



2016 Top Markets Report **Franchising**

Overview and Key Findings

Introduction

American brands and franchise systems are rapidly expanding to new markets all over the world, fueling job creation at home, boosting the export of American products and services and playing a role in commercial diplomacy. In exporting franchise systems, companies not only bring U.S. brands to all corners of the globe, they also help promote local economic development in many countries.¹

With its long history of success, franchising is a global success story where economies from all over the world have benefitted from the franchise model. The system of franchising is made up mostly of small and medium-sized concepts, which creates jobs and provides an avenue to entrepreneurship to millions of people.

Franchising has always been associated with the entrepreneurial spirit. The idea of taking an idea and making something with it financially has been a major selling point of the franchise sector. The allure of starting your own business, self-employment and making your own work hours has drawn people to franchising. There are numerous success stories of people with a vision or an idea that have made fortunes in the franchise sector, either by creating their own idea or purchasing a franchise that has already been established.

As a major job creator, franchising has been able to provide opportunities for workers and franchise owners in both developed and developing markets. Successful concepts are able to tailor their goods or services to meet the needs of each market.

Franchising offers products and services in over 300 business categories, including food and beverage, lodging, health and educational services,

professional services, auto care, accounting and tax services, real estate, home services, IT services and retail products.²

For the franchise fee and royalties that are paid to the franchisor, the franchisee receives the right to operate under the franchisor's marks and use its business system, training, support and often additional services such as site evaluations. The agreement between the franchisor and franchisee creates a partnership. Franchisors rely on royalties (a percentage of the franchisees' revenue), so they are invested in the ongoing success of their franchisees.

Franchising is small business. Although most people associate franchising with big companies, such as McDonald's, Subway and Hertz, the overwhelming majority of franchise owners are actually small to medium-sized businesses. Most franchise owners only own one unit (establishment) and employ less than 30 people. Because of the efficiency of the franchise model, most franchisors are also small or mid-sized businesses.

Trade agreements, such as the Trans-Pacific Partnership (TPP), provide greater opportunities for U.S. franchises to export their concepts. These agreements level the playing field for U.S. firms by eliminating barriers and creating transparency. With more than 95 percent of the world's consumers living outside our borders, TPP will significantly expand the export of made-in-America goods and services and support American jobs, especially in the Asia-Pacific region.

The International Trade Administration's (ITA) Global Franchise Team is committed to providing assistance to U.S. franchisors to enter new international markets. The future looks bright for international franchising, and the Global Franchise Team will

continue to work closely with franchise leaders to plan future events, including trade missions throughout the world.

The International Trade Administration is making a comprehensive and significant effort aimed to support U.S. jobs by ramping up and maximizing U.S. exports. Franchising has always been a tremendous job creator, both in the U.S. and abroad, so support of franchising exports is in line with U.S. government policy objectives.

The International Franchise Association (IFA), a major contributor to this report, is the world's oldest and largest organization representing franchising worldwide. The IFA notes that its members include over 1,300 franchisor companies, over 12,000 franchisee members and 700 supplier companies. The IFA is a strategic partner with the Department of Commerce.

Key Findings: Top Markets and Methodology

When determining which global markets policy-makers should target for export promotion and trade policy activities, it is important to account for the primary decision-making criteria of U.S. businesses engaged in franchising. In this report and the case studies that follow, the criteria for ranking markets were rankings on government/regulations, labor force, infrastructure and demand. These are reflected in the created scorecard and country case studies.

The scorecard developed for this report is based on rankings in the competitiveness index created by the World Economic Forum. By using this competitiveness index, a cross-country analysis of the four criteria listed above was possible, reflecting the primary criteria that industry indicated as a priority in market selection.

The case studies of this report analyze selected potential markets and assess important competitiveness factors. These case studies are

intended to aid the International Trade Administration in promoting the export of franchising to improve U.S. export opportunities. Inclusion in the case studies section does not necessarily indicate that a country is among the highest ranked but rather that there has been interest expressed from government or private sector in exploring these countries. The initial countries selected for review have been identified by industry as holding the most relevance for companies exploring exporting their franchise concepts.

