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THE ASSET VALUE OF FRANCHISING

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Summary: Franchising is perceived as a marketing concept used to expand business. The paper discusses the development of franchising agreements in the context of the expansion of a trademark from a local or national level to international markets. It aims at determining how the economic integration has contributed to the development of franchising agreements. The author focuses on the fashion industry and analyses two different international brands: H&M and Zara, taking into account their market targets and international expansion.

Keywords: trademark, internationalization, consumer, intangible assets.

Streszczenie: Franchiza jest postrzegana jako koncepcja marketingowa wykorzystywana do rozszerzania działalności. Artykuł porusza kwestię rozwoju umów franczyzowych w kontekście ekspansji znaków towarowych z poziomu lokalnego lub krajowego na rynki międzynarodowe. Ma on na celu ustalenie, w jaki sposób integracja gospodarcza przyczyniła się do rozwoju tego typu umów. Autor koncentruje się na branży odzieżowej i analizuje dwie znane międzynarodowe marki: H&M i Zarę, biorąc pod uwagę ich cele rynkowe oraz ekspansję międzynarodową.

Słowa kluczowe: znak towarowy, internacjonalizacja, konsument, aktywa niematerialne.

1. Introduction

The paper is about the development of franchising agreements. Franchising is a way used to expand business. The expansion of a trademark from a local/national level to international may be the result of franchising. In the following analysis it is important to consider how the economic integration has helped in this development. The paper also takes into account the fashion industry, by focusing on two different international brands. Their international expansion and their market target are mentioned. The different strategies used show the importance of management administration in order to expand this kind of portfolio. It also shows that the brands involved are diverse and are related to many kind of industries and types of services.

The point to be considered is how it affects the consumer. Is his trust on a certain brand shaken up because the retailer is a franchisee? Would he consider this fact in order to get a product and prefer to acquire it only in branches from the titleholder? Another aspect is that, usually, it is impossible to distinguish a branch from a franchisee. The consumer considers the trademark itself and is normally not concerned with the legal status of the store he is acquiring the product or the service from. It is more important and relevant to have the suitable service and also the proper warranty to ensure its quality.

In this terms, the franchising is not only a suitable solution, but it also enables the titleholder to concentrate on intangible assets, their recognition and protection against misuse, adulteration and faked products. A consequence of the franchising agreements is the organization of how the business will be made and how the consumer will be treated. As a matter of fact, there are two points to be considered. The first one is related to the purpose of franchising and the second one is how it refers to the asset's value of the enterprise.

2. The intangible assets

It must be considered that nowadays, the appropriate use of intangible assets is vibrant resource [Mehta, Madhani 2008, p. 11]. The economic transformation has imposed the implementation of new legal standards in a very quick way. The intangible assets have become essential for business success as they provide an increase in the value of products and services. In many companies today, the value of intangible assets is worth more than the tangibles; they can reach approximately 80% of the total of the corporation value [Schaeffer, Robins 2008, p. 185]. They can even be considered the reason why a certain business works, contributing so far for the earning power of the enterprise [Karius 2016, p. 4]. One possible explanation for this fact is the way intangible assets are offered in the market. The franchising agreement allows for and enables extending the capacity of offering a product or a service at a level which is more difficult if considered the opening of a subsidiary. There are local legal aspects to be considered and also the knowledge of the local traditions and costume. B. Schaeffer and S.J. Robins point out that the percentage of the intangibles assets taking the market capital into account is in the case of Applebee 75.87%, Burger King – 82.27%, McDonalds – 73.66%, Papa Johns – Pizza – 80.71% and YUM Brands – 91.55% [Schaeffer, Robins 2008, p. 186].

This evolution has become important in the last century and intangible assets are also referred to as Intellectual Property [Schaeffer, Robins 2008, p. 185]. According to T. Karius [2016, p. 4] the assets could refer to Intellectual Property, but also to Organizational Capital in which the management quality is involved. It may also include the Informational Capital, which underlines the difference between the companies and the quality of the gained information, as well. In order to understand the way intangible assets work, it is necessary to demonstrate the difference, if tangible

assets are considered. It must be considered that intangible assets are not homogenous and normally recognized in financial reports. The table by A.D. Mehta and P.M. Madhani considers those points (Table 1).

