



## **INTERNATIONAL EXPANSION THROUGH FRANCHISING: AN ECONOMIC PERSPECTIVE**

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**Abstract:** International franchising has become a prominent strategy for firms seeking global growth, offering a rapid path to scale with limited capital investment. This article analyzes the key economic drivers that make franchising an attractive mode of international expansion and examines the benefits franchisors reap, such as accelerated growth, risk sharing, and efficiency gains. It also discusses the economic challenges and risks franchises face abroad, including cultural and regulatory hurdles, reduced control, and financial vulnerabilities. Drawing on relevant economic theories – notably resource scarcity and agency theory – and using real-world case studies, the analysis highlights how franchising enables firms to leverage local entrepreneurship while expanding globally. The article is structured in a scholarly format with a review of literature and theory, a discussion of drivers and challenges, case examples, and a conclusion. The findings underscore that while international franchising can deliver significant economic advantages in scaling and market entry, success depends on careful management of risks and alignment of incentives across borders.

**Keywords:** International franchising; economic drivers; resource scarcity theory; agency theory; transaction cost economics; institutional theory; global expansion; capital efficiency; risk sharing; brand recognition; local adaptation; franchisee incentives; cultural challenges; legal frameworks; market entry strategies; McDonald's case; KFC case; emerging markets; globalization of business.

### **Overview**

Franchising has emerged as one of the fastest-growing modes of business expansion worldwide. In a franchising arrangement, an independent local entrepreneur (franchisee) operates a business under the franchisor's brand and business format in exchange for fees or royalties. This model has proven highly effective for international growth: by 2024, nearly 39% of outlets of the top 200 U.S. food franchises were located overseas. Global franchise networks span dozens of countries – for example, the 7-Eleven convenience store chain operates over 85,000 outlets across 19 countries – illustrating the expansive reach achievable through franchising. International franchising allows companies to tap into new markets with comparatively lower investment and risk than establishing wholly owned subsidiaries. It has consequently attracted extensive academic interest from economics, management, and international business scholars. This article examines international franchising from an economic perspective, analyzing the key drivers and benefits that motivate firms to franchise abroad, as well as the economic challenges and risks inherent in this mode of expansion. Relevant economic theories and models – including

resource-based views on capital constraints, agency theory, and transaction cost economics – are reviewed to provide a conceptual foundation. Real-world examples from global franchise brands are used to illustrate how these dynamics play out in practice. The goal is to provide a comprehensive, journal-style analysis suitable for a peer-reviewed economics or international business audience, shedding light on why franchising has become a strategic vehicle for international expansion and what economic factors determine its success or failure in foreign markets.

## Literature Review and Theoretical Framework

**Franchising in Internationalization Theory:** Several theoretical perspectives explain why firms choose franchising as an entry mode. Dunning's OLI paradigm (Ownership-Location-Internalization) traditionally focused on foreign direct investment, but franchising represents an alternative internationalization path where firms leverage Ownership advantages (brand, know-how) and Location advantages via local partners, while opting for a less integrated mode (forgoing full internalization) to reduce capital commitment and risk. Early franchising research introduced the *resource scarcity theory* (also known as resource acquisition theory) which posits that young firms franchise to overcome constraints in financial and human resources. Oxenfeldt and Kelly's seminal work (1969) argued that new ventures often lack sufficient capital and managerial talent to expand quickly on their own; franchising is a strategy to surmount these shortages by tapping into franchisees' resources. Franchisees are effectively an inexpensive source of capital, enabling the franchisor to raise expansion funds at a lower cost than other financing methods. This infusion of franchisee capital and effort allows rapid initial growth, which can be critical for achieving economies of scale in advertising, brand recognition, and preempting competitors in new markets. In the words of Thompson (1994), franchising "combines decentralized ownership of physical assets with centralized brand name ownership and operational know-how," facilitating swift expansion while easing constraints on critical inputs.

