

**ST. PETERSBURG INTERNATIONAL ECONOMIC FORUM**

**JUNE 16–18, 2011**

**FRANCHISING: A NATIONAL PRIORITY IN THE GLOBAL CONTEXT**

**Securing Global Growth**

**JUNE 16, 2011 — 14:00–15:30, Pavilion 8, Conference Hall 8.3**

**St. Petersburg, Russia**

**2011**

As the global economy recovers, franchising is taking an increasingly important role in increasing investment, creating new businesses and helping to create an expanding class of new entrepreneurs as they gain access to new technologies and modern production and management techniques. Franchising significantly lowers risks for start-up companies, making it possible to attract broad sections of customers and more efficiently spend allocated capital for business development.

**Moderator:**

**James Gansinger**, President, Subway Russia LLC

**Panelists:**

**Merab Ben-EI (Elashvili)**, President, GMR Planet of Hospitality

**Osman Bilge**, Secretary General, Franchise Association of Turkey UFRAD

**Carol Chopra**, Executive Director, European Franchise Federation

**Jack Earle**, Chairman, International Franchise Association (IFA)

**Mark Hilton**, Vice President International, Sbarro International

**Andrei Krivonos**, Director of the Board, Ukrainian Association of Franchising

**Alexei Likhachev**, Deputy Minister of Economic Development of the Russian Federation

**Boris Nuraliev**, Director, 1C

**Agnessa Osipova**, General Director, Baskin Robbins Production International

**J. Gansinger:**

Good afternoon, ladies and gentlemen. I would like to get our programme started. My name is James Gansinger. I am the President of Subway Russia. We are the franchisors for Subway restaurants here in Russia. So I am actually in the franchising business here.

Our topic today is 'Franchising: A National Priority in a Global Context'. The recovery trends observed in the world's leading economies today indicate a growing role for franchising as a powerful way to conduct business and multiply the number of entrepreneurs.

Franchising substantially reduces the risks for start-up businesses, promotes broader population involvement in enterprise, and assures the smarter application of capital investment. Franchising offers solutions to entrepreneurs and offers proven cutting-edge technologies to them.

Our panel today includes representatives from the Franchising Associations of Russia, Ukraine, Turkey, the United States, the European and Black Sea Federations, and some of the exponents of the foremost franchise concepts in Russia and the rest of the world.

I would like to introduce the panel members to you. To my left is Alexei Likhachev, the Deputy Minister of Economic Development of the Russian Federation.

Jack Earle, who is sitting to the left, is the Chairman of the Board of the International Franchise Association.

To my right, Merab Elashvili is the President and Chairman of the Board of the Russian Franchise Association. He is also the President of GMR Planet of Hospitality Holdings.

Osman Bilge, to the far left, is the General Secretary of the Turkish Franchising Association.

Andrei Krivonos, to the far right, is the Head of the Directorate of the Franchise Association of Ukraine.

Mark Hilton is Vice-President of Sbarro International, one of the top quick-service restaurant brands in the world.

And Boris Nuraliev is the CEO and Director of 1C Company, Russia's premier innovator in software, for primarily the accounting services industry.

Some of the issues that our panel is going to talk about today are:

What benefits does franchising in the large international chains provide to Russia and its economy?

Do brands from the developing economies have a place in the sun?

Does franchising change the consumption culture and service standards?

And what can be done to maximize the effect of franchising in the interest of building a modern infrastructure for the consumer market, as well as for the health and educational sectors across the Common Economic Space of the Eurasian Economic Community?

We have a limited amount of time here and a lot of material to cover. So the worst part of my job is going to be enforcing some relatively rigid time restrictions on our speakers.

We are going to start with Alexei Likhachev, Deputy Minister of Economic Development of the Russian Federation.

My questions to Mr. Likhachev are: firstly, how do you view the role of franchising in creating a modern infrastructure for the consumer market, and specifically, for the healthcare and educational sectors within the common economic environment of the Eurasian Economic Community; and secondly, how can government help with these processes? Mr. Likhachev.

**A. Likhachev:**

Thank you very much, Mr. Gansinger. Dear Colleagues, The first thing I'd like to do is to welcome all the attendees of our Forum. Our conversation, our discussion of franchising, is one of the first—and therefore one of the most important—events of the Forum. I have the utmost respect for people who are

currently working on the practical development of franchising in Russia, and who represent the interests of Russian franchisors abroad. Today, we'll try to discuss this issue during our conversation. And my biggest wish for our collaboration today, and for our future work, is to define practical steps for cooperation. I'll try to touch upon this in my speech. Our esteemed moderator asked me to talk about this when preparing the agenda for today's discussion. With this audience, and considering that I'm no big specialist in this sphere, talking about the benefits of franchising would be a bit beside the point. I came primarily to listen to you.

In the first part of my speech, I'd like to draw your attention to the things the Ministry of Economic Development, and by extension the economic arm of the government, currently considers to be additional key factors which the franchising sector has already begun to use and must keep using even more actively to boost the Russian economy. About a year and a half ago, when we had the first discussion with our colleagues from the Russian Franchise Association, we thought of this form of business development as an anti-crisis measure. And our premonition, as they say, turned out to be true: the official survival rate of projects based on the franchising model is several times higher than the typical life expectancy of other startups. The number of participants in franchising operations and their growth in the last year and a half to two years are also quite impressive. The sector has doubled. For the stage of post-crisis development and overcoming the recession in some industries, this is truly an anti-crisis measure.

The second important factor is what we call Russia's integration into the global economy—the desire and ability to implement global experience directly, to use financial and business organization rules that are acknowledged worldwide on the broad Russian stage. Obviously, in the context of Russia's accession to the WTO and strengthening of the ties with the European Union, which began when Russia joined the OECD, this provides an additional deposit to the store of quality behind Russia's economy, its compliance with international rules and

international standards, and practical implementation of global business expertise. This is why franchising is so timely for us.

The third major group of questions has to do with development of competition, a competitive edge, and saturation of the commodity and service markets in the Russian Federation. I think the large-scale entry of major franchising companies into a whole number of sectors may prove to be the key element here. Our moderator is right: this really does depend on the regions and on the degree of development in the service, healthcare, and education sectors. It's interesting to note that the low degree of development in the sectors I just mentioned is accompanied by a low degree of entrepreneurial activity in the same sectors. That's why, to my mind, the entry of major companies, which will bring their global experience, their practices and technologies, and their training, into the regions which are commonly called—and I will immediately ask you to forget this word—depressed, may kill two birds with one stone. We will increase the quality of education and—even more important and more necessary—the quality of healthcare services. This will give a serious boost to the economic development of these regions and of small and mid-sized enterprise. This is a major third point: our goals.

It so happens that several of my ministry colleagues and I are responsible for providing support to small businesses. I'd like to focus on this in more detail. We've learned to utilize some of the mechanisms used to support small businesses, small and mid-size enterprise, enough to get at least a 'B'. This might not be true for all regions, but overall, we have a business support infrastructure: RUB 17-18 billion, and this year nearly RUB 21 billion, is spent directly on various programmes. We have a great deal of centres and business incubators, and the regions are very actively developing support centres for the export potential of innovative small and mid-size businesses. In other words, this work is under way. I got involved in this relatively recently, but I have a feeling that far from all tools are being utilized. That's why during our discussion today,

we should talk about adopting a new tool for the government to support small and mid-size enterprise—specifically, franchising. I'm not prepared to say that we'll be able to find these tools today, and to identify them as the nation's first priority in the development of small business. But I think it's necessary to jumpstart the discussion on this topic and find practical solutions.