Table 1. Difference between intangible and tangible assets

| | Intangible Assets | Tangible assets |
|--------------------------------------|---|--|
| Public awareness | Use by one party need not prevent use by another | Use by one part prevents simultaneous use by another |
| Depreciation | Does not wear out; but usually depreciates rapidly | Wears out; may depreciate quickly or slowly |
| Transfer costs | Hard to calibrate (increases with tacit proportion) | Easier to calibrate (depends on transportation and related costs) |
| Recognition of trading opportunities | Inherently difficult | Inherently easy |
| Disclosure of attributes | Relatively difficult | Relatively easy |
| Variety | Heterogeneous | Homogeneous |
| Property rights (extension) | Limited (patents, trade secrets, copyright, etc.) | Generally comprehensive and clearer, at least in developed countries |
| Property rights (enforcement) | Relatively difficult | Relatively easy |

Source: [Mehta, Madhani 2008, p. 15].

Therefore, it is possible to define intangible assets as a non-monetary asset, that cannot be seen, touched or physically measured, which is divided into three groups: the rights, where franchising is included; the relationships, where distribution relationships is a part of, and the last one, intellectual property, where the business knowledge is a part [Mehta, Madhani 2008, pp. 11, 12]. All those groups play an important role in the implementation of a franchising agreement. It is not the license of a trademark, but it also involves the way of implementing a certain type of business, which is not necessarily written in published manuals. There is much information which is restricted because it is related to the trade secret. On the other hand, it is also necessary to include the way the business is done, its knowhow, pricing data, the way to approach the suppliers. All these are important factors to establish a franchising agreement and are directly related to the intangible asset of a company. The goodwill has also to be included and it arises in different ways, such as a good infrastructure facility, established brand name, customer loyalty. It shows the prospective of future earnings [Mehta, Madhani 2008, p. 14]. Figure 1 shows exactly the way it works.

It is therefore possible to consider the intangible asset's importance. It is based on the perspective of the consumer, because its reputation is not based on objective basis but mostly on subjective perception. There is a strong believe that a certain brand, know-how has achieved a certain position, related to its quality and also with the idea



Figure 1. Stock-vector-business strategy

Source: own elaboration based on [http://thumb7.shutterstock.com/display_pic_with_logo/5880/272993099/stock-vector-business-strategy-concept-infographic-diagram-illustration-of-intangible-assets-types-vector-272993099.jpg].

that its consumer belongs to a selected group, which may explain a higher cost of it. The value is not based on a certain product, but on the way it is considered by the consumer, which can also change quite quickly, depending on information obtained, which may also be related to fake news.

3. Franchising

The trademark enables its titleholder to obtain an increase of the value of its intangible asset. The consumer values a certain trademark, depending on how a determined product or service is considered. It enables the owner to license it, which means that other companies will explore a certain brand without being its titleholder. The contract of licensing a trademark is a form of renting it. Consequently, A.D. Mehta and P.M. Madhani [2008, p. 14] define franchising as follows: “Franchising is a retail system for distributing goods or services through selected outlets; basically, franchising is a trademark license, entitling its holders to market particular products or services under a brand name or a trademark according to predetermined terms and conditions of license agreement. The accounting treatment for franchising or license is, debit it for the acquisition cost and amortize it over reasonable life. Franchising is contract-based intangible asset.”

Franchising is a broader way of fixing the trademark in a worldwide scale, because it is not limited to its license, but also comprises a knowhow transfer. According to E. Popova [2016, p. 15] the concept is based on the following principles: “First of all, there is a difference between the concepts of ‘franchising organization’ and

‘franchising’. The first one represents a network, which consists of the franchisor and its franchisees, while ‘franchising’ is used to describe the contractual process between the franchisor and its franchisees, which develop the franchising organization. Franchising organizations are characterized by high degree of geographical dispersal of organizational units as they operate on several local markets. Furthermore, the business format is very similar across the units and residual rights are shared between the franchisor and franchisee. Two main strategies in franchising are licensing agreements (e.g. Coca Cola), where a product or service is produced and sold under a specific trade mark, and business-format-franchising, where the whole business operation is adapted.”

