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## Article

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Article

# Critical Circumstances Influencing Franchisees' Business Performance: A Review of the Saudi Arabian Franchise System

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## Abstract

Franchising operates as a proven business model that drives substantial growth for small and medium-sized enterprises (SMEs) worldwide. The franchise ecosystem in Saudi Arabia lacks sufficient research, despite established frameworks for success in markets such as the United States, the United Kingdom, and Australia. This research investigates the elements that lead to franchise success in Saudi Arabia through a combination of qualitative and quantitative data. This research evaluates franchise performance through metrics such as Average Revenue Per Unit (ARPU), Return on Investment (ROI), Franchise Success Rate, Time to Break Even, and Market Growth Rate, comparing Saudi Arabia with the U.S., the U.K., and India to identify essential success determinants. The research reveals that franchise success depends on regulatory frameworks, cultural alignment, economic diversification, and supply chain efficiency. The U.S. and U.K. enjoy established legal protections, whereas Saudi Arabia faces regulatory complexities and resource limitations. The research proposes three strategic recommendations: government incentives, locally adapted business models, and carefully selected locations to boost franchise success. The analysis provides essential information to policymakers, franchisors, and entrepreneurs seeking to expand their businesses in Saudi Arabia. The implementation of Vision 2030 growth barrier solutions and market opportunities will enable Saudi Arabia to build up its franchising sector and enhance market performance. This research adds new knowledge to the franchising literature in emerging markets and its impact on sustainable business growth.



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**Keywords:** franchise; business performance; small and medium enterprise; international business; Saudi Arabia

## 1. Introduction

Franchising is one of the commonest means of making money in the current global world, and it is considered one of the safest means of investing today. It is a business model that has proliferated across different industries and geographical locations. Franchising provides aspiring entrepreneurs leverage to operate and own their businesses under established brands via access to their systems and operations. Beyond its benefit to the franchisees, franchising also allows established brands to expand their businesses and gain access to new locations and new customer bases without expending much capital and human resources as required. Despite the alluring benefits of franchising, this business strategy has its inherent challenges that critically impact the success of the enterprise.

Saudi Arabia is the fastest growing economy in the Middle East with oil being the core of the economy. However, there has been a large emphasis on the diversification of the

economy from being oil-dependent to a non-oil sector, given the abundance of resources that have been acquired from the oil resources. Over the past decades, there has been tremendous growth in franchising in Saudi Arabia, with many American and European companies entering the Saudi Arabian market. The Saudi Arabian franchise market is dominated by the food, beverage, fashion, and retail industry. While there is a growing number of franchising businesses in Saudi Arabia, the majority of these franchises are owned by a small group of large companies, most of which are international companies (Alharbi, 2014).

There has been an extensive range of academic research conducted on franchising to either proffer solutions to problems accompanying franchising or enhance the franchise environment. However, most of these studies are carried out in the UK and North America with very limited studies conducted in Asia (Nijmeijer et al., 2013). In the past few decades, there has been an increasing interest of researchers on franchising in developing markets like Mexico, Hong Kong, India, and others. However, there is a very low focus on Gulf Corporation Council Countries like Bahrain, Kuwait, United Arab Emirates, and Saudi Arabia, despite their almost 50 years of experience in franchising. According to Alharbi (2014), the reason for the low interest in the franchising business in these countries is largely due to the small number of franchise businesses present in the countries and also because most of their franchise businesses are imported from the developing countries. The majority of the enterprises in Saudi Arabia and other GCC countries have failed to adopt the concept of franchising in expanding their businesses.

On the other hand, countries like the United Kingdom have franchising at the centre of their economic growth and power. For example, the 2009 recession in the UK had very little impact on franchising businesses in the country (Thomas & Kwan Yuk, 2009). Additionally, the COVID-19 pandemic has received extensive scholarly analysis regarding its diverse effects on franchising operations. A research study about Polish startups analysed organizational resilience after the COVID-19 pandemic. The research showed that startups with adaptable organizational structures and forward-thinking adaptation methods performed better in handling pandemic-related uncertainties (Korpysa & Oláh, 2024). The research on franchisors and franchisees determined essential elements which helped them survive the pandemic. The crisis required franchisors to maintain operations and franchisee satisfaction through effective communication and robust support systems and innovative capabilities (Abdul Ghani et al., 2022). This provides evidence of the economic power of franchising in such regions. Most franchising businesses in the UK are small and medium enterprises, and these enterprises are the backbone of any economy. Thus, for a developing country like Saudi Arabia with an increasing number of small and medium enterprises, the SMEs in the country must be encouraged to embrace franchising to aid economic development in the country.

Several factors (social, cultural, legal, institutional, etc.) contribute to the varying nature of the franchising environment across different countries. As a result, research findings conducted in a particular region cannot be generally applied to other regions, especially when there is a large gap in cultural, social, economic, institutional, and legal orientation. Based on these differentiating factors, Welsh et al. (2006) recommended that more research on franchising should be conducted in developing countries, with due consideration for institutional and governmental responsibilities in creating an enabling environment for franchising in the country.

**The research gap and contextual background are as follows:** The research on franchising success factors and market dynamics, as well as regulatory environments in developed economies such as the United States, the United Kingdom, and Australia, is extensive. The general business perspective of current research fails to address the institutional factors

that include legal requirements for joint ventures with local partners, cultural and religious norms, and Vision 2030 policies for economic diversification. Firm-level quantitative data on franchise performance metrics, such as Average Revenue Per Unit, Return on Investment, and Time to Break Even, are not well explored in this context. There is a limited understanding of how institutional and contextual factors in Saudi Arabia influence franchisees' performance compared to established markets.

The expansion of franchising in Saudi Arabia has been substantial. However, there is still limited information on how the country's institutional and contextual factors influence franchisee performance as compared to more developed markets like the United States and the United Kingdom. Some of the areas that have been identified as part of this research gap include the following: (1) **regulatory environment**: although the Saudi Franchise Law of 2019 attempts to regulate franchise business activities and provide legal requirements for the operations of the franchise, there are still issues such as poorly worded and poorly enforced regulations that affect franchisee performance; (2) **cultural and social norms**: Saudi Arabia's cultural environment of religious and social rules imposes certain conditions that determine how franchisors and franchisees interact in the market, e.g., the company has to comply with the rules on the segregation of premises and consumption of halal food; (3) **market-specific challenges**: apart from normal business issues, the franchisees in Saudi Arabia have to face risks related to their supply chain and workforce nationalisation policies that may affect their performance; and (4) **the lack of comparative analysis**: there is a lack of research comparing how Saudi Arabian franchisees tackle institutional and contextual issues compared to those in other established markets. Otherwise, the applicability of the existing franchising theories to other emerging markets cannot be asserted.

These gaps need to be addressed for both theoretical and practical purposes. It can also theoretically contribute to a better understanding of franchising by including institutional theory and context-specific variables. It can also provide useful information to the franchisors and franchisees on how to improve their performance and operations in Saudi Arabia.

Against this backdrop, this study aims to critically assess the performance of the franchise system in Saudi Arabia, 'examine the critical circumstances influencing franchisees' performance in Saudi Arabia, and compare the Saudi franchise system with established franchise market. It will identify the key factors that determine franchising in the country and compare Saudi Arabia's franchise system with both developed and developing countries. It will also investigate why SMEs in Saudi Arabia find it difficult to adopt the franchise model to expand their businesses locally and internationally. Additionally, this study develops a conceptual framework to examine the performance of Saudi franchises through four testable hypotheses. The study evaluates four performance metrics including Average Revenue Per Unit, Return on Investment, Time to Break Even, and Average Revenue Per Unit across Saudi Arabia, the United States, the United Kingdom, and India. The selection of the United States, the United Kingdom, and India for comparison is based on their different franchising systems, regulatory development, and cultural or economic ties to Saudi Arabia. The US and UK represent developed economies with mature franchise systems while India represents an emerging market with comparable dynamics to Saudi Arabia. Finally, this paper aims to contribute to the discourse on the current state and future directions of franchising in Saudi Arabia as the country executes Vision 2030.

## 2. Conceptual Review

### 2.1. Meaning of Franchising

There is no consensus regarding the definition of franchising. Its definition is construed depending on the structure, jurisdiction, application, and discipline of the franchise

arrangement (Buchan, 2014). Based on discipline, franchising could be defined as a form of organisation, a contractual business, an extended licencing, a distribution channel, or permission to exploit an intellectual property. In the law discipline, franchising is a contractual relationship between two entities and a licence which may contain other elements of legal relationships like employment, distributorship, and investment and customer relations (Spencer, 2013). The legal definition of franchising varies across different countries based on the purpose of developing the legal intervention for franchising. However, despite the differences, there are two consensuses for the purpose of legal intervention: economic development and social welfare. Hence, most countries define their franchising towards economic goals like promoting business development (China) or reducing the cost of dispute (Australia), or social welfare like protection of individual rights or protecting franchisees from discrimination (USA) (Spencer, 2013).