Before I get to the closing part, just one more thing I'd like to note: as of January 1, 2010, we have an economy which is structured somewhat differently. I mean that in the last two years, the process of integration in the post-Soviet countries has become a reality. The St. Petersburg International Economic Forum is designed for economic discussion. It's not the appropriate place for political declarations. But I can simply share my personal opinion: this is the first time I've heard the Prime Minister of the Russian Federation repeat the same idea twice in three months. I'm talking about the idea that the administration and the country's leadership didn't actually expect the goals set on June 9, 2009 to be realized within a year and a half to two years. In other words, the Customs Union—a single customs territory, the external boundaries of which are managed on the supranational level—has already become a reality. The transfer of customs tariffs regulation authority to the Committee of the Customs Union and the signing of 17 agreements defining a common economic space are truly novel organizational features of the Russian economy. The process of ratification of these agreements in Russia and Kazakhstan is actively underway right now. Belarus ratified them on January 1. An integrated regulatory basis that includes the territories of the three countries has been created. This is the first step towards freedom of movement, not only of products, but of services, capital, workforce, and intellectual property. What's more, specific efforts have been made to ensure the legal competence of the Customs Union, its positioning on the global stage as an integrated economic entity, an integrated economic union. In this respect, I also think that the importance of franchising tools is only growing, both on the territory of the common economic space and across the entire EurAsEC, which

we are planning to enlarge to the level of the Commonwealth of Independent States. In this sphere, we are also working on a new, much less burdensome free-trade agreement between the countries of the CIS. This, to my mind, also creates more favourable conditions for your idea—for companies currently granting franchises, and for entrepreneurs buying them.

Now, I think, to the most important point. What kind of results do we want to see from our current actions, and most importantly, from our future effective collaboration with the Russian Franchise Association? There are probably questions about the regulatory basis of legislation. I think we'll talk about them today. I'm almost certain that we will assume joint responsibility for solving the problems that have accumulated in this area. I'm sure there are questions about new cutting-edge, more effective tools for the support of small and mid-sized enterprise. We are ready to incorporate both linear and infrastructural financial cooperation into our programmes—and even PR cooperation with the Franchise Association and leading franchisors, if you wish (and the Forum is proof of this)—as main components. This requires commitment in practice. We have to understand that we mustn't simply exchange opinions—we must move forward, create realistic programmes that include indicative points. I'm talking about creating new jobs; I'm talking about increasing tax collection rates; I'm talking about growing entrepreneurial activities in the regions and in the sectors we consider pivotal.

Once again, we understand that franchising relationships are actively growing. As I am aware, various associations are signing mutual agreements; national organizations are joining your corresponding associations. Here, I'd like to regard our goal—the creation of a truly integrated market for goods, services, labour, intellectual property, and finance—as paramount for our medium-term and long-term prospects on the territory that is commonly referred to as post-Soviet. Though these days, you'll hear us using the label 'Eurasian Economic Community', or 'EurAsEC', more and more often. I have to stress that this isn't an

end in itself. I really hope that the end-goal of these actions will be a single economic space from Lisbon to the Kuril Islands. I'm not joking. I am completely serious in this regard. We have to build it not as an end in itself; not as a new political category, but as a new set of conditions for the conduct, expansion, and development of business.

Based on these three directives, I'd like to welcome all of you once again to our roundtable at the St. Petersburg International Economic Forum. I am ready to listen carefully to the speakers, because franchising is currently at the forefront of business organization and the development of enterprise. I want to stress once more that the ministry is extremely interested in our future cooperation. Thank you for the introduction.

**J. Gansinger:**

Thank you, Mr. Likhachev. As someone who is in the franchising business here in Russia, I am personally very appreciative of the interest shown and the continuing support of the Russian Federation, so thank you.

We would now like to turn to a company that is an excellent example of a Russian company that is playing a major role in franchising here in Russia, and it is the 1C Company. 1C is a leading Russian software company that provides enterprise resource planning and accounting solutions in Russia, Ukraine, Kazakhstan, Belarus, and other places. 1C has over 7,500 franchisee companies, which in turn employ over 100,000 engineers and other staff members in their businesses.

Mr. Boris Nuraliev is the CEO and Director of the 1C Company, and I would like to turn the microphone to Boris and ask him these questions. Firstly, can franchising help modernize Russian enterprises and organizations; and secondly, do you see an important role for the government in this process?

**B. Nuraliev:**

Thank you very much. Can we start the presentation? Thank you very much. I'm actually ready to give positive answers to both questions. In regard to 1C, 1C has been doing franchising for a long time. The company develops computer programs. Last year, the holding company reached more than USD 600 million in turnover. For the first time last year, we were included in the Forbes list of Russia's 200 largest private companies and in the top 100 list of European software vendors.

Our flagship product is the 1C:Enterprise system of programs. It was designed as a platform with applied solutions. 1C makes the platform and the main applied solutions itself. But customization of applied solutions and applied solutions for various sectors are written by company specialists. Approximately 200,000 people work on programming 1C:Enterprise, and approximately 100,000 specialists work in more than 7,000 franchises. In other words, franchising is fundamental. In the last eight years, sales of 1C:Enterprise have grown by 700%. Why? How can we reach this kind of growth? After all, 1C is almost 20 years old. We're no longer a startup. First off, automation is one of the key methods for increasing the efficiency of businesses and other organizations, so it's of crucial importance. Secondly, good products. Thirdly—and very importantly—how franchising works. I'm not the only one thinking about how to sell it at a better price: I have 7,000 franchise managers thinking how they can help to sell 1C:Enterprise. We have formidable competitors. When people ask me why I work so much, I tell them, "Do you know who I'm competing with? Oracle, SAP, and Microsoft, which until recently belonged to the richest person on the planet." In other words, these are very strong competitors. Nevertheless, our share of the market for integrated offerings is growing.

There actually haven't been that many cases of domestic technologies increasing their market share as compared to leading Western brands. We'd have to look long and hard for another example. We were probably able to do this thanks, in part, to franchising. Franchises help us position the product, make it effective.

They have, in effect, a common product, and over time, they've developed a common marketing campaign. We conduct seminars based on a fine-tuned programme and a single shared technology in a hundred cities across the country at 10:00 local time. It would be too expensive for each of them to design their own technology. They wouldn't be able to do that. After the crisis, we stopped advertising for new franchisees—but the chain continues to grow anyway, at the rate of about 50–70 new contracts a month. But stability is also crucial: 87% of franchisees which signed contracts with us before the last crisis, in other words before 1998, are still in operation. This is practically unheard of in small business. Why? We all understand the economic effects of franchising: a combination of efficiency, energy, and mobility of a small business in which the owner works in close proximity with the client; the might of a well-promoted trademark; and large-scale technologies created by a major company. The Russian, post-Soviet, as you said, territory also relies on the psychological effect. On the one hand, franchisees feel that this is their business; that it belongs not to Nuraliev, but to them: they can sell it or leave it to their children. On the other hand, they are not alone: they are part of a crowd, and they can benefit from each other's achievements. But they are competitors—how can they help each other? In small business, they can. Remember how, in the post-Soviet time, cab drivers from the same car park used to wait outside a station. They were direct competitors: a passenger would choose to take one cab rather than another. But just try to offend one of the cab drivers!