At this point we should also consider that a franchising agreement is usually happening between unrelated parties. At an international level it generally involves the trademark and other kinds of IP rights, which are first licensed to a member of the entity group and afterwards at a local level [Schaeffer, Robins 2008, p. 185]. The exploration of different intangibles, including those which are not registered at a Patent Office should also be considered. Although they are not registered, and therefore subjected to a certain uncertainty, they are considered when evaluating the business, together with the registered articles [Schaeffer, Robins 2008, p. 187]. There must be a certain level of trust and confidence between the involved parties and the necessary transparency of the data which is included in the balance report. But they become the most important issue of the franchising agreement.

The valuation of IP intangibles is important to show how pertinent it is for a certain market. If know-how is considered, it must be also stated that the way it is transferred includes the establishment of a confidentiality agreement, as well. The same happens with the consumer list, which may also include personal data and establish a certain way of using the product or service in order to get benefits the way it is used. B. Schaeffer and S.J. Robins also suggest a method for valuating the intangible assets, as shown in Table 2.

Table 2. Common methods for valuing certain intangible assets

| Asset | Valuation | Method | | | |
|----------------|--------------------------|--------------|-----------------|-----------------|---------------|
| | Excess Operating Profits | Cost Savings | Royalty Savings | Market Approach | Cost Approach |
| Brands | X | | X | X | |
| Customer Lists | | | | X | X |
| Patents | X | X | X | | X |
| Know-how | X | X | X | X | X |
| Franchises | | | | X | X |

Source: [Schaeffer, Robins 2008].

It is not the same as an exploring license of a certain trademark. It is much more, it considers the brand, the consumers, the know-how and the way the product is made and offered to the consumer. The franchisor has not the liberty to choose the products he will offer, but he is limited, in the food industry for the instance, to the products mentioned in the contract. The different ways of exploring this form of business have to be considered. According to P. Vu [2015, p. 13]: “In business, even though franchise is defined in different ways, they all describe the same basic meaning of franchise.” According to M.N. Scarborough et al. [2009, p. 121]: “A franchise is a legal and business relationship between the owner of a trademark, service mark, trade name or advertising symbol and an entrepreneur who pays for the right to use that identification for his or her business.”

Specifically, the franchisor is a parent company that owns products and services, whereas the franchisee is a business owner who pays the franchisor for the right to sell the former's products and services. The franchisor is responsible for providing the franchisee business expertise, resources as well as assistance, while the franchisee pays the fees and royalties in return. Additionally, the franchisee also uses the franchisor's business format and system so as to make the franchise successful” [Scarborough et al. 2009, p. 121]. Briefly, franchising is a relationship that the one party (franchisor) authorizes another part (franchisee) the right to operate a business by selling the former's products and services under the former's trademark, business format and management system.

According to Emerson [2014, p. 559] the franchising agreement is based on mutual trust, which includes expatiating and also mutual concessions. For the franchisor there is the possibility of expanding their business and making it well known to the consumer. This point is also mentioned by E. Popova [2016, p. 15]. “The business format form of franchising was defined by Konigsberg as follows: ‘The franchisor grants to the franchisee the right to use the franchisor's trademarks and know-how as well as the right to use the entire business format or system developed by the franchisor. The franchisee, in turn, is obliged to carry on the franchised business according to the business format or system’ [Konigsberg 2008, p. 5].”

On the one hand, the fact that the franchisor wishes to obtain a reasonable financial compensation as a result of their effort to achieve a certain standard must be considered. It is not just licensing a brand, but also, the way to use it, to produce a certain product, to provide a certain service. There is a know-how transfer, which is not limited to a common license.

On the other hand, the franchisor expects a financial compensation, because this form of business enables the commercial expansion of a certain brand, without having the duties of opening branches. The franchisee has all the obligations in order to fix the brand in the new place, although for the consumer his proper identification is not important. There are, according to B. Ribeiro [2009, p. 19], four types of franchising:

- a) conventional franchising: 100% of the investment is made by the franchisee;
- b) partial franchising: franchisor and franchisee are responsible for the initial cost of the business;

c) franchise rental: 100% of the initial cost is taken by the franchisor. the franchisee takes the responsibility of its management;

d) hierarchy franchising: the branches are open by the franchisor and when they become well known they are included in a franchising model business.

