

# UKRAINIAN FRANCHISES RESILIENT IN TURBULENT TIMES

Franchise Sector Overview and Indicator

Fall 2015

Special Report

**U.S. COMMERCIAL SERVICE KYIV**

<http://export.gov/ukraine/franchising>



FRANCHISE GROUP



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# ABSTRACT

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The U.S. Commercial Service in Ukraine's Franchise Sector Overview and Indicator, "Ukrainian Franchises Resilient in Turbulent Times," was developed in 2015 to provide U.S. franchise companies with information to consider in assessing the Ukrainian franchise market. The U.S. Commercial Service developed this project in cooperation with two domestic groups working in these areas – the Franchise Group (a consulting firm that assists franchisors) and the Retail Association (an industry body representing the Ukrainian retail sector) - in order to provide real-time information on Ukraine's evolving retail sector and the developmental stage of franchising. This report includes multiple data rich sections, including: a snapshot of the retail market, with unique insights regarding Ukrainian consumer confidence and consumption patterns; an overview of franchising in Ukraine, with statistics regarding growth, the state of the sector's development, and the market share of domestic versus foreign companies; key findings and detailed results of a survey of more than 100 franchised and independent retailers; and an overview of the key macroeconomic indicators impacting franchises. Taken together, the data tells a story of surprising resilience among franchises in Ukraine, against the backdrop of severe macroeconomic challenges and a Russian-backed separatist conflict in the east of the country. The survey data referenced in this publication is based on a survey conducted in cooperation with the Franchise Group, Retail Association, and multiple regional Chambers of Commerce in Ukraine. From July 14 to October 4, 2015 these groups sent an on-line survey to 101 retailers of varying sizes. A cross-section of respondents was sought to provide readers with an understanding of Ukraine's retail market from both the franchised and non-franchised, small company and large company, and capital city and regional perspective. The questionnaire consisted of twenty questions, focused on past year performance and future projections.

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# HIGHLIGHTS

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**Large Market, Significant Room for Growth** - With a market of 45 million people, Ukraine is one of the largest countries in Europe. But because of low per capita retail sales relative to Western Europe, there is significant potential for future growth. Given the structure of household expenditures in Ukraine, near-term growth is most likely in sales of products and services related to affordable food and essential household services.

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**Growth Potential among Middle Class Consumers in Regional Centers** - Consumer segments that will likely drive future retail sales growth in the near term include middle-class Ukrainians ages 25 to 34 who are concentrated in regional centers. These middle class consumers strongly prefer western brands. Among Ukraine's regional centers, Kyiv is the clear leader, where purchasing power is nearly 80 percent higher than the country's average.

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**Franchising is an Established and Desired Model in Ukraine** - Today there are 565 franchisors working in Ukraine and 431 of these are well established companies. Even when the number of franchisors fell in 2014, the number of franchisees still grew. Franchising is viewed as a reliable way to reduce operating risks and improve a company's chance of long-term survival because only eight percent of franchises exit the Ukrainian market after five years.

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**Domestic Franchises Currently Dominate** – Ukrainian franchises control 66 percent of market share. The origin of the foreign franchises that control the remaining 34 percent of the market include companies from Western and Eastern Europe, China, Russia, the U.S. Due to recent sharp currency devaluations there is a growing interest in franchise licenses that are denominated in local currency and that are not tied to foreign equipment.

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**Performance in 2014-2015 Shows Resilience among Franchised Retailers** - Over the last year, the majority (66.3 percent) of independent and franchised retailers surveyed in the Franchise Indicator reported that their company's annual revenues either increased or stayed the same. Franchised retailers were more likely to report increases in annual revenues and independent retailers were more likely to report decreases.

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**Most Retailers Optimistic about Growth in 2016** - Both franchised and independent retailers seem optimistic about the year to come. Over the next year, more than three in four survey respondents anticipate that their company's annual revenues will increase. Their optimism significantly exceeds the forecasts for general economic growth, with more than eight in ten of those anticipating growth in annual revenues, expecting growth of six percent or more.

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**Conflict in the East only Somewhat Likely to Influence Most Retail Operators in the Future** -The separatist conflict in eastern Ukraine has taken an enormous toll on Ukraine's people, security, and economy. It is therefore surprising that nearly half of the respondents of the Franchise Indicator said that the conflict will only somewhat impact their businesses in the next year and roughly a third expects that the conflict will significantly impact their operations.

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**Ability to Unleash Full Potential of Franchising Depends on Structural Reform** - Ukraine's ability to fully capitalize on its economic potential depends not only on its macroeconomic performance but also on its ability to institute economic and regulatory reforms. While Ukraine has made initial progress in many critical areas, including changes to regulations affecting franchises, the most essential structural and institutional reforms are still pending

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# INTRODUCTION



**Michele Smith,  
Commercial Officer**



**Anatoliy Sakhno,  
Commercial Specialist**

## **Franchising Team, U.S. Commercial Service Ukraine**

Welcome to this special report prepared by the U.S. Commercial Service. As an agency dedicated to delivering services and information that ensure that U.S. businesses can compete and win in the global marketplace, the impetus for this report was to provide clarity regarding seemingly contradictory trends in the Ukrainian market. On one hand, Ukraine has experienced severe political and economic challenges since February 2014. On the other hand, Ukrainian trade industry experts in retailing and franchising express optimism about growth under these circumstances. To fill a gap in publicly available market information and to ensure that U.S. franchisors do not overlook potential market opportunities, we sought to systematically gather information to verify and explain the reasons for market optimism among franchises in Ukraine.

The result of this effort is a story of resilience among franchises in Ukraine, with those adopting franchising as a model outperforming the majority of the economy. Our 2015 publication focuses on 2014-2015 operating results and forecasts for the next year. Surprisingly, given the extreme political and economic challenges facing Ukraine, the majority (65.2 percent) of franchises we surveyed reported an increase in annual revenues, compared with negative growth in the economy overall. Industry experts point to this trend as a testament to the ability of the franchising model to create economies of scale for businesses and to reduce operational risks associated with retail through the dissemination of standardized operating practices in franchised outlets. We also believe that it is a testament to the entrepreneurial spirit of Ukrainian business men and women.

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# FRANCHISE GROUP CONTRIBUTION

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**Myroslava Kozachuk**  
Managing Partner, Franchise Group

On behalf of the Franchise Group in Ukraine, I am pleased to welcome you to this special report: the Franchise Sector Overview and Indicator. This resource gives us valuable insight into the Ukrainian franchise sector, which has continued to grow through the darkest times in our country's history.

Ukraine's figures for franchising described in this report are self-explanatory: today, there are more than twenty thousand franchised outlets working in the Ukrainian market and their annual gross income has topped \$1.3 trillion. This proves that the franchising market really exists in Ukraine and that despite the negative economic situation in recent years, franchising has had a significant positive impact on business development. The perseverance of franchising in Ukraine during recent times also demonstrates that Ukrainian businessmen and women usually find a way to turn negative factors to their advantage.

This resilience lies at the heart of the art of business – the ability to use both advantages and disadvantages to one's favor. While adverse factors complicate the work of the Ukrainian franchise, they also make the lives of its competitors difficult as well. Additionally, while instability means more risk, it also means more reward for those businesses that understand the market better than others and for those who know how to navigate the future.

The clear trend in the growth of the number of franchise businesses during Ukraine's crisis is evidence of this. Given the resilience of major market players and growth of the industry, we believe that the Ukrainian franchise market is in a positive stage of development. The crisis has tested the strength of many franchises and the overwhelming majority have weathered these hard times and come out even stronger as a result.

We predict that the next stage of development in the Ukrainian franchise market will focus on small and medium-sized enterprises. Today, many small and medium-sized entrepreneurs are not yet aware of the benefits of franchising. To raise awareness among these businesses, we are initiating the first "School of Franchising." The goals of this project are to disseminate information on the "nuts and bolts" of franchising and to create a culture of using franchising to create economies of scale in Ukrainian businesses, both at home and abroad.

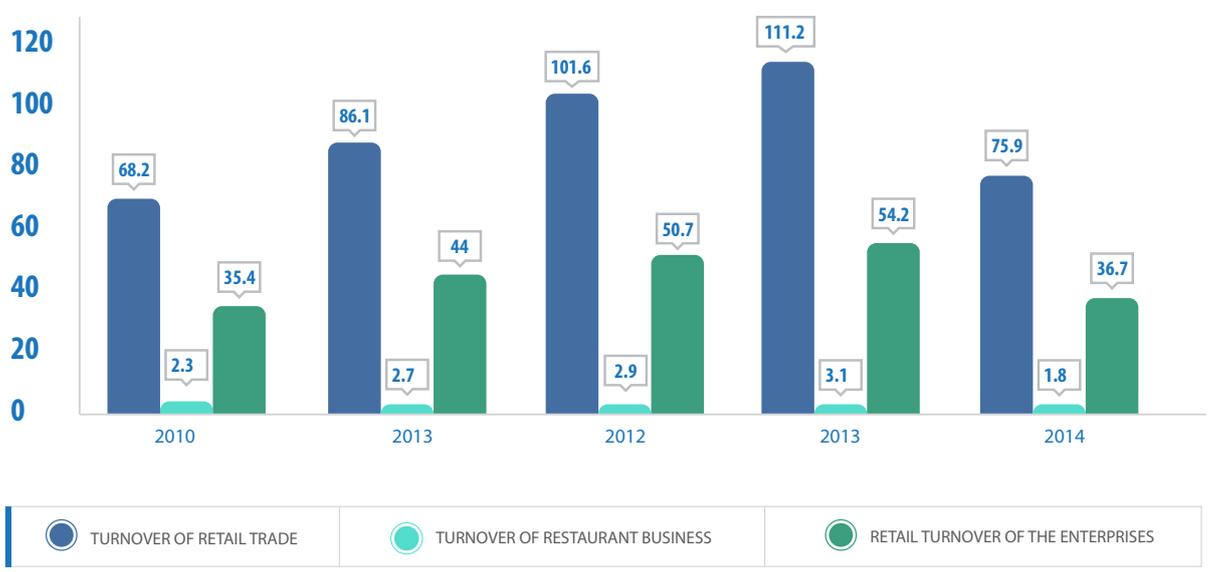
If small and medium sized enterprises succeed in franchising, we predict that the market will expand by an additional five to seven percent each year. This means that in three to five years Ukraine may have an enormous market of prosperous companies selling their franchises. Our ultimate goal is to make Ukraine's franchising market as intellectually developed and competitive as those of larger foreign markets.

