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The institute of franchising and internal threats to national economic security

Abstract. *Introduction.* Small and medium businesses play an important role in the national economy, driving economic growth rate. Establishing a relation between the institute of franchising and economic security (the two notions are often viewed separately) is an important element in the creation of competitive economy and forestalling threats to national economic security. *Purpose.* To develop the institute of franchising as an indispensable precondition of forestalling threats to national economic security. The condition and the main development trends in Ukrainian franchising market have been reviewed. *Results.* It has been proved that the institute of franchising may act as a «block» to economic security threats by offering legal business mechanisms, broad range of franchises and training of skilled cadres, creating new jobs and bringing in additional investments. *Conclusions.* The institute of franchising helps improve the level of the country's technological, innovative and investment development and leads to civilized ways of running a business and market culture. It creates conditions for development and protection of intellectual property (preventing occurrence of primitive, low-tech production).

Keywords: Institute of Franchising; National Economic Security; Threats to Economic Security; Small and Medium Business; Franchise; Ukraine

JEL Classification: H56; M13; M29

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Анотація. У статті проаналізовано розвиток інституту франчайзингу як необхідну передумову попередження загрози економічній безпеці держави. Висвітлено стан та основні тенденції розвитку вітчизняного ринку франчайзингу. Доведено, що Інститут франчайзингу може виступати «блокатором» загрози економічній безпеці, пропонуючи механізми легального бізнесу, підготовку кваліфікованих кадрів, широкий діапазон франшиз, створюючи робочі місця, залучаючи додаткові інвестиційні ресурси.

Ключові слова: інститут франчайзингу; економічна безпека держави; загрози економічній безпеці; малий та середній бізнес; франшиза.

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Аннотация. В статье проанализировано развитие института франчайзинга как предпосылки предупреждения угроз экономической безопасности государства. Отображено состояние и основные тенденции развития отечественного рынка франчайзинга. Доказано, что институт франчайзинга может выступать «блокатором» угроз экономической безопасности, предлагая механизмы легального бизнеса, подготовку квалифицированных кадров, широкий диапазон франшиз, создавая рабочие места, привлекая дополнительные инвестиционные ресурсы.

Ключевые слова: институт франчайзинга; экономическая безопасность государства; угрозы экономической безопасности; малый и средний бизнес; франшиза.

1. Introduction.

During the last five decades, franchising has become a leading intellectual strategy for various products and services offered by companies at various stages of development. «In Ukraine, over 100 brand names (not only foreign but also Ukrainian) already operate under franchising system. The key positions in development of franchising systems are taken by companies having master franchisees and representing Western franchises, experience and international standards on the Ukrainian market. Some of these franchisees skillfully combine national and foreign franchises to achieve maximum enlargement and satisfaction of target audience» [1].

The phenomenon of the **institute of franchising (IF)** is one of the key in understanding specifics of small business and **national economic security (ES)** and conceptualizing their interaction strategy.

2. Brief Literature Review

Theoretical basis of this study is comprised of the works by prominent Ukrainian scholars and experts in security and franchising, in particular, I. Binko (1997) [2], Z. Varnalii (2013) [3], A. Tsirat (2010) [4]. Among the foreign scholars who made a substantial contribution to the study of franchising relations development processes and their effect on economic development of the world countries and international investment proce-

sses are Peter E. Keup (2012) [5], Steve Olson (2008) [6], Ilan Alon (2010) [7].

3. Purpose

To develop the institute of franchising as an indispensable precondition of forestalling threats to national economic security.

4. Results

Economic and financial crisis and the «humanitarian intervention» by the Russian Federation have a strong asymmetric impact on regional labor markets. The growing unemployment is observed in all regions of Ukraine. Unemployment rates in regions which have already been struggling to cope with the large number of unemployed people are now reaching the critical level. For instance, the highest unemployment rate (people aged between 15 and 70) as of September 2014 were observed in the following regions: Donetsk (205.7 thousand), Dnipropetrovsk (123.4 thousand), Luhansk (106 thousand) and Kharkiv (101.1 thousand) Oblasts. The regions with the lowest unemployment indicators include: Chernihiv (35.5 thousand), Volyn (44.8 thousand), Ivano-Frankivsk (46.4 thousand), Kirovohrad (46.5 thousand) and Sumy (47.2 thousand) Oblasts [8].

