RUSSIA:

FRANCHISING IN THE LARGEST COUNTRY ON EARTH

Russia may win in terms of sheer land mass, but when it comes to franchising potential, the country's story gets a little more complicated

WORDS BY KIERAN MCLOONE

Politically, socially, and financially, Russia is often viewed as a literal world apart from what we've come to understand as western culture. This could be due to the fact that Russian culture and news isn't widely publicized in the West, which extends to the current positioning of its burgeoning franchise industry.

You may be surprised, then, to learn that past its mysterious exterior, the Russian franchise industry isn't just similar to what can be found in the West; it arguably borrows many lessons and best practices from the market, too.

A business behemoth

Before we dive deep into what franchisors and entrepreneurs can expect from Russia's business landscape, it's important to understand what kind of country we're dealing with in the first place.

Russia is almost double the size of the U.S., and covers a whopping 17 million square kilometers, making it the largest country in the world. Russia is so large, in fact, that its surface area makes up one-eighth of the earth's total. Across that vast expanse are around 144.5 million people, situated in several key cities around the country. The capital, Moscow, is home to roughly 12.7 million residents, and is often regarded as one of the main franchise markets within Russia.

To ignore Russia's other large cities would be a mistake, however, and these include St. Petersburg (with around 5.5 million inhabitants), Novosibirsk (1.66 million), and Nizhniy Novogorod (1.25 million). In total, Russia has 12 cities with over one million inhabitants, and a further 201 smaller cities that contain between 100,000 and one million people. As expected from a country so large, the on-paper opportunity for franchisors in Russia stretches as far as the eye can see – and then some.

Russia's franchise industry was first established in the early 1990s, following the collapse of the Soviet Union. Despite the past decade seeing considerable instability in the Russian economy, the country's franchise industry is estimated to be worth around $7.5bn, and consists of roughly 1,450 different franchise brands; with more than 50,000 individual franchisees operating in Russia.

65 per cent of brands within the country are of Russian origin, and of the remaining 35 per cent, nearly half of that figure is comprised of U.S. organizations.

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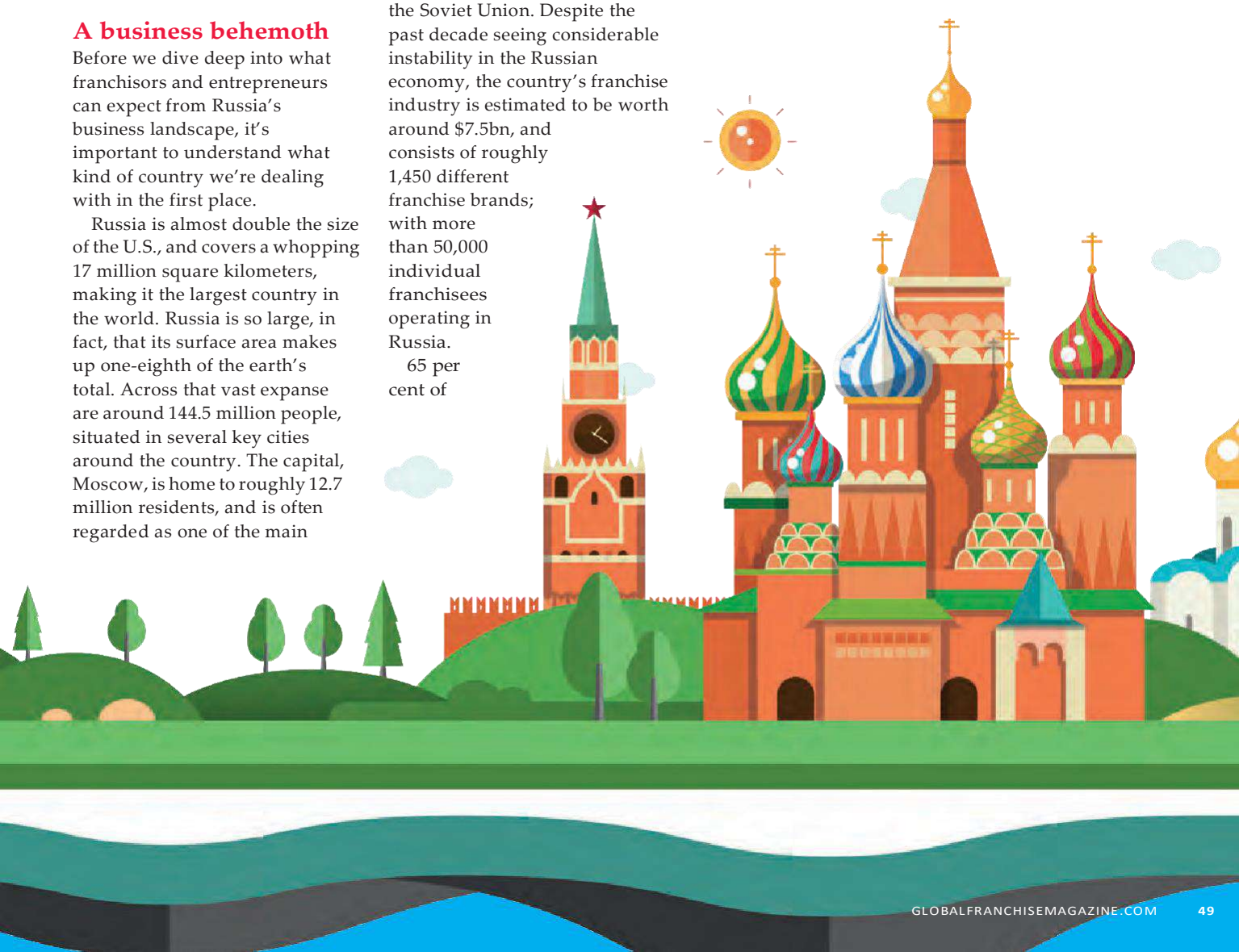