It is obvious that this kind of contract has multiple varieties and forms. It is a consequence of the way the business is managed and takes into account the characteristics of the market and consumer. The contract will be the proper document to specify its form and will rule the juridical regulation to be applied. In Brazil, according to the Law 9279, of 1996, the franchising agreement is registered at the Brazilian Patent and Trademark Office and the actual figures are shown in Table 3.

Table 3. Franchising registered at the Brazilian Patent and Trademark Office

| Category | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Franchising | 37 | 31 | 27 | 14 | 66 | 38 | 35 | 26 | 32 | 49 | 51 | 55 | 94 |
| Foreign franchising | 12 | 20 | 25 | 14 | 33 | 32 | 33 | 23 | 28 | 46 | 50 | 55 | 93 |

Source: [www.inpi.gov.br].

This modality of contract enables the establishment of a large form of varieties. One of those fixes the international transfer of financial values, which also includes royalties and profit transfer. It is one of the index used to determine the international degree of insertion of the Brazilian economy. The reason is the use of international brands in the national market.

But this contract modality has an important magnitude at an international level. There are well known trademarks which are part of franchising agreements and have an expressive asset value. Table 4 presents the most valuable franchising agreements according to the report of Franchising Direct.

Table 4. The most valuable franchising agreements

| Position | Franchisor | Country | Industry |
|----------|----------------------------|---------|-------------------|
| 1 | 2 | 3 | 4 |
| 1 | McDonald's | USA | Alimentation |
| 2 | KFC | USA | Alimentation |
| 3 | Burger King | USA | Alimentation |
| 4 | SUBWAY® | USA | Alimentation |
| 5 | 7 Eleven | USA | Convenience store |
| 6 | Hertz | USA | Car rentals |
| 7 | Pizza Hut | USA | Pizza |
| 8 | Marriott International | USA | Hotel |
| 9 | Wyndham Hotels and Resorts | USA | Hotel |

Table 4, cont.

| 1 | 2 | 3 | 4 |
|----|-------------------------------------|--------|-------------------|
| 10 | Hilton Hotels & Resorts | USA | Hotel |
| 11 | RE/MAX | USA | Real Estate |
| 12 | InterContinental Hotels and Resorts | UK | Hotel |
| 13 | Domino's Pizza | USA | Pizza |
| 14 | Carrefour | France | Convenience store |
| 15 | Groupe Casino | France | Alimentation |
| 16 | Kumon | Japan | Child Education |
| 17 | Dunkin' Donuts | USA | Alimentation |
| 18 | Ace Hardware Corporation | USA | Real Estate |
| 19 | Chem-Dry Carpet Cleaning | USA | Carpet cleaning |
| 20 | DIA | Spain | Convenience store |

Source: [<http://www.franchisedirect.com/top100globalfranchises/rankings/>].

Data included in Table 4 confirms that the majority of the franchising agreements are held by US companies. Moreover, a growing number of business establishments based on franchising business model was observed between 2010 and 2015 (Table 5).

Table 5. Franchising numbers in the USA (business establishment)

| Year | Business establishment numbers |
|------|--------------------------------|
| 2010 | 740.095 |
| 2011 | 736.114 |
| 2012 | 747.359 |
| 2013 | 757.857 |
| 2014 | 769.782 |
| 2015 | 781.999 |

Source: [<https://www.franchisedirect.com/top100globalfranchises/rankings/>].

Table 6. Job creations in the USA

| Year | Number of job creations |
|------|-------------------------|
| 2010 | 7.750.000 |
| 2011 | 7.940.000 |
| 2012 | 8.127.000 |
| 2013 | 8.334.000 |
| 2014 | 8.569.000 |
| 2015 | 8.615.000 |

Source: [<https://www.franchisedirect.com/top100globalfranchises/rankings/>].

One consequence of this kind of business is the creation of opportunities for new jobs (Table 6). The economic impact is also important because they have an impact on the value of intangible rights, which are a part of the production chain. The creation of new jobs was a part of the report for 2015, of Franchise Direct.