# RETAIL MARKET SNAPSHOT

## MARKET SIZE

Ukraine’s consumer retail market is one of Europe’s largest, with annual retail trade of \$75.9 billion. Prior to the conflict in eastern Ukraine and subsequent economic recession in 2014, Ukraine’s annual growth rates in retail sales averaged 18 percent (Figure 1). In 2014, however, with sharp currency devaluations and reductions in purchasing power, retail sales decreased by nine percent year-over-year and are estimated to fall 20 percent in 2015.

**Figure 1: Retail Trade Turnover, USD (billion)**



1 Source: State Statistical Service of Ukraine

## Ukraine's Shadow Turnover:

The statistics regarding retail trade turnover, per capita income, and GDP in this report are official statistics. It is important to note, however, that most experts believe that 25 to 50 percent of the turnover in the private sector is not reflected in official statistics.<sup>2</sup> According to State Statistical Service estimates, Ukraine's shadow economy was calculated as 47 percent of official GDP in the first quarter of 2015.<sup>3</sup> Additionally, independent experts predict that shadow turnover is particularly high among small businesses (accounting for 80 to 90 percent of turnover). They also believe that shadow turnover is especially prevalent in trade (80 percent of turnover), construction (66 percent of turnover), real estate (60 percent of turnover), gambling (53 percent of turnover), catering (53 percent of turnover), media (53 percent of turnover), and transportation (46 percent of turnover).

## GROWTH POTENTIAL

In 2016 retail sales are likely to grow as Ukraine's economy and personal incomes begin to return to pre-conflict norms. Historical household income data suggests that there is room for growth in retail sales of at least 30 percent over the next several years, as average salaries start their long climb back to 2013 levels. For example, in 2014 the monthly salary for the majority (64 percent) of Ukrainians ranged between \$101 and \$223, whereas between 2010 and 2013 the monthly salary for the majority of Ukrainians (about 70 percent) ranged between \$151 and \$332 – 30 percent higher than economic crisis level.

In the medium to long term, continued growth will depend on Ukraine's ability to reform its economy. If the country is able to successfully develop its economy, there is significant potential for future growth in retail sales. Ukraine's per capita retail sales are considerably lower than in Western Europe (Figure 2). It is important to note, however, that comparative retail data does not consider Ukraine's shadow turnover and in reality Ukraine's per capital retail trade turnover may be closer to other Eastern European countries than it appears. Consumer segments that will likely drive future growth include middle-class Ukrainians ages 25 to 34. According to a poll, conducted by the Razumkov Centre in October 2014, Ukraine's middle class, using western definitions, represents about 14 percent of the population and its members strongly prefer western brands.

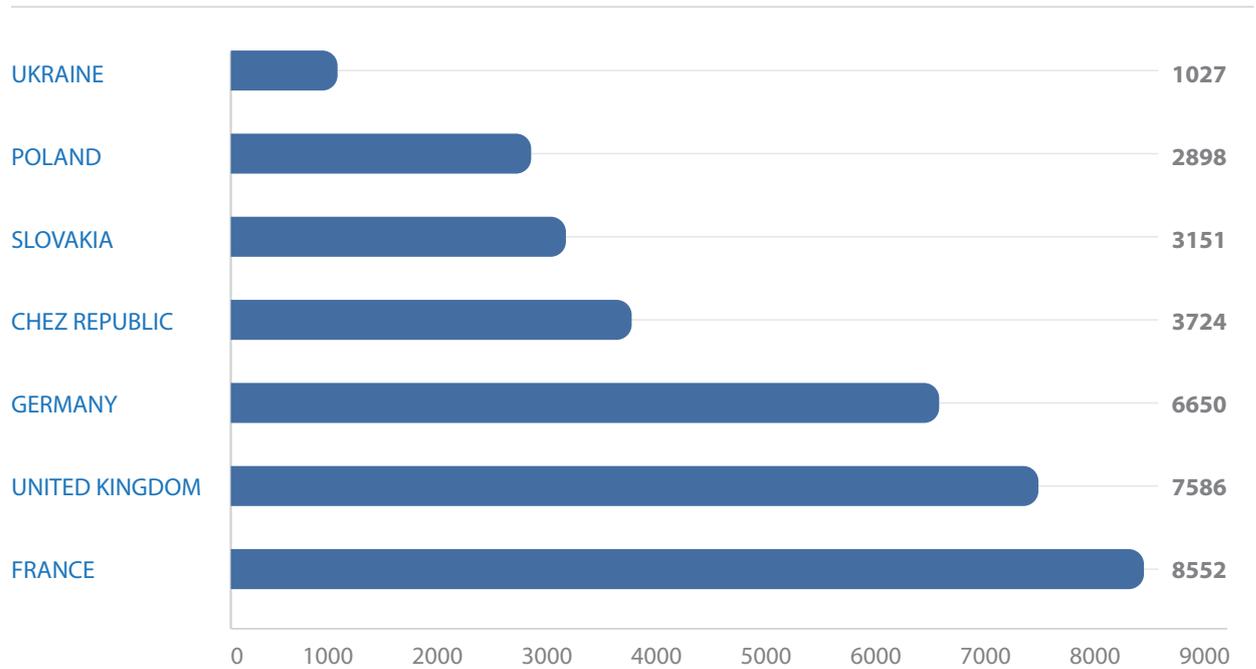
<sup>2</sup> [http://business-inform.net/pdf/2011/12\\_0/4\\_14.pdf](http://business-inform.net/pdf/2011/12_0/4_14.pdf)

<sup>3</sup> [http://espreso.tv/news/2015/08/14/tinova\\_ekonomika\\_ukrayiny\\_vyrosla\\_do\\_47](http://espreso.tv/news/2015/08/14/tinova_ekonomika_ukrayiny_vyrosla_do_47)

<sup>4</sup> Razumkov Centre is a Ukraine's non-governmental think tank that carries out research of public policy in various spheres.

<sup>5</sup> Source: State Statistical Service of Ukraine; "Retail Market" Report by EY

**Figure 2: Comparative Per Capita Retail Trade Turnover,<sup>5</sup> USD**



### TOP REGIONS

Ukraine's consumers are concentrated in its largest cities including Kyiv (2,868,702), Kharkiv (1,451,132), Donetsk (932,562), Odesa (1,017,022), Dnipropetrovsk, (993,094), and Lviv (729,038). Among these regional markets, Kyiv is the clear leader, where purchasing power is nearly 80 percent higher than the country's average. Before the military conflict in 2014, the



<sup>5</sup> Source: State Statistical Service of Ukraine; "Retail Market" Report by EY

industrial regions in eastern Ukraine also exhibited considerably higher retail turnover and purchasing power than Ukraine's western agricultural regions. Due to the conflict in the east, however, retail turnover dropped 91 percent in the Luhansk region and 71 percent in the Donetsk region between January and April 2015.

## CONSUMPTION PATTERNS

In 2014, Ukrainians spent most of their income on basic household needs. Among total household expenditures, more than half (52 percent) are for food, nine percent for housing and utilities, and six percent for clothing (Table 1). To compare, in 2014 Americans reported spending only seven percent of the income on food (at home), in favor of a larger share of expenditures for housing and utilities (29 percent), items of household consumption (4.2 percent), restaurants (5.2 percent), leisure and culture (5.1 percent), and education (2.3 percent). The Franchise Group concludes that Ukraine's focus on the basics means that the types of franchises that are likely to be most successful in the near-term future would be those that offer products and services related to affordable food and essential household services (e.g. child care, household repair, etc.).