ES becomes exposed to internal threats (low wages, absence of work incentives, social vulnerability of a substantial part of population, growing poverty, involuntary requalification), growing risks of social tensions and additional outlays for unemployment benefits (the unemployment benefit fund amounting

The National Bank of Ukraine		
Innovation loans	Transformation of «frozen» deposits	
Considering negative experience of innovation financing, this method is ineffective	Providing a guarantee to franchisee before franchiser to implement franchise project	Investment protection mechanism must be harmonized with EU laws

Fig. 1: Mechanism of domestic «frozen» private investments transforming
Source: Own research

to UAH 474.6 million in January 2013 has increased by 1.32% in January 2014 and by 9.48% in January 2015 vs. 2013¹) [9].

Relief of tax pressure and legal support from the government and specialized ministries are not enough for small and medium businesses. Spending cuts in their budgets have resulted in mass layoffs and reduction of jobs.

In this aspect, ES becomes exposed to an internal threat: situation forces small and medium businesses either to go into «shadow» or stay in the «shadow». The ex-Director of the State Fiscal Service I. Bilous believes that «the main reserve of budget revenues, perhaps the only one as of today, is the funds brought out of shadow and certain upturn in production thanks to restored balance between the needs of businesses and government interests» [10]. In the author’s opinion, legal business is strategically important from the standpoint of providing vital support to society and ensuring ES.

In Ukraine, small businesses operate and develop in the conditions of drastic limitation of financial resources. Currency exchange-related destabilization and default of a number of

financial institutions (Delta Bank, Nadra Bank, VAB Bank, Imex Bank, Finance & Credit) [11] have dealt the heaviest blow to the public. In other words, in a situation like that the National Bank’s policy must guarantee protection of investors, including foreign ones. Enabling private individuals with «frozen» banking investments to transform them into implementation of a franchise project could be one of the areas of this protection (Figure 1). In the light of recent developments, this mechanism will help partially offset the sharp escalation of social tensions in the country. The mechanism of transforming investor deposits could be included in the program of cooperation with the EU. Ukraine’s integration into European political, economic and legal area is one of the national priorities [12].

Insufficient attention to this matter will result in another internal threat to ES: growing risks of social tensions and declining investment activity. In this context, strengthening of national ES requires availability of a legislative framework necessary to create proper conditions for the successful functioning of IF.

Ukraine’s domestic franchising market offers various franchises in public catering, retail and service industries

Table 1: Franchises in Ukraine

Brand name / country of origin / foundation year	Head office / launch of franchising	Franchise fee	Investments / royalties
Public catering			
Pizza Celentano – restaurant business / Ukraine / 1998	Lviv / 1999	6,000-15,000 EUR	up to 150,000 EUR / 1.5% of monthly sales turnover
New York Street Pizza – fast food pizza restaurant / Ukraine / 2001	Lviv / 2002	as agreed upon	from 94,200 EUR / 2% of monthly sales turnover
Vienna Buns – bakery café / Ukraine / 1997	Kyiv / 2009	depending on format, location and agreement terms	20,000-180,000 USD / 2-3% of monthly sales turnover
COFFEE LIFE – coffee / Ukraine / 2007	Dnipropetrovsk / 2011	19,500 EUR	78,000 EUR / 5% of monthly sales turnover
KFC Corporation – drive-thru restaurant / Kentucky, USA/ 1952 [15]	Moscow, Russia / 2013	as agreed upon	as agreed upon
Retail			
TOP SECRET – women’s and men’s clothes, accessories, footwear / Poland / 1996	Kyiv / 1996	none	63,000 EUR / none
VIANOR – tires and tire maintenance / Finland / 1999	Kyiv Oblast, Boryspil Raion / 1999	up to 500 EUR	from 23,500 EUR / up to 500 EUR
GLOSSARY – organic cosmetics and foods / Ukraine / 2009	Kyiv / 2011	from 1,500 EUR	from 1,500 EUR / 2% of sales turnover
IDS AQUA SERVICE – water delivery to homes and offices / Ukraine / 1996	Morshyn, Lviv Oblast / 2011	1,000-3,000 EUR	from 13,000 EUR / 6% of sales turnover
1 st Capit – The Travellers Electronics Company – operated by Pavo Duty Free at Zhuliany Airport in Kiev, Ukraine / Netherlands / 1894 [15]	Kyiv / 2014	as agreed upon	as agreed upon
Services			
HELEN DORON – English classes for children starting from early age; early development / Israel / 1986	Odesa / 1986	5,500-6,380 EUR	3,500-4,000 EUR / 14% per quarter
INVITRO – laboratory test services / Ukraine / 1995	Dnipropetrovsk / 2005	special terms	31,400 EUR / special terms
LEOPARK – children’s entertainment center / Ukraine / 2009	Lviv / 2010	as agreed upon	300-400 EUR per sq.m / depending on property
SONATA – tourism and related services / Ukraine / 2002	Kyiv / 2009	from 590-1,570 EUR (depending on package)	from 780 EUR / from 80-160 EUR (depending on package)
Royal Carwash [16] – network of car washes without water / Ukraine / 2012	Dnipropetrovsk, Lviv / 2014	400 – 4, 000 \$	21 \$ / per month

