Franchising Opportunities in China, Japan and Singapore

APEC
Asia-Pacific Economic Cooperation

FLA SINGAPORE
Franchising and Licensing Association (Singapore)

PRICEWATERHOUSECOOPERS

ie Singapore
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APEC#206-TP-01.1 ISBN 981-05-5200-9

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Acknowledgement

The authors acknowledge the contributions made to the study by the many organisations, trade associations, franchisors and franchises that were consulted throughout its preparation. Specific gratefulness is extended to the following:

- Internationalisation Enterprise Singapore
- China Chain Store and Franchise Association
- Franchising and Licensing Association (Singapore)
- Japan Franchising Association
- Japan External Trade Organisation
- Shanghai Xianzonglin Food & Beverage Ltd
- Beijing Donglaishun Group Co., Ltd
- Dio F&B Management Co., Ltd
- Chongqing Cygnet Investment & Holding (Group) Co., Ltd
- Shanxi Pingyao Qingeda Catering Services Co. Ltd.
- MOS Food Services, Inc
- Yoshinoya D&C Co., Ltd
- Pepper Food Service Co., Ltd
- Duskin Co., Ltd
- Carona Holdings Pte Ltd
- Thai Village Holdings Ltd
- Malan Noodles Fast-Food Chain Store Pte Ltd
- PastaMatrix International Pte Ltd
- ONYX Concept Restaurant Pte Ltd
- Jack’s Place Holding Pte Ltd
- APEX-PAL International Pte Ltd

¥	Japanese Yen
ACFP	Administration of Commercial Franchising Procedures
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
AVA	Agri-food and Veterinary Authority of Singapore
BERI	Business Environment Risk Intelligence
Bn	Billion
BSE	Bovine Spongiform Encephalopathy
c.	Circa
CAGR	Compounded Average Growth Rate
CCFA	China Chain Store and Franchise Association
CCSE	China Chain Store Exhibition
CEPA	Closer Economic Partnership Agreements
CRIC	China Retail Industry Convention
DSPF	Domestic Sector Productivity Fund
EDB	Economic Development Board
EII	Enterprise Investment Incentive Scheme
ERC	Economic Review Committee
F&B	Food and Beverages
FDI	Foreign Direct Investment
FIE	Foreign-Invested Enterprises
FLA	Franchising and Licensing Association
FSR	Full-service Restaurant
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GST	Goods and Services Tax
HDB	Housing and Development Board
IDA	InfoComm Development Authority
IMD	International Institute of Management Development
IPOS	Intellectual Property Office of Singapore
IPR	Intellectual Property Rights
IT	Information Technology
JAS	Japanese Agriculture Standard
JFA	Japan Franchise Association
JPO	Japan Patent Office

LEFS	Local Enterprise Financing Scheme
LETAS	Local Enterprise Technical Assistance Scheme
MAFF	Ministry of Agriculture, Forestry and Fisheries
MEWR	Ministry of Environment and Water Resources
MOFCOM	Ministry of Commerce of China
Mn	Million
MTI	Ministry of Trade and Industry
psf	per square feet
psm	per square meter
RMB	Chinese Renminbi
S$	Singapore dollar
SAIC	State Administration for Industry and Commerce
SAR	Severe Acute Respiratory Syndrome
Singstat	Singapore Department of Statistics
Singtel	Singapore Telecommunications
SME	Small and Medium Enterprises
SPRING	Standards, Productivity and Innovation Board
sqm	square meters
STB	Singapore Tourism Board
Tn	Trillion
TRIPS	Trade Related Aspects of Intellectual Property Rights
TRSCG	Total Retail Sales of Consumer Goods
USD or US$	US Dollar
VAT	Value Added Tax
w.e.f.	with effect from
WTO	World Trade Organisation
Yoy	Year on year

Exchange Rates

Where possible, we have consistently used the exchange rates of:

- S$ 1 to US$0.58
- RMB 1 to US$0.12
- ¥ 100 to US$ 0.85

Contents

Foreword

In recent years, more companies are taking the franchising and licensing route to grow their brands and business concepts internationally. The encouraging progress of Singapore franchisors overseas is also a reflection of how companies can leverage on their intangible assets such as a strong brand and innovative technology to penetrate new markets successfully.

To ensure the continued success of franchisors based in Singapore, FLA (Singapore) is taking the lead in helping to develop the core competencies of the fraternity. FLA (Singapore) assists members to improve their skills and knowledge through various training courses, providing a forum for members to exchange ideas, exploring areas of co-operation as well as liaising with the relevant authorities on franchising matters. The use of FLA (Singapore) logo on members' collaterals is a stamp of recognition and compliance to the association's code of ethical practices.

I commend APEC for their effort in driving this market study project, as well as the research team in PricewaterhouseCoopers for their tremendous effort in compiling and highlighting these key findings for all the franchisors expanding into the China, Japan and the Singapore markets. Last but not least, my sincere appreciation to the support from IE Singapore for coordinating this project.

Yours

Mr Ron Sim
Chairman 2004/2005
Franchising and Licensing Association (Singapore)

Entrepreneurs and businessmen seeking to expand and grow their business within this region have affirmed that franchising is an effective business strategy for overseas growth. Singapore also recognises franchising as an established mode of internationalisation which International Enterprise Singapore has promoted and supported over the years.

Whilst the conditions are promising, one cannot over-emphasise the importance of gaining in-depth knowledge of each market before taking the plunge. This publication aims to give you an overview of the three selected markets' economy, business and regulatory environment. More importantly, there are lessons to be learnt from successful franchisors/master franchisees in this region. In their quest for internationalisation, the issues and opportunities facing business decision makers everywhere are becoming increasingly alike, especially within the F&B industry.

The contributions from the successful franchisors/master franchisees are presented in the format of case studies, and you will see from some of these candid sharing sessions, how the issues facing a restaurant chain in Japan can be very similar to the challenges faced by a coffee chain in China. However, as you read on, you will realise that there is no one prescribed method or best method towards addressing these issues. Factors such as the corporate culture, business environment and local market practices come into play, and affect how each challenge should be approached.

I hope you will find their candid opinions useful in giving you an insight into how successful franchise network operates.

Yours

Aw Siew Juan
Director
Trade Promotion Group
International Enterprise Singapore

Franchising is one effective avenue for companies to consider when seeking growth; both within the local economy or overseas. By its very nature, the documented systems in franchises ensure easy emulation by the franchisees. Furthermore, with the growing legal protection in the areas of intellectual property rights, the interests of companies who are seeking to pursue the franchising route would be better protected. Thus, it is no surprise that F&B businesses are increasingly exploiting overseas market through franchising.

By and large, food and beverages (F&B) sector has been and remains a key component of franchising and is the logical choice for this study. However, it may not as easy when it comes to deciding which among the APEC member economies, to be examined. After much considerations APEC has decided on China, Japan and Singapore, notably supported by the following considerations:

- China is the world's most populous economy. Its fast growing economy has spurred the growth of its F&B sector including franchising businesses - both overseas originating concepts and those developed indigenously by the Chinese. It would be of great interest to take a snapshot of China's F&B franchising developments.

- Japan is the largest economy in Asia and second largest globally after the US. It is obviously an interesting target market for overseas franchisors. On the other hand, Japanese F&B franchising systems have over the last decade been made great success overseas.

- Although dwarfed when compared with China and Japan on population size, Singapore is one of the more sophisticated F&B markets in Asia. Having a relatively small domestic has helped to catalyse the more enterprising Singapore F&B business to expand overseas.

Lastly, this publication is essentially a compilation of 3 separate reports, each looking into the economies understudied individually. They are intended to provide the readers with a high level understanding of the F&B potential with particular focus on franchising as a business strategy. I hope you would find the experiences of both franchisors and franchisees presented in the case-profiles insightful and useful.

Yours

Mr Keoy Soo Earn
Partner
PricewaterhouseCoopers

1. Executive Summary

China F&B Industry

With a booming economy and rising disposable income, China has become a land of opportunity for many F&B service retailers, both local and foreign, looking to capitalise on the attractive market. China's food service sector has been experiencing a CAGR of 12.9% from US$45.3 billion in 2000 to US$73.3 in 2003. This growth has been attributed mainly to growing time pressure and longer hours at office. With increased incomes, eating out is becoming more and more common for the Chinese. Demand for F&B service appears to be concentrated in selected regions. The top 8 regions that contributed to the food service turnover for the whole Chinese economy include Guangdong, Shangdong, Jiangsu, Zhejiang, Sichuan, Liaoning, Henan and Hubei. These regions, in particular the coastal provinces such as Guangdong and Jiangsu, have a strong dining-out culture.

Franchising first began in the late 1980s as a result of the open door policy. Though China adopted franchising later than that of Singapore and Japan, its franchise industry has grown exponentially in a matter of 20 years. China has the highest number of franchise systems in the world, outperforming even Japan – a pioneer in the franchise development in Asia. According to statistics issued by the China Chain Store & Franchise Association, by 2004, there were about 2100 franchise systems and 120,000 franchised outlets operating in China engaged in nearly 60 business sectors. Every franchise system has 57 franchised outlets on average.

Out of these 2100 franchise systems in China, F&B accounts for 31.6%. According to the survey done by CCFA, more than 60% of chained F&B companies are having or going to have more than 1 brand especially for Chinese full service restaurants, Chinese fast food and hot pot restaurants. The rapid growth of F&B franchises is attributable to several reasons:

- huge success of giant foreign franchisors;
- economic and demographic changes such as rising affluence and sophistication of consumers; and
- growing sense of entrepreneurship.

On the other hand, to be successful in franchising, one needs to be aware of the following factors:

- a recognisable franchise brand name that is already famous in China.
- a good support system within China such as staff, Chinese-speaking personnel, and Chinese-language operational materials. Chinese franchisees generally do not believe strong overseas franchise support systems to be very useful.
- a chain of successful company-owned stores in China. As successful company-owned flagship stores in China may give potential franchisees confidence that a particular franchise concept works in China.

On the whole, China's F&B sector is experiencing rapid growth and the areas of particular interest to F&B franchisors include:

- sectors, touted to be the next fastest growing sectors, such as cafes/bars, fast food, and full service restaurants;
- growing consumers' preference towards convenience food, environmentally-friendly food, healthier food, brand image and sophisticated & hygienic packaging for food products.

However, it is important to note that the growth potential of the sectors varies from region to region, depending on the consumption and spending habits of the residents, and on the maturity level of the F&B market. It would be prudent for the F&B players to have a thorough understanding of their own target markets, as well as each region's demography and supply and demand for foodservices, before they enter the Chinese market.

Geographic markets that are most attractive in terms of F&B opportunities are:

- tier one cities such as Beijing, Tianjin and Shanghai which are more mature F&B markets in terms of the number of chained restaurants serving the population and are usually selected for its upmarket and brand equity factor; and
- second tier cities and provinces within the eastern regions, the central and western regions such as Jiangsu and Zhejiang. These markets tend to have lots of room for existing restaurant chains to expand or for new F&B brands to penetrate into the market as well as offer higher

profitability levels for its F&B restaurant businesses, and make good starting grounds for businesses.

Singapore F&B Industry

The F&B industry contributes about 1% to Singapore's GDP. Despite its relatively small contribution, the F&B industry has been singled out as an important component in Singapore's economy.

Singapore has over 4,300 eating establishments and generated a total operating receipt of close to S$3.9 billion in 2003. Singapore's vibrant F&B sector offers consumers various range of cuisine from local delights to eclectic fine cuisine.

Table 1: Food Service Receipts in Singapore

	2000	2001	2002	2003
Food Service Receipts (S$ Billion)	3.6	3.9	3.9	3.8

Source: Department of Statistics

Furthermore, the F&B service industry market is highly fragmented with 9,655 registered cooked food outlets and 6,385 food stalls. Notably, reflecting the challenging market conditions, both the number of registered cooked food outlets and food stalls, have been declining at CAGR of 5% and 1%, respectively from 2002 to 2004.

Table 2: Number of registered cooked food outlets and food stalls

	2002	2003	2004
Number of registered private cooked food outlets (coffee shops, food courts, restaurants, cafes, etc)	10756	10738	9655
Number of food stalls in hawker centres i.e. located at HDB and MEWR premises	6539	7278	6385

Source: National Environmental Agency

Looking specifically at our study subject i.e. F&B establishments including hotels, restaurants, fast food restaurants, cafes, etc. there were around 4,340 units in 2003 which declined by 2% from 2002.

Table 3: Number of F&B Establishments

	2001	2002	2003
Number F&B Establishments	4387	4436	4340

Source: Department of Statistics

In the overall F&B service industry, chained outlets grew faster than independent operations in the Restaurants and Café/Bars segment. Table 4 and Table 5 below highlight the breakdown of chained vs. independent operations for FSR and café/bar F&B establishments.

Table 4: Full Service Restaurant by Independent/Chained slit from 1999-2003

Types	1999	2000	2001	2002	2003	CAGR 1999-2003
Full service restaurants	996	972	1001	1046	1081	2.1%
Chained FSR / *As a % of total*	88 *8.8%*	98 *10.1%*	137 *13.7%*	146 *14.0%*	164 *15.2%*	16.8%
Independent FSR / *As a % of total*	908 *91.2%*	874 / *89.9%*	864 / *86.3%*	900 *86.0%*	917 *84.8%*	0.2%

Source: Consumer Foodservice in Singapore, Euromonitor August 2004

Table 5: Café/bars by Independent/Chained slit from 1999-2003

Types	1999	2000	2001	2002	2003	CAGR 1999-2003
Total Café/Bars	909	940	1061	1097	1134	5.7%
Chained Café/bars *As % of total*	102 *11.2%*	114 *12.1%*	137 *12.9%*	154 *14.1%*	168 *14.8%*	13.3%
Independent café/bars *As % of Total*	807 *88.3%*	826 *87.8%*	924 *87.1%*	943 *86.0%*	966 *85.2%*	4.6%

Source: Consumer Foodservice in Singapore, Euromonitor August 2004

Franchise Industry in Singapore

The franchising landscape in Singapore has matured since the late 1970s when franchising first made its appearance. The Food and Beverage ("F&B") service industry is significant part of the franchising landscape. Of all franchising in Singapore, about 30% are in the F&B industry.

Table 6: Franchise Statistics

	2001	2002	2003
Number of franchise systems	-	350	380
Number of F&B franchise systems	73	102	114
F&B Franchises as % of total franchises		29%	30%
Number of chained outlets (corporate-owned and franchised)	851		
Number of F&B Establishments	4387	4436	4340
Chained outlets as % of F&B establishments	19%		

Source: IE Singapore public speeches, FLA Franchising Directory 2002, Department of Statistics, PwC Analysis

As indicated above, while the number of F&B establishments have declined slightly from 4387 in 2001 to 4340 in 2003, the estimated number of F&B franchises which stood at 73 in 2001, grew a CAGR of 25% during the same period.

Aside from satisfying the taste-buds, success comes from having a winning concept with multiple presences in the right locations. Multiple outlets will not only help to promote greater brand visibility but it also enables greater business efficiency and operational economies of scale.

A sizeable market with 4.18 million residents, the total receipt for the Singapore's F&B service industry reached S$3.8 billion in 2003. Food is a significant expenditure item and accounts for 21.3% of the average household expenditure of S$3,244. In all, Singaporean's love affair with food presents both local and foreign franchisors opportunities in the F&B arena.

There are now approximately 56 locally originated franchises, an increase of 54% from the 29 local franchises recorded in 2001. These suggest that franchising could well be a way forward in building a sustainable and successful F&B business here.

Opportunities

There is no law regulating franchise in Singapore. However, the fair and transparent legal system enforces the relevant Contract Law and other related legislations equally to all parties. Singapore presents foreign franchisors with an attractive investment climate. The pro-business environment, favourable investment climate and Singapore's position as a regional hub present foreign franchisors with an attractive environment to operate in. Foreign franchisors can also use Singapore as a franchising hub to test its concepts and cuisine before bringing it to the region.

In propelling tourism to greater heights, Singapore is keen to promote Singapore's reputation as the 'eating capital' to tourists worldwide. Going forward with the announced development of two Integrated Resorts which are slated to be operational in 2009, the food services industry is poised to ride on the increased tourism dollar for further growth. This is likely to support the continual growth of F&B franchises in Singapore.

Japan F&B Industry

Japan's demographic changes, particularly its fast greying population and dual-income workforce, is expected to have a profound impact on its domestic food and beverage sector. The impact will range from total expenditure on food, to type of food preferred and retailing considerations.

Japan's expenditure on the F&B food service sector was ¥20,467 billion (US$ 174.2 billion) in 2003. This represented a marginal growth of c. 1% yoy over 2002 and a CAGR of c. 0.03% between 1999 and 2003. Research reports predict that F&B retail sales will suffer a decline of about 0.03% while the total number of F&B retailers remains largely the same.

This would mean an increasingly competitive landscape where the same number of players is fighting for a smaller piece of pie. As such, securing multiple presences via chain stores may be a way to go. Chain outlets are predicted to increase by 1.4% amidst this backdrop of intensifying competition, as brand owners seek to dominate the market by establishing more outlets for product accessibility and brand visibility. In addition, it offers hard pressed F&B retailers to minimise cost, via economies of scale, in an increasingly difficult times.

As such, it may be of no surprise that franchising as a business format is increasingly popular. Sales via franchise outlets registered a CAGR growth of 4.24% -- the largest growth amongst other retail formats such as cooperatives, independent retailers and multiples etc., while total retail sales declined by 0.44%. In addition, the number of franchise systems has grown by c.1.2% whilst the number of franchise outlets increased by c.2.5% between 2001 to 2003. In terms of segmental contribution, F&B represents the largest segment of franchises at c.40% followed by retail (32%) and services i.e. beauty salons, education etc (28%).

The franchise industry in Japan appears to be dominated by local franchisors. Even though franchising in Japan started in 1960s, till today, foreign franchise concepts remain relatively small at about 10% of the entire Japan franchise industry. However, research seems to indicate that Japanese are receptive to foreign concepts. It appears that in order to successfully penetrate the Japanese market, foreign franchisors will need to build an understanding of the Japanese market because of its size and complexity.

To be successful as a F&B franchisor in Japan, one must take note of several factors such as having a strong brand, flexibility in franchise terms and providing excellent product and service quality.

2. Introduction

2.1 Project Objective

In 1995 APEC SME Second Ministerial Meeting called for an APEC franchising study. Arising from which, the 1996 APEC Franchising Study was carried out to help enhance APEC SME's understanding of the benefits of systems based on a business franchise format; explore possible best practice models for local or international franchise operations; and compare codes of conduct governing franchises in APEC member economies.

Continuing with the earlier efforts, this 2005 study attempts to examine the franchising opportunities in some of these economies, namely China, Japan and Singapore; specifically

- looking from the perspective of assisting enterprises venturing into the food and beverage business in the these target markets
- highlighting best case practices for enterprises; and
- Facilitating the understanding of the intellectual property right of the franchises in the target markets.

Definition of Food and Beverage Industry for this Study

By definition, Food and Beverage Franchising (F&B) Industry is vast and encompasses food development, new ingredients creation, manufacturing of food products and other-service related activities including food & beverage services (retailing), marketing and branding.

The specific focus of this study will be on food & beverage services. This refers to all the food places - restaurants, fast food outlets, food caterers, coffee shops, tea bars, pubs etc. and which particular emphasis on **establishments which operate as chain outlets under consistent branding** where franchising is or could be adopted as a mode for business growth. F&B Establishments serving a “captive” population in places like schools, hospitals etc. are excluded from the report.

Definition of Franchise for this Study

Franchise

Franchise is the rights a franchisee acquires to offer specific products or services under explicit guidelines at a certain location for a declared period of time.

Franchising

Franchising is an arrangement in which a franchisor licenses the rights to operate his/her business format, under its trademark or name, to a franchisee. The business arrangement involves a legal contract between the franchisor and the franchisee and continual support to the franchisee to run the business on a predetermined basis.

Franchisor

Franchisor is the party owning/controlling the rights to grant franchises to potential franchisees. Franchisor usually provides management services such as advertising, promotions, updating of procedures and continuous product development.

Franchisee

Franchisee is the party paying a royalty and often an initial fee for the right to operate business using franchisor's trademark and system.

Franchise Fee

The amount of money the franchisee pays to the franchisor to acquire the franchise. It includes an initial fee which is an upfront payment and royalties or management fees which are on-going payments made monthly to the franchisor.

Tenure of Agreement

Tenure of agreement is a period of validity of the legal contract between the franchisor and the franchisee. Such legal contracts can be as short as 3 years or as long as 10 years.

A. CHINA FOOD & BEVERAGE FRANCHISING

3. China Overview

3.1 China Overview

China as most would agree could become the world's largest economic powerhouse by as early as 2015. Since China started to adopt a free market policy about 25 years ago, the Chinese economy has been growing in leaps and bounds, and the average annual growth rate from 1979 to 2003 is 9.4% and the growth rate for year 2004 is 9.5%.[1] China's GDP has reached RMB13.65 trillion (USD1.65 trillion) with GDP per capita of USD1270. Currently its GDP is only slightly less than one-third of Japan.

For food companies, China's huge population base of 1.3 billion consumers is the major attraction. Rising per capita disposable income is creating strong growth in retail sales of food products. Total retail sales of catering services reached RMB748.6 billion in 2004 and a per capita basis of RMB576. Whilst this may appear relatively small in comparison with Singapore and Japan, it is understandably so given its huge population base.

China adopts the "five-year-plan" strategy for its economic development. Now into its 10th Five Year Plan (2001 – 2005), its key focus for the five year period starting at the turn of the century included sustaining economic growth, promoting further restructuring and reform, making further improvements to infrastructure, encouraging private investments and allowing greater participation in international cooperation and competition[2].

Much of the key focus stated in the 10th Five Year Plan was achieved and even the 9th Five Year Plan was a success. Hence, it led to China enjoying unprecedented economic growth and becoming one of the world's major economic powers with huge growth potential. With a yearly foreign trade volume of over US$1.1 trillion in 2004, China is currently the world's third largest trading economy, trailing behind United States and Germany. This represents an annual average increase of 30% since the restructuring of the economy started[3].

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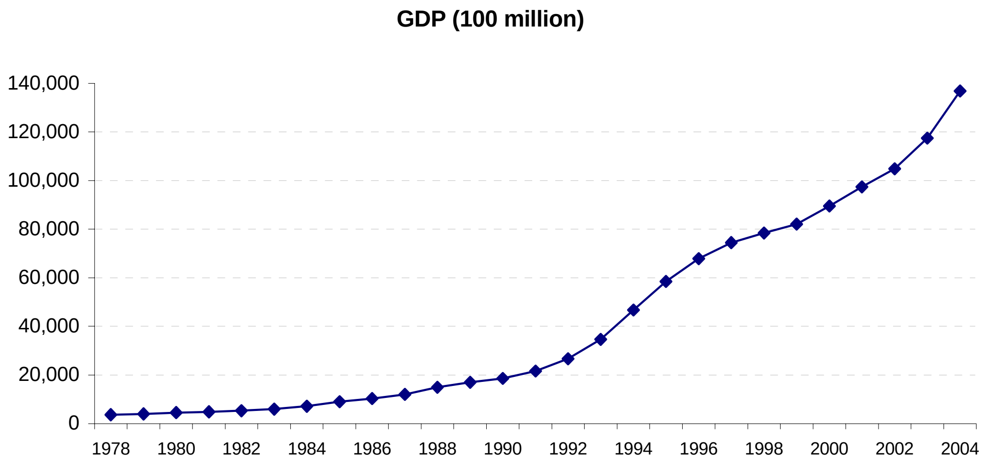
[1] Bureau of Statistics of China
[2] More information on the 10th Five Year Plan can be obtained from www.china.org.cn.
[3] China International Business, 2005 Business Guide.

On the domestic front, its gross domestic product (GDP) also grew at an admirable rate, averaging almost 10% a year since the late 1970s[4]. In 2004, China further strengthened and improved its macro control, and China entered its best ever developed period of recent years. The GDP for 2004 amounted to RMB13,687.6 billion, which is 9.5% higher than the previous year.

Figure 1. China's GDP since the start of its reformed economy



Source: Bureau of Statistics of China, China Statistical Yearbook

China's focus on international economic co-operation in recent years, and China's entry into the World Trade Organisation (WTO) in 2001 has also helped spur the economy to greater heights. China started to open its markets by reducing or eliminating import tariffs and quotas and relaxing foreign investment restrictions. Continued strong economic growth is to be expected with further liberalisation of its market, and the China's focus on economic reforms and upgrading of industries.

[4] The Economist Intelligence Unit, China Profile 2005.

Population of Major Cities

Almost all the major cities in China experienced population growth in the period of 1990 to 2003, except Beijing. Guangzhou, Wuhan, and Shijiazhuang rank in the top three of population growth rate over the period between 1990 and 2003 and the period between 2000 and 2003, partly due to the small base of the population and high speed of urbanisation.

On the other hand, Beijing exhibited a population decrease since 1995, and was the only city to show a negative growth rate over the 1990 to 2003 and the 2000 to 2003 periods. The high price of real estate is another reason that makes it difficult to settle down in Beijing, and thus has slowed migration from other rural areas.

Living standards in big cities are higher than in small cities. Beijing and Shanghai rank in top place in the rankings of the living expenses of the major cities in China. However the variety of opportunities in big cities attracts people pursuing a higher standard of life. Suburbs around the big cities are better developed than in the rural areas, though living standards are lower than those of the big cities.

Figure 2. Population of Major Cities: 1990/1995/2000-2003

	1990	1995	2000	2001	2002	2003
Beijing	10,860	12,510	11,075	10,742	10,288	9,655
Chengdu	9,195	9,716	10,134	10,234	10,329	10,447
Chonqing	29,209	30,018	30,911	31,079	31,276	31,491
Guangzhou	5,943	6,467	7,007	7,140	7,290	7,457
Harbin	8,835	9,373	9,346	9,421	9,505	9,604
Qingdao	6,563	6,866	7,067	7,113	7,166	7,212
Shanghai	12,834	13,014	13,216	13,299	13,388	13,499
Shijiazhuang	7,986	8,459	8,898	9,011	9,127	9,262
Tianjin	8,663	8,947	9,120	9,174	9,230	9,282
Wuhan	6,698	7,100	7,492	7,582	7,672	7,771
% urban households	22.87	26.46	30.75	29.21	28.23	27.71

Source :Euromonitor

Income

Although the incomes of the urban and rural residents have grown significantly since the opening up of China's economy, the disparity between urban and rural incomes has become increasingly pronounced as well. Figure 3 shows the per capita GDP by the different regions. The per capita GDP is generally higher in the eastern part of China, and much lower in the economically backward western areas of China.

Figure 3. Per Capita GDP by Region

Western China		Interior region		Coastal region	
Population, millions	83	Population, millions	710	Population, millions	482
GDP per capita, $	773	GDP per capita, $	765	GDP per capita, $	2,117
Share of national GDP	4%	Share of national GDP	38%	Share of national GDP	58%

Source: "Opportunities for SMEs in greater China", Australia

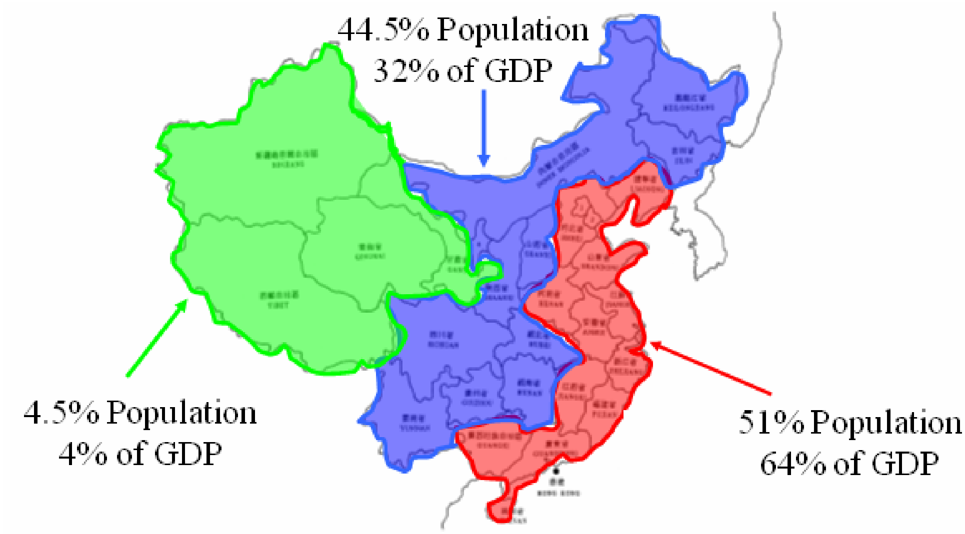
A survey by the Bureau of Statistics revealed that the top 10% of China's richest are enjoying 45% of the wealth, whereas, the bottom 10% are only enjoying 1.4% of the wealth. The same survey, which polled 54,000 urban and rural households, also revealed that China's richest 10% had disposable income 11.8 times greater than the lowest 10% at the end of the first quarter of 2005.

Figure 4. Per Capita Income for Urban and Rural Residents - Aggregate data (2003)[5]

Item	1978	1989	1997	2002	2003
Per Capita Annual Disposable Income of Urban Households (RMB)	343.4	1374	5160	7702	8472
Per Capita Net Income of Rural Residents (RMB)	133.6	601.5	2090	2475	2622

Figure 5 shows the unequal distribution of wealth across the different regions; the richer regions to the southern/eastern part of China hold 64% of the GDP, whereas the poorer regions to the western part of China hold only 4% of the GDP. Hence, the disparity in income shows up both across the different social groups as well as economic regions.

Figure 5. Geographical Spread of Wealth (GDP)



Source: Asian Demographics Ltd

[5] Bureau of Statistics of China

Expenditure

Per capita expenditure for the following regions as listed under Figure 6 is amongst the highest in China. These are regions located predominantly on the eastern coastal area of China. The average for living expenditure is RMB6029.88, with about 38% of that amount spent on food.