Those numbers are more impressive if the financial aspect of this kind of business is considered, namely the revenues from franchising agreements (Table 7).

Table 7. The revenues from franchising agreements in USA

| Year | Revenues (US\$ billion) |
|------|-------------------------|
| 2010 | 699 |
| 2011 | 734 |
| 2012 | 768 |
| 2013 | 804 |
| 2014 | 844 |
| 2015 | 889 |

Source: [<https://www.franchisedirect.com/top100globalfranchises/rankings/>].

This data shows the importance of franchising. The global franchising system enables the franchisors to expand their business in a worldwide scale, without having the necessity of opening local branches, which has also an impact of the implementation of many local legal roles. On the other hand, the franchisee will lose its direct identification to the consumer but achieve a market share position as a consequence of how well known the franchisor is. Brazil is the 4th biggest market share of the global franchising business, according to data of the Commerce Department of the USA Government. This sector has grown in 2015 to revenue of 50 billion US\$.

It is also important to observe the evolution of the fast food sector. It is based on a world scale, where certain brands are established in almost all the countries.

It is quite complex form of business. The consumer is often not aware if he is dealing with a proper branch or a modality of franchising. In the majority of situations, the knowledge of a certain trademark is more important than the information of how the business is dealt. The implementation of an international regulation in order to enforce the necessary measure to grand the consumer's protection is being studied by specialists and has been taken into consideration in the European Union since 2016. The global financial importance of franchising has achieved, in 2014, the amount of 3,79 trillion US\$ [HKTDC 2014, p. 1]. Figure 2 shows how it is divided by region.

The evolution of this kind of business is remarkable. The obvious targets are the biggest consumer markets of the USA and EU, with almost 77% of the global amount. It is not specialized in a certain commercial activity or service, but is widely used in all those categories. It is important for the consumer to be sure he will be handling with a certain form of business, where the quality and way to handle the product or service is a standard all over the world. At this point, it is also possible to wonder

which are the advantages for the franchisee. It will not develop its own identity and will be always known by the brand of the franchisor.

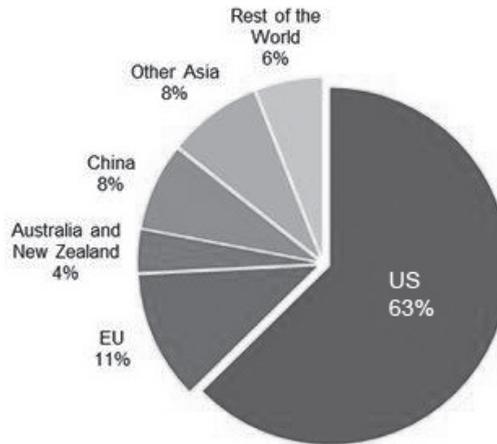


Figure 2. Franchising revenue by region in 2014

Source: [HKTDC 2014, p. 1].

One key issue to be dealt with is related to the measurement and management of intangible assets. According to A.D. Mehta and P.M. Madhani [2008, p. 16] “performance of firms is highly dependent on their customer relationship, supplier relationship, performance of employees, brand loyalty, etc. – all of these are examples of intangible assets in terms of accounting practices. All these intangible assets are key performance indicators of a firm’s profitability and future performance sustainability. Intangible assets provide potential source of competitive advantages for firms.”

Another aspect to be considered is the enormous investment that has to be made in order to establish a new trademark in the market. It has to become known by the consumer and, above all, it has to demonstrate why the user will switch from his known trend to a totally new one, where he certainly has no reference. The franchisor has not this kind of problem. The brand which is the franchising object is already known by the consumer and so it is not important for him to fix a new intangible in the market and invest expressive amount of money in order to achieve the objective, which also takes into account the possibility of failure.

4. Franchising in the fashion industry

It is a common strategy from the titleholders to expand their activities worldwide. Therefore, the search for partners is necessary, especially if the target will not be achieved by opening branches. The franchising enables the titleholder to expand

its business, without having the risk of new branches, which is also related to the different pattern of legal regulations. It is also very widely spread and, as the fashion industry is concerned, quite often used. Taking as an example the brands H&M and Zara, whose intangible value is impressive, it is possible to understand why franchising is a success. The expansion of H&M is shown in Figure 3.