We need the regions. They say our Russian business is growing in Moscow, and also in St. Petersburg and Tyumen. Take a look at the growth rates of our franchise in the regions. You would think the Far East is depressed and the North Caucasus district is difficult—and yet the growth rates are high. Franchising is a sure way to boost regional economies. Mr. Likhachev actually already talked about this.

This is the average temperature and overall mood of the franchise. On the right, you see the average numbers measured by Delovaya Rossiya for Russian business overall, and for us in particular. And they already knew that instead of the unified social tax, their salary outflows will jump from 14% to 34%. But that's okay, they are still optimistic: the market is growing; they have work; everything is great.

What impedes and, most importantly, what harms Russia's franchising sector? It's Russian legislation. Our Civil Code has chapter 54, called 'Commercial Concession', though I would call it the 'Chapter on the Prohibition of Franchising in Russia'. Most companies building the Russian franchising sector have to work around it. Actually, franchising—resale of products—is regulated by other articles, while licensing agreements are governed by part 4 of the Civil Code, 'Intellectual Property'. We can continue to work around it, but it is impossible to operate in compliance with this chapter. Less than a thousand agreements a year are registered under this chapter. That's despite the growth of franchising across the country. Back when the law was written, they probably wanted to protect citizens from greedy franchisors. And in the end, they over-protected them—but you have to permit something. Chapter 54 contains some completely unbelievable things and some silly nonsense. For example, you have an initial lump-sum investment and regular payments. Chapter 54 says, "No, it has to be one or the other". Why only one or the other? Just because. They're more than 10 years old. Next come requirements that have no equal in the world. The most mind-boggling thing is in chapter 253, where it says that after the contract expires, it must be renewed on the same terms. That's it. It can't be modified at all. But modernization is the lifeblood of franchising. We bring modernization to regions across the country. It's like workshops from the Middle Ages: you can't change technologies, you can't change contracts. You don't see this anywhere else. They say they'll look at it. I want to thank the International Franchise Association. They sent us a 17-page letter saying that this doesn't happen

anywhere else in the world. Russian law also doesn't have anything of the kind. But there are leasing contracts—for example, the effective article 621. When a lease expires, the former leaseholder is at an advantage. That's what we have to use as a foundation.

I know one case when this wonderful chapter about franchising contradicts Russian laws. We have a pretty tough, but effective anti-monopoly law 135. For example, vertical price fixing is allowed there. But it's prohibited in chapter 54. We can't have two small potatoes at opposite sides of the mall trying to beat each other's prices. They have to compete with Subway, with KFC, not with each other. The Franchise Association's initiative to change the law met with great support. I spoke with Surkov directly. Last year, he was explaining Skolkovo to business, the innovations, and I told him, "You see, we can put 1C in Skolkovo, but who is going to spread modernization across the country?" And he says, "Write a letter. Alright, we'll support you". Let's start with the highest level. The Ministry of Economic Development supports us. Dvorkovich supports us. Members of Parliament introduced a bill: Fyodorov, who currently heads the Economic Policy and Entrepreneurship Committee. And now, Gruzdev is handling this question in the Legislative Committee. When the bill had its first reading, Putin had a meeting with business leaders. We had to pose the question in a way that would focus his attention on the problem. He considered it carefully and authorized Nabiullina to handle it. Even the first reading was a big victory for the Franchise Association. Legislative changes passed the first reading, and unanimously at that. I deal with legislation—I was elected on March 17 of last year. It's a difficult task, and this achievement is far from irreversible. Now, we are facing the critical need for a second reading. We have to keep working away. I wrote down a Chinese saying: "We shall reach our goal step by step." It's not that I'm so persistent and self-assured, but because of its Russian transcription. If you see the screen, you can read it. I want to say again: I was at a meeting on May 26, where Putin made a speech and said that we must create 25 million new

modern jobs. Darn straight we can! 1C has directly created 100,000 state-of-the-art programming jobs, not counting managers and accountants, plus another 200,000 jobs indirectly. If 250 companies like 1C are permitted to open, this seemingly difficult target will be achieved. We just have to fix up the legislation. Thank you very much.

**J. Gansinger:**

Thank you very much, Boris.

You can see from Boris's remarks that we have a lot of major questions to discuss and very little time in which to discuss them here on this panel. Thank you very much.

I would like now to turn to Jack Earle. Jack is the Chairman of the Board of the International Franchise Association. Jack, the president of your association, Steve Caldeira, was recently quoted as saying, "Franchising, if properly financed, can be a catalyst to turn the US economic recovery into a jobs recovery".

My questions to you, Jack, are: what benefits does franchising in the large international chains provide to Russia and its economy; and secondly, do brands from the developing economies have a place under the sun? If you would, share with us your thoughts on current trends in franchising in the world and the role of franchising in the recovery of leading economies, particularly in the United States.

**J. Earle:**

Thank you, Jim. Let me first thank the Russian Franchise Association as well as the St. Petersburg International Economic Forum for your invitation. Thank you very much.

First and foremost, Jim introduced me as the Chairman of the International Franchise Association, but in my paying job, I'm a McDonald's franchisee. I have been a McDonald's franchisee in the States for the past 28 years.

So let me start, if I may. First and foremost, a healthy market for franchising includes both international franchise brands as well as local brands. Local brands can learn a lot from international brands that focus on the delivery of quality products, services and attention to customer service.

And international brands can benefit from watching local companies thrive and deliver on their products that may tie in to cultural and regional trends in customs. There is an especially significant impact in developing, changing or emerging economies.

A new business model, wherever it flourishes, always represents a reduced or shared risk. And to the extent this concept is understood and absorbed by developing economies, the risk-benefit ratio will be seen as a strong advertisement for investing in franchising.

System support, that is, advertising, training and a strong central direction. Training, in particular for mid-management level, is especially important. The range of types of assistance that franchising offers has been particularly important to Eastern and Central European countries, and to markets in new independent states.

Franchising continues to be a particularly attractive option for smaller businesses. Franchises' pre-tested systems assure quality and uniformity and provide a structure readily adaptable to another culture.

Franchises can deliver, fairly rapidly, consumer goods and services of equal quality and modest prices to consumers. Integration into one global economy carries benefits, such as the potential to expand commercial relationships with other markets relatively swiftly and economically. The potential to encourage a shared sense of societal relationships with other economies. The impact of icons, the trademarks, the trade dress, radio, television, and press advertisements that are among the best-known systems of the past 50 years.

Franchising creates jobs at a time when economic upheaval tends to increase the levels of unemployment. Almost two decades after the shift to a market economy, it provided an indisputable boost to the Russian economy.

In relation to the record-low unemployment rates that might have been reported, franchising clearly is on the upward trajectory here in your economy, and it is very clear that franchising can provide an employment boost to Russia.

The removal of job security can be just the boost needed for people to take a step into franchising. As more and more people become available, franchisors have a larger pool of people to select their candidates from. There was a continually imperative need worldwide for foreign investment, and that is true no matter where we look, whether in Eastern Europe or in Sub-Saharan Africa. Foreign investment is a common requirement for all economies to grow.