"There's not a single franchisor I can think of that wasn't backed by international concepts taken from the West"

The universal appeal of the golden arches

Many of the franchises currently operating in Russia could be considered relatively young, with 45 per cent having been established in the market for less than five years.

There are of course some notable outliers of this trend; namely, the brand that arguably started it all: McDonald's. Known as the first major success story for franchising within Russia, McDonald's was introduced after a partnership between the Moscow city government and the brand, which saw the government take a 49 per cent stake in the Russian entity.

McDonald's launch in January 1990 was something to behold, and saw more than 30,000 people queuing around the block from 4:30 am to get their first taste of American fast food.

Unlike other U.S. concepts that have come and gone since then, McDonald's remains a popular investment choice in Russia and has seen exponential growth in the 30 years that it has operated. Just this year, in fact, the organization announced that it would open new locations in Russia's far east in December 2020, in cities such as Khabarovsk and Vladivostok for the first time. With these openings, McDonald's hopes to launch its 800th site in Russia; showcasing a true success story of a foreign brand within the country.

But proven success in the U.S., and even a wider international market, doesn't always guarantee prosperity in Russia. Square burger favorite, Wendy's, encountered this in 2014 when it announced that it would be closing all eight of its Russian locations. This announcement came only four years after Wendy's first entered Russia, and at the time, the brand planned to open 180 locations throughout the country.

With the announcement of these closures, a spokesperson for Wendy's told *Bloomberg* that its Russian franchisee "has not expressed interest in growing Wendy's business in Russia, nor have they shown that they have the resources to successfully operate the existing restaurants on a long-term basis."

Gary Chaglasyan, the World Franchise Associates' Russian representative, emphasizes the need for caution, and not letting the success stories of brands like McDonald's cloud strategic thinking: "A brand could be huge in your country, but in Russia, nobody knows about it. You may be in demand and trendy in somewhere like the U.K., but because nobody knows you in Russia, it's all about providing value. Brands should definitely think about promotions and marketing before entering the Russian market."

Local success story

So what kind of approach works well in the Russian market? If Wendy's struggled to gain a foothold half a decade ago, what could the brand have done differently today to instead prosper and develop throughout the region? The answer can be found in a local Russian pizza chain, which has used this past decade to exponentially grow; both within Russia, and in 13 countries around the world.

Dodo Pizza was founded as a brick-and-mortar restaurant brand in 2011, and has since pivoted to being a delivery-first operation centralized by a proprietary tech platform called Dodo IS. With 550 locations in Russia and many more overseas, it's something of a domestic success story and can provide some key insight into the Russian consumer mentality.

"Fyodor Ovchinnikov, the founder of Dodo Pizza, saw huge potential in the pizza market – in Russia and globally," says Max Kotin, chief storyteller for the brand. "He wanted to revolutionize the way this business is managed by developing a proprietary cloud-based tech platform that would be deeply integrated with the brand's managing system.

"There was also very little competition across Russia since Domino's Pizza and Papa John's focused their efforts on Moscow and left the rest of the country almost unattended. This allowed Fyodor to launch his first highly successful unit, scale the network fast through franchising, and use profits to reinvest them in the development of Dodo IS, Dodo's tech platform that allowed the brand to achieve outstanding results in less than a decade."

While some of the key differentiators offered by Dodo Pizza don't seem exclusive to the Russian market, they serve as important reminders to international franchisors that nailing the basics can make all the difference when entering a new region: "Dodo developed a format that was better suited to the market with well-designed dine-in areas and more balanced mix of dine-in/delivery operations," explains Kotin. "Also, the brand's radical transparency and commitment to the win-win principle in building partnerships attracted the most gifted and ambitious franchisees and suppliers; this also allowed us to connect our franchisees with investors and help them raise capital that would otherwise be hard to attain given the state of the financial market in Russia."

The key takeaways from this take-away success story? Find a niche in the market, don't be afraid to pivot to suit evolving trends, and make sure franchisee relationships are at the forefront of all ongoing strategies. Not exactly revelatory observations, but crucial pillars that some foreign brands seem to forget when attempting Russian growth.

