



Summary

Franchising is a relatively new business concept in Kazakhstan and is currently not leveraged to its full extent. Kazakhstani companies, which have accumulated financial resources but lack suitable investment options, are stimulating interest in the sector. With the second highest per capita GDP in the former Soviet Union, Kazakhstan is the obvious franchising leader in Central Asia and is poised to replicate the retail and franchising boom that Russia has experienced over the last decade. Several well known U.S. brands have already successfully entered the Kazakhstan market, but on a limited scale. The U.S. Commercial Service in Almaty anticipates significant potential for this sector's development. This report provides information for American franchisors looking to enter the Kazakhstani market, and includes an overview of the franchising landscape, best prospect sectors, and market issues across cultural and legal environments.

Market Outlook

Although franchising is a relatively new business concept in Kazakhstan, entrepreneurs are becoming increasingly interested in pursuing this business model. In the past several years, spending and consumption patterns in Kazakhstan have begun to resemble those of the West, creating demand for name brands and recognizable retail stores. Additionally, Kazakhstani companies have accumulated financial resources that, combined with a lack of available investment instruments, are stimulating interest in franchising as an investment tool.

There is no single registration agency for franchising, and consequently there is no reliable statistics on franchising in Kazakhstan. Industry specialists indicate that since 1998 the number of franchises in Kazakhstan has grown from about 20 to approximately 120, with about 1,000 franchising outlets. The Kazakhstan Franchising Agency states the total number of all franchises and brands operating under a franchising or similar agreement are about 300.

Kazakhstan is characterized by a large number of franchisees working under sub-franchising agreements with master franchisees based in Russia or Turkey. Only a few foreign franchisors work directly with Kazakhstani partners. There are several reasons for this situation, including the small market size (15.7 million) combined with low population density and low activity level of Kazakhstani entrepreneurs in the international franchising market. Kazakhstani entrepreneurs find it easier to work with Russia-based franchisors instead of foreign owners, as Kazakhstani and Russian consumers share the same language and similar tastes, thus sub franchises bought from a Russian partner can be used in Kazakhstan without significant adaptation. However, as Kazakhstan increasingly integrates itself into the international market, the number of direct franchising agreements is expected to grow.

Given transparency issues and lack of statistical information in the market, it is difficult to define the combined sales turnover of franchises operating in Kazakhstan. Based on industry specialists' best estimates, the approximate turnover is in the range of \$500 million. On average, each franchisor has 2-3 franchisees in Kazakhstan. Most franchises operate in the following sectors: retail, business services (especially accounting services), consumer services (hairdressing salons, cleaning, dry cleaning), mass media, and fast food. About 60% of all franchises are in Almaty, 30% in the country's capital Astana, and the rest are scattered over oil industry related cities in the west of Kazakhstan.

Economic Outlook

Kazakhstan's economy continues to grow in spite of the ongoing global credit crunch. Economic growth was 3.2% in 2008 (a drop from 8.5% in 2007); GDP reached approximately \$104 billion, and GDP per capita \$6,600. During the last eight successive years Kazakhstan's economy developed rapidly, with an average annual rate of real GDP growth between 2000 and 2007 of 9%. The main external growth factor during recent years has been high commodity prices, primarily for oil and metals. Additionally, more than 40% of past GDP growth can be attributed to the financial services and construction sectors, both of which currently have zero or negative growth due to the lack of international financing.

Early predictions for 2009 GDP growth were set at 1-2%, though some economists are now predicting a recession of -1%. The economic stagnation is related to insufficient liquidity experienced by commercial banks due to limited opportunities to raise external funds. As a result, commercial banks have considerably reduced lending to industrial enterprises. A fall in global crude oil prices has also contributed to economic decline and has raised concerns about Kazakhstan's economic stability, since oil exports account for 60% of the country's exports and about 18% of GDP. The Government of Kazakhstan is taking unprecedented measures to support the economy and avoid further economic slowdown by injecting \$15 billion in the economy from 2008 - 2009.

Legal Background

In 2002 Kazakhstan adopted a franchising law entitled "On Complex Entrepreneurial Licenses". The law represents the first stand alone piece of Kazakhstani legislation devoted to franchising relations, definition of franchising contracts and creation of the foundation for government support of franchising development in Kazakhstan.

