

STATUS OF THE FRANCHISING MARKET IN BULGARIA

In the conditions of economic recession franchise systems are more stable due to their more recognizable brand names and the constant quality they offer. Thus, in joining a franchise chain independent entrepreneurs see an opportunity to survive the crisis.

The main problem which franchise companies face in Bulgaria is the lack of information about franchising basics. Despite its steady growth, the real boom of franchising business in Bulgaria is still to happen. There are many sectors with no operating franchise system and they have the potential for great development in the future.

PARAMETERS OF THE "AVERAGE" FRANCHISE IN BULGARIA

- Fee: the average fee required by franchisors for starting a franchise business is 2970 EUR. In comparison, it is \$40 000 in the USA.
- Royalties: for the companies which require such fees – 4.9% of the turnover. Some franchisors set a minimum fee (i.e. 5% of the turnover but no less than BGN 500 per month). Third franchisors (usually distribution franchises) have no such fees, however, franchisees are obligated to buy the offered goods only from their franchisor.
- National advertising fund fee: 4.2% - when such fee is required.
- Overall investment to start a franchising business: BGN 29 500 (15 000 EUR).
- Number of units: the franchise chains in Bulgaria have 11 units on average.
- Average contract duration: 5 years.
- Profits from franchising business: results vary immensely and depend on many factors: location, size of business, competitors' activity, how well developed the business is, personal efforts of the franchisee, etc. As a whole 73% of the franchisees agree that "The profit from my franchise is bigger than the sum needed for the allowance of my family."

PROBLEMS AND OPPORTUNITIES OF THE FRANCHISING DEVELOPMENT IN BULGARIA

Practically unanimously – 92% of the franchisors define the lack of information as the greatest problem for franchising development in Bulgaria. Both entrepreneurs and the general public are unfamiliar with this model and the advantages it offers. What is given as the greatest opportunity for franchise development is the presence of an exclusively large number of undeveloped franchise niches. Especially in the fields of services and retail there are whole sectors in which not a single franchise business is being offered (i.e. unlike Bulgaria, in the USA you can start an independent small or medium sized business in different categories such as: auto repair shops, dry cleaning services, house repair services, accounting companies, etc.).

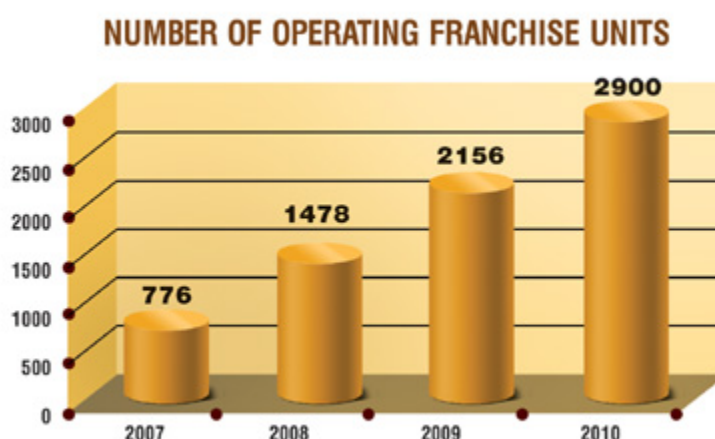
SURVEY RESULTS FOR THE FRANCHIZING MARKET IN BULGARIA FOR YEAR 2009

The following results are from a survey conducted by franchising.bg.

For the past two years the franchising market in Bulgaria has been booming. Since the end of 2007 the number of companies offering franchise in Bulgaria has tripled. Yet, by the end of 2008 their number was no more than 60. Since the beginning of 2009 over 20 new franchise systems have started operating in Bulgaria. By 1 of July 2009 over 80 offer their franchise rights for starting small businesses. 62% of these are Bulgarian companies and 68% of them have been on the market for more than 5 years.

By the end of 2007 the number of trading sites operating as franchises had been 776. New 702 units were opened in 2008, which constitutes an increase of 90% in only a year. Franchisors expect that trading sites in the country operating as franchises will reach 2156 by the end of 2009 and those will be over 2900 by the end of 2010.

The highest number of franchising systems (over 15) operates in the fast food and restaurant business. 7 companies offer franchise for starting a business in the real estate sector.



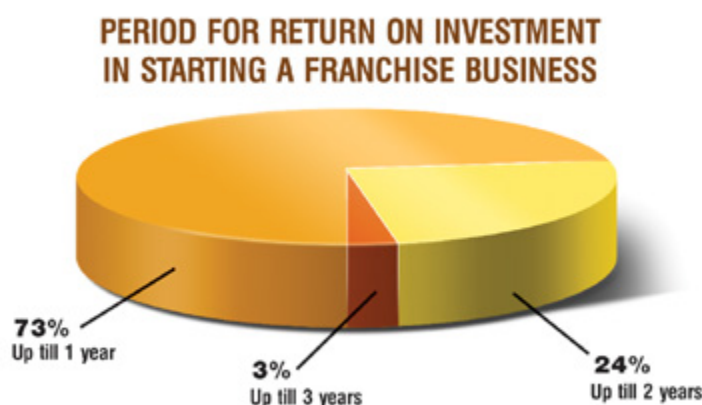
For the period 1 January – 1 September 2009, 8% of the franchisees dropped out of the business. The main reason for closing sites down is the insufficient capital available to resist the present economic conditions. As a reason for dropping out of the franchise systems 63% of interviewees give the high rental costs which, after the setback of the economic environment in Bulgaria, make business unprofitable. According to 49% the main reason for that is the decreased purchasing power of customers. 19% believe they did not research the business well before joining it. Only 16% of those who have dropped out think that franchisors did not provide enough support, and 12% give other reasons (family, health issues, appearance of a competitor nearby, etc.) The sum of the percentage is over 100 as interviewees have given more than one answer.