**Table 1: Ukrainian Consumer Expenditures (as a percentage of total household expenditures) 2014**<sup>6</sup>

Consumer Expenditure	% of total household expenditures
Foodstuff and non-alcoholic beverages	51.9
Housing, water, electricity, gas and other type of fuel	9.4
Clothes and footwear	6.0
Transport	4.3
Healthcare	3.6
Alcoholic drinks and tobacco goods	3.4
Communication	2.8
Various goods and services	2.7
Items of household consumption (home electronics, housing maintenance)	2.3
Restaurants and hotels	2.3
Leisure and culture	1.8
Education	1.1

<sup>6</sup> Source: State Statistical Service of Ukraine

## CONSUMER CONFIDENCE

Ukrainians have traditionally demonstrated low levels of confidence in both their personal and the country's financial future. Its average Consumer Confidence Index, based on the GfK survey, was 78.87 between 2000 and 2015. A maximum index of 200 indicates that all survey respondents respond positively and an index of less than 100 indicates the prevalence of negative assessments. Ukraine's consumer confidence levels fell to a record low of 41.10 in February 2015, after which consumer confidence began improving. These improvements were driven by wealthier citizens and residents of large cities, while middle-class consumers continue to purchase low-cost goods and services.

### The Historical Mismatch between Consumer Confidence and Economic Performance

**Performance:** It is important to note that even during past periods of growth and stability, Ukrainian consumers have been pessimistic. Only briefly has the Consumer Confidence Index topped 100, when it ranged between 100 and 105 during the first two years after the orange revolution (2004-2005). According to an analyst at GfK, the primary explanation for Ukrainian skepticism is a lack of political stability. Only once since gaining independence has Ukraine had a two-term president. Another reason for skepticism is the combination of low personal incomes and macroeconomic turbulence, which causes Ukrainians to constantly brace themselves for a potentially negative future. In other words, despite real indicators, Ukrainians tend to believe that good news and positive projections are "too good to be true." This changed after the Revolution of Dignity in 2014. Since this event, Ukrainians have started to say that they are positive about their and the country's economic future five years in the future, even though they may be pessimistic about the year ahead.

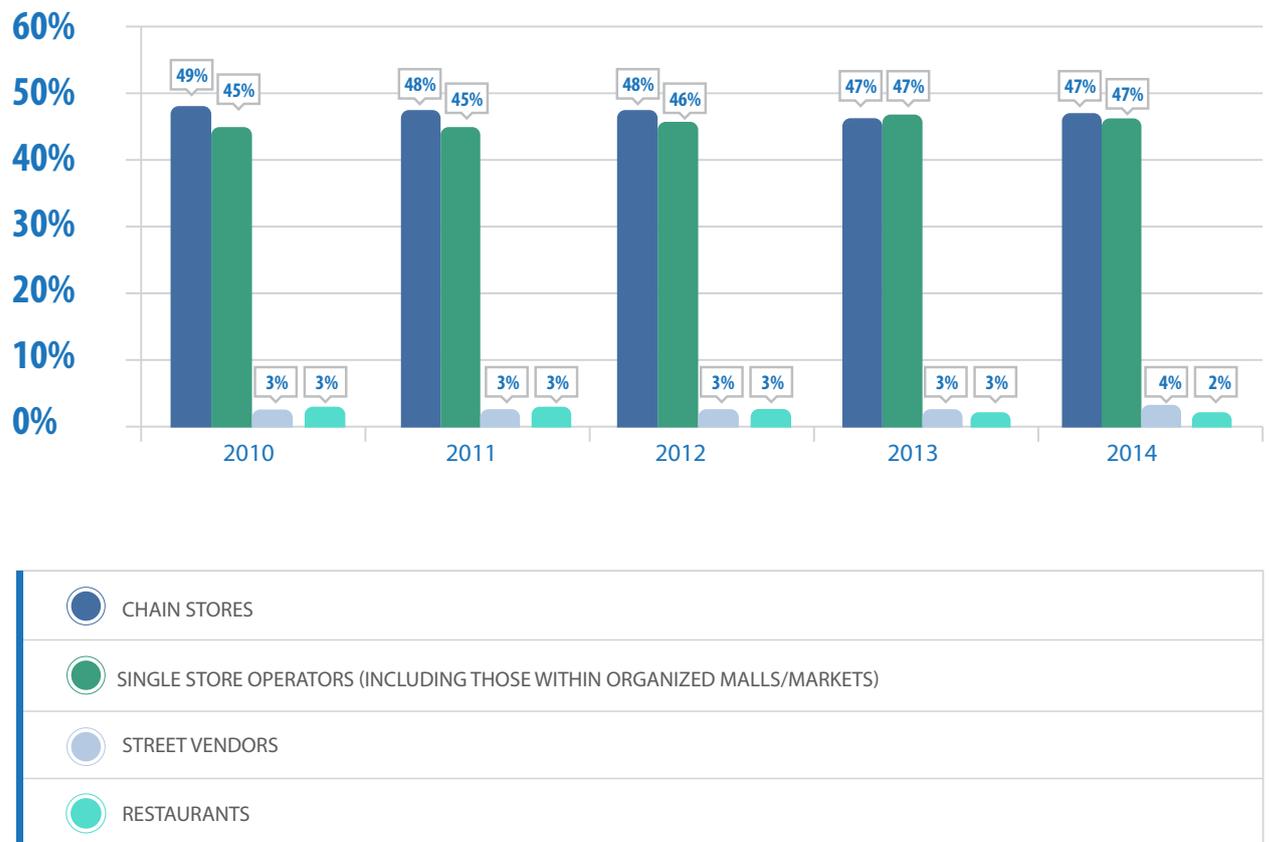
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<sup>7</sup> The largest internet auction in Ukraine ([www.aukro.ua](http://www.aukro.ua))

## RETAIL SALES CHANNELS

More than 90 percent of sales are concentrated in chain stores and single stores, including those located within organized malls and markets (Figure 3). In the coming years, the volume of sales through chain stores is expected to increase, as is the volume of online sales. Based on Aukrotop100<sup>7</sup> data, the Ukrainian e-commerce market, which is comprised of approximately 2.8 million online buyers, passed the benchmark of \$2 billion in 2014 and is expected to reach \$10 billion by 2018.

**Figure 3: Retail Trade Turnover by Sales Channel** <sup>8</sup>



<sup>8</sup> Source: State Statistical Service of Ukraine

# FRANCHISE OVERVIEW

## NUMBER OF FRANCHISES

Despite recent economic challenges, franchising in Ukraine continues to develop rapidly and expand to multiple sectors and in many regions. According to the Franchise Group, a leading franchise consulting group in Ukraine, one reason for this is that Ukrainians view franchising as one of the most viable forms of investment because it offers reliable and proven business models. Today there are 565 franchisors working in Ukraine - 431 of these are well-established companies and 134 are new to market players that are in the process of opening their first sites. Among Ukraine's franchisors, 77 percent are currently active, meaning that they work with franchisees that operate outlets, and 23 percent are inactive, meaning that they are registered as franchises but only operate their own outlets. The total number of outlets is 20,134.

**Figure 4: Number of Franchisors in Ukraine 2001-2015**

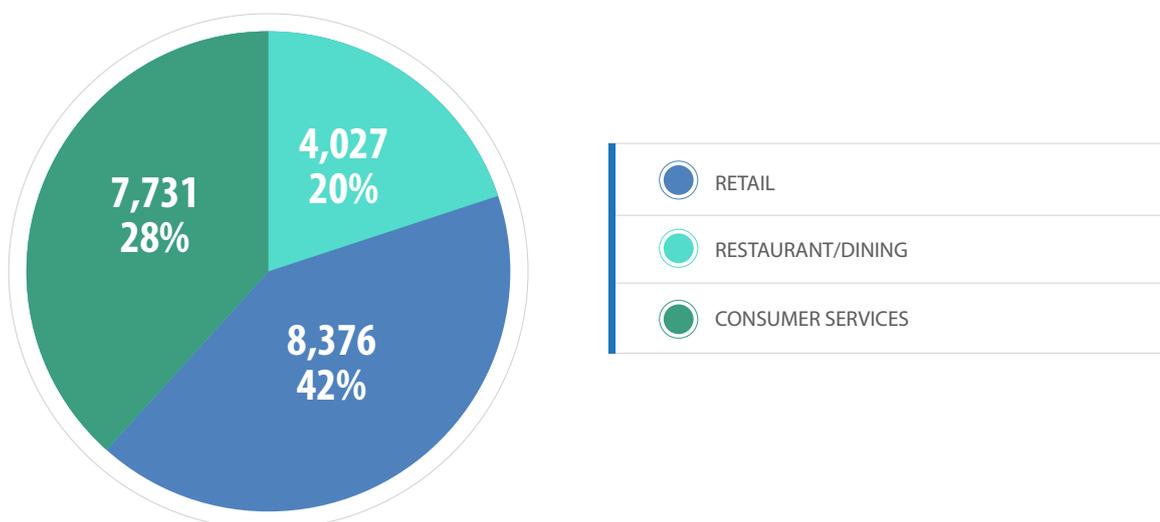


As Figure 4 illustrates, growth in the number of franchises has been consistently positive since 2009, with the exception of a small dip in 2014. Even in 2014 when the number of franchisors fell, due to their inability to weather Ukraine's economic crisis, the number of franchisees still grew. In some ways, the economic crisis that began in 2014 was positive for franchising overall, as survival during this period depended on a company's ability to make significant improvements in business processes and those that did not make improvements exited the market.

## NUMBER OF FRANCHISES BY ECONOMIC SEGMENT

As Figure 5 illustrates, most Ukrainian franchises operate in the retail products and services subsector. More than four in ten of Ukraine's franchised outlets are in the retail products sector, nearly another four in ten franchised outlets are in the service sector, and two in ten franchised outlets are in the restaurant sector.

