

Why Adopt Microfranchising? Evidence from Brazil on an Organizational Innovation Designed to Face New Challenges



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Abstract This paper deals with the economic rationality underlying organizational innovations in franchising and the rationale behind them. Using Brazilian primary data, we obtain evidence that spatial distribution of microfranchised units is sensitive to the sector of activity. Our results suggest that labor-intensive activities are suitable for microfranchised units in less populated municipalities. In addition, we provide evidence that the spatial distribution of microfranchising reflects network growth. Indeed, larger networks, in terms of number of units as well as territorial extension, are more likely to be present in smaller markets than smaller networks. Older networks (incumbents) that had a business experience prior to franchising tend to concentrate their franchised units in densely populated areas, while entrants that adopted microfranchising from their foundation target unexplored markets in less populated municipalities.

1 Introduction

Franchising networks contractually bind an upstream party, the franchisor, to a network of retailers using its brand name and business format, the franchisees. Used internationally in all retail and services sectors, this organizational form

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stands out as a dominant model of trade in the twenty-first century. Due to its peculiar structure and behavioral aspects, franchising represents a rich context of investigation. Comparing Brazil with the USA and France, Dant et al. (2008) showed the importance of franchising in this country.

In Brazil, the economic crisis that started in 2014, coupled with the saturation of specific location areas, has raised new challenges related to organizational innovations in franchising. In this continent-sized country, spatial dynamics play a key role, for example, the allocation of sector performances when considering the different regions. As reported by the media, many networks find in the favelas their most profitable units. In addition, other studies have observed an interest of the networks in exploring areas outside the southeast usual circuits, specifically in the north, northeast, and midwest (Bitti et al. 2019).

Additional issues arise from the contemporary franchising landscape in Brazil, regarding the evolution of the prevailing system and the attractiveness to new franchisees. In that direction, the design of a new generation of franchising systems has begun to emerge in Brazil: microfranchising, a small business model which replicates proven marketing and operational concepts. It is common to associate such a business model with the idea of empowerment of the poor (e.g., Burand and Koch 2010; Lehr 2008), although in some cases opportunities for self-employment and increasing incomes emerge as unintended consequences of for-profit franchising network expansion (Kukec and Erceg 2017).

According to the Brazilian Franchising Association (ABF), a microfranchise is defined as a business concept whose total investment does not exceed three times the Brazilian annual income per capita (of approximately USD 25,000). This new generation has already attracted interest from some conventional franchise networks. For these reasons, there is the need to properly and systematically explore this alternative format, motivating the research interests of this paper.

To sum up, the current competitive context of franchising in Brazil generates organizational innovations associated with growth strategies facing new challenges. Focusing more precisely on microfranchising, the following research question arises: from the Brazilian current experience, what do we learn about the economic rationality of microfranchising? In other words, taking into account spatial and sector-based dynamics, in which cases is this innovative format relevant? We provide here the first quantitative exploration of microfranchising in the literature. Econometrics allows us to test hypotheses that can be generalized to better understand this new format and go beyond extant information and descriptive case studies.

Our estimation results, based on a new and unique dataset, show that the choice of microfranchising as a business format is mainly related to locational aspects (places difficult to reach, social vulnerability, and logistical aspects). We discuss interesting practical and research implications of our findings.

The rest of the paper is organized as follows: Section 2 presents the analytical background, dealing with the definition of microfranchising and the related hypotheses. In Sect. 3, we specify the Brazilian context, before presenting the data and the

methodology in Sect. 4. Section 5 contains our empirical results and the related comments. Finally, we offer a conclusion in Sect. 6.

2 Analytical Background and Hypotheses

2.1 *Microfranchising and Social Franchising Versus Business Format Franchising*

While business format franchising is a well-known and successful organizational format in retailing, the literature on microfranchising and social franchising is scarce but developing (Alon and Naatu 2019). Recent advances concern case studies (e.g., Alon 2014) and discussion of the links and differences between the three concepts (Crawford-Spencer 2015; Du Toit 2017; Zafeiropoulou 2017). Yet, the concepts and definitions are still not used in the same way and with the same meaning in all the articles on the topic.

