



# Kazakhstan: Franchising Industry

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## Summary

- Per capita income of \$13,000 and a moderately large disposable income for its urban population make it an attractive market for the retail sector
- Kazakhstan ranked as the 10<sup>th</sup> (previous 11<sup>th</sup>) most attractive market for retail development in 2014 (previous 2013) based on improving incomes, a growing economy, positive demographics, and an educated population
- Brand-orientation of the market, geared towards quality, makes it a good fit for well-known international franchising brands
- The franchising sector took off after 2009 and has shown constant growth since, particularly in food and retail sectors with the likes of Burger King, Hard Rock Café, KFC, Pizza Hut. McDonalds and Subway recently announced their plans to come to Kazakhstan
- Kazakhstani companies have accumulated financial resources that, combined with a lack of available investment instruments, are stimulating interest in franchising
- Ten large malls are under construction or planned for development in Kazakhstan. Almaty and Astana account for more than half of retail sales in the country, and with competition becoming fierce, some developers are targeting second tier cities in other regions.

## Market Data

Although franchising is still a fairly new business concept in Kazakhstan, it is drawing increased interest from entrepreneurs. In the past several years, spending patterns in Kazakhstan have begun to resemble those of the Western world, creating a demand for name brands and quality products. Kazakhstani companies have accumulated financial resources that, combined with a lack of available investment instruments, is also stimulating interest in franchising. Kazakhstan is a franchising leader in Central Asia and can serve as a gateway to the growing economies of the Central Asian countries.

At the moment, there are more than 450 franchises operating in Kazakhstan, most of them located in Almaty. Kazakhstan is characterized by franchisees working on the basis of sub-franchising agreements with master franchisees based in Russia, Turkey, or elsewhere. Only a few foreign franchisors work directly with Kazakhstani partners but their numbers are growing.

The opening of The Coca-Cola Bottlers Almaty plant in Almaty in 1994 is considered the birth of franchising in Kazakhstan. In the late 1990s other franchising projects such as Baskin Robbins, Adidas and InterContinental appeared. While the relatively small population of 17 million and low population density of Kazakhstan limits franchising opportunities, this sector has significant potential for development thanks to a moderately large disposable income of the country's urban population with an overall GDP per capita of over \$13,000. In 2002, the Parliament adopted a Law on Franchising providing legal grounds for franchising development in the country. In 2013, the Kazakhstan market experienced a consumer boom, which resulted in retail sales steadily rising by 10%. Overall retail volume growth is nevertheless expected to remain high over the full forecast period, at an average of around 6.4% a year in real terms, as real incomes continue to rise.

Current brands represented in the market include KFC, Pizza Hut, Burger King, Gloria Jean's, Coca-Cola, Hard Rock Café, Baskin Robbins, Cinnabon, FasTracKids, GAP, New Yorker, Tiffany Marble, FitCurves, Marriot, Sheraton and Intercontinental as well as retail brands like Adidas, Armani, Burberry, Debenhams,

Gucci, Lacoste, Mango, Marks & Spencer, Mexx, Mothercare, Next, Saks Fifth Avenue, United Colors of Benetton and Zara. Domestic supermarket chains include SM-Market, which has a total of 40 stores in Kazakhstan. Leading retailers by sales are Metro Cash & Carry (Germany), Migros Ticaret (Turkey), Eldorado (Russia), Inditex (Spain) and Mothercare (UK).

Foreign brands see Kazakhstan as a fertile market and A.T. Kearney's Global Retail Development Index ranked Kazakhstan as the 10th most attractive market for retail development in 2014 11th most attractive market for retail development in 2013, up from 19th the previous year, and ahead of Russia in 23rd place.

Domestic franchising is just starting to develop with 30 local franchises and 200 franchising outlets. According to the Kazakhstan Franchise Union, five local franchises, mostly in retail, even expanded their own franchise concept outside of Kazakhstan – with brands such as Happyton, ShBS, Mimioriki, Biba, Zibroo currently operating their franchise outlets abroad.

According to experts, more than 200 foreign franchisors are taking active steps to seek partners in Kazakhstan and are potentially willing to work with local entrepreneurs. Kazakhstan Franchising Agency estimates that the total number of all franchises and brands operating under franchising or other similar terms will grow to 500 by 2016, with approximately 3,000 new franchising outlets which will employ over 30,000 people and with an estimated annual turnover of \$1.2 billion. Today in Kazakhstan the share of franchising in business is 1-3.5%, with more than 25 000 people employed in this sector. Experts estimate that by 2016 the market share will be increased up to 15%.

Regional centers of franchising in Kazakhstan are Almaty, Astana, Atyrau, Karaganda, and Shymkent. Major international brands are concentrated in Almaty and Astana.