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Moscow or bust?

One of the other lessons that can be learned from the success of Dodo's Pizza is that while Moscow is the capital of Russia and often regarded as its prime franchise market, incoming brands would do well to explore other areas as part of their national strategy.

"Previously, brands just focused on Moscow. Moscow and St. Petersburg were the main cities," says Gary Chaglasyan. "Moscow is comparable to New York, and St. Petersburg is like California. The rest of the country was less developed a few years back, but now, all of the cities that have over one million inhabitants are nicely developed and can be approached with a good strategy.

"Some brands find that Moscow is too hard to crack with all the competition, so they start from some other regions. They slowly grow outside of Moscow, and then develop into the city. The reason brands tend to look at these main cities, though, is that they have better supply chains, distribution, and large markets."

Fortune favors the prepared

Give or take a few high-profile failures, franchising in Russia may seem a surefire way to develop your brand. After all, household names like McDonald's, Subway, and Burger King reportedly open around 70 to 100 new locations in the country every year, and the proven growth in both international and domestic tourism means that brand awareness is organic and reliable.

As it turns out, though, there's one main barrier to entry when it comes to Russian franchising: the economy. And while this can be a challenge in every single country a franchisor may try to penetrate, there's some unique problems presented by Russia's unpredictable and volatile financial situation.

"The main problem is exchange rates, which are a huge issue that stop a lot of brands from entering Russia," says Chaglasyan. "Brands are usually western, based in the U.S. or Europe, and all of their fees are in USD or Euro. Many of them have their own products which aren't manufactured in Russia, so they need to import them from their own suppliers overseas. Due to that, they need to pay shipping and transport fees, which increase prices.

"What's worse is that you're working in Russia so it's based on rubles. Just this year, the ruble fell down by 20 per cent. Over the last four years, that was almost 50 per cent. But we still have to pay the USD figure for royalties; the spending power here went down, but the cost to work with brands doubled."

Baskin-Robbins was faced with high import fees when it first attempted Russia in 1988, as it found that Russian sources of supply didn't meet its high standards. As a result, the ice-cream franchisor built its own $30m factory in Moscow's Ostankino district in 1996, which produced 70 tons of ice-cream every day upon opening. This was certainly a solution, but not necessarily one that smaller brands could enact at a moment's notice.

Overcome these issues, however, and Russia can be a fertile market for the right brand to mop up swathes of customers, who are hungry for international concepts and their best practices.

While franchising is still a relatively new concept to Russia, there's starting to become a national understanding of the model's benefits. Case in point: in the first four years of franchising in Russia, 42 brands opened in the country, which is approximately 10 new concepts per year. By 2018, this number had increased by more than 50 times. By 2030? Russia could become a world contender on the franchise stage.

"The Russian market could be second to America – trust me"

INTERVIEW

Vitaly Sorokin, area director Russian federation for Franchise World Link

Franchise World Link works with entrepreneurs, franchisors, and various kinds of franchisee to help businesses grow all around the world. As the area director for Russia, Vitaly Sorokin has a deep immersion in the market, and understands what makes it tick.

Q Why do you think many Russian brands have only developed within the past ftve years?

A I think it's mostly because people are now communicating more than ever thanks to the internet. When I worked at DHL, we used internal mail and sent messages in a paper envelope; now, Russians can find everything they need in a minute. They can find franchises and compare which models work best for them; outside of that, though, there isn't much advertising for the franchise model within Russia.

Q Are Russians receptive to international brands?

A Russians like foreign concepts because they're interested in quality and standards, which all emerge from the West. There's not a single franchisor I can think of that wasn't backed by international concepts taken from the West. That's not necessarily America, but we see franchising as a western way of doing business. After all, we cannot reinvent the wheel when the model came about over 100 years ago.

Q What are some of the main appeals of Russia for franchisors?

A The opportunity in Russia is huge. People here aren't spoiled when it comes to service, which means that a potential franchisor can bring its high standards of service and really stand out. There's also a very strong labor force within the country, and there are many segments of the market which are yet to be developed by a leading brand.

Q And what about the challenges of the market?

A The main challenge is the absence of the term 'franchising'. Officially, it's not recognized, and all contracts are called 'commercial concession contracts'.

In Russia, we also have a unique property system, where property belongs to the government. This is different from the West, of course, and I used to handle a project between Germany and Russia where there was a lot of unfamiliarity with our system. That being said, I'd certainly like to see many more western franchises in the Russian market.

Q Do you have any advice for entrepreneurs looking to penetrate Russia?

A You can't take a model from one country and apply it directly to Russia. There are different consumer categories and rental rates which set the market apart. Trying to introduce a franchise without any kind of adaptation could result in a high risk of losses.

If approached properly, though, the return on investment is considerably high. Find the right approach, recognize the differences, and there's success to be had. The Russian market could be second to America – trust me.