From a marketing discipline, franchising can be defined as a system of distribution and marketing in which an independent entity (a franchisee) buys the licence to market and distribute the goods and services of another entity (the franchisor) according to the process and procedures stipulated in the franchise agreement (Bellin, 2016). Based on this definition, franchising is regarded as just a marketing tool and not a separate business form or an industry. The economic perspective of franchising is also highly similar to that of marketing. According to this perspective, franchising is an alternative to vertical integration. It is basically a contractual relationship that allows the franchisor and franchisee to attain the benefits of economies of scale and harness the retailing effort and profit incentives of local owners (Killion & Meiklejohn, 2013).

There has also been a general debate among scholars on whether franchising is entrepreneurship or not. Studies like Clarkin and Rosa (2005) and Dada et al. (2015) do not view franchising as entrepreneurship as franchisees basically buy into a business model in a highly prescribed manner and therefore do not have the independence and autonomy attached to entrepreneurship. Other studies like Dant and Gundlach (1999) posited that franchising is a form of entrepreneurship that combines autonomy with dependency. Bürkle and Posselt (2008) also justified that franchising is entrepreneurship since franchisees offer innovations and ideas as a result of their proximity to local markets and customer base. The International Entrepreneurship and Management Journal published a 2024 study which investigates franchising as a corporate-affiliated entrepreneurial strategy (CAES). The research based on Panel Study of Entrepreneurial Dynamics II data shows that entrepreneurs with both management and startup experience tend to select franchising as their business approach. The research demonstrates that entrepreneurs who start franchises reach positive cash flow faster than independent business owners thus establishing franchising as a practical entrepreneurial choice (Hopp et al., 2024).

The Journal of Entrepreneurship in Emerging Economies published research about franchisee entrepreneurial characteristics in India. The research study of 409 franchisees reveals that numerous respondents display entrepreneurial characteristics and conduct entrepreneurial behaviours. The selection process of franchisors shows preference for franchisees who demonstrate entrepreneurial characteristics which suggests franchising serves as an entrepreneurial outlet (Bashir & Saqib, 2023).

A 2024 article in Administrative Sciences investigates how franchisee associations within a multinational quick-service restaurant chain utilized the five dimensions of entrepreneurial orientation (EO) which include innovativeness, proactiveness, risk-taking, autonomy, and competitive aggressiveness. The research demonstrates that franchisee associations promote both innovation and entrepreneurial conduct in franchise networks thus showing franchising structures can encourage entrepreneurial activities (Balsarini & Lambert, 2024).

## 2.2. History of Franchising

There have been different stories on how franchising came into existence. In the European context, franchising can be traced to the Middle Ages when the catholic churches licensed tax collectors as franchisees. Some historians traced it to the 18th century when the German brewers entered a contractual relationship with the taverns to sell their beers. Other historians argued that franchising practices were first developed in the ancient Chinese business models (Bellin, 2016; Hoffman & Preble, 2003). However, the concept of modern franchising started in the 1800s after the American Civil War by the Singer Sewing Machine Company which instituted a manufacturer-retailer franchise system to distribute their sewing machines and repair services across the United States due to their limited capacity to cover the country's entire market themselves (Cunill, 2006). This type of franchising started in the US and progressively spread to other nations in Europe. At first, franchising concentrated on three industries: car dealerships, gas stations, and companies that bottle soft drinks (Welch, 1989). According to Kaufmann and Dant (1999), franchising is a form of business ownership in which the franchisor, who owns the business, grants the franchisees use of the brand and services in exchange for money (Stanworth et al., 2024). The franchising model started as a form of wholesaler jobber or independent agent in which manufacturers contracted with agents to sell products to independent retailers. In this system, agents can sell products from different manufacturers. In 1830, a new form of agency termed 'exclusive agent' emerged in which only one agent had the sole right to distribute products from a particular manufacturer to a particular market. As a result of this, the agents lost a great deal of their freedom to act, and the relationship shifted from that of principal and agents to franchisor and franchisee.

Following the success of Singer's franchising system, other manufacturing companies like McCormick Machine Harvesting Company started product distribution franchising to help overcome the barrier of distance and seasonal conditions associated with the distribution of farm implements. By 1900, several drinks companies and the automobile industry have adopted the franchise distribution system to meet their various market demands given their limited capacity. Coca-Cola issued its first franchise in 1989, General Motors issued its first franchise in 1988, and Henry Ford issued its first franchise in the early 1900s (Killion & Meiklejohn, 2013).

In the 1800s and early 1900s, the form of franchising that was common was product distribution franchising (Justis & Judd, 2002). However, by 1891, business format franchising was pioneered by Martha Matilda Harper, who developed the 'Harper Method' of hairdressing and skin care and began franchising after training women in her school (Zdatny, 2001; All USA Franchises, 2023). In subsequent years, this mode of franchising was adopted by McDonald's, Burger Chef, and Kentucky Fried Chicken (Love, 1986; Blair & Lafontaine, 2005; Justis & Judd, 2002; Berliner, 2013).

## 2.3. Types of Franchising

Simpson (2022) provides a clear classification of franchising, stating that it can be divided into five types: (1) **distribution franchising**, which refers to a form of franchising in which the franchisee distributes the franchisor's products or range of products. Distribution franchising can either be manufacturing distribution franchising or product distribution franchising. This type of franchising model is mostly adopted by beverage companies and automobile companies. Here, the franchisor permits the franchisee to distribute and sell their products under the franchisee's identity and name. The franchisee, however, does not have access to the franchisor's operation system or business model; (2) **business format franchising** is a form of franchising in which the franchisor provides the franchisee with an entire business model. Here, the franchisee does not only take on the franchisor's

trademark, products, or services, but other elements of the franchisor's business model like brand standards, training, operating manuals, marketing strategy, and business supports, among others. According to [Hoffman and Preble \(1991\)](#), the business format franchising accounts for most of the US franchising growth since the 1950s. This type of business is prevalent in the retail industry and food industries; (3) **conversion franchising** is a modification of typical franchising. It involves converting independent firms in similar industries into a franchise system. Conversion franchising mostly occurs in an intensively competitive industry, causing independent firms with a lower competitive edge to buy into a franchisor's brand name, economies of scale, and a large customer base ([Hoffman & Preble, 1991](#)). This implies faster growth and increased brand share for the franchisor. The franchisor also benefits from this via units and royalty fee income; (4) **job franchising** refers to a low-investment or sometimes home-based franchise run by an individual or a very small workforce (maximum of 5 employees). This type of franchising has low cost and purchases minimal equipment and sometimes a vehicle. This type of franchise model allows a business to enjoy all the benefits of franchising at a lower cost, so it is mostly adopted by individuals who are risk-averse and want to take advantage of the franchise model. The job franchising model is adopted by a range of service providers like travel agencies, cleaning services, coffee trucks, and other similar small-scale services; and (5) **investment franchising** is a divergent form of a job franchise. This usually involves a huge capital investment in large-scale projects. Most times, the franchisees have little or no say in the management decision of the franchise and always employ the services of a specialised management team to supervise the day-to-day running of the business. Examples of this type of franchise model are restaurant and hotel franchises.

#### 2.4. Benefits of Franchising

The benefits of franchising extend to all parties in the franchise agreement. Firstly, to the franchisor, the major benefit accrued to them is an expansion of their business. There is a saying that franchising is an avenue to do something for yourself by others. Other benefits of franchising accrued to the franchisor include increased access to capital and access to human resources for business expansion, benefits from economies of scale, increase in the efficiency of business growth, and increased brand awareness and spread of business risk ([Bradach, 1997](#); [Sorenson & Sorenson, 2001](#)). Secondly, for the franchisee, the benefits of franchising include the following: ease of entering the market, reduced business risk, brand recognition that reduces the need for marketing activities, access to built-in customer base, benefits from economies of scale, and access to well-developed business technologies ([Seyedghorban et al., 2020](#)). Thirdly, the benefits of franchising to the government and economy are the following: increased employment, increased tax revenue, proffers support to other local businesses, and enhanced economic growth and business ([Sebastiani et al., 2014](#)). Research has also shown that franchising promotes economic stability as businesses with franchising have a higher chance at survival in the face of an economic downturn compared to businesses without franchising ([Lanchimba et al., 2020](#)).