As to the question whether there is a place under the sun for localized brands in the developing nations, certainly the answer to that question is yes, because in most instances, franchise systems deliver food and other products and services that are quite basic, and changes that are required for those economies or those different countries can be made quite easily. A hamburger could become a lamb burger in India. Pizza may be topped with squid in Southeast Asia. All easily changed and easily made available within those countries. Franchising, because of its structure, attention to delivering quality, consistent products and services, will continue to alter consumer culture in the future.

Franchise companies demand a very high level of quality to deliver their products, whether it is in the preparation of food, the delivery of exceptional service or providing a guarantee of a product or service to the consumer, because franchisors stake their reputation on this high level of service and quality. Franchisees must adhere to the principles and follow the system.

As consumers grow accustomed to this level of service and quality, independent businesses that compete with franchise friends must improve their level of service as well or risk being put out of business. The consumer will always

benefit from this type of competition that drives innovation and excellence in customer service.

One of the issues that we have been working on at the International Franchise Association in the US is access to credit. This is a large problem in the US, and as one of the efforts to help with that issue, we conducted a lending summit last month, in which we brought together franchisors, franchisees, bankers and government officials, not to place blame on either side, but really to talk about how we can improve the relationship and understanding. And in many cases, it is an issue of understanding.

It is an issue of franchisors making sure they know how to approach banks and how to get new franchisees access to credit. And I can say that, although it's quite early, we've seen some very early positive results. So we are pretty excited about that. Right now, in the US there is a shortage of about 20% of credit that is needed to grow franchising in the US economy. Actually, I am finished with those remarks, but if I may do a quick advertisement for McDonald's in Russia.

**J. Gansinger:**

That will be all, Jack.

**J. Earle:**

Come on, Jim. There are 277 McDonald's restaurants in Russia, serving more than 1 million consumers. There are 130 local suppliers here in Russia, with more than 80% of those products being locally sourced.

Our suppliers employ more than 100,000 people here in Russia. And McDonald's is employing more than 26,000. As it relates to our involvement within the Russian community, Ronald McDonald House Charities have contributed more than USD 330 million to local charities. And the Ronald McDonald House, which was opened in 1995, has served more than 69,000 children. Thank you very much.

**J. Gansinger:**

Thank you, Jack. I'd like to follow up on one thing that Jack mentioned, which was access to credit. I think it is one of the really critical issues here in Russia for franchising and small business as a whole to develop.

I saw a very favourable notice about six weeks ago when I was here in Moscow, that Sberbank had announced the formation of a small business loan project. And we have been following that very, very closely, because access to credit at affordable rates can be a real impetus to development in this country for small business. So I did want to mention that...

I think it is time for my slides. As I mentioned, I am in the quick-service restaurant business – fast food. Subway has been in this country now for a number of years. I would like to talk about our experience here in Russia as a way of demonstrating what I believe are the major benefits for the Russian economy that franchising can show and can produce. I would like to start with the definition of franchising.

I have read many, many definitions of franchising through the years. I think the simplest and most all-inclusive definition of franchising is the licensing of a proven business model for a fee or royalty.

One of the critical benefits that franchising provides, and has been providing here in Russia through our company, is that franchising creates entrepreneurs. Here in Russia, since 2005, we have sold 298 franchises, and we have created 103 new entrepreneurs through May of this year. That amounts to 103 Russian citizens who now own their own business. Many of them are now opening their second, third, fourth Subway restaurants. So franchising creates entrepreneurs.

This slide shows the development of the number of our restaurants and how quickly our system has developed. We have developed quickly in Russia because we are franchising. We now have 216 stores in Russia. We finished last year with 167. Russia is the fastest-growing market in Europe for Subway, and

the second-fastest growing market in the world for Subway, second only to Brazil.

Importantly, franchising creates entrepreneurs. Entrepreneurs create jobs. Jack mentioned the number of people working in McDonald's restaurants in this country. This slide shows the development of jobs through those years to the point where we added, Subway added, over a thousand new jobs to the economy last year. We project with the growth that we are showing that in 2011, we will create 2,000 new jobs this year just in our company alone, here in Russia. In addition to that, franchising creates jobs in other sectors. For example, with Subway, we buy all the food products, or actually almost 100% of the food products that are sold in our stores is purchased in Russia. Almost all of the equipment that we use in our stores is purchased in Russia.

We create, Subway creates, our franchisees create jobs in packaging, manufacturing, food production, logistics, transportation, construction, real estate, and other sectors. We estimate and project that in 2011 alone, Subway will create between 2,500 to 3,000 new jobs, and as our system expands, we are projecting a doubling of our system this year. We will continue to produce and generate that many new jobs in the Russian economy, and it will keep growing and growing and growing.

In addition to creating jobs, franchising also speeds both the rate and the geographical breadth of development. This slide shows how our company has spread through the last several years. We have grown and spread our geographic reach across Russia.

We have 216 restaurants now in 37 cities in Russia. How did we do that? That is franchising that does that. Franchising grows because it relies on the business decisions of local entrepreneurs. So for each one of these cities that we have expanded into, there are local entrepreneurs who become our franchisees, who are making business decisions. They are making capital investment decisions in markets where they live. They know the market. They know the real estate

market. They know the people. They understand the economies of those cities in those regions, and they are willing to make the investment of their money in these businesses.

If you look at some of the places where we have stores. Last week, I was out in Siberia. I visited Irkutsk, Angarsk, and Ulan-Ude, places where we have Subway stores owned by Russian citizens who made that investment capital work for them. We have a franchisee in Chita, down near the border of Mongolia, Andrei Tokarev, who this week is opening his fourth Subway restaurant in Chita and has purchased his fifth franchise. So he will have five restaurants in Chita.

Now, I can tell you without hesitation that if we were making our capital investment decisions in Moscow or St. Petersburg or the United States as to where we would open restaurants, there would not be a restaurant in Chita during my lifetime. That is the difference between franchising and making decisions from a corporate level, as to where you are going to invest your money and where you are going to spread your brand.

Our brand has been growing almost like wildfire because those decisions are being made by local people. They are making decisions about their own money. They want to have businesses. They want to start businesses and that is why our company has grown so rapidly, and grown through so many regions of the country.

Profitability drives growth in the franchising industry. What this slide shows is the growth in our system in the number of stores that we have had in each year. You can see, even in a year like 2009, which was a major crisis year, our franchisees grew our system 41%, in a crisis year. In 2010, we more than doubled the number of stores in our system. That was done by franchising.

Our store sales, if you look at 2009, a crisis year, we had very small growth of actual sales in the individual stores because of the crisis conditions. We still had positive growth of 3%. We returned to much higher sales growth in 2010 and even higher sales growth through this year. So our store sales in the stores

themselves for this year are up system-wide at 24%, which represents a very healthy level of growth for any business.

Here is a slide that I wanted to use to strike back at Jack, who wanted to do some advertising. McDonald's remains the number-one restaurant chain in Russia and I have nothing but respect for McDonald's. But McDonald's is not franchising in Russia, and if you look at the growth in the McDonald's chain last year, they still have more restaurants than anyone else. But last year, they grew their system 13%. We grew our system 104%. Our franchisees did that. I did not do it. Russian business owners, Russian entrepreneurs grew the Subway system 104%. This year, we are going to have over 300 restaurants here in Russia.