Asemota and Chahine (2017) distinguish social from microfranchising on the grounds of business model design: while the former aims to achieve social goals by incorporating people at the bottom of the pyramid as franchisees, the second seeks to promote well-being by offering products and services accessible to people who would have otherwise been out of the market. Du Toit (2017) emphasizes the relationship between microfranchising and microfinance, with the term “micro” in microfranchising referring to the concept of microfinance which consists of loans granted to help poor individuals to start a business. Poverty reduction is thus central and links the two concepts. Microfranchising can thus be defined as a specific format of franchising enabling impoverished people to start a business. Christensen et al. (2010) show that microfranchising is linked to social goals, namely, poverty reduction, via the reduction of unemployment. Indeed, microfranchising facilitates access to employment, enabling impoverished individuals to become self-employed and eventually hire people in their communities. Asemota and Chahine (2017) recognize the effect of microfranchising on employment but stress access to basic goods and services at affordable costs. Brodie et al. (2002) study the direct sale of branded products as a specific form of franchising and identify some unintentional positive effects on the welfare of part-time workers most of whom are women, since it is a low-cost and low-entry barrier business opportunity. This business model benefits the selling firms by grouping an “army of individuals” around friendship circles, without advertising expenses and special premises. The idea of women empowerment through microfranchising is also emphasized by Chatnani (2010).

Finally, microfranchising has at least two different meanings: on one hand, a financially sustainable model that provides affordable goods and services in response to the failure of the formerly structured market to supply these and, on the other hand, just a down-sized business, with comparatively low fixed capital

and cash investments. The first concept encompasses explicit social goals and financial constraints in order to attain sustainability, while the second departs from a profit-oriented firm that produces social benefits, either intentionally or unintentionally.

These two opposing views are consistent with the definitions by Zafeiropoulou (2017), who considers microfranchising as being part of social franchising and emphasizes an inclusion relationship, and by Du Toit (2017), who highlights intersections between micro- and social franchising. Defending the idea that microfranchising is an organizational form like business format franchising or a plural form organization, whereas social franchising offers a specific content, we agree with the last view (Du Toit 2017), which underlines the complementarities between micro- and social franchising and corresponds to our focus in this study.¹

As with business format franchising, the social franchisee uses the brand name and business concept of the upstream party, the franchisor. In both cases, business format and social franchising, the franchisee and the franchisor are legally independent entrepreneurs, related by a franchise contract defining their rights and obligations. As with business format franchising, a branded network is thus created, with the franchisor being in charge of brand promotion and reputation preservation. Yet, there is a central difference: social franchising is just a means that uses market-based solutions to achieve social goals. Thus, social franchising merges goals of different natures: economic efficiency (efficiency with respect to the market) and social efficiency (efficiency with respect to the whole society—including poverty reduction, improvement of living conditions, and environmental concerns).

The emerging academic literature on social franchising is ambiguous regarding this duality of goals. Some authors, such as Du Toit (2017), assert that social franchising networks can sometimes be defined as nonprofit organizations supported by public programs and donors. On the other hand, Aliouche and Bonet Fernandez (2017) insist on the necessity to generate revenues, at least to achieve long-term sustainability.

In Brazil, microfranchising is defined by the ABF as a format for small businesses, requiring a low initial investment by the franchisee. This definition does not explicitly take social goals into consideration, yet those are implicit in our study. In addition, Brazilian microfranchising networks are usually for profit-oriented firms. The Brazilian experience is rich in lessons as the microfranchising format proves to be economically efficient, sometimes even more than the commercial business format. Our goal in this paper is to precisely explore the conditions of this economic rationality.

¹The authors are grateful to editor Gérard Cliquet for his help in removing ambiguities and clarifying the concepts.

2.2 Microfranchising and Social Entrepreneurship as Partially Overlapping Concepts

Because of complementarities between micro- and social franchising, the literature on microfranchising overlaps the literature on social entrepreneurship. While we have identified ambiguities in the extant conceptual framework distinguishing micro-, social, and business format franchising, the relationship between franchising and social entrepreneurship is clearly stated in the literature.