In line with internationally adopted legal principles Kazakhstan's franchising law includes the following provisions:

- 1) Franchisor has the right to control franchisee activities and business operations;
- 2) Optional state registration of intellectual property rights (IPRs) transferred in accordance with franchising agreements. Government of Kazakhstan will bear responsibility for protection of IPRs registered with the government;
- 3) Franchisor has the priority right to purchase property back from franchisee, shall the latter decide to discontinue its business or forfeit its stake in a business;
- 4) Should confidential information be made available by franchisee to any third parties, franchisor has the right to terminate the agreement and file for damages;
- 5) Franchisee has a legal obligation to follow franchisor's instructions related to organization and conduct of business; franchisee has to explicitly state that franchisee acts on the grounds of its franchise agreement and not as a fully independent entity (Article 17, Section 1.5).

However, the law does not address several other key areas of franchising arrangements, particularly:

- 1) Full disclosure requirements are not clearly stated;
- 2) Inheritance issues and cases of franchisee death are not addressed (in Kazakhstan this might present a challenge if a contract is signed with one person and later on rights and obligations are transferred to a totally different person);
- 3) Advertising territory and territory of operations issues are not addressed;

- 4) The Law does not contain provisions related to monopoly behavior/anti-monopoly cases, price fixing, or franchisor's requirements related to purchases from specified suppliers.

Competitive Analysis

The U.S. Competitive Position

Kazakhstani businessmen recognize the United States as the home of franchising, producing state-of-the-art franchise concepts and a superior level of ongoing support. Several well known U.S. franchises have successfully entered the Kazakhstani market. Among the most visible brands are: Baskin Robbins, Crestcom, FasTrackKids, Sbarro, KFC (through its co-branding with the Russian franchise Rostiks), Office 1 Superstore, Tiffany Marble, Hyatt Regency, Intercontinental, and Calvin Klein Jeans.

The U.S. Commercial Service in Kazakhstan is working with a number of prospective franchisers that are either finalizing agreements with local partners or in the midst of constructing their first outlets in Kazakhstan. Fast food is one of the areas in great demand for U.S. franchise models. U.S. market presence is also visible in business education and training services, business services, and children's services/preschools.

Third-country Competitors

The majority of non-U.S. foreign franchises in Kazakhstan are from Russia and Western Europe, mainly the U.K., France, Germany, Spain, and Italy. In the last ten years a number of franchise companies have entered Kazakhstan, including: Benetton, Colin's, Froggy, Gloria Jean's Coffees, Hugo Boss, LEFUTUR, MANGO, Mexx, and Tony&Guy. From Russia, [RosInter Group](#) has dominated the market with Rostiks, Planeta Sushi, Costa Coffee, American Bar and Grill, and Patio Pizza.

Domestic Franchises

Currently, very few Kazakhstani brands can compete with foreign ones in terms of name recognition and popularity, nor have any domestic firms been able to create and reproduce a recognizable brand outside of Kazakhstan under a franchising concept. An opportunity to offer goods and services under a well-known brand name, which is a major benefit of franchising, makes Western brand names more attractive for potential franchisees in Kazakhstan. Kazakhstani firms, helped by the February 2009 depreciation of the national currency (tenge), may be better positioned to offer low-cost competition in some sectors, but only if they are sourcing product locally. However, since most franchise concepts are not about cost, but about achieving a brand consistency, few local firms have the ability to successfully create such a business. Domestic franchising has just started to develop, and currently there are 20 local franchises with about 200 franchisees. Some examples of locally created and successfully developing franchises: BeautyManiya (retail of cosmetics, toiletries, perfumes), DLC Forex Trade, Exotic Tea (tea café), Bukhuchet Nap (accounting services to small and medium sized businesses), Folding Space (furniture production and retail), Nails Club, S.mile (food retail).