You have to have training, as Jack mentioned. Critical to a franchise operation is good training. We established a Russian-language training centre in St. Petersburg in 2005. We are now averaging around 20 Russian people coming through that training centre every month. Through the years since we have opened that centre, that centre trains franchisees and their senior management people. We have had over 500 people come through our training centre and receive their certificates.

So the formula for franchising success, as we see it, is affordability, quality training and support, a quality brand, quality products, and good service. And that equals profitability and success. I think that one critical need here in Russia, and one reason I am so pleased to be invited to a forum such as this, to see the interest shown by the Russian Federation, is the need to spread the word about franchising. We need to educate the general public. We need to better educate the business population and we need to better educate the political population about franchising and its benefits.

One of the things that I wanted to announce here today, that what we want to do to promote that, is we are announcing today the establishment of the Subway Russia Journalism prize, which will be a prize awarded annually to the author of the best article annually on franchising, published in any newspaper, magazine,

or online media here in Russia, offering an annual prize of RUB 300,000 to the author of the best article on franchising. So I wanted to mention that to all you journalists out there.

Okay, thank you very much. I would like now to turn the programme over to Merab Elashvili, to my right.

**M. Ben-EI (Elashvili):**

Thank you very much. First of all, I want to thank the organizers of the Forum for including this Franchising segment in the programme. This is already saying a lot: the people in this room are paying attention to franchising, not just on the part of enterprise, but also on the part of the government. I also want to thank Mr. Likhachev for his active involvement in this work and for the fact that we are meeting here today. I want to give my sincere thanks to the ministry.

My colleagues have already spoken a lot about what a franchise is, why it's needed, what it provides. But I want to remind everyone once again, as a business person, that Russia faces an overall difficult situation from the point of view of enterprise and in terms of its situation. If we promote franchising, but don't change the general climate in the country, it won't work. But we see how much attention has been paid to business and its needs in recent years, and we hope that we created the Franchise Association at the right time. A year or so ago, we updated the association. The main association includes all major franchising entrepreneurs. Each of them has a large chain. We agreed that if franchising doesn't work out in this country, then nothing will work out. And we gave each other a gentleman's word. Let's try it, and see what happens after we get this sector off the ground. I'm not saying, nor am I boasting, that I know how the franchising sector has developed and is developing right now. But I think that in the last year, year and a half, thanks to our achievements, people have begun to understand what franchising is and who franchisees are. We no longer hear what we used to hear: that franchising is the same as leasing. We are at the

beginning of our journey, and we have a great deal of work in front of us. The ministry is beginning to support us, but we want somebody else to hear us even more clearly. When the association says that this is necessary, it speaks for real companies, real successful people. Members of our Board of Directors have hundreds of outlets in various sectors employing a great deal of people.

As far as where we are today and the status of franchising in America, what we want to achieve, and where we want to be by 2020: this slide will show you that in 2010, the number of people working in the franchising sector was 330,000. Our pessimistic forecasts show that by 2020, this number will be more than 800,000. If we look at annual growth in Russia, and consider how we grew in 2009–2010, we can see that, in our opinion, the sector will continue to grow. But to achieve active growth, business won't be able to do this alone. We are all paying lip service—and that's good. I don't want to be a pessimist, and by nature I am an optimist. But my experience tells me this: I have had 15 franchising partners in Russia, and I have dissolved contracts with eight of them. I have just seven left out of 15. It's not because I'm too fussy or too pedantic, and the others are different. It's just culture. First of all, entrepreneurs don't expect more from franchising than they would from franchisors. We have to foster this culture. We must use our platforms to promote the business as much as possible. The government can support us in this, but this also depends on enterprise, on people who make up the business. No matter what we do, if legislation doesn't support property and copyright owners, nothing is going to work. They can refuse to pay; they can buy rights and then default on payments or do whatever they want. The law doesn't really protect us in this respect. Mr. Nuraliev said that he was working very actively with our association, and we were all prepared for positive developments, but now things aren't really moving. Mr. Likhachev also supported us. He says he will personally support us and will work on this issue. We really hope that this process doesn't leave us with legislation that's even worse than when we started.

Overall, franchising is the right tool for growth and development. It was invented a long time ago, and not by us. We just want to properly adapt it to Russian conditions and use it to create new jobs. I'll use the example of my company Planet Hospitality (I'm not going to advertise my company). We have several brands, but I started the business with a chain of Sbarro restaurants. In 1997, I bought the rights for Russia. Right now, we have the right to operate in 29 countries, though we don't operate in all of them. In 2002, we opened our own brand. We currently have 175 restaurants. By the way, the slide about Subway wasn't quite right. It said that Sbarro's growth from 2009 to 2010 was negative 1%. We did grow in 2009–2010. Once we learned how to properly adapt this model to our country's conditions, we created three proprietary brands, and have already begun franchising. This brand is also turning a profit—no less successfully, by the way, than Sbarro in the regions. For example, our Vostochny Bazar already has 50 restaurants.

We have to pay close attention to training, promotion, legislation, and so forth. I agree; I support all these directions. But believe me when I say that we are the ones who have to do this, because nobody else will. Our business community has to be more cohesive. Currently, the association includes, I think, 60 organizations. But the country has a lot more people working in the franchising sector. The more members join the association, the more experience and knowledge we'll have. We have to unite and focus more efforts and energy on what we want and how we want to achieve it, to make sure our more senior friends can hear us. I also want to propose that World Franchise Council representatives create a permanent Secretariat that would function as central management for the franchising development process. It would publish an international journal highlighting reliable franchising organizers, provide a unified forum, and organize exhibitions and so on. For our part, as a Russian association, we will support this and will be able to share a great deal of information. This will give our Russian companies a better understanding of what

they should focus on, because the information in brochures will be coming from such a respected organization. I can talk for hours on end about franchising, but I know we don't have as much time as we'd like. So at this stage, I would like to urge everyone to work in this direction. It's a very successful, very lucrative direction. Come join the association—or work in this direction without joining the association. It's good for you; it's good for the country; and it's good for everyone in general. So I'm all for joining and for active franchising. Thank you.

**J. Gansinger:**

Thank you very much, Merab. Now I would like to ask Osman Bilge, who is the General Secretary of the Turkish Franchising Association. Osman, Russia is seeking to become a member of the Black Sea Franchising Federation. As the Turkish representative, tell us about the Black Sea Franchising Federation and what it has to offer to the nations seeking to join it as members. And please also share with us the Turkish experience of franchising.

**O. Bilge:**

Sure. Thank you. First of all, I want to congratulate the Franchise Association of Russia that franchising is a session in this Economic Forum, because of the importance of franchising. We are turning more than 20 years old in Turkey and we are still not as successful as you.

Our Franchise Association in Turkey was founded in 1991, and we mainly consist of franchisors. We also have supporting members. We are part of the International Franchise Association, the European Franchise Federation and the Black Sea Franchise Federation.

We have been organizing franchise fairs since 1994. We make TV shows. We have our magazines. And we are running our franchise academy and compliance system check. This is also very important. We are checking our members.

Now, at the end of last year, we had 1,800 chains in Turkey. They are working in the franchise discipline. That is something else about franchising. Only 20% of them say they are franchising, but all of them can change in a minute to franchising because they are in the franchise discipline.