Firstly, fostered by the impacts of the global economic crisis of 2008, intractable poverty, and environmental issues, scholarly interest in social enterprise has progressed. A large amount of research is now available (e.g., Davies et al. 2019; Doherty et al. 2014; Fayolle and Matlay 2010; Short 2014; Short et al. 2009; Stevens et al. 2015; Tracey and Jarvis 2007). In this literature, the goal of societal value creation is inseparable from financial sustainability. A dual mission thus explicitly defines social enterprises. The main issue of this underlined hybridity is to succeed in combining social purposes with economic rationality.

In this context, social franchising is “simply” defined as a scaling strategy for social entrepreneurship, the application of franchising to social entrepreneurship (Aliouche and Bonet Fernandez 2017; Alon 2014; Kistruck et al. 2011; Volery and Hackl 2010; Zafeiropoulou 2017). Both are therefore complementary. With the replication process inherent in franchising, challenges to the economic sustainability of the micro- or social franchisor and the overall micro- or social franchising model are stressed.

2.3 Hypothesis Development

Based on the previous discussion, we assume that each microfranchising network chooses where its units will be located, with the aim to maximize expected profits or at least to achieve economic sustainability (Sivakumar and Schoormans 2011). The latter depends on the franchisee’s performance. We also assume that the size of the market is relevant to this decision-making process. Large markets offer the possibility to exploit economies of scale, though in this context the new units face fierce competition (Bitti et al. 2019). As an organizational innovation, microfranchising can be considered as an attempt to solve this trade-off.

From this analytical context, we argue that microfranchising in the Brazilian market is relevant when the product or service is complex. For such types of goods, consumer utility increases when the purchase is complemented with information provided by the franchisee. In addition, the franchisee has more information than the franchisor about the consumers. The theoretical background for these flows of information is the theory of information asymmetry, drawn from the field of contract theory (Akerlof 1970). Following this reasoning, microfranchising is suitable for

sectors where the utility of products and services depends on complementary information provided to the consumer, such as new features of innovative electronic products. The related hypothesis is as follows:

Hypothesis 1 Microfranchising is relevant in specific sectors, related to the product complexity.

In addition, microfranchising is relevant in locations difficult to reach by traditional formats. This argument is related to the idea that microfranchising is the result of a rescaling of an already proven business model, with the purpose of making it feasible in smaller markets, that is, in less populated municipalities where the exploitation of economies of scale is limited. For this reason, we formulate the following hypothesis:

Hypothesis 2 Microfranchising is relevant to explore markets in less populated municipalities where conventional franchised units would be inefficient.

Finally, even in large metropolises in developing countries, there are potential markets partially isolated from major urban centers, such as the “favelas” in Brazil and “misery villages” in Argentina. Microfranchised units, especially when conducted by local residents (Zafeiropoulou and Koufopoulos 2013), can be instruments to exploit such market segments. From this reasoning, we derive the following hypothesis:

Hypothesis 3 Microfranchising is relevant to explore hidden markets in dense urban places.

3 Franchising and Microfranchising in Brazil

Well established in North America and Europe, franchise networks are growing strongly in emerging economies, despite the social, economic, and political crises. Indeed, statistics show a remarkable dynamism in several African countries, China, Turkey, Mexico, and Brazil (Fadairo and Lanchimba 2017; Perrigot 2017).

Regarding the number of brands, Brazil occupies a central place in Latin American franchising: in 2013, there were 2703 franchised brands in the country, 80% more than in Mexico which is the second largest market for franchising in the region. This predominance is confirmed by per capita changes.

Yet, statistics presented in Fig. 1 highlight a contrasted evolution of Brazilian franchising (ABF 2017). Since the economic crisis, the growth of the system has changed from its level prior to the crisis. Indeed, recent changes are characterized by a smoother growth in sales (from 8%, e.g., between 2016 and 2017), units (2%), and employment (1%) and even a decrease in the number of chains (−6%).