**Figure 5: Number of Franchised Outlets by Economic Segment August 2015**

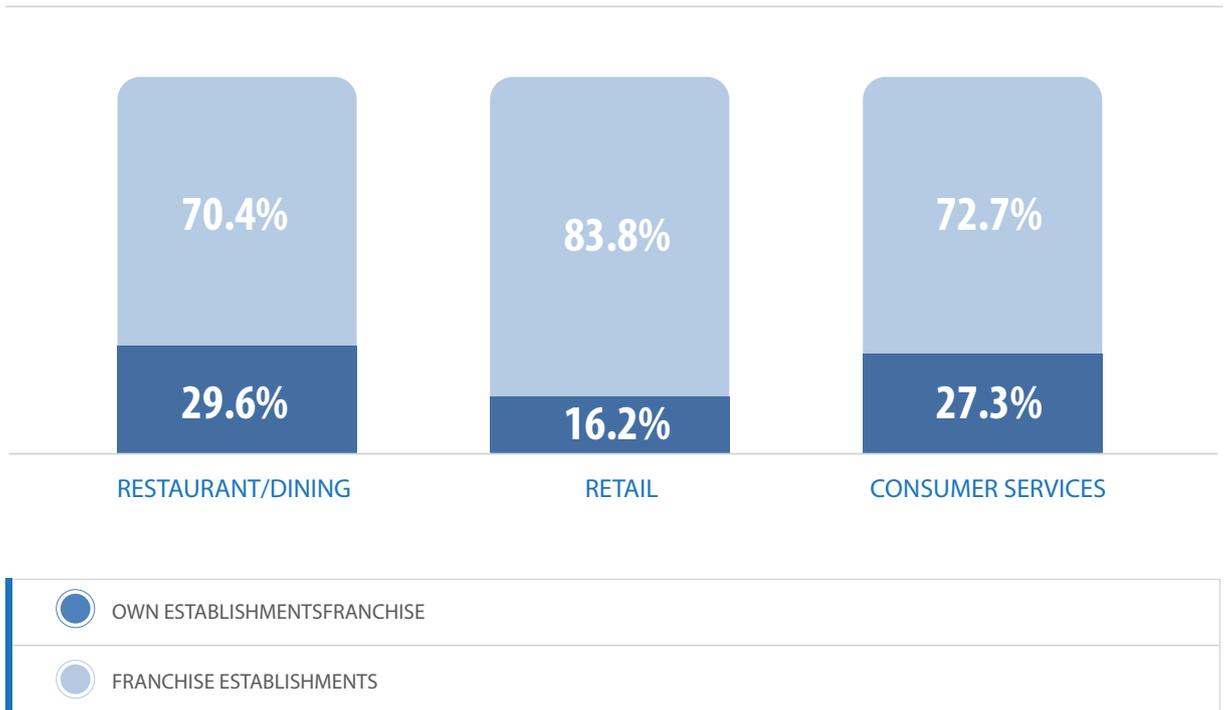


In each of these segments, franchised outlets strongly dominate independent operators (see Figure 6). One explanation for the high prevalence of franchised outlets versus independent operators in each economic segment is the dominance of a few major players.

- In the retail segment, the five largest franchisors account for more than 60 percent of retail outlets: Nasha Ryaba (with 2,600 franchised outlets), Havriliivsky Kurchata (with 1,300 franchised outlets), CifroTEX (with 801 franchised outlets), TOM FARR (with 247 franchised outlets), and Nash Kray (with 161 franchised outlets).
- In the service segment, the top three franchisors account for nearly 60 percent of franchised retail outlets: Nova Poshta (with 2060 franchised outlets), Universalna (with 1800 franchised outlets), and Express-Cleaning (with 400 franchised outlets).
- In the catering and restaurant segment, the largest player, Fast Food Systems, controls nearly ten percent of outlets with three franchises: Pizza Celentano (with 163 franchised outlets), Kartoplyana Khata (with 21 outlets), and Yappy (with four outlets).

**IN PROFILE:** Nasha Ryaba - Nasha Ryaba is the undisputed leader of Ukraine's poultry industry, operating as a vertically integrated company that produces, delivers, and sells poultry both domestically and for export. Today the company employs more than 30,000 people and successfully operates more than 2,600 franchised outlets in Ukraine. It holds 50 percent market share in domestic poultry sales and is Ukraine's leading exporter of poultry. Its franchised chain of retail grocery stores is the leading franchise in the retail sector.

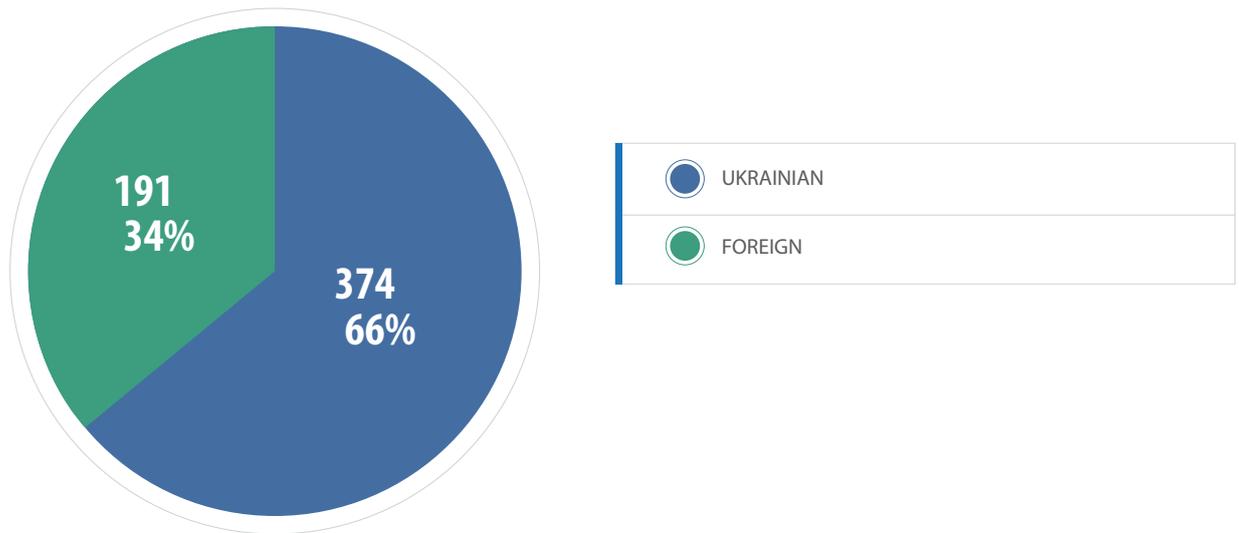
**Figure 6: Franchised vs. Non-franchised Outlets by Economic Segment August 2015**



Another explanation for the prevalence of franchised outlets is that franchising has proven to be a reliable way to reduce operating risks and improve a company's chance of long-term survival. Statistics show that for all businesses in Ukraine, after seven years of operations 77 percent of private entrepreneurs exit the market and that after ten years of operations only 18 percent remain. For enterprises working under franchise arrangements, the data is much better, with only eight percent exiting the market after five years and 90 percent remaining in the market after 10 years.

**IN PROFILE:** Nova Poshta - Nova Poshta offers express document, package, and cargo delivery services in Ukraine. Approximately 40 percent of its outlets are franchised. With more than 60 million packages handled a year, it is the leader of express delivery in Ukraine. Its operations include 36 modern sorting terminals, approximately 16,000 qualified specialists, more than 350 cash desks for money transfers, and a 4,000 square meter modern logistics compound. Nova Poshta operates in both large cities and small towns and guarantees the delivery of cargoes of any weight or size to any destination within the country.

**Figure 7: Domestic versus Foreign Franchises**



### DOMESTIC VERSUS FOREIGN FRANCHISES

Domestic franchises currently dominate the Ukrainian franchise market, controlling 66 percent of market share (Figure 7). The origin of the foreign franchises that control the remaining 34 percent of the market include 191 companies from countries such as Belgium, France, Poland, Belarus, Germany, China, Finland, Russia, the USA, Italy and Hungary. Due to currency devaluations, inflation, and a decline in consumer purchasing power, there is a growing interest in franchise licenses that are denominated in local currency and that are not tied to foreign equipment. Among these factors, the currency devaluations are the most influential and have caused prices for foreign franchises to increase nearly three times in the last year alone.

**IN PROFILE:** Pizza Celentano - Pizza Celentano is a fast food restaurant chain that includes food-court and stand-alone restaurant formats. The chain operates 163 franchised outlets. The company's gastronomic concept is pizza and wine and its pizzas are made by professional pizza-masters who use Italian products and recipes and who also use sophisticated acrobatic tricks to turn pizza-making into entertainment. The brand was established in 1998 in Lviv and franchised in 2000. Since it opened its doors, Pizza Celentano has sold more than 100 million pizzas and today it controls 26 percent of the fast food restaurant market share. The network employs 3,645 people and spends approximately 17 percent of its gross revenues on labor.

