China: Franchising

Overview

Franchising shows promise in China. Statistics from China Chainstore & Franchise Association (CCFA) show that enterprises from more than 70 industries have applied for franchise operations, including enterprises from the traditional sectors of catering, retailing, and individual and business services. By the end of 2011, China had 5,000 franchise and chain store companies creating over 10 million jobs nationwide.

Many brands have been lured to China by the increasing disposable income of its growing middle class. This is one of the key drivers that motivated major brands such as Subway and Papa John’s to expand quickly in China. Their goal is to fight for a share of the market with well-established early entrants such as KFC, McDonald’s, and Pizza Hut.

Challenges to U.S. franchise firms include a relatively weak regulatory system, increasing costs of labor and real estate and a lack of qualified Chinese franchisee candidates.

There is no lack of Chinese entrepreneurs willing to invest in a franchised store, but few are competent to manage it. Many local franchisees do not have a good understanding of the franchising concept and lack modern management experience.

A key challenge that slows the take-off of franchising, or for that matter any other foreign business in China, is the widespread violation of Intellectual Property (IP). While regulations are in place, enforcement is weak. The responsibility to track down violations often falls on the IP owner. Though registering trademarks may not guarantee the franchisors recourse stemming from IP violations, failure to do so may lead to irreparable consequences. As China grants trademarks on a “first-to-register” basis, there have been cases of individuals maliciously registering another’s trademark and subsequently demanding payment for the use of it. It is therefore imperative for companies to register all trademarks, brand names (both English and Chinese), domain names and patents before entering the Chinese market.

Choice of cities for franchise expansion is as important as structuring an effective organization model. With Tier 1 cities becoming increasingly expensive and saturated, many franchisors have explored the option of expanding in Tier 2 cities such as Dalian, Shenzhen, Tianjin, Nanjing, Qingdao, Xi’an, and Chongqing. In some of these cities, the population is already familiar with foreign brands, but not saturated with choices. These cities offer excellent opportunities for new franchise entrants.

The most recent legislation released by the Ministry of Commerce stipulates that franchise firms can start franchising in China as long as they own and operate two company-owned stores for one year in any part of the world. In addition, franchise firms must file with the local commercial authority for record within 15 days after the execution of the initial franchise contract.
Best Products / Services

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

Franchising opportunities abound in non-F&B industries. The best prospects in this form of franchising include sectors such as car rental and after sales services, budget hotel chains, general business services and fitness.

Success Factors to Consider

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

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

Foreign franchise brands are receiving greater interest from second and third-tier market developers. Additionally, we are seeing an increase in F&B companies entering the market as wholly owned enterprises to manage the brand, demonstrate proof-of-concept and create a strong foothold prior to expanding into the franchise model. At the same time, the fast-growing market offers potential to yield higher returns through the direct ownership of stores.

Resources

International Franchise Association: [www.franchise.org](http://www.franchise.org)

China Chain Store and Franchise Association Website: [http://www.ccfa.org.cn](http://www.ccfa.org.cn)

Shanghai International Franchise Show, Every September, Shanghai International Exhibition Center, China: [http://sh.ccfa.org.cn/](http://sh.ccfa.org.cn/)