

# FRANCHISE AS A NEW FORM COORDINATION OF ECONOMIC ACTIVITY IN RUSSIA: PROBLEMS AND PERSPECTIVES

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## Abstract

The paper contains the economic and legal characteristics of the new Russian economy sphere of business relations - franchising. Despite the fact that in today's Russia a growing number of entrepreneurs using the franchise as a promising scheme business, official statistics on this issue is not conducted. The author of the article describes the problems of adaptation of the franchise to the Russian market. In this connection, summarizes statistics on the legal and economic literacy of the participants of property turnover in a given plane, about the extent of franchising development in the economies of foreign countries in comparison with Russia. Analyzing Quantitative indicators of franchising as an economic phenomenon, the author makes the following problems and their resolution on the legal level. The first this, it is of paramount importance is the development of a law on franchising and making appropriate changes in related laws and regulations. The second this, creating a system of tax incentives, especially at the initial stage, it will also motivate the interest of the participants of market relations.

**Key words:** franchising, business relations, law on franchising.

**JEL Code:** H 25, K 12, K 33

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## Introduction

Franchising is a shining example of the legitimate coordination of economic activity of entrepreneurs. Most of them are looking for the most secure and convenient option for entrance to the market. It is important to find an actual project that will provide a stable income. The right choice will minimize potential risks of financial loss and deal with the competition.

Considering international franchising, in other words, franchising with foreign participation, it can be defined as a method of adaptation of the franchisor in a foreign country, in view of its economic and environmental features, through the expansion of the business size, complex of intellectual and property rights. Therefore, the implementation of the new business model in the new economic space should take into account the level of development of small business, employment, social and cultural factors, consumer values, technical capabilities, and more ( Joyoung, 2008).

In context of franchise way of doing business, relation between franchisor and franchisee is crucial for success, not only for the individual member of franchise but for entire franchise system. Franchise relationship actually begins with meeting the needs of clients through cooperation of franchisor and franchisee. Each party is directly interested in success of franchise. The element that varies franchise from most other forms of business is a symbiotic relationship of interdependence and confident of two legally different economic (Kavic & Sercer, 2014).

The aim of this study is the formation and a substantiation of the theoretical approaches and practical recommendations on the business organization using the franchising schemes. To achieve this goal the following aims are set: analysis of historical and economic preconditions of the origin and development of the franchise relationship, identifying the scope of application of franchising in Russia; analysis of existing problems and possible ways of negotiations.

## **1 Research Methodology**

The system of techniques and methods of competence, common to the economic and legal sciences were used in this research. Through the positive method, the article provides the actual results of application of franchising in Russia and in foreign countries. The eclectic approach of studying the issue gave the opportunity to evaluate the possibility of participants in entrepreneurship from different sides: historical, cultural, ethnic. The method of mass statistical observation allows to demonstrate the strengths and weaknesses of the franchise's position as a form of business organization in tables and diagrams. Having a general idea of franchising as a social phenomenon, from scientific and practical points of view, the author comes to a logical conclusion about the existing problems in a given plane. Legal methods of system-structural analysis helps to find possible ways to solve the economic problems by legal means.

## **2 The historical and economic preconditions for the development of franchising in Russia and foreign countries.**

It is known that the franchise in the modern sense was tested by "General Motors" for the first time in the late 19th century that later served as a model for such well-known brands like - "McDonald's", "Coca-Cola", "Pepsi."

As it has been demonstrated on globally franchise is spread in different business areas: automobile industry and car service; assistance in the organization and conduct of business (accounting, secretarial, advertising); construction, services related to the repair and maintenance of buildings; fast food restaurants, snack bars; health and beauty services, and many others.

According to the materials of the International Franchise Expo 2015 exhibition:

- In Europe, total sales of the franchise has made more than 160 billion dollars.
- In the United States, sales exceeded \$ 1 trillion a year.

The rapid development of franchising is observed in Canada, Western Europe, Japan, the Pacific, Australia, the Caribbean.

In many developing countries franchising as a form of business relations with foreign companies gained rapid development especially in recent years. For example, the Korean market of goods and services is expanding at the expense of international franchising. However, when entering foreign markets Korean manufacturers faced certain difficulties. The lack of practical experience and worthy legal regulation are the main issues requiring resolution (Park & Jong, 2011).