Another key lens is *agency theory*, which examines the incentive structure between franchisor (principal) and franchisee (agent). Franchising is partly motivated by the desire to align incentives and reduce the agency costs that arise when company-owned units are run by hired managers. By granting ownership to local operators, franchisors ensure that franchisees have a direct profit motive to maximize sales and maintain quality – franchisees "work for their own profits, while simultaneously contributing to the profits of the parent company". This alignment mitigates the moral hazard of an employed manager who might not exert maximal effort. Agency theory thus predicts franchising will be favored when unit-level monitoring is difficult or costly, since the franchisee's equity stake in the business serves as a self-monitoring mechanism. Empirical research has supported aspects of this view, finding that franchised outlets often outperform company-operated outlets on service quality and sales, attributed to the franchisee's higher motivation and local market knowledge.<sup>1</sup> At the same time, franchisors balance this with the need for control; many systems retain a mix of franchised and corporate units (a "plural form" structure) to safeguard certain key markets or as platforms for experimentation and training within the company network.<sup>2</sup>

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<sup>1</sup> Alon, I. (2020) *A Systematic Review of International Franchising*. [Journal Title]. Available at: <https://www.sciencedirect.com/org/science/article/pii/S1525383X20000249>

<sup>2</sup> Varotto, L. F. and Aureliano-Silva, L. (2017) *Evolution in Franchising: Trends and New Perspectives*. *Revista Eletrônica de Negócios Internacionais (Internext)*, 12(3), pp. 31–42. DOI: 10.18568/1980-4865.12331-42. Available at: <https://www.redalyc.org/journal/5575/557561287003/html/>

Transaction cost economics also offers insight, suggesting that firms choose franchising when the costs of hierarchical control outweigh the costs of contracting with franchisees. If local adaptation is important and local partners possess superior on-the-ground knowledge, contracting via franchising can be efficient despite some loss of control. However, if safeguarding quality and brand reputation is very critical and hard to enforce contractually, firms may prefer ownership to avoid potential free-rider problems by franchisees. Thus, franchising is more likely in industries where standardized formats can be codified and transferred, and where local operation does not require proprietary assets that must remain in-house. **Institutional theory** further suggests that host-country institutional environments (regulatory frameworks, legal protections, cultural norms) influence international franchising. Companies tend to expand via franchising into countries with stable legal systems that protect trademarks and enforce contracts, which reduce the risks of partnering with independent franchisees. In emerging markets with weaker institutions, firms often use master franchising or joint ventures to gain local expertise and share risk. Overall, the decision to franchise abroad is a strategic choice influenced by a combination of resource considerations, incentive alignment, risk sharing, and institutional fitness.

### Key Economic Drivers and Benefits of International Franchising

**Rapid Expansion and Scale Economies:** A primary economic driver for franchising internationally is the ability to achieve rapid expansion with limited corporate capital. Franchising leverages the investment capacity of franchisees, allowing the franchisor to scale up quickly without bearing the full cost of each new unit. This is particularly valuable when timing is crucial – for instance, to establish a global footprint ahead of competitors or to capitalize on a fast-growing foreign market. By multiplying outlets through franchise partnerships, a firm can attain a broader revenue base and global brand presence much faster than via wholly owned growth. McDonald's Corporation is a salient example: it has over 44,000 restaurants in 100+ countries, approximately 95% of which are owned and operated by local franchisees. This massive international network was built on franchising; independent owners supplied the capital and local acumen to open thousands of outlets, while McDonald's provided the brand, product systems, and operational know-how. The result is an unparalleled economies-of-scale advantage – in procurement, marketing, and logistics – enjoyed by the franchise system. Operating on an international scale allows franchise networks to negotiate bulk purchasing deals and spread marketing costs over many markets, lowering unit costs. As one industry source notes, global franchising enables “economies of scale and cost efficiencies” through **centralized buying and standardized operations**, which in turn boost profitability for both franchisor and franchisees. Large franchise systems can undertake expensive national or international advertising campaigns and benefit from worldwide brand recognition, a level of marketing spend that individual business owners could rarely afford on their own.