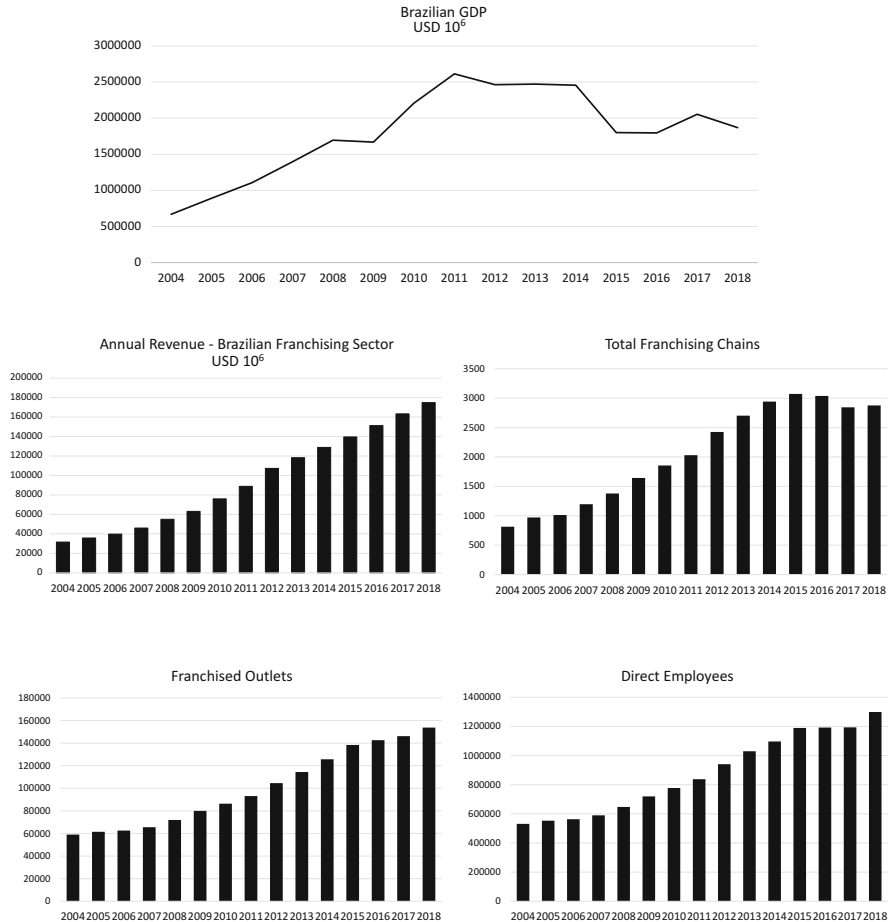


Fig. 1 Evolution of Brazilian franchising (2004–2017). Source: Based on IPEA-Data and ABF

A closer look at sector performances reveals some important features. The food sector appears as one of the important sectors in Brazilian franchising (Table 1). As shown in Table 1, the growth of franchising in this emblematic sector has known no slowdown since the Brazilian crisis.

However, the impact of the Brazilian economic crisis on the franchised food sector is clearly suggested by Table 2. All the big international brands in Brazilian food franchising presented a slowdown in the number of stores opened between 2014 and 2015. In addition, with the crisis impact, the hypothesis of a saturation process regarding the expansion of well-established brands is relevant, at least in some Brazilian locations. Whatever the argument, it is pertinent to note that the crisis compelled companies to reconsider their strategies.

Table 1 Sector-based allocation of Brazilian franchising (2013–2017)

Sectors	2013 (%)	2017 (%)
Business and other retails	21.1	5.6
Food	20.0	28.3
Health, beauty, and well-being	NC	21.7
Clothing	7.4	12.6
Hotel and tourism	7.3	3.0
Educational services	6.6	11.6
Entertainment and leisure	NC	1.0
Home/building and construction	5.1	7.1
Automotive services	3.5	3.5
Communication, computer, and electronics	3.0	2.5
Cleanliness and conservation	0.9	3.0

Source: Based on CNS and ABF. NC, non-comparative statistics resulting from changes in the methodology used by the ABF in the nomenclature of the sectors

Table 2 Number of franchising fast-food stores opened in Brazil

Source: Chain websites	2014	2015
Subway	414	354
Burger King	130	104
Bob's	74	55
McDonald's	86	44
Giraffas	12	25
Pizza Hut	17	22
Spoletto	51	16
Habib's	25	7
KFC	7	3

The search for adaptive paths goes directly through the microfranchising sector. The ABF pointed out a total of 557 franchise chains employing the microfranchising model in Brazil in 2016, either exclusively or concomitant with the traditional model (Fig. 2).