#### 2.5. Empirical Study

##### 2.5.1. The Concept of Franchising

The origins of franchising can be traced to the Middle Ages when tax collectors were granted franchises by the Catholic Church in exchange for a portion of their earnings ([Cunill, 2006](#)). The first company to use franchising to distribute its goods was the Singer Sewing Machine Company ([Cunill, 2006](#)). This type of franchising started in the US and progressively spread to other nations in Europe. At first, franchising concentrated on three industries: car dealerships, gas stations, and companies that bottle soft drinks ([Welch, 1989](#)).

According to [Kaufmann and Dant \(1999\)](#), franchising is a form of business ownership in which the franchisor, who owns the business, grants the franchisees use of the brand and services in exchange for money ([Watson et al., 2005](#)).

The franchisor and the franchisee needed to work together as a team and share information for this kind of collaboration to succeed ([Paswan & Wittmann, 2009](#)). Product/tradename franchising and business format franchising are the two categories of franchising. According to [Falbe and Dandridge \(1992, p. 43\)](#), “Product/tradename franchising is a distribution system in which suppliers make contracts with dealers to buy or sell products or product lines”. Product/tradename franchising and business format franchising vary in that the former offers an operational procedure with a strategic plan for advancement and ongoing assistance ([Falbe & Dandridge, 1992](#)). According to [Khan \(2016\)](#), the fast food industry uses franchising as the most prevalent business type. This kind offers the franchisee strong training, technological support, and a tried-and-true business model.

Furthermore, franchising has gained popularity in the restaurant industry as a business model, largely due to the encouragement of American restaurant brands expanding into other markets ([Alon, 1999](#)). The initial and ongoing services provided by the franchisor benefit the franchisee, according to [Stern and El-Ansary \(1988\)](#). For instance, the franchisee can obtain the first services prior to starting the business, such as choosing the location, negotiating the terms of the lease, and offering financial support. After running the firm, the franchisee can access centralised data processing and inventory control through the continuing services. According to [Usha \(2010\)](#), franchisees carry a plethora of information about the domestic market with them. This allows franchise locations to start operations much faster and more efficiently than if the franchisor had to do it alone. In reality, a franchisor would struggle to understand how the home market works. According to [Affes \(2016\)](#), American franchisors are interested in expanding into international markets for three reasons: the presence of a middle-class consumer, a stable business climate, and a local investor interested in their product/service.

Franchising is a well-established business that has assisted both the franchisee and the franchisor in achieving their mutual aim. The franchisee benefited from the franchisor’s competence, while the franchisor gained from the franchisee’s local understanding. The British Franchise Association (BFA) defines franchising as “a contractual license granted by the franchisor to the franchisee that allows the franchisee to carry on a particular business belonging to the franchisor during the period of the franchise; it obliges the franchisor to provide the franchisee with assistance during the period of the franchise to pay fees” ([Mendelsohn, 2004](#)).

In regard to franchise agreements, the franchisor–franchisee relationship is defined by a contract that is normally valid for 3 to 20 years ([Kaufmann & Eroglu, 1999](#)). Franchise contracts outline which items will be offered, the quality requirements, prices, and hours of operation, as well as the start-up date, contract duration, renewal periods, and termination conditions. In contrast to other forms of business activity, franchising legitimately elaborates the symbiosis and distinguishes between economic types. According to [Monroy and Alzola \(2005\)](#), the relationship between the franchisor and franchisee can be helpful because the proprietors convey their expertise to the agents.

According to [Fulop \(2007\)](#), a franchisor who performs transactional duties in the franchise system professionally promotes system success and improves partner performance. An agency relationship involves two partners in all business sectors: the principal and the agent. There will always be some misalignment between the principal’s and the agent’s interests. Because the principal lacks the necessary expertise or resources, the principal delegated tasks to an agent. The principal expects the agent to behave in the best interests of the principal, but the agent’s self-interest may dictate otherwise ([Anderson, 1984](#)). Fran-

chise relationships are successful when the partners acknowledge the competence brought into the connection, resulting in increased value.

According to [Stephenson and House \(1971\)](#), the benefits of franchise connections lie in the potential for greater earnings through teamwork rather than working alone. According to [Hunt and Nevin \(1974\)](#), franchisee participation can be encouraged by exerting influence over the franchisee's behaviour or enticing the franchisee with the possible benefits of the relationship. Teamwork and accountability strengthen the relationship between the franchisee and the franchisor, resulting in the success of the franchise business. The format of the franchising system is based on a contractual agreement between the principal and the agent. The two parties' agreement allows the franchisee to utilise the franchisor's brand name under certain conditions ([Barkoff & Selden, 2008](#)). The contract is divided into two portions. The first requires the franchisee to pay the franchisor the upfront costs for the duration of the contract. The franchisee is also required to pay royalty fees, which are a fixed proportion of sales ([Lafontaine, 1991](#); [Ozanne & Hunt, 1971](#)). [Daszkowski \(2019\)](#) estimates that the 14 royalty fees account for around 5–8% of overall gross sales.

The payment of royalties assists both parties in avoiding doubt about the success of the outlet. [Rubin \(1978\)](#) claimed that if the franchisee just pays the franchisor's initial fees, the franchisor will not be able to share in the business's success if things go better than predicted. A franchise agreement is defined by [Caves and Murphy \(1976\)](#) as "a contract for a definite or indefinite period of time in which the owner of a protected trademark grants the right to operate under said trademark for the purpose of producing or distributing a product or service". In an agency partnership, one party (the franchisor) delegates work to another (the franchisee), who then completes the work ([Eisenhardt, 1989](#)). Rewards and insurance are indispensable for principals within an agent-theoretic framework. Consequently, franchisors must ensure that their sales efforts are in line with the level of incentives extended to the franchisee ([Lafontaine & Slade, 1997](#)). The formal contractual agreement between participants in a franchise system serves as a pivotal control mechanism, promoting goal congruence and enabling monitoring capabilities ([Eisenhardt, 1989](#); [Leblebici & Shalley, 1996](#)). Especially when operating in a foreign country with a different culture, the contract holds significant importance in regulating the relationship between the franchisee and franchisor.

### 2.5.2. Theories of Franchising and Hypothesis

**In regard to resource scarcity theory**, according to [Oxenfeldt and Kelly \(1969\)](#), the resource scarcity theory postulates that franchises are formed because firms have limited resources. Resources here are primarily capital but extend to other forms like knowledge, information, or management systems. [Caves and Murphy \(1976\)](#) argued that businesses leverage franchising to have access to significant resources that they lack, especially in their early stage of development. In order to overcome their resource constraints and grow their businesses, entrepreneurs can either borrow money, sell equity, or sell/buy franchises. However, most entrepreneurs adopt franchising over the other available options because they are unable to take on debt at the early stages due to their inability to provide adequate collateral for the amount of loan required; and selling equity only provides them with access to capital and no other resources ([Dant & Kaufmann, 2003](#)). Franchising, on the other hand, offers access to different types of resources (capital, managerial, and information) and is arguably less expensive than other options ([Caves & Murphy, 1976](#); [Dant, 1995](#)).

According to [Mishra \(2017\)](#), the implication of the resource scarcity theory is that, when businesses eventually mature, and their resource constraints are relaxed, they opt out of franchising and adopt a company-owned strategy. Contrary to this thought though, the study found that about 80% of the matured businesses are still franchised while only 20%

are company-owned, indicating that, with or without constraints to resources, franchising is a viable and sustainable model.

Contradicting the resource scarcity theory, [Rubin \(1978\)](#) argued that resource constraint cannot be the reason for franchising, as the franchisor's cost of capital is higher in franchising than in raising capital from the public market. Also, the franchisees incur a higher cost of capital as their limited capital is invested in a single business unit, reducing diversification and increasing their risk. In support of his argument, Rubin adopted the agency theory to explain the concept of franchising. However, some studies have faulted Rubin's argument that it is based on the assumption that the franchisors have access to the public capital market, which is mostly untrue; and the cost of capital in the private capital market is significantly higher than franchising ([Mishra, 2017](#)).

### 3. Research Questions and Hypotheses

**Research Question 1 is as follows:** Do SMEs with limited access to capital adopt franchising to overcome resource constraints?