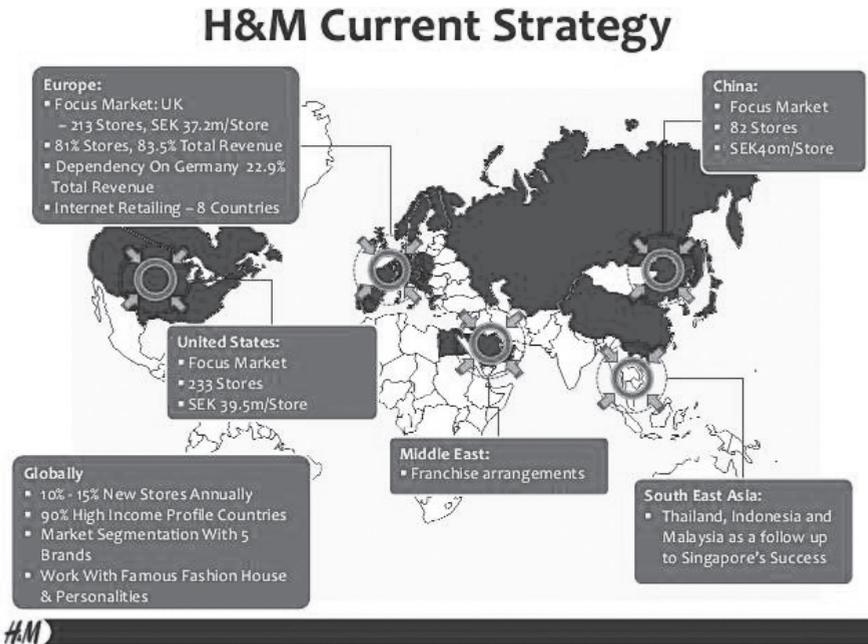


Figure 3. H&M current strategy

Source: [<https://www.slideshare.net/banganh1995/hm-55723546>].

The focus of this franchising contract is divided into three: one in the USA, with 233 stores, another one in Europe with 213 stores and a third one in China with 82 stores. It can be also observed that the franchisor's strategy focuses on the social level of its consumer, which is considered by a constant valuation. H&M is the second more expensive trademark with a value of 21.08 billion US\$, according to a report from 2014. According to this report, the value of the 10 most expensive fashion trademarks was about 121.74 billion US\$ [Gould, DeBord 2015]. Figure 4 shows these brands.

It is also H&M strategy to expand its franchisees in Eastern Europe and, considering Poland, where its activities have started in 2003, the number of stores has reached in 2017 a total of 169. In Brazil the same happens, not with H&M, but with Zara. The retail concept may also be taken into account [Vu 2015, p. 60]. As for Zara, there are 1770 stores around the world, spread in 86 different countries (Figure 5).

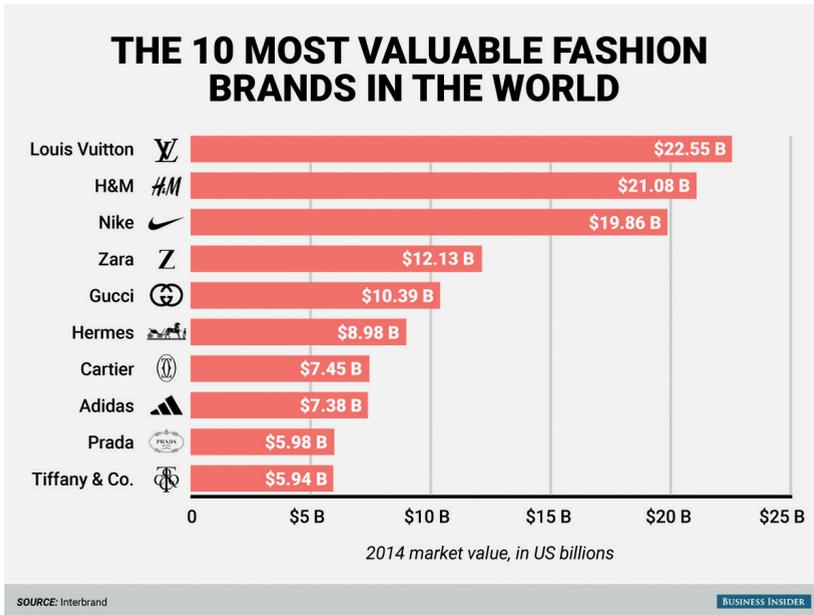


Figure 4. The 10 most valuable fashion brands in the world

Source: [Gould, DeBord 2015].