## Market Demand

Local franchise buyers are primarily interested in retail, particularly the segment of fashion and footwear. Brand restaurant segment, which includes street food, fast food, cafes, and other restaurant concepts, is also growing quite rapidly.

The Government of Kazakhstan (GoK) sees franchising as a promising sector, bringing brands with international quality standards into its business infrastructure to help diversify and develop Kazakhstan's economy outside the extractive sector. The key measures to support the franchising sector that might be of interest are as follows:

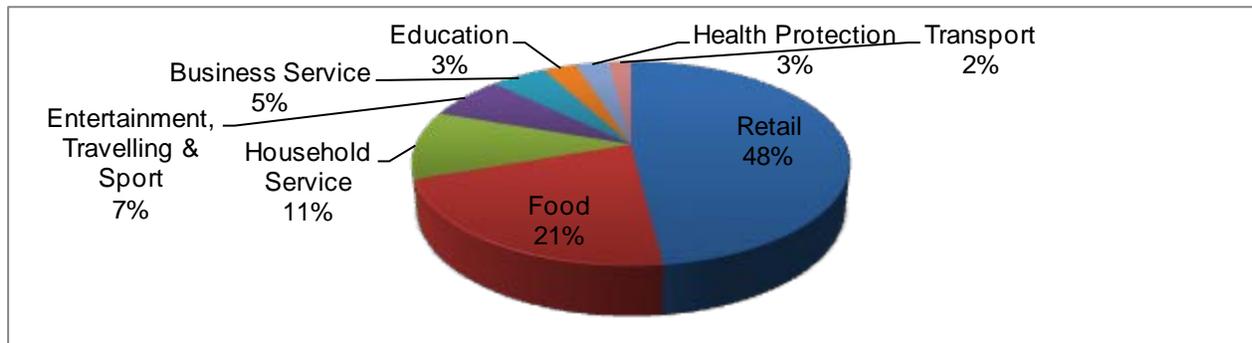
- Damu Fund National Centre for Franchising opened in 2010 under this state fund for developing small and medium-sized businesses in the country
- Kazakhstan's National Agency for Export and Investment, KazNex Invest, provides support for exporters by 50% cost reimbursement incurred during export of domestic products to foreign markets. This support extends to the purchase of the franchises in the production sector for export-oriented production.
- National Institute of Intellectual Property (Kazpatent). The main mission is the regulation of the turnover trademarks sector and registration of franchise agreements.
- Central Asian Franchising Development Agency (CAFLA). The main mission of the agency is the consulting on franchising and licensing
- Independent Association of Entrepreneurs. The main direction is the development of franchising in Kazakhstan, conducting exhibitions, seminars, trainings
- National Centre for Development of Franchising. The purpose of the new organization is to unite the efforts of the Damu fund and the Franchise Union. The Centre has an extensive network of offices in all regions of Kazakhstan and provides support for franchising in Kazakhstan

The GoK provides 30% reimbursement of the project cost based on the franchise contract in case if the franchise is accredited by a bank, DAMU Fund or Franchising Union. Business Road Map 2020 program

of state grants for start-up of entrepreneurs with grants of up to \$20,000 issued, including grants for purchase of franchises.

## Best Prospects

This chart shows the current franchising sector breakdown and reflects current market trends:



Source: Kazakhstan Franchising Association

### Retail

The Almaty market is the primary retail destination in the country and has witnessed steady growth over recent years. The growth of the consumer market and development of consumer culture stimulates the inflow of international retail chains and the expansion of existing operators. However, during the first half of 2015 the market was adversely affected by the country's uncertain macroeconomic prospects, mostly based on the low price of oil, which translated into a slowdown in retail sales. As the economy slows, retailers modify strategies and adopt a more conservative approach. International retailers continue to be interested in the Almaty market, but are carefully assessing their growth prospects in the region. Consumer spending is set to remain the main driver of growth in Almaty. International designer and fashion brands have grown in popularity in recent years. From 2014-2018 brands will increase their retail space in the urban centers of Kazakhstan owing to higher demand from richer Kazakhs. Both upmarket brands such as Louis Vuitton and Christian Dior, and mid-priced outlets such as Topshop, Zara, GAP and Monsoon are expanding rapidly. Chanel, Prada opened their first stores in Kazakhstan in 2013. Hermès is also present, operating with a local-venture partner, Premier Metro Group. Brand awareness among Kazakh consumers is high, and foreign products command a significant price premium. The apparel and footwear market relies on imports, as domestic production cannot meet demand. Local output of textiles and sewn products accounts for less than 1% of total manufacturing output.

The retail market remains fragmented and unsaturated because of a scattered population, poor infrastructure leading to high logistics costs, and the rural population's relatively low purchasing power. Many brands perceive the market as promising; however, retailers are not ready to expand directly and, in general, turn to local partners to help them establish their brand presence in the region.