**Hypothesis 1.** *SMEs in Saudi Arabia with limited access to capital are more likely to adopt the franchise model as a means of overcoming resource constraints.*

**Agency theory is as follows:** The agency theory is regarded as one of the theories that promote the separation of a company's ownership from its management. The theory was widely promoted in the 1970s by studies like [Ross \(1973\)](#), [Caves and Murphy \(1976\)](#), and [Jensen and Meckling \(1976\)](#). [Ross \(1973\)](#) defines an agency relationship as a contractual relationship in which an entity (the agent) acts on behalf of another entity (the principal) in an aspect of decision-making. The agency theory in franchising proposes that businesses adopt franchising because they want to minimise their risks and leverage on opportunities even if it means trading off their independence ([Castrogiovanni et al., 1993](#); [Michael & Combs, 2008](#)). According to [Mathieu \(1997\)](#), the agency theory explains franchising agreements in the face of uncertainty and incomplete information, given the potential risks and costs associated with every business.

According to the agency theory, the two most common problems of franchising are adverse selection and moral hazard. Adverse selection deals with the inability of the principal to know if the agent has the required capabilities to carry out the responsibilities he is employed for, and moral hazard deals with the refusal of an agent to maximally carry out his duties. This theory has been adopted in other concepts like separating ownership from control, merger and acquisition, and business model franchising and associated enterprise ([Sanfeliix & Puig, 2017](#)).

**Research Question 2 is as follows:** Does a lack of understanding of contractual obligations hinder franchising adoption?

**Hypothesis 2.** *Small and medium enterprises in Saudi Arabia find it difficult to adopt franchising due to a lack of understanding of the contractual obligations required under agency theory. This hypothesis examines whether the complexity of franchise agreements contribute to the challenges faced by SMEs in Saudi Arabia.*

**Signalling theory is as follows:** The signalling theory develops a different perspective on franchising. The priorities of other theories have been on the micro (internal)-constraints facing firms. The signalling theory offers a different approach to harnessing externalities from imperfect markets and information asymmetry ([Dant & Kaufmann, 2003](#)) in the market to understand how organisations make choices. In a market where all the parties do not have access to complete information, franchisors use signals to help franchisees

differentiate between the good franchisors and the bad franchisors. The different signals firms use to provide information about themselves include pricing, advertising, warranties, and promotions.

According to the signalling theory, information asymmetry in the market is driven by two primary forces: (1) the nature of the object for which the agent(s) seek information and (2) the limitation of individuals to assess this information or knowledge due to the possibility of the information misrepresentation by the supplier (Varotto & Aureliano-Silva, 2017). In franchising, most of the assets traded are intangible assets like trade name, operational know-how, and knowledge and managerial guidelines; hence, signalling has become one of the core concepts in the franchise world.

The signalling theory proposes a franchising business for observing dual distribution while creating a chain of company-owned outlets until the organisation is able to create a profound signal for their concepts, after which the company strategies towards franchising (Gallini & Lutz, 1992). The theory also explains the concept of royalty and fees in franchising. Royalty and fees signal business profitability to potential franchisees who want to join the chain. Lastly, the signal theory proposes that franchisors who are yet to establish their reputation can create a contractual agreement that signals confidence in the profitability of the business and the quality of their product, by connecting their revenue to the performance of their outlets (Varotto & Aureliano-Silva, 2017).

**Research Question 3 is as follows:** Are Saudi franchises less successful than those in developed markets?

**Hypothesis 3.** *Saudi Arabian franchise market experiences greater barriers to success and resource constraints than the franchise market in developed markets, such as the United States and United Kingdom, resulting in lower levels of performance.*

**Research Question 4 is as follows:** Does regional franchise density affect adoption rates?

**Hypothesis 4.** *The more the number of established and successful franchises in an area, the stronger the prospective franchisees, leading to higher franchise adoption in Saudi Arabia.*

#### 4. Methodology and Analysis

This research conducts a comparative assessment to study the franchising system in Saudi Arabia together with its existing challenges. This research obtained quantitative data through secondary information collection from industry databases and academic sources. The research used descriptive and comparative statistical methods to test hypotheses to determine the relative strength of performance indicators and validate or refute each hypothesis. The summary of the comparative analysis is presented in Table 1.

**Table 1.** Comparison of franchising in Saudi Arabia and the reviewed countries.

	USA	UK	India	Saudi Arabia
Entry Modes	Master franchise agreements (26.3%), single franchise agreements (22.5%), and joint ventures (18.4%).	Flexible	Flexible with sectoral regulations	Joint venture with Saudi partners

Table 1. Cont.

	USA	UK	India	Saudi Arabia
Regulations	<ul style="list-style-type: none"> <li>- Governed at federal and state levels.</li> <li>- The Federal Trade Commission (FTC) requires franchisors to provide a Franchise Disclosure Document (FDD).</li> <li>- State laws vary, with 26 states having unique regulations.</li> </ul>	<ul style="list-style-type: none"> <li>- Minimal government oversight; lightly regulated.</li> <li>- Guided by the British Franchise Association (BFA), whose code of ethics provides non-legally binding standards.</li> <li>- Franchise contracts adhere to existing commercial and business laws (e.g., Trading Scheme Act 1996, Fair Trade Act 1973).</li> </ul>	<ul style="list-style-type: none"> <li>- Governed by Franchise Regulations Rules (2007), Indian Franchise Act, and sector-specific laws (e.g., Competition Act 2002, Trademark Act 1999).</li> <li>- Focused on fair trade practices and consumer protection.</li> </ul>	<ul style="list-style-type: none"> <li>- Governed by the Ministry of Commerce.</li> <li>- Requires joint ventures with Saudi partners for foreign franchises, allowing foreign investors to own up to 75% equity.</li> <li>- Third-party ownership is not allowed for foreign investors (except in GCC countries).</li> </ul>
Regulation Level	Strict (FTC and state laws)	Lightly regulated	Moderately regulated	Moderately strict
Industry Size	The largest global franchise industry with more than 805,500 businesses, which generated \$860 billion in revenue and created 8.7 million jobs in 2023.	<ul style="list-style-type: none"> <li>- About 48,000 franchises, 900 franchise brands, employing over 700,000 people.</li> </ul>	<ul style="list-style-type: none"> <li>- Second-largest global franchise market, with 4600 active brands and over 200,000 outlets, growing at 30% annually.</li> </ul>	<ul style="list-style-type: none"> <li>- Franchise market valued at \$15 billion, with annual growth of 15–20%.</li> <li>- Food sector leads (17%), followed by clothing and retail sectors.</li> </ul>
Ease of Entry	Structured but requires compliance	Easy due to minimal regulation	Requires adherence to several acts	Complex due to joint venture rules
Key Drivers	Strong brands, regulatory framework.	Legal trust, financial market, English.	Entrepreneurship, consumer demand.	Economic diversification, retail demand.

#### 4.1. Franchising in the United States of America

The USA has one of the largest franchise industries globally with over 3000 brands in the industry. Reports indicate that, as of 2023, the number of franchise businesses in the United States was 805,500 generating about 860 billion U.S. dollars and creating 8.7 million jobs in the country (Statista, 2023). The size of the franchise industry in the US made it one of the largest consumers of commodity goods, suppliers of branded products, and employers of labour. Prominent in the US franchise industry are organisations like McDonald's, Kentucky Fried Chicken, Burger King, 7-Eleven, and Subway. These organisations define and dominate the US franchise landscape. The USA franchising structure is defined by certain elements like contracts, systems, branding, and grant of rights and payment (Sotiroski, 2016).

The franchise model which is currently in use in the United States was first developed in 1800 by the Singer Sewing Machine Company which created a maintenance network for sewing machines. By the 1950s, several organisations in different industries had adopted this model, and the industry started growing significantly. One of such organisation is the McDonald's business, which is one of the largest franchises in the whole world with over 30,000 restaurants in 118 countries. By 1960, the International Franchising Association (IFA) was established to regulate the activities of the franchise industry in the United States. The IFA developed a general code of ethics which guides its members against conflicts and protects the interest of all shareholders. Although membership in this association is optional, it is highly desirable, and most of the top franchises are part of this

association. The association also provide its members with updates on the current activities and trends in franchising, legal development, and information on available opportunities. A similar association formed in the franchising industry is also the American Association of Franchisees and Dealers (the AAFD). This association is formed with an exclusive trademark for all franchise systems that are members of the association. The main purpose of this association is to help franchise systems in the United States make informed and unified decisions to promote equitable franchise relationships.

