INTERNATIONAL TRADE ADMINISTRATION

2016 Top Markets Report Franchising
Country Case Study

China

As one of the largest economies in the world with over 1 billion people, China represents an enormous opportunity for U.S franchise firms. Although its economy has shown signs of slowing down, China's middle class continues to expand, resulting in rising incomes and more potential consumers for franchise establishments. Franchising has shown promise in China with over 4,500 franchises and chain store companies creating more than 5 million jobs nationwide.

Overall Rank

3

Statistics from China Chainstore & Franchise Association (CCFA) show that the country's top 100 franchises generated total sales of RMB 428 billion (about $66 billion) with the total number of stores across these 100 franchises at 124,086. China has over 4,500 franchises and chain store companies creating more than 5 million jobs nationwide.

The Chinese franchising market is dominated by traditional franchise operations, like food and beverage (F&B) and retail outlets. According to CCFA, nearly 40 percent of all franchisers in China are engaged in such industries. U.S. franchisers have established a particularly strong foothold in the F&B market.

Franchising opportunities abound in non-F&B industries. The best prospects in this form of franchising include sectors such as car rental and services, education and youth learning, and health and fitness.

Foreign franchise brands are receiving greater interest from second and third-tier market developers, as markets in Beijing and Shanghai become more saturated. Major locations that were abandoned by foreign multinationals over the past few years were almost all in first-tier market cites. High rent is expected to negatively impact more foreign franchises in Beijing and Shanghai. There is, however, room for growth in China's western and inland regions that boast advantages such as lower labor costs, reasonably-priced real estate facilities and untapped consumer spending.

Some foreign companies are beginning to establish multiple retail outlets under a variety of creative arrangements, some of which function as franchises. Virtually all of the foreign companies who franchise in China either manage the operations themselves with Chinese partners (typically establishing a different partner in each major city or region) or sell to a master franchisee, which then leases out and oversees several franchise areas within a territory.

Challenges to U.S. franchise firms include a relatively nontransparent regulatory system, increasing costs of labor and real estate, and a lack of qualified Chinese franchisee candidates. The most recent legislation released by the Ministry of Commerce in 2004 is the two-plus-one requirement. This requirement stipulates that franchisors own at least two directly operated outlets anywhere in the world before being allowed to operate a franchise model in China. In addition, franchise firms must file with the local commercial authority of record within 15 days after the execution of the initial franchise contract.

It is important for entities considering a franchise model for expansion in China to consider steps to protect their brand and image. Prior to making substantive moves into the market, including negotiations with potential partners or franchisees, companies should consult with appropriate counsel regarding trademark registration and the protection of their intellectual property rights.

One of the most difficult aspects of franchising in China is finding qualified franchisees. Franchising is still a relatively new concept in China, with many Chinese still unfamiliar with this model. Moreover, collecting royalty payments and ensuring that the franchisee maintains brand integrity can be formidable challenges. Experts recommend that companies first open their own stores in China to show the market that the business concept works and to solidify its brand positioning before attempting a franchise model. Another suggested approach is to find a franchise partner for Mainland China in a more developed area such as Hong Kong, Taiwan and Singapore.

China has issued regulations generally implementing its commitments in the area of franchising services. As part of its distribution commitments, China committed to permit the cross-border supply of franchising services immediately upon its accession to the WTO. It also committed to permit foreign enterprises to provide franchising services through a commercial presence in China, without any market access or national treatment limitations, by December 11, 2004.

In December 2004, as previously reported, MOFCOM issued new rules governing the supply of franchising services in China, which included a requirement that a franchiser own and operate at least two units in China for one year before being eligible to operate franchises in China. In 2007, following U.S. engagement, China eased the requirement that a franchiser own and operate at least two units in China by allowing a franchiser to offer franchise services in China if it owns and operates two units anywhere in the world. The United States welcomed this action and has been monitoring developments in this area since then.[1]

Major international franchise firms have established the following best practices for doing business in China:

- Register the brand in China before entering the Chinese market.
- Find local partners who can help navigate the local business environment.
- Understand the cultural differences and adjust market access strategies accordingly.
- Have an ability and willingness to localize your product if necessary, without changing the core product.
- Minimize the price of the final product and the franchising fee to achieve rapid expansion and mass acceptance.
- Manage government relations by establishing and maintaining solid working relationships with relevant Chinese government agencies.

World Economic Forum's Global Competitiveness Index (GCI):[2]

As the largest country in the world with over a billion people, China poses great opportunities for U.S. business, including franchising, but challenges do exist. China is faced with rising production costs and diminished returns on capital investments, which used to be China's selling point to foreign firms. Moving towards a consumption economy is important to China's economic future.

China

Competitiveness Index	Score (1-7)
Government/Regulatory	4.1
Labor Force	4.7
Infrastructure	4.7
Demand/Business Factors	4.9
Industry Interest*	6.8
	5.04 total

World Economic Forum
International Franchise Association*

Economic Statistics	
Population	1.364 billion
GDP	10.35 trillion
GNI, per capita (PPP)	$13,170
Income Level	Upper Middle
Unemployment	4.7%
Inflation	2.0%

World Bank (2014)

Government/Regulatory

A major impediment to conducting business in China is its difficult and onerous regulatory environment that stymies foreign investment. China's legal system can also be difficult to navigate and lacks the transparency that is needed for foreign firms. China still ranks low on its protection of intellectual property rights, which is a major concern for U.S. franchise firms.

Labor Force

With its enormous population, China still provides a large labor pool for prospective investors into the Chinese market. The ability to attract and retain workers, however, has been an ongoing issue. In addition, the female population is under employed in China.

Infrastructure

Through the years, China has invested large sums of money on its infrastructure, including roads, and ports, but its infrastructure still needs work. For example, an inadequate and inefficient cold chain system poses challenges for temperature sensitive products such as food (meats and produce) and pharmaceuticals.

Demand/Business Factors

As a result of its large population and rising middle class, China offers foreign firms a huge consumer base to sell their goods and services. China's market is one of the most coveted in the world. The current economic slowdown in China, however, is a major concern for foreign investors and the world economy as a whole.

Industry Interest

Of the top 12 markets identified by the members of the International Franchise Association as markets most valuable to them for international expansion and to have profiled in the Top Markets Report, China was ranked second.

Resources

U.S. Commercial Service - China
http://www.export.gov/china/

China - Country Commercial Guide
http://export.gov/ccg/china

Guide to Investment in China (site of China's Ministry of Commerce)
http://fdi.gov.cn/

Industry Expert's Take:

Extreme change going on in the economy's GDP growth from 70 percent manufacturing and construction to 50 to 70 percent consumer spending will lead to an increased desire for western brands focused on the middle and upper class consumer (about 300 million people). For the next one to two years, finding new licensee investment will be difficult. Food supply issues are hampering new food and beverage franchise investment.

William Edwards, Edwards Global Services, Inc., December 15, 2015

[1] 2015 Report to Congress on China's WTO Compliance United States Trade Representative, December 2015, pages 134-135.
[2] World Economic Forum, The Global Competitiveness Report 2015-2016