Of this total, 79.8% are employed exclusively with microfranchises, and 20.2% operate with both formats, i.e., conventional and microfranchises. In turn, the ABF revealed that among the chains that still do not operate with microfranchising, 36% indicated their intention to develop this format in the coming years.

The current interest in microfranchising is also related to a better performance of this organizational innovation compared with the conventional model. Indeed, according to the ABF, microfranchising has recorded a growth in sales of 22% against 16% of business format franchising during the period 2016/2017.

A better performance was also recorded in terms of growth in both the number of new networks and the number of new units, with microfranchises in Brazil growing by 10 and 6%, respectively, over the period 2016 and 2017, while the conventional model slowed down, respectively, by 6 and 2%.

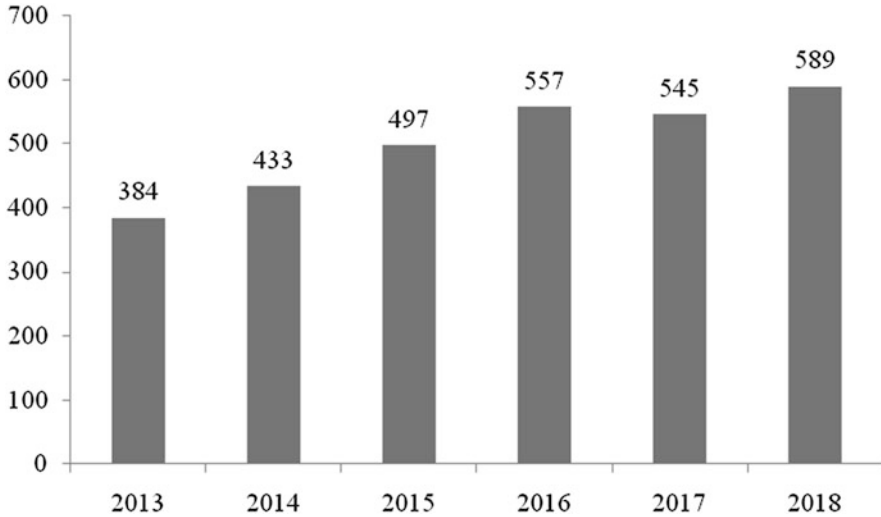


Fig. 2 Number of networks operating microfranchising units (2013–2018). Source: ABF (2018)

4 Data and Measurement

4.1 Data Collection and Sample

We use cross-sectional data on microfranchising networks in Brazil covering the year 2017. The data source is the ABF. The unit of analysis is the franchise network. Our sample consists of 132 observations of “pure microfranchised chains,” that is, networks constituted only by microfranchised units. For each brand, the data contains information regarding the location of the units. This is a new and unique dataset. Moreover, the data was collected for this specific research.

4.2 Variables of Interest

4.2.1 Dependent Variables

The dependent variables are the number of microfranchised units belonging to a given network settled in municipalities. Municipalities are classified into six groups, according to their population. The thresholds are established aiming both to avoid an unbalanced distribution in the sample and to capture different profiles of municipalities. This implies that a municipality with about 100,000 inhabitants is not just five times more populated than one with 20,000 inhabitants, but it offers in addition qualitative differences in terms of infrastructure and services.

Thus, we distinguish six dependent variables. Each of them refers to the number of franchised units per network (NUM) in a specific class of municipalities: municipalities with 20,000 inhabitants (NUM20); between 20,001 and 40,000 inhabitants (NUM40); and successively 100,000 (NUM100), 250,000 (NUM250), and 1 million inhabitants (NUM1000). NUMMORE refers to the number of franchised units per network in municipalities with more than 1 million inhabitants.