They are working under the same brand name, they have good support behind it, they have a good supply chain. So they are either franchising or they call themselves a dealership, but they can change to franchising. Thirty percent of them opened their own outlets, but many of them are ready to franchise if they cannot succeed with their own outlets.

And this changed. Some franchise chains in Turkey changed to outlet chains. They bought their franchise back because they could run it. In fact, franchising is, in my opinion, the saviour of retailers. As an independent retailer, we have no chance against international chains. But as a franchise chain, we have a chance to fight against them.

I wish to summarize how we have lived through these 25 years, because I think we are five years ahead of Russia. We started in 1985 with McDonald's. And we learned a lot from them. Our development of franchising was interrupted three times by three major crises. Each time, the crisis worked as a sieve; the better ones remained, while the weaker ones fell by the wayside. So each time after every crisis, we had another world of franchising.

As we are five years ahead of Russia, I can say you will go through what we did. First of all, we had no mass franchisees, only giants: only McDonald's, Burger King, etc. And we wondered how they worked. We did not know what they did. We just wondered. We were customers of them, and later we transferred their people. We learned from them. Not only as hamburger producers, but all sectors in which we could learn from them. At the end, hamburger producers could not compete with McDonald's. But others, such as doughnut producers, learned a lot from them.

After the first crisis, we saw that our local franchisors were growing in number. Then we had the Twin Towers, and a year before, a big earthquake. This was a big crisis. But after that crisis, we saw that the demand of franchisees let the franchise world grow.

And also shopping malls. Shopping malls have had a huge impact on franchising. They selected who would enter the society of brands. And with the impact of shopping malls in Turkey, the brands of franchisors grew and strengthened.

After a reduction in the crisis, we were now in the final phase. We saw that our franchisors were going into mass franchising, exporting their concept. And they were very successful.

So this will repeat also in other developing countries, I guess. First we start with giants, then we learn from them, and then we build up our systems and export them. The chance of local brands is very important in our view, because there are three different kinds of them. Not all of the producers are creative and can resist and grow and compete and export against the giants. In some specific industries in Turkey, we did it in clothing, accessories, furniture and jewellery.

Local traders have a chance against giants if they copy and compete. In cosmetics, toys, gifts, supermarkets, electronics and building supplies, we did it in Turkey. And with successful local concepts, especially in fast food, we learned a lot from the giants and now can compete with them.

Those are very well-known and successful brands which failed in Turkey. You will wonder; they are leaders of their industries but they opened and they failed in Turkey. Because we often had crises, we learned from them, we competed with them, and we could fight against the giants.

7-11 is a leader. Hard Rock Cafe is a leader of its industry. Alpha Graphics' Johnny King. Anyway, we can compete with them now. And we can export our concepts. This is a short list of those who are exporting their concepts from Turkey as a mass franchise.

What we did at this time as a franchise association was we supported our export companies, and not only one, but whoever was successful. But every year we supported only one, and we worked a lot to introduce the franchise and to let the public and consumers and investors understand it.

So at the beginning, when mass franchisors came, franchising was perceived as something modern, but they did not believe that a franchise fee should be given. There was resistance at the beginning. When they developed, there were some clever guys who opened several franchises. They made money.

The second stage was that people were eager to buy a franchise, but there were no more franchises in good places. Now they pay a lot for franchises.

We had typical problems. I guess you also go through this in Russia. For 25 years in Turkey, we had, first of all, a lack of franchise knowledge. No one knew what to do, what to expect. There is an automatic trust in franchising, and this was misused. Very badly misused.

We fought against this by educating, by selecting, by telling, but it was never enough, a little background. Ease of entrance is another problem. Everybody could claim, "I'm giving franchises. Don't you want to buy me?"

Some franchisors claimed to sell a franchise, and I asked them, "Why should I buy from you?" They said, "Because I am cheaper than McDonald's. Why not me?" That is impossible.

But banks are another problem. They did not consider franchising a secure form of business and they asked us what they ask any other businessman. But we had security in our hands. We had a brand, which had a selling value. And shopping malls, this was another problem. They asked for too much money. Outside on the street, we paid 10% for rent, but in the shopping mall we paid 20%.

So our association introduced a code of ethics, and we founded the Franchise Federation of the Black Sea region in 2009. And when we were making the

announcement, we also mentioned that Russia was to be among the members and founders, along with Azerbaijan, Bulgaria, Romania...

**J. Gansinger:**

Osman? I am afraid we are really running out of time. I apologize, but we need to move it along.

**O. Bilge:**

OK.

**J. Gansinger:**

Alright. I am pleased to announce that we have reached the part in the programme where we are going to have a signing of a protocol between Russia and the Black Sea Federation. Signing on behalf of the Black Sea Federation is Mr. Bilge, and signing on behalf of the Russian Franchising Association is Mr. Elashvili.

Thank you very much gentlemen. Congratulations. We are running a little behind, so we are going to try to move the programme along a little more quickly. Our next topic and speaker is Mark Hilton, Vice President of Sbarro International.

The questions for Mark are: does franchising change the consumption culture and service standards, and how will franchising reshape the consumer market in the services sector in the near future? Mark, if you would please share your thoughts on how franchising impacts other service segments in your vision of the consumer services market and business overall in the near future. Mark Hilton.

**M. Hilton:**

Thank you very much. Cognizant of time, I will move through this pretty quickly. First of all, just a couple of words about me. I have actually worked in Russia for a long time. I started working back here in 1997 with Pizza Hut and KFC,

so I have seen a lot of changes in this country and the Russian business authorities, and the Russian people deserve huge credit for the way the market has moved forward in the last 15 years that I have been involved here.

Sbarro is a US brand with 54 years of heritage. It is the world's largest Italian fast food concept. We have 400 restaurants around the world. Russia has 25% of those and I'd like to formally thank Merab for his leadership of the franchise and the business here. He has done an outstanding job for the brand and we are very optimistic that we will continue to grow very healthily over here.

As far as the questions that James asked, brands are increasingly looking—when you look around the world—at franchising as their primary growth vehicle. Why? Because it allows fast growth. It is a much safer investment for people, rather than opening their own businesses. As James highlighted on one of his slides, when a franchisor signs up to use a brand, they are signing up to approve the model.

So, brands are choosing franchising, and it is going to grow exponentially over the coming years. In Russia at the moment, in the restaurant sector, 32% of the restaurants in Russia are under brands or within brands, so that is growing. The UK has 39%. Russia has got 32%. So it is already a significant driver of restaurant growth in this country.

When you look at franchising, it drives uniformity. Whether that is the product, service, the actual assets or the communication, customers go into the stores because they have confidence that what they are going to get meets their expectations. That really is what franchising drives: that uniformity to meet and exceed customer expectation. You can still go to individual outlets and have a good time. I am not denigrating them at all. But for somebody that does not know those locations, there is always a seed of doubt as to whether that expectation will be met.

Franchising removes that doubt, and consumers today are becoming increasingly demanding over anything and everything. Not only in the food

sector, but in the retail sector as a whole. Product quality has to improve. They need consistency and standards, so they are becoming increasingly demanding as to what they have for brands.

They are also becoming increasingly vocal about their experience. So, a few years ago, if you went into a restaurant and had a bad experience, you would go home later in the evening, and if you were still upset about it, you would then write an email to somebody. Now, it is instantaneous.