# FRANCHISE INDICATOR

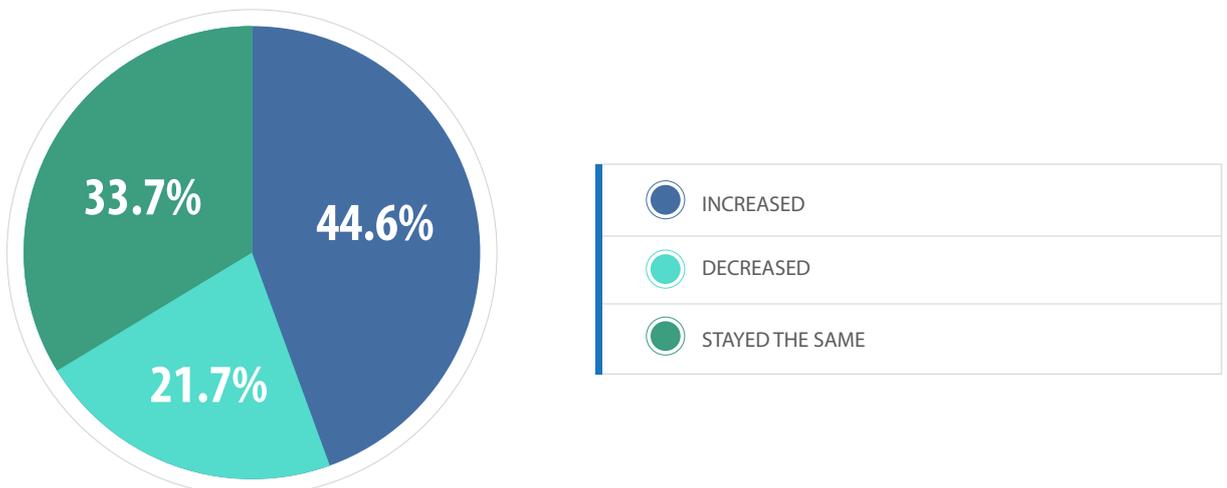
## SURVEY METHODOLOGY AND SAMPLE

The Franchise Sector Indicator is based on a survey conducted in cooperation with the Franchise Group, Retail Association, and multiple regional Chambers of Commerce in Ukraine. From July 14 to October 4, 2015 these groups sent an on-line survey to 101 retailers of varying sizes. A cross-section of respondents was sought to provide readers with an understanding of Ukraine's retail market from both the franchised and non-franchised, small company and large company, and capital city and regional perspective. The questionnaire consisted of twenty questions, focused on past year performance and future projections. Respondents were also asked to what extent the political conflict in Eastern Ukraine had or will affect their operations and plans for the future.

Respondents from nearly all segments of the retail market are represented, with the largest numbers of respondents representing retail products and services (37.4 percent), personal services (14.1 percent), and quick service restaurants (13.1 percent). Four in ten respondents (40.4 percent) were from franchise-based systems and nearly five in ten (46.7 percent) were from non-franchised systems. The majority of respondents (83.1 percent) operate networks of fifty or fewer outlets, with most operating networks of ten units or less. Correspondingly, the majority of respondents (73.1 percent) report gross annual revenues of 50 million hryvnia (UAH) or less. See Appendix 1 (Ukraine Franchise Business Outlook Survey Respondent Profile) for details and definitions.

## 2014-2015 PERFORMANCE

**Figure 8:** Over the Last Year (e.g. from July 1, 2014 to June 30, 2015) did Your Company's Annual Revenues (in UAH) Increase, Stay the same or Decrease?



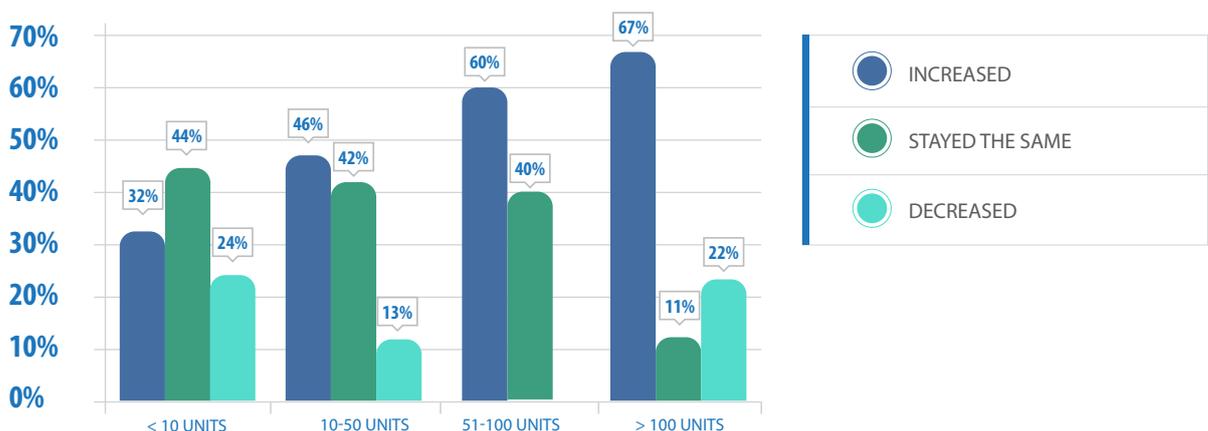
As Figure 8 shows, over the last year the majority of survey respondents (66.3 percent) reported that their company's annual revenues either increased or stayed the same. The responses of franchised versus non-franchised operators were significantly different. Nearly two in three (65.2 percent) franchisors reported an increase in annual revenues, whereas only 33.3 percent of independent retailers reported an increase in annual revenues. In contrast, nearly half (46.2 percent) of independent retailers reported a decrease in annual revenues, whereas only 13 percent of franchises reported a decrease in annual revenues. As described below, franchisors seemed better able to weather stormy economic conditions due to their ability to introduce new products and services.

While it may seem logical to assume that annual revenues increased simply due to the impacts of macroeconomic indicators like currency devaluation and inflation (leading consumers to buy less and pay more), respondents point to different reasons for increased revenues. Respondents who reported an increase in annual revenues said that the top three reasons for growth were the introduction of new products or services (57 percent), better market positioning (43 percent), and/or improved operational efficiency at the site-level (40 percent). Franchisors in particular said their success was due to the introduction of new products or services, with nearly nine in ten (86.7 percent) giving this as one of their top three reasons for growth in revenues. Two thirds (66.7 percent) of retailers with 50 to 100 outlets said their growth was due to improved operational efficiency at the site-level.

On the other hand, the impacts of macroeconomic forces were more often cited by respondents who reported a decrease in annual revenues. Among this group, the top three reasons for reductions in revenues were general economic conditions (93 percent), decreased market demand (71 percent), and/or the unavailability of credit (36 percent). More than eight in ten (82.4 percent) independent retailers reported that general economic conditions caused a decrease in revenues (versus 33.3 percent of franchisors who have this as a reason).

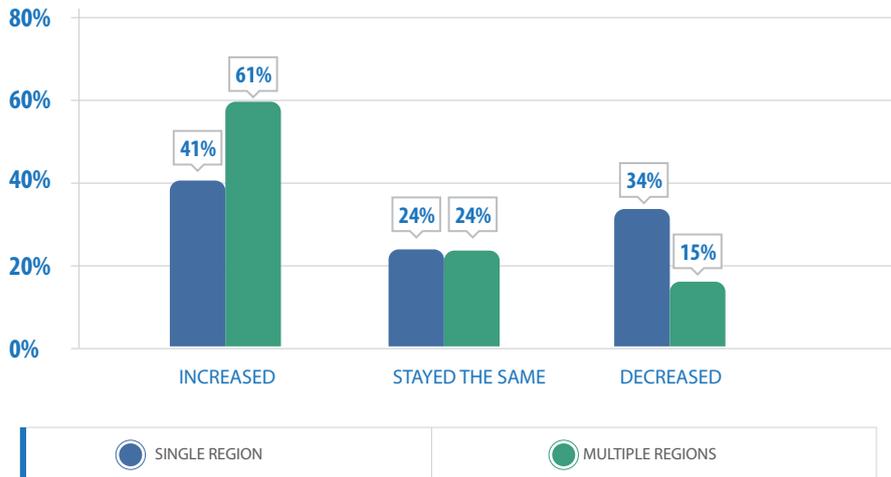
During this same period, the majority of survey respondents (81 percent) reported that their number of stores either stayed the same or increased. As Figure 9 illustrates, larger operators were most likely to report an increase in the number of stores.