Key Market Assessment Requirements

Key variables impact the viability of markets for the international growth of U.S. franchise businesses. The five primary criteria are the governmental regulatory environment, whether there is a trainable skilled labor force, the infrastructure environment, the potential demand within the country or region and results from a survey of top international franchise representatives identifying their top markets to export.

Government/Regulatory

Regulatory environment is one of the most important factors impacting the attractiveness of a market to U.S. franchise exporters. The first aspect that U.S. companies consider when looking at a new market is the regulatory environment of the country. In particular, U.S. industry looks for a stable government with transparent policymaking and legal frameworks that allow companies to resolve legal disputes.

Labor Force

Another important aspect for deciding whether to enter a market is the quality and skill levels of the workforce in the market. Industry must have the capacity to train and develop the talent and the management required to run a franchise.

Figure 1: Projected Franchise Markets (Rank Order)

- | | | |
|--------------|-----------------|----------------------------------|
| 1. Canada | 5. South Africa | 9. Colombia |
| 2. Australia | 6. Mexico | 10. Brazil |
| 3. China | 7. India | 11. Argentina |
| 4. Indonesia | 8. Vietnam | To be considered: United Kingdom |

Infrastructure

The infrastructure within a country is another top aspect in the decision-making process. Electricity and IT infrastructure must be sufficient to support logistics operations. Transportation infrastructure must be of a level capable of supporting the reliable distribution of product, such as food and equipment, within the country or region without excessive delays. In addition, local sourcing of products and a reliable cold chain are also very important.

Demand/Business Factors

The demand within a country must be considered. The potential size of the market will vary according to the size of its middle class, consumer wants and needs, the number of consumers of the country, products produced in and demanded by the market, as well as the level of development within the market.

Industry Input

Direct industry input is also a major category to be included. The final category reflects the results of a survey conducted by the International Franchise Association asking its internationally active franchisors members which countries they see as holding the best export potential for their franchise concepts.

Industry Overview and Competitiveness

What is Franchising?

Franchising is a method of distributing products or services by licensing business processes, products, services and intellectual property to investors who will operate within an established business model. At least two levels of people are involved in a franchise system: (1) the franchisor, who provides its trademark or trade name and a business system and (2) the franchisee, who pays an ongoing royalty and usually an initial fee for the right to do business under the franchisor's name and system.³

Business format franchising is the type most identifiable to the average person. In a business format franchise relationship, the franchisor provides to the franchisee not just its trade name, products and services but an entire system for

operating the business. The franchisee generally receives site selection and development support, operating manuals, training, brand standards, quality control, a marketing strategy and business advisory support from the franchisor.

While less identified with franchising, traditional or product distribution franchising is actually larger in total sales than business format franchising. In a traditional franchise, the focus is not on the system of doing business but mainly on the products manufactured or supplied by the franchisor to the franchisee. In most, but not all, situations, the manufactured products generally need pre and post-sale service as found in the automobile industry. Examples of traditional or product distribution franchising can be found in bottling, gasoline, automotive and other manufacturers.

Domestic Landscape

Franchising is an important driver in our economy - it is responsible for one in seven jobs in the United States, and accounts for 50 percent of all retail sales that will take place in our country across 75 industries.⁴ In the United States, there are over 780,000 franchise businesses that directly employ over 8.8 million people and account for over \$890 billion in direct economic output.⁵

Franchise businesses continue to grow faster than the rest of the U.S. economy. The Franchise Business Economic Outlook: 2015 report released in January 2016 notes that franchising will outperform the U.S. economy for the sixth consecutive year in terms of overall growth. The report forecasts that in 2016, the economic output of the U.S. franchise sector will increase by 3.1 percent to \$944 billion and that direct franchise employment will grow by 278,000 jobs.