Source: [14-16] systematized by T. Makarenko

¹ Statistical data for 2014 and 2015 excluding occupied AR of Crimea and Sevastopol

with affordable range of costs and sixteen years of experience (Table 1). The Chairman of the Franchising Association Directorate A. Kryvonos and Vice President of the Franchising Development Federation O. Nohachevskyi place emphasis on the promising areas of business franchise development: preschool education, public catering, real estate agencies, clothing and footwear retailing, B2B services [13].

Franchise Group estimate that the total number of franchisees expanded by 63% from 2010 till June 2014 [17]. In 2015, franchise sector growth will improve in line with the expected overall improvement in economic conditions, and franchisees will continue to outperform within their industries.

IF devises strategies, determines prospective areas, develops business running tactics, works with public authorities on creating, implementing and controlling mechanisms of establishing and supporting businesses, and is capable of generating ideas and bringing investments.

We can study the development of **IF** as an indispensable precondition for forestalling **ES** threats by analyzing the segments of their interaction (Table 2).

The analysis of interaction between **ES** and **IF** can thwart the occurrence of risks for franchisers, franchisees and potential investors.

In this aspect, emphasis should be placed upon:

- creation of a reliable system that guarantees protection of investors' and shareholders' rights (protecting investments, combating corruption);
- creation of a legislative framework for successful functioning of **IF** (commercial concession agreement² registration mechanisms are overburdened with red tape and take way too much time; if partners (or one of the partners) are (is) non-resident/s of Ukraine, registration of commercial concession agreements becomes impossible and that is a huge obstacle for running a business and bringing in foreign investments);
- financing resources affordability for small and medium businesses (reduced-interest loans, interest-free loans, loan holidays);
- tax preferences (also within the context of implementation of advanced technologies);
- creation of conditions for the development of investment-attracting

and efficient domestic market and combating corruption and «shadow» imports and trade.

The Franchising Association operating in Ukraine continuously monitors business environment and works with banks and international investment funds on financing franchising, offering instruments to finance establishment of franchises.

Beginning from 2004, TRIARH has been actively implementing projects envisaging creation and implementation of the franchising model in Ukraine and Russia. In 2012, the first office was opened in Almaty, Kazakhstan. The company operates in managerial consulting sphere and specializes in strategic consulting, operational consulting, development of franchise systems and financial and investment consulting.

In franchise network development sphere the company borrows from the experience of leading international franchising companies and works closely with international civic and commercial organizations developing franchising relations in Europe and the United States.