Figure 6. Per Capita Annual Living Expenditure of Urban Residents by Region (2002)[6]

Region	Living Expenditure (RMB)	Food (RMB)
Total	***6029.88***	***2271.84***
Beijing	10284.60	3472.08
Tianjin	7191.96	2607.00
Shanghai	10464.00	4120.20
Zhejiang	8713.08	3474.36
Fujian	6631.68	2881.20
Guangdong	8988.48	3460.44

Breaking down the living expenditure for urban households by their income levels, we see a proportional increase in their total living expenditure as their income increases. However, we see a reverse relationship when it comes to expenditure spent on food. Beyond the bottom 25% of the urban households, we actually see a decreasing percentage of their total living expenditure spent on food, due to their exponential growth in their income.

[6] Bureau of Statistics of China

Figure 7. Per Capita Annual Living Expenditure of Urban Households (2003)[7]

	Average	Lowest Income Households	Poor Households	Low Income Households	Lower Middle Income Households	Middle Income Households	Upper Middle Income Households	High Income Households	Highest Income Households
Total Living Expenditures (RMB)	**6511**	**2562**	**2237**	**3549**	**4558**	**5848**	**7547**	**9628**	**14516**
Living Expenditure for Food (RMB)	2417	1223	1087	1595	1926	2294	2763	3338	4333
Total Living Expenditures (%) - Food	37	48	49	45	42	39	37	35	30

3.2 Economic Characteristics

China embarked on a program to reform and open up its economy from the late 70s and transformed from a largely centrally planned economy to one which is more market-oriented, albeit a "controlled" version where the authorities continues to exercise close influence over important elements of the economy.

Key changes included the setting up of Special Economic Zones to allow local officials more autonomy to offer tax incentives to increase foreign trade and foreign investments; permitting a wide variety of small-scale enterprise in services and light manufacturing; switching to a system of semi-private household responsibility agriculture in place of the old communes; promoting the optimisation of resources; and linking domestic and international markets. Emphasis was also placed on foreign trade as a major vehicle for economic growth.

[7] Bureau of Statistics of China

The reformed economy also saw a change in the characteristics of the industry players. During the pre-reformed days, the main players were largely state-owned enterprises which slowly became inefficient and loss-making enterprises. The shift came after the late 70's where more collective enterprises, private entrepreneurs and foreign investors came on board.

China's economy is still largely dominated by industry and it is the world's largest producer of steel, coal, cement, fertilisers and a wide range of household appliances. Foreign investments were largely pumped into industries such as equipment manufacturing and electronic machinery.

However, the reformed economy showed disparate growth patterns with the coastal regions growing at a much faster pace than the interior provinces. The regions which grew at a much faster pace included Guangdong and the southern province of Guangdong (in particular the Pearl River Delta), Fujian, Shandong province and the north-east, and the Yangtze Delta. To address the issue, China started an initiative to draw local and foreign investments to the central and western parts of China. They met with certain success but the road ahead is a slow one as their efforts will be hampered by inadequacies of human resources and physical infrastructure.

An overview of the top 10 commercial cities at the end of 2004[8] is as follows:

- Shanghai – High commercial costs but remains the most dynamic economy in the Yangtze Delta and China.
- Beijing – Always the first choice for the head offices of many multi-national corporations, and stands to gain from business opportunities arising from Olympics.
- Shenzhen – A young city with extremely high economic growth rate, per capita income and labour productivity, coupled with efficient administration, and good economic policies and living environment.
- Suzhou – Multi-national research and development centres are attracted to this city for reasons of it being close to Shanghai.
- Guangzhou – A city that is at the forefront of China's economic reform policies, the key driving sectors are auto making, shipbuilding, exhibition and logistics.

[8] People's Daily Online, Top 10 commercial cities in Chinese unveiled, 6 January 2005.

- Hangzhou – As another major central city in the Yangtze delta, commercial costs is high, but it has other advantages in terms of commercial environment, human resources, and quality of life.
- Dalian – Known as the best commercial city in northeast China, it possesses favourable geographic position, environment, economy, human resources and infrastructure.
- Qingdao – A city that enjoys an advantages geographical position and urban environment, and has reasonable commercial costs and efficient governmental management.
- Ningbo – As one of China's most dynamic coastal cities, it is known for its high GDP, per capita income, flexible economic structure, export-oriented economy, and the business spirit of its locals.
- Chengdu – Faces strong competition from its neighbour, Chongqing, but holds the advantage of having first-class talents and a strong scientific and technological environment.

3.3 Trade

China's export reached US$593 billion in 2004, allowing the Chinese economy to overtake Japan to become the third-largest exporter in the world. The Economist Intelligence Unit estimates that 6.5% of the world's exports were made in China in 2004, up from 5.9% in 2003.

China's main export commodities are: machinery and equipment, plastics, optical and medical equipment, iron and steel.

Main export partners are: US 22.8%, Hong Kong 16.2%, Japan 12.4%, South Korea 4.4%, Germany 4% (2004).

China imported US$561 billion in 2004, increased 36% in comparison with 2003. In 2003 China became the world's second-largest oil importer and the Chinese economy is currently experiencing the world's highest rate of growth in oil consumption.

China's main import commodities are: machinery and equipment, oil and mineral fuels, plastics, optical and medical equipment, organic chemicals, iron and steel.

Main import partners are: Japan 16.1%, Chinese Taipei 10.9%, South Korea 10.4%, US 7.7%, Hong Kong 7.4%, Germany 5.4% (2004).

FTAs are part of China's long-term strategic plans as they reduce the cost of trade and help China-based companies improve their access to much needed raw materials and equipment. China's FTA summary is as follows:

Concluded:
- CEPA - Hong Kong and Macao
- ASEAN - China FTA

Ongoing:
- Australia - China
- New Zealand - China
- Pakistan - China
- India - China
- Gulf Co-operation Council - China
- Chile - China

In addition to the above, China recently called on Japan and Korean to fast-track a study on a possible three-way FTA.

3.4 Investment Environment

With US$153.5 billion contractual FDI and US$60.6 billion utilised FDI, China remained the world's top destination for foreign direct investment in 2004. In order to create a favourable investment environment and to encourage overseas firms to invest in China, China gradually set up a relatively complete legal system, and constituted a foreign investment policy system, which mainly includes industrial policies, regional policies, tax policies and financial polices.

However, in respect of ease of doing business, China is in the 91st place among

155 economies according to World Bank.

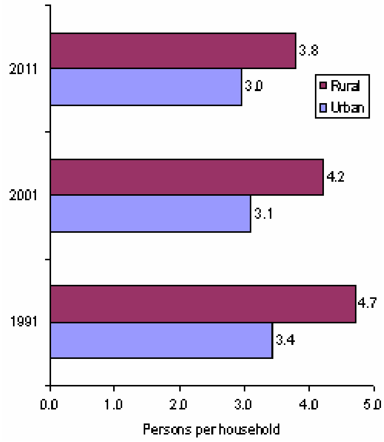
China's transportation system has undergone considerable improvement especially for highway and civil aviation. China is spending billions of dollars to modernise and expand railways, highways and seaports to relieve the pressure following the booming trade and raising pace of urbanisation. All services in telecommunications industry saw a big increase in terms of the number of users/subscribers over the last six years. Energy shortage and water shortage, however, are problems China is facing.

As to intellectual property right, although China has a relatively sound law protection system, to control the infringement of intellectual property is still a long way to go.

3.5 Family and household structure

The average family size in 2000 was 3.44 people, down from 3.96 in 1990. The trend in average household size shows that there is steady movement to smaller households. According to the current estimates by Asian Demographics Ltd, the urban household size will decline from 3.1 persons to 3.0 persons by 2011 and rural household size will decline from 4.2 persons to 3.8 persons by 2011.

Figure 8. Family Size: 1991-2011



Source: Asian Demographics Ltd

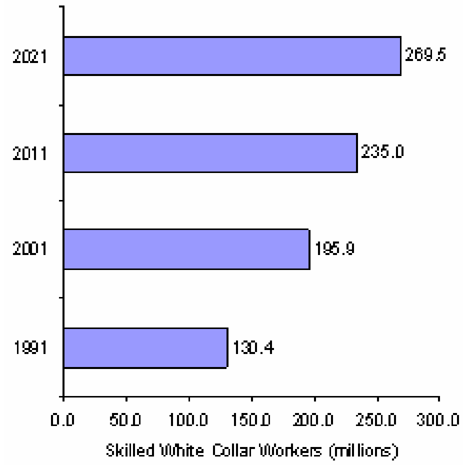
On average, the number of employed persons per city household was 1.58 and number of able-bodied and semi-able-bodied labourers per rural household was 2.76 in 2002.

Rural residences accounted for 60.91% in 2002 while urban residences increased from 27.46% in 1992 to 39.09% in 2002. Thousands leave the countryside, where unemployment and underemployment prevail, to find employment in the cities. The rapid socioeconomic development has greatly quickened China's urbanisation process.

Chinese people are better educated than before. The number of illiterate and semi-literate people had fallen to 11% of the total population over 15 years of age by 2003. Number of universities and institutions of higher education increased from 1,075 in 1990 to 1,552 in 2003 and student enrolment was 11.1 million in 2003 in comparison with 2.1 million in 1990.

The skilled white collar segment which represents better educated and higher income people has a high growth in absolute numbers. It will reach 235 million in 2011 increasing at CAGR of 1.8% from 2001 to 2011.

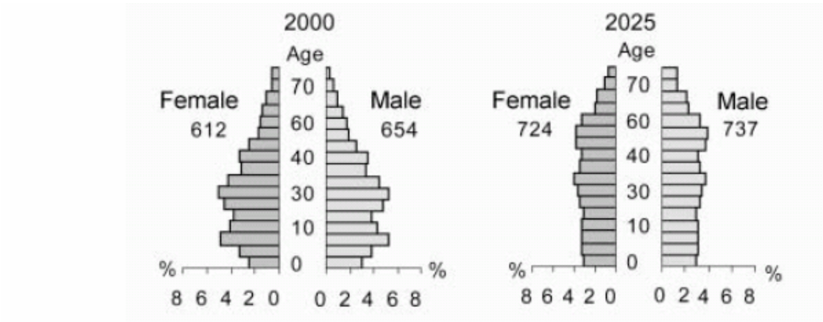
Figure 9. Number of Skilled White Collar Workers: 1991-2021



Source: Asian Demographics Ltd

Largely owing to the one-child policy and improved health and medical care services, Chinese population is ageing. The fifth population census results show that big changes have taken place in the population's age composition. The number of people aged between 0-14 was 22.89% of the total population, 4.8 percentage points down from the rate of the 1990 population census. The number of people aged at and over 65 accounted for 6.96% of the total population, up 1.39 percentage points. According to the World Bank, the proportion of China's population aged 65 and over will rise from 9% in 1990 to 22% by 2030. In the late 1990s every retired person was supported by ten workers. By year 2020 this ratio will have fallen to 1:6, and by year 2050 to 1:3.

Figure 10. Population's Age Composition: 2000-2025



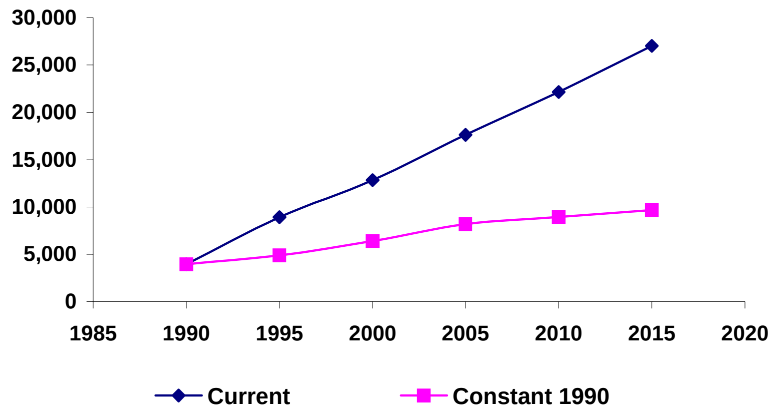
Source: China's fifth population census

Mean disposable household income witnessed a sharp increase of 224% over the period from 1990 to 2000, reaching RMB12,825 per household. This is partly a reflection of the economic boom in China.

Backed up by the increase of income, the standard of living has changed significantly for many households and the emergence of the Chinese middle class.

Figure 11. Mean Disposable Household Income: 1990-2015

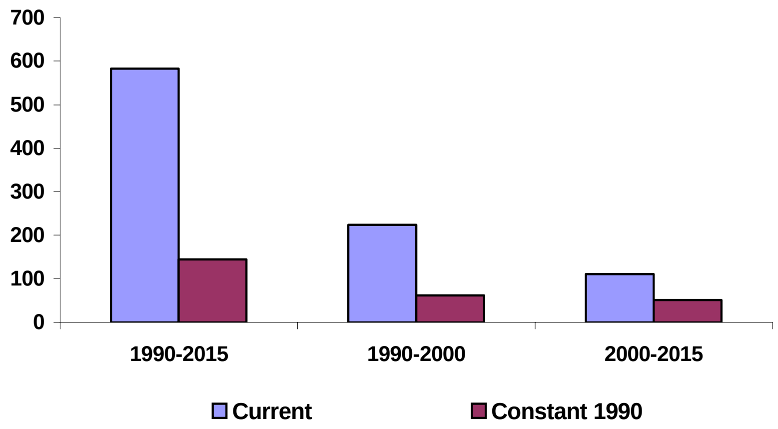
RMB per household



Source: Euromonitor

Figure 12. Mean Disposable Household Income (Growth): 1990-2015

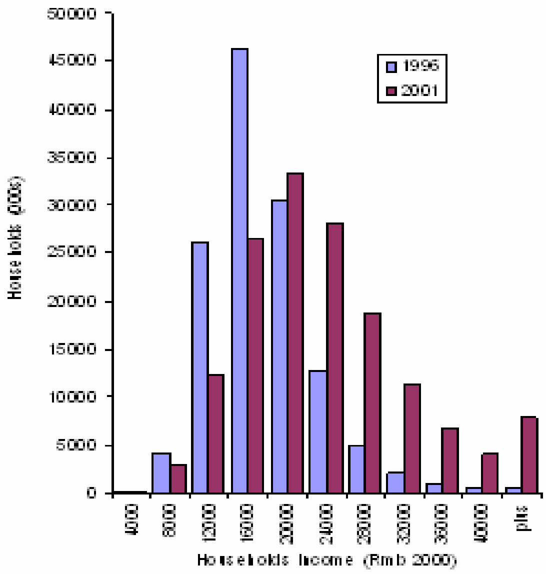
% change



Source: Euromonitor

The number of middle class (RMB 20,000 to 40,000 pa 2000 values) households grew from 21.3 million in 1996 to 69.2 million in 2001 with a growth rate of 26.5% per annum. At the same time the affluent (40,000 +) grew from 69,000 to 1.49 million households.

Figure 13. Household Income Structure: 1996-2001



Source: Asian Demographics Ltd

3.6 Food and Beverage Sector

It is not surprising that populous China has a huge food consumer market with revenue estimated at US$81.3 billion in 2000. Out of this, the food services sector accounted for over 61%, followed by food wholesale at 25% and food retail at 14%.

China's food service sector has been experiencing a CAGR of 12.9% from US$45.3 billion in 2000 to US$73.3 in 2003. Demand however appears to be concentrated in selected regions. The top 8 regions that contributed to the food service turnover for the whole Chinese economy include Guangdong, Shangdong, Jiangsu, Zhejiang, Sichuan, Liaoning, Henan and Hubei. These regions, in particular the coastal provinces such as Guangdong and Jiangsu, have a strong dining-out culture.

Broadly, the food service sector can be segmented into full-service restaurants, fast food outlets and others.

- Restaurants are the largest segment accounting for over 77% of the total market revenue. Largely, this segment could be sub-divided into:-
    - High End Restaurants - Located in hotels; both International Hotel Chains (e.g. Hilton, Shangri-la, Hyatt, etc.) and Domestically-Managed Hotels (typically 4 and 5 stars and is dominated by State-owned Enterprises).
    - Family style restaurants – These restaurants are growing rapidly on the back of the expanding cohort of middle class Chinese.

- Fast-food restaurants account for about 22% of the total market for food services and this segment is dominated by foreign chains such as KFC and McDonald's. Chinese fast food companies whilst smaller in aggregate are growing at rapid pace. The more prominent ones are Malan Lamian, Mian Dian Wang, Yong He Da Wang, and Laobian Dumplings.

- Others would include corporate catering, such as those in China-owned enterprises, offices, schools, hospitals, which account for 1% of overall market revenue.

In terms of the total number of F&B establishments within the food service sector, there were 3.6 million units throughout China by end 2003 involved in transactions amounting to 41.5 billion RMB in the same year. It represents a jump in 5.5% and 10.3% respectively as compared to the previous year, and a 25.1% and 43.9% increase from five years ago.

Figure 14. Units, Transactions and Value Sales in Consumer Foodservice: 1999-2003

	1999	2000	2001	2002	2003
Units	2,871,765	3,018,980	3,204,070	3,405,276	3,592,242
Transactions (million)	28,835	31,153	34,145	37,643	41,506
Value sales in RMB million (current prices)	760,243	796,462	839,213	887,296	933,639
Value sales in RMB million (constant prices)	760,243	794,434	833,215	888,058	932,576

Source: Consumer Foodservice in China, Euromonitor May 2004

Figure 15. Units, Transactions and Value Sales in Consumer Foodservice: 1999-2003 (% Growth)

	2002/2003	CAGR (1999-03)	TOTAL (1999/03)
Units	5.5%	5.8%	25.1%
Transactions	10.3%	9.5%	43.9%
Value current prices	5.2%	5.3%	22.8%
Value constant prices	5%	5.2%	22.7%

Source: Consumer foodservice in China, Euromonitor May 2004

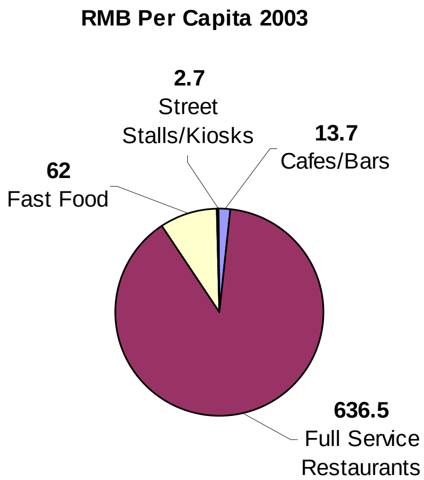
Eating Out[9]

Expenditure on eating out for Chinese people has increased significantly over the period between 1999 and 2003 due to growing time pressure and longer hours at office. Expenditure in cafes/bars and on fast food has each shown particularly sharp increases of 95%. Expenditure on full-service restaurants and street stalls also increased over this period.

With increased incomes, eating out is becoming more and more common for the Chinese. In the past, most people ate out only during special occasions but today, many people eat out only on account of convenience. Generally for the youth, time saved from preparing meals outweighs the added cost of eating out.

The fast food sector has deeply influenced the eating habits of the Chinese. This has become a common sight today especially amongst the youth. Takeaway food has become a major eating habit for young people who have great work pressures and look at saving time.

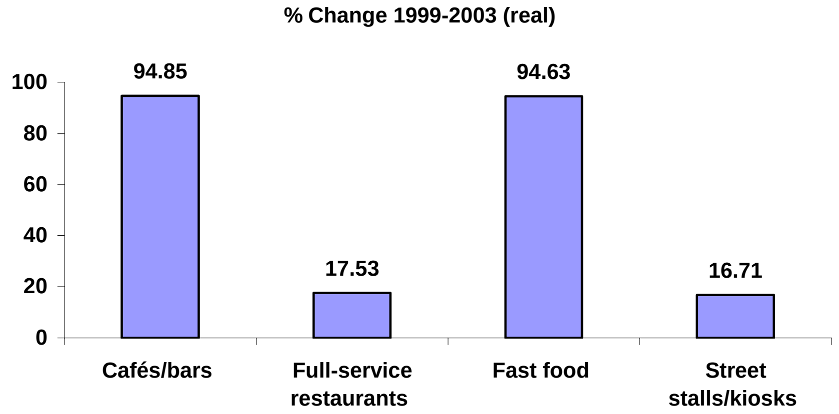
Figure 16. Expenditure on Eating Out by Sector: 2003 (RMB Per Capita)



Source: Euromonitor

[9] Euromonitor, from trade sources.

Figure 17. Expenditure on Eating Out by Sector: 2003 (RMB Per Capita percentage change)



Source: Euromonitor

In large and medium-sized cities, 80%-90% women in working age are employed or self-employed. They may have less time and energy to prepare dinner after work. Even though most families prefer to have dinner at home if they have time, eating out is becoming more and more common especially for dual-income families because of the work pressure.

4. Franchising in Food & Beverage Services Industry

4.1 Local Franchises

Franchising of local brand first began in the late 1980s as a result of the open door policy. Some of the state-owned enterprises, who already had a well-established brand names, attempted to develop through franchising. Unfortunately, all efforts were unsuccessful. In 1995, local franchises started to grow by benchmarking the practices and management skills of foreign franchisors and franchisees who had operated their business for a number of years.

4.2 Foreign Franchises

Many foreign franchising organisations planned to enter China after the introduction of open door policy. However at that time they generally started their business through joint ventures with Chinese partners rather than franchising because of limited knowledge of the market, concerns of risks and restrictions. This helped them expand through franchising more successfully later by accumulating relevant experience.

In recent years, more and more foreign franchisors have started franchise business in China such as KFC, McDonald and Subway etc. The method of entry for foreign franchisors are either appointing master franchisee or setting up corporate office.

4.3 Number of Franchise Systems

In 2004 there are 2100 franchise systems in China while F&B accounts for 31.6%. That means there are about 664 F&B franchise systems. According to the survey done by CCFA, more than 60% of chained F&B companies are having or going to have more than 1 brand especially Chinese full service restaurants, Chinese fast food and hot pot sectors.

4.4 Number of franchise outlets/establishments

In China the number of enterprises above designated size in catering service is increasing and domestic funded enterprises are still the majority.

Figure 18. Basic Conditions of Enterprises above Designated Size in Catering Services by types of Registration[10]

Item	No. of Corporation Units in 2002	No. of Economic Active Units in 2002	No. of Corporation Units in 2003	No. of Economic Active Units in 2003
Catering Services	5021	7424	5935	8908
Domestic Funded Enterprises	4375	6060	5277	7363
Enterprises with Funds from Hong Kong, Macao and Chinese Taipei	391	707	385	829
Enterprises with Foreign Investment	255	657	273	716

Source: Bureau of Statistics of China

According to China's Bureau of Statistics, the number of company-owned chained outlets[11] with local fund is 573 accounted for 23.23% of total company-owned chained outlets. The number of franchised F&B outlets[12] with local fund is 2397 in 2004, accounted for 92% of total franchised outlets, 4.6% up from 2003. The total sales income for these franchised outlets is RMB9.14 billion in 2004 up 45% in comparison with that in 2003.

The number of company-owned chained outlets[13] with funds from Hong Kong, Macao and Chinese Taipei is 329 accounted for 13.34% of total company-owned chained outlets. The number of franchised F&B outlets[14] with funds from Hong Kong, Macao and Chinese Taipei is 136 in 2004, accounted for 5.21% of total franchised outlets, 115.9% up from 2003.

[10] number for those annual sales income at and over RMB2 million in 2004 and year-end employees at and above 40.

[11, 12, 13, 14] number (Tibet's number is not available) for those annual sales income at and over RMB2 million in 2004 and year-end employees at and above 40.

The number of company-owned chained outlets[15] with foreign investment is 1565 accounted for 63.44% of total company-owned chained outlets. The number of franchised F&B outlets[16] with foreign investment is 76 in 2004, accounted for 2.91% of total franchised outlets, 100% up from 2003.

4.5 F&B Franchising in China

Though the concept of franchising in China began in late 1980s, it has since become one of the fastest growing business areas in China. According to statistics issued by the China Chain Store & Franchise Association, by 2004, there were about 2100 franchise systems and 120,000 franchised outlets operating in China engaged in nearly 60 business sectors. Every franchise system has 57 franchised outlets on average.

[15, 16] number (Tibet's number is not available) for those annual sales income at and over RMB2 million in 2004 and year-end employees at and above 40.

Figure 19. No. of Franchise Systems and outlets

Year	Total # of franchises systems	Total number of franchise outlets
2000	410	NA
2001	800	32000
2002	1200	45000
2003	1900	87000
2004	2100	120000
CAGR (01-04)	38%	55%

Source: CCFA

China has the most franchise systems in the world while the number of average franchise outlets (57 outlets17) for each system is far less than more developed economies like US.

According to the sample survey done by CCFA, currently, one single franchise outlet hires about 20 people, with an investment of about RMB500,000 and an annual sales revenue of about RMB2,500,000.

Some development characteristics of Chinese franchise companies are as follows:

1) The franchise network has become more stable. According to the survey, annual operating income of franchise outlet increased by 38% in 2004, which is the same growth rate as outlet numbers. 92% of franchisors set the tenure of agreement to be more than 3 years and contract renewal rate is 88%, 3% higher than that in 2003.

2) Company-own outlets grow in a faster rate while the development of franchise outlet slows down. In order to maintain the brand's image and to keep the operational quality of the franchise system, franchisors have provided more support and service to their franchise outlets however the franchise fees are relatively low. For many franchisors, franchise fee

[17] "Blue Book of Franchise in China" China Chain Store & Franchise Association

accounts for less than 1% of their total income. Majority companies collect a set amount as the royalty fee. The cost to keep the franchise business running is growing which leads to lower output in franchise outlet than in company-own outlet provided the inputs are the same.

3) Franchisors have made great improvement in their training capacity but central distribution is still an area needed to be improved.

4) There are some problems in internal management. Improvement is needed for many franchisors in their promotion concept, R&D capacity and product standardisation. Lack of effective support and management in on-going business gives competitors a chance to imitate. There are many such cases that franchisees delay or deny to pay initial base fee or royalty fee. Franchisors are always in the circle of opening outlets, closing outlets and trying to collect overdue bills.

According to the report issued by WTO, the global service export amounted to US$2.1 trillion. Ranked the eighth and the ninth place respectively, China's service import was US$69.7 billion and export was US$58.9 billion. The trade deficit in service industry was US$10.8 billion. Among them the import and export of patent licensing fee and patent royalty fee were US$4.49 billion and US$236 million respectively with a gap of US$4.26 billion. China has become an important import economy for international franchise brands and a fast growing part of global franchise market.

On the other hand, local enterprises who have independent IPR with local culture elements and high recognition are venturing out by franchise. Malan Lamian and Daniang Dumpling are some of these examples.

The market segments which are generally regarded as providing the greatest potential for foreign franchisors are the F&B concepts and retail industries. According to Blue Book of Franchise in China the number of F&B franchises is about 664 and accounts for 31.6% of the total franchises.

The rapid growth of F&B franchises are attributable to

- huge success of giant foreign franchisors like McDonalds, KFC and Pizza Hut has inspired the interest of many; both local and foreign franchisors
- a rapidly expanding middle class, particularly though in coastal provinces where there is a strong culture of dining out
- China's growing breed of Chinese entrepreneurs who have the business acumen to run, and more importantly the financial capital to invest in a franchise, and F&B is considered as less complex business. Franchising makes up for some commercial inexperienced Chinese franchisees with strong sources of funding by linking their investments to completed training within a well-tested operating system.

A foreign franchisor has commented that having a recognised brand name, a track record of successful franchisees around the world, a time-tested operational system and manual, and a strong support infrastructure **may not be good enough** to convince the Chinese to purchase individual franchises.

The typical problem encountered in selling franchises in China was the different understanding of franchise concept. In the United States, franchising is a familiar, well-established practice. Most franchisees there accept the premise that there is value in the name, experience, and support of a franchise and are willing to pay a franchise fee and royalties to get the right to take advantage of a franchise system's offerings.

Most US franchisees know that in the United States, owners of small businesses that are a part of franchise systems are more successful than those operating independently. However, as a fast expanding economy, China has great business potential everywhere including market for independent small businesses.

To many potential franchisees in China, franchising is an abstract concept and they do not see the benefits set forth above a significant franchise fee and royalties. They generally regard that the purchase price of a franchise should include machinery, technology, goods, or services that are unavailable through any other means. If all these that the franchise offers are otherwise available, would-be Chinese franchisees will usually draw a conclusion that they are better off starting their own independent small business.

However, this conclusion can be overcome under the condition that:

- the franchise brand name is already famous in China. Potential franchisees will see added value in paying a franchise fee and royalties. On the other hand, Chinese franchisees will not usually see the value in paying franchise fees and royalties for world-famous brand names that are unknown in China.
- the franchise already has a significant presence in China in the form of a good support system such as staff, Chinese-speaking personnel, and Chinese-language operational materials. With all these, franchisees will feel that the franchise system has a better chance of succeeding. Chinese franchisees generally do not believe strong overseas franchise support systems to be very useful.
- the franchise has successful company-owned stores in China. Franchisees will be more willing to consider purchasing such a franchise. Most potential franchisees in China do not necessarily view success in oversea market as an indication that the franchise will succeed inside China. Successful company-owned flagship stores in China may give potential franchisees confidence that a particular franchise concept works in China.

According to the survey on chained F&B companies done by CCFA, in 2004 the average turnover in company-own outlets increased by 37.23%, while turnover in franchise outlets grew by 25.89%. Both of these numbers are bigger than the average growth rate for F&B industry (21.6%). About 80% of the responded chained F&B companies have no more than 10 company-own outlets. More than 50% of them have no more than 50 franchise outlets. Besides normal franchise fee (initial base fee, royalty fee and management fee), guarantee fee is also a kind of payment collected by franchisors. Nearly 70% of responded companies require guarantee fee. In China, most F&B franchisors use individual franchising instead of master or regional franchising.

4.6 Recent changes in franchising regulatory environment

In the early days, China franchising industry experienced a period of disordered development. Some franchisors defrauded franchisees of money and some franchisees delayed payments to the franchisors or infringed on their intellectual property rights.

On December 30, 2004, the Ministry of Commerce (the "MOFCOM") of China published the *Measures for the Administration of Commercial Franchises* (the "Measures"). The Measures became effective on February 1, 2005, replacing the 1997 *Interim Measures of Administration of Commercial Franchise Operations* (the "Interim Measures").

The measure outlines the requirements and obligations of the franchisor and the franchisee. It defines more clearly the way foreign brands operate franchise business in China.