### Food service

The foodservice sector remains underdeveloped, and is dominated by small businesses and restaurants. As incomes continue to rise, and the quality of restaurants improves, eating out will become more popular. Interest in foreign food is rising and Astana and Almaty now boast coffee houses, cocktail bars, pubs and restaurants serving a wide range of international cuisine. Several international fast-food chains operate in Kazakhstan, including Pizza Hut and Carl's Jr. Almaty also continues to stand as the focal point and the most attractive local market for fast food retailers. On the background of a gradual increase in consumer demand towards dining-out the market is expected to further develop through the expansion of established brands and attraction of new international retailers. As shopping malls increase their share of total retail floor space, the number of major food chains and international brands is likely to increase. Since May 2012 Burger King has opened three food courts and three fast-food restaurants, investing over

US\$3 million in the country. Major investors view the fast-food market as far from saturated. McDonald's recently announced that they will soon launch their first outlets with local partners. The large international fast food restaurant chain 'Subway' is currently identifying and assessing their local market opportunities.

Kazakh consumers are curious to experiment with new food products and varieties, particularly after years of Soviet rule when there was little variety available. Diets have become more diverse over the past 10 years, a trend that is expected to continue. Foods that would have been considered luxury items in the past, such as snacks, sauces and seasoning, are all growing in popularity, contributing to the higher value of food sales. Busier lifestyles are also contributing to the rising demand for convenience foods such as powdered soups. Both of these trends are mostly evident in major urban centers. Wealthier urban residents are becoming more aspirational and developing increasingly sophisticated and diverse tastes, fuelling the sale of non-essential, higher-value food and drink items.

## Key Suppliers

The majority of non-U.S. foreign franchises in Kazakhstan are from Russia and Western Europe, mainly the UK, France, Germany, Spain, and Italy. Europe is dominating in Kazakhstan's franchising sector with 36% of the European brands, mainly in retail, followed by the U.S. with 15% in a variety of sectors but mainly in food and beverage, Russia – 28%, other countries – 12 %, and local 9%. The number of franchising outlets opened under Russian franchising reached 400 as of 2014. U.S. franchisors have developed 50 franchise concepts in Kazakhstan, which include 250 franchised outlets. However, U.S. share is the most significant in total franchising turnover.

In January 2010, the Customs Union (CU) between Belarus, Kazakhstan, and Russia became effective and has somewhat eased the market entry for Russian and Belarusian companies. However, increasing barriers for other countries import as import tariffs rose from 6.7% to 11.1% in 2013. In January 2015, the agreement on the Eurasian Economic Union (EEU) entered into force, ushering in the next stage of the integration project of Belarus, Kazakhstan, and Russia. The EEU provides for free movement of goods, services, capital and labor, pursues coordinated, harmonized and single policy in the sectors determined by the Treaty and international agreements within the Union. This factor is predicted to cause an increase in the number of franchises from 20% currently coming from Russia to 30-40% from both Russia and Belarus to Kazakhstan.

Kazakhstan completed its negotiations to enter the World Trade Organization (WTO) in 2015 and is expected to join before the end of the year. The country will have further five years to timeframe to adjust its regulations in compliance with WTO standards. Joining the WTO is expected to cause a decrease in some of the import tariffs which were raised through the creation of the Customs Union with Russia and Belarus. Experts note that as a result of WTO negotiations, Kazakhstan has liberalized import tariffs on over 3,170 goods. Agriculture tariff will go down most dramatically: from 16.7 percent to 7.6 percent.

## Prospective Buyers

Income growth for the next five-year period will be sufficient to enable the growing middle class to shift gradually towards higher-quality food and beverage products. Consumer expenditure on food, beverages and tobacco will rise to \$95 billion in 2018, more than double the level in 2013.

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.

As consumers, Kazakhstan's middle class is increasingly affluent, partly because of the trickle down from the nation's lucrative oil exports. This has boosted the retail sector, including luxury retail chains like Saks

Fifth Avenue opening their first mall in Almaty in September 2012. Though they still trail far behind the average household income of Americans – as consumers they tend to have a large portion of their money for discretionary spending. They are unburdened by the hangover of consumer debt that affected purchasing power in the developed world. Nor do Kazakhstan citizens have high medical bills because the health care system, if flawed, is largely socialized. The income tax is a flat 10 percent. And a majority of Kazakhstan own property mortgage-free, as a legacy of the mass privatization of apartments in the 1990s.

A small and medium-size business support and development fund - Damu has a special center for franchise development opened in 2010. More than 500 entrepreneurs from all regions of Kazakhstan became clients of Damu and more than 5,000 active new entrepreneurs are part of Damu's database.

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 saturated.