Similarly, the situation in China, where the franchise has been actively developed since 1990 and widely used at present. However, China still lacks the regulation of relations Franchising in law and judicial practice. In this connection, it is the necessity of borrowing the experience of foreign countries, combined with the actual national conditions of China (吴日焕, 2010).

Far otherwise the situation differs in China. Japanese franchise began to develop at the same time with the US. It is no secret that nowadays Japan has the strongest economy in the world. Foreign and local Japanese franchisors adapted to the social and economic changes taking place in the country. In the 60 years of the 20th century the local brands began to actively develop and Japanese franchises soon appeared in many countries around the world. For example, such well-known brands of all "Suzuki", "Corporation Duskin", "Kozo sushi",

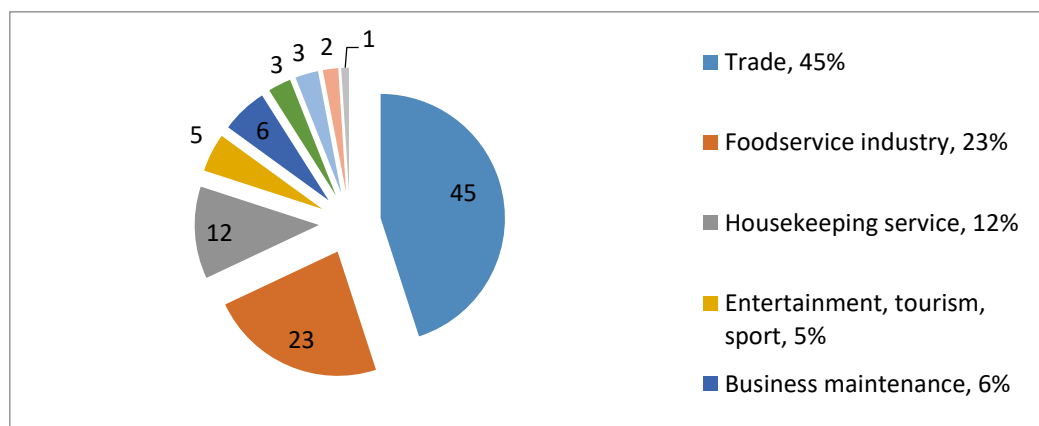
“Mitsubishi”, “Sacura”, ”Samura” and others. In Japan, unlike many countries, there is no need for registration and licensing of franchisors. The partnership is based on a franchising arrangement. But despite the apparent freedom, the country has a special law Medium-Small Retail Business Promotion Act. This regulation provides for the mandatory control standards by the state (우석희, 2010).

In Russia, interest in the new instrument of economic organization of business entities revived in the 90s last century. During this period, at the same time there were some domestic franchise systems and with the participation of foreign capital. It is considered that the «Baskin Robbins» company sold the first franchise with foreign participation in the Russian territory in 1993. Today, this brand in the Russian market successfully developed and has great prospects.

In fact, franchising has become a pioneer of Russian businessman Vladimir Dovgan. He founded two companies: “Doc-Bread” and “Doc's Pizza”. He was a person who took the popularization of this phenomenon among his compatriots, published a book, and even became the first Russian who has joined the International Franchise Association.

The population of our country spends much of household budgets on food, clothes, shoes. Therefore franchising in Russia, the most actively developed in the retail and catering: there is a faster turnover of money, profit and return on investment. At the same time, manufacturing franchise in the tertiary sector Russia is not practically developed in Russia, despite the fact that the manufacturing business is the most stable, durable and profitable. And in order to open the enterprise to provide services, as a rule, it requires an order of magnitude less than investments (Fig. 1.).