According to Faegre & Benson LLP, The following is what foreign franchisors need to know about the Measures:

Two Franchise Models. The Measures permit a franchisor to grant either a master franchise or individual, direct franchises, allowing in each case the franchisee to sub-franchise in China.

Franchisor Qualifications. The Measures specify certain qualifications for undertaking franchise arrangements in China. Most notable for foreign franchisors wishing to roll-out franchises within China is the requirement that a foreign or FIE franchisor has operated, for over one year, at least two directly-operated franchise businesses (or stores owned by its subsidiary or holding company).

Franchise Term. The Measures provide that the duration of a franchise agreement should normally be no less than three years.

Information Disclosure. A foreign or FIE franchisor is required to provide any prospective franchisee, at least twenty days before execution of any franchise agreement, with a draft of the franchise agreement and written materials containing a variety of specified information relating to the franchise operation. This required disclosure includes: background information on the franchisor; the franchisor's audited financial statements; information about existing franchisees; and information regarding all relevant litigation during the preceding five years.

The Measures also grant a private cause of action to a franchisee for any economic losses caused by a franchisor's misrepresentation or omission in connection with such disclosure.

Confidentiality. An obligation is imposed on franchisees to keep their franchisors' trade secrets confidential, both during the period of the franchise agreement, and following its expiration or termination. In addition, confidentiality obligations are imposed on prospective franchisees which receive trade secrets as part of the pre-contract disclosure process.

Trademarks and Trade Names. Unlike the U.S., China has a "first-to-register" trademark system that requires no evidence of prior use or ownership, leaving registration of popular foreign trademarks open to anyone. It is imperative that any foreign franchisor considering establishing a franchise in China take immediate steps to register its trademarks and trade names with the relevant Chinese authorities. A failure to do so can have devastating consequences. Franchisors should also register their trademarks and trade names as domain names.

Without implementing a proactive trademark registration plan in China, problems may also emerge after a franchisor terminates a relationship with its franchisee: the franchisee sometimes continues using the franchisor's proprietary trademarks by registering the trademark for its own business and offering similar services or products, either directly or indirectly. This can occur because China has two separate systems for the registration of trademarks and trade names. Trademark registration with the People's Republic of China Trademark Office is valid across the whole Chinese economy. Trade name registration, however, is with different levels of business registry offices and applies only to the jurisdiction of the local registry office.

The Measures require that a franchisor must possess trademarks, trade names, and other economic resources which it may legally authorise franchisees to use. The Measures also stipulate that after a franchise agreement expires, the franchisee must not use the franchisor's trademark or trade name without authorisation, or register the franchisor's trademark as a trademark or a trade name.

Finally, a franchisor must register its trademark license before the franchising operations commence. If the franchise business will utilise patents, the franchisor similarly must enter into and register in China a patent license.

Franchise Fees. The Measures explicitly permit franchisors to collect the following types of fees from franchisees: one-off initial franchise fees, periodic operational fees, and other fees as agreed in the franchise agreement for the supply of goods and services.

Reporting. Each January, franchisors are required to file with the local regulatory authorities a report containing information on franchise agreements signed during the previous year.

FIE-Specific Requirements. In addition to these general requirements, FIEs must obtain specific approval to engage in franchise activities. As part of the approval process, a FIE is required to submit to its original approval authority documentation evidencing the FIE's compliance with the franchisor qualification requirements imposed by the Measures. FIEs are also required to submit the written disclosure documentation which must be provided to franchisees. FIE franchisors must further report to both the local commerce regulatory authority and its original approval authority each January specified information regarding its franchising operations during the previous year.

"Amnesty" for Existing Franchises. The Measures provide an "amnesty" for those FIE franchisors offering franchises in the PRC prior to the adoption of the Measures. Provided that their franchising operations have not been conducted in a fraudulent manner, a form of amnesty is offered to these FIEs whereby they are required to file a report of their franchising operations and undertake the approval procedures described above to expand their business scope, as applicable.

Penalties for Non-compliance. Franchisors or franchisees that fail to satisfy the qualification requirements may be required either to remedy the non-compliance, or pay a fine of a maximum of RMB 30,000 (approximately US $3,625), or both. In addition, in circumstances where the violation is considered sufficiently serious, the business license of the offending party may be cancelled by the Administration of Industry and Commerce.

Conclusion; Practical Options and Considerations There remains a great deal of uncertainty regarding how the Measures will work and be implemented over time. We will continue to monitor and provide updates regarding developments in China, particularly as the Chinese authorities settle upon uniform policies and procedures for implementing the Measures and as the expected supplemental franchise legislation is finalised and made public.

For full contents of the measures, please refer to the website of MOFCOM or the following:

http://landwant.com/ENGLISH/leg/ASP/mailshow_en.asp?year=2005&month=02

According to some articles, with the promulgation of the measure the franchise market tends to be more regulated; the rights of franchisees and franchisors are better protected; franchise business may develop more orderly and healthily. At the same time, some criticised the measure as being too strict such as: both franchisor and franchisee must be an enterprise or other economic entity duly organised under the laws and regulations.

The measure is the guideline for franchise market however the coming formal legislation - tentatively entitled the "Commercial Franchise Regulation" which remains pending will be enacted into law.

The application of other Chinese laws, namely:

- The General Contract Law as it may apply to the relevant franchise agreement
- The Trade Mark Law with respect to registration of the franchisor's trade mark

- Labour Regulations to ensure that the franchisor can conduct its business as intended
- Land Use Rights with respect to leasing rights and obligations for specific sites

4.7 China Chain Store and Franchising Association

3F Zhong Ya Tower,
No. 8 Beifengwo, Haidian District,
Beijing, P.R. China 100038
Tel: (86-10) 51916555
Website: www.ccfa.org.cn

China Chain Store and Franchise Association (CCFA) is the unique representative of China retailing and franchise industry. Its aim is to drive the expansion of chain store industry in China.

CCFA has group members and individual members. Group members comprise domestic & overseas retailers, franchisors, suppliers all over the China. Individual members are those store managers, well-know experts and journalists.

In 2004, the number of its group members reaches over 650. As an important part, retailer members' sales amount to RMB400 billion, account for 10% of the Total Retail Sales of Consumer Goods (TRSCG). The main target and service providing to its members are representing the interest of chain store industry, safeguarding the legality rights of its members and building an impartial competitive environment by policy suggestion etc. CCFA also delivers relevant knowledge and training about chain store and franchise industry. It bridges the cooperation between retailers and suppliers, franchisors and franchisees through China Retail Industry Convention (CRIC), China Chain Store Exhibition (CCSE), and China Franchise Exhibition & Convention. CCFA also makes industry statistics and specific survey.

5. Opportunities for Franchisors

5.1 Overview of China's Foodservice Sector

China's consumer foodservice market has been enjoying sustained growth over the last few years. This growth is expected to continue over the next few years especially with China's rapid economic development, their membership into the WTO, changing lifestyles, growing middle class, rising consumer education and sophistication levels and related rising consumer affluence levels.

Within the consumer foodservice market, the three sectors touted to be the next fastest growing sectors are cafes/bars, fast food, and full service restaurants (FSR).

Figure 20. Growth Potential of the Foodservice Market (By Sector)

Food Sectors	Growth Potential
Full Service Restaurants (FSR)	• In terms of market size[18], FSR is the largest in 2003 at 76%. • The number of independent FSRs outnumbers chained FSRs by about 400 to 1, but the chained FSRs are outgrowing the independent FSRs in terms of growth rate for both market size and value. • Traditionally targeted at the older household markets, as well as the high-end businessmen, this demographic group is set to grow with the increase in ageing population and increased economic activities. • Novel dining concepts, ethnic food, western and foreign cuisine are the noted trends in this sector. Chinese residents are looking more towards western and foreign cuisine, whereas international tourists are looking more towards ethnic and Chinese cuisine. • Food quality, top-of-the-range products, and branding continue to be the focus for FSR players.
Fast Food	• In terms of market size, fast food is the second largest in 2003 at 22%. It was worth RMB81 bn in 2003, an increase of 17% since 2002. • Largely a fragmented sector with independent fast food units accounting for 72.5% share in market value[19]. However, chained fast food gained a growing share in terms of units and value in recent years. • With higher globalisation and more exposure to Western influences, the younger generation, the working

[18] Market size refers to the number of units.
[19] Market value refers to the actual spending by consumers.

	professionals and the well-travelled are getting increasingly attracted to Western fast food chains. • Chains with impressive brand culture tend to do better in this segment. • Price, packaging, speed and friendliness of service, healthy food choices, and branding will play an important role in the future of this sector.
Cafes/Bars	• Though China is traditionally a tea-drinking society, coffee drinking is slowing catching on, especially among the younger generation, the working professionals, and the well-travelled. • Though small in numbers in terms of number of shops, specialist coffee shops demonstrated the strongest performance in 2003. • Growing trend towards a healthy lifestyle and keeping fit has also fuelled the growth of tea houses, making the next fastest growing sector in 2003 after specialist coffee shops. Continued strong levels of growth are expected for tea houses. • Although independent cafes/bars are much larger in terms of market size and market value, the chained cafes/bars are the ones growing at an exponential rate. The CAGR for chained cafes/bars from 1999 to 2003 is 73.9%, whereas the CAGR for independent cafes/bars for the same period is 18.1%. • Cafes/Bars players continue to focus on keeping prices low, while enhancing other aspects like product quality and variety, brand image, positioning strategy (e.g. music) and the environment/ambience.

The global shift by consumers towards convenience food, environmentally-friendly food, healthier food, brand image and sophisticated & hygienic packaging for food products is not lost on China as well. The table above shows that the key driving forces behind China's foodservice market in the future is in line with global trends as well. Chained outlets with a focus on building their brands and products will also be a key driving force.

The growth potential of the sectors however varies from region to region, depending on the consumption and spending habits of the residents, and on the maturity level of the F&B market. It would be prudent for the F&B players to have a thorough understanding of their own target markets, as well as each region's demography and supply and demand for foodservices, before they enter the Chinese market.

5.2 Analysis of opportunities by regions

To assist us in analysing the F&B opportunities by the different regions in China, we divided the geography of China into the Eastern/Coastal region, the central region and the western region. The Eastern/Coastal region consists of Beijing, Fujian, Guangdong, Guangxi, Hainan, Hebei, Jiangsu, Liaoning, Shandong, Shanghai, Tianjin and Zhejiang provinces. This region is predominantly more affluent than the other regions as it has the highest average GDP per capita at RMB18,931 and average disposable income at RMB10,151. The residents in the Eastern/Coastal regions also tend to spend more on food and on meals taken outside their home.

The central region consists of Anhui, Heilongjiang, Henan, Hubei, Hunan, Inner Mongolia, Jiangxi, Jilin, and Shanxi provinces, and the western region consists of Chongqing, Gansu, Guizhou, Ningxia, Qinghai, Shaanxi, Sichuan, Tibet, Xinjiang, and Yunnan provinces. As to be expected, the economically backward western region with its hinterlands has the lowest average GDP per capita at RMB6,493 (which is only about one third of the eastern region's average GDP per capita).

Figure 21. Demand of Food Services in Different Regions

Region	Total Population (100,000 persons)	Total GDP (100 million RMB)	Average GDP Per Capita (RMB)	Average Disposable Income (RMB/ person)	Average Expenditure on food (RMB/ person)	Average Dining Out Expenditure (RMB/ person)
Eastern	5,348	82,019	18,931	10,151	2,878	540
Central	4,521	35,451	8,292	7,034	1,944	293
Western	2,969	18,069	6,493	7,203	2,272	395

Source: Bureau of Statistics of China, China Statistical Yearbook 2004

With respect to the supply of food services, the figures below show that the eastern region is generating the highest retail sales volume at RMB29.5 billion. It also has the highest average number of restaurants operating as a chain at 408, which is more than triple the average number of restaurants for the central and western regions. However, this also means more intense competition within the developed eastern region in the F&B industry.

Figure 22. Supply of Food Services in Different Regions

Region	Retail Sales for catering services (100 million RMB)	Average no. of Chained Restaurants[20]	Company-owned Outlets[21]	Franchised Outlets[22]
Eastern	295	408	302	106
Central	178	112	50	62
Western	101	112	34	78

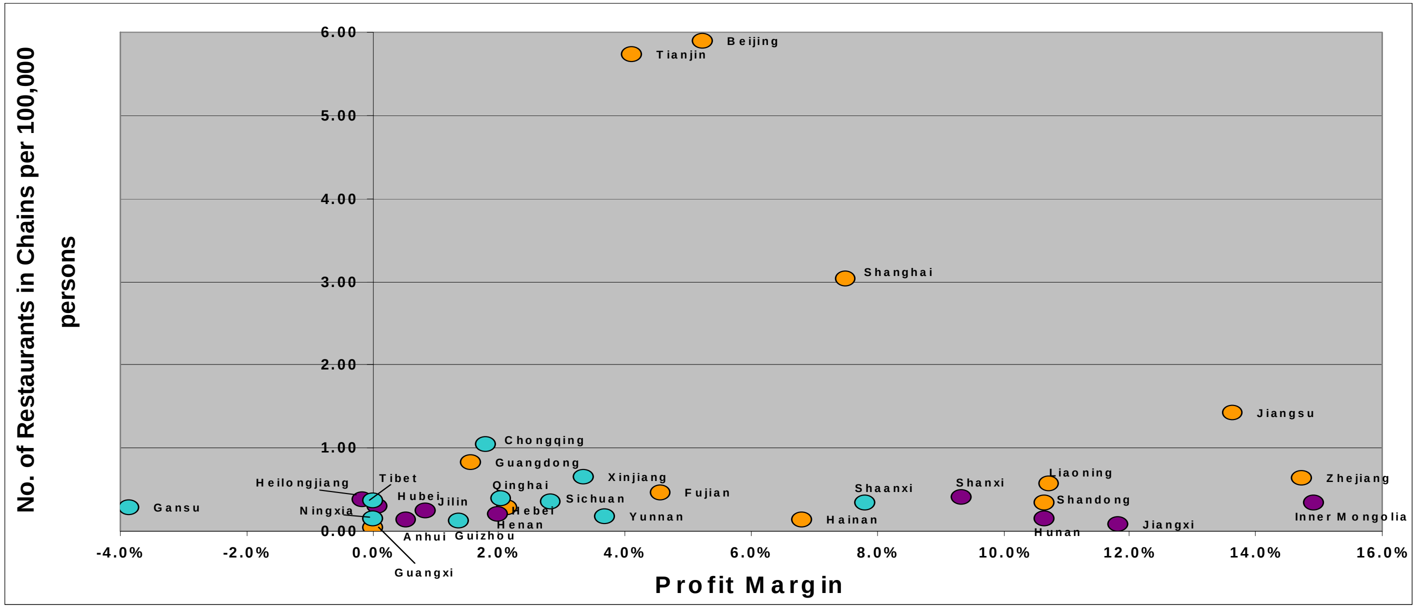
Source: Bureau of Statistics of China, China Statistical Yearbook 2004 & Statistical Yearbook of China Restaurants in Chain, China Statistics Press

Comparing the regions at a deeper level across all the 31 provinces[23], we see that the leading provinces, Beijing, Tianjin and Shanghai, have a more mature F&B market in terms of the number of chained restaurants serving the population. However, their profitability is below average, faring far worse than provinces like Zhejiang, Jiangsu and even Inner Mongolia. One contributing factor to their low profitability is the high cost of operations (e.g. rental, labour) and intense competition associated with Tier One cities like Beijing and Shanghai. Hence, although these metropolitan cities/provinces are often popular choices for F&B operators looking to expand into China due to their upmarket factor, one must calculate their sums carefully to ensure sustainability of their businesses.

[20, 21, 22] Number (Tibet's number is not available) for those annual sales income at and over RMB2 million in 2004 and year-end employees at and above 40.

[23] Refer to appendix for more details on the 31 provinces.

Figure 23. No. of Restaurants in Chains and their Profitability (by region)[24]



Source: Bureau of Statistics, China

[24] Provinces in orange-coloured bubbles are from the eastern/coastal region, those in purple are from the central region, and those in blue are from the western region. Guangxi, Ningxia and Tibet have a default "zero" for their profit margins due to unavailable data for these provinces.

On the whole, more than 80% of the provinces still have a lot of room for existing restaurant chains to expand or for new F&B brands to penetrate into the market. The majority of them are second tier provinces within the eastern regions, and cities/provinces within the central and western regions. Some of the provinces like Liaoning even have high profitability levels for its F&B restaurant businesses, and make good starting grounds for businesses.

Different business owners adopt different strategies when it comes to location selection for their operations. Some insists on tier one cities because of brand equity issues, while others prefer second tier cities for the less intense competition they will face. Both strategies can succeed provided proper planning is conducted. These are explained in detail in the next chapter.

6. Business Considerations in Running Franchise Operations in China

6.1 Brand name registration

Without official brand name registration, even a well-known company will find itself in an awkward situation when someone else has registered their brand name ahead of them. Especially in an economy like China where copycats are rampant, brand owners should pay even more attention to the registration of their brand name prior to them exposing their brand in the China market for the first time.

In China, company name registration and trademark registration are handled by two entities. Information sharing between them is not well-developed. There are cases that people use famous brand name as their company name and get registered.

6.2 Advertising and promotion

Advertising Law[25]

The Advertising Law states that the contents of advertisements published in China must be truthful, lawful and not misleading consumers. In addition to various requirements related to the accuracy of statistics and general descriptions of products and services featured in advertisements, the Advertising Law prohibits the use of superlatives such as "highest level" or "the best". It also lists the advertising content that is deemed to be illegal, both generally and for specific industries, such as the medical industry. Finally, it prohibits advertising of various drugs as well as tobacco products.

[25] "China's Media & Entertainment Law" TransAsia Publishing Ltd

An advertisement shall not employ or do any of the following[26]:

- Use the national flag, the national emblem, or the national anthem.
- Use the names of state organs or their functionaries.
- Use terms such as "state-level," the "highest-grade", or "the best".
- Hinder social stability, endanger the safety of persons or property, or harm the public interest.
- Hinder public order or violate sound social morals.
- Contain information that suggests pornography, superstition, terror, violence, or hideousness.
- Contain information that engages in ethnic, racial, religious, or sexual discrimination.
- Hinder the protection of environment or natural resources.
- Impair the physical and mental health of minors or disabled persons.
- Other circumstances prohibited by laws or administrative rules and regulations.

The Advertising Law requires that the contents of all advertisements be examined and verified by appropriately trained personnel prior to publication. Advertising agencies and media organisations are thus made to assume responsibility for the accuracy and appropriateness of the advertisements they produce. The Chinese Advertisement Association (CAA) has been designated to examine and verify the contents of advertisements in accordance with the guidelines set forth in the relevant legislation. In this connection, advertisers must seek the approval of the CAA for each advertisement that they publish, and the examination of each advertisement is subject to a fee.

Foreign franchisors need to be aware that Chinese consumers, especially those in big cities, no longer fancy every Western brand name. Instead, they try to figure out what a foreign brand can bring to them. So foreign franchisors should be prepared to invest not only money but also time and energy.

[26] http://www.hsbc.com.hk

6.3 Key issues and challenges in China's franchise system

The challenges faced from the franchisor's point of view:

- Unqualified franchisees

There are large numbers of potential franchisees in China however it is not easy to find out qualified franchisees. In the past, F&B industry was regarded as a field does not need high education people. Investment can be more or less and entry level is low. Now this concept still has its influence on modern F&B franchise industry. Some franchisees have little knowledge about franchise and can not really understand the standardisation so they may tend to violate the contract during operation.

- Difficulty in collection of royalty fee

While it is relatively easier to collect the franchise fees as it is a lump sum payment that is collected up-front prior to the establishment of the franchise business, it is much harder for the franchisor to collect the royalty fees on an on-going basis. While it is a phenomenon not unique only to China, it is nevertheless more pronounced in China than elsewhere because of the lack of maturity of China's franchisees. The little knowledge they have of franchising as a concept makes it harder for them to understand the rationale and reason behind the payment of royalty fees. They feel that the revenue made is through their own hard work, and generally do not see the need to share this with the franchisor.

- Non-adherence to quality control and system standards

The hallmark of a franchise is in achieving a consistent standard across all its outlets and enforcing strict quality control measures to ensure that. Again, arising from the franchisees' lack of understanding on the franchising concept, they tend to think that franchising is a means of borrowing the franchisor's brand to start their own business, and hence, they are allowed to do whatever pleases them. Hence, quality control systems and processes are not adhered to, and they end up altering the menus to include food items that are not approved by the franchisor, altering the taste of the food, or altering the concept of their food franchise.

- Difficulty in accessing supplies

Close proximity to critical food supplies may be difficult for some franchisors. This is especially true for foreign brands which require food ingredients that can be found only in certain foreign land. Importing such raw ingredients will only end up increasing the food cost for the franchisees. Also, due to the vastness of China and their less than perfect transportation system, it may be difficult and expensive for the franchisees to transport the perishables within their franchise network in a timely manner.

The challenges faced from the franchisee's point of view:

- Lack of products and services

Some franchisors are not able to provide adequate products and services to the franchisees. To survive in a competitive F&B environment like in China, the franchisees have to be able to capture the interests of their customers and to retain their loyalty by ensuring a big variety of products and services on display, and to continuously introduce innovative and new items. Some franchisors, however, are not able to keep up to speed to assist the franchisees in this area.

- Marketing and advertising

Most Chinese F&B franchise companies are selling Chinese food. Most of them have laggard marketing concepts. Only a few of them put their efforts on marketing and advertising. Some even regard marketing and advertising as something that is unnecessary if they have good products, as they believe that their products are a marketing tool in itself. However, these cases are far and few in between, and they end up doing a disservice to their brand and suffer a drop in their brand value.

- Lack of training

Some F&B franchise companies have not set up a mature system. The headquarters are not able to conduct sufficient training for franchisees. Training is often ad-hoc and the curriculum is not properly defined and planned beforehand. Some trainers are not even qualified to be trainers.

- Lack of support

Some of franchise systems are actually investment traps. The headquarters do not have mature profit earning model and do not have the support system for franchisees. What they have are only an attractive concept and a nice brochure. Those investors who lack in F&B experience and franchise knowledge may easily be duped.

6.4 Cultural difference

Foreign franchise restaurants should try to understand the Chinese culture and think about localising their menu, where necessary. For example, Chinese prefer hot dishes. Sandwich makers may find the expansion tough because many Chinese consider bulky and cold sandwiches less than appetising. Foreign franchisors should do their homework before they enter the China market.

6.5 Target Market

China is a very big market with different cities and provinces that have different living standards, taste preferences and traditions. For example, people in the south prefer soup-based dishes. On the other hand, people in the north, prefer noodle-related dishes. Hence, a market study on the target market to understand the characteristics and behaviour of the consumers is necessary before entering the market.

6.6 Higher franchise fee required by foreign brands

International brands normally have higher cost in raw material and logistics so they set stricter entry requirement. For a world famous international brand, initial base fee is at least US$10,000 while total investment reaches several hundred thousand US dollars. In comparison, most local brands only require about RMB100,000 as total investment. Chinese investors are price-conscious. Because of the required large amount of capital outlay, investors are shying away from investing in foreign brands.

7. Market Entry Considerations

7.1 Type of Franchising Arrangement

There are two vehicles of entering China. The first channel is direct cross-border franchising. The second is to establish wholly owned enterprises, joint ventures and cooperative enterprises.

7.2 Appointing Master Franchisee

Direct cross-border franchising: Successful market entry depends on the quality of the local partner. Finding the right local partner is a critical decision. This mode requires less capital but the support from the headquarter is also less. Market development and brand maintenance are handled by master franchisee which is not as effective as handled by franchisor.

Measures for the Administration of Commercial Franchises: a foreign or FIE franchisor has operated, for over one year, at least two directly-operated franchise businesses (or stores owned by its subsidiary or holding company) within China.

7.3 Setting up corporate office[27]

Setting up a **representative office** is a relatively cost effective way of entering the market in China for foreign franchisor. Representative office can conduct marketing research so as to get hold of useful information such as consumer patterns and behaviour, market demand, market practices, local laws and regulations, local costs, etc. Representative offices can also oversee other joint ventures and operations, and establish contacts with business partners and customers. On the other hand, representative offices are restricted from receiving fees, providing service or signing contracts which directly generate income.

[27] http://www.hsbc.com.hk

Establishing a **joint venture** is a popular way of direct investment in China. Apart from conducting market research and establishing contacts with business partners, a joint venture can also conduct sales and production activities. McDonald's is an example to use joint venture in China market. There are generally two types of joint venture in China: the equity joint venture and the cooperative joint venture.

The profit and risk sharing of **equity joint ventures** is proportionate to the equity of each partner. The success of a joint venture relies very much on the local and foreign partners complementing one another. It is also important to select a good Chinese partner who shares the same strategies for development. Equity joint venture is usually structured as a limited liability company with the foreign partner contributing a minimum of 25% of the registered capital.

Unlike equity joint venture, the profit and risk sharing of **cooperative joint venture** is divided according to the contract terms, rather than the investment shares. Hence, cooperative joint venture allows more flexible organisation structure, management and assets. Investors may contribute cooperative conditions to cooperative joint venture in a form which is more flexible than that of equity joint venture. In addition, there is no minimum foreign contribution required. The cooperative joint venture may be established as a non-legal person entity and there is no need to establish a new corporation in China.

This form may be suitable for some franchisers, while a well-known international franchisor may not be willing to share profits with a local partner. Conversely, a strong local partner may not be willing to work with a weak international franchisor.

Wholly foreign-owned enterprises are foreign companies fully invested by foreign investor(s). They can enjoy full independence in business operations subject to regulations and policies and have become increasingly popular. Tricon Group, which owns KFC and Pizza Hut is one of the examples to use wholly foreign-owned enterprises in China. This form has become increasingly popular.

Currently foreign franchisors especially those with strong brands and those cherishing its brands are more likely to use wholly foreign-owned enterprises to enter China market. They will not start its franchise business until they are more familiar with the market, the culture, customers' preference and forming their supply chain etc. Those overseas enterprises with limited capacity or restricted by industry features are more willing to use the way of appointing master franchisees to enter the market.

8. Investment Climate

8.1 Tax

8.1.1 Tax on FIEs and Foreign Enterprises[28]

Foreign-invested enterprises (FIEs) and foreign enterprises have to pay income tax on their income derived from production, business operations and other sources within the territory of China. (Please refer to Appendix for more details)

In a bid to attract foreign investment, China has introduced a range of tax concessions to FIEs and foreign enterprises. (Please refer to Appendix for more details)

8.1.2 Withholding Tax on Payments to non-residents[29]

Starting from 1 January 2000, a concessionary rate of 10% has generally been applied to interest, rental, royalties and other income. In addition, the withholding tax rate may also be reduced by a tax treaty.

Royalty payment to a non-resident from patent, trademark, copyright and other similar rights will generally be subject to withholding tax at the rate of 10%. That rate may be reduced through the operation of a tax treaty or by concession. Certain royalty payments may be exempt from withholding tax.

8.1.3 Double Taxation Treaties[30]

China is a signatory to a Treaty for the Prevention of Double Taxation with many countries all over the world including Japan and Singapore.

A Double Taxation Prevention Treaty, in principle, enables offsetting tax paid in one of 2 economies against the tax payable in the other, in this way preventing

[28] "Guide to Doing Business in China (2004/05)" HKTDC Research Department
[29] PwC HK: http://www.pwchk.com
[30] http://www.worldwide-tax.com

double taxation. Another important factor is the grant of an exemption or tax at a reduced rate on certain receipts such as interest, royalties, dividends, capital gains and others that are connected with a transaction carried out between parties associated with the Double Taxation Prevention Treaty.

8.2 Intellectual property rights[31]

Foreign trademarks registered in the China are protected by law. China has Trademark Law, Patent Law and Copyright Law. Since 1988, China has officially adopted the international system for commodity classification and the Vienna system for design elements classification, thus internationalising the China's trademark registration and administration.

Applications for trademark registration are handled in accordance with China's Trademark Law and the Implementing Regulations of the Trademark Law. The Trademark Office under the State Administration for Industry and Commerce (SAIC) is the authority for the registration of trademarks in China. The Trademark Management Office under SAIC is the administrative arm responsible for managing all trademark-related matters, while Trademark Affairs Offices set up in various major cities are trademark agents designated by the state and under the supervision of SAIC. The Trademark Review and Adjudication Board, also under SAIC, is responsible for handling disputes related to trademarks. Provincial-level administration offices for industry and commerce handle matters concerning trademarks under their jurisdiction, such as protecting the exclusive right to use registered trademarks and investigating acts of trademark infringement.[32]

In 1989, China took part in the Madrid Protocol. An international mark registered in a member economy's trademark office is equivalent to an application or a registration of the same mark effected directly in each of the economies designated by the applicant. If the trademark office of a designated

[31] "China: Licensing and intellectual property, BRIEFING FROM THE ECONOMIST INTELLIGENCE UNIT
Protecting intellectual property in China, The McKinsey Quarterly, 2005 Number 3
[32] "Guide to Doing Business in China (2004/05)", HKTDC Research Department

economy does not refuse protection within a specified period, the protection of the mark is the same as if it had been registered by that Office. http://www.wipo.int/madrid/en/ China has a "first-to-register" system that requires no evidence of prior use or ownership, leaving registration of famous marks open to third party.[33] However, the Chinese Trademark Office has cancelled some Chinese trademarks due to their unfair registration.

Patent applications are subject to examination and approval in China in accordance with its Patent Law and Implementing Regulations of the Patent Law. The State Intellectual Property Office is responsible for patent work. It handles and examines patent applications and grants patent rights in accordance with the law. Patent offices under provinces, autonomous regions and municipalities are responsible for patent administration work in their respective areas as well as handling matters involving foreign-related patents. They are also responsible for patent enforcement, settling patent disputes, as well as investigating and penalising patent infringement acts.[34]

China has a first to file system. Food, beverages and flavourings are patentable.

Copyright Law was established in 1990 and amendment was made in 2001. Copyrighted works do not require registration for protection.

Unregistered trademarks, packaging and trade secrets also have some protection by China's Unfair Competition Law.