4.2.2 Summary Statistics (See Table 3)

Table 3 The study variables

Exploratory variables	Description	Average	Median	Min.	Max.	SD
NBRMUN	Number of municipalities in which the franchise brand is present—counting variables	45.20	20.5	1	600	83.94
UNITMUN	Average number of units per municipality—number of units divided by NBRMUN	1.85	1.33	1	28	2.54
OWNUNIT	Percentage of own units in the network—%	19.49	0.47	0	100	65.49
LAGFRAN	Time until the adoption of franchising model—years	5.83	3	0	40	8.11
STARTBUS	Time since the business started—years	14.34	10	0	60	11.56
PLFORM	Adoption of either a single- (0) or multiple (1)-franchise format	0.26	0	0	1	0.44
PAYFRANC	Payment of franchise fee (0 = absence; 1 = presence)	0.90	1	0	1	0.30
PAYROYAL	Payment of royalties (0 = absence; 1 = presence)	0.96	1	0	1	0.19
SECFOOD	Sector: Food (1 if the network belongs to the sector, if not 0)	0.11	0	0	1	0.32
SECHOME	Sector: Utilities and services for home	0.06	0	0	1	0.24
SECCOMM	Sector: Communications and electronics	0.14	0	0	1	0.35
SECHOTUR	Sector: Hotels and tourism	0.04	0	0	1	0.19
SECCLEAN	Sector: Cleaning and maintenance services	0.08	0	0	1	0.27
SECFASH	Sector: Fashion	0.05	0	0	1	0.21
SECAUTO	Sector: Automotive services	0.04	0	0	1	0.19
SECEDUC	Sector: Educational services	0.14	0	0	1	0.35

5 Estimations, Results, and Discussion

The statistics in Table 4 are consistent with Hypothesis 1, which relates the use of microfranchising to the sector. These preliminary results justify the inclusion of sector dummies in the econometric models. Indeed, the chi-square test in Table 4 leads to the rejection of the independence hypothesis ($p < 0.001$), implying that the spatial distribution of franchised units depends on the sector in which they operate.

Six regressions—one for each type of municipality—are estimated, using the OLS method. We control for heteroscedasticity with the White test and multicollinearity by means of the variance inflation factor (VIF).

The estimation results presented in Table 5 highlight the factors underlying the spatial pattern of microfranchising, taking into account the population classes. These results are of great interest for expansion strategies within franchising networks.

Thus, if a franchise unit of a brand is settled in a municipality of up to 20,000 inhabitants, it is probably the only one (NBRMUN, $p < 0.001$). The average number of units per municipality (UNITMUN) is statistically noticeable only in municipalities with more than 1 million inhabitants, suggesting that microfranchising is a format used both to reach small municipalities—in this case the size of the market limits the exploitation of economies of scale—(Hypothesis 2) and to target markets hidden within dense urban areas (Hypothesis 3).

In Table 5, the dependent variable is the number of franchise units in municipalities included in population class.

As suggested by preliminary results (Table 4), the business sector of a microfranchising network exerts a significant influence on the spatial distribution of its units. Automotive services microfranchised units are more abundant in municipalities with less than 250,000 inhabitants. One possible explanation is the real estate rental differentials between larger and smaller municipalities, reducing the minimal efficient scale in small towns. Labor-intensive activities such as automotive services are apparently suitable to less populated municipalities.

Additional results concern first the number of franchisor-owned units. This variable appears to be irrelevant in explaining the spatial distribution of microfranchised units. Yet, some caveats are required. Indeed, the ABF's data repository contains only formal ownership of franchise units, not the effective control exerted by the franchisor over units formally belonging to third parties, but closely tied to the franchisor.

A year of increased activity in the franchise network tends to increase by double the number of units in cities with more than 1 million inhabitants (STARTBUS, $\beta > 0$ and $p < 0.001$), but decreases the presence of old brands in smaller municipalities (STARTBUS, $\beta < 0$ and $p < 0.05$). Businesses that from the beginning started as franchise networks tend to have a more noticeable presence in small municipalities (LAGFRAN, $\beta > 0$ and $p < 0.001$) than businesses that took time to be converted to the franchise model (LAGFRAN, $\beta < 0$ and $p < 0.001$).