**Fig. 1: Development of the Russian franchise according to spheres of activity (in %)**



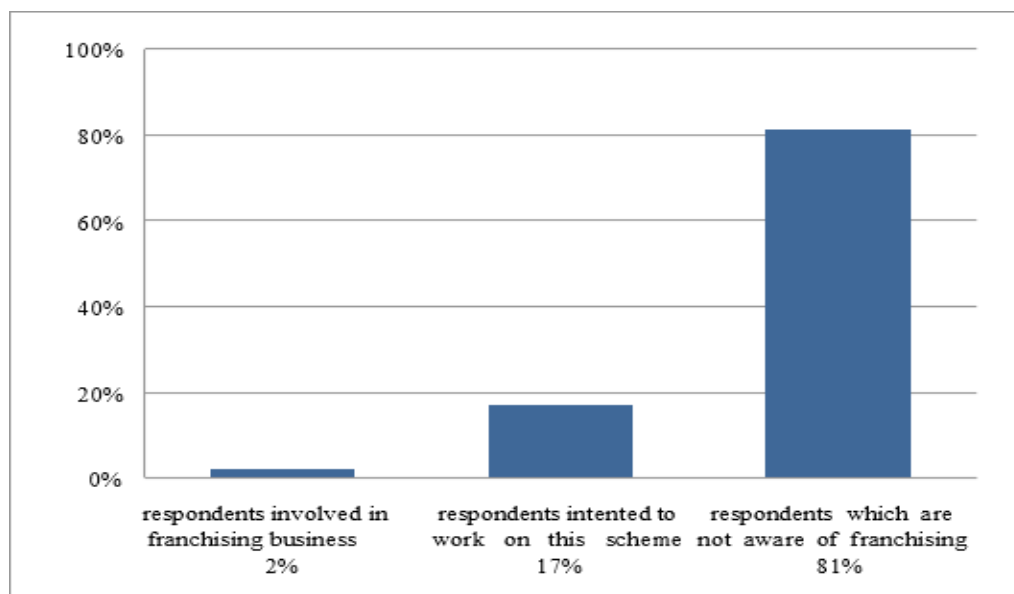
Source: author's own data

In addition, the development of franchising in Russia is unsteady. Unfortunately, at present, in several Russian regions it can only be called where the franchise is used widely enough. The main of them are: Moscow, St. Petersburg, Novosibirsk, Nizhny Novgorod and Omsk. The use of franchising in the region is inextricably linked to the economic situation of the territory and business development level in the market (Yegorova, 2015).

According to the forecasts of the Russian Franchise Association, about 400 thousand points of sale of goods and services controlled by the franchisee in Russia will work by 2025. Today, experts account for only about 40 thousand franchise outlets in the country.

In an effort to minimize the financial risks, people wishing to start a business, pay attention to the franchise. But at the same time, according to the research by the National Agency for Financial Studies, only 2% of companies run a franchise business, 17% would like to work on such a scheme, while 81% of respondents do not know what a franchise is (Fig. 2).

**Fig. 2: Results of the National Agency for Financial Studies (in %)**



Source: author's own data

### **3 Problems and perspectives of franchising development in Russia.**

#### **3.1 Problems in legislation and ways to resolve**

The lack of legal route adequate to existing environment complicates the use of franchising in the domestic economy. Improvement of effectiveness and development of franchising in Russia require making amendments in legislation (Kondratieva, 2015).

In Civil Code of the Russian Federation we should: introduce the concept and definition of franchising; formulate the basic concepts such as: franchising product, franchising objects and franchising entities (franchisor and franchisee); determine the types of franchising and usage patterns; introduce the concept of franchise (franchising agreement). It is believed that the economic position of franchisee as the weakest party of business relations needs a special approach from the legal aspect. The need for developing contractual structures in service sector is important for business newcomers (Lapiedra, 2012).

To increase flexibility, franchisors should modify standards informally when possible, while retaining the authority to modify them formally in situations where the franchisees may be tempted to renege, particularly due to free-riding. I also show that when the prohibition of unequal treatment is replaced with a rule-of-reason approach-whereby courts allow unequal contract terms that are economically beneficial-the rule of reason may backfire because it makes any informal agreements less attractive and, hence, harder to sustain (Zanarone, 2013).

Besides, in provisions of Civil Code regarding to intellectual property rights franchising schemes should be taken into account, but they are out of the picture.