So the consumers, driven through their experience of that outlet, are actually making the world, through those blogs, through those websites, and understand what that experience was like in that store, and that has huge ramifications for franchising that are being driven by the consumer.

Competition is driving brands, and therefore entrants, in two different ways. One is in similarities: more and more businesses are doing similar things at work, looking at different times of the day, looking at similar products. But also they are looking to try and differentiate themselves wherever possible, bringing in unique propositions that drive loyalty with consumers. I think what you will find is that franchising is shifting towards a much broader customer experience.

So, when mystery-shopping programmes first started, it was largely around the product. Now it is much more around the broader customer experience, and that is not because restaurants want to do that, but because they are being driven by the consumer, who is demanding more and more.

But brands are actually helping to drive that as well, through a couple of ways. One, they are helping to drive consumers to use their brands, why they use them, and how they use them.

So, a lot of the businesses are driven largely by McDonald's and now moving towards breakfast, looking at different times of the day, different days of the week, and how they can take advantage of them. Online ordering, the technology in the web is really driving a different use of those brands through consumers.

I think what you will see over the coming years is more and more of those brands, whether they are on this slide, whether they are international brands, but also local brands as well, owning that middle sector of the business. You will still get one or two new brands popping up and businesses popping up in that sector. In the UK and in the US in the last few years, one of the clear examples of that has been in the Gourmet Burger segment, which offers a high-priced product against the likes of McDonald's and Burger King. The consumer responded and those brands have grown significantly.

But really, the smaller businesses now are going to be at either end of that scale, the premium niche players or those that focus on value, and you will see more and more of these brands operating in that middle sector driven by consumer demand.

So I guess to summarize, I hope, James, I have kept this as short as possible. Consumers are changing, driven by higher expectations, and they are becoming more and more vocal about it, and brands that do not respond to the consumer are losing their way.

Franchising drives uniformity and consistency, and therefore helps address consumer demand. Product quality, which before was one of the things that helped differentiate businesses and the service standards that helped differentiate them, are now the base point. If you go in and the product quality is not good enough, you are not going to succeed. If your service standards are not good enough, you are not going to succeed.

The customers nowadays expect that as a given, and certainly from a Russian perspective, I have seen a huge change in the consumer's expectations and demands. So more and more businesses are striving towards attaining a broader customer experience, and brands are actually actively looking at technology as a means to influence the way consumers behave.

I think that as far as restaurants are concerned, you will see a move in a similar vein as the retail sector, with a few big brands dominating the market and the individuals moving in to meet the position.

**J. Gansinger:**

Thank you very much, Mark. Our final speaker today is Andrei Krivonos. Andrei, you are the head of the Ukrainian Association of Franchising. What benefits has franchising provided the economy in Ukraine and in this post-crisis business climate, is this really a good time to start a new business?

**A. Krivonos:**

Thank you for this opportunity to talk about our problems in such company. This autumn, we'll be ready to invite you to discuss this with us in Ukrainian parliamentary committees. In Ukraine, our debate about what to do next about franchising has grown such that we are ready to present it directly to Members of Parliament and look for solutions along with them. Over the 10 years of the association's existence, we've managed to calculate and figure out where we are going. The total turnover of goods, the total profit collected last year by members of the association and by the franchising outlets themselves, has already passed the billion-dollar mark. More than 50,000 people are employed. The total number of Ukrainian brand-name chains is more than 370 franchises. During the economic crisis (we would like to distinguish our crisis from all the others due to its specific nature and particular solutions), we implemented a very strict definition of franchisor. This was probably the most important conclusion that allowed companies close to franchising to avoid the disgrace of bankruptcy. A company that doesn't own franchising outlets, but tries to sell franchising offers, should not be called a franchisor. A company mixed up in the management of owned and operated outlets as well as franchising outlets also isn't quite a franchisor. A company that can't remember the name of its trademark and

promotes itself in the regions under random names is also not a franchisor. These three postulates allowed us to exclude from statistical franchising data in 2008–2009 and stop, let's say, associating with more than 100 companies which, to be frank, didn't survive the Ukrainian crisis.

Our discussion should have probably ended the moment Jack said that our biggest issue is the search for, and access to, financing. This is a sore point for all franchisees, especially in our country. But the devil is in the details—and it's the details I want to focus on. The main questions facing us today are: should we develop new chains, new franchising offers in our post-crisis times, and how have the franchisee's motives for buying a franchise changed? In theory, crisis gives birth to new ideas. This is the time when people who think in creative and proactive ways can come up with something. The franchisee can buy a proper, interesting franchising offer that will allow him to grow further. The franchisor, or a person who considers himself a franchisor, will find and implement a business within a new niche.

The franchisor and the franchisee mustn't forget for a moment that we live in a post-industrial society, when it's not enough to produce a lot of metal. It's necessary to have the right sales strategy and to reach out to the client in the right way; to understand your client: your guest, your visitor, your customer, and so on and so forth. A crucial premise in our society is that many of the ideas have already been implemented abroad. We need to take them and transplant them to our country in a proper way, or to adapt and select the right solutions. Unfortunately this term wasn't translated quite accurately, but in English and Russian it would go something like this: globalism has become event-based. Many developments on the global stage influence the structure of future enterprise. We subsist on football championships; we subsist on Olympic Games; we subsist on major international events supported by a sizeable entertainment and guest services infrastructure, in which franchising, chains, and standardized client service plays a crucial role.

Event-based development, event-based globalism, really allows sectors, markets, and territories to move forward. So should we get started? The answer is a doubtless 'yes'. The crisis opened up new niches; the crisis allowed us to move forward—but in which direction? First, let's go for the things that will always be in demand: small necessities, food, office support, the Internet, and so forth—things we simply can't live without. We can't drive a dirty car. We need medical services, and we'll always find consumers for them. Correspondingly, properly structured chains will survive by dealing in necessities. Stores selling cheap, accessible products; discount outlets; dollar stores; pawn shops, and other similar companies are surviving, and will continue to survive. Small pleasures: none of us, no matter how bad things get, can deny ourselves certain luxuries, because this small indulgence will brighten your day, and you'll be able to move forward. As a consequence, franchisees can consider these niches, and franchisors can figure out how to make money on them. Let's take *All About Home*. Our home is our castle—and our castle has to be sound and good. We like design: it correlates perfectly with our small pleasures. Our kitchen has to be in perfect order. And of course children's products are in the same category.

A very important element that develops during a crisis is how to increase productivity, how to raise labour efficiency. Training companies, IT technologies, web technologies, and other solutions that can enable companies not to waste time on activities outside their scope that can be outsourced to the chains. That's how we found a way out of the situation in Ukraine. The same trends, I'm sure and I assure you, exist in many countries. How do we ensure the stability of our chain regardless of its origins? The answer is simple and a cliché: keep dubious people out. The more thoroughly and unequivocally the chain selects franchisees, the easier it is to ensure stability. The more carefully it approaches the selection process, the clearer the relationship will be in the future. I'll ask you to read this slide carefully. In dealing with any franchisor, foreign franchisees, in dealing with each potential or current franchisor, franchisees must remember that

franchising relationships are more involved than simply buying a sandwich, a book, or some product in a store. We build relationships before we sign the contract, before we open an outlet, as well as in the course of the outlet's operations and after the franchising relationship has been established. A firm grasp of responsibilities, liabilities, and other actions throughout each of these stages provides for a truly stable chain.