The franchising business in the United States is regulated at both the federal and the State levels. At the federal level, the Federal Trade Commission (FTC) guides and regulates the activities of the franchise industry, and these regulations are commonly called the FTC Franchise Rules (Marzheuser-Wood & Baggott, 2016). The FTC franchise rule requires the franchisor to provide prospective franchisees with a disclosure document that contains specific information about the franchise business, its officers, and other franchisees. The FTC regulation also defines franchising as any commercial relationship or arrangement in which there is a verbal or oral agreement or contract which contains the following elements: (1) the franchisee has the right to operate a business that is associated with the franchisor's trademark. (2) The franchisor has a level of control over the franchisee's mode of business operations; (3) the franchisee makes a payment to obtain or commence the operation of the franchise. The franchising regulation includes the Franchising Disclosure Documents which covers 23 items that the franchisor is required to disclose to the franchising. These items include the identity of the franchisor, business experience, litigation, bankruptcy, initial fees, other fees, initial investments, restrictions on sources of product, franchisees' obligations, financing, franchisor's assistance, advertisement and training, territory, trademark, patents, copyright and proprietary information, obligations for franchisees' participation, restrictions on products to sell, renewal, termination and transfer, public figures, financial performance, other franchisees' information, financial statement, and contracts and receipts.

The state law of franchising differs from state to state. There are about 26 states with different laws regarding franchising activities in the United States (Woods et al., 2016). According to the state laws, there is no uniform definition of franchising, but each state defines franchising as it is applicable to it. For example, in California, when a franchise is established, (1) the franchisee is given the right to sell or distribute the goods and services of a franchisor, (2) the operations of the franchisees' business are associated with the franchisor's trademark, and (3) the franchisee is required to pay the franchisor or an affiliate of the franchisor a fee of \$500 or more (Woods et al., 2016).

When expanding internationally, most franchises in the US use the master franchise agreement (26.3%) in which they contract or partner with a local organisation to create the franchisor's brand in a particular location according to the agreed contract (Woods et al., 2016). Other forms of entrance adopted by US franchisors for the international market include single franchise (22.5%), joint venture (18.4%), area franchise (11%), and market entry (5.5%) (Hoffman et al., 2016).

#### 4.2. Franchising in the United Kingdom

Franchising has deep roots in the United Kingdom as it dates as far back as the 16th Century when the Feudal Lords gave permission to peasants to use their lands for a certain amount of money (Adeiza, 2019). However, the first set of franchise networks in the UK started in the 1960s with the launching of franchise businesses like Dyno-Rod. Currently, there are about 48,000 franchises in the UK, with over 900 franchise brands, and over 700,000 people employed in the industry (FranchiseUK, 2023). The franchising business in the UK is one that is thriving, highly profitable, and significantly contributes to the

growth of the country's economy (Adeiza, 2019; Hua & Dalbor, 2013). Generally, the UK is regarded as the beachhead for franchising in the European market.

One of the distinct features of the UK franchise market, and one that makes it highly attractive to foreign investors, is the lack of strict rules or regulations in the franchise industry. As such, there is a free ease of operation of franchise business in the country. The franchise industry is guided by the British Franchise Association (BFA) code of ethics, and the franchise contracts are drafted in accordance with the existing business and commercial law in the UK (Hamilton Pratt, 2017). Apart from the UK's reputation as a lightly regulated environment for business and franchising, other features that garnered its popularity as a major market for international business include the emergence of the English language as a global language, the highly developed London capital market, and the perceived trust in the country's legal system (Adeiza, 2019).

The British Franchise Association (BFA) provides a code of ethics, which is not legally binding but strictly complied with by members of the association, provides excellent guidance and benchmarks on issues pertaining to the industry like advertisement, recruitment, and a fair business relationship among its members. The code of ethics requires the franchisor to issue a full disclosure document containing accurate and all relevant information regarding the business and the franchise relationship to the franchisee before signing a franchise agreement. Aside from the BFA code of ethics, there are other regulations and rules that guide foreign investment in the UK like the Trading Scheme Act 1996, The Fair Trade Act 1973, the Bribery Act 2010, and some others. While there are no general restrictions on foreign ownership of UK companies, it is expedient for every company in the UK to be registered with the Company House and fulfil its official requirements.

Based on the unavailability of strict franchise regulation in the UK, franchisors are often faced with the decision to choose a governing law for their business. The UK has a bilateral treaty with a number of countries which acknowledges judgements passed by courts in these countries. However, most foreign franchisors in the UK adopt their country's governing law. It is important to check and verify the impact of the mandatory English law on the franchise agreement, especially for those businesses using the UK as a spearhead to enter into other European countries.

#### 4.3. Franchising in India

There has been a shift in focus of the empirical literature on franchising from developed countries like the UK and the US to developing countries in Asia, Africa, and South America (Terry & Grunhagen, 2017; Perrigot, 2017; Fadairo & Lanchimba, 2016). The franchise industry in Asia is one that is largely expanding especially in countries like China, India, and Pakistan, among others. However, the majority of the empirical literature on franchising has been devoted to the eastern region and the southern region of the continent (Terry & Grunhagen, 2017; Hussain et al., 2020), with limited studies in the western part of the country. This can be attributed to the development of the franchise market in these regions compared to the other regions in the continent. Since Saudi Arabia is in Southeast Asia, this study shall examine one of the developed franchise markets in South Asia—India.

India has one of the largest markets for franchising in Asia and the second largest globally after the USA, boasting of about 4600 active franchise brands and about 200,000 franchise outlets (Dawson, 2018). According to India Filings (2019), the first franchise business in India was Bata Shoe organisation which started in 1931 and currently has over 5000 outlets in India. Other franchise businesses like Pizza Hut, Domino's, and McDonald's entered the Indian market in the late 90s and early 2000 (Hussain et al., 2020). The franchise industry is one of the fastest-growing industries in the country with an expected annual growth of 30%. Prominent sectors in the Indian franchise industry include

retail, food and beverages, health and wellness, and home services. With the increasing awareness of franchising in the country, and the ever-growing entrepreneurship trend, the franchise industry in India has a positive prospect in the coming years. Over the years, there has been significant growth in the number of franchise brands and the employment statistics of the franchise industry in India (Hussain et al., 2020). Sectors such as food and beverages, cosmetics, education, and health are leading sectors in India's franchise market.

Franchise business in India is regulated by the Ministry of Corporate Affairs and Competition Commission of India through the Franchise Regulations Rules, 2007. The franchise agreement between the franchisor and the franchisee is governed by the Indian Franchise Act, providing the basic principles of agreement between the two parties (Sebastian & Kalavathy, 2023). The 2002 Competition Act is also one of the governing regulations in India's franchise industry, ensuring fair trade and anti-competitive practices in the industry. Other regulations guiding franchising activities in India are the Indian Contract Act (1872), the Consumer Protection Act (1986), the Competition Act (2002), the Trade Practices Act (1969), and the Trademark Act (1999), among others (Law Blend, 2024). Aside from the general laws guiding franchise practices in the country, there are sector-specific laws that also govern the operations of different franchise businesses in different sectors of the country (Sebastian & Kalavathy, 2023).

#### 4.4. Franchising in Saudi Arabia

Saudi Arabia is the largest country in the Middle East and has the largest population in the Gulf Cooperation. The country has a heavy reliance on oil as its major source of income. However, due to the changing landscape of oil globally, the government has been making significant attempts to diversify the economy (Al-Kinani, 2025).

There are several options for foreign investors to enter the Saudi Arabian market, ranging from informal contractual relationships to forming a Saudi Arabian company. Most international companies in Saudi Arabia set up a limited liability which allows foreign investors to have complete ownership of the company. However, there are special tax treatments for international companies that partner with Saudi Arabian businessmen (Dentons, 2022; BusinessLink, 2024).

The Saudi Arabian franchise industry is valued at over 1 billion US dollars with an expected annual growth rate of 12–15%. The industry covers various sectors like cleaning services, the apparel line, fast food, automotive parts, the packaging industry, and convenience stores, among others. The food sector has the highest franchise business accounting for over 17% of the industry, followed by the clothing and apparel sector (Al-Kinani, 2025; Dentons, 2022).

The increased inflow of pilgrims as well as the high penetration of the internet in the country has been a major boost for the retail sector, providing a good platform for franchising in the country. The increasing number of immigrants in the country also provides a large consumer market for franchising in the country (Al-Kinani, 2025).