**Figure 9: Over the Last Year (e.g. from July 1, 2014 to June 30, 2015) did Your Number of Stores Increase, Stay the Same, or Decrease? (Operators by Number of Units)**



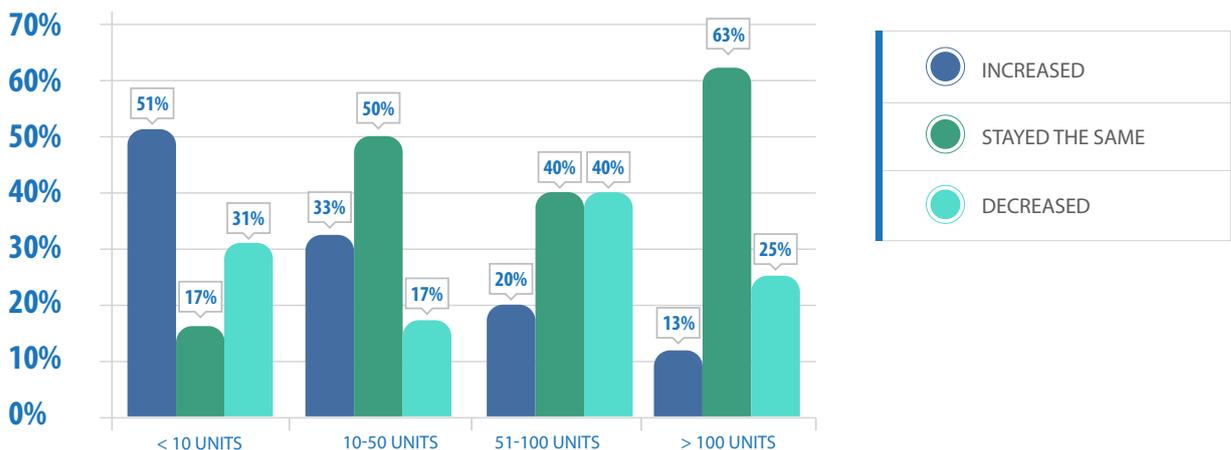
The majority of survey respondents (77.3 percent) also reported that their customer counts either increased or stayed the same and the majority of survey respondents (79.7 percent) said average sales per customer increased or stayed the same. As Figure 10 illustrates, retailers with operations in more than one region were more likely to report increases in customer counts.

**Figure 10: 9) Over the Last Year (e.g. from July 1, 2014 to June 30, 2015) did Your Customer Counts Increase, Stay the Same, or Decrease? (Operators in Single versus Multiple Regions)**



Finally, more than seven in ten respondents (38.9 percent) also report that the level of repeat sales either increased or stayed the same. As Figure 11 illustrates, smaller operators were most likely to report an increase in the number of repeat sales. According to the Franchise Group there are three main reasons for this trend. First, small operators were able to more quickly offer new product and services. Second, they were able to slash prices faster than larger operators to keep customers. Finally, they are more nimble and generally better able to respond to shifts and changes in consumer demand.

**Figure 11: Over the Last Year (e.g. from July 1, 2014 to June 30, 2015) did the Level of Repeat Sales Increase, Stay the Same, or Decrease? (Operators by Number of Units)**

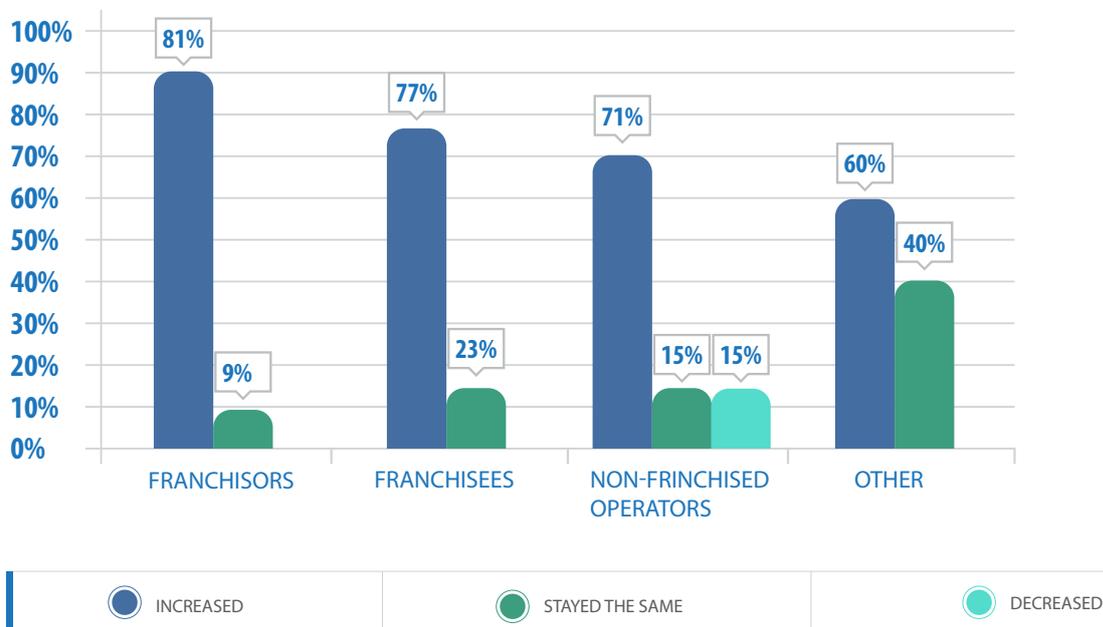


## GROWTH

While the past year seems to have clearly favored franchised operators, both franchised and independent retailers seem optimistic about the year to come. Looking forward, more than three in four (77.3 percent) survey respondents anticipate that their company's annual revenues will increase over the next year. Their optimism significantly exceeds the forecasts of general economic growth, with more than eight in ten (83.9 percent) of those anticipating growth, expecting growth of six percent or more in annual revenues. Both franchised and independent retailers are similarly optimistic about their plans to expand their footprints, with more than eight in ten respondents (84.9 percent) reporting that they plan to open new locations next year.

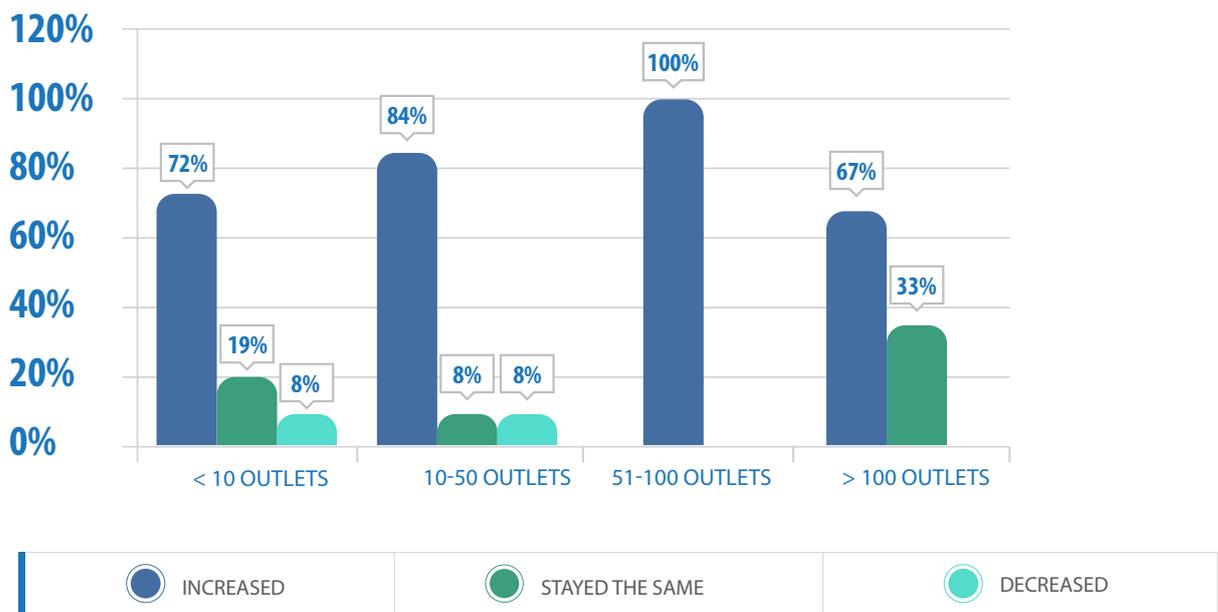
Though both franchisors and independent retailers expect annual revenues to increase, franchisors are more optimistic, with nine in ten (90.9 percent) expecting revenue growth (Figure 12). Franchises are also more aggressive in terms of the levels of growth they expect, with three in ten (31.8 percent) franchisors and one in four (25 percent) franchisees expecting growth in annual revenues in excess of 20 percent.

**Figure 12: Over the Next Year (e.g. from July 1, 2015 to June 30, 2016) Do You Anticipate that Your Company's Annual Sales Revenues Will Increase, Stay the Same, or Decrease? (Franchised versus None-Franchised Operators)**



In terms of revenue growth, Figure 13 illustrates that the most bullish respondents are larger operators with fifty or more stores – eight in ten (80.0 percent) of these respondents anticipate revenue growth of at least 11 percent next year. One hundred percent of these respondents also anticipate opening new locations during this period.

**Figure 13: Over the Next Year (e.g. from July 1, 2015 to June 30, 2016) Do You Anticipate that Your Company’s Annual Sales Revenues Will Increase, Stay the Same, or Decrease? (Operators by Number of Units)**



It also appears that regional expansion is on the horizon for those companies that already have a regional presence. More than nine in ten (91.3 percent) respondents who already work in more than one region report that they plan to open new locations next year.

## HOT SPOTS

For franchisors looking to enter the market next year, survey respondents listed retail products and services and quick service restaurants as the types of franchises they would choose to buy. According to the Franchise Group, “The quick service restaurant segment is attractive because it is relatively developed, mature, and segmented, and hence a lower risk investment. While the retail products and services sub-sector is less developed, this sub-sector is attractive because it has a high potential for growth and new niches. Children services remain the most attractive in the personal services sub-sector.”