The incidence of franchise fees (PAYFRANC) and the payment of royalties (PAYROYAL) did not reveal clear influence on the spatial allocation of microfran-

Table 4 Franchised units per sector and municipality population

	NUM20	NUM40	NUM100	NUM250	NUM1000	NUM MORE	Total	%
Food	5	8	28	111	249	464	865	8.0
For home	1	0	8	13	30	50	102	0.9
Communications/electronics	20	58	111	209	437	474	1309	12.1
Entertainment and leisure	0	0	1	1	3	4	9	0.1
Hotels and tourism	2	1	17	55	105	109	289	2.7
Cleaning and maintenance	15	22	99	176	286	448	1046	9.6
Fashion	4	9	36	78	131	132	390	3.6
Health and beauty	9	28	94	141	206	282	760	7.0
Automotive services	84	121	259	315	443	474	1696	15.6
Business services	66	78	190	240	363	365	1302	12.0
Educational services	102	243	454	519	731	1034	3083	28.4
TOTAL	308	568	1297	1858	2984	3836	10,851	
%	2.8	5.2	12.0	17.1	27.5	35.4		100

Table 5 OLS regression coefficients

	NUM20	NUM40	NUM100	NUM250	NUM1000	NUM MORE
Const	0.008	-0.905	-2.665	-0.944	-13.122	-52.303***
NBRMUN	0.096***	0.171***	0.338***	0.412***	0.613***	0.631***
UNITMUN	-0.102	0.009	-0.122	0.046	0.552	3.240***
OWNUNIT	0.004	0.010	0.011	0.013	0.020	0.031
LAGFRAN	0.252***	0.245***	0.480***	0.315 **	0.008	-2.258***
STARTBUS	-0.100 **	-0.154 **	-0.299***	-0.082	0.315	2.082***
PLFORM	0.152	-0.135	0.225	0.451	-1.117	0.952
PAYFRANC	-1.458	-1.845	-1.787	-2.495	-1.676	2.769
PAYROYAL	-0.181	-0.031	1.378	-2.445	3.029	24.678
SECFOOD	-0.621	-0.955	-2.960	0.985	6.942	16.815*
SECHOME	1.226	1.621	2.167	3.179	6.471	7.182
SECCOMM	-1.465	-0.834	-3.816*	-0.263	7.324	11.792
SECHOTUR	-2.650	-3.714	-6.377*	-2.743	-0.716	-8.230
SECCLEAN	-1.652	-3.303*	-3.310	0.038	0.435	4.833
SECFASH	-2.592	-3.710*	-5.812*	-1.423	1.370	1.862
SECAUTO	5.228***	4.438*	10.951***	12.130***	10.851	6.978
SECEDUC	-1.325	1.231	-1.019	-5.911 **	-14.466***	-14.688
R ²	0.861	0.917	0.942	0.952	0.908	0.834
Adjusted R ²	0.840	0.904	0.934	0.945	0.894	0.809
F statistics	41.075***	73.084***	108.2 * **	132.5 ***	65.36 ***	33.21 ***

Note: *Significant at $p < 0.05$; ** 0.005; *** 0.001

chised units. The same result holds for the simultaneous adoption of more than one channel (PLFORM): store, kiosk, home-based activity, and mobile units. Regarding educational services, microfranchised units are scarcer than the average microfranchising presence in medium- and large-sized municipalities.

6 Conclusion

Microfranchising is innovative in the sense that franchisees do not bring massive capital inflows to franchising brands, but franchisees’ local market knowledge and personal networks. These are features of the microfranchising model fitted to entry strategies of franchising brands in new markets, especially small ones. These markets are placed not only in less populated municipalities but also in the densely populated metropolitan areas.

Location decisions attempt to solve the trade-off between the exploration of economies of scale and information costs in pristine markets.

The coexistence of more than one business format in a franchising network does not seemingly play any relevant role in location decisions. The same stands for contractual mechanisms for rent transference such as franchising fees and royalties.

We found evidence that the spatial distribution of microfranchised units is sensitive to the sector of activity. Labor-intensive activities seem to be suitable to microfranchised units in less populated municipalities. Spatial distribution also reflects the growth of franchising networks. Larger networks in terms of number of units as well as in territorial extension are more likely to be present in smaller markets than smaller networks. Older networks (incumbents) that started franchising after developing a business model in single firms concentrate their franchised units in densely populated areas, while entrants that adopted franchising just from their foundation targeted unexplored markets in less populated municipalities.

As a device to make use of local market knowledge, microfranchising competes with direct sales, a contractual relationship in which there is no investment in fixed capital. Direct sales are suitable to the distribution of finished goods with which the consumer is unfamiliar. Direct sales and franchising networks that combine traditional and microfranchising are promising subjects for future research.

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