**Franchising in Russia**

Franchising - from the French for 'Free', is a method of doing business wherein a franchisor licenses trademarks and methods of doing business to a franchisee in exchange for a recurring royalty fee.

The term is commonly used to describe a wide variety of business relationships which may or may not fall into the legal definition provided above. For example, a vending machine operator may receive a franchise for a particular kind of vending machine, including a trademark and a royalty but no method of doing business.

In the US franchising falls under the jurisdiction of a number of state and federal laws. Contrary to what might be expected, there is no federal registry of franchising or any federal filing requirements for information. Instead, states primarily collect data on franchising companies and enforce laws and regulations regarding their spread.

Franchising is at least 150 years old. One early example resulted in the characteristic look of historic hotels (bars) in New South Wales, with franchising agreements between hotels and breweries. An American example was the telegraph system operated by various railroad companies but controlled by Western Union, or selling a certain make of automobiles in a car dealership.

Some people would argue that franchising (in a non-profit sense) goes back even further; science-fiction author Neal Stephenson pointed out a resemblance between franchising systems and churches (specifically the ones that proselytize) in his breakthrough novel, Snow Crash.

Modern franchising came to prominence in the 1950s with the plethora of franchise-based fast food restaurants, of which McDonalds is the first and most globally successful. Many retail sectors, particularly in the United States, are now dominated by franchising to the point where independently-run operations are the exception rather than the rule. As an example, the Sport Clips Franchise organization only opens company owned stores to test new marketing concepts or ideas. As a result, Sport Clips owns very few of the over 200 franchisee owned stores. There is much information on franchising online.

As practiced in retailing, franchising offers franchisees the advantage of starting up a new business quickly based on a proven trademark and formula of doing business, as opposed to having to build a new business and brand from scratch (often in the face of aggressive competition from franchise operators).

As long as their brand and formula are carefully designed and properly executed, franchisors are able to expand their brand very rapidly across countries and continents, and can reap enormous profits in the process, while the franchisees do all the hard work of dealing with customers face-to-face. See customer service.

In response to the soaring popularity of franchising, an increasing number of communities are taking steps to limit these chain businesses and reduce displacement of independent businesses through limits on "formula businesses."

Franchising is both an old and a new concept. The term from the French originally meant to be free from servitude. Its meaning in the context of present-day promotions is the opportunity for an individual to own his or her own business, even if he or she is inexperienced and/or lacks adequate capital. During recent years, franchising, as a type of business operations, has been expanding rapidly and entering into new areas of application. The most recent industry study estimates that franchised businesses accounted for $803 billion in annual sales in 1992. Retail (business format) franchising is estimated to account for 35% of total U.S. retail sales. More than 8 million people are employed by franchise establishments.

Franchising is a form of licensing by which the owner (the franchisor) of a product, service or method obtains distribution through affiliated dealers (the franchisees). The holder of the right is often given exclusive access to a defined geographical area.

The product, method or service being marketed is identified by a brand name, and the franchisor maintains control over the marketing methods employed, or assists the franchisee in the operation of the business.

In many cases, the operation resembles that of a large chain with trademarks, uniform symbols, equipment, storefronts and standardized services or products. The franchisor maintains uniform practices as outlined in the franchise agreement.

The International Franchise Association, the major trade association in the field, defines franchising as "a continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organizing, training, merchandising and management, in return for a consideration from the franchisee."

Franchising has been described as "a convenient and economic means for the filling of a drive or desire (for independence) with a minimum of risk and investment and maximum opportunities for success through the utilization of a proven product or service and marketing method." The owner of a franchised business, however, must give up some options and freedom of action in business decisions that would otherwise be open to the owner of a non-franchised business.

In a way, the franchisee is not his own boss, because in order to maintain the distinctiveness and uniformity of the service and to insure that the operations of each outlet will reflect favorably on the organization as a whole and protect and build its goodwill, the franchisor usually exercises some degree of continuing control over the operations of its franchisees and requires them to meet stipulated standards of quality. The extent of such control varies. In some cases, franchisees are required to conduct every step of their operation in strict conformity with a manual furnished by the franchisor. In other cases, the franchisor may allow considerable latitude on the part of the franchisee.

In return for following the franchisor’s guidelines, the individual franchisee can share in the goodwill built up by all of the other franchised outlets bearing the same name.

A company that depends upon the successful operation of franchised outlets needs individual franchisees who are willing to learn the business and who have the energy for a considerable amount of effort. The franchisor can supply the other essentials for the successful operation of the outlet. Among the services the franchisors may provide to the franchise operators are: (1) location analysis and counsel; (2) store development aid, including lease negotiation; (3) store design and equipment purchasing; (4) initial employee and management training and continuing management counseling; (5) advertising and merchandising counsel and assistance; (6) standardized procedures and operations; (7) centralized purchasing with consequent savings; and (8) financial assistance in the establishment of the business.