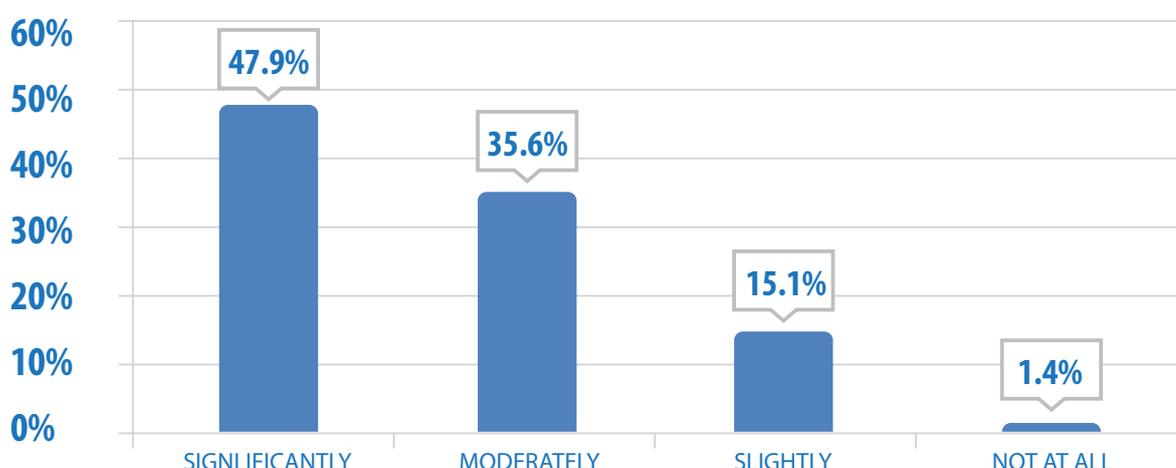
Also, according to the Retail Association, “The most attractive sub-sectors in the retail segment are food chains and restaurants. To a certain extent there was a decline in consumer demand in the non-food segment, but the demand for food grew. Living in an atmosphere of social and psychological instability, people started spending their free time out of the house as a means of distracting themselves from negative news. This is one reason for the constant growth in the number of food outlets. Regarding the popularity of retail products and services, household services are also in high demand and people are ready to pay for higher quality service and brands.”

**Table 2: Top Sectors for New Franchises**

Retail Sub-Sector	Number of Respondents	% of Respondents
Retail Products & Services	<b>33</b>	<b>46.5%</b>
Quick Service Restaurants	<b>23</b>	<b>32.4%</b>
Personal Services	<b>18</b>	<b>25.4%</b>
Retail Food	<b>17</b>	<b>23.9%</b>
Business Services	<b>15</b>	<b>21.1%</b>
Commercial & Residential Services	<b>14</b>	<b>19.7%</b>

Within these categories, survey respondents report that Western brands are particularly sought after because of the positive attitude of local consumers towards these brands. The majority of survey respondents (nearly 80 percent) believe that Western brands are gaining popularity among Ukrainian consumers (Figure 14). In particular, Western brands are highly appealing to existing franchisors (e.g. potential franchise license buyers), to respondents who have more than 100 outlets, and to operators who operate within one oblast (e.g. administrative division). The latter is probably because operators that are confined to one region have less exposure to Western brands and find them to be more novel.

**Figure 14: To What Extent are Western Brands Gaining Popularity Among Ukrainian Consumers?**



Overall, the top reasons that survey respondents give for the increasing popularity of Western brands are their perceived higher quality, as well as general global consumer trends (56.7 percent and 38.3 percent correspondingly) (Table 3). It is important to note that despite relatively low incomes in Ukraine, consumers are often willing to spend more for high quality goods and services. As the popular saying in Ukraine goes “We are not rich enough to spend money on cheap things,” meaning that conventional wisdom dictates that the less money you have, the more you should spend money on products that will last.

**Table 3: Primary Reasons of Popularity of Western Brands**

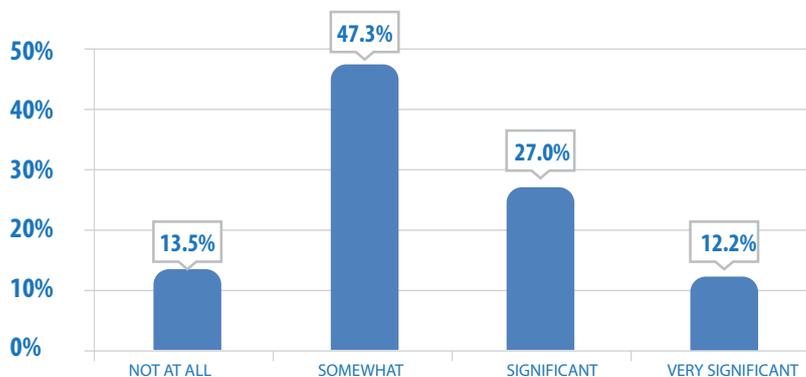
	% of Respondents
Western brands are perceived as those that have higher quality	<b>56.7%</b>
Western brands are popular due to consumer trends	<b>38.3%</b>
Western brands are not that expensive	<b>3.3%</b>
Other	<b>1.7%</b>

## IMPACT OF THE CONFLICT IN THE EAST

The Russian-backed separatist conflict in eastern Ukraine has taken an enormous toll on the country and it is both a human and political tragedy. In addition to the human aspect of this conflict, the pace of economic recovery during the rest of 2015 and into the future depends most importantly on the evolution of this military situation. As described in the Macroeconomic Backdrop below, assuming that there is no major increase in hostilities, economic output is set to stabilize by the end of 2015 and begin growing in 2016.

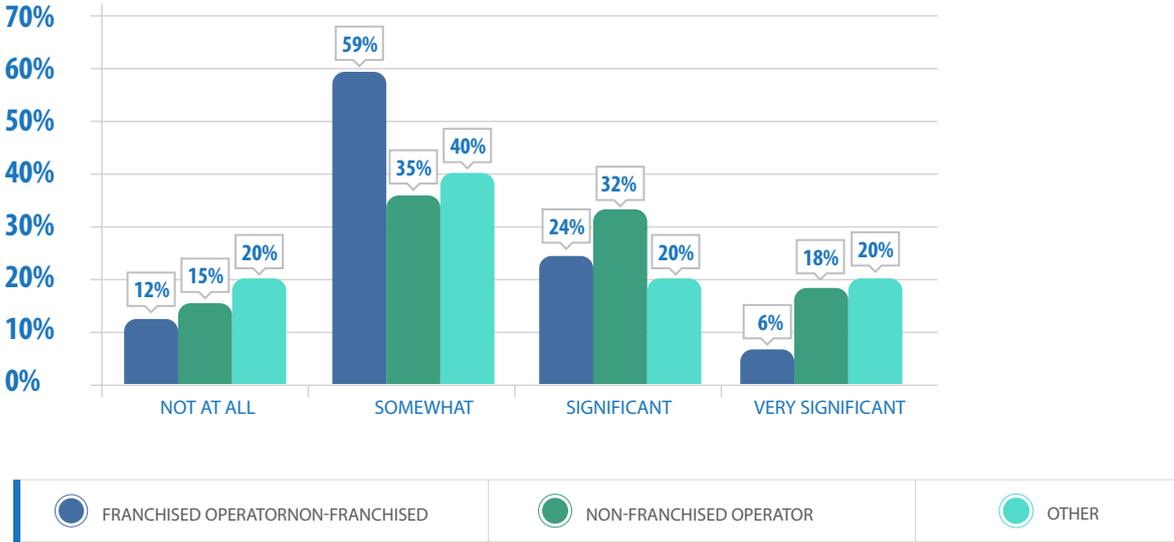
For retailers, the psychological impact of the conflict and hopes of peace are very tangible and in the front of consumers' minds. For example, according to quick-service restaurant owners, the average customer receipt increased by about 40 percent after each peace agreement and decrease of hostilities. To determine the extent of the conflict's impact on retailers, including franchisors, the Franchise Indicator Survey asked respondents to what extent the conflict in Eastern Ukraine will impact their operations in the future. Perhaps surprisingly for American readers, most respondents (47.4 percent) indicated that the conflict will only somewhat impact their businesses and less than a third (27.0 percent) expect that the conflict will significantly impact their operations (Figure 15).

**Figure 15: To What Extent Will the Conflict in Eastern Ukraine Have an Impact on Your Operations in 2016?**



It is interesting to note that even answers regarding this sensitive topic differ among franchised and non-franchised operators (Figure 16). The majority of franchised operators believe that the conflict will either "slightly" or "not at all" impact their operations (59 percent and 12 percent correspondingly). On the flip side, most non-franchised operators believe that the conflict will either "significantly" or "somewhat" impact their operations (32 percent and 35 percent correspondingly).