## Market Entry

The franchise agreement is the main document regulating relationships between the parties, and requires its thorough study, and, if necessary, detailed explanation of its essence to franchisees. Any franchising contract should be carefully drafted because judges in Kazakhstan are not familiar with this area of law. In fact, the Law of Franchising adopted in June 2002 does not even use the term but retains the archaic term 'complex business license'. Under the Civil Code of Kazakhstan franchise agreement is called a contract for a complex entrepreneurial license, where one party (the licensor or franchisor) shall grant a set of exclusive rights or so-called license complex to the other party (the licensee or franchisee) for remuneration.

When entering into a franchising agreement the basic and necessary requirements in part of granting rights to use a patent or trademark are:

- The presence of the legal protection of a patent or a trademark in the territory of Kazakhstan; and
- Registration of a license agreement on the trademark use with the Intellectual Property Rights Committee under the Ministry of Justice of Kazakhstan

Many exporters designate a Kazakhstani-based trading company as their local sales agent responsible for handling customs clearance of imported goods, dealing with established wholesalers and/or retailers, marketing the product directly to major corporations or the government, and handling after-sales service. In some cases, especially when selling to the government, a Kazakhstani distributor is vital.

With a history rich in clan and tribal relations, business in modern Kazakhstan is still based on personal relationships. In an economy where rule of law is not yet firmly established, the quality and depth of key business relationships are often your best protection against loss and your key to market access. Selection of a local franchisee (or franchisees) is probably the most important decision your company will make in its market entry. Though some firms choose to cover the Kazakhstani market from a regional office in Russia, an on-the-ground presence is crucial for effective business development.

Access to finance for potential franchisees is a very important condition that can develop the sector. But among the franchised business, demand on standard bank loans with high interest rates is not really common.

Internet and social networks are rapidly growing in Kazakhstan. The number of national users approached 10 million people. More than 3 million citizens are active users of different kinds of social

networks, which will be used as the main tool to promote the brand, record consumer trends and to create an effective feedback system to the potential audience.

## Market Issues & Obstacles

Some factors limit the growth rate of franchising in Kazakhstan such as: weak legal protection of intellectual property rights, supply chain and logistics issues, lack of long-term financing opportunities, lack of transparency in Kazakhstan's business environment, and low awareness of Kazakhstani entrepreneurs of franchising opportunities. Despite these negative factors and considering the small population and low population density in Kazakhstan, this sector has significant potential for development.

There are many barriers that impede the development of the sector. Among the strongest: the lack of qualified staff. The franchising sector is still relatively unknown for many Kazakhs; there is no training and no educational prospects in universities on this sector. A deficit of professionals in franchising: lawyers for intellectual property, especially on trademarks, franchise consultants, specialists in brand, sales managers and marketing franchise. Additionally, major franchising locations are in big cities. Business is not developing in towns, and local villages. Most of the chains are not developing in regions; there is no connection between a city's market and regional medium business.

With the Eurasian Economic Union between Russia, Kazakhstan and Belarus in effect since January 2015 (with Kyrgyzstan to be included later), Kazakhstan's position within the economic space remains uncertain. Key risks at this stage include a potential surge in inflation from normalized tariff arrangements. Importers are affected by a poorly planned implementation of the territories' integration, non-standardized application of the common customs code, and unclear documentation requirements. Continued low oil prices and potential devaluation will decrease some consumer spending.

## Trade Events

### **KazFranch 2015**

Date: October 24, 2015

Venue: Rixos hotel

Location: Almaty, Kazakhstan

Event website: [www.expokz.all.biz/KazFranch 2015](http://www.expokz.all.biz/KazFranch%202015)

### **FranchExpo Central Asia 2015**

Dates: November 4-6, 2015

Venue: Atakent Expo Center

Location: Almaty, Kazakhstan

Website: [www.franchexpo.kz](http://www.franchexpo.kz)

### **U.S. Commercial Service Event**

Dates: February/March 2016

Location: Almaty, Kazakhstan

Website: [www.export.gov/kazakhstan](http://www.export.gov/kazakhstan)

## Resources & Contacts

- Agency of statistics of the Republic of Kazakhstan - [www.stat.gov.kz](http://www.stat.gov.kz)
- A.T. Kearney's Global Retail Development Index 2013 - [www.atkearney.com](http://www.atkearney.com)
- BMF Legal Advisors – Kazakhstan franchising regulation overview
- Business Monitor International, Kazakhstan Food & Drink Report2 2014 - [www.businessmonitor.com](http://www.businessmonitor.com)
- Damu Entrepreneurship Development Fund - [www.damu.kz/en](http://www.damu.kz/en)
- Forbes Kazakhstan - Issue #17 in January 2013 article on Franchising Development

- Kazakhstan Entrepreneurs Association – [www.kazka.kz/en](http://www.kazka.kz/en)
- Kazakhstan Franchising Association – [www.kافل.kz](http://www.kافل.kz)
- Kazakhstan Franchise Union - [www.franchise-union.kz](http://www.franchise-union.kz)

### For More Information

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