Franchising in Saudi Arabia is prominent in the wholesale and retail sector. International investors interested in investing in Saudi Arabia need to form a joint venture with a Saudi Arabian counterpart, and this joint venture allows foreign investors to own up to 75% of the equity as opposed to the previous 50%, in order to attract more foreign investors into the country (BusinessLink, 2024; SB Saudi Lawyers, 2024). The Saudi Arabian Ministry of Commerce is in charge of franchise registration in the country, and it requires international franchisors to have the name of the brand before they can register the franchise. However, foreign franchisors are required to be the original owners of the franchise business as third-party ownership is not allowed, except for investors in Gulf countries. The registration of a franchise business in Saudi Arabia takes up to 4–6 months

and is subject to different difficulties (Baghdadi, 2024; The Law Firm, 2024). Hence, it is always advisable for international investors to consult a lawyer versatile with the Saudi Arabian Law before starting a franchise business in the country.

#### 4.5. Comparison of Franchising in Saudi Arabia and the Reviewed Countries

**The origin of franchising includes the following:** The origin of franchising in a country aids the development of the franchise industry in such a country, specifically the date of entry. An early entry of franchising in a country gives the citizens and consumers ample time to understand and accept the business model and also enhances the transformation process and maturity level of the franchise industry in such a country. Franchising dates back to 1850, 16th century, and 1931 in the US, the UK, and India, respectively, and this provides the countries with a long and rich history of franchising, which significantly aids the development of the franchise industry in the countries. Franchising started in Saudi Arabia in the late 1970s but only started succeeding in the early 1990s. This might have contributed to the late development of the franchising business in the country. Findings from the empirical literature like Huszagh et al. (1992), Shane (1996), and McIntyre et al. (2006) show that resource-based factors such as age, size, and growth rate aid the development of the franchise industry and franchise businesses in a country. This also explains why franchise businesses such as McDonald's are dominating most franchise industries in different countries as a result of their long history in franchising.

**The number of international businesses includes the following:** Countries like the US and the UK that have a highly developed franchise industry adopted the franchise model primarily as a mode of expansion. Hence, their franchise industry is highly dominated by local industries. For example, the British Franchise Association reports that 80% of the franchise businesses in the UK are UK-owned, with 38% of the UK-owned franchises having franchise units outside the UK. Also, 57% of US franchises have US roots, and some of the major US brands like Subway and McDonald's dominate the franchise industry in most countries (Lindner, 2024). On the other hand, most developing countries accept franchising as a business model so as to attract foreign investors into their economy. However, it is expected that the entrants of these foreign investors will enhance the development of local businesses in the country. In the case of Saudi Arabia, most of the franchise businesses in the country are owned by international organisations with about 76.7% owned by US and UK companies (Alharbi, 2014). This domination of foreign-owned companies in the franchise industry stifles the growth of locally owned SMEs and start-ups in the country and hinders the growth of locally owned franchises in the country.

**The level of regulations includes the following+:** How regulated the franchise market of a country is significantly impacts the development of such markets. While there is no general consensus regarding the overall impact of regulations on franchising in a country, the state of a country's franchise market should inform the kind of regulations to put in place. The US and UK have a highly developed franchise market. However, when it comes to regulation, the two countries are on the opposite end of the spectrum. While the US franchise market is guided by a number of regulations and rules, there are not any stringent rules or regulations to starting a franchise business in the UK (Adeiza, 2019; Marzheuser-Wood & Baggott, 2016), although there are general rules that guide business operations in both countries. India also has quite a number of regulations guiding franchise business in the country, but the rules are not stringent or highly specific. In the case of Saudi Arabia, there was a stringent rule, especially for foreign investors that limits entry into the franchise industry in the country. In recent years, the government has been actively working to reduce these barriers and attract more foreign investors into the economy, while enhancing the development of the franchise market in the country. One of

such attempt is the liberalisation of the ownership structure from 50% equity to 75% equity for foreign-owned investors. Also, in 2020, the Saudi franchise law was enacted to guide franchise relationships in the country. According to [Hussain et al. \(2020\)](#), liberal laws or contract laws are more suitable for countries that are just beginning franchising; however, for countries with a more mature franchise market, franchise-specific laws are required to enhance further development of the market.

## 5. Hypothesis Testing

### 5.1. Hypothesis 1

**Hypothesis 1.** *SMEs in Saudi Arabia with limited access to capital are more likely to adopt the franchise model as a means of overcoming resource constraints.*

Although there is hardly any direct empirical evidence of the role of capital constraints in the adoption of franchise by Saudi SMEs, secondary data can help understand the financial situation of the SMEs and how franchising can be used as a solution: (1) In regards to the availability of capital for SMEs in Saudi Arabia, SMEs in Saudi Arabia generate 30% of the country's GDP and have set their target to generate 35% of the GDP through SMEs by Vision 2030. However, these enterprises are characterised by severe financial constraints including (a) a financing gap in which the growth and economic contribution of SMEs are hampered by a SAR 300 billion financing gap, which is significant ([Udhwani, 2024](#)), and (b) credit concentration because, in Saudi Arabia, the financial institutions prefer to give credit to bigger firms than to SMEs ([Tameed, 2024](#)). This is partly due to the perception that small firms are riskier than they really are. (2) In regards to franchising as a strategic model for SMEs, it provides a ready-to-implement business model that can help overcome some of the constraints that are typical for SMEs: (a) entrepreneurial support, as franchising has been encouraged by Saudi authorities as a means to encourage entrepreneurial activity among the SMEs ([Sadi & Henderson, 2011](#)), and (b) sharing of resources, as in this case, SMEs can be able to use the existing brand recognition, operational support, and shared resources of a franchise company to avoid the need to raise large amounts of capital and start operations. (3) In regards to capital constraints and franchise adoption, as of now, there is no specific data available that can link lack of capital to increased franchise adoption among Saudi SMEs; however, the following can be inferred: alternative financing avenues: this shows that there is a huge financing gap, which may force the SMEs to look for other forms of business models like franchising that are less risky and have more certain results. In regard to policy measures, the promotion of franchising by the government shows that there is an understanding of how this model can help to solve some of the financial and operational problems of SMEs.

The limited, direct empirical evidence shows that SMEs in Saudi Arabia face major financing challenges, yet the government supports franchising which makes franchising a potential solution for resource-constrained SMEs. Additional empirical research is required to establish the exact relationship between these variables and draw final conclusions.

### 5.2. Hypothesis 2

**Hypothesis 2.** *Small and medium enterprises in Saudi Arabia find it difficult to adopt franchising due to a lack of understanding of the contractual obligations required under agency theory. This hypothesis examines whether the complexity of franchise agreements contributes to the challenges faced by SMEs in Saudi Arabia.*

The existing studies and reports help to understand the problems of Saudi SMEs in franchising and contractual complexity. (1) Legal and contractual barriers studies show that Saudi SMEs are faced with severe legal and contractual issues in the process of selecting franchising as a means of expansion: (a) complex contracts, as Alharbi (2014) pointed out that the technical aspect of the franchising contracts is a problem for SMEs because many of them are not legally prepared to understand these contracts, and (b) awareness issues, as according to Al-Mojel (2020), there is a problem of lack of knowledge among the Saudi entrepreneurs on how franchising works and how it is different from agency agreement, which can lead to legal mistakes in the contractual relations. (2) Regulatory changes include the following: To solve these issues, Saudi Arabia has adopted regulatory changes: (a) implementation of franchise law: Saudi Arabia adopted a comprehensive Franchise Law in 2020 to promote franchising activities and provide a regulatory framework for such activities. This law focuses on the transparency and the rights and obligations of the franchisor and the franchisee as well as to protect the both of them. (3) In regards to educational and institutional support, despite the fact that the regulatory measures have been put in place, there is the need to build on educational and institutional support: (a) educational gaps: there are no sufficient formal training programs aimed at franchising and contractual literacy for SMEs which means that many entrepreneurs may not understand all the terms and conditions of the franchising agreements.

The available literature and reports indicate that Saudi SMEs encounter challenges in franchising adoption because they do not fully grasp contractual obligations. The solution to these challenges requires specific educational initiatives together with simplified legal systems and strong institutional backing to improve SMEs' understanding and trust in franchising opportunities.

### 5.3. Hypothesis 3

**Hypothesis 3.** *Saudi Arabian franchise market experiences greater barriers to success and resource constraints than the franchise market in developed markets, such as the United States and United Kingdom, resulting in lower levels of performance.*

To test this hypothesis, it is required to analyse the franchising environments and performance metrics across these markets.