China's intellectual property legislation stipulates that infringement of intellectual property rights (IPRs) are dealt with by administrative procedures and legal proceedings. In terms of civil liabilities, the infringer may be ordered to stop the infringing act, eradicate the damage done, make public apologies or compensate for damages. In terms of administrative measures and criminal liabilities, they include warnings, orders to stop the infringing act, confiscation of unlawful gains, finds, and compensation for damages.[35]

[33] http://www.mac.doc.gov
[34] "Guide to Doing Business in China (2004/05)", HKTDC Research Department
[35] "Guide to Doing Business in China (2004/05)", HKTDC Research Department

China has established a relatively sound law protection system of intellectual property right; however there are still many intellectual property abuse cases. Uncertainty over China's intellectual property (IP) protection has undermined some deals with Chinese enterprises.

8.3 Investment promotions[36]

China remained the world's top destination for foreign direct investment (FDI) in 2004[37]. Utilised FDI, indicating actual inflows, increased by 13% to US$60.6 billion in 2004, from US$53.5 billion in 2003, according to the Ministry of Commerce (MOFCOM). Contractual FDI, indicating future investment flows, grew by 33% to US$153.5 billion.

In order to create a favourable investment environment and to encourage overseas firms to invest in China, China has gradually set up a relatively complete legal system, and constituted a foreign investment policy system, which mainly includes industrial policies, regional policies, tax policies and financial polices.

China adopts low-tax policy toward foreign invested enterprises and at the same time grant preferential tax to the industries and regions. At present, taxes applicable to the foreign-invested enterprises as well as foreign individual includes: enterprise income tax, personal income tax, turn over linkage tax (including value added tax, consumption tax and business tax), tariff, land value added tax, resource tax and city real estate tax etc.

In the new foreign exchange management system adopted in 1994 domestic enterprises are required to sell their foreign exchange revenues to designated banks according to the current exchange rate, and when they need foreign exchange they would buy it from the bank according to the current exchange rate. Foreign-invested enterprises, however, are allowed to retain their foreign exchange revenues.

[36] The Economist Intelligence Unit
[37] AT Kearney October 2004

Wholly-foreign-owned ventures have become the most popular investment vehicle, at the expense of equity joint ventures and contractual, or co-operative, joint ventures.

China welcomes foreign investment and is bound under World Trade Organisation rules to open its industries further to foreign businesses, but it does not wish to see control over important or “strategic” sectors of its economy slip into foreign hands and thus foreign investment is restricted to certain designated sectors. Beginning from July 2004, China’s economy is divided into four parts for foreign-investment purposes: prohibited, restricted, permitted and encouraged.

China’s complex system of restrictions on foreign investment is changing now that it is a WTO member. Some of the industry-specific concessions made to gain access to the trade body were the following:

Figure 24. Industry-Specific Permissible FDI

Industry	Maximum Permissible FDI	Date
Incremental telecommunications and paging service of basic telecommunications; Mobile and data service of basic telecommunications; Domestic business and international business of basic telecommunications.	50% 49% (1) 25% (2) 35% (3) 49%	11 Dec 2003; 11 Dec 2004; (1) 11 Dec 2004; (2) 11 Dec 2006; (3) 11 Dec 2007;
Life Insurance Non-life insurance	51% 50%	11 Dec 2003 No regulation
Wholesale (exclude salt and tobacco);	100%;	(1) 11 December 2004 (exclude chemical fertiliser, product oil and crude oil);

Industry	Maximum Permissible FDI	Date
		(2) 11 December 2006 (include chemical fertiliser, product oil and crude oil);
Retail (exclude tobacco).	100% (no more than 49%, if a company owns more than 30 chain stores in the retail areas of books, newspapers and magazines, automobile, medicine, pesticide, agricultural film, product oil, chemical fertiliser, food, vegetable oil, sugar, tobacco and cotton).	(1) 11 December 2004 (exclude chemical fertiliser); (2) 11 December 2006 (include chemical fertiliser, product oil and crude oil);
Banking	RMB business	(1) 11 December 2003 (need approval) (2) Will absolutely open on 11 December 2006
Securities company Securities investment for fund management company	33.33%; 49%	11 Dec 2004; 11 December 2004
Hotels	100%	End-2005

Source: EIU

8.4 Commercial Franchising

The launch and development of Commercial Franchising (abbreviated below as Franchising) activities within the territory of China is subject to its Administration of Commercial Franchising Procedures (hereunder referred to as ACFP). The Ministry of Commerce carries out supervision and administration of franchising activities throughout China. The department in charge of commerce at each level administrates and coordinates franchising activities within its own administrative district, and offers guidance for the launch and development of local industry associations (chambers of commerce). They are also responsible for establishing credit files of franchisors and franchisees, and timely announcement of the list of enterprises in violation of regulations.

According to ACFP, franchising is defined as a franchisor, by entering into a contract, authorising a franchisee to use operating resources such as trademark, trade name and operation model that the franchisee, in accordance with the contract, conducting operating activities under a uniform operating system and paying franchise fees to the franchisor. Mere licensing of a trademark should not be regarded as franchising even if accompanied by quality controls and/or certain types of technical assistance.

Only an enterprise or other economic organisation is qualified to be a franchisor or a franchisee. No franchisor is allowed to falsely borrow the name of franchising and illegally engage in direct selling activities. Franchisors are liable to guarantee the goods quality of its designated suppliers, as well as the quality of any goods that they supply themselves. Each trademark and each patent that is licensed requires separate legal compliance including a separate filing of the licence agreement, and the trademark licensing contract filings must be handled before launching and developing franchising activities.

Generally, a franchise contract can last for three years and more. Upon expiration, the parties to the contract can extend the contract based on the principles of fairness and reasonableness. When a franchise contract terminates, the former franchisee must not continue to engage in relative activities without the consent of the franchisor.

The franchise fees paid by the franchisee include join-in fee, usage fee, as well as other contractually agreed fees. Security deposit is not one part of the franchise fees; it shall be refunded to the franchisee upon expiration of the contract.

Both parties to the franchise contract are responsible for the timely disclosure of the relevant information before signing the contract and during the course of the franchising. Specifically, the franchisor shall disclose basic information in writing, and the franchise contract text, 20 days before “formal signing” of the franchise contract. The franchisor is liable for compensation if a franchisee suffers economic loss as a result of inadequate disclosure of information or provision of false information. Without the consent of the franchisor, the franchisee shall not disclose, use or permit other parties to use the franchisor’s commercial secrets that they have mastered.

Foreign-invested enterprises (FIEs) are forbidden to engage in franchising activities falling in the categories of industry prohibited under the Foreign Investment Industry Guidance Catalogue, and they remain subject to other laws, regulations and rules related to foreign investment. An FIE is only permitted to grant franchises to other China companies only after directly operating at least two shops for at least one year. Such requirement is also met if an FIE’s subsidiary(ies) or “sharecontrol company(ies)” have directly operated the two shops for one year.

If the FIEs are engaging in franchising activities, they will have to submit to the original examination and approval department, an application to add the business scope of “commercial activities engaged in by way of franchising”. If the application is approved, the FIEs shall, in January of each year, “file-for-the-record” the circumstances of franchise contracts signed in the preceding year, and if a foreign company was already engaging in franchising from offshore directly to Chinese franchisees before such transactions.

8.5 Business Environment

Ease of Doing Business[38]

The ease of doing business index calculated by World Bank ranks economies from 1 to 155. China is in the 91st place. The index is calculated as the ranking on the simple average of economy percentile rankings on each of the 10 topics (starting a business, dealing with licenses, hiring and firing, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business) covered in Doing Business in 2006. The ranking on each topic is the simple average of the percentile rankings on its component indicators.

Among the 10 topics, China ranks 126th in the ease of launching a business. The challenges are shown below. Entrepreneurs can expect to go through 13 steps to start a business over 48 days on average, at a cost equal to 13.6% of gross national income (GNI) per capita. They must deposit at least 946.7% of GNI per capita in a bank to obtain a business registration number.

Figure 25. Challenges in Launching a Business

Indicator	China	Region	OECD
Procedures (number)	13	8	6
Time (days)	48	51	19
Cost (% of income per capita)	13.6	41.7	6.5
Min. capital (% of income per capita)	946.7	117.5	28.9

Source: World Bank

[38] World Bank: http://www.doingbusiness.org

8.6 Infrastructure

8.6.1 Transportation

China’s transportation system consists of railroads, subways, highways and roads, inland waterways, civil aviation and maritime shipping. It has undergone major transformation over the last decade, with air transportation and highways growing at a much faster pace than traditional transportation methods like the railways and water transport. The prosperous coastal regions on the eastern side of China have a better developed network of transportation system than the economically backward western regions.

Railway - With the exception of Tibet, all other regions in the have been connected together through railways. There are about 15 major trunk rail routes currently divided mainly into north-south and west-east trunk lines. It is traditionally the predominant carrier of both passengers and goods. However, under-investment has resulted in bottlenecks within the network. Upgrading works are underway but is expected to fall short of the anticipated demand growth.

Highway – It is estimated that about 97 per cent of counties and towns in China are accessible by highways. The highway transport system has developed rapidly, and for short and medium distance, the usage of the highways is more advantages over the usage of railways.

Civil Aviation – As the trade activities within China increases, air transport is by and by becoming a leading choice for transportation of passengers as well as cargoes because of the considerable improvement efforts carried out to enhance the quality of the aviation infrastructure.

Water transport – China’s waterway infrastructure has strengthened with the increased building of major coastal and inland ports and berths. However, with the focus being placed on foreign trade, offshore and ocean-going shipping has flourished at the expense of inland water transportation. Major ports in China currently include those at Shanghai, Ningbo, Dalian, Tianjin, Xiamen, Guangzhou and Shenzhen.

With booming trade and raising pace of urbanisation, the transportation system is currently suffering from bottlenecks, especially in the developed coastal regions. Hence, it is affecting the speed in which goods are transferred from one point to another and leading to high logistics costs. Estimates by World Bank officials show that twenty percent of a product's price in China is attributed to logistics cost, compared with ten percent for United States and other developed economies. They also estimated that the amount of goods lost due to poor or obsolete transportation infrastructure has equalled one percent of China's gross domestic product in recent years.

If this issue is not addressed in time, it will hamper the economy's sustainable development. Hence, to ease the crunch, China is spending billions of dollars to modernise and expand railways, highways and seaports. They aim to develop a modernised transport network with improved facilities of higher quality and increased capacity to relieve the pressure on the transport infrastructure of the Chinese economy.

8.6.2 Telecommunications

With the rapid development of the telecommunications industry in China, all services ranging from internet to mobile phone saw a big increase in terms of the number of users/subscribers over the last six years (refer to chart below).

Figure 26. Development in services of Telecommunications Industry

	1999	2000	2001	2002	2003	2004
Personal computers in use *('000)*	15,500	20,600	25,000	35,500	47,311	62,241
Online households *(mn)*	-	5.79	9.98	13.67	16.88	20.42
Internet users *('000)*	8,900	22,500	33,700	59,100	101,195	162,097
ISDN subscribers *('000)*	170	689	1,088	1,177	1,396	1,615
Telephone lines in use *('000)*	108,716	144,829	180,368	214,420	248,472	282,524
Int'l outgoing telephone calls *(minutes)*	1,569	1,547	1,253	1,276	1,251	1,263

	1999	2000	2001	2002	2003	2004
Mobile telephone users *('000)*	43,296	85,260	144,820	206,620	262,875	334,082
Mobile SMS messages sent *(mn)*	-	-	-	58,330	74,295	93,156

Source: Euromonitor

The biggest growth comes from the number of internet users, which surpassed 162m by end-2004. In fact, China now boasts more subscribers for cable television (around 100m) and mobile phones customers (270m at end-2003) than the US.[39] Numerous services which cater to businesses are now available, and they include international express mail service, international automatic telex, data transmission, express fax, and TV program transmission services. In the near future, third generation (3G) mobile systems will be rolled out and optic-fibre cable links in the home may allow every urban household to have broadband multimedia access as early as 2010.

The potential growth for China's telecommunications industry remains large as the penetration rates for several services like mobile and fixed-line still remain low. To push for the advancement of the industry and to increase utilisation rate, China is increasing its investment on technological research and encourages its domestic enterprises and research institutes to develop their own advanced equipment to be used within their telecommunication networks.

8.7 Utilities

China, the world's second-largest electricity consumer (after the United States), is facing energy shortages across 24 provinces, with the hardest hit being Zhejiang and Jiangsu[40]. Power shortages have become frequent since 2003 and key industrial regions affected by the power snag were required to shut down intermittently during peak hours of demand and reschedule their production to weekends and night time.

[39] Economic Intelligence Unit, Profile 2005, China
[40] BusinessWeekOnline, Power Shortages Are Zapping China

This has impacted the operational cycle of many businesses and increased their operational cost due to more expensive alternative sources of energy. A rapidly growing economy coupled with an inefficient transportation system is not helping the situation either. Coal, which is the main energy producer for China, is not being transported to the coal-fired power plants in time due to the overloaded rail system.

To ease the shortage situation, new power plants and infrastructure is being built, and China has even opened up the utilities market to foreign investment in the hope of attracting advanced foreign technology and investment to improve the efficiency of this sector. Power capacity over the next few years is expected to increase but a continued supply shortfall is still to be expected. A new regulator, the State Electricity Regulatory Commission (SERC) was also formed and tasked with supervising and regulating market competition within the electricity industry.

The water sector in China is also suffering from a shortage, and the shortfall is estimated at about 40bm^3 every year[41]. Water resources are unevenly distributed with the southern areas receiving it in abundance as compared to the northern areas. This is because most of the major rivers (e.g. Yangtze, Yellow, Heilong, Pearl, Liaohe, Huaihe and Haihe) which form the water resources are situated in the wet southern/eastern part of China, and the northwestern area has only a small number of rivers.

To improve the situation, China is looking into ways to improve the exploitation of water resources in a river basin. One way is to open up the market to allow foreign funds and expertise to flow in to improve the existing infrastructure and distribution networks. A US$60 billion project has also been commissioned to help divert water from southern China to arid northern cities, and China is also revising its regulations to include mandatory treatment of waste water.

[41] Deutsche Bank AG, China – Great Expectations, Investment Strategy, February 2005.

9. Profile of Select Franchisors in China

9.1 Summary

Through the assistance of CCFA, PwC Singapore got into contact with five prominent franchisors with substantial F&B operations in China. They are RBT 仙踪林), Donglaishun (东来顺), Dio Coffee (迪欧咖啡), Chongqing Cygnet Hotpot (重庆小天鹅), and Qingeda (亲圪墶). Their businesses span across different F&B concepts like restaurants and coffee and tea houses, and offers varied cuisine and dining experience that is currently very popular amongst the Chinese market.

From all the interviews conducted, a common recurring theme across all the success case studies could be seen – innovation and perseverance. Many of these household brands like Donglaishun, Chongqing Cygnet Hotpot and Qingeda started with a humble beginning, with only one or two outlets located at non-prime areas. With their foresight and a will to fight head-on with bigger competition and changing times, they gamely took on the challenge and started to innovate their products, upgrade their management skills, hire more people with the right skills-set, and change their concept to keep up with the times.

Another lesson learnt from these experienced F&B operators include the expansion strategies that each took for their own businesses and their own target markets. There are no hard and fast rules when it comes to doing business in China. Some have gone the way of franchising while others have preferred to open up self-owned outlets in key new market first before they start their franchise business. Some chose to expand within the popular coastal and eastern (first-tier) regions, while others expanded successfully within the central (second-tier) regions. The important things to take note instead are how you manage the franchisee-franchisor relationship, how you adapt your food products to suit changing consumer preferences, how you protect your brands and how you ensure consistent quality across the network.

9.2 RBT (Xianzonglin) – 仙踪林

Shanghai Xianzonglin Food & Beverage Ltd.
Unit A, 9F, No. 728, West Yan An Road, Shanghai
China 200050

Profile

RBT (Real Brewed Tea) was founded in 1994 to introduce tea and snacks to the market. It has since expanded to Hong Kong, China, Canada, Australia, Malaysia, Philippines and Indonesia in the past 10 years. Today RBT has 127 outlets throughout the world, including 22 company-owned outlets in China and Hong Kong. Mr. Albert Wu, chairman of RBT from Chinese Taipei, mentioned that they would have their first outlet in Chicago by November 2005.

RBT is famous for its bubble tea, a milky tea-based concoction with large chewy tapioca balls, served in a variety of flavours. RBT outlets are easily recognised by its bright green signage, featuring a little white cartoon rabbit. RBT pays close attention on ambience and customer services. The quality of comfortable, relaxing design and decor is an essential part of the total “RBT” modern tea culture experience.

RBT’s experience in penetrating China market

“China is a big market yet there is much difference among provinces. So the practice in one province cannot apply to the whole China market,” said Mr. Wu. As the early market entrant to the China market, Mr. Wu regards there is increasing intense competition in China, especially in big cities like Beijing and Shanghai, with the entry of world famous brands and consortia.

According to Mr. Wu, China has a lot of business opportunities yet if you make any mistake, opportunities will probably lead to a big loss. Mr. Wu mentioned that around 80% of the bubble tea companies failed in China market. There were a lot of differences between Hong Kong and China so RBT used two distinct development models in these markets.

For Hong Kong, RBT started its franchise business about three to four months after it had been in the market. It increased its popularity in a short time through franchise outlets. For China, RBT adopted a different strategy. Before setting up its outlet in China, it sent two of its management staff to the market first to understand the local laws and regulations, local culture and lifestyle. After conducting its market study, RBT established a company to do the planning and evaluation. RBT was very clear that China should be its development focus at that time but which city should they start with?

After three years of observations, they decided to choose Beijing, Shanghai and Guangzhou as its start-up bases. These three cities have high GDP, good infrastructure and a dense population. Among the cities, RBT narrowed down its scope and chose Shanghai for its first outlet. Shanghai has the best commercial environment in China yet it is also a market with the most intense competition. According to Mr. Wu, you can find almost every top brand in Shanghai. Many famous companies choose to set up their branches in Shanghai, not caring profitable or not, because the presence in Shanghai brings them higher position and brand image within their respective industries. With all these big names here, intensive competition is inevitable. In order to be a well-known company, RBT knew it must find its way into Shanghai market. In 1996 Shanghai had RBT's first China outlet.

When RBT first entered Shanghai market, the outlets were not located within the city centre for cost saving reasons. It planned to target the middle to lower class consumers in order to differentiate themselves from other two main competitors. After opening seven outlets in the outskirts, Mr. Wu realised that he must do something to better promote the brand name.

Mr. Wu was ambitious to have an outlet in Huaihai road. Huaihai Road is one of the busiest roads in centre of Shanghai. Rental there has been driven up by many big enterprises fighting to have a place there, and even money may not secure them a spot. Mr. Wu took three months to analyse the importance of having an outlet in Huaihai Road and to convince the shareholders that it will improve RBT's image as an international company. Then the problem was how to rent a suitable location.

After narrowing down his focus to one location (a hot pot restaurant at that time), Mr. Wu noticed that two other companies were also targeting on it. He went to the hot pot restaurant; chatted with the boss and established friendship with him. After half a year's regular visit, Mr. Wu won the trust of the boss and finally rent the place from him. RBT's Huaihai outlet started operation in August 1998. This outlet attracted the attention of media and a lot of reports appeared in all kinds of newspaper and TV programs. The strategy of having a flagship outlet in Huaihai Road helped RBT beat its competitors and became No. 1 in the industry.

With regards to the selection of a suitable location, Mr. Wu had another tip for potential investors - check whether the targeted outlet is in the list of demolition and relocation beforehand to avoid unexpected losses.

Preparing tea is like making high-tech products

"Focus on your product. Study every processing step. Try to be the best even when you are handling a small product. Then you will succeed", said Mr. Wu.

RBT has its R&D base in Chinese Taipei with lots of food science experts working there. Every half a year, RBT will change its menu and the adjustment range is from 20% to 40%. Continuously coming up with new tastes is a way to keep RBT vibrant.

Standardising tea making processes is what Mr. Wu does to achieve success. Every three months, staff in RBT must undertake a test. Tea making staff is required to make three cups of drink in two minutes while the taste and volume should be exactly the same. Mr. Wu always says that preparing tea is like making high-tech products. Quantification and standardisation are possible and critical. Ice tea at 2 to 3 degree Celsius tastes the best is one of the quantification found out by Mr. Wu.

RBT also has its own bubble tea college. Every RBT franchisee and its staff must attend the courses in bubble tea college. In the college, they will have class room learning and actual practice in the mock outlet. The mock outlet is exactly the same as a real one except it is not open to public.

Multinational management team

RBT has a diversified management team. Its general manager is an American Chinese; chief operational officer is from Hong Kong; R&D manager and training manager are Singaporeans and marketing manager is an Australian. All of them are familiar with overseas market and have exceptional professional achievement in their fields. "A company is like a bus. Sometimes you have people getting on and sometimes people getting off. However people on the bus will discuss together and decide the heading direction as well as the way to get there." Mr. Wu said. The multinational management team helps RBT better understand the business and the market.

RBT's franchise business

RBT expands its business by using company-owned outlets and franchising. If any franchisee violates the franchise agreement, RBT will terminate the contract and change the outlet to company-owned one. For master franchising, RBT has its own practice requirement. At the beginning, it will negotiate with the master franchisee and set a specific number of outlets that he/she can have, for example 3 or 5. If the master franchisee operates well in a certain period of time, RBT will consider giving him/her the right to open more outlets. By using this method, less time and energy are required in discussion and in collection of franchise fees in comparison with individual franchise. Currently, RBT has five-year contracts with master franchisees and gets higher franchise fees from them.

RBT does not have a smooth sail in its franchise business. Occasionally, some franchisees are in breach of contracts such as avoiding buying from headquarters. In RBT, 80% of the products are distributed by headquarters including many of them especially tea are imported from Chinese Taipei and Hong Kong. After adding import duty, the prices of these raw materials are higher in comparison with those in other brands. Some franchisees talked to Mr. Wu for price deduction and some even started to buy from other sources which lower the quality of the products. Mr. Wu explained to them that by selling raw materials the company intended to maintain the quality but not to earn money. If the headquarters was interested in getting money in this way, it would have expanded its sale to other brands.

For those who insisted on purchasing from others, Mr Wu told them “we will settle it in court if you continue to do so. Even if I lose the case, it is worth while. RBT will get more trust and support and the brand will be more successful.” Those franchisees who were expecting to win price discount from Mr Wu, lost their strength in the present of his determination to protect the brand. Eventually they took Mr Wu’s warning into serious consideration. Breach contract cases have been controlled in large extend. At the same time, RBT increases its R&D effort in new products that can use local sourcing. So now the raw material prices for many products have been decreased. A win-win situation is created through communication and mutual understanding.

RBT has started to enter a new era evolving from traditional frothy-tea house into a new international modern tea culture. It is committed to create a new life style to its customers through a comprehensive franchising program in the coming decades. It defines the style as providing daily necessity for tea lovers, a place to relax the daily stresses of life, chat with friends or just relax in a comfortable environment.

Key Learning Points

- China is a big market yet there is much differentiation amongst the provinces.
- Adequate preparation and location selection are two important steps to penetrate the China market.
- Study your product and make it the best.
- Diversity of management team may do help to the business.
- Communication and mutual understanding are needed in franchise business.

Shanghai Xianzonglin Food & Beverage Ltd.

- Product category: Bubble tea, snacks, light meals
- Brand Name: RBT Bubble Teahouse
- Franchisee Fee (RMB): 150, 000
- Initial Investment (RMB): 1,000,000
- Monthly Royalty Fee (RMB): 5000/120 square meters and above
- Others: Guarantee fee: 100,000

9.3 Donglaishun - 东来顺

Block E, Hua Long Street,
Nan He Yan Ave., East City District,
Beijing, China

Profile

With a history spanning more than 100 years, the origin of Donglaishun can be traced back to 1903. Donglaishun, once a small porridge stall in the Dong'an Bazaar is known for its thinly-sliced mutton from Inner Mongolia, heated at the table in a chafing dish. The name "Donglaishun" implies a smooth and successful business. In 2003, it became Beijing Donglaishun Group Co., Ltd.

Donglaishun is a well-known Muslim restaurant famous for its instant-boiled mutton. It has developed its own Muslim menu consisting of more than 200 dishes cooked in a unique cooking method: dipping, boil, stir-fry, quick-fry and broil.

A new way to grow

Like other famous brands with long histories in China, Donglaishun with its small business model and single outlet, appeared to be fragile in the industrialising food industry. Donglaishun realised that if they kept their traditional catering model, they may not be able to adapt to the fast changing society. In order to be more competitive, they had to grow their business into a more substantial size.

In 1987, Donglaishun opened its first chain store in Lianyungang. From the next eight years until 1995, it opened up more than 30 outlets in China. However, because of the lack of theoretical guidance and practical experience in managing chain stores, they struggled to maintain the quality across all their outlets, and failed to benefit from any economies of scale.

Meanwhile, China's F&B market was undertaking great changes. New business models like Chinese fast food, fast food chain stores are spreading around China with the introduction of western fast food. How can Donglaishun sustain and grow in this fast changing business?

Realising the century-old brand is its unique intangible asset, Donglaishun found out that franchising was the way to expand without much capital requirement. In order to inject new energy to the century-old brand, Donglaishun started its franchise business in 1996. Utilising its brand name, product and business model, Donglaishun and its franchisees arrived at a win-win situation. Now Donglaishun has 138 outlets spanning across 21 provinces and cities. It also opened its first outlet in Hong Kong in 2004. Each outlet maintained the original method of sourcing for supplies and service standards.

Trademark protection is a key to international expansion

Donglaishun hand its first foray into the overseas market in 1995 but due to some reasons, the Middle East outlet didn't last long. In 1997, Donglaishun reconsidered its overseas expansion plan and started to register its trademark in their target countries. Initially, they filed their applications in their target countries one by one, which is more costly and more arduous. Subsequently, Donglaishun registered its trademark in the Madrid system, and followed up to register its trademark separately in other markets not included within the Madrid system.

While registering their trademark, issues regarding their trademark surfaced. According to Mr. Tang Qingshun, Chairman & General manager of Donglaishun group, their trademark was registered either by overseas Chinese who used it as the name of their Chinese restaurants or by people who register for re-selling purposes. The Hong Kong market was one of such examples that Donglaishun intended to enter long time ago but delayed till 2004 because of trademark issues.

Quality Control- Raw Material is its secret weapon

The main ingredient used in Donglaishun's restaurants is mutton. Their mutton is selected through strict regimes. Only short-tailed, black sheep from Donglaishun's feeding base in Inner Mongolia are used. They must be about one and a half to two years old, and Imam slaughtered in Donglaishun's feeding base. The mutton is processed via removal of acid and deep-frozen, and only 40% of meat is finally selected for use. The lamb is air-flown and is sliced by machine; each slice is 0.9mm in thickness and 5 g in weight. Each dish weigh about 200g and has about 40 slices of mutton. Mr. Tang told us proudly that the slice is tender, fresh, as thin as a paper and as delicate as a silk handkerchief. It is cooked instantly with no mutton smell, not greasy and very delicious.

Donglaishun's Hong Kong franchise outlet is located in the Royal Garden, Kowloon. The franchisee loved the mutton in Donglaishun so much that he decided to open one in his own hotel. He spent a lot of time and energy in the internal design of the restaurant. The traditional Chinese bed canopy with dragon and phoenix inside the outlet was brought back from an auction house in London. Before the opening, everyone in the hotel from cleaner to general manager was asked to try the mutton and to give their honest feedback on areas of improvement.

The mutton and condiments served at Donglaishun (Hong Kong) are imported directly from Beijing. Only the best pieces of black-headed white sheep from Inner Mongolia are used. Succulently seasoned saused made from ancient secret recipe also adds a wonderful array of savoury flavours. Experienced chefs from Beijing regularly visited the Hong Kong outlet to ensure that close attention is paid to every aspect of this unique cuisine's preparation.

In the coming 2-3 years, Donglaishun is going to strengthen its businesses in Beijing, Shanghai, North China and North East China while expanding to other regional centre cities. For overseas market, it will focus on cities with large Chinese population and similar catering habits.

Key Learning Points

- Trademark protection is a key to international expansion.
- High Quality of raw material is a key to success.
- A good partner is critical in franchise business.

Donglaishun

- Initial Investment (RMB): 500,000 and above
- Franchisee Fee (RMB): 40,000 - 150, 000
- Yearly Royalty Fee (RMB): 60,000 – 200,000
- Guarantee fee: 60,000 – 20,000

All fees stated above vary according to the size of outlet and the size of the territory. More information can be obtained from www.donglaishun.com.

9.4 Dio Coffee – 迪欧咖啡

Dio F&B Management Co., Ltd
Dio Building, No. 1-13, Xue Shi Street,
Su Zhou, China

Dio Coffee was established in 2001 and is the first coffee brand that has acquired ISO9001 certification in China. "DIO" translated from Esperanto, means "The love from god". In DIO's logo, green represents the freshness of coffee, red represents warm service, and gold represents traditional royal culture. Dio Coffee is a relatively new local Chinese brand famous for its European continental environment, elegant decoration and sincere service. Normally with size between 700 to 1,100 square meters, Dio Coffee intends to give customers a place to think freely and the cultural experience beyond coffee.

"We are selling the atmosphere," said Melanie Yang, vice general manager for Dio F&B Management Co. Ltd. "We are not just providing coffee or food but a place to sit and talk, with good service, Internet access and other features."

Franchise is not the only way to grow

The company is a Sino-foreign joint venture. It has three options for investors who are interested in opening Dio Coffee outlets: 1) Wholly funded and managed by investors with support from headquarter; 2) Joint venture with fund from investors as well as headquarter, managed by headquarter; 3) Wholly funded by investors but managed by headquarter and monitored by investors.

Presently, Dio Coffee has about 200 outlets in China. Of which nearly 110 are managed by the headquarter and the rest (nearly 90) are franchised outlets.

China market is big so franchise is not the only way to grow. Starbucks as an international famous coffee brand also shares the same view. Starbucks Coffee entered China market in 1995. At the beginning, outlets were owned by three Chinese franchisees and Starbucks can only get franchise fee according to the agreement. Since 2003 Starbucks began to negotiate with its Chinese franchisees to increase its shares. In July 2003, Starbucks bought 45% shares from Shanghai Uni-President. The relationship between Starbucks and Uni-President has been changed from franchisor and franchisee to joint venture partners. Starbucks, with some 140 stores in China now, has also started opening stores directly as China loosens regulations on foreign ownership in the sector.