In this slide, or rather based on the lack of understanding of this division, we ventured to remove a number of potential franchisors, or companies that think of themselves as franchisors, from our membership roll. They keep trying to do something with no awareness of the difficult and multifaceted nature of franchising relationships.

**J. Gansinger:**

Andrei, we are going to have to wrap it up I think. We are a little bit over our allotted time, and I really appreciate Mr. Likhachev's patience for spending this much time with us. I really want to open up the programme to the audience to ask some questions, but I would like to thank Mr. Likhachev. If you want to leave at this time, Mr. Likhachev, I certainly understand that. But I would like to thank him for his participation.

**A. Likhachev:**

If you'll allow me, I'd like to take a minute to say goodbye. Our discussion has given me further evidence of the significance and, most importantly, of the timeliness and urgency of the need to focus the state's efforts on franchising. I'm here representing the ministry. But I guess modernization, if I can use that word, and the behaviour of the business community—its individual members, as well as associations—we can clearly define three areas on which we must work. I'll start with promotion of the idea that franchising is a way of life, and a form of business structure. Secondly, I would probably mention the significant factor of our

collaborative work. This is a regulatory basis in the broad sense of the word, from laws to other possible statutes. I'm sure you know that the Ministry of Economic Development was given a whole range of new powers allowing us to evaluate the regulatory impacts of other agencies on business. Let's focus on this in more detail. Later, if you want. And third, we need to improve financial tools. For one of our speakers, the problem lies in access to financing. But in Russia, I would define the problem as the need to reduce the price of financial resources and to simplify access to them. In other words, nobody doubts that we have plenty of resources. But the process of getting them and the costs have a critical effect on a number of industries, a number of spheres. I want to say that we are ready to work in this direction. We are ready for further dialogue, and I'm sure that we'll find concrete solutions for all three areas and that we will take concrete action. I'm speaking primarily to our Russian association, and indirectly through it, to international associations represented here. We are open to working with you. I am sure that today's discussion wasn't an assessment of our collaborative efforts, but focused on determining the game plan for our further cooperation. Thank you very much. This was really interesting and useful. You've really widened my worldview. Thank you very much.

**J. Gansinger:**

I'd like to now open the floor to anyone out in the audience who has any questions for any panel members. I think there is a microphone, somewhere. Is there a question here?

**From the audience:**

My name is Julia. I am from the US and China. The first question is to Jack and James: Are you Russian-Americans? Do you have a Russian background?

**M. Hilton:**

No, I don't.

**J. Gansinger:**

Nor do I.

**From the audience:**

The second is: suppose the Chinese restaurants, the Chinese Kung Fu schools, Chinese massage chain businesses and Japanese food businesses—because they are very strong—come to Russia to franchise their business and are looking for partners. Where do you suggest they start with? Also, do you think the Russian market is ready for the group, because there are also very different perceptions about the racism issue. Even when I came to Russia for the Forum, the local Russians warned me not to walk alone as an Asian in the street. Is that true? Forgive for my very innocent questions. Thank you.

**J. Gansinger:**

No, I think it is a very good question. I am not from Russia, I apologize for not being a Russian speaker, but I have been doing business here for a number of years. It is like anywhere in the world, there are challenges in this environment, but I tell everyone that asks—people ask me all the time—who are your major competitors? And I tell people, we do not have any competitors. The market here is so large and so undeveloped that I'm not fighting with McDonald's or Sbarro for market share. We have not scratched the surface of the market yet, so there is room for every conceivable type of franchising activity in this country, because the market is totally undeveloped. And I welcome it, if you want to bring Chinese or Japanese fast food into this market, that is good for all of us. Because the more products and brands that are introduced to the Russian population, the more you develop a tradition and culture of quick-service restaurants and things like that, so we welcome more and more brands as a company. I am not going to

pretend to be able to give you advice on how to come to Russia and do business, I made all of my own mistakes, so I think one of our Russian panel members would be far better suited to answer that question than I would.

**From the audience:**

I will be very quick, I am actually representing a local government body which I am advising, a Chinese government body. They are very interested in exporting their chain business and expanding outside of the Chinese market. That is why I wanted to ask if the Russian market is ready? Where should they start? Who do they start with?

**J. Earle:**

Let me help you a little bit, if I may. Last month, six weeks ago, I gave a presentation to the Chinese Franchise Association in Beijing. Ms. Lucy Wu heads that organization and they have some really great ideas about exporting Chinese brands, so that would be one suggestion.

**J. Gansinger:**

Merab, do you have comments you would like to make on that?

**M. Ben-EI (Elashvili):**

I wouldn't call this advice. We need organizations like that. We are doing everything we can, working with embassies and economic missions, among others. We tell them that if any Western organization is interested in coming to Russia to sell or buy a franchise, that's exactly what our organization is for. We have brochures—you can pick them up later. You can meet our CEO, and we'll recommend how to approach this problem. I hope you don't have any bigger problems in your life. Consider this taken care of. Thank you.

**J. Gansinger:**

Do you have other questions? Do we have a question right here?

**From the audience:**

Thank you. My name is Alexander. I represent a group of companies. One of our areas is the production of window structures, floor coverings. In other words, the things Mr. Krivonos mentioned very appropriately, I think: small things, primarily interiors. It was a pleasure to hear the opinions of the directors of four franchise associations: Turkish, American, Russian, and Ukrainian. We've all heard about the success of food companies. But I want to hear more on the issue of small construction and design companies within this business model. Do you have any experience with these companies in the countries I mentioned? We have a large regional chain; we have a presence in 60 cities, represented by small dealers and a few branches; and our technologies and designs get a lot of interest on the ground. We have a serious production base. We've been around for 10 years now, and we've cultivated a great number of dealers and processors. But the crisis has completely changed our plans. We all know that Russia's construction industry has been through a period that was far from perfect. We want to resume these trends, these rates. I would be very grateful if the esteemed panellists could talk about construction franchising in their countries. Thank you.

**J. Gansinger:**

Boris, can you comment on it?

**B. Nuraliev:**

I'm ready, though you asked about other countries, but I only know about Russia. Production franchising is having a harder time in Russia than consumer franchising. I know there's Masterbordur, so the association does have this type of company as members. Masterbordur makes all sorts of tiles. So we do have

experience in this field. I won't speak for everyone; I'll talk about the pros and cons. It's difficult, but it's possible. I'm a big proponent of franchising to begin with, and I see that the others have something to say as well.

**J. Gansinger:**

Andrei, do you want to comment?

**A. Krivonos:**

If I'm not mistaken, our association has four companies with a specialization like yours: two specializing in windows, and two in floors. In reality, it's all up to you. To what extent you have differentiated between the business of window production, for example, and the business of selling a business that can sell windows. Keep in mind that for you, franchising is a new way of doing things, a new business. And most importantly, you shouldn't confuse the quality of your franchise with the quality of the product your franchise is selling. As long as you are clear on all these things, it will keep working. But if there is confusion, if your franchise presentation focuses on windows or sandwiches, you'll have a hard time selling your franchise.

**J. Gansinger:**

We are running past our time quite a bit, but first I want to thank all my fellow panel members for participating in this panel, I very much appreciate it. Mostly I want to thank you ladies and gentlemen in the audience for coming and showing your interest in the subject, we really do appreciate it. So thank you very much and have a good evening everyone.