**The franchise environment can be analysed through the barriers to success and resource constraints:**

Several of the empirical literature have highlighted different barriers to franchising business in Saudi Arabia. These barriers include the following: (1) **domination of the franchise market by a few large players**, as, according to Alharbi (2014), about 20% of the franchises in Saudi Arabia are owned by just 8 companies and the domination of these big players makes it difficult for new start-ups to enter and thrive in the industry; (2) a **poor legal environment**, as empirical findings have shown that the legal environment in Saudi Arabia has been a major constraint to franchising in the country (Mattar, 2021), there is a high disparity in the interpretation of franchise laws among different government agencies in the country which results in a difficult registration process for franchises, and the difficulty in comprehending the laws and regulations guiding business operations in the country discourages local and foreign investors from setting up a franchise in the country; (3) **financial constraints**, as, according to a survey conducted by Alharbi (2014), most participants complain of the inability to access financial resources from financial institutions in Saudi Arabia and the majority of the participants who are owners of SMEs narrated their numerous failed attempts to secure funds from financial institutions to start a franchise business, despite the existence of over 16 funded institutions; and (4) **bureaucracy**,

as the process of opening a franchise in Saudi Arabia is quite tedious and complex and a franchise cannot exist until there is a registered name for the brand, which, obtaining a trade mark in the country, takes up to 12 months. The entire business process takes up to 4 or 6 months, and it requires the presence of legal consultants that are versatile in Saudi Arabian law to avoid complications in the registration processes. Also, the franchise business is required to register with different government authorities, each with its bureaucratic processes, making the overall process stressful and complex. There are also the following: (5) **regulatory ambiguities and compliance challenges**: despite the establishment of the Saudi Franchise Law in 2019, there are still many regulatory ambiguities with some of them being unclear provisions that can be interpreted differently and applied differently, which can be confusing to franchise operators, and the compliance challenges only worsen the situation, especially for international businesses that are not familiar with the legal environment (Almalki et al., 2024); (6) **economic dependence on oil**: the economy of Saudi Arabia is dependent on oil and therefore vulnerable to oil price volatilities in the international market (Ali, 2020), and economic recessions that result from low oil prices affect consumption and, consequently, affect franchise performance and retail and food services sectors; (7) **supply chain inefficiencies**: international franchises face several challenges in the supply chain in Saudi Arabia, including import restrictions, customs delays, and localisation policies that hinder efficient operation, and these inefficiencies can lead to increased costs and time to deliver the products and can be detrimental to the franchise's profitability (González-Márquez et al., 2023); (8) **workforce challenges**: Saudi Arabia's Saudisation policy requires that businesses have a certain percentage of Saudi nationals on their staff, and this policy of increasing the employment of Saudi citizens is well-intentioned but adds complexity and expense, especially for franchise operators who need highly skilled labour, especially in certain sectors, and so many franchises may find it hard to meet these workforce regulations (Riyadh Behavioral Insight Center, 2022); (9) **market saturation in specific sectors**: certain sectors, especially the fast food industry, have become overcrowded with both international and local franchise entries, and this over-competition in the market reduces the possibility of new businesses emerging and growing, thus making it difficult for franchises to gain their market share (González-Márquez et al., 2023); (10) **lack of local business expertise**: Many of the small-scale franchisees in Saudi Arabia do not have the necessary experience or knowledge of the business environment, and the lack of experience and knowledge can result in inefficiency in operation and poor decision-making, which can be detrimental to franchise businesses (Abdul Ghani et al., 2022); and (11) **cultural and religious considerations**: Saudi Arabia is a strictly Islamic country with a strictly defined culture and values, which any business that wants to operate in the country should strictly adhere to. Cultural and religious norms in Saudi Arabia greatly affect consumer behaviour. Consumer acceptance of franchises that are not ready for the norms of the market, for instance, not halal-certified or not supporting gender segregation, is low. Therefore, operators of franchises and other businesses in the country are advised to be aware of the culture and religious sentiments of the society and should adhere to their concepts and operations accordingly. For example, only using food ingredients that are Halal-approved. This cultural incompatibility can greatly reduce the market potential and success of franchises (Abdul Ghani et al., 2022).

#### **Comparative Analysis of Franchise Performance Metrics and the Reviewed Countries**

As shown in Table 2, franchise performance metrics are reviewed against the reviewed countries. Franchising is an important part of world economies with variation in market share, revenue, regulation, and business performance. This analysis includes Average Revenue Per Unit (ARPU), Return on Investment (ROI), Franchise Success Rate, Time to Break Even, Market Growth Rate, and other similar indicators.

**Table 2.** Comparative analysis of franchise performance metrics and the reviewed countries.

	United States	United Kingdom	India	Saudi Arabia
Number of Franchise Establishments	806,270 franchise units	50,421,270 franchise units	200,000 franchise units	1200 franchise units
Franchise Market Size	\$858.5 billion	£19.1 billion billion (approximately \$25.8 billion)	Rs 800 billion (approximately \$50.4 billion)	\$15 billion
Annual Market Growth Rate (%)	4.3%	4%	30–35%	27%
Average Revenue Per Unit (ARPU)	\$1.2M–\$2M	£400,000 (approximately \$544,750)	\$200,000	-
Return on Investment	20–25%	12–20%	12–18%	15–20%
Franchise Success rate (%)	85%	89%	53%	60–65%
Time to Break Even (Years)	2–3 years	2.5–3.5 years	2–3 years	3–6 years

Source: Compiled by author from various sources.

Franchising is a common global business practice with varying market sizes, revenue generation, regulatory frameworks, and business success rates across different countries. These key performance indicators include Average Revenue Per Unit (ARPU), Return on Investment (ROI), Franchise Success Rate, Time to Break Even, Market Growth Rate, and any other relevant parameters.

#### Franchise Market Size and Growth

The United States stands as the world's biggest franchise industry because its market value reached \$858.5 billion according to the [International Franchise Association \(IFA\) \(2024\)](#). The Indian franchise market stands at Rs 800 billion (approximately \$50.4 billion) according to D'Andrea & Partners Legal Counsel in 2025 while the United Kingdom has a franchise market worth £19.1 billion (approximately \$25.8 billion) ([BFA, 2024](#)), and Saudi Arabia operates with a franchise market valued at \$15 billion ([Argaam, 2025](#)). The growth rate in India leads the market because its expanding middle class drives a 30–35% increase. The annual growth rate in Saudi Arabia reaches 27% because of its Vision 2030 initiative ([Argaam, 2025](#)).

#### Financial Performance

The American franchises get the highest average revenue per user (ARPU) (\$1.2M–\$2M) IFA, 2024, and specific ARPU data for Saudi Arabia is not available, but the franchise market is growing at an immense rate, with registrations up by 866% in the last three years, which means that there is a high potential for revenue growth of franchise units ([Al-Kinani, 2024](#)). The Return on Investment (ROI) is the highest in the United States (20–25%), whereas the ROI in Saudi Arabia is not the same as the United States (15–20%) due to regulatory constraints.

#### Franchise Success Rate and Break-Even Period

The United Kingdom has the highest success rate (89%) ([BFA, 2024](#)), and this can be attributed to the existence of well-known brands and legal protections. Saudi franchises have a 60–65% success rate with a longer break-even time (3–6 years) due to market barriers.

#### Regulatory and Institutional Complexity

Saudi Arabia has a fairly strict franchise regulation, which provides that only joint ventures are allowed for foreign investors, and while the US is very strict, UK is light, and India is moderate. This makes entry difficult; it needs local partnerships.

Although there is currently very limited direct comparative data between Saudi Arabia and developed markets, current research indicates that franchises in Saudi Arabia face more barriers and resource constraints. ([Alharbi, 2014](#); [Alotaibi, 2019](#)). Such challenges as legal complexities, a developing franchise ecosystem, and limited access to performance data lead to lower franchise performance in the region ([Alharbi, 2014](#); [Frederick, 2017](#)). These

issues can be addressed through regulatory improvements, the enhancement of market support services, and increased transparency in the reporting of performance data which could help to enhance the Saudi franchise industry and overall business results (Alharbi, 2014; Alotaibi, 2019).

#### 5.4. Hypothesis 4

**Hypothesis 4.** *The more the number of established and successful franchises in an area, the stronger the prospective franchisees, leading to higher franchise adoption in Saudi Arabia.*

This hypothesis examines whether a higher concentration of successful franchises in a region positively influences the decision of prospective franchisees in Saudi Arabia. This paper explores the expansion of franchise registrations in Saudi Arabia and the factors that govern the adoption of franchise.