For many companies, franchise is their first choice for a new market while company-own outlet is preferred for a familiar market. Dio Coffee however has another way of practice. Melanie explained that if a new market is important to Dio Coffee, it will enter the market by opening company-owned outlet. The first try is important. If it is successful, the brand will be well accepted by local people. So Dio Coffee believes it should take the risk by itself to exploit the market which may include lots of local adaptations. After getting success in the market by itself and accumulating some experience, Dio Coffee will then consider franchise. At that time, it will understand the market better and can have something to share with franchisees. In East China, Dio Coffee has higher percentage of franchise outlets in comparison with other parts of China because it is a more developed market for the company.

Localisation

Dio Coffee sells not only coffee but also food with 300 varieties like steaks, noodles, congee, sandwiches etc. In order to meet the local demand, Dio Coffee creates a big menu which is a standard one for every outlet and a small menu which includes local and seasonal food. The headquarter is responsible for the R&D of seasonal theme products in the small menu and franchisees can create their own dishes and put in the small menu as well with some coordination. The small menu which is updated for every three months represents the balance of standardisation and localisation in the franchise system.

Selling Point: Sincerity, respect and care

Sincerity, respect and care are the slogans and culture of Dio Coffee. It uses them as its guideline in serving customers, managing franchise business and their staffs.

The staffs in Dio Coffee are proud to be part of the company. They have a lot of trainings and love their corporate culture. In Dio's internal magazines, you can find not only the information about the outlets, company activities, trainings but also stories of their cooks, waitresses etc. Staffs with financial difficulties may also receive help from company's internal raised fund. By using all these means, Dio makes its staffs feel at home when working in the company. Melanie believes that when its staffs feel at home, they can create the "home' environment for customers.

Dio Coffee has many regular customers mainly professionals or businessmen aged 30 to 50. Some of them go there almost every day; some of them go to Dio Coffee for a rest after their business trip instead of rushing home and some search for Dio Coffee when travel to other cities before they look for a hotel. They regard themselves part of Dio Coffee family. There are cases like customers donating for Dio's internal fund for staffs in difficulties, customers giving gifts to staffs who are transferring to other outlets and also customers ready to help others in Dio Coffee for IT problem. Dio Coffee won these customers mainly by its sincere service and the home feeling it created. Staffs in Dio Coffee do especially well in recognising its customers and memorising their preference which deeply impress the customers.

Dio Coffee regards its franchisees as their friends and tells them the actual risk and return. At the same time, it is selective in choosing its partners. Every month Dio Coffee receives about 1,000 franchise enquiries; undertakes around 100 location evaluations and concludes only less than 10 franchise deals. However the success rate of the franchise outlets is still not 100%.

Currently Dio Coffee has large presence in Yangtze River Delta and is targeting at Hunan, Jiangxi, Sichuan etc. West region is also in its development plan if it can find out suitable location. With around 7,000 employees (not yet including staff in franchise outlets) chained by its corporate culture, Dio Coffee has entered into its second development phase. It looks forward to have more partners and friends with it to develop the coffee business.

Key Learning Points:

- Franchise is not the only way to grow in China.
- Standardisation and localisation can be balanced through cooperation between franchisor and franchisee.
- Corporate culture and service quality can be differentiating factors to make you stand out from your competitors.

Dio F&B Management Co Ltd

All outlets are in China, located in 17 provinces and municipalities.

Fee:

Initial Base Fee: RMB400,000

Training Fee: RMB100,000

Design & Decoration Support: RMB100,000

Guarantee Fee: RMB40,000

Royalty Fee: RMB3,000-6,000/month

If managed by headquarter: 6% of turnover/month

9.5 Chongqing Cygnet Hotpot – 重庆小天鹅

Chongqing Cygnet Hot Pot
No. 78, Jiangxin North Rd.,
Jiangbei Dist., Chongqing

Profile

Chongqing Cygnet Investment & Holding (Group) Co., Ltd. was founded by Mr. Liao Changguang and Madam He Yongzhi on November 1, 1982. Since that, Cygnet hot pot has developed from a very small restaurant with three hot pots and RMB3,000 assets to a group company with RMB380 million assets in total and five lines of business. Chain restaurant (Chongqing Cygnet Hot Pot) is the flagship of Cygnet, and its other businesses include hotel management, real estate, logistics and education. Ranked among top 500 Chinese private enterprises and top 50 of Chongqing, Cygnet has been ranked one of the 50 Most Promising Franchise Companies in China and has been entitled Top 100 Chinese Chain Enterprises in 2000-2002.

Mr. Qiu Yi, general manager of Chongqing Cygnet Hot Pot mentioned three factors which lead to the success of its franchise system.

The first one is history. Cygnet has experienced ups and downs in its more than 20 years' operation. Not many private-owned F&B companies in China have such a long business life. Learnt from every step it went through, Cygnet became stronger and stronger and get more and more popularity. Being a simple product, hot pot may date back to hundreds of years. It gives consumers large food variety, length flexibility and an experience of participation.

The second one is successful examples. Cygnet has more than 40 company-owned restaurants which can serve as flagship outlets to give franchisees the confidence to invest.

Last but not least, human resource is Cygnet's source of development. With "credit, factuality, solidification and dedication" as its corporate culture, Cygnet tries to create the atmosphere of belonging, accomplishment and harmonicity. Furthermore it offers the necessity and space for staff development.

Innovation

Chongqing is famous for its hot pot. Cygnet noticed that many tourists want to have a try but could not stand the spicy taste. It then came up with a new design of hot pot: "Love Birds hot pot": divided a hot pot into two parts, one with very spicy broth and the other containing no chili at all. Later, it created "Mother and Son hot pot", meaning nesting hot pot which has been awarded patent. It is a design with a small pot in a big pot and higher side for the smaller one. Like the "Love Bird hot pot", it can contain red and white soup. With soft white soup in the middle small pot, the soups get even better flavor.

Medicine Meal hot pot is another innovation. It represents the essence of Chinese food culture: cooked with special Chinese marmites, uniquely belonging to the Chinese. It is based on combination of eating and medicine, gastronomy and healthcare, treatment and prevention.

Cygnet introduced China's first ever hot pot buffet to suit the needs of price-conscious people. Cygnet put a funnel on a hot pot to keep the guests from being bothered by smoke. It also invented an aftertaste flavoring to put in the broth.

Cygnet's every invention not only helped attract more customers to its outlets, but also influenced the whole restaurant industry.

Learn from past experience

Cygnet started its restaurant franchise business in its own way since 1994. At that time, Madam He even didn't know what franchise was. At that time one investor expressed his strong wishes to cooperate with Cygnet while Cygnet was searching for a way to expand its business without pumping in much capital. Then their first "franchise" outlet opened with investment from franchisee, brand and management from Cygnet. This outlet was very successful and got back its investment in 8 months. At the end of 1998, Cygnet had already had 50 this kind of franchise outlets throughout China.

But it was also in 1998 that Cygnet stumbled on its first crisis with rapid business growth. In the peak time, Cygnet signed one franchise contract every month which means it needs to send out a well-trained team of more than 70 to a new outlet each month. Cygnet didn't have enough human resources to meet the speed of business growth. Many other problems are accompanied. Firstly, local investors had their concerns because they were not involved in management. Secondly, because of cultural difference people from Chongqing headquarter could not get along well with local managers. Thirdly, the quality of staff stationed in new restaurants became worst as more and more outlets opened.

At the end of 1999, Cygnet came out with the solution with the help of a consulting firm. It reorganised the management system, standardised the service procedures and regulated its franchise agreements. Actually, on whether to engage a consulting firm Madam He and her senior executives had a heated debate at that moment. Some complained it would cost a large amount of money. Her response was without consultation they would lose a lot more in operating costs.

With the modern franchise system in place, Cygnet started a new round of expansion. In July 2000, Cygnet established a training school as a support system. Till the end of 2004, Cygnet had 328 outlets including around 40 company-owned restaurants and others through direct franchising. Cygnet hot-pot franchise system follows the principle of "standard, support and communication", and aims to bring profits to both parties.

Cygnet created the support team concept to help franchisees on opening matters and operational problems. The team travels to every franchise outlet which gives help and confidence to franchisees.

China F&B market is large with a lot of development space yet intellectual property right violation and cut-throat competition are problems needed to be improved said Mr. Qiu. The brand of Cygnet means little swan while in the market, there are “big swan” or fake “little swan” restaurants. In 2004, Cygnet spent a lot of effort on its trademark protection. As to oversea market, Cygnet has already had company-owned outlets in U.S. and Australia. It regards visa problem as one of the barriers when seeking overseas expansion.

Having more than 300 outlets now, Mr. Qiu does not take Cygnet’s further expansion as an easy job. Cygnet is planning to explore the markets in Eastern China and Western China while it is doing well in central region. It targets to open 30 company-own outlets and 200 franchise outlets in 3 to 5 years.

Full list of head office support system by Cygnet is as follows:

Location selection/Business Opening Support	**Operation support**
Training support	Materials supply support
Layout Support	Handbook support
Location selection	Feasibility analysis
Recruitment	Supply of condensed dish backing material
Opening design	Cultural handbook
Business Analysis	Balance analysis
Management training	Supply of dishes
Marketing design	Finance handbook
Design plan	Cost control
Protocol service	Supply of costume
Advertising	Personnel handbook
Equipment pla	Achievement evaluation
Professional promotion	Purchase of original materials
Sales promotion	Kitchen handbook
Restaurant interior plan	Running problem diagnose
Training evaluation	Supply of relevant objects
Public welfare activities	Service handbook

Preferred/ Key Locations:

Sichuan Province, East China, Northwest China, Beijing, Shanghai, Hong Kong, Macao, Chinese Taipei, Korea, Japan, Singapore and other Southeast Asian markets.

Requirements on area, fund, league membership, and royalty:

A Level League Member Restaurant:

1,500-2,000 square meters in area; with song and dance performance; self-service.

B Level League Member Restaurant:

600-1,000 square meters in area; self-service and dish-ordering.

C Level League Member Restaurant:

300-600 square meters in area; dish-ordering

D Level League Member Restaurant:

under 300 square meters in area; dish-ordering

Key Learning Points:

- Three success factors: history, flagship outlets and human resource.
- Innovation helps you gain competitiveness.
- Learning from the past is a way to success in the future.

Chongqing Cygnet Hot Pot

- Initial franchise fee: RMB120, 000 - RMB380,000
- Guarantee Fee: RMB30,000 – RMB100,000
- Royalty Fee: RMB3,000 – RMB10,000 per month
- Setup cost of one unit is estimated to be RMB800,000 - RMB3.5million

9.6 Qingeda - 亲圪墶

Shanxi Pingyao Qingeda Catering Services Co. Ltd.
No. 29, Beiguan Avenue, Pingyao, Shanxi
China 031100

Profile

Shanxi Pingyao Qingeda Catering Services Co. Ltd. was established in 1999 by Madam Li Lingqin. Shanxi, literally meaning west of the mountains, was named for its location. Pingyao is an extant, well-preserved model of the Ming Dynasty (1368-1644) and Qing Dynasty (1644-1911) located at center of Shanxi province. Since becoming a world heritage site, Pingyao has attracted many tourists who have spent a lot of money there.

Shanxi is the hometown of flour food. It boasts nearly 1,000 kinds of flour food, made of a wide variety of materials. Qingeda is a new creation of flour food developed from Qiageda, a traditional handmade flour food. Madam Li developed Qingeda by herself using unique soup and creative handmade technique. The name Qingeda has profound cultural meanings. In Pingyao, people call the thing they loved as "Qindandan" or "Gedada", and "Geda" also means unity and cohesion.

Brand Development and Franchise

Madam Li is a successful entrepreneur because she built up her own brand- Qingeda, however she is not born to be success. In 1993, Madam Li contracted in a restaurant. Lacking management experience, she made a loss of RMB260,000 after 4 years of operation. Instead of giving up, she borrowed money to conduct market studies in Beijing, Shanghai, Tianjin and other cities. Finally Madam Li found out that to be successful, a restaurant must have its own special and unique feature. In 1999 she set up a small restaurant with only four tables to sell mainly her own creation- Qingeda. Because of its unique and tasty food with reasonable price, the restaurant became famous not long after and business was very well. Paying back all her debt of more than RMB200,000 within two years, Madam Li opened three more outlets. Every restaurant gave her good return. In 2000, Madam Li was approached by a person who wanted to use Qingeda as the brand name in his restaurant. In return, he gave Madam Li RMB600. At that time, she still did not know much about franchise. She felt happy even though the amount she received is only RMB600. After that some more restaurants came to her and expressed their wishes to use her brand. Only then she thought of using franchise to expand her business and turned down an offer from an F&B company to buy her brand with RMB700,000.

In February 2001, Madam Li registered her trademark and started to do franchise business.

SME from Inner city

Currently Qingeda has 49 franchise outlets and 4 company-own ones. Being a small and medium size company located in inner city, it experienced certain barriers when seeking the expansion of its franchise business.

Human resources are an important element for a franchisor to succeed. Located in a city at county level - Pingyao, Qingeda faces difficulties in attracting capable people. “In Pingyao there are not much local talents while professional people in big cities are not willing to move to this small inner city” said Madam Li. Now Qingeda is expanding its business to Beijing. Madam Li told us that she was planning to move the headquarter to Beijing gradually.

Franchise concept is comparatively new to people in inner cities than coastal cities. Madam Li said she herself was in the learning process. She attends every seminars organised by CCFA and takes every opportunities to improve her knowledge about franchise. Meanwhile she also needs to educate franchisees and potential franchisees about franchise issues. According to Madam Li, some franchisees focus more on short term return and some try to change the taste without approval from the headquarter. All these bring Madam Li challenges.

Woman Entrepreneur

Being a woman entrepreneur, Madam Li believes her personal characters and the way she treats others make her what she is today. Learn to be successful as a person before try to be successful in business said Madam Li.

Madam Li regards her franchisees as her family members. When she travels to other cities to give support to franchisees, she dines and sleeps in their home instead of in hotels arranged by them. She said that would make them feel closer to each other. She visited the wife of one of her franchisees when the wife was hospitalised; she showed her concern to one of the staff in a franchise outlet when the staff delivered a baby at her forties and she also celebrated staff's birthdays. All these small things make her success as a woman entrepreneur.

Madam Li is perseverant. She failed once but she did not give up and created Qingeda. Madam Li is responsible in her work and is sincere to franchisees. Even though sometimes a few franchisees are not cooperative, she still tries to settle the problem smoothly. She believes that if they can not be partners, they may still be friends.

When asked about Qingeda's future plan, Madam Li told us that she was going to open 3 more company-own outlets soon. The success of company-own outlets will set up the image and standard for franchise outlets to follow. As to its franchise business, Madam Li wants to take some time to summarise the past experience and slow down the growth rate. Qingeda will be more selective in choosing its franchisees. The number of outlets is not everything, while making every outlet successful is more important said Madam Li.

Key Learning Points:

- To be successful, a restaurant must have its own special and unique feature.
- SME in inner city may face certain barriers in expansion like lack of capable human resources, unfamiliarity with franchise concept etc.
- Personal characters and the way people treat others can influence their business.

Shanxi Pingyao Qingeda Catering Services Co. Ltd.

Information to be suggested by Qingeda's

10. Appendix I

Major Taxes[42]

The major taxes applicable to foreigners, foreign investment enterprises ("FIEs") and foreign enterprises ("FEs") doing business in China are as follows:-

Category	Type of Tax
Tax on income	• Enterprise income tax ("EIT") - standard tax rate is 33%, but the tax rate could be reduced to 24% for enterprises located at the coastal cities or 15% for those located at the special economic development zone (Note: Currently, separate EIT systems are applicable to foreigners, FIE and FE, as contrasted with those applicable to local Chinese and domestic companies). • Withholding income tax on payments to non-residents - a concessionary rate of 10% is currently applicable to interest, rental, royalty and other income. • Individual income tax ("IIT") - progressive rates range from 5% to 45%.
Tax on transactions (turnover tax)	• *Value-added tax* - general tax rate is 17%, certain necessities are taxed at 13%. • *Consumption tax* - Tax rates range from 3% to 50%. • *Business tax* - Tax rates range from 3% to 20%.
Tax on specific objective	• *Land appreciation tax* - enterprises or individuals who generate gains realised from transfer of the real property and its attachments will be taxed at the progressive rates ranging from 30% to 60%.
Tax on resource	• *Resources tax* - a tax levied on the natural resources
Tax on property	• *Urban real estate tax* - a tax imposed on the owners, users or custodians of houses and buildings at the rate at either 1.2% of the original value with certain deduction or 12% on the rental value.

[42] *PwC Hong Kong: http://www.pwchk.com/home/eng/prctax_corp_overview_taxation.html*

Category	Type of Tax
Tax on behaviour	• *Vehicle and vessel usage and license plate tax* - a tax generally levied on vehicles and vessels at a fixed amount. • *Motor vehicle acquisition tax* - 10% of the taxable consideration will be levied on any purchase and importation of car, motorcycles, trams, electric buses, cart and certain types of trucks. • *Stamp tax* - enterprises or individuals who execute or receive "specified documentation" in China will be taxed and the tax rates vary between 0.005% to 0.1%.
Tax levied by the Customs	• *Customs duties - enterprises or individuals who import or export goods will be taxed at various rates*
Tax levied by finance department	• *Deed tax - transferees or assignees of the ownership of land use rights or real properties will be taxed and the general tax rates are ranged from 3% to 5%*

Various EIT incentives are currently available for FIEs. However, due to the accession to the World Trade Organisation (WTO), some of the said incentives would be removed. For the companies engaging in manufacturing and trading activities, a WTO impact study would be helpful in the planning of future business strategy in China. IIT compliance issue is the major tax investigation target lately, especially for the MNC whose assignees or/and expatriates are working in China. An IIT health check will therefore help to mitigate the future risk.

2005 Corporate Tax Information for China

2005 Tax Information	China
Tax rates	33%
Income not subject to tax	All income subject to tax, except for certain specified types of income such as dividend, interest income on loans to the Bank, royalty relating to approved certain approved new and hi-tech projects.
Non-deductible items. In general include: Expenses not related to earning assessable income; Capital expenses (although depreciation may be claimed on certain categories of assets) and income tax; Additional items as listed.	Interest on capital; entertainment expenses above certain limit; fines and penalties.
Tax incentives	Tax holiday for all manufacturing Foreign Investment Enterprises ("FIEs") - a two-year exemption followed by 50% reduction in tax rate for three years, starting from the first profitable year after utilising tax losses; 15% tax rate in Special Economic Zones; 24% tax rate in certain coastal cities; Foreign investor reinvesting its share of profits for at least five years gets a 40% refund of tax paid on sum reinvested or 100% if reinvestment in advanced technology industries or export oriented enterprises.
Loss treatment	Carry forward five years
Are dividends received taxed?	Dividends received by a FIE are not taxable; Dividends derived from a FIE in the PRC and received by a foreign investor are tax exempt.
Taxes on capital gains on sale of assets	Taxed as ordinary income.
Stamp duty	Yes
VAT/GST	Generally 17% VAT; 13% for certain types of tangible goods. Meanwhile, a 3%-20% Business Tax is imposed on provision of services and transfer of intangible assets.

Note: Tax information as of 30 April 2005.
The above table was first published in the May 2005 issue of CFO Asia (page 45).

Source: PwC Hong Kong: http://www.pwchk.com/home/eng/tax_inf_cn_2005.html

Demand for Foodservices by Provinces[43]

Region	Population (100,000 persons)	GDP[1] (100 million RMB)	GDP Per Capita[2] (RMB)	Disposable Income[3] (RMB/ person)	Living Expenditure[4] (RMB/ person)	Expenditure on food (RMB/ person)	Dining Out (RMB/ person)
National	**12,923**	**117,252**	**9,101**	**8,472**	**6,511**	**2,417**	**438**
Eastern							
Beijing	145.6	3,663	32,061	13,883	11,124	3,523	830
Fujian	348.8	5,232	14,979	10,000	7,356	3,105	347
Guangdong	795.4	13,626	17,213	12,380	9,636	3,584	924
Guangxi	485.7	2,735	5,969	7,785	5,764	2,306	353
Hainan	81.1	671	8,316	7,259	5,502	2,463	467
Hebei	676.9	7,099	10,513	7,239	5,440	1,912	184
Jiangsu	740.6	12,461	16,809	9,262	6,709	2,567	428
Liaoning	421.0	6,003	14,258	7,241	6,078	2,395	222
Shandong	912.5	12,436	13,661	8,400	6,069	2,051	386
Shanghai	171.1	6,251	46,718	14,867	11,040	4,103	897
Tianjin	101.1	2,448	26,532	10,313	7,868	2,964	612
Zhejiang	468.0	9,395	20,147	13,180	9,713	3,558	828
Total:	5,348	82,019	227,176	121,809	92,299	34,531	6,477
Average:			18,931	10,151	7,692	2,878	540
Central							
Anhui	641.0	3,972	6,455	6,778	5,064	2,239	298
Heilongjiang	381.5	4,430	11,615	6,679	5,015	1,784	245
Henan	966.7	7,049	7,570	6,926	4,942	1,662	230
Hubei	600.2	5,402	9,011	7,322	5,963	2,280	482
Hunan	666.3	4,639	7,554	7,674	6,083	2,179	367
Inner Mongolia	238.0	2,150	8,975	7,013	5,419	1,706	252
Jiangxi	425.4	2,830	6,678	6,901	4,915	1,980	243
Jilin	270.4	2,523	9,338	7,005	5,492	1,958	269
Shanxi	331.4	2,457	7,435	7,005	5,105	1,712	250
Total:	4,521	35,451	74,631	63,304	47,998	17,500	2,637
Average:			8,292	7,034	5,333	1,944	293
Western							
Chongqing	313.0	2,251	7,209	8,094	7,118	2,702	502
Gansu	260.3	1,305	5,022	6,657	5,299	1,908	334
Guizhou	387.0	1,356	3,603	6,569	4,949	1,968	332
Ningxia	58.0	385	6,691	6,530	5,330	1,919	354
Qinghai	53.4	390	7,277	6,745	5,400	1,987	339
Shaanxi	369.0	2,399	6,480	6,806	5,667	1,960	493
Sichuan	870.0	5,456	6,418	7,042	5,759	2,241	374
Tibet	27.0	185	6,871	8,765	8,045	3,543	206
Xinjiang	193.4	1,878	9,700	7,174	5,541	1,987	397
Yunnan	437.6	2,465	5,662	7,644	6,024	2,507	624
Region's total:	2,969	18,069	64,933	72,027	59,132	22,722	3,953
Average:			6,493	7,203	5,913	2,272	395

1: Figures are for year 2003 calculated at current prices.

2: Figures are for year 2003 calculated at current prices. Per capita gross regional products of Beijing, Tianjian, Shanghai, Chongqing, and Sichuan are calculated by the population of permanent registered residence, others by de factor population.

3: Per capita annual income of urban residents by source and by region (2003)

4: Per capita annual living expenditure of urban residents by region in 2003

[43] Source: China Statistical Yearbook 2004, Bureau of Statistics of China

Supply of Foodservices by Provinces[44]

Region	Restaurants in Chain	Company-Owned Outlets	Franchised Outlets	Sales Revenue of Restaurants in Chain (10,000 RMB)	Restaurants in chain per 100,000 persons	Profit Margin
Eastern						
Beijing	858	803	55	492007	5.89	5.2%
Fujian	161	141	20	47572	0.46	4.6%
Guangdong	660	542	118	1130292	0.83	1.6%
Guangxi	19	6	13	n/a	0.04	n/a
Hainan	11	6	5	294	0.14	6.8%
Hebei	194	22	172	1174	0.29	2.1%
Jiangsu	1051	988	63	218361	1.42	13.6%
Liaoning	240	110	130	178926	0.57	10.7%
Shandong	307	113	194	81930	0.34	10.7%
Shanghai	520	467	53	316138	3.04	7.5%
Tianjin	579	166	413	111394	5.73	4.1%
Zhejiang	297	263	34	207835	0.63	14.7%
Total	4897	3627	1270	2785923	19.37	81.7%
Average	408	302	106	232160	1.61	6.81%
Central						
Anhui	85	66	19	39379	0.13	0.5%
Heilongjiang	144	51	93	2373	0.38	-0.2%
Henan	192	23	169	4864	0.20	2.0%
Hubei	175	124	51	146177	0.29	0.1%
Hunan	97	61	36	36658	0.15	10.7%
Inner Mongolia	81	29	52	435288	0.34	14.9%
Jiangxi	33	20	13	15140	0.08	11.8%
Jilin	67	36	31	1670	0.25	0.8%
Shanxi	135	38	97	35176	0.41	9.3%
Total	1009	448	561	716725	2.22	50.0%
Average	112	50	62	79636	0.25	5.56%
Western						
Chongqing	326	139	187	371523	1.04	1.79%
Gansu	73	17	56	8946	0.28	-3.85%
Guizhou	45	20	25	11379	0.12	1.36%
Ningxia	9	2	7	n/a	0.16	n/a
Qinghai	21	11	10	2165	0.39	2.03%
Shaanxi	123	29	94	14933	0.33	7.82%
Sichuan	307	51	256	41757	0.35	2.84%
Tibet	10	n/a	10	n/a	0.37	n/a
Xinjiang	127	31	96	12699	0.66	3.35%
Yunnan	76	39	37	31141	0.17	3.69%
Total	1117	339	778	494543	3.87	19.03%
Average	112	34	78	49454	0.39	1.90%

Numbers (Tibet's number is not available) in the above table are for those annual sales income at and over RMB2 million in 2004 and year-end employees at and above 40.

[44] Source: China Statistical Yearbook 2004, Bureau of Statistics of China

B. JAPAN FOOD & BEVERAGE FRANCHISING

11. Japan Overview

11.1 Introduction

Japan has a land area of around 380,000 km2. This is about 1/25th of the size of the USA about half the size of Chile, around 1.5 times that of the UK, and about 1.3 times that of the Philippines. Some 67% of Japan's landmass is covered with forests, while farmland accounts for around 13%, making this an economy with quite a large amount of greenery.

Japan has an estimated total population of 127.7 million (62.3 million males, 65.4 million females) as of October 2004[45], making it the 9th[46] largest in the world. Its population is concentrated in 4 major metropolitan areas, namely Tokyo, Yokohama, Osaka, and Nagoya.

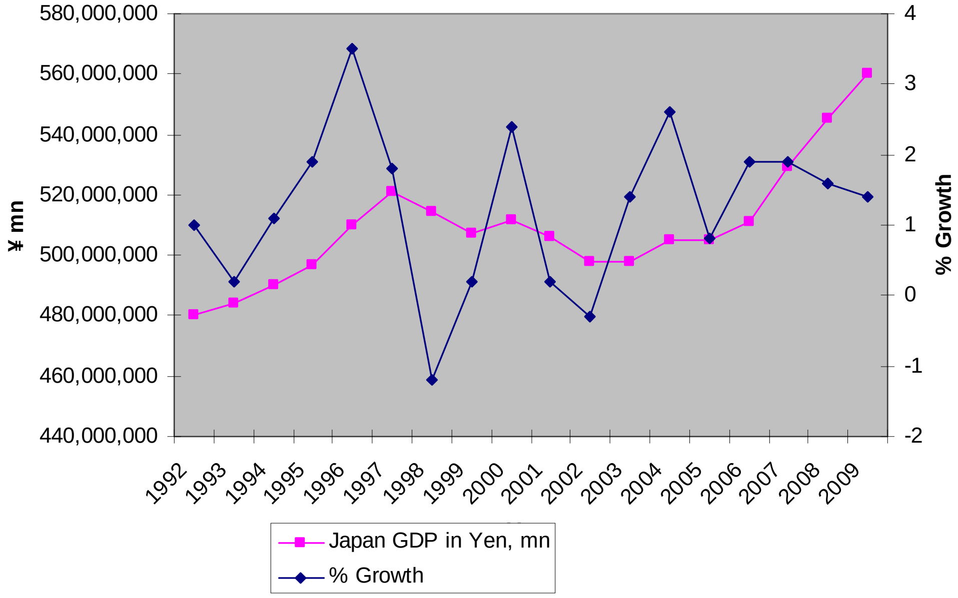
11.2 Japan's Economic Overview

Japan's economic recovery is set to continue, with real GDP growing by a relatively brisk 1.9% in 2005. Fiscal tightening will, however, help to drag growth down to 1.3% in 2006. Japan has continued its push to conclude free-trade agreements (FTAs) with key trading partners, reaching a basic agreement with Thailand in August 2005. The introduction in July by China of a new exchange-rate regime could make life difficult for Japan if it leads to a refocusing by the US on alleged unfair trading practices by Japan.

Real GDP grew by 0.3% quarter on quarter in the second quarter of 2005. Business investment, private consumption and exports all grew respectably. The labour market tightened in the second quarter. Wages also rose in the period. Year-on-year corporate goods price inflation has picked up, but this has yet to feed through fully into consumer prices. The continuing economic recovery and rising confidence from the LDP win of the lower-house election have boosted the yen and the stock market.

Figure 27. Japan's GDP and % growth at current prices

[45] Institute of Population and Social Security Research,
[46] United Nations Population Fund, State of world population 2004.



Source: EIU, Euromonitor

11.3 Economic Characteristics

Japan has the second largest economy in the world in terms of Gross Domestic Product (GDP)[47], next to the United State and almost three times that of China. Japan's GDP per capita in 2004 was US$36,672, one of the highest in the world. This economic scale was achieved largely due to high economic growth from 1955 to the late 1960s when it surpassed more than those of the West. Although Japan maintained a relatively high rate of growth until the late 1980s, the pace of economic growth slowed in the early 1990s, when the "bubble economy" collapsed. As a result, retail consumption has similarly declined as well.

[47] Source: American Enterprise Institute for Public Policy Research

Japan’s free market economy is highly industrialised. Primary industries (agriculture, forestry, and fisheries) make up c. 1% of total GDP. On the other hand, secondary industries (manufacturing, mining, and construction) account for approximately 25 % and tertiary industries (ex. services, transportation, distribution and banks) make up 70%. The Japanese economy is efficient and competitive, in particular, in some manufacturing fields such as computer technology and automotive industries.