Consumer Market

U.S. franchisors should focus marketing efforts on the growing middle class, estimated to be as high as 15-20% of the population and responsible for 50-70% of the financial value of all goods sold in Kazakhstan. Multibillion dollar investments made by oil companies in Kazakhstan are creating a retail market for locals employed in the energy and related services sectors, as well as for the growing expatriate communities. According to levels of income, the middle class can be roughly divided into two groups: the lower middle class, employees with salaries of \$12,000-24,000 per year per person (70% of the middle class) and upper middle class, with salaries of \$24,000-60,000 per year per person (30%).

To understand the potential for franchising in Kazakhstan, it is important to consider the rapidly developing retail infrastructure of new shopping malls. The development of hypermarkets (i.e., megastores that include grocery stores), which is accompanying and spurring retail growth, is opening up new opportunities for franchisors. In the past ten years about twenty new hypermarkets opened in Almaty and Astana. The process is echoed by other major cities on a smaller scale. According to investors involved in developing new trade centers, retail infrastructure development is far from saturation and will continue growing. In 2009, at least three more new hypermarkets will open in Almaty, including [Metro Superstores](#).

Best Prospects

With the growth of domestic consumer capacity, demand for various services is growing and practically all services where franchising can be used represent considerable business opportunities in Kazakhstan. According to experts, franchising is quite attractive for businesses that are interested in sales of business support services (business consulting - audit and accounting services, advertising, HR related services, technical consulting), housing construction and repair services, education services (tutoring, foreign language courses), leisure and entertainment, fast food, medical and cosmetic services, retail sale, and other personal services (laundry, footwear and clothing repair, delivery services etc).

Currently, the majority of local potential franchisees are seeking agreements with franchisors operating in the following sectors:

- Fast-food and casual dining
- Retail sale (clothing, footwear, furniture, sporting goods, supermarkets, gasoline stations)
- Auto repair and maintenance services, gasoline stations
- Hotel chains for low and medium income travelers
- Printing and copying services, photo-shops, etc
- Body/health care services (beauty salons, gyms, etc.)

Market Issues and Obstacles

Some factors limit the growth rate of franchising in Kazakhstan: small population of 15.7 million people and low population density of 5.79 people per square kilometer, weak legal protection of intellectual property rights, lack of long-term financing opportunities, lack of transparency in the business environment, and low awareness of franchising opportunities or the franchising model by local entrepreneurs. Huge growth in real estate prices from 2001-2007 also negatively impacted the profitability of new franchise outlets, especially in high traffic areas. Due to the financial crisis, however, real estate prices have decreased considerably and are expected to stay relatively low for the next 2-5 years.

Trade Promotion Opportunities

Kazakhstan Franchising Forum 2009

June 2, 2009 in Almaty and June 3, 2009 in Astana

The U.S. Commercial Service in Kazakhstan, in cooperation with the Kazakhstan Franchising Agency and the International Franchising Association, is organizing Kazakhstan Franchising Forum 2009. Intended for an audience of businesses, investors, and government officials, this forum will promote franchising and franchising brands, explain the fundamentals of franchising, convey its critical role as an economic development tool, and explain the steps involved in acquiring and maintaining franchises.

U.S. Catalog Show at Franchising Forum 2009

June 2, 2009 in Almaty and June 3, 2009 in Astana

http://www.buyusa.gov/kazakhstan/en/trade_events_by_almaty_office.html

Resources & Key Contacts

- Central Asian Franchising and Licensing Agency (CAFLA) (covers Kazakhstan and Uzbekistan) – www.cafla.com. CAFLA President, Mr. Beknur Kisikov, has published the first, and so far only, book on the sector, *Franchising in Kazakhstan*, which is available for sale.
- Committee for Support of Entrepreneurs under the Ministry of Industry and Trade of Kazakhstan www.mit.kz
- Franchising Agency of the Independent Entrepreneurs Association www.nap.kz. - the most active organization supporting franchising development in Kazakhstan.
- Kazakhstan Franchising Agency– www.franchising.agentstvo.kz
- Kazakhstan Franchising Association - www.souz-atameken.kz/rus/associations/otr/14
- National Institute for Intellectual Property Rights under the Ministry of Justice of Kazakhstan www.kazpatent.kz – an organization that fulfills expert functions of the patent office.
- Small Business Development Fund - www.fund-damu.kz

For More Information

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