**Brand Recognition and Credibility:** Entering a foreign market as an unknown company can be costly, requiring heavy marketing to build customer trust. Franchising often involves well-known brands that carry their reputation with them. An established franchise brand can confer instant credibility in a new country, lowering the “liability of foreignness” that a new entrant would normally face. Consumers are more likely to try and trust a product that is backed by a global name with a successful track record. This brand advantage accelerates customer acquisition and revenue generation for new international units. For the franchisee, joining a reputable international brand reduces the market entry risk – they are investing in a concept that has demonstrated success elsewhere, and they benefit from the franchisor's advertising and brand image. From the franchisor's perspective, every new international franchise location further reinforces the brand's global presence and can create network effects (e.g. tourists from one country patronizing the familiar franchise in another country). However, it should be noted that

brand recognition is not universal; in some cases a brand that is famous in its home country may initially be obscure abroad. Still, compared to starting an entirely new brand overseas, franchising an existing brand provides a head-start in marketing terms. For instance, when U.S. fast-food franchises like KFC or Domino's Pizza expand into foreign markets, they often find that prior exposure (via media or travel) has created latent demand for the brand among local consumers, which translates into immediate sales upon launch. This brand-driven demand can make franchising a more economically attractive expansion mode than an unbranded startup venture.

In summary, the economic rationale for international franchising is multifaceted. It offers **financial leverage**, using others' capital to grow; it aligns incentives to improve unit performance; it spreads and reduces risk; it enables exploitation of scale economies across markets; and it harnesses local expertise to maximize revenue in diverse environments. These drivers have made franchising a powerful engine of global growth for industries ranging from fast food and hotels to retail, education, and services. As a 2020 systematic review concludes, franchising is "a model for businesses to achieve scale with limited resources" and a mode of entry that opens new markets with relatively low risk (albeit with reduced control). The next section will consider the flip side: the economic challenges and risks that accompany these benefits when franchises venture abroad.

### **Economic Challenges and Risks in Foreign Markets**

While franchising facilitates international expansion, it is not without significant challenges and risks. These can erode the economic benefits if not properly managed. Some of the key risk factors include:

**Cultural and Market Adaptation Risks:** A franchised concept that succeeds in one country may not automatically translate well to another. Differences in consumer preferences, cultural norms, and habits can undermine the performance of a franchise if the offering is not adapted. An "arrogant, implicit assumption" that what worked at home will work everywhere has led to high-profile failures. For example, Dunkin' Donuts' early expansion assumed universal appeal for its doughnuts-and-coffee menu, but in some cultures the products and breakfast customs differed, resulting in poor sales. If a franchisor or franchisee misjudges local tastes or fails to localize the product, the franchise outlet will struggle to attract customers. Likewise, branding and marketing messages that resonate in one country might backfire in another – as illustrated by Walmart's experience in Japan, where the emphasis on "everyday low prices" clashed with local perceptions equating low price with low quality. For franchise systems, the challenge is to find the right balance between consistency and localization. There is a financial risk in over-standardizing (insensitivity to local needs can mean lost revenue) and also in over-customizing (straying too far from the core concept can increase costs and dilute the brand). Franchisors must invest in cultural research and often rely on the local franchisee's knowledge to navigate these nuances. Failure to do so can lead not only to weak sales but also potential brand damage if consumers perceive the foreign brand as out-of-touch or culturally inappropriate.

**Brand and Reputation Risk:** When expanding internationally, franchisors expose their brand to new environments that they do not fully control. A strong home-country reputation may not carry over – the "goodwill associated with the franchise in the U.S. may be non-existent in another country". In fact, foreign consumers may even have biases against outside brands or prefer local alternatives. This means a franchise could face an uphill battle building its reputation from scratch, requiring significant marketing expenditure by the franchisee and franchisor. Moreover, because franchisees operate the units, there is a risk that a poorly performing or ill-behaving franchisee could harm the brand's image in that market. One franchisee's failure can



draw media attention or customer backlash that affects the entire brand. For instance, inconsistent service or quality at a few franchise locations might lead foreign consumers to generalize that the brand is inferior. This risk is amplified in the age of social media, where negative experiences in one country can quickly become global news. Franchisors attempt to manage this through strict operational standards and training, but enforcement across borders can be challenging. The economic cost of brand damage can be substantial – lost sales not just in the affected market but potentially reputation spillover elsewhere.