Japan’s industrialised economy relies on such factors as a well-educated work force, high level of technology, high savings, and investment rates. Since Japan has few natural resources, Japan has to import most of the raw materials it needs to manufacture industrial products. Exports of industrial products help Japan earn the foreign currency needed to purchase raw materials for its economy. As of 2004, imports of raw materials such as foods and fuels make up about 38.5 % of Japan’s total imports. Exports of industrial products account for approximately 90%.

While Japan's long-term economic prospects are considered good, Japan is currently in its worst period of economic growth since World War II. The Koizumi administration is committed to address such economic issues as non-performing loans and deflation, and to conduct regulatory and other structural reforms, in order to revive the Japanese economy.

Latest economic statistics indicate that Japanese economy is steadily recovering. Revised GDP data show Japan's economy grew by 0.8% quarter on quarter in April-June, almost three times the rate previously estimated. High growth is expected to continue in 2005 and forecasted to achieve 1.9%. This is a very reasonable performance for an economy that has a rapidly ageing population and a shrinking labour force.

11.4 Family and household structure

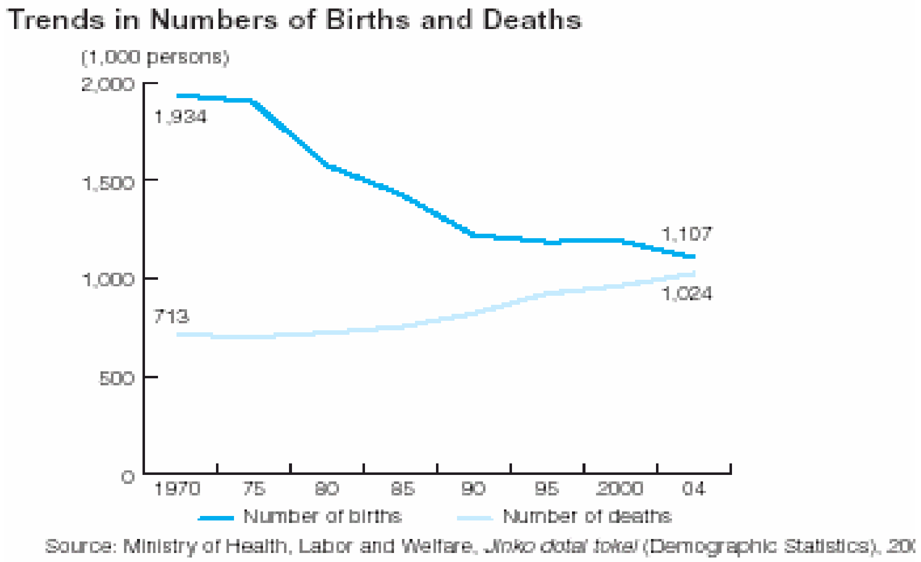
Japan’s population is characterised by an ageing population and a low birth rate. By 2015, it is expected that the median age of the population will be around 44.3 years old and the annual death rate per 1,000 inhabitants will be 12 persons. Consequently, the population whose age bracket is 65 years old and above will increase markedly.

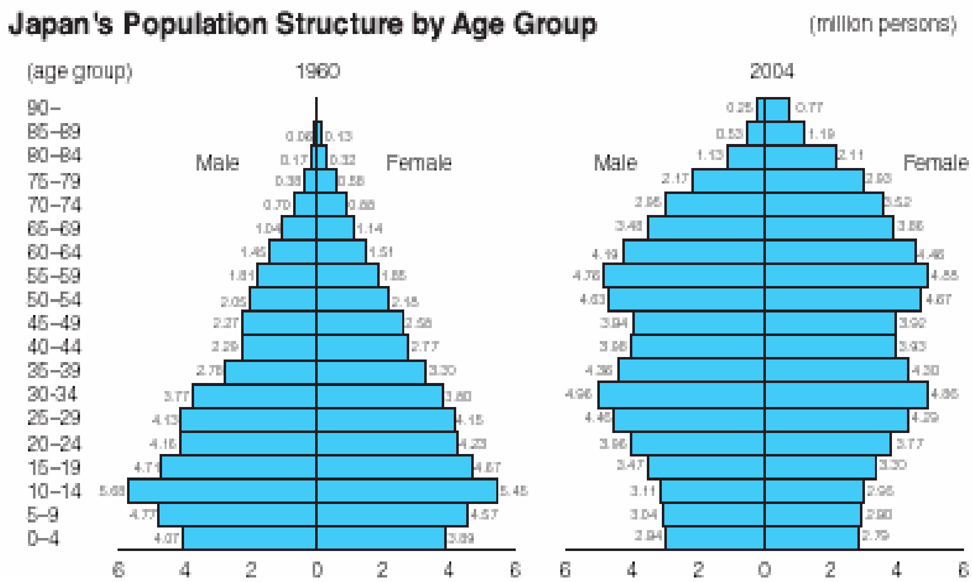
This is in contrast to the younger generations aged 29 years old and below, which will experience a decline. As a result, there will be one elderly person for every two persons of working age by 2015, which will leave Japan with a high old age dependency ratio. The fastest growing segments of the population are all above 60 years of age, and by 2015 the proportion of the population over 35 years of age is predicted to reach almost 65% of the population. As in other industrial markets, declining fertility along with longer life spans is pushing the average age of the population upward.

Japan’s first baby boom came from 1947 to 1949, shortly after the Second World War, and the second from 1971 to 1974. After the second baby boom, however, the number of births, which peaked in 1949 at 2.70 million, has been declining and dropped to a record low of 1.12 million in 2003 (1.29 total fertility rate). Number of children (aged 0 -14) occupied about one third of total population in 1950, but the ratio plummeted to 14.0% in 2003. On the other hand, the elderly population is growing. The ratio of those aged 65 and over, which accounted for only 4.9% in 1950, surpassed that of children in 1997 and climbed to 19.0% in 2003.

Such trends have decelerated Japan's population growth, and the annual growth rate dropped to 0.10% in 2003. Japanese society is expected to experience a declining population in a few years, the first time except for a short period during the war.

Figure 28. Population Statistics





Source: Ministry of Internal Affairs and Communications, (Current Population Estimates), 2004.

Household Expenditure

Average monthly household expenditure in Japan peaked in 1993 at ¥335,246 (US$ 2,853), up 30% from ¥259,521(US$ 2,209) a decade earlier in 1983. Since then it has declined almost constantly. In 2004 the figure was ¥304,203 (US$ 2,589) in nominal terms, up 0.5% over 2003. In real terms, the figure also represented a 0.5% increase over 2003, because people spent more on such leisure activities as overseas travel. Compared with 1994, declines in spending were striking in such fields as food (13.0%) and clothing (36.0%), while increased spending was observed in transportation and communications (20.2%), medical care (25.8%), and other areas. Japan's Angel's coefficient, the proportion of food spending in overall expenditure, was 23.0% in 2004, a decrease of 9.0 percentage points from 1975.

Figure 29. Expenditure per household

Yearly Average of Monthly Receipts and Disbursement per household (Value in Yen)

全 国 All Japan

						Select Food Expenditure Items			
	世帯人員(人)	有業人員(人)	消費支出	食 料		調理食品	飲料	酒類	外食
Actual figures	Persons per household(persons)	Earners per household (persons)	Living expenditure	Food	Food as % of Living Expenditure	Cooked food	Beverages	Alcoholic beverages	Eating out
1994	3.47	1.6	333840	80552	24%	7166	3207	4073	12820
1995	3.42	1.59	329062	77886	24%	7334	3200	3869	12643
1996	3.34	1.54	328849	77042	23%	7303	3223	3897	12786
1997	3.34	1.54	333313	78306	23%	7827	3322	3819	13131
1998	3.31	1.52	328186	78156	24%	7968	3408	3833	12844
1999	3.3	1.49	323008	76590	24%	8015	3594	3727	12802
2000	3.24	1.47	317133	73844	23%	7963	3515	3642	12448
2001	3.22	1.46	308692	71534	23%	8069	3493	3474	11924
2002	3.19	1.41	306129	71286	23%	8039	3513	3436	12008
2003	3.21	1.41	302623	70260	23%	8121	3492	3360	11743
2004	3.19	1.39	304203	70116	23%	8054	3653	3371	11813
CAGR 1994 - 2004	-0.9%	-1.6%	-1.0%	-1.5%		1.3%	1.5%	-2.1%	-0.9%

Source: Statistical Survey Department, Statistics Bureau, Ministry of Public Management, Home Affairs, Post and Telecommunications

According to a survey conducted by the Japan Bureau of Statistics, the average monthly living expenditure per household was ¥302,623 (US$ 2,575) in 2003, down by 1.1% in nominal terms and 0.8% in real terms from the previous year, due in part to a 0.3% decline in consumer prices. In 2004, the figure increased to ¥304,203 (US$ 2,588) whilst as a percentage of food expenditure remains at 23%. Notably, Japanese households are spending slight lesser on eating out, while their purchases of cooked food increase marginally. On the whole, one could conclude food expenditure during this period was relatively stable suggesting the food services company are competing is stagnant and in which revenue growth is achieved through taking market share from the competitors

According to Public Policy and Economic Research Group of Hitachi Corporation, for fiscal 2003, the poor employment and income environment, greatly discouraged personal consumption and the decline of real disposable household income will surely be witnessed until 2005 due to the reforms to the tax and social security systems.

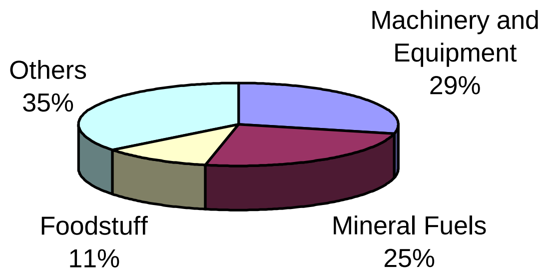
There are some positive expectations however that given the condition of a much enthusiastic and confident household in the next eight or ten years period, pushed measures to inject enthusiasm in the economy, it is expected that current mean disposable household income could rebound to a more positive marks, hitting 6.9 million by 2015.

11.5 Trade

Japan has the third largest volume of trade in the world, next to the United States (US) and European Union(EU). Its merchandise trade surplus (fob-cif) stood at ¥4.5 tn (US$42 billion) in the first half of 2005, a slip from the ¥6.2 tn recorded in the same period of 2004. Reasons for the narrowing surplus include the rapid rise in oil prices and slowing demand from China. The current-account surplus narrowed to ¥8.8 tn in the period, down from ¥9.6 tn in the same period of 2004.

Since Japan has few natural resources, Japan has to import most of the raw materials it needs. As of 2005 May, imports of raw materials such as foodstuff and fuels make up about 36% of Japan's total imports.

Imports by Commodity (YTD May 2005)



Currently, Japan has signed FTAs with 3 economies. Table 7 below highlights the concluded FTAs and on-going negotiations.

Figure 30. Summary of Markets which Japan has FTAs with

Concluded	Ongoing
• Singapore	• ASEAN
• Mexico	• Australia
• Philippines	• Indonesia
	• Thailand
	• Korea
	• Malaysia
	• Chile

Source: Ministry of Foreign Affairs

12. Franchising in Food & Beverage Services Industry

Japan first embraced franchising in the early 1960s, making it the first economy in Asia to do so. The pioneers of the franchise industry were the service businesses and food service businesses, who adopted it in 1963 for the first time. Till today, the franchise system in Japan has grown in numbers and sophistication – evident from its consistent growth despite the sluggish Japanese economy.

We are also starting to see a growing maturity in Japanese franchise industry. For one, there is a proliferation of Japanese franchisors that have similarly adopted the franchise model in their international expansion. Next, the Japanese franchisees have grown to learn, adapt and improve the original franchise model. Examples would include Ito-Yokado, 7-Eleven's franchisee, improved its operations via an "item-by-item sale management system" so much so that it was eventually adopted by the US franchisor, Southland Inc.; and Duskin who similarly, improved on the original model to great success and has now bought over the license rights to the rest of Asia.

12.1 Japan's F&B Sector

Expenditure on F&B Sector

Expenditure on food in the F&B sector showed some signs of stagnation. In 2003, consumer expenditure on F&B grown by less than 1% on 2002. CAGR between 1999 and 2003 was a mere 0.26%. Several reasons have been attributed to this stagnant growth. Firstly, set against a backdrop of unfavourable macro-economic trends, Japanese consumers have been watchful of their spending. As such, lower price points items/sectors such as frozen prepared food, ready to eat meals offered at retail outlets, and fast food outlets have become more popular. Corporate spending on business entertainment, banquets and receptions have also bottomed out as a result.

In addition, because of recent BSE and Avian Flu food scares, consumers stayed away from restaurants that offer a predominantly beef -based menu such as yakiniku, gyudon, burger and steak restaurants and chicken-based items. As a result, sales declined across the board for these restaurants.

Figure 31. Consumer Expenditure, Transactions and Units in the F&B sector

	1999	2000	2001	2002	2003	CAGR 1999-2003
Units ('000)	826.9	818.8	812.6	823.2	829.6	0.1%
Transactions (mn)	9,439.4	9,682.7	10,060.3	9,958.8	10,193.6	1.9%
Current prices (¥ bn)	20,638.8	20,392.0	20,366.7	20,677.7	20,857.4	0.26%
Current prices YoY Growth	-	-1.2%	-0.1%	1.5%	0.9%	-
Constant prices (¥ bn)	20,638.8	20,529.7	20,655.6	21,164.7	21,499.1	1.03%
Constant prices YoY Growth	-	-0.5%	0.6%	2.5%	1.6%	-

Source: Euromonitor

As seen in Figure 31 above, expenditure on eating out has increased marginally by about 1% in 2003 over 2002 and a CAGR of 0.26% over the past 5 years. While the industry remains stagnant, several sectors, particularly fast food and home delivery/takeaway, are enjoying higher than average growth rates. This may be attributed to the preference for economical meals as well as convenience amidst a backdrop of bleak economic climate and hectic lifestyles as mentioned above.

Figure 32. Expenditure on Eating Out by Sector 1999-2003 (¥ billion)

Consumer foodservice by type	1999	2000	2001	2002	2003	CAGR
Cafés/bars	6,366.2	6,209.5	6,151.8	6,261.0	6,403.6	0.1%
Full-service restaurants	10,624.1	10,434.7	10,278.7	10,357.4	10,343.3	-0.7%
Fast food	1,404.8	1,430.4	1,549.6	1,596.7	1,609.0	3.5%
100% home delivery/takeaway	2,073.9	2,147.2	2,215.7	2,287.3	2,320.4	2.8%
Self-service cafeterias	145.8	146.1	146.3	150.7	156.6	1.8%
Street stalls/kiosks	24	24.2	24.5	24.5	24.6	0.6%
	20,638.8	20,392.0	20,366.7	20,677.7	20,857.4	0.26%

Source: Euromonitor, 2004

F&B Outlets

As of 2004, there were a total of 275,558 F&B retailers in Japan, out of which, 54,457 are part of a chain concept[48]. These are units that part of a group of 10 or more units under a single ownership entity (either a person or business). Each individual unit under common ownership is considered as one chain unit.

Research indicates that on the whole, the total number of outlets will remain somewhat stagnant. This may be due to the period of consolidation amongst F&B retailers which saw independent outlets, unable to survive through the depressed economy and increased competition from international players, either closing down or converting into chain-store format.

However, analysts generally agree that the growth of chained outlets will occur at a faster rate than that of independent outlets, and on a sustained basis. Similarly, sales of chain stores registered CAGR growth of 7.9% versus that of independent outlets at -0.5%. This may signify that chain outlets may be the way to go as they benefit from economies of scale, branding visibility and consumer accessibility to their products via multiple presences.

Figure 33. Number of F&B outlets

	Outlets		CAGR Growth	Chain Outlets		CAGR Growth
	2004	2009		2004	2009	
Cafés	14,058	14,271	0.3%	3,472	3,712	1.3%
Pubs and bars	91,464	90,938	-0.1%	8,963	9,322	0.8%
Restaurants: FSR	61,569	61,053	-0.2%	11,636	12,684	1.7%
Restaurants: QSR	26,078	26,106	0.0%	14,604	15,944	1.8%
Takeaways (main activity)	6,782	6,788	0.0%	1,492	1,596	1.4%
Hotels & lodging	75,607	76,492	0.2%	14,290	15,126	1.1%
Total	**275,558**	**275,648**	**0.0%**	**54,457**	**58,384**	**1.4%**

Source: Datamonitor

[48] Datamonitor F&B Database, 2004

F&B Trends

- Internationalisation and Modernisation of F&B concepts

Foreign fare such as Chinese, Western, and Vietnamese etc., has been experiencing steady growth in Japan. This could be because the younger generation – ie working adults, youths etc., who are the key consumers of food services, are more adventurous in their food selection and are more exposed to foreign cultures via travelling and/or media influences.

As more options become available, the traditional Japanese menu of rice and fish may have suffered a decline as a result. The younger Japanese has been replacing the traditional staple with alternatives such as pizza, hamburgers etc. In addition, even beverage consumption has shifted from the traditional green tea to soft drinks, flavoured water and other beverages. In addition, food consumption has gradually shifted from being a basic requirement/need to a lifestyle trend/product. This has been attributed to the influx and acceptance of western culture into Japan.

We also see the localisation of international menu in Japan. Food service retailers are modifying their menu with local flavours such as green beans, shrimp, squids etc. Some popular examples include green tea ice-cream, Japanese curry and squid topping pizza etc.

- Organic Food

In the midst of food scares such as BSE and Avian Flu, consumers have turned to alternatives such as organic food. Demand for organic food appears to be increasing.

However one should note that organic food sold in Japan must be produced according to the organic standards of the JAS. All such organic foods are given the official JAS seal, and those that do not are not officially recognised as organic products.

- Eating out

The pattern of eating out is both a functional and social activity in Japan. While many Japanese still have the desire to cook and serve their food at home, more are being attracted to eating out due to the convenience and variety available.

In addition, dining at restaurants can sometimes be more practical for a family than cooking at home due to the high prices of ingredients at the supermarket as well as the extra time and effort spent in preparing the meals.

As Japan progresses towards a society with more dual income families, working women and working single individuals, dining out is becoming increasingly popular. This is because they may not know how to cook or are too tired to cook after work.

- Convenience

Demand for convenience foods is anticipated to increase in line with the hectic lifestyles faced by dual-income households, working women and single-person households. This means that takeaway/delivery services and fast food to go will be popular amongst Japanese consumers. Some examples include takeaway shops located at train stations, restaurants offering take away and home delivery services, prepared meals to go etc. Products offered include traditional style Japanese meals, pizzas, sandwiches, pastries etc.

This trend is largely spurred by several factors such as the lack of skills or inclination to cook for themselves; the convenience of having food delivered directly to the office or home and affordability of these takeaway options.

- Consolidation and Proliferation of Chain-store Concepts

The Japanese eating-out markets are highly fragmented, consisting mostly of small-scale chains and independent outlets, catering to a small local consumer base. However, consolidation is currently occurring as more international players enter the market, and competitive pressures serve to squeeze out small - scale operations unable to cope with heavy competition and economic downturn.

A USDA report suggested that Japan's Food Service Sector is experiencing structural changes. For example, during the decline in sales between 1997 and 2003, the top 1000 food service companies showed an average yoy growth of 1.9%. While the number of food service companies decreased by 386,000 between 1992 to 1998, the number of outlets increased by 4.1%. It is believed that this trend will recur on a continued basis and result in a market characterised by chain stores.

12.2 Japan's Franchise Sector

Japan is the first in Asia to embrace franchising, with the franchises being established in the Japanese market around 1960s. Since then, franchising has become the one of the largest growing organisation type. Growth in sales through franchised stores has been maintained in recent years despite a bleak economy and depressed retail spending, as retailers have turned to franchising as a cheap way to expand their retail networks, while new business owners have valued the security and assistance provided by joining franchise chains..

The franchising system was introduced to Japan from the United States, and was originally used mainly by foreign F&B companies such as Mcdonalds, KFC and Mister Donut, looking to capitalise on the lucrative Japanese market. However, it has since extended into the service and retail sectors as well. The franchise market in Japan has grown in scale as well as maturity. This is evident in the multitude of local companies that have chosen to expand via franchising within Japan as well as internationally.

It is also interesting to note how the success of the local Japanese franchisees has outperformed that of the franchisors. A well known case study example would be that of Ito-Yokado of 7-Eleven Japan, which implemented a highly successful "item by item" sales management and logistics system for its Japanese operations. Its business performance exceeded that of its US franchisor and 7-Eleven Japan eventually gained full control over Southland Inc. in 1991. We have seen also seen similar examples in other franchisees such as Duskin Co.

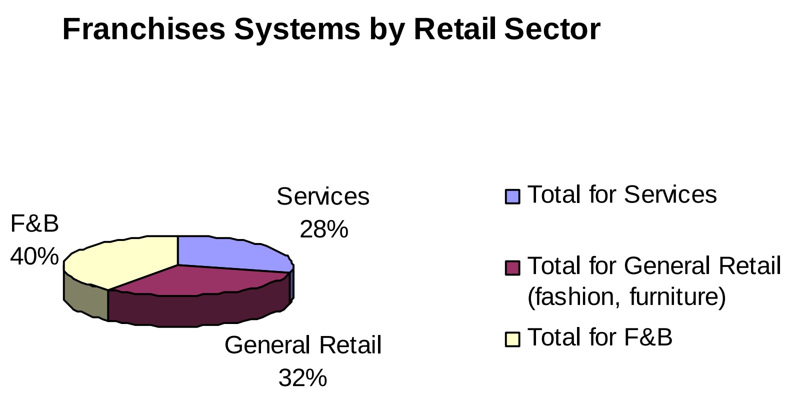
A brief history on the development of franchise sector is as follows:

1960s	The pioneer of the franchise industry in Japan is Duskin Co. which started renting out dust control products in 1963. This was followed closely by Fujiya Co. in the confectionary business.
1970s	Following measures for liberalisation of capital controls, many foreign franchise business entered Japan, fuelling a franchise boom from the late 1960s to early 70s. Some examples include Kentucky Fried Chicken (1970), McDonald and Mister Donut (1971).
1980s	Growth of Japanese economy and disposable income leads to increase in demand for services. Retailers, local and foreign, sought to capitalise on the demand by expanding via franchising. Franchise sales increased by more than 10% almost every year in the 1980s. Local Japanese franchisors embark on international franchising.
1990s	As a result of the Japanese economic recession, franchise sales, though still on a continual growth phase, fell back to single digit growth rates of about 6-8%. This is relatively better compared to other industries during the recession period.
2000 to present	Franchising continues to outperform the economy as well as other retail formats. The outlook for the Japanese franchising sector is for continued steady growth in the near future. Analysts believe that franchising is expected to see the highest growth in retail sales, with value sales in 2008 forecasted to reach ¥24,120 bn (US$ 205.3 bn) at constant 2003 prices[49].

[49] Euromonitor, Retailing in Japan, 2004

According to research by JFA, annual gross sales of the franchise industry stood at approximately ¥17,868,851 billion (US$152,062 billion) in 2003. According to research, the franchise industry has performed well even during Japan's economic recession – registering a CAGR growth of 1.88% in sales. It appears that franchising as a business format registered representing the largest growth amongst other retail formats, while total retail sales decreased by 0.44%. In 2003, there are a total of 220,710 franchise outlets in Japan, growing at about c. 3% per annum. In addition, the number of franchise systems has grown by c.1.2% between 2001 to 2003. In terms of segmental contribution, F&B represents the largest segment of franchises at c.40% followed by retail (32%) and services i.e. beauty salons, education etc (28%).

Figure 34. Franchises by Trade category in Retail Sector



Source: JFA, 2003

It is believed that the franchise industry will continue to grow as retailers adopt it as a less risky and capital intensive business model for retail expansion in an increasingly competitive landscape. In addition, the rise of entrepreneurship in Japan may also serve to boost the franchise sector as it is seen as a relatively safe business venture, with access to support and know-how from the franchisor.

12.2.1 Local Franchises

According to JFA statistics, local Japanese concepts make up 75% of the entire franchise universe.[50] Out of which, only 31% of Japanese franchises have expanded overseas. Examples of F&B franchises that have overseas presence include Mos Burger, Yoshinoya, BeardPaPa etc. [51]

Figure 35. Major Local Franchises in Japan[52]

Franchise Brand	Sector	Sales (US$, mn)	Outlets
Kozo Sushi	F&B- Sushi/Lunch Box	507	1348
Mos Burger	F&B- Fast Food	929	1476
Hottsuka Hottsuka Tei	F&B- Sushi/Lunch Box	1706	3519
Yoshinoya	F&B- Gyudon	867	992
Skylark	F&B- Family Restaurant	2428	2450
Doutor Coffee	F&B- Cafe	749	1294
Kohikan	F&B- Café	127	411

Source: USDA HRI Food Sector Report, STDB Franchsiing in Asia Pacific Report, Company websites and interviews.

12.2.2 Foreign Franchises

There are no recent statistics available on foreign franchisors' presence in Japan. The latest information, in a JFA report dated in 2000, documents that the number of foreign franchises in Japan, as of 1999, was relatively small i.e. 44 out of a possible 255 brands in Japan. Out of these 44 foreign franchises, 25% were in the F&B segment. These include brands such as KFC, Haagen Daz, Mister Donut, and Subway. 86% of these brands originated from the US, while the remaining were from France, Canada and UK. A more recent, but unofficial, source by the President of Franchise and Thai SMEs Business Association, states that there are 200 foreign franchisors in Japan, comprising of about 16% of the entire market. On the whole, foreign concepts occupy less than a quarter

[50,51] JFA Statistics

[52] USDA Foreign Agricultural Services, HRI Food Service Sector Report 2005; Singapore Trade Development Board, Franchising in Asia Pacific, 1995;

of the franchise market, a marked difference from Singapore where they make up at least 60%.

By type of business, the 44 companies could be broken down as follows: 7 retailers, 11 food service providers and 26 service providers. There were 38 US, 3 French, 2 Canadian and 1 British company. Three of the French companies were beauty salon chains[53].

In our interviews, several reasons were given for the ethnocentrism of Japan's franchise industry. For one, the Japanese market is a highly competitive and difficult market to penetrate, particularly for food franchises. The F&B industry is highly mature and any new entry by an unknown foreign brand would have to face stiff competition where even domestic players are struggling to survive. Some notable failures include: Carls Junior, Wimpy's, Wendy's, White Castle and most recently Burger King. In addition, like any market, the Japanese market also has it peculiarities. Foreign brands must learn to adapt to the strict Japanese culture where excellent service standards and food hygiene are critical in consumer acceptance of the brand. For example, Mr. Usui, from JFA, quoted an example of when GAP a leading US retailer first which opened in Japan, it embarked on an additionally longer training program for its staff to ensure that it was up to par with strict Japanese standards for quality and service when it first opened in Japan, thereby ensuring its success. .

It is also interesting to note that in our interviews with foreign franchisors attempting to penetrate the Japanese market, many have echoed a sentiment that Japanese partners tend to prefer western concepts and have cited high investment costs as a main deterrent in their expansion plans into Japan. However, interviews with master franchisors and associations in Japan have pointed out that a franchisor a strong brand, good understanding of the Japanese market and suitable partner are critical to success in Japan. In addition, some have advised potential foreign franchisors to enter Japan directly by running its own flagship store to prove the feasibility/possibility to run the business/concept in Japan otherwise it may be quite difficult to convince the potential Japanese partners. Alternatively, potential foreign franchisors can also

[53] JFA, JETRO Franchise Report 2000

consider a joint venture.

12.2.3 Number of Franchise Systems

Figure 36. Growth in Number of Franchise Systems in Japan

	2001	2002	2003	CAGR (2001-2003)
Fast Food	201	205	208	1.73 %
Restaurants	124	117	122	-0.81 %
Bars & Pubs	44	57	63	19.66 %
Tea-houses/ cafes	28	38	34	10.19 %
Total for F&B	**397**	**417**	**427**	**3.71 %**
Total for Franchise Industry	**1049**	**1063**	**1074**	**1.18 %**

According to data from the JFA, there were 1074 franchisors in 2003. It is apparent that F&B franchising is the most popular sector, making up c.38% of the total franchise industry. Service providers such as beauty salons, education services and car repair made up 32% while general retail such as fashion, household goods etc. made up 30%.

The number of franchisors in the F&B segment grew 3.71% from 2001 to 2003, outstripping the growth in the overall franchise industry (i.e. retail and services). Franchising as a business model appears to be most prevalent amongst the Fast food sector – it was the largest segment amongst F&B franchising at 49%. Restaurants serving Japanese, Chinese, Western and other cuisines was another major segment at 29%. However, it was the only segment that showed a decline of c.1%, which was converse to the overall growth trend. This may be due to highly competitive market conditions as a result of lower consumer expenditure in the segment. Bars, pubs, tea-houses and cafes accounted for the remaining 22% and registered double-digit growth between 2001-2003.