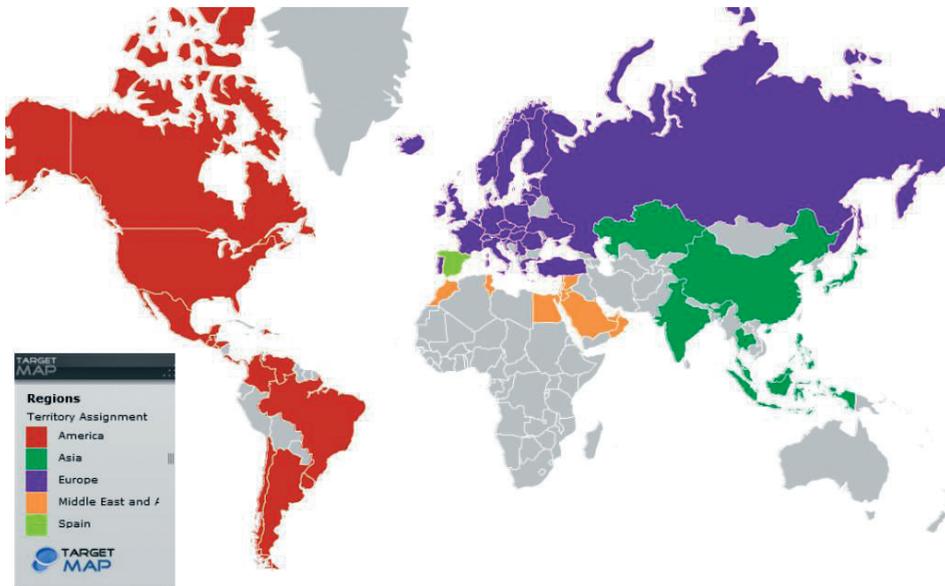


Figure 5. Zara stores all over the world

Source: [<https://sites.google.com/site/zararetailer/international-expansion/countries-expanded-to>].

The intangible value of Zara, which is also spread around the world, was, in 2014, about 121.3 billion US\$. In Brazil, the franchising in the fashion industry assumes an important position of its trade – 13.5% in 2017 [*Brazil – Franchising 2017*]. The Polish integration with the European Union should also be considered and its impact on the GDP growth, the third one, according to I. Morawski [2017]. According to him there is quick GDP growth in Eastern Europe. One of the causes is the expansion of the European Union and also the participation of these nations in the global economy chain. The fashion market, due to the proximity of the producers centers, becomes one factor that explains this expansion.

5. Conclusions

The analysis made here considers the international evolution of commerce and service branches. There is a tendency that the intangible holders stick to spreading out the knowledge of their brand. It is a difficult task since two major solutions are possible. The first one would consider the opening of branches. The advantage is that those stores would be directly linked to the headquarter. But, on the other hand, there are many disadvantages to take into account, such as the cost of installing the branches, legal tasks, related to different national regulation. The second one would be the establishment of franchising agreements. In this case, there is no need to invest directly in the opening of new branches; all the installation's costs and legal questions will be solved by the franchisor. The main goal to be achieved is that the consumer will consider the brand. He usually does not care if he is dealing with a branch or a franchisor.

The franchising contract permits a certain kind of internationalization of the intangible target. The same trademark and also the way of making business is used in different countries all over the world. The consequence may not be the best for local brands, except for those that decide to expand their business. There are many examples of local trademarks that are transformed into international ones by establishing franchising agreements. It does not mean that there is no space for local production. There will always be, but considering the development of international tourism, it is possible to conclude that franchising will continue its expansion.

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