**Loss of Control and Agency Problems:** Franchising by its nature means relinquishing a degree of control over day-to-day operations to independent owners. This can give rise to *agency problems* despite the alignment incentives, especially when franchisees pursue cost-cutting or local tactics that conflict with the franchisor's standards. A classic issue is *franchisee free-riding*: a franchisee might under-invest in quality or customer service (for instance, using cheaper ingredients or skimping on cleaning) to boost short-term profits, harming the brand equity that all franchisees share. Such behavior could go unnoticed for some time, particularly in far-flung international markets where the franchisor's field supervision is infrequent or constrained by distance. Monitoring overseas franchisees is costly – it “may require more management resources than the franchisor can spare,” and providing adequate support and quality control across multiple countries is logistically difficult and expensive. If oversight lapses, the uniformity and reliability that consumers expect from a franchise brand may suffer. There is also a strategic control issue: franchise agreements typically last many years, and franchisors might find it hard to enforce changes or new initiatives if franchisees resist. For example, introducing a new technology system or shifting a product strategy worldwide requires buy-in from all franchisees, which may not be forthcoming if local franchisees fear disruption to their established business. This can slow down innovation or adaptation at the system level, potentially putting the franchise network at a competitive disadvantage versus more agile local competitors or company-owned chains.

**Financial and Macroeconomic Risks:** Franchising in foreign markets entails exposure to various financial risks. Currency exchange fluctuations can affect the franchise system's economics – for instance, royalties are often denominated in the franchisor's home currency (e.g., USD), so if a host country's currency depreciates sharply, the royalties effectively become more expensive for the local franchisee and can squeeze their profit margins. The franchisor in turn might see royalty revenues fall or face pressure to make temporary fee concessions during currency crises. International franchisors also often earn lower net revenues per unit internationally than domestically, due to the need to share revenues with master franchisees or local partners and to higher support costs abroad. As noted in one analysis, a franchisor's net income from an overseas franchise can be reduced by additional expenses, profit splits, and tax considerations that do not apply at home. Moreover, host country economic conditions – inflation, interest rates, and overall growth – influence franchise success. A franchise concept that relies on consumers' discretionary income could stall in a country during a recession or under high inflation. For example, many U.S. fast-food franchises in developing countries saw sales decline when those economies hit slowdowns, as consumers cut back on non-essential dining. Political and economic instability poses the extreme risk of franchise outlets shutting down (as was seen when several Western franchises suspended or exited operations in markets facing conflict or sanctions). Hence, franchisors must carefully evaluate macroeconomic indicators like GDP growth, consumer spending power, and political stability when selecting markets. Entry into very volatile economies might promise high growth but comes with the possibility of abrupt contractions or regulatory shifts that jeopardize the business.

### Case Studies and Examples

To concretize the above analysis, this section highlights a few real-world examples of international franchising outcomes:

**McDonald's Global Franchise Network:** McDonald's exemplifies the prototypical success of international franchising. As noted, over 90% of McDonald's restaurants worldwide are franchised. The franchising model allowed McDonald's to establish a presence in over 100 countries, adapting to local markets while retaining core efficiencies. In France, McDonald's franchisees introduced café-style adaptations and localized menu items (such as macarons) to resonate with French dining culture, contributing to France becoming one of McDonald's most profitable markets outside the U.S. In China, McDonald's initially expanded via direct ownership but later sold many stores to franchisees (a master franchise partnership) to accelerate growth; these local owners brought operational insights that helped McDonald's tailor its menu (e.g., offering spicy chicken and localized beverages) and real estate strategy for Chinese cities. The economic results are telling – McDonald's international segments now generate a majority of the company's revenues, and its asset-light franchising strategy has produced high profit margins by earning steady royalties without heavy capital expenditure. However, McDonald's has also faced challenges, such as the aforementioned India dispute,<sup>3</sup> and an exit from Russia in 2022 due to geopolitical risk (where it had to sell the franchised network). These instances underscore that even successful franchisors must navigate political and partner risks carefully.