Federal Law of the Russian Federation «About franchising in the Russian Federation» must develop the main provisions of Russian Civil Code and contain: basic concepts and definitions: definition of franchising which must have the same meaning and content as the western one, typology of the basic concepts of franchising; definition of royalty and other specific concepts; describe the features of each franchising type separately for sections of a law; cession of trademarks, licenses, copyrights, patents, know-how. The definition of know-how based on Russian Civil Code should be extended; enclosures in the form of list of documents, fixing all the necessary steps to create franchising system, including contracts samples and document lists used in various franchising types.

All these changes should bring both the legislation and the terminology of franchising to international practice, it is especially important to create franchising systems with the involvement of overseas capital. Today in the world there are no unified legal rules and regulations regarding the franchising relations, as there are in the international sale and transportation. Along with that, under harmonization and unification of European legislation, model franchising rules are enshrined in DCFR – in the global coordinate system of European

private law. DCFR international norms include the practical realities and decisions unsolvable from legal perspective (Opritoiu, 2015).

It should be mentioned that the Russian deputies attempted to review the draft law on franchising. The document was sent back for revision, as was perceived very negatively by franchising community.

### **3.2 State aid**

It is necessary to be switched to the government program of support of small business, including the development of the franchising system.

Creating a system of tax incentives for franchisee, especially at the initial stage of development of franchising system, also seems a matter of paramount importance. It is reasonable to enable application of franchisee of simplified accounting system.

It should be noted that state aid for 90% of franchising business in Europe is growing through targeted loans. In Russia the government is paying little attention to this business segment. In Russian Franchising Association it is believed that we need to develop and implement a program of franchising development in Russian Federation, which would provide subsidies for the lump-sum payment, the creation and financing of measures to promote franchising, as well as assistance in promotion of domestic franchises overseas.

In some franchises lump-sum payment is often unsupportable for starting entrepreneurs, so there is a need to find borrowings from the side. Unfortunately, it is extremely difficult to find such financing sources in Russia. The pioneer is widely regarded as Sberbank of Russia which offers loan product for starting franchisee. Loan product «Business-start» is aimed primarily at beginners in business. It is also notable that according to statistics collected by bank the largest number of loans for the purchase of a franchise can be attributed to retail sector as entrepreneurs choose cheap franchise and initial investments which do not exceed three million rubles.

### **3.3 Providing economic safety for franchising scheme.**

For potential franchisee very likely to come across the so-called «busted franchise». «Busted franchise» - franchise, commercial effectiveness and popularity which artificially inflated. This project was created out of nothing, and exists only on paper. There are also so-called «pseudofranchise», used the name of these brands. Such companies create their own brand, which copies the famous brand down to the smallest detail. The most common

example of such franchises are ZaraZara, Evrosvyaz, Mr.Burger. These franchises do not bear any commercial value, and, in addition, all participants bear criminal responsibility for the illegal use of the scheme. «Semi-finished franchise», created by beginning franchisors. By selling its franchise, the franchisor is simply not ready to support its franchisee; usually such cooperation does not last long and very quickly ends. «Shadow-franchise» uses the trademark with well-crafted descriptions to deceive customers. They appear on the market only for a short time to sell the greatest possible amount of deductibles and disappear from the market. For this reason despite the fact that the activities of independent entrepreneurs and is always associated with risk, control by the public authorities is needed, including at the level of prescriptive and binding rules of public law (Sangotra , 2015).

## **Conclusion**

To sum it all up, the author comes to the conclusion that franchising in Russia as an economic phenomenon is not temporary, but rooted and is growing mainly in the trade. There is high proportion of franchising with the involvement of overseas capital. The main problems for applying franchising in Russia are connected with the shortcomings of the legislation, there is no clear legal regulation. Therefore the main task is to bring Russian legislation in accordance with international standards in the light of foreign practice.

Prospects of franchising development in Russia are presented very impressive by many experts. The author sincerely hopes that soon breaking the lack of information and legal regulation we will witness the rapid development of this type of business in many areas of the national economy.

It is likely that with proper franchising development from different perspectives: from the legal perspective, economic incentives, state control and state aid of business entities, Russian producers of goods and services will have the opportunity to promote its brand outside of the Russian Federation.

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