The U.S. Commercial Service in Russia has identified the franchising sector as one possessing a significant potential for development and offering vast opportunities for U.S. franchisers. Growing domestic consumption and demand for high quality services in the country has led to an increase of interest in franchising. The popularity of American franchise brands and improved trade relations between the two countries in combination with positive macroeconomic trends and an improving investment environment in Russia have created the necessary conditions for successful market entry by U.S. franchisers.

While an interest in franchising has existed in Russia since the fall of the Soviet Union and the opening of a market economy, the real start of development of this sector did not occur until the mid 1990's. Initially, the unstable economic situation hampered market growth in franchising. Despite the adverse economic conditions, the sector continued to expand. The recent macroeconomic stabilization of the last two years has created conditions for more rapid growth in this sector. Furthermore, the state of entrepreneurial activities is increasing support and actively endorsing the development of this sector.

Both foreign and local franchisers successfully operate in the Russian market and are quite optimistic about opportunities for expansion. Although there are currently, fewer foreign than domestic franchisers present in the market, it is far from saturated. The number of local franchisers (and potential franchisers) however is not sufficient to meet the growing demand and with new market entries by foreign franchisers the competitive situation may quickly change.

In Russia, franchising is utilized in the restaurant business, printing and copying services, photo-shops, repair and maintenance services, body/health care and leisure services, retail sale (clothing and footwear shops, furniture shops, sport wear shops, supermarkets, gasoline stations), business management and other services.

Because of the specific time, when franchising emerged in Russia, it has not had an opportunity to develop and spread as widely as it potentially could in a more stable environment. The main impediments that have constrained market development could be summarized as follows:

– Legal environment was lacking clarity that would boost the development of the sector.

– Local businesses had very limited knowledge of the mechanisms and advantages of franchising.

– Until recently, the state did not undertake any significant efforts to support SME development.

– Cultural and psychological particularities of local business ethics made the idea of purchasing intellectual capital unattractive.

– The high degree of mistrust among businesses, and inadequate protection of ownership rights.

Unfortunately, insufficiency in the local legislation governing franchising created a situation of the complete absence of market statistics. The franchisers and franchisees preferred to register franchise agreements under various legal forms, such as a licensing agreement, or a sales contract. Consequentially such deals were not reflected in the books of the State Registration Chamber - a main source of statistical data on the Russian market. Thus no justifiable data reflecting the size of the market is currently available.

According to recent research reports, during its very short history, franchising has generated more than 17 thousand jobs and attracted more than US$ 350 million in foreign investments to Russia. Even more significant grow of this sector is foreseen by many analysts. The following factors are expected to create better conditions for new market entries.

The Russian economy has seen an upturn over the past three years (1999-2001). After a decade of political and economical instability, the main trend now emerging in Russia is stabilization. The State is consolidating its control functions, the economy is expanding, and political and macroeconomic risk factors have been significantly reduced. Consumer spending and investment expenditure have grown at dizzying rates which has led to an increase in consumer demand. This has led to growth in economic sectors that are primarily focused on the domestic market.

Substantial progress was achieved in improving legislation governing economic, business and investment activity. The Government is successfully implementing structural reforms, aimed at lifting the tax burden, a more liberal currency regulation system, and a further reduction of administrative barriers such as: simplified procedures for registering legal entities, streamlined inspection procedures, and fewer licensing requirements.

Increasing economic globalization is forcing Russia to make effective use of resources and increase the competitiveness of its domestic market. Russia is making efforts to actively foster global economic links and to create conditions conducive towards generating revenue and increasing in-bound investment.

The top rating agencies agree that Russia has become an increasingly attractive place to invest. Fitch, S&P and Moody's have raised their ratings and upgraded the outlook on Russia from stable to positive, with Fitch citing "exceptional macroeconomic performance and acceleration in structural reform," that makes Russia "well placed to weather even a severe global downturn."

The macroeconomic situation in Russia creates favorable conditions for boosting small- and medium-sized enterprises (SME) and new business development. Moreover, SMEs are likely to receive strong political backing from the Russian Government given the ongoing restructuring in the majority of industry sectors, and their role as a source of political support for market reforms.

A simplified tax structure, streamlined regulation, and increased access to bank financing creates conditions for the development of small enterprises and is likely to stimulate the development of franchising in Russia. One of the latest examples of reform is the simplification of small business taxation. Beginning in January 2003, small businesses (enterprises with fewer than 100 employees and an annual turnover of less than RUR 15 million, which is approximately US$ 470,000) will be given a choice of paying either a unified tax rate of either 6% of turnover or 15% of income.