The January 2016 report highlights the following:

- For the past five years, the average annual job growth in the franchise sector was 2.6 percent, nearly 2 percent higher than all businesses economy-wide.
- Over the last five years, the franchising sector has added nearly 1 million jobs to the economy.
- The number of franchise establishments is expected to grow this year by 13,359, or 1.7 percent, to 795,932.

- The gross domestic product (GDP) of the franchise sector is projected to rise 5.6 percent this year to \$552 billion, adding \$29 billion in GDP to the U.S. economy. The franchise sector will contribute approximately 3 percent of U.S. GDP in nominal dollars.

Franchising Misunderstood/Changing the Perception

The franchising model is a unique business model that continues to be misunderstood. According to Aziz Hashim, Chairman of the International Franchise Association and Managing Partner of NRD Capital Management, “The model does not require previous business experience to own a business, create jobs and contribute to the local economy and communities”.⁶ The franchise concept has years of experience training and mentoring franchise owners while also training the employees. “For those unemployed or underemployed, franchises offer entry-level employees a starting wage and basic skills training with no prior experience required.”⁷ The perception that it is big business is inaccurate. The big name franchise concepts do not own the thousands of stores and restaurants that carry their

name. As noted earlier, those individual establishments are owned and run mostly by small business owners.

The vast majority of franchise employees work in units owned by franchisees; additionally, many well-known franchisors have less than 500 employees, qualifying them as SME companies.

Being labeled as big business has created difficulties for the franchise sector, both in the United States and abroad. Policies and regulations that target large business and that have been established or proposed are sometimes unfairly pushed onto the small business franchise owner since they are being incorrectly identified as a big business. These policies endanger the franchise business model.

Military Friendly

One in seven franchise businesses are owned and operated by veterans of the U.S. military, according to a study conducted by PricewaterhouseCoopers for the International Franchise Association Educational Foundation based on U.S. Census data.

Figure 2: Leading U.S. Franchise Firms

		Company	Industry	Sales	U.S. Locations	Total Locations
1		McDonald's Oak Brook, IL	Restaurant	\$87.78 B	14,344	36,258
2		7-Eleven Dallas, TX	Retail	\$84.50 B	7,836	55,801
3		KFC Louisville, KY	Restaurant	\$23.40 B	4,391	19,420
4		Subway Milford, CT	Restaurant	\$18.20 B	26,958	43,154
5		Burger King Oakville, ON	Restaurant	\$17.01 B	7,126	14,372
6		Ace Hardware Oak Brook, IL	Retail	\$14.29 B	4,251	4,794
7		Hertz Naples, NJ	Automotive	\$14.20 B	5,760	11,230
8		Pizza Hut Plano, TX	Restaurant	\$12.20 B	7,908	15,605
9		Marriot Hotels & Resorts Washington, DC	Hotel/Travel	\$9.60 B	347	578
10		Wendy's Dublin, OH	Restaurant	\$9.30 B	5,750	6,515

*Franchise Times

More than 66,000 veteran-owned franchise businesses in the U.S. directly provide jobs for 815,000 Americans and generate more than \$41 billion in GDP. Since 2011 over 250,000 veterans have started careers in franchising.

Global Industry Landscape

Due to the high quality of their products (enforcement of brand standards is a backbone of the franchise model) and strong training and support systems, U.S. franchise firms are global leaders and are some of the most famous brands in the world.

Modern franchising emerged from the United States. Because America is the world's most mature franchise market, use of the franchise model internationally is a competitive advantage for U.S. exports. Initially, international expansion was reserved for the large franchisors in each market segment. International franchising has now become a priority for small and mid-sized franchise companies across many different industries.⁸

According to Franchise Times data, 38 percent of the units of the 200 largest U.S.-based franchisors are already outside the United States. Over the last three years (2012 to 2015), these companies have collectively added four international units for each unit they opened domestically. When a franchise is exported, the international franchisee pays the franchisor a percentage of their revenue (franchise fees) in return for the right to operate the business in their country. The American franchisor collects the income and provides support. Because of this structure, franchise growth across borders tends to create new jobs at home, not export jobs from the United States. Bureau of Economic Analysis data shows that franchise fee exports nearly doubled from 2006 to 2014. According to Bureau of Economic Analysis data, franchise fees have an overwhelmingly (34 to 1) positive impact on America's trade balance.