TRIARH offers a comprehensive approach to optimization of financial and investment operations. It includes development

Table 2: **IF** and **ES** interaction segments

IF. Types of franchising [4]	Relation between IF and ES	ES elements [18]
Production franchising	The most effective use of patented technologies, growing innovativeness and improving competitiveness of economy	Production security
All types of franchising	A proper franchising system guarantees continuous commercial and technical support for the entire duration of franchise agreement, which in turn, truly boosts the steady growth of startups, especially in times of crisis	Demographic security
International, regional, national franchising	Franchising helps develop the platform of independent medium businesses between large distribution groups and independent small businesses in retail and service spheres. As a result, market competitiveness begins to increase. Franchising fosters the best practices and healthy competition among international brands and the country's active participation in worldwide division of labor.	Foreign economic security
Investment franchising	Franchising represents a method of business development both at domestic level (generating ideas concerning establishment of businesses, employment and wellbeing), and internationally. At the latter level, franchising is a natural vector for business exports and border trade and a conduit of foreign investments.	Investment and innovation security
Franchising of business format	Business format of franchising is a dynamic and efficient system of business growth thanks to clearly formulated rights and obligations of the franchisor and the franchisee stipulated in franchise agreements, a scheme of transferring know-how from franchiser to franchisee and development of bilateral cooperation between them. Franchising fosters transformation into a new format, modernization and improvement of professionalism of traditional retail and service businesses. It also brings significant transparency into a substantial number of shadow sectors from the viewpoint of employment and tax benefits.	Macroeconomic security
Industrial, commodity, fast food franchising	The strategic objective of the IF is to provide a base from which progress can be measured and establish a mechanism for an informed change when needed. Provides a clearer focus for the organization, thereby producing more efficiency and effectiveness. Increases productivity due to enhanced efficiency and effectiveness. The strategic objective of the IF is to ensure an increase in the quality of services provided, we have an increased need to find meaningful ways to measure our own performance. Customers must be able to evaluate the level of services they receive. As such, we recognize the continued value for additional, meaningful, and measurable ways to manage the overall performance of major processes and activities. Meeting this objective extends in two directions, the first of which is the internal performance measures or the ones that we establish ourselves to gauge the performance. The other is the identification and application of external performance measures. Strategic goals: to develop and implement a franchise governance process, to develop and implement food management performance metrics; to review existing service line performance metrics and identify improvements or new metrics to better evaluate performance; to manage and adapt to new line of business metrics and other external quality of service standards.	Food security
Labor, combination franchising	Thanks to special in-house training programs for franchisees (often for their personnel) franchising fosters the study of entrepreneurship, as numerous examples of organic transformation of personnel into independent franchisees prove. Use of motor vehicles for self-employment in many segments of workforce, including persons who want to change their lives and who do not necessarily have entrepreneurial experience. Franchising helps establish small and medium businesses, and as a result, increase employment rate and goods turnover.	Social security
IF	Proper support of franchisers and franchisees by the government, particularly by offering tax preferences (reduced tax burden on startups) and providing affordable financing resources which will help achieve national economic growth. Transformation of 'frozen' domestic private investments into implementation of franchise projects.	Financial security

Source: Compiled and offered by T. Makarenko

² Under Article 1118 (2) of the Civil Code of Ukraine the commercial concession (franchise) agreement requires state registration by the authority which filed state registration of the franchiser. Under Article 367 (2) of the Commercial Code of Ukraine the commercial concession agreement requires state registration by the authority which filed registration of the business entity – franchiser under the above agreement.

of a decision-making strategy and system, project planning and assessment, etc. As part of the project, TRIARH experts provide investment search and management services, oversee merger and acquisition agreements, manage problematic assets, develop comprehensive procedures for top management's own handling of investment matters [19].

5. Conclusions

IF is a stable economic structure of interaction of two (or more) organizations, namely franchiser and franchisee (one or more) which can produce own corporate solutions. It is aimed at fostering creation of an efficient mechanism of their interaction and achieving maximum effectiveness in implementation of its goals.

The franchise development level does not nullify the development level of internal production. **IF** helps improve the level of the country's technological, innovative and investment development and lead to civilized ways of running a business and market culture. It creates conditions for the development and protection of intellectual property (preventing occurrence of primitive, low-tech production).

«Frozen» domestic corporate investments are proposed to be transformed into implementation of franchise projects under the auspices of the government and the National Bank of Ukraine as an antidote to escalating social tensions in the country. **IF** is aimed at creating a comprehensive mechanism of encouraging investments, particularly financial security, by a more active use of internal reserves of franchisees, businesses and individuals.

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