**KFC and Yum! Brands in Emerging Markets:** KFC (Kentucky Fried Chicken), under parent company Yum! Brands, pursued aggressive franchised expansion in emerging markets, notably China and other parts of Asia. KFC entered China in the 1980s and grew to thousands of outlets, becoming China's largest restaurant chain. Interestingly, KFC's China strategy differed from a pure franchising model: to maintain tighter control and speed, the company initially kept most Chinese outlets company-owned or in joint ventures. Only later did it begin franchising more widely in lower-tier cities. The KFC case shows that franchisors may modulate the degree of franchising based on market conditions – in a market seen as highly strategic, with complex operational demands, KFC chose more ownership (accepting higher capital cost for greater control). Nonetheless, KFC's international success (it now operates in over 140 countries) is heavily reliant on local market adaptation, such as offering congee for breakfast in China or vegetarian options in predominantly Hindu regions. Economically, Yum! Brands benefits from diversifying its earnings: as of the mid-2010s, China alone accounted for a significant portion of KFC's global revenue, insulating the company when U.S. sales stagnated. A challenge KFC encountered in some countries (e.g., Indonesia) was ensuring halal certification and aligning with local dietary laws – a necessary investment to access those large consumer bases. KFC's experience highlights that franchising can deliver market penetration, but companies may need to provide extensive support (supply chain development, marketing adaptation) to franchisees in emerging markets. It also demonstrates the *master franchising* approach: Yum! often grants a territorial franchise to a local conglomerate (as done in many Middle Eastern countries), which then sub-franchises locally. This can accelerate growth but adds another layer of agency relationship (franchisor – master franchisee – sub-franchisee) with its own incentive and monitoring complexities.

**Failed Franchise Expansion – Target Canada:** Not all franchise (or franchise-like) expansions succeed; understanding failure is instructive. Target Corporation's move into Canada, while not a franchise operation (Target owned the stores), is often cited in franchising discussions as a cautionary tale of international expansion gone wrong economically. Target opened over 100

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<sup>3</sup> Muralidharan, V. (2019) *McDonald's settles with former India partner to reopen restaurants in two weeks*. Reuters, 9 May 2019. Available at: <https://www.reuters.com/article/world/mcdonalds-settles-with-former-india-partner-to-reopen-restaurants-in-two-weeks-idUSKCN1SF1NW>

stores rapidly without sufficient local supply chain infrastructure or market research, leading to empty shelves, pricing missteps, and dissatisfied customers. By 2015 Target withdrew from Canada at a loss of over \$2 billion. For franchisors, the Target case underlines the importance of local knowledge and paced growth – advantages that a franchising strategy might have provided by involving local franchise partners. In contrast, some franchise retailers (like 7-Eleven) have entered Canada more gradually and leveraged franchisees' understanding of local preferences, avoiding such pitfalls. While Target's failure was not a franchise venture, franchise systems have had their own failures: e.g., American fast-food franchises in certain countries that closed after a short time due to poor product-market fit (Krispy Kreme's initial failure in Indonesia, or Wendy's exit from Japan in the 2000s before later re-entering) were often due to inadequate localization and strong local competitors. These cases reinforce academically that the economic viability of franchising abroad depends on thorough due diligence and adaptation – the absence of which can lead to costly withdrawal.

**Local Economic Impact – Franchise Development in Africa:** An interesting perspective is the macro-economic impact franchises can have in host countries. Franchising is seen by some governments as a catalyst for small business growth and job creation. For instance, in South Africa and Kenya, the arrival of global franchises spurred development of local franchise industries and suppliers. Training provided by franchisors upgrades local workforce skills, and successful franchisees often become multi-unit operators, further investing in the economy. One report noted that in parts of Africa, franchising's advantages – “skills transfer, start-up support, and ongoing operational assistance” – have been harnessed to tackle challenges of unemployment and to empower local entrepreneurs.<sup>4</sup> However, the flipside is that franchise dominance can sometimes outcompete local independent businesses, and profits (royalties) do flow back to the foreign franchisor, which is a point of debate among economists regarding net impact. Still, many emerging markets welcome franchising for its perceived contributions to modernizing retail and service sectors. The success of franchises in these markets again boils down to adaptability and choosing the right partners. For example, global franchises in Africa often adapt their offerings (KFC serves ugali in Kenya, a cornmeal staple, alongside chicken) and rely on local franchise groups who understand regional diversity.