Franchised business has been adapted to and thrived in almost every culture on earth. Even the least developed parts of the world are encountering a form of franchising, as many non-profits are adopting franchise models to distribute health products and services.

Beyond the world's largest brands, most franchise companies seek international development. A recent IFA member survey found that:⁹

- 74 percent of franchisors want to start or accelerate international operations,
- 72 percent believe international growth is important to future success of the sector,
- 84 percent plan to start or accelerate international operations,
- 25 percent generate 25 to 50 percent of revenue internationally.

Key factors that franchise firms look for in evaluating which countries to pursue for international expansion include:

- population (size of the market)
- middle class (consumers ability to purchase goods and services, disposable income)
- regulatory framework (how restrictive is government to business)
- currency (valuation and ability to move money in and out of country)
- and legal system (fairness and efficiency).

Challenges, Barriers and Opportunities

When discussing with franchisor representatives, several of the same issues are noted as challenges to exporting franchising, such as onerous regulatory requirements, restrictions on market entry requiring the establishment of joint ventures, local sourcing requirements, currency transfer issues and lack of qualified investors in foreign markets.

Regulation: Licensing and registration requirements pertaining to franchising are relatively common. Some governments, however, have made it difficult to do business by imposing onerous licensing and registration requirements that take months, even years, to complete.

Joint venture requirements: In certain countries, foreign companies are required to establish businesses as joint venture partnerships with local firms. In some cases, U.S. franchise firms encourage entering joint venture agreements to take advantage of the local expertise of a company or an individual. On the other hand, being forced into these relationships can be counterproductive. In some markets the synergies created by a joint venture are not realized, and the partnership is not conducive to a successful arrangement.

Local sourcing: Although many franchises would welcome sourcing locally when possible, the quality

of goods and services may not meet the high standards required by U.S. franchise concepts. Local sourcing requirements can be deal breakers.

Currency issues: When discussing currency, two issues come to mind that franchise firms must be aware of: the strength and stability of a country's currency and the ability to move money into and out of the country. If a country's currency devalues, it causes profits to erode when it is converted back into U.S. Dollars. Unrestricted movement of currency to and from a country is important to allow for ease of investment and to take profits out of a country.

Lack of qualified investors: Franchise fees range from several thousand dollars to several million dollars. Finding qualified investors is especially difficult in foreign markets where a company or a person's ability to purchase a franchise is hard to evaluate.

Franchising's Multiplier Effect

International growth of franchises often acts as a significant export multiplier, with other goods and services flowing through the door opened by the franchise agreement. Franchising is identified with royalties, fees and sales of the franchise's goods and services. Consumers may encounter franchising when they buy a house through a real estate firm, stay in a hotel, buy sandwiches, purchase auto or hardware supplies, use tax services, join fitness clubs and rent cars. They may not understand or see that numerous additional industries are positively impacted by franchising.

Many franchise concepts require specific products for their concepts. These may be proprietary goods owned by the franchisor and may involve the use of supply chains the franchisor has established to meet brand standards. For instance, numerous food and beverage franchises must purchase specific fryers to cook their food and refrigerators to store food items. These are examples of the multiplier effect that international and domestic franchises can have on the U.S. economy. In addition, services, such as

accounting, legal and advertising services, are directly impacted. For example, franchising may impact the following:

- **Information Technology:** software programs to record sales, control inventory, produce accounting records, payroll and other business related functions.
- **Equipment:** fryers, grills, refrigerators, televisions, sports equipment and computers.
- **Legal:** legal advice and consultation.
- **Advertising:** producing and implementing marketing plans.
- **Accountants:** maintaining the accounts and filing taxes.
- **Agriculture:** U.S. food products.

