international markets simultaneously. In such cases, franchising is an entry mode that may be chosen by the firms [2,4]. This expansion is driven by the firm interest to expand the franchise system [23,24], through the opening of new outlets [17].

Franchising is also an entry mode chosen when firms perceive to have brands that are attractive to franchise partners [11], when they have self confidence in their ability to control foreign franchisees, and when deciding to enter into countries with high political and economic risks [21].

### **Market Selection**

Several factors are suggested in the literature as relevant when deciding the market to enter by means of a franchise system, including economic factors, geographic conditions and cultural variables, among others. Franchisors should consider countries with favorable overall GDP and GDP per capita [1,2,5], with low potential country risks [2], and with lower geographic distance [1,3]. As to cultural aspects, the evidence suggests that novices in international franchising choose countries with similar languages [1] and with similar personal and social values [16].

This analysis is sometimes more segmented and pertinent to firm's activities, in cases where they look for similar customer micro-clusters inside foreign countries [16]. It also may be an specific evaluation of the industry, such as the cases of retailing firms that choose franchising as an entry mode in countries in which retail markets are less developed [1].

### **Franchisee Selection**

Locating good and reliable franchisees is considered the most important task for the

success of an international franchisor [9,10,18,19,25], and essential to the success of the franchise itself [25]. Failure to select the “right” partner could lead to a divergence of goals between franchisors and franchisees [7].

When choosing a franchisee in a foreign country, the franchisors’ selection criteria should include some characteristics that are considered relevant to the success of the foreign venture. The franchisee must have strong managerial capabilities [9], robust financial strength [8,9,10,12], general business experience, formal education and adequate psychological profile [10], specific industry experience [10,12], local knowledge [9,12], and the ability to successfully adapt the franchise concept to suit foreign market needs [9].

Both franchisors and franchisees claim that some factors are important to the success of the partnership: a shared understanding of brand image and of the strategic direction of the business [12], the existence of a right “chemistry” within the relationship [7,10,12,13] and trust, communication and support between the parties [13], the recognition of mutual value, and a compatibility of vision, organizational culture and goals [7].

### **Difficulties encountered**

An expansion using franchise involves the agreement between two parties: the franchisor, who detains the business knowledge and is the owner of the brand, and the franchisee, who contributes with the local knowledge and is responsible to locally implement the franchise system adherent to the brand image.

In the early stages of the expansion there are informational barriers [19], and a lack of international market knowledge and knowledge about franchise operation in foreign markets, which are downsides of the expansion [20]. There is also a need to understand host country policies concerning the transfer and repatriation of dividends, fees, and royalties [14]. In latter stages, marketing and financial barriers became more important [19].

During an international expansion, franchisors face some difficulties related to the control, from distance, of their partner. Although the franchising entry mode demands less resources, this control is still difficult and costly [14]. Franchisors may also face the possibility of discontinuing the franchise operations in a country. This is usually related to lack of motivation of the franchisee [22] or dissatisfaction [15], to differences in objectives and management style between franchisor and franchisee, to the lack of mutual understanding, trust and commitment [25], or due to negative growth rates [6].

### **Methodology**

The study has a descriptive and technical nature. The information from both primary and secondary sources was used to present a portrait of the internationalization path of Brazilian franchisors. Secondary data was collected from several sources including the internet, the specialized press and publications of the Brazilian Franchising Association. As to primary data, it was obtained by means of in-depth interviews with executives responsible for international operations, and transcripts of interviews with franchising executives from other studies by the same authors.

The study identified a total of 102 Brazilian franchises with foreign operations. Although some of the information was available for all the firms, other data were obtained only for part of the population. Therefore, the results of this study cannot be generalized to all Brazilian franchisors with foreign operations but remain indicative of the characteristics and nature of their international operations.

## Results

In this section we present and discuss the results of our investigation. These results show that Brazilian franchisors have several characteristics in common, although there are certain specificities given the fact they operate in different industries.