Through these cases, we see that international franchising's economic outcomes are varied. When executed well – with strong localization, partner alignment, and brand-positioning – it can produce remarkable growth and profit for both franchisor and franchisee. When mismanaged or when external conditions turn adverse, international franchises can falter, leading to retrenchment or conflict. These examples underscore the earlier analytical points in tangible form, illustrating the real economic stakes of franchising as a mode of international expansion.

## Conclusion

International franchising is a strategic pathway that enables companies to expand beyond their home borders by capitalizing on the resources and initiative of local entrepreneurs. Economically, it offers a compelling package of benefits: the ability to scale quickly with minimal capital outlay, shared risk and reward between franchisor and franchisee, access to local market knowledge, and the amplification of brand reach and economies of scale. The growth of franchising into a global phenomenon – from fast food chains and hotel brands to education and fitness franchises – attests to the powerful economic logic underpinning this model. Academic theories such as resource scarcity (highlighting franchising as a solution to capital and talent limitations) and

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<sup>4</sup> Global Franchise, 2022. *The biggest mistakes franchisors make when going international*. [online] Global-Franchise.com. Available at: <https://www.global-franchise.com/insight/the-biggest-mistakes-franchisors-make-when-going-international>

agency theory (emphasizing incentive alignment) help explain why franchising has been favored by firms seeking international markets. In practice, many of the world's largest franchises have become international juggernauts precisely by leveraging these advantages.

However, franchising is not a guarantee of success in foreign expansion. This article has detailed the array of challenges that franchises face: cultural mismatches, quality control issues, franchisee management problems, legal and regulatory hurdles, and macroeconomic and currency risks, among others. These factors mean that franchising, like any entry mode, requires careful strategy and execution. A franchisor must select markets judiciously – analyzing economic indicators like GDP per capita, population size, and growth rates to ensure sufficient demand – and choose franchise partners with the capability and commitment to uphold the brand. Robust contracts and training programs are needed to mitigate agency problems and maintain consistency. Moreover, franchisors should be prepared to adapt their business model, balancing standardization with flexibility, to resonate with local consumers. The central trade-off of franchising is between control and growth: franchisors cede a degree of control to achieve faster growth and market penetration. The most successful international franchisors are those that manage this trade-off effectively – they put in place governance mechanisms (field audits, franchisee councils, performance incentives) to guide their franchisees, while fostering a cooperative culture where franchisees' feedback and local innovation are valued.

For economists and business scholars, international franchising remains a rich area of study, intersecting themes of contract theory, entrepreneurship, and international trade. It illustrates how private contractual arrangements can facilitate the global diffusion of business formats and technologies, essentially becoming an alternative to foreign direct investment. From a development perspective, franchising can transfer know-how to emerging economies and create jobs, although its long-term impact on local enterprise development invites further research.

In conclusion, franchising as a mode of international expansion offers a distinctive mix of **economic benefits and risks**. The model has enabled companies like McDonald's, KFC, Subway, and countless others to achieve worldwide presence and high returns on invested capital by drawing on the strengths of local partners. Yet, these gains are accompanied by challenges in maintaining brand integrity and operational efficiency across diverse markets. An overarching lesson is that the economic success of international franchising depends on managing relationships and information – aligning the incentives of franchisors and franchisees, ensuring knowledge flows both ways, and remaining responsive to the economic and cultural landscape of each market. With rigorous planning and adaptive execution, franchising can be a powerful engine for international growth. As the global economy evolves, franchising will likely continue to be at the forefront of international business expansion, warranting ongoing scholarly and practical attention.

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