12.2.4 Number of franchise outlets/establishments

Statistics from JFA indicates that there were a total of 220,710 franchise outlets in 2003. This represents a CAGR growth of 3.1% between 1999 to 2003. In terms of segmental contribution, F&B represents the smallest segment of franchises at c.23% followed by retail (36%) and services i.e. beauty salons, education etc (41%). F&B franchise outlets grew at a faster pace compared to the other segments, at c.5% annually. Amongst the more popular F&B franchise concepts are restaurants (CAGR of 12%) serving fare such as Japanese cuisine and sushi, steakhouses, Italian cuisine etc., tea houses and cafes (CAGR 9.9%) and fast food (CAGR 4%)

Figure 37. Number of franchise outlets by segment

	Franchise outlets					
	1999	**2000**	**2001**	**2002**	**2003**	**CAGR (1999-2003)**
Services	81,388	87,811	86,378	87,289	87,890	1.94%
General Retail (fashion, furniture)	70,061	71,786	74,926	77,202	79,498	3.21%
F&B	43,886	46,012	48,676	51,219	53,322	4.99%
Total	**195,335**	**205,609**	**209,980**	**215,710**	**220,710**	**3.10%**

Figure 38. Segmental contribution by number of outlets

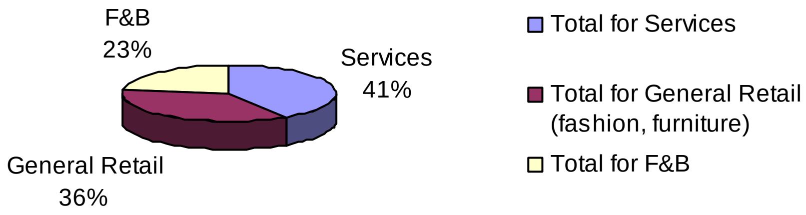


Figure 39. F&B Franchise Outlets by segment

	Franchise outlets					
	1999	**2000**	**2001**	**2002**	**2003**	**CAGR (1999-2003)**
Fast Food ie Take-out sushi, boxed lunch, noodles, beef bowls, hamburger and ice-cream	29,681	31,293	31,869	34,078	34,762	4.03%
Restaurants ie Japanese, Western, Chinese, roast meats and others	6,142	6,488	7,834	8,348	9,625	11.89%
Bars & Pubs	5,782	5,785	6,046	5,793	5,609	-0.76%
Tea-houses/ cafes	2,281	2,446	2,927	3,000	3,326	9.89%
Total for F&B Franchise	**43,886**	**46,012**	**48,676**	**51,219**	**53,322**	**4.99%**

12.2.5 Type of Franchising Arrangement

As with Singapore, there are three general methods of franchise systems in Japan – direct, master and regional. The various types of franchising agreement is determined by the origin of the franchise (local vs. foreign concept) and the preference and financial affordability of the franchisee and the nature of the F&B outlet.

Foreign franchisors typically enter Japan through Joint Venture Franchising, Master Franchising or Area Franchising via a local partner(s). The local partner will then sell sublicenses for different geographic areas to other Japanese firms or direct to the store operators. Foreign franchisors may wish to consider forming a joint venture and assuming a portion of the investment risk because Japanese companies often view this as a demonstration of the company's confidence in its own product/service. As Japanese attach a high degree of importance to personal relationships and possess an implicit culture, a vested interest in the franchise business by the foreign franchisor may also indicate a commitment to invest in the relationship.

The cost of opening a franchise outlet differs between brands; however, the initial capital outlay typically falls between ¥15-30 million[54]. Most master franchisors in Japan charge an initial franchise fee and then receive royalties on a monthly basis, either in the form of a fixed fee or percentage of monthly turnover.

However, we understand that royalty payments tend to be kept low because the initial investment cost tends to be very high, particularly for real estate, as well as for labour, equipment, and/or imported foreign made ingredients. In addition, the franchisor typically also has earnings from margin from selling supplies to franchisees.

In addition, franchisors should have a long term view with regards to succeeding in the Japanese market for several reasons:

- high initial cost of investments and operation costs
- selecting the right franchisees
- selecting the right locations
- learning to adapt to the local market.

[54] Euromonitor

13. Japan Support in Franchising

13.1 Japanese regulations for franchising

The franchising business is subject to regulations for ensuring proper business relationship between a franchisor and franchisee. Among them, key regulations applicable are:

- Law on the Promotion of Small and Medium Retail Business and
- Act Concerning Prohibition of Private Monopolisation and Maintenance of Fair Trade.

13.1.1 Law on the Promotion of Small and Medium Retail Business ("Retail Business Promotion Law")

The Retail Business Promotion Law, which is aimed at promoting the modernisation of small and medium retail business in general, demands the franchisor to disclose in written form and explain important items to the prospective franchisee before the franchise agreement is concluded so that the prospective franchisee can make a proper judgement, and any fraudulent inducement by the franchisor is prevented. The Retail Business Promotion Law is administered by the Ministry of Economy Trade and Industry (METI) and implemented by the METI's rule.

In case the franchisor fails to comply with such disclosure requirement, the METI may advise the franchisor to be in compliance. In the next step, the METI may announce the franchisor's identity in public after the advice was not followed. In addition, the fact of failure to comply with the disclosure requirement would adversely affect the validity of the franchise agreement.

The items required to be disclosed under the Retail Business Promotion Law include among others:

1. The business owner's name, address and number of employees (In case of a corporation, the name and title of its representative as well)

2. Capital, main stockholders, and other businesses run by the business owner

3. Name and business field of the corporation, majority share of which is virtually held by the business owner

4. The business owner's financial statements for the last three business terms

5. Date of establishment of franchise business

6. Change in number of franchise shops for the last three business terms

7. Number of litigation cases involved in the franchise business for the last five business terms

8. Matters regarding initial payments, including franchise fee, security and other financial details:
   - amount of money to be paid or calculation method,
   - type of money,
   - time of payment,
   - payment method,
   - terms and conditions for refund, if applicable

9. Matters regarding royalties and/or other ongoing payments:
   - amount of money to be paid or calculation method,
   - type of money,
   - time of payment,
   - payment method

10. Special obligations to the franchisee (Details must be specified if special obligations are imposed on the franchisee concerning the appearance of the store.)

11. Matters regarding terms and conditions of sales or recommendation of goods to the franchisee:
    - types of goods to be sold or recommended to the franchisee,
    - method of settling charges for applicable goods

12. Matters regarding management consultations:
    - whether initial training and lectures will be given,
    - content of training and lectures,
    - method and frequency of ongoing management consultations

13. Trademarks, trade names and other indications:
    - trademarks, trade names and others,
    - indications to be used,
    - details of terms and conditions on use of such indications

14. Term, renewal and termination of the agreement:
    - term of the agreement,
    - terms and conditions for renewal of the agreement,
    - requirements for terminating the agreement,
    - details of payment of compensation for damages caused by termination of the agreement and other obligations.

13.1.2 Act Concerning Prohibition of Private Monopolisation and Maintenance of Fair Trade ("Antimonopoly Act")

The commercial relationship between a franchisor and a franchisee is subject to the Antimonopoly Act, which bans inappropriate business tactics by the party who has the upper hand over the other party or can take advantage of its predominant market position. The guideline titled "Views on the Antimonopoly Act concerning Franchise System", which was issued by the Japan Fair Trade Commission (JFTC), the competent authority of Japan, on September 20, 1983, provides JFTC's recommendation and interpretation on what can be regarded as the inappropriate business tactics to be prohibited by the Antimonopoly Act when developing a franchise business. On 24 April 2002, the JFTC issued the revision to the guideline. The new guideline consists of three parts: a general description of franchising; provisions for the disclosure of necessary information at the time of the offer of a franchise; and a part on vertical restraints between a franchisor and its franchisees.

According to the second part of the guideline, the failure to provide necessary information items leading to the misjudgement of the franchisee shall constitute a “deceptive customer inducement”, which is violation against Article 19 of the Antimonopoly Act. The guideline lists the following as examples of the necessary information items to be disclosed:

- the conditions regarding the supply of goods to the franchisee (e.g. recommendation of the supplier);
- the details of the assistance to be offered to the franchisee, such as a description of the assistance to be offered, its manner, frequency and costs;
- the nature, amount and conditions of return, if any, of the fee to be paid at the time of entering into a franchise agreement;
- the amount, method of calculation, as well as the timing and manner of payment of royalties;
- the description of any settlement arrangement between the franchisor and the franchisee, as well as the interest rate of any loan to a franchisee offered by the franchisor;
- whether or not the franchisor is prepared to indemnify the franchisee for its deficit or to render assistance to the operation of a franchised unit that is not doing well;
- the term (length) of the franchise agreement and the conditions of its renewal, resolution as well as termination; and
- whether or not the franchisor in the franchise agreement reserves a right to operate a unit on its own or to grant another franchise close to the franchisee’s shop and whether or not the franchisor plans to do so.

The second part of the guideline also requires that if the franchisor provides the franchisee with the projected sales or profits, such projection shall be made in a reasonable manner, on the basis of reliable data. The underlying data as well as the way in which the projected sales or profits are worked out must be disclosed to the franchisee.

As regards the vertical restraints imposed by a franchisor upon its franchisees, the third part of the guideline observes that, if these restraints go further than is needed to duly operate the franchising business, they can constitute an “abuse of a dominant position”, a “tie-in”, a “dealing on restrictive terms” or a “retail price maintenance”, which are also violation against Article 19 of the Antimonopoly Act.

In the first of these cases, when the franchisor holds a dominant position as against its franchisee, requirements in the franchise agreement or acts of the franchisor under it, such as:

- restraints on the sources of supply in order to exclude more reasonable supplier;
- quotas on the amount to be purchased by a franchisee without allowing the return;
- coercion to dispose of the merchandise (perishable goods), in case the wholesale price of the merchandise thrown away is to be included in the gross sales and enhance the royalty;
- coercion to offer services that were not prescribed in the original franchise agreement; or
- a prohibition to engage in a competing business after the termination of the franchise agreement to a greater extent than is necessary for the protection of the know-how provided by the franchisor,

can fall under the category of “abuse of a dominant position”. The franchise agreement as a whole, rather than each of its clauses or each act of the franchisor, can also constitute an “abuse of a dominant position.” The points to be examined in this regard are, to name but a few, restraints on the goods to be offered or on the manner of sale, the sales quotas, restrictions on the right of the franchisee to terminate the franchise agreement, and the excessively short or long term of the agreement.

In these cases the franchisor will be found to hold a dominant position if the franchisee would be faced with difficulties when the transaction with the franchisor were to be terminated.

Secondly, if a franchisor requires its franchisee to purchase goods or materials from either itself or a designated supplier in addition to the provision of business know-how under the franchise agreement, such a requirement may, if there are anti-competitive effects, be found to constitute a “tie-in” or a “dealing on restrictive terms”.

Thirdly, the fixing of a retail price by a franchisor as it supplies goods to the franchisor, as opposed to its indicating a suggested price, shall basically be illegal per se as “resale price maintenance”. Even in the case where the franchisor is not itself supplying the goods, forcibly designating the retail price may fall under the category of “dealing on restrictive terms”.

If the franchisor is found to violate against Article 19 of the Antimonopoly Act, the JFTC may order the franchisor to suspend the inappropriate business tactics in question and delete the problematic clause of the franchise agreement; the franchise agreement may be judged to be invalid in litigation; and the franchisee is entitled to file a suit seeking damage compensation or injunction.

13.1 Japan Franchising Association (JFA)

Japan Franchise Association, Elsa Building 602, 3-13-12 Roppongi
Minato-Ku, Tokyo 106, Japan
Tel.: (011-81-3) 34 01 04 21; Fax: (011-81-3) 34 23 20 19

The Japan Franchise Association (JFA) is a public corporation established in 1972 under the auspices of the Ministry of International Trade and Industry and is the official franchise association in Japan. Its primary aims are to foster healthy growth of the franchise business and to contribute to the improvement of management in companies engaged in the food service, retailing and service industries. Their responsibilities include encouraging and maintaining a good environment for franchise businesses, development of franchise industry via the maintenance of positive public-relations and provision of educational and training activities, and developing a code of ethics voluntarily amongst member companies. Membership is comprised of major Japanese franchisors and companies that share the interests of the association

As mentioned above, JFA acts as the regulator for the franchise industry in Japan. It adopted the Franchisor Registration System in order to stimulate the industry to modernise the management of franchise systems, and required that a qualified business owner must have at least one year's experience in the management of the applicable business. This system was initiated in 1983 to help a prospective franchisee to select an appropriate franchise business and to decide whether to enter into an agreement with the franchisor. Under the system, matters required to be disclosed under the Small and Medium Retail Commerce Promotion Act must be registered with JFA and the registered information is supplied to the prospective franchisee.

Registration fee per franchise chain
Registration fee for the year when registered ¥ 100,000
Annual administration fee for subsequent years ¥ 20,000
Note: For JFA members and associate members, the above fees are appropriated from JFA's membership fees.

Registration fee for the second chain of a franchisor who owns two or more franchise chains
Registration fee for the year when registered ¥ 50,000
Annual administration fee for subsequent years ¥ 20,000
Note: JFA members and associate members also must pay the above fees.

JFA also annually organises "The Franchise Chain Show and Business Expo" which is held in September at Tokyo Harumi and attracts about 380 exhibitors.

14. Investment Climate

14.1 Tax

14.1.1 Withholding tax[55]

Certain type of income, such as wages received by employees, is required to be withheld by the payer, whether it is an individual or a corporation. Amount of the withholding income tax is determined based on the payments made.

For detailed information on the nature of payments and applicable rates, please refer to Table 2 in Appendix II.

14.1.2 Corporate Income Tax[56]

The taxes levied in Japan on income generated by the activities of a corporation include corporate tax (Japan tax), corporate inhabitant tax (local tax), and enterprise tax (local tax) (hereinafter collectively referred to as "corporate taxes"). Except in instances requiring exceptional treatment, the scope of income subject to corporate inhabitant tax and enterprise tax is determined, and the taxable income calculated, in accordance with the provisions for corporate tax. Corporate inhabitant taxes are levied not only on income but also on a per capita basis using the corporation's capital and the number of its employees as the tax base. Corporations having paid-in capital of more than ¥100 million are subject to corporate enterprise tax on a pro forma basis, using a pro forma standard ratio of one-fourth.

The income calculated for each taxable year is used as the tax base for determining these corporate taxes to be levied on a corporation's income. Other corporate taxes include corporate taxes on liquidation income and corporate taxes on reserves for retirement pensions, etc.

The tax rates for corporate tax, corporate inhabitant tax and enterprise tax on income (tax burden on corporate income) and per capita levy on corporate

[55], [56] http://www.jetro.go.jp/en/invest/setting_up/section3.html

inhabitant tax for each taxable year are shown below (a small company in Tokyo is used as an example). The rates for local taxes may vary somewhat depending on the scale of the business and the local authorities under whose jurisdiction it is located.

Figure 40. Tax burden on corporate income

Brackets of taxable income	Up to JPY 4 million	JPY 4 million to JPY 8 million	Over JPY 8 million
Corporate tax	22%	22%	30%
Inhabitant taxes (1)Prefectural (2)Municipal	 1.1% 2.7%	 1.1% 2.7%	 1.5% 3.7%
Enterprise tax	5%	7.3%	9.6%
Total tax rate	30.8%	33.1%	44.8%
Effective tax rate	29.3%	30.9%	40.9%

(Note) This is applied in the following cases:

Capital amount of the corporation is JPY 100 million or less and the corporation pays no dividend.

Corporate tax amount is JPY 10,000,000 or less and taxable income is JPY 25,000,000 or less.

Offices or factories located in two prefectures or less.

Figure 41. Per capita levy on corporate inhabitant tax

Capital amounts		Employee number	Per capita levy
Over JPY 5,000,000,000	-	Over 50	JPY 3,800,000
Over JPY 1,000,000,000	Or under JPY 5,000,000,000	Over 50	JPY 2,290,000
Over JPY 5,000,000,000	-	Or under 50	JPY 1,210,000
Over JPY 1,000,000,000	Or under JPY 5,000,000,000	Or under 50	JPY 950,000
Over JPY 100,000,000	Or under JPY 1,000,000,000	Over 50	JPY 530,000
Over JPY	Or under JPY	Or under 50	JPY 290,000

Capital amounts		Employee number	Per capita levy
100,000,000	1,000,000,000		
Over JPY 10,000,000	Or under JPY 100,000,000	Over 50	JPY 200,000
Over JPY 10,000,000	Or under JPY 100,000,000	Or under 50	JPY 180,000
-	Or under JPY 10,000,000	Over 50	JPY 140,000
-	Or under JPY 10,000,000	Or under 50	JPY 70,000

13.1.3 Double taxation treaties[57]

The worldwide income of corporations established in Japan is subject to taxation, but when that income includes profits earned in foreign markets that are taxed in the source markets of that income, foreign taxation deductions are available whereby taxes paid in a foreign economy may within certain bounds be deducted from Japanese taxes owed for the purpose of eliminating double taxation between the source economy of income and Japan. Measures have also been implemented to avoid double taxation internationally of Japanese branches of foreign corporations, among these being to make only certain income generated within Japan subject to taxation in Japan.

Japan has concluded tax treaties with many economies for the purposes of avoiding double taxation of income internationally and preventing tax evasion. The provisions of tax treaties supersede those of domestic law. In determining the tax liability in Japan of individuals and corporations domiciled in an economy with which Japan has a tax treaty, the location of the source of income deemed taxable income under Japanese law may at times be amended to accord with these tax treaties. Provisions have also been established in Japan for reducing the tax on, or exempting from tax, various types of income sourced in Japan.

[57] http://www.jetro.go.jp/en/invest/setting_up/section3.html

Figure 42. Japanese Tax Treaties

Arab, Republic of Egypt	Georgia	Norway	Tajikistan
Armenia	Germany	Pakistan	Thailand
Australia	Hungary	Philippines	U.K.
Austria	India	Poland	U.S.A.
Bangladesh	Indonesia	Republic of Fiji	Turkey
Belarus	Ireland	Republic of Korea	Turkmenistan
Belgium	Israel	Rumania	Ukraine
Brazil	Italy	Russia	Uzbekistan
Bulgaria	Kyrgyzstan	Singapore	Vietnam
Canada	Luxemburg	Slovakia	Zambia
China[1]	Malaysia	South Africa	
Czech	Mexico	Spain	
Denmark	Moldova	Sri Lanka	
Finland	Netherlands	Sweden	
France	New Zealand	Switzerland	

[1] Not applicable to Hong Kong and Macau.

14.2 Intellectual property rights[58]

Any company with patents, trademarks or other intellectual property may enter into a licensing agreement with a Japanese company. The agreements are private, and the foreign firm need not establish a presence in Japan. Licensing is most common in electronics, information technology, chemicals and pharmaceuticals.

Although it is narrowing, a conceptual gap remains between Japan and the West on the subject of intellectual property, particularly on applying antitrust concepts to intellectual property rights (IPRs). As Japan and the industry have long been collaborating on technology development, the ownership of intellectual property sometimes remains unclear. However, there has been a push to increase IPR protection at the higher level. Some of these initiatives include establishing an Intellectual Property Strategy Headquarters which would be responsible for formulating a IPR strategy at the highest level. Its policy

[58] EIU Viewswire, 2005

agenda includes the transfer of intellectual property from academic institutions to industry, the expansion of personal incentives for corporate employees involved in research and development, and tougher enforcement of IPR laws against infringement. As part of the commitment to protect IPR, the agency is looking to double the maximum jail term against IPR violations to ten years in the next round of changes to the Patent Law and other relevant laws.

In 2002, The Basic Law on Intellectual Property broadened the definition of intellectual property to cover not only specific rights, such as patents and copyrights but also business assets based on knowledge, including trade secrets. Under this law, intellectual property refers to inventions, devices, new varieties of plants, designs, works and other property produced by human creative activities; trademarks, trade names and other marks used to indicate goods or services in business activities; and trade secrets and other technical or business information useful for business activities. It also calls on Japan to speed up the registration of patents and to develop human resources.

The JPO provides free online patent information (at http://www.jpo.go.jp). Its Industrial Property Digital Library has online information on existing patents, utility models, designs and trademarks, and also on those undergoing official screening. As part of the ongoing effort to revitalise the Japanese economy, the JPO and the Ministry of Economy, Trade and Industry have started promoting a secondary market for patents to spur the commercialisation of patents that may not have been exploited as yet. The Centre for Industrial Property Information and Training was established in April 2001 as an independent administrative agency under the JPO to provide database and other information support for patent licensing.

It appears that negotiation and arbitration may be more successful than litigation in enforcing IPRs in Japan since Japanese courts are overburdened and trials can be quite complex. Court proceedings involving intellectual property usually take two years to conclude. There are no legal restrictions on access by foreign investors to Japanese lawyers, but some factors hinder foreign investors from getting proper legal advice on IPRs. These include strict limits on legal practice in Japan by foreign lawyers and the few Japanese lawyers capable of handling international business transactions.

Parties to an IPR dispute may turn to the Arbitration Centre for Industrial Property, established in 1998 by the Japan Federation of Bar Associations and the Japan Patent Attorneys Association. The centre offers mediation services for speedier out-of-court settlements.

Figure 43. Trademarks

Aspects	Remarks
Duration	Ten years, renewable for like periods
Legal effect	First applicant is entitled to registration and exclusive use, but a trademark may be registered without having been used. A trademark unused for more than three years may be cancelled. Service marks are registrable.
Registrable	A registrable mark may be a set of characters, letters, figures or signs, or any combination thereof. Names and marks that might be confused with existing ones are not registrable.
Fees	Application: ¥21,000 Registration: ¥66,000 Renewal application: ¥151,000 Renewal registration: ¥151,000 Demand for trial or retrial: ¥55,000 Opposition: ¥11,000. All fees are payable in cash or by patent-revenue stamps

Conventions.

Japan is part of these conventions:

1. Paris Convention for the Protection of Industrial Property (joined 1899)
2. Bern Convention for the Protection of Literary and Artistic Works (joined 1899)
3. Madrid Agreement for the Repression of False or Deceptive Indications of Source on Goods (joined 1953)
4. Strasbourg Agreement Concerning the International Patent Classification (joined 1977)
5. Convention for the Protection of Producers of Phonograms Against Unauthorised Duplication of Their Phonograms (joined 1978)
6. Patent Co-operation Treaty (joined 1978)
7. Budapest Treaty on the International Recognition of the Deposit of Micro-organisms for the Purposes of Patent Procedure (joined 1980)
8. International Convention for the Protection of New Varieties of Plants (joined 1982)
9. International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations (joined 1989)
10. Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (joined 1990)
11. Trademark Law Treaty (joined 1997)
12. Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (joined 2000)
13. WIPO Copyright Treaty (joined 2002)
14. WIPO Performances and Phonograms Treaty (joined 2002).

14.3 Investment promotions

Japan offers an increasing range of incentives to encourage imports and inward foreign direct investment (FDI). There is no overt discrimination between foreign and domestic firms in access to incentives, though some are designed primarily to spur FDI. Japan has put into place a substantial programme to promote imports of manufactured goods by providing many types of assistance to foreign exporters. These include tax breaks and financing support.

Officials are also eager to encourage investment in rural areas by high-technology companies, such as electronics and biotechnology firms. Prefectures and municipalities offer a variety of incentives, including construction, land acquisition and labour-hiring subsidies. Most prefectures offer loan programmes to encourage companies to establish local operations.

Under the Import and Inward Investment Law (in effect from July 1992 through 2006), tax incentives and credit guarantees are provided for foreign companies and foreign-affiliated companies that meet certain requirements ("designated inward investors") to support them in start-up stages after investment. Applications should be directed to the ministry concerned with the industry area in question; it usually takes less than a month to process the request. Eligibility requirements for a designated inward investor are as follows:

- foreign enterprises' Japanese branches or offices or Japanese corporations whose foreign capital ratio exceeds one-third of the total capital;
- companies that have been operating for less than eight years since the date of establishment; and
- operations in manufacturing, wholesale, retail and service industries.

Companies certified as designated inward investors may carry forward certain net losses for up to seven years, instead of the standard term of five years (which is now seven years in any case for blue-return taxpayers). Such losses are limited to those incurred in the first five years after establishing a business. Local authorities offer various reductions and exemptions in business taxes, fixed-asset taxes and real-estate acquisition taxes. Many of these incentives are offered to domestic as well as foreign companies.

The present tax and financial measures for foreign or foreign-affiliate companies focus on the start-up phase, when a foreign company sets up operations in Japan and is trying to gain a foothold. Specific objectives of the support include facilitating business deployment (tax incentives), facilitating financing (loan guarantees and low-interest loans) and improving infrastructure.

Funds can be obtained from state-run development banks: Japan Bank for International Co-operation (JBIC), Development Bank of Japan (DBJ) and National Life Finance Corp (NLFC). The JBIC operates on two fronts: international financial operations, which include export loans, import loans, overseas investment loans, untied loans and equity participation in overseas projects of Japanese companies; and overseas economic co-operation operations, which provide financial assistance, including overseas development aid loans, for developing markets. The DBJ provides long-term financing and other services for qualified domestic and foreign companies undertaking projects as part of their long-term investments in Japan. The bank directs many policy loans. The NLFC offers programmes to help finance the import-promoting operations of small companies including retailers.

The Japan External Trade Organisation provides advice and counselling to investors.

14.4 Infrastructure

Japan has a highly developed transportation and info-communications infrastructure network.

In addition to its world-famous transportation network, Japan's infrastructure is developed to a high standard for information and communications technology (ICT), logistics, and other purposes, enabling your own development of advanced information businesses and logistics systems based on these infrastructures.

14.4.1 Transportation

Japan possesses a highly reliable world-class transportation infrastructure infrastructure of roads, highways, railroads, airports, and harbors for distribution of all types of goods and services. Its railroad, air, road density have been ranked amongst the top 3 in the world. Japan has a well-developed network of roads and railways, with expressways stretching from one end to another and the high-speed Shinkansen, or "bullet train," running from Morioka in the north to Fukuoka in the south. In large cities, there are well-developed public transportation systems such as buses, trains and subways. Commuters tend to use these systems more than cars. However, it appears that urban roads and highways tend to be overcrowded and roll roads are expensive.

In addition, Japan's airports which are among the world's most expensive, contribute to the high cost of doing business. Reports have indicated that Japan's port practices are generally opaque and inefficient by global standards; and import processing, while improving, remains relatively slow[59]. Japan has recently made progress, reducing Customs overtime fees by fifty percent and extending hours of operation at major air and seaports to make them 24/7 facilities[60]. Japan is also engaged in a large, though slightly reduced, expansion of public works projects both to enhance the business infrastructure and to help stimulate the economy. It is generally believed that more reforms are required to ensure Japan’s competitiveness.

14.4.2 Telecommunications

Japan has the highest densities of mobile phones and Internet penetration in the world.

[59,.60] US Commercial Service, Japan “Doing Business in Japan: A Country Commercial Guide”

	1999	2000	2001	2002	2003	2004
Personal computers (PCs) in use ('000)	36,300	40,000	45,600	48,700	51,570	53,569
Online households (mn)	-	12	17	21	24	26
PC households online (% of PC households)	-	69	75	82	88	95
Internet users ('000)	27,060	38,000	48,900	57,200	64,100	68,410
ISDN subscribers *('000)*	6,738	9,699	10,317	9,598	8,879	8,160
Availability of digital main lines (% of telephone main lines)	100	100	100	100	100	100
Capital investment in telecommunications (¥ mn)	3,398,000	3,522,000	2,992,000	1,978,000	1,582,826	1,227,453
Telephone lines in use ('000)	70,530	74,344	73,325	71,149	76,080	77,790

15. Opportunities for Franchisors

Japan has a well established franchise market, being the first economy in Asia to adopt franchising -- with American franchises such as KFC, Mister Donut and Mcdonalds leading the way in the early 70s. Japan has also developed a host of local franchisors, such as Mos Burger, Yoshinoya and Pepper Lunch, that have successfully ventured overseas. We have noticed in the course of our interviews and research that Japanese franchisors appear to prefer to work with Japanese companies and/or individuals overseas. For example, Pepper Lunch franchisee in Singapore is a subsidiary of Suntory in Japan, Beard Papa's franchisees in US and Hong Kong are Japanese businessmen based in the county of interest.

Foreign entrants are likely to find master franchisees with track record in Japan. Historically, local partners have been large Japanese companies and/or trading houses such as Mitsubishi (KFC), Suntory (Haagen Daz), Marubeni (Dairy Queen) and WDI (Tony Romas) who will then find, qualify, recruit, train and supervise individual franchisees to expand the operations. The Japan Franchising Association can act as a contact point for those franchisor and franchisee.

Japan's F&B service landscape, described in the above sections, appears to be characterised by heavy competition fighting for stagnating expenditure amongst consumers. While this may appear daunting for some to enter Japan's F&B sector, there remains pockets of optimism amongst the companies interviewed and from our research.

For one, many expect the Japanese economy to continue on its path to recovery; as such the sector will similarly return to growth. Similar to Singapore, the high levels of disposable income and high expenditure per household on food bodes well for the F&B industry. As the population demographic changes and the lifestyle adapts, it is expected that eating-out will become an increasingly common in Japan. Furthermore, though the market is competitive, Japanese consumers are not adverse towards adopting new F&B concepts, so long as it attracts their interest and lifestyle. Thus, there are pockets of opportunities that remain to be exploited.

15.1 Demand for Convenience

Franchisors that offer consumer convenience such as takeaway services, fast food, pre-cooked meals etc may have a ready market available. Per capita expenditure in the fast food and home delivery/take away services have shown the highest growth in the industry. This “grab and go” culture has been attributed to the lifestyle changes of Japanese consumers – a working population of both sexes, with neither the skills nor inclination to cook for themselves, leading hectic urban lives.

15.2 New international concepts

The Japanese consumers are well travelled and open to trying new tastes and types of food. We have observed that the variety of cuisines available in Japan has been increasing in recent years – South East Asian, Europe, Australian and American fare are becoming increasingly popular. Franchisors that can offer a new product or form of product that is new to the Japanese market may prove to be successful in Japan.

15.3 Growth of Entrepreneurship

Possibly fuelled by the economic recessions of the 1990s, it appears that there are more Japanese who are interested in started up their own businesses, and thus a larger and receptive pool of potential franchisees . This is an evident shift from the stereotypical Japanese “salary-man” culture which places corporate employment as a yardstick of success.

Supporting this trend is the findings that:

- According to a 2005 survey of 712 people sponsored by the National Life Finance Corporation, c.75% of those planning to start their own businesses within the year will do so with ¥3 million (US$ 25,530) or less in start-up funding. In addition, more than 95 percent of respondents said they intend to start service businesses.
- According to estimates from the Ministry of Economy, Trade and Industry (METI), about 150,000 people in Japan started their own businesses in

2001. While this only about one in 1,000 people, industry watchers believe that the number is growing steadily each year.

In addition, social and demographic trends also appear to support the growth in entrepreneurship in Japan. For example:

- the large number of senior executives who are taking early retirement and have no new positions into which to go into;
- corporate downsizing brought on during the recession released potential franchisees who may be more affluent and possess business know-how; and
- a growing new breed of entrepreneurs in Japan who are young, typically having started a company while students or just after graduation.