### Motivation to internationalize

Behind any franchise operation abroad there is usually the understanding that this type of operation allows the company to benefit from the knowledge obtained from local market partners in the target country, as well as resources - financial and human - that the partner brings. Moreover, a possible motivation for internationalization through franchising is exactly the possibility of using a franchise formula already tested and approved. We identified eight motivations to internationalize of Brazilian franchisors, summarized in Table 2.

**Table 2: Motivations to Internationalize**

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- Growth through the expansion of the franchise system
  - CEO's desire to expand abroad
  - Perception that internationalization would add value to firm and brand image
  - Perception of the uniqueness of the offer
  - Perception of the international replicability of the business concept
  - Perception of ownership of a strong brand
  - Potential for cross fertilization and learning
  - Potential improvement of the company's offer
- 

The most common reason seems to be the desire to grow using the franchise system. Of the motivations identified, six can be found in the literature: (1) the CEO's personal desire to internationalize, (2) the perception that the internationalization would add value to firm's and brand's image, (3) the perception that the firm had an unique offer, (4) the perception of the international replicability of the business concept, (5) the possibility of cross-fertilization and learning, and (6) the perception that internationalization would force the firm to improve its offer.

### Market Selection

Brazilian franchisors operated in 53 countries in the world in 2013. These firms had a total of more than 700 units, with an average of 3.1 franchise units per country. As shown in Table 3, the main destination is the U.S., followed by Portuguese-speaking countries and South American countries. The only exception is Spain, which was chosen because it is perceived (together with Portugal) as a gateway to the European market.

With the exception of the United States, whose choice is motivated by the huge market potential and the great use of the franchise system in the country, there is a clear trend towards internationalization guided by the similarity of the language and the perception of cultural closeness, with Portugal being the main destination and Angola the fourth, in addition to a strong presence in Latin countries. Of the 53 countries, 15 have only one Brazilian franchisor operating in the country; these markets are, in general, geographically and psychically distant.

As to the number of countries, the firms with a larger geographic scope of operations had franchises in 20 countries (Table 4). Only six firms had operations in more than 10 countries, and only ten had more than 10% of its franchise units in foreign countries. Most

franchisors operate in only one country.

**Table 3: Number of Brazilian Franchisors per Country**

Country	# of Companies
Portugal	36
United States	36
Paraguay	25
Angola	16
Argentina	15
Chile	14
Spain	14
Mexico	14
Colombia	11

These results agree with the main findings in the literature concerning market selection by franchisors; a country with favorable GDP (i.e., the U.S.) and psychically-close countries (i.e. with the same language, or similar culture) are the main factors that seems to have driven foreign market choice of Brazilian franchisors. Nevertheless, there are some cases of Brazilian franchises that opened foreign franchises because they were approached by potential franchisees. In this opportunistic type of expansion (12), there seems to be no logic in the choice of foreign countries.

**Table 4: Leading Firms by Number of Countries with Franchise Operations**

Firm	# of Countries
Via Uno	20
O Boticário	20
Dumond	15
Carmen Steffens	15
Showcolate	13
Wizard Idiomas	11
CCAA	9
Cantão	9
Localiza Rent a Car	8
Colcci	8
Lilica & Tigor (Marisol)	8

As to the specific criteria used by firms, we found the following criteria being used by some Brazilian franchisors (Table 5):

**Table 5: Criteria used by Some Brazilian Franchisors in Market Selection**

<ul style="list-style-type: none"> <li>• Cultural and language similarities</li> <li>• Market size</li> <li>• Purchasing power of the population</li> <li>• Market potential</li> <li>• Attractive market segments</li> <li>• Geographic proximity</li> <li>• Positive image of Brazil in the foreign market</li> <li>• Interest in starting a franchise operation in a country seen as a gate to other attractive markets</li> <li>• Availability of potential franchisees with the right credentials</li> </ul>
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## Franchisee Selection

Several aspects were found to be considered when selecting a foreign franchisee (Table 5). The three most important aspects considered to select the franchisee are: experience in the industry, knowledge of the local market, availability of financial resources. One factor found in this study does not appear in the literature: the choice of a franchisee with an entrepreneurial profile.