As for indirect benefits, franchise firms, especially U.S. firms, are known to attract high levels of business traffic to malls and shopping centers, which create additional sales for businesses already established at these places.

The International Franchise Association has commissioned a report due 2016 to 2017 that will analyze and quantify the multiplier effect associated with franchising.

Franchising's Close Relationship to Department of Commerce (DOC)

The relationship between the DOC, ITA's parent agency, and the IFA goes back many years. In the 1990s, Commerce led a franchise trade mission to China, with which the IFA was directly involved. DOC has a very active Global Franchise Team, which works closely with both the IFA and the Franchise Times, a leading franchise publication. The team has coordinated with these partners on numerous trade missions and on addressing international trade issues. For several years, DOC and the IFA have worked on the International Franchise Expo (IFE), which is an IBP event that is strongly supported by DOC.

Figure 3: Multiplier Effect Impacts

Services: Accountants, Lawyers, Cold Chain, IT, Advertising and Transportation, to name a few.
Manufacturing: Refrigerators, Fryers, Sports Equipment and Computers, among others.

Trade Missions

DOC, IFA, and Franchise Times have coordinated numerous trade missions over the years. Below is a list of the most recent and the proposed missions for 2016.

- 2016: Plans for Middle East (Oman, Qatar, UAE and Turkey); Latin America (Brazil, Uruguay); and India and Sri Lanka.
- 2015: Central America (Costa Rica, El Salvador, Guatemala); Asia (South China, Taiwan); and Nordic countries (Norway, Sweden, Finland)
- 2014: India, Philippines, Mexico
- 2013: Middle East (Egypt, Jordan, Qatar); Sub Saharan Africa (South Africa, Kenya, Nigeria); China

International Franchise Exhibition (IFE)

The IFE is an extremely successful annual event for the U.S. franchise community, which DOC has supported for many years. In 2015, the three-day event has featured over 400 franchise exhibitors, with investments ranging from \$5,000 to over \$1 million for a wide range of product categories. As the largest franchise expo in the U.S., visitors have the opportunity to meet face-to-face with executives of the exhibiting franchisors and attend in-depth conference programs as well as free seminars. The opportunities at IFE cover multiple markets and

industries. The event brings together expanding and developing franchise concepts with the most qualified franchisee candidates in the U.S. and around the world.

The IFE is an International Buyer Program (IBP) event. The IBP is a joint government-industry effort that brings thousands of international buyers to the United States for business-to-business matchmaking with U.S. firms exhibiting at major industry trade shows.

DOC provides comprehensive trade counseling, market intelligence, business matchmaking, export assistance services and trade promotion to the franchise firms that participate in the IFE. The IBP assists international visitors in meeting with targeted exhibitors to cultivate partnerships and promote the sale of U.S. products and services. The IFE includes IBP delegations and more than 400 top franchises from all industries, including restaurants, repair-cleaning services, education, business consulting, exercise, rental services and many more. Top executives from business and government attend the event to network and to hear about the latest international trends, financial challenges and new market opportunities. Fourteen percent of the more than 20,000 attendees at the 2015 show came from 122 countries outside the United States.

¹ International Franchise Association (IFA), MDCP Application, March 2015

² International Franchise Association (IFA), MDCP Application, March 2015

³ International Franchise Association (IFA), MDCP Application, March 2015

⁴ International Franchise Association (IFA), MDCP Application, March 2015

⁵ International Franchise Association (IFA), MDCP Application, March 2015

⁶ Aziz Hasham, "Communicating the Positive Message of Franchising", IFA Convention, February 2016.

⁷ Aziz Hasham, "Communicating the Positive Message of Franchising", IFA Convention, February 2016.

⁸ International Franchise Association (IFA), MDCP Application, March 2015

⁹ Willian Edwards, Edwards Global Services, 2016 IFA Convention, February 22, 2016