**Figure 16: To What Extent Will the Conflict in Eastern Ukraine Have an Impact on Your Operations in 2016 (Franchised vs Non-franchised Retailers)?**



# MACROECONOMIC BACKDROP<sup>9</sup>

**Table 3: Key Macroeconomic Indicators for Ukraine**

Indicator	2011	2012	2013	2014	2015F
GDP. \$ billion	176.6	163.4	182.0	127.4	98.0
Real GDP Growth. % yoy	0.2	5.5	-6.8	-6.8	-11.0
Private Consumption. real growth. % yoy	8.4	15.7	-9.6	-9.6	-17.0
Consumer Inflation. eop. % yoy	-0.2	4.6	24.9	24.9	45.0
Hryvnia Exchange Rate per USD. eop	8.0	8.0	15.8	15.8	25.0

Source: SigmaBleyzer

## GDP

Despite the depressing trends in Ukraine's macroeconomic indicators, in terms of real GDP, data released in the summer of 2015 suggests that the economy bottomed out in the second quarter of 2015. Following two sharp declines in real GDP in 2015 (17.2 percent year-over-year in the first quarter and 15 percent in the second quarter), the government now estimates that GDP will decline by about nine percent in the third quarter and by three percent in the fourth quarter. This trend is supported by data that shows that the low point was likely in May, because in June, overall industrial production increased by 1.5 percent on a month-to-month basis, following similar increases in many industrial subsectors in May. These positive monthly growth rates held even after seasonal adjustments. Recent IMF forecasts also predict a two percent growth in GDP for 2016.

## INFLATION

Despite a Consumer Price Index hike in October related to increases in utility prices, inflation is expected to decrease in the final quarter of 2015. Considering the current dynamics of consumer prices, it is expected that consumer inflation will slow to around 45 percent year-over-year by the end of 2015. Going forward, a business survey conducted by the National Bank of Ukraine shows that inflation expectations have improved, with businesses expecting inflation to decrease to 27 percent by June 2016.

## UNEMPLOYMENT

Ukraine's unemployment rate decreased to 9.6 percent in the second quarter of 2015 from ten percent in the previous period and the number of unemployed people dropped by 66,000. At the same time, the number of job seekers per vacancy increased from nine to ten people. Though high, it is worth noting that Ukraine's historical unemployment rates have been comparable,

<sup>9</sup> Based on the "Ukraine Macroeconomic Situation - July 2015," an analytical report prepared by the SigmaBleyzer

averaging 8.6 percent from 2003 until 2015. The unemployment rate is expected to peak in 2015 at 11.5 percent and will likely fall to 11 percent in 2016. Additionally, according to the Fund of Compulsory State Unemployment Insurance, the number of Ukrainians who do not have a permanent job is about five million people.

## IMPACTS ON FRANCHISES

As illustrated by the results of the Franchise Indicator, despite the bleak, albeit improving economic trends in 2015, the good news for the franchise sector is that there is a growing interest in franchise business models in Ukraine. Small and medium-sized entrepreneurs in particular are beginning to express greater interest in franchises because in an insecure macroeconomic environment, franchises offer more security and remove considerable uncertainty in business operations. Plus, as a result of the recession, undercapitalized businesses in various sectors have exited the market, leaving good locations to rent or buy at affordable prices for franchisees. For example, compared to 2006, prices for retail real estate locations have decreased nearly three times. Finally, because of the current oversupply of labor, franchises will find it easier to find qualified staff.

Despite the silver linings in Ukraine's economic storm cloud, potential foreign franchisors should be aware that due to the overall weakness of the economy, the demand for franchise licenses denominated in local currency has increased, while the demand for franchise licenses in hard currencies has declined. Similarly, the demand for franchise licenses that do not obligate franchisees to purchase foreign equipment in hard currency has increased. The macroeconomic reasons for this are a series of sharp local currency devaluations in 2015 that nearly tripled the prices for foreign franchises and foreign equipment.

### Opinion Leader: Mark Zarkhin, General Director of Fast Food Systems (the owner of a portfolio of franchised brands including Pizza Celentano)

– “It goes without saying that the fall in real estate prices, currency devaluation and fluctuation, and instability in the banking sector over the last year and a half scared small and medium investors. This led to a fall in the rate of development in the franchise sector. While this is definitely negative, the positive side for the franchise industry is that Ukrainian investors are looking beyond real estate to invest in reliable and tested franchise business models. I believe that starting from the second half of 2016 there will be a sharp increase in franchising.”

### In Profile: Regulatory Reform in Franchising

- As a part of a larger reform package aimed at deregulation, the Ministry of Justice approved “The New Order of Registering Franchise” in October of 2014. This law, which became effective in April 2015, eliminates confusion in this sector and makes the process of registering a franchise mandatory and transparent. Ultimately, this will also lead to a decreased tax burden for franchises in Ukraine.

## In the End it always comes Down to Politics

Much of Ukraine's ability to fully capitalize on its economic potential depends on its macroeconomic indicators and its ability to institute economic and regulatory reforms. It is therefore essential to take stock of the country's progress in these areas over the last year. While Ukraine has made initial progress in many critical areas, most essential structural and institutional reforms are still pending.

**Steps Forward:** This year Ukraine jumped from 84 to 76 in terms of Global Competitiveness and an IMF staff report issued in July highlighted progress in the following areas:

- Implementation of appropriate fiscal and monetary policies to secure economic stabilization and disinflation
- Measures to improve the institutional capacity and independence of the National Bank of Ukraine
- Initial measures to restore the health of the banking sector; including liquidation of insolvent banks
- Improvements in public procurement of medicines
- Improvement in energy sector pricing policies
- Initial steps in anticorruption with the establishment of the National Anticorruption Bureau
- Progress in investors' protection

**Next Steps:** While the progress above is indeed notable, the IMF report and local experts, including American Chamber of Commerce in Ukraine, also state that essential structural and institutional reforms are still pending. Major areas still in need of significant improvement include:

- Public administration reform
- Continued deregulation
- Further improvement in the banking sector
- Reform of state-owned enterprises and privatization
- Reform of the judiciary and general prosecutor's office

# APPENDIX 1:

## APPENDIX 1:

### UKRAINE FRANCHISE BUSINESS OUTLOOK SURVEY RESPONDENT PROFILE

#### Distribution of Respondents by Retail Sub-Sector

Retail Sub-Sector	% of Respondents	% of Respondents
Retail Products & Services	37	37.4%
Personal Services	14	14.1%
Quick Service Restaurants	13	13.1%
Real Estate	10	10.1%
Automotive	6	6.1%
Business Services	6	6.1%
Commercial & Residential Services	5	6.1%
Retail Food	6	6.1%
Table/Full Service Restaurants Establishments	1	1.0%
Lodging	1	1.0%
Total	99	100%

#### Status of Retail Business – Franchised vs. Non-Franchised

Status	% of Respondents	% of Respondents
Franchisor	25	25.2%
Franchisee	14	15.2%
Non-franchised operator	43	46.7%
Other	10	10.9%
Total	92	100%

#### Size of Operations

Size	% of Respondents	% of Respondents
<10 units	48	53.9%
10-50 units	26	29.2%
51-100 units	5	5.6%
>100 units	10	11.2%
Total	89	100%

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## Number of Regions in which Operations are Located

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Size	% of Respondents	% of Respondents
Single region	<b>35</b>	<b>39.8%</b>
Multiple region	<b>53</b>	<b>60.2%</b>
Total	<b>88</b>	<b>100%</b>

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## Approximate Gross Sales Revenues

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Size	% of Respondents	% of Respondents
≤ 10 mln UAH	<b>38</b>	<b>46.3%</b>
10 - 50 mln UAH	<b>22</b>	<b>26.8%</b>
51 – 250 mln UAH	<b>10</b>	<b>12.2%</b>
> 250 mln UAH	<b>12</b>	<b>14.6%</b>
Total	<b>82</b>	<b>100%</b>

# ACKNOWLEDGEMENTS

## FRANCHISE GROUP

The Franchise Group seeks to facilitate the development of the franchising market in Ukraine. The Franchise Group's mission is to provide a full range of services to businesses in the franchising field to assist them in effectively developing franchise networks. The Franchise Group's portfolio of services include: advisory services for franchise start-ups; the development or improvement of legal documents need to establish a franchise; promotion and network development advisory services; and franchise selection advisory services.

For more information, please contact Julia Chernjak, Head of Sales, at  
E-mail: [jchernyak@franchisegroup.com.ua](mailto:jchernyak@franchisegroup.com.ua)  
Website: [http://franchisegroup.com.ua/en/page/o\\_kompanii](http://franchisegroup.com.ua/en/page/o_kompanii)

## RETAIL ASSOCIATION

The Retail Association is the industry body representing and working for the benefit of the Ukrainian Retail Sector. It is a nationally incorporated not-for-profit association, providing member services including industry sector focus groups, brunches and annual industry summit in Ukraine. Membership in the Retail Association is voluntary and is open to interested and sector relevant companies.

For more information, please contact Yana Zubar, CEO, at:  
E-mail: [yana.zubar@rau.com.ua](mailto:yana.zubar@rau.com.ua)  
Website: <http://rau.com.ua/>

## LIST CHAMBERS OF COMMERCE THAT SENT SURVEY OUT

Ukrainian Chamber of Commerce and Industry  
Dnipropetrovska Chamber of Commerce  
Khmelnyska Chamber of Commerce  
Volynska Chamber of Commerce

## SURVEY RESPONDENTS

The U.S. Commercial Service in Ukraine would like to thank the 101 respondents from the retail and franchise community for giving their time to take part in this important part of research into the sector. Respondents were asked 20 questions, the highlights of which have been provided in this report.

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<http://export.gov/ukraine/franchising>

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