Franchising is an ideal tool to be utilized in the development of a favorable environment for SMEs. It is widely utilized by existing businesses, as well as by first time businessman and individual entrepreneurs. For the first group franchising represents a very attractive tool for diversification of business activities and leveraging of risks for the latter group it serves as an unfailing means for starting their own private businesses.

The improving business environment (including good governance, intellectual property rights and investors' rights protection)in the mid-term is expected to improve the image of Russia in the eyes of foreign investors. Which may attract more foreign franchisers to the local market.

Russia's efforts to join the WTO in the near future positively affects the business and economic environment for U.S. products and services. The Russian Government is successfully building an efficient market and is making efforts to raise the country's long-term standard of living. WTO accession would foster greater competition among enterprises, increased transparency, attract foreign investment, reduce corruption, and open Russian markets for exporters. Russia is already gradually lowering tariffs and quotas.

Since 2001, the U.S.-Russian relations have become very close, which also very positively affected the trade and investment climate and created conditions for U.S. exports in Russia. The current Administrations of the two countries are capitalizing on this momentum. The U.S. Department of Commerce Secretary, Donald Evans has visited Russia three times since mid-2001 and created excellent working relationships with his Russian counterpart Minister of Economic Development and Trade, German Gref.

The private sector Russian-American Business Dialogue (RABD), a business-driven mechanism aimed at strengthening the trade and investment ties between Russia and the U.S, has further enhanced the level of economic cooperation between our two nations. In May 2002, Russia was formally recognized by the U.S. as a market economy.

With the growth of domestic consumer capacity, demand for various services is growing and practically all services where franchising can be used represent considerable business opportunities in Russia. According to experts, franchising is quite attractive for the businesses that are interested in sales of technically complicated equipment, business support services (business consulting - audit and accounting services, advertising, HR related services, technical consulting), housing construction and repair services, education services (tutoring, foreign language courses), leisure and entertainment, fast food, medical and cosmetic services, retail sale, and other personal services (laundry, footwear and clothing repair, delivery services etc).

Currently, the mainstream of local potential franchisees is seeking agreements with franchisers operating in the following sectors:

– Fast-food

– Printing and copying services, photo-shops, etc.

– Auto repair and maintenance services

– Body/health care services (beauty saloons, gyms, etc.)

– Retail sale (clothing, footwear, furniture, sporting goods, supermarkets, gasoline stations)

In 2002, a marketing agency MAGRAM Market Research conducted an analysis of the fast food industry. The main result of the study was that the market is expansively growing. However, the research did not define a precise size of the market. Experts estimate the annual volume of transactions on the market as US $15 - 40 billion. In Moscow alone, approximately 30-40 restaurants and cafes open each month. And still many experts comment that the demand is significantly undersatisfied, especially in suburban areas where most Moscovites live in multi-flat apartments. According to the Department of Consumer Markets of the Moscow City Government, in March 2002 there were 5,717 catering facilities (2000 restaurants, 130 nightclubs, 40 locations with around the clock service facilities, 45 pubs, 500 fast food facilities, and 2000 cafes and bars).

The concept of fast food remained largely unknown to Russians until the late 1980s and early 1990s when Pizza Hut - then operated by PepsiCo and McDonald's - opened its first stores in downtown Moscow. At that time fast-food restaurants were viewed as exotic Western attractions rather than regular eateries.

The first fast-food restaurants were too expensive for ordinary people and mostly catered to the very limited. Gradually, salaries rose in dollar terms, making imports more affordable, and fast-food restaurants began to serve a wider clientele, which brought about a decline in the quality of services. Insiders say that the quality of service is a common problem for the entire sector and while some firms have made better progress, there is still a long way to go before Russian fast-food restaurants can offer customers proper levels of service. A more significant presence of international food franchising giants in the market could improve the industry's overall quality standards.

With salaries on the rise and more discretionary spending, fast food chains are prospering in Moscow. The market is divided between international fast-food giants and their domestic competitors, and both are looking at expansion. The market is far from saturated however, with unsatisfied demand for high quality fast-food chains.

The Russian automotive sector has been growing rapidly since the beginning of the 1990s and during the last ten years the average growth rate is approximately 7-10% per year. Import of foreign automotive industry products is also growing. Analysts predict that this growth will continue in the near future. According to various industry sources, the annual per car maintenance expenditure in Russia exceeds $ 1,000. In Moscow alone, there are over 2 million private cars, thus the Moscow market exceeds $ 2 billion. In Moscow there is only one network of independent car service outlets – Bosh Service. It has approximately 54 car service shops in Russia (including 11 in Moscow). A Pennsylvania based ChipsAway Inc. is successfully using franchising to increase its presence on the Russian market of car paint restoration services and has already opened six car body maintenance centers in Moscow and one in Vologda.

**Literature**

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