##### **Growth of Franchise Registrations in Saudi Arabia**

The following are recent data of the franchise registrations within the kingdom: (1) surge in registrations, as franchise registrations in Saudi Arabia have increased by 866% over the past three years, a total of 1788 by the end of the third quarter of 2024 (Al-Kinani, 2024), and (2) regional distribution, as the regions with the most franchise registrations were Riyadh with 647 registrations, followed by Makkah with 363 registrations, and the Eastern Province with 225 registrations (Batic Law Firm, 2024).

##### **Factors driving Franchise Businesses in Saudi Arabia**

Various factors are driving the performance of franchisees in Saudi Arabia. These factors include the measures being taken to encourage business activities: (1) **economic diversification initiatives:** the Vision 2030 plan is a major plan that is now in practice to change the economy of Saudi Arabia and reduce its dependence on oil, and this plan focuses on developing new areas of business such as retail, food services, and education to create new markets for franchise businesses, and so the business environment is, therefore, considered friendly by Vision 2030, and this has encouraged both local and international franchises to look for markets in Saudi Arabia (Vision 2030 Annual Report, 2023; The Franchizery, 2024); (2) **government support and regulation:** the pronouncement of the Saudi Franchise Law in 2019 has put in place a much-needed framework for the franchise sector in Saudi Arabia, as this law is said to provide better legal frameworks and stronger legal provisions for franchise agreements, which has increased the confidence of investors and, therefore, the number of investors in the market (Chiu & Murray, 2020; Almalki et al., 2024); (3) **rising consumer spending:** the population of Saudi Arabia has a growing middle class, and more people are now earning and spending more, which has increased the demand for all kinds of franchises, as people are willing to spend their money on different products and services, and this has created a good market for franchise businesses in the food and beverage and retail and entertainment sectors (Mattar, 2021); (4) **cultural alignment of global brands:** experience has shown that those franchises that are able to align their products or services to the culture and religion of the Saudi market tend to do well in the market. For instance, brands that offer halal certified food or provide for gender separation have received a lot of acceptance and loyalty from the market, and this cultural adaptability has become a crucial factor in the success of international franchises in Saudi Arabia (González-Márquez et al., 2023); (5) **market growth potential:** in the last few years, there has been growth in areas such as food and beverage and retail and education in the Saudi market, as these industries are growing due to changes in consumer behaviour, urbanisation, and government policies and, therefore, offer the franchisees an appropriate area for investment (Almalki et al., 2024); and (6) **infrastructure development and NEOM Project:** the formation of NEOM and similar infrastructure projects are changing the face

of cities in Saudi Arabia, as these transformations enhance the level of urbanisation and increase the accessibility of the franchise market. With better infrastructure and transportation networks, businesses are in a position to explore new customer/consumer segments and expand their operations (*Vision 2030 Annual Report, 2023*).

#### **Correlation Between Established Franchises and New Adoptions**

The correlation between existing franchises and new adoptions includes the following: Although there is scarce research that provides direct evidence on quantifying the relationship between the size of established franchises and franchise growth rates in Saudi Arabia, the increase in the number of franchise registrations indicates the possibility of a positive trend (*Argaam, 2025*). This is because having successful franchises around probably makes prospective franchisees more confident that the business model is viable and profitable.

The growth of the franchising sector in Saudi Arabia can be attributed to strategic economic reforms, government support, cultural compatibility, and improving infrastructure. These factors have placed the country on the map as a potential market for franchise development for both local and international businesses.

The rise in franchise registrations throughout Saudi Arabia demonstrates that more successful franchises in established areas attract prospective franchisees who then adopt more franchises. The economic stability combined with government support and Vision 2030 reforms drives this trend.

## **6. Conclusions**

A comprehensive review of the franchise sector in Saudi Arabia, in comparison to other established franchise markets, reveals several key findings regarding the challenges and opportunities within the Saudi Arabian franchise system. This study addresses a significant research gap by contextualizing and testing hypotheses related to franchising in Saudi Arabia. The results highlight the necessity of adapting global franchise models to local conditions and offer actionable insights for investors, policymakers, and researchers. Future studies should expand statistical testing with primary data and investigate causal relationships.

### *6.1. Franchising Opportunities*

As one of the largest economies in the Middle East and there being the continued emphasis on economic diversification, Saudi Arabia has numerous franchising opportunities. Foreign investors can venture into the Saudi Arabian market through informal contractual relationships. Forming a Saudi Arabian company is also an opportunity. Most companies in Saudi Arabia offered very minimal liabilities, allowing foreign investors.

The growth prospect of the franchise sector in Saudi Arabia has been promising with a growth rate of 27% (*World Franchise Centre, 2024; Argaam, 2025*). Additionally, the market is diverse covering various critical sectors such as automotive, apparel lines, and fast food. This high growth rate especially in retail is associated with an influx in pilgrim migration, which provides a large consumer market, as well as a high penetration of internet connectivity. Investors must however consider the legal requirement of franchising in Saudi Arabia.

### *6.2. Comparison with Other Franchise Markets*

From an analysis of different franchise markets, developed and developing, notable disparities and influencing factors in the franchise sectors exist. This study concluded that the historical inception of franchising plays a major role in influencing its adoption and acceptance in any country. Countries such as the US and the UK have a long history of franchising that dates back to the 16th century. It is therefore apparent that the countries have a better understanding and acceptance of the franchising business model. The fran-

chise sector in these countries is quite developed. In Saudi Arabia, however, franchising as a business model started in the late 1970s, and this delayed entry has contributed to the slow pace of development.

Furthermore, there is a strong disparity in the dominance of international versus local businesses within the franchise industries. Franchise markets such as the United States, which are well established, are characterised by a strong presence of local business reflecting maturity and strength of local business in such markets. Emerging franchise markets such as Saudi Arabia are characterised by a strong presence of foreign-owned companies. This disparity can be explained by the easy access to capital and resources in developed markets, characterised by favourable lending practices that support small and medium enterprises. Moreover, early entry into franchising by developed markets such as the UK has enhanced their market penetration, and globalisation has favoured their venture. International brands have a proven track record of success and are easily preferred by consumers. Other factors such as legally friendly business environments have led to these disparities.

Lastly, the level of regulations in established franchise markets is similarly well developed, and despite their stringent approach, they favour franchising. Emerging markets such as Saudi Arabia and India have significant regulatory complexities which act as barriers to franchising in these markets. It is until recently that the Saudi government has taken a major step in developing its legal infrastructure through the Saudi Arabian Franchise law implemented in 2020 in an attempt to support a conducive franchising environment.

### *6.3. Barriers to Franchising in Saudi Arabia*

The study found numerous barriers that inhibit the growth of the franchise sector in Saudi Arabia, with a poor legal environment being the major barrier. The lack of an elaborate legal framework guiding the franchise industry leaves room for the disparity in the interpretation of existing laws and consequently making franchise registration difficult for investors and interested partners. Furthermore, their bureaucratic process of franchise registration is time-consuming and resource-demanding. An analysis of the empirical evidence of different studies shows that domination by few market players, financial constraints, bureaucracy, and cultural and religious considerations are the key barriers.

## **7. Policy Implications**

The findings of this paper highlight the urgent need to streamline regulatory frameworks from a policy point of view. Policymakers must deliberately develop a standard framework supporting franchising in Saudi Arabia. Bureaucratic hurdles should be minimised to create a conducive business environment for both local businesses and foreign investors. If the implications of the recent policy changes through the Saudi Franchise law are anything to go by, then the future of franchising in Saudi is largely dependent on policy and legal frameworks that the nation will adopt in future.

Moreover, policy initiatives targeting local enterprises should be implemented, including enhancing access to capital for SMEs. This, coupled with initiatives that support innovation, will help Saudi Arabia realise its franchising goals. Also, policymakers should be deliberate in developing and implementing policies that support local partnerships and international collaboration to accelerate the growth of the franchise market in Saudi Arabia.

By addressing the challenges that face the franchise sector in Saudi Arabia and implementing targeted policy initiatives, the nation can unlock the benefits of economic diversification and franchising. The sustainable economic growth of the Kingdom relies on streamlining legal frameworks, supporting local businesses, enhancing access to financial resources for small-scale businesses, and enhancing international collaboration.

## 8. Recommendations

Franchise businesses in Saudi Arabia should be made to fit the cultural and religious norms of society and thus meet the expectations of the consumers in the area. Also, they should not try to expand into already saturated markets but rather into strategic areas and sectors that are currently growing. To enhance the visibility of the opportunities, franchisees need to take advantage of the government incentives and programs that support localisation to ensure that they are well incorporated into the Saudi business environment. Furthermore, the cost of technology investment can enhance supply chain management and fulfil localisation policy standards that would enhance the efficiency and effectiveness of the market.

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