**Table 5: Franchisee Selection Criteria**

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- Financial strength
  - Strong managerial capabilities
  - General business experience
  - Specific industry experience
  - Franchising experience
  - Specific local market knowledge
  - Entrepreneurial profile
  - Shared understanding of the strategic direction of the business
  - Ability to adapt the franchise concept
  - Right “chemistry”, trust
  - Organizational compatibility
- 

## Difficulties encountered

Difficulties encountered during the internationalization process are presented in Table 6. Besides cultural differences, problems with local franchisees are one of the most frequent difficulties encountered in these firms’ international expansion. Three factors were mentioned which were not found in the extant literature as difficulties encountered by franchisors: franchisee failure to achieve the results, currency fluctuation, and increase in social violence in the foreign country.

**Table 6: Difficulties encountered by franchisors**

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- Problems with franchisee
  - Cultural differences
  - Franchisee fail to achieve the results
  - Resources availability to provide enough support
  - Delivery of an inadequate offer to the foreign market
  - Currency fluctuation,
  - Differences in foreign laws,
  - Increase in social violence in the foreign country
- 

## International Presence

Some firms already have a relevant international presence. As shown in Table 7, there are three firms with more than a third of its units in the international market. However, more than 90% of the firms analyzed had less than 10% of its units abroad and the average percentage of foreign units is 7%. Footwear chains and language schools are among the most internationalized franchisors, both in terms of absolute number of stores and of percentage of units in foreign countries.

## Conclusions

This study’s results showed that Brazilian franchisors are still in the initial stages of internationalization, with only ten franchisors (out of 102) with significant international operations. Nevertheless, they share several characteristics, although they operate in different

industries. Their internationalization is usually driven by the desire to grow. The main countries where they established franchises are the U.S. and Portugal, followed by psychologically-close countries (Portuguese-speaking countries and South American countries), suggesting the adoption of a less risk approach to internationalization. Some companies, however, simply explored the opportunities that appeared. In some cases, franchisors have only one operation abroad, probably with the intention to convey value to its brand in the domestic market.

**Table 7: Leading Franchisors by Number and Percentage of Foreign Units**

Firm	# of Units	# of Foreign Units	% Foreign Units
Via Uno	270	82	42%
Dumond	79	28	35%
Sobral	15	5	33%
Igui	571	170	30%
Showcolate	54	14	26%
Fabrica di Chocolate	46	9	20%
Livraria e Papelaria Nobel	184	29	16%
Pastelândia	34	4	12%
Carmen Steffens	284	30	11%
Escolas Fisk	999	105	11%

It is also noteworthy that most of the companies that have a larger number of international units show strong dispersion of these units in many countries. Therefore, they do not take advantage of their presence in a country to leverage economies of scale or to get the benefits of learning about the local culture and the institutional environment. This situation implies a low commitment to specific markets (with a few, but remarkable exceptions). This may be one of the reasons why Brazilian franchisors often complain about the low (or absence of) profitability of their international operations.

Difficulties in foreign markets can easily cause startups to retreat in their internationalization process, or even exit foreign markets. The great danger, particularly with regard to novices, is the lack of a structure capable of supporting the franchisees abroad and lack of international experience of managers in Brazil. A promising aspect is the learning process of franchising companies. Large franchisors made mistakes along their internationalization process, but the knowledge gained from these same errors and the international experience provided more solid advances.

Results must be regarded with caution, given the type of information used in this study. However, the use of several sources of information may have helped to reduce potential biases. More studies are needed to get a better understanding of Brazilian franchising, including studies by type of franchise. This kind of study may identify idiosyncratic characteristics common to some business, which may not be relevant to others.

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