In 2008, the franchise units created 2370 new jobs. Regardless of the economic recession over 3300 new positions were opened since the beginning of this year until 1 Sep. Presently, over 8000 employees are working in franchising businesses throughout the country.

When can return on investment be expected?

It is strictly individual for each business and depends on the skills and efforts of the franchisee. Since 2007 the average period for return on investment made upon starting a franchise business has been 15 months.

73% of the interviewees claim that the investment in their franchise returns by the end of the first year. For 24 % of the franchises the investment is returned in 24 months, and for 3% - in 3 years.



How does the economic recession affect franchise chains?

Different market sectors are affected differently by the recession. The interviewees share that depending on the sector the decline in turnovers is between 10 % and 70%. Among the most affected businesses are real estate and other sectors related to buying on credit. The least affected are franchises in the fast food business. 63% of the interviewees think that their companies' decline is less than that of the independent entrepreneurs in the respective sector, which do not operate as franchisees. As a main reason for that they point out the fact that franchise companies work under a more popular brand name and offer products of a more constant quality. According to 82% of the interviewees, when the recession is over, regardless of the decreased sales, those operating as franchisees will have higher market share since some of the independent entrepreneurs will have dropped out of the market.

According to franchisors due to the restructuring in the economy many entrepreneurs from sectors affected by the crisis are searching for new opportunities. They have capital and business experience, but they lack the necessary know-how. In this case franchising is among the most preferred options because it offers proved business model, takes shorter time start the enterprise and is less risky.

Because of the crisis a number of small entrepreneurs face the dilemma - whether to fight the economic conditions till full exhaustion of their financial resources or to join a big chain. Thus, the so-called conversion franchise is practiced more and more often in Bulgaria. This is an opportunity for an already existing business to join a franchise system by agreeing to operate under its name, in accordance with its policies, and to pay fees for that. The interviewees point out the lack of crediting as a main problem; it cuts the financing of the enterprises and decreases clients' buying power. The

percentage varies in different sectors, however, an average of 73% of the interviewed agree that "The crisis will be over when banks start crediting again."

The economic crisis has a positive impact on the possibility to provide employees for the fast developing franchise structures. This opinion is shared by 82%. The average number of candidates for low-qualified positions has almost tripled in comparison with the same period of the previous year.

Who looks to buy a franchise?

An interesting fact is that the greater part of candidates are operating entrepreneurs who either want to redirect to an entirely new business or aim to develop a franchise in addition to an existing enterprise. On one hand, this is a result of the economic crisis, on the other – it is a reflection of the fact that employees and investors are not familiar enough with franchising. In the USA a typical franchise candidate is an employee who wants to be "his own boss". There, additionally, it is typical for investors to buy regional and master franchises for large territories or whole countries. Generating an interest in franchising in these two groups (employees and large-scale investors) presupposes an even stronger development of franchise chains in Bulgaria.

Franchisors share that only 28% of the candidates for their franchise are familiar with the principles of the business model. Despite the advantages of franchising, the society is poorly informed about it and according to the franchisors' estimate only 19% of the Bulgarians running a business know what franchise actually is.

Why do entrepreneurs prefer buying a franchise instead of establishing their own business?

When asked to give the two main reasons to buy a franchise, 52% of the candidates say they do it because of the strength of the established brand, 59% - because they want to be a part of a national or regional chain, 72% - because they will receive training and proved business model, 9% - because of the opportunity to buy goods, supplies, advertising, etc. at preferential prices and 8 % give other reasons. What is interesting here is that the franchisees in Bulgaria believe more in "security of the group" than in the strength of the brand name.

Which are the most common conflicts between a franchisor and a franchisee?

Conflicts arising in franchising chains are rare. As main reasons for misunderstandings, franchisors give: „not observing the work standards in the franchise system" (19%) and "violation of contract agreement" (13%).

According to 76% of the franchisors their experience in the past two years has made them more demanding when choosing a franchisee and observe if the latter understands the procedures required by the business model. This experience has made 46% of the franchisors to set higher requirements for franchise candidates and companies have introduced additional tests or requirements for financial stability.

How do new franchise systems appear?

36% of the new franchises which have started operating in the country in the past 12 months are “imported” international chains and the remaining 64% are Bulgarian companies that developed their business by offering franchise. The average sum the new Bulgarian franchisors invest in developing a new franchise system – operational manual, contract, branding, software, tests for candidates, training of a franchise manager, popularizing the franchise and other administration costs - is BGN 48 000 (24 000 EUR).

How will the share of sales made by franchise businesses increase in the next 5 years?

Franchise managers are positive that the share of sales made by franchise companies in the next 5 years will increase enormously, the views varying greatly from 200% to 500%.

Source: www.franchising.bg