16. Business Considerations in Running Franchise Operations in Japan

16.1 Critical Success Factors

Some important points for Franchisors to note in penetrating the Japanese market are as follows:

- Brand Character

Japanese are discerning and well travelled consumers who readily adopt new concepts. However, the difficulty lies in that the Japanese consumers are somewhat fickle. Thus, according to the Managing Director of Japan Franchise Association, Mr Kaieda, a brand with a strong concept is the key to success in Japan's franchise industry. For example, even in a highly competitive F&B industry, there is still plenty of room for the likes of Mos Burger and Macdonald. These two brands target slightly different markets and pay attention in creating and maintaining a unique character.

- Flexibility in Franchise Terms

Japanese franchisors can offer a range of contract types to give franchisees more options and thus room for success. Franchising agreements can range from single unit franchising, sequential franchising and sub-franchising depending on the franchisees' financial and managerial resources as well as entrepreneurial ability. This was apparently one of the reasons behind Familymart's success in Japan. On top of the arrangements mentioned above, Family mart also allows franchisees to lease equipments and fittings from them if required. Service fees and royalties, which last for typically 20 years, are also negotiable.

In addition, it should also be noted that franchise terms are slightly different compared to other economies. For example, the royalties paid to franchisors tend to be less because of the high initial investment cost and variable costs such as labour and rent.

- Product and Service Quality

Service quality plays a huge component in typical F&B operations. However this is even more important in Japan, where consumers expect quality service. Successful franchisors are those that will invest a significant amount of time in training their staff on customer service as well as product knowledge.

- Localisation [61]

As the tastes and culture of Japanese people are very different from those of Europe and America, goods sold in a foreign economy may not be well accepted by Japanese consumers and may not generate business. Especially in the food industry, it is risky to introduce products from a foreign economy into Japan without modification. Furthermore, as Japanese people attach great importance to cleanliness and quality, only products and services of the highest standard will be accepted.

However, a franchise agreement usually stipulates details such as the furniture, fixtures and even small operational matters, and so the Japanese side cannot change such details in general. Such details may constitute part of the franchise know-how and so might need to be followed. However, leading franchise companies like Duskin have worked hard to negotiate with their licensors to change details of their business to suit the Japanese market. For example, Duskin changed the size and taste of donuts in the Mister Donut business.

Therefore, it may be wise to establish a pilot store and conduct test marketing before starting franchise development, and to adopt a flexible attitude to the details of the agreement depending on the results of the test marketing.

However, some would insist that the core of the franchise system should not be changed in a franchise business that provides products like Snap-on Tools and that changes should be restricted to certain aspects such as business practices. Although a franchise contract might include the provision of goods, the more important advantage is the provision of business know-how concerning marketing, operation and other aspects of business. Otherwise, it is sufficient for a franchisee to purchase goods from a sales agent.

[61] Extracted wholesale from JETRO Franchise Business Report, 2000

16.2 Market Entry Considerations

Market entry strategies greatly depend on the Franchisor's needs and requirements. However, in Japan, it appears that short of entering the Japanese market directly, Franchisors should also consider the JV or Master Franchisor route. Several reasons that may justify this approach include:

1- Managing the market

Japanese market presents several barriers stemming from its native language and geographical coverage. It may thus be easier, from an organisational and control perspective to engage in a relationship with a suitable partner, from which to manage the whole of Japan. In addition, as localisation is key to Japanese acceptance of the brand/taste, a Japanese partner may offer local insights into the Japanese culture, customs and preferences that a foreign entrant may not possess.

2- Access to real estate

Prime retail locations in Japan command one of the highest rental rates in the world and are keenly competed for by retailers. To get into the best locations, foreign franchisors/brand owners may need to partner with an established Japanese company with financial clout and real estate links. For example, while Benugo, a British sandwich outfit, had to enter into a sub-franchising agreement in order to secure a suitable location for their outlet in Osaka.

16.3 Franchise Laws

When entering the Japanese market with a franchise business, it is important to note that various applicable laws and regulations differ according to the type of business. While there are no specific franchise law as yet, the industry adopts a self-regulation model, with JFA acting as a coordinating body for its members.

Key regulations applicable to franchise businesses are:

- Law on the Promotion of Small and Medium Retail Business administered by the Ministry of International Trade and Industry; and

- Act Concerning Prohibition of Private Monopolisation and Maintenance of Fair Trade administered by the Japan Fair Trade Commission.

16.4 F&B Operations Related Laws

Food Sanitation Law (1947)

The Food Sanitation Law encompasses various rules regarding food standards, food additives, sanitation monitoring, and the food service license system are stipulated in this law for the purpose of preventing sanitary risks attributable to eating and drinking, as well as improving/enhancing public health.

Amended in August 2002, this law prohibits any person of falsely or exaggeratedly labelling or advertising any food, additive, apparatus or container/package in any manner which may injure public health. Moreover, this law treats the entry of all imported foods to the Japanese economy with important certification, notification and quarantine laws before they are admitted and accepted.

Governed by the Department of Food Safety, Pharmaceutical and Food Safety Bureau, Ministry of Health, Labour and Welfare.

The following is a summary of the law:

- Prefectural governors shall stipulate the food service establishment standards for restaurants, coffeehouses, and prepared food manufacturing sites.
- Prefectural governors shall grant licenses for the operation of food service establishments.
- The Ministry of Health and Welfare (currently called the Ministry of Health, Labour, and Welfare) established the “Sanitary standards for packaged meals and prepared foods” in June 1979.

Food Recycling Law (May, 2001)

The competent authority in charge is the Food Industry Environment Policy Office of the Food Industry Policy Division, General Food Policy Bureau, Ministry of Agriculture, Forestry and Fisheries.

The purpose of the Food Recycling Law is to promote an effective use of unused food resources as well as to reduce the volume of food processing waste. This law requires manufacturers and distributors of foods and food service businesses to exert effort to reduce food processing waste generated at the time of manufacturing and processing foods, unsold foods and food waste, and food processing waste generated at the time of cooking, as well as recycle such waste, if possible, into fertiliser, animal feed, etc. If such waste cannot be recycled, the law requires reducing the amount.

Food-related businesses to which the law applies include food manufacturers, department stores, supermarkets, convenience stores, marine and water transportation industry such as passenger ships and ferries, and wedding facilities. Hotels, inns, and meal supply businesses are included among food service businesses. If stores are directly operated by the headquarters of a food service company, the total food waste generated by the company should be calculated by adding together the waste generated by the shops and by the factories. Under the franchise system, individual shops are regarded as an independent food business.

If a business operator with total food waste of 100 tons or more does not abide by an improvement order by the authorities, a fine of as much as 500,000 yen can be imposed on the business operator.

Japan Agricultural Standards (JAS) Law

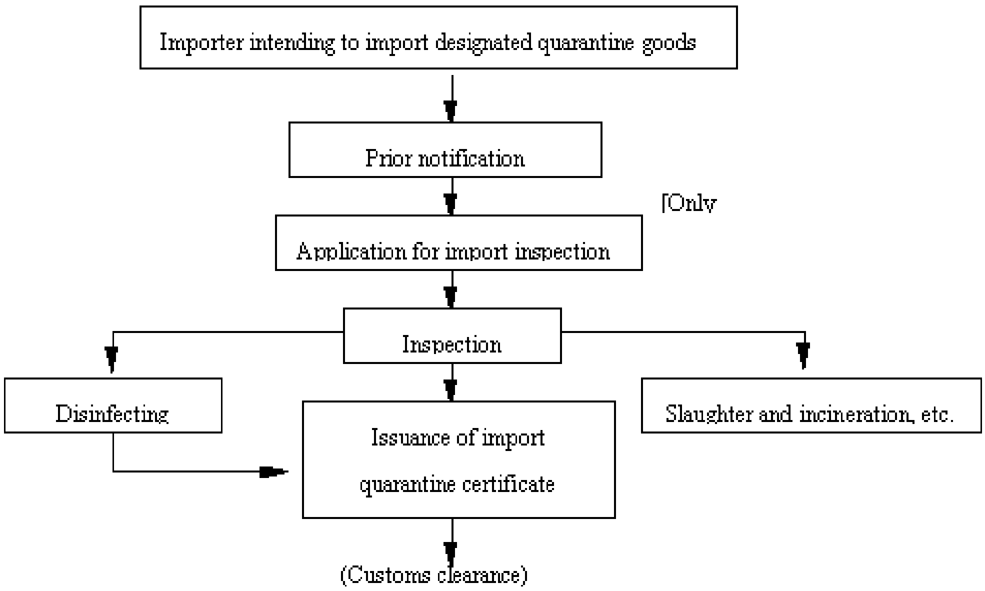
This is a law concerning the standardisation and proper labelling of agricultural and forestry products as well as the establishment of quality labelling standards for all food and beverage products sold to ordinary consumers.

Nutrition Improvement Law

This refers to the law which sets the standards for the foods on sale. When employing labelling for nutrition ingredients or calories, labelling must be in accordance with the requirements under this law.

Domestic Animal Infectious Diseases Control Law

Along with Japan's Food Sanitation Law, this law was instrumental in banning imported beef from Canada in 2003. This law was established to prevent the transmission of infectious diseases to domestic animals in Japan, through an export quarantine system arising from importation or international distribution.



Items covered include:

(a) Clove-hoofed animals, horses, chickens, ducks, turkeys, quail, geese, dogs, rabbits, honeybees and remains of the aforementioned.

(b) Eggs of chickens, ducks, turkeys, quail, and geese

(c) Bones, meat, fat, blood, hides and skins, hair, feathers, horns, hooves, tendons, and viscera of animals under (a)

(d) Raw milk, semen, embryo, ovum, excrement, and urine under (a)

(e) Bone meal, meat meal, meat and bone meal, blood meal, skin meal, feather meal, horn meal and viscera meal of animals under (a)

(f) Sausage, ham, and bacon derived from (c)

(g) Straw and Forage

(h) Articles for which importation is prohibited, but approval for import has been obtained from the Minister of Agriculture, Forestry and Fisheries for testing and research and other special circumstances.

16.5 Import Regulations and Requirements

Japan food service sector is known to be receptive to the use of imported food products. This is due to the fact that imported food tend to be less expensive compared to domestically produced products. In addition, as the Japanese food service sector often imports new food concepts from abroad, it is similarly more receptive towards importing the raw materials used in the menu.

However, while importing food and raw produce into Japan may not be a problem, Franchisors should take note that the importation is subjected to strict requirements and bear in mind the costs associated.

Food entering the Japanese market is subject to several import regulations:

- Domestic Animal Infectious Diseases Control Law

As mentioned above, the Domestic Animal Infectious Diseases Control Law sets out an import and export quarantine system. The system requires all products covered under the law to be subjected to a import inspection and obtain a Import Quarantine Certificate before it can clear customs. Strict guidelines are placed on importing live stock into Japan such as prior reporting, quarantine peroids and import inspections. For animal products such as eggs, bacon etc, proir reporting and quarantine periods are not required, but import inspections still need to be carried out.

Beef or other meat products for sale in Japan must go through regular customs inspection plus a special quarantine inspection at the Animal Quarantine Service Office. Under the Law, the import quarantine inspection requires submission of two meat inspection certificates from the economy of origin, which certifies the meat products have met Japan standards

- Food Sanitation Law

In addition, all food products are also subject to examination under the Food Sanitation Law. Japan has control over the usage and import of most additives, which are added to or used with foods, beverages and medicines. However, a limited number of synthetic vitamins, minerals, and amino acids is to be used as food additives. Processed foods entering Japan are subject to three types of inspection: examination for bacterial content, testing for chemical content (including food additives), and visual inspection.

Furthermore, processed meat products are subjected to mandatory labelling requirement of the Food Sanitation Law and Law Concerning Standardisation and Proper Labelling of Agricultural and Forestry Products (JAS). This includes: product name (non-heat-treated and dried foods must indicate so), ingredient name (in order by percentage for each ingredient of total contents. All additives must also be listed.), content volume, import date, economy of origin, importer name and address, freshness expiry date, and preservation method.

- Other Regulations to Note

The Japanese Measurement Law requires that all imported products and shipping documents show metric weights and measures.

The Japan Agricultural Standard Law and Consumer Products Safety Law apply to mineral water artificially charged with carbon dioxide gas.

In addition Franchisors should also take into account the costs of importing food products, in addition to the cost of the food itself, into Japan. This includes[62]:

- Freight and insurance charges
- Costs associated with payment such as cost for transfers, letter of credit and account settlement.

[62] JETRO

- Costs associated with customs clearance such as procedural proxy services (for food sanitation inspection procedures, import declaration procedures, animal or plant quarantine procedures), port cargo handling operations, storage facilities costs etc
- Import taxes such as tariffs and consumption taxes. Import tariffs are determined by the product category:
  - sausages & preserved meat products 17.5-23.2%;
  - beef & pork meat 3.8-50%;
  - fresh, chilled and frozen shrimp and prawn 4%;
  - shrimp and prawn for prepared products (smoked, boiled in water or in brine, chilled, frozen, salted in brine and dried after being boiled in water or in brine) 4.8%;
  - vegetable products 0-16%;
  - dried mushroom 12.8-14%;
  - canned vegetables and fruit 9-28%;
  - canned mushroom 12.8-14%;
  - soya source 9.6%; and
  - biscuits & bakery products 8-27.8%.

  Consumption tax is assessed at 5% of the customs value of the product including any tariffs.
- Transportation cost within Japan.

16.6 Disclosure of information and appropriate response to vague contracts[63]

The franchise business first appeared in the US and developed there. Therefore, the franchise system is more advanced in the US than in Japan. In the US, detailed disclosure of information is required by law as well as by the Unified Franchise Offering Circular (UFOC), which is adopted in 14 states. In contrast, disclosure of information is only subject to the Small and Medium Trade Commerce Promotion Act in Japan as mentioned above. Some franchise agreements are as short as a few pages, and serious problems could arise in

[63] Extracted wholesale from JETRO Franchise Business Report, 2000

case of a dispute between the franchisor and a franchisee.

In Japan, not only franchise agreements but agreements in general tend to allow vague stipulations. Japanese people tend to be unwilling to take their grievances to court and, even when a suit is filed, franchisors often try to resolve it through an out-of-court settlement due to fear of damaging their reputation.

However, the number of suits has increased recently in some types of businesses, including convenience stores, and so some franchisors have reviewed their franchise agreements and increased the requirement for disclosure of information, making them fair both to the franchisor and the franchisee. Since Japanese society is not based on contracts in the US style and people are not fully aware of the importance of agreements, foreigners must make the other party understand such importance during the negotiations, apart from the legal system.

16.7 Selection of a qualified partner

The selection of a qualified Japanese partner is critical for developing a franchise system in Japan. Though historically, many foreign franchisors have formed tie-ups with major Japanese companies to enter the Japanese market, it does not always guarantee success, as seen in the forced withdrawal of foreign franchisors such as Burger King (Japan Tobacco and Seibu Shoji) and Dunkin Donuts (Seiyo Food Systems). The history of the franchise industry in Japan shows that a company that is lead by an excellent entrepreneur is likely to be successful regardless of the size of the company[64].

In addition, as the franchising industry matures, it may no longer a prerequisite to work with a huge Japanese conglomerate (with financing and real estate know-how/access) to open the market. This is because more companies and individuals are more familiar with the concept of franchising and have greater access to capital such as via SME loans[65] and support.

[64] JETRO Franchise Business, 2000
[65] Japan Finance Corporation for Small Business, National Life Finance Corporation and Shoko Chukin Bank offer low-interest loans to SMEs according to their purposes of fund use.

17. Profile of Select Franchisors in Japan

17.1 Summary

Through the assistance of JFA, PwC Japan contacted several key Japanese franchisors and franchisee with significant experience in the franchise F&B business.

Mos Burger, Yoshinoya, Ajisen and Pepperlunch are some of the key Japanese Franchisors that have amassed a vast local franchise network and have since expanded overseas successfully, into markets such as Singapore, China, Chinese Taipei and United States. Duskin, the pioneer of franchising in Japan, first started to rent out dust control products via a franchise system and subsequently became a successful master franchisee for Mister Donut. Through our interviews, we were better able to understand what it takes to build sustainable success in Japan's F&B sector as well as how these brands have successfully ventured overseas.

Some of the recurring themes include:

- Partner Selection Criteria

Several of the franchisors that have ventured overseas have attributed their success to their partners. It appears that to these profiled brands, a suitable franchisee/partner is one with an excellent understanding of the local market. However, just as importantly, the franchisee must understand and fit into the culture and values represented by the brands itself.

- Quality and innovative product

Throughout the case studies profiled, we have seen how these brands sought to harness a distinct image and product for itself. With Mos Burger, it was its fresh unique-tasting burgers. With Yoshinoya, it targeted its key customers and sought to meet their needs for convenience and taste at an economical price point. With Pepperlunch, it was the novelty of cooking their own steaks – made achievable with patented know-how. With Duskin, it was the high quality ingredients that may have lead it to succeed where Dunkin Donuts failed. This appears to be a winning formula for Japanese consumers who are known to be fickle and fastidious.

- Localisation

Duskin has confirmed our learnings that localisation is a key criteria to success in the Japanese market. Particularly in the F&B industry where tastes may be very different from culture to culture, it is imperative to attempt some form of localisation in order to gain Japanese consumers’ acceptance. Furthermore, as Japanese people attach great importance to cleanliness and quality, the franchisor should also similarly adopt and emphasis these factors into their product, service standards and incorporate it into the training. Duskin did this to great success by changing the flavor to suit local palates and increasing the quality of base ingredients. They also focused on product and service training to its franchisees by building a world-class training center. The result was an end product and experience that endeared itself to the Japanese market for 36 years and counting.

17.2 MOS Burger: Differentiating itself by adhering to its philosophy

MOS FOOD SERVICES, Inc.

22 Tansu-machi, Shijuku-ku,

Tokyo 162-8501 Japan

Company profile

MOS Food Services, Inc. opened its first hamburger specialty shop in 1972. It took its name from the first letters of "Mountain", "Ocean" and "Sun" as Mr. Satoshi Sakurada, the founder of the company, wished MOS Food Services to become a company whose people placed importance on human beings and nature, having dignity as high as a mountain, minds as broad as an ocean and passion as everlasting as the sun.

Operating 1,461 outlets throughout the Japanese economy, its successful growth as a high quality hamburger shop chain is supported by its high brand awareness and appreciation by customers of its products such as "MOS Burger", "Teriyaki Burger" or "MOS Rice Burger". In an article that appeared in "Nikkei MJ" (April 25, 2005), one of the most read business journals in Japan, MOS Food Services ranked No.1 in the food service sector[66]. Running 5 other lines of businesses other than "MOS Burger", MOS Food Services achieved total outlet sales of 105 billion yen for the fiscal year ended March 2005.

MOS focused its international expansion to the Asian market, which would be more familiar with the delicate Japanese food derivations. MOS started its expansion in Asia through a joint venture partnership, opening its first outlet in Taipei in 1991. It has since rapidly established its presence in Asia and as of

[66] Based on a survey conducted on 24,000 consumers called "Brand Japan 2005".

31, March 2005, MOS operates 105 outlets through its JV in Chinese Taipei, and 17 outlets through its subsidiary in Singapore[67].

Success factors in domestic market

It is MOS's philosophy not to compromise on delicious, safe and healthy products regardless of time or money. MOS Burger serves delicious, fresh, hot burgers to its customers by preparing the meal after customers place an order, unlike other competing hamburger chains. MOS won the support of customers by introducing unique products using Japanese ingredients, such as the "Teriyaki Burger (seasoned by soy sauce and soy bean paste)" or the "Rice Burger (replacing buns with rice)". MOS succeeded in differentiating itself through its policy of strictly maintaining the safety and quality of its products.

For its domestic operations, MOS carefully selects its franchisee candidates by examining whether the partner expresses a strong passion for introducing MOS Burger to its area and shares the same business philosophy with MOS. By this manner, MOS can realise consistently its high quality service, which drives its successful operation.

Penetrating the brand in a new market

Without using mass advertisement, MOS enhanced its reputation in the market through services provided by each of its outlets. MOS typically spends 5 to 6 years to win brand awareness in a new overseas market. During this period, MOS Burger patiently develops by providing customer friendly, home style services. MOS carefully chose to run its business through a joint venture partnership or with its subsidiary to deliver this type of services. MOS runs all outlets in Chinese Taipei and Singapore directly by the JV or a subsidiary. For MOS, maintaining the quality of its services and adhering to its business philosophy are the top priority.

While MOS's domestic success was achieved through utilising the franchise

[67] MOS originally set up the Singaporean subsidiary as a joint venture with a Malay partner in 1992, and later converted it into a wholly owned subsidiary.

system, MOS has chosen to participate in management for its operations outside Japan in order to maintain its brand value and to conduct the business under its control and responsibility. This has perhaps resulted in the protection of its intellectual property rights for MOS.

MOS established a central kitchen in Chinese Taipei and has dispatched 2 staff from its Headquarters. In addition, it has sent 2 other staff to its Chinese Taipei JV for supporting local staff on management and product development. By co-working with its local partner, MOS has been able to maintain its brand philosophy and harmonise its core value with local preferences at the same time. Learning the preferences and tastes of the local market, MOS found that its chicken-based menu items were one of the Chinese Taipei and Singapore customers' favourites. To meet customer needs, MOS is providing new, original products using chicken, especially for the Asian market.

Keeping to the same business philosophy in the domestic and foreign markets, MOS realises the management's concept of "Human contribution, social contribution". In terms of environmental protection, MOS has acquired an ISO14001 certificate in March, 2005; it was the first in the fast-food industry in Singapore[68].

Next target for expansion

MOS states that it does not have any specific schedule or plan to enter a new overseas market for the time being, but it is continually considering new possibilities. Because of the great success in Chinese Taipei and in Singapore, MOS receives business partnership offers everyday from overseas companies who recognise its strong brand in Asia. Although there are no fixed criteria for selecting a partner, choosing the best partner is what MOS believes is the most important condition. As a major company listed in the Tokyo Stock Exchange for over 17 years, MOS already has adequate funds and facilities. Thus, instead of funds or facilities, MOS is seeking people with the knowledge of local culture and market preferences i.e., human capital in its local partners' organisation.

[68] Note that MOS had already acquired the ISO14001 certificate in Japan in 2004.

In respect of market selection criteria, MOS points out 2 factors in scoping out candidates; the first is consumer buying power and the other is market growth potential. For example, Hong Kong, Australia and South Korea fall under the former category. On the other hand, Thailand falls under the latter. MOS is currently considering the feasibility of entering into these markets.

MOS's insight on the Japanese market

In the face of fierce competition within its domestic business, MOS is responding to its customers' needs by proposing a new concept model called "Green MOS", or the fast-casual business model, which provides high-quality food in a cozy restaurant atmosphere. MOS has begun to transform its existing "Red MOS" outlets, or ordinary fast-food burger shops, to "Green MOS" from last year. MOS believes that this sort of timely response to customers' changing requirements is a key success factor and will further enhance its brand value.

MOS FOOD SERVICES, INC.

Headquarters: Japan
Number of outlets:

- Japan 1,461 outlets (1,394 franchise outlets)
- Singapore 17 outlets (owned by 100% subsidiary)
- Chinese Taipei 105 outlets (owned by JV)

(As of September 30, 2005)

Key Learning Points:

- Spreading brand awareness among customers requires endurance and unswerving consistency in business practices
- Stressing quality and keeping to philosophy support the winning of brand value
- The first step to success in overseas markets is adherence to the core business philosophy coupled with savvy local partners

17.3 YOSHINOYA: With 100 years of tradition, “Gyudon” spreads globally

YOSHINOYA D&C CO., LTD.

da Vinci Shinjuku Building, 4-3-17

Shinjuku-ku, Tokyo 160-8451 Japan

Company profile

YOSHINOYA takes pride in its well-known “Gyudon”, or “beef bowl” -a bowl of rice topped with seasoned beef strips and onion-. Not only being famous for its Gyudon, YOSHINOYA has achieved status for being one of the most famous brands in the Japanese food industry. Starting as a family-run restaurant in Tokyo in 1899, YOSHINOYA D&C CO., LTD. has a history of more than 100 years. Although faced by financial challenges in the 1980s, it has succeeded in widely spreading its motto “Delicious, fast and affordable” among its customers. YOSHINOYA successfully introduced its products and services throughout Japan and has over 1,000 outlets. It also has 252 outlets abroad. YOSHINOYA is listed in the first section of the Tokyo Stock Exchange as a major food company with 26 subsidiaries / affiliates. Although its business temporarily slowed down since the Japanese ban on imports of US beef in December 2003, total sales of the chain stores was approximately 75 billion yen.

Targeting the right market

By grasping the needs and the trends of the age, YOSHINOYA appropriately targeted the right customers who were busy and had their minds set on saving time for eating, such as drivers and male business people. YOSHINOYA succeeded by initially targeting a narrower range of customers, then gradually widening its target in response to the needs from young families by expanding its outlets to suburban areas. Strictly adhereing to its motto of “Delicious, fast and affordable", YOSHINOYA has established a strong brand value based on customers' trust for its quality, speed and price.

Going abroad by choosing the right partner

In 1987, YOSHINOYA embarked on a renewed challenge toward penetrating the Asian market. Enjoying a successful operation through a joint venture with a local partner in Chinese Taipei, YOSHINOYA next stepped into China from Hong Kong in 1991. By setting up a joint venture with a Hong Kong partner, YOSHINOYA expanded into Beijing the following year, by obtaining a license from a sublicensee of this JV due to regulations imposed on foreign investments at that time in China. Now, YOSHINOYA operates 101 outlets in China located in cities such as Beijing, Hong Kong, Shanghai and Shenzhen.

When starting a business in a new economy, YOSHINOYA considers offers from potential local partners. YOSHINOYA appoints a reliable partner by carefully choosing the party that has a strong logistics infrastructure and experience in the food industry among other factors, the most important being the deep understanding and respect of YOSHINOYA's philosophy and values. While allowing its local JV partner to develop side menus and drinks to adapt to the local preference, YOSHINOYA insists on 3 core products for its Asian outlets; namely "beef bowl"(Gyudon), "teriyaki chicken bowl" and "pork bowl" for maintaining its brand identity. Furthermore, based on the belief that local people know their market best, YOSHINOYA establishes its core bases of operation in certain parts of China.

YOSHINOYA also found "walk-up" style outlet layouts as more suited to its outlets outside of Japan. This style has become the standard type outlet for all the outlets outside of Japan, while YOSHINOYA has continued to utilise "counter-style"outlets in Japan.

YOSHINOYA is expanding its overseas outlets through directly managed subsidiaries and JVs (in China, this includes those receiving an area license from a JV and franchisee). YOSHINOYA has abundant experience in the Japanese franchise business and has a deep understanding of the system and how it can be beneficial in increasing the number of outlets. However, it is being careful in applying this system in expanding the business in foreign markets. In order to maintain the quality of its products, YOSHINOYA believes that it is important to have franchisees understand its business philosophy and in order to realise this, it does not allow the operators in each area to apply the franchise system when increasing the number of outlets. YOSHINOYA focuses on the quality and skills of its outlet staff to serve the best quality food, which is not ready-made but handmade hot dishes, to its customers. On the other hand, YOSHINOYA has started to consider the possibility of introducing the franchise system for its US operations for a further expansion of the business, provided that there is sufficient time allotted for providing training and making other necessary preparations.

Success story in Beijing

YOSHINOYA recognised the difficulties in differentiating its core product "beef bowl" from the ordinary Chinese meal consisting of a bowl of rice with cooked meat and onion which can be seen everywhere in daily Chinese life, served at much lower prices. Even though YOSHINOYA needed to wait 5 to 7 years for its brand recognition in the local market, the reasons for its success in Beijing, according to its analysis, was because it strictly maintained the core YOSHIONOYA philosophy, "QSC", i.e. Quality, Service and Cleanliness.

With the growth in the Chinese economy, the Chinese consumers, especially those living on the east coast, increased their buying power and started cherishing subtle customer-service attributes like "smiles" or "greetings" which YOSHINOYA had continuously been providing to its local customers. According to YOSHINOYA, relatively wealthy families who live on the east coast have a high interest in quality and safety. The Beijing franchisees have also become active in pointing out these core values to their customers. YOSHINOYA believes that winning reputation by responding to the customers' expectations is important, especially for foreign food companies entering the Chinese market. Through its continuous efforts, YOSHINOYA finally achieved a top-rank brand evaluation among the foreign food companies conducting business in Beijing.

Additionally, YOSHINOYA benefited from having a suitable person as a former CEO for its Beijing franchisee who had served as president in a China-owned company. He had excellent abilities in managing his staff by motivating them to actively find better ways to run the business. These factors have resulted in YOSHINOYA's success story in Beijing.

Future expansion plans

YOSHINOYA will be concentrating on the Chinese market, targeting the Beijing Olympics which will be held in 2008 and the Shanghai Expo in 2010. YOSHINOYA is also considering to re-enter South Korea, Thailand and Indonesia, economies which all have strong consumer buying power, and Europe, markets with cold days with potential needs for hot meals like "beef bowl".

Key Learning Points :

- Market entry with right targets.
- No compromise with core taste and concept, but being flexible to harmonise with the local market.
- Especially for expanding the number of outlets in the overseas market, training human resources will be the key to introducing the franchise system to recruit outlet owners.

YOSHINOYA D&C CO., LTD.

Headquarters: Japan

Number of outlets:

- Japan 1,012 outlets (including 672 directly owned with 10 new business outlets)
- US 83 outlets (owned)
- China 104 outlets (owned by JV/sublicense)
- Chinese Taipei 42 outlets (owned)
- Singapore 16 outlets (owned by area franchisee)
- Philippines 5 outlets (owned by area franchisee)
- Malaysia 3 outlets (owned by area franchisee)
- Australia 1 outlet (owned by area franchisee owned)

(As of November 2, 2005)

17.4 Pepper Lunch: Leveraged by franchise, new concept of affordable steak lunch seeking an entry into the world market

PEPPER FOOD SERVICE CO., LTD.

3-3-2 Azumabashi, Sumida-ku

Tokyo 130-0001 Japan

Company profile

PEPPER FOOD SERVICE CO., LTD was founded by Mr. Kunio Ichinose, the president, in 1970, starting as a local restaurant in Tokyo. Operating the business as an owner-chef, he faced difficulties in controlling professionals, such as chefs, in expanding the number of outlets. Meanwhile, he was aware that some food businesses, that were traditionally expensive such as Sushi or Yakiniku had become a killer category if they could be served at a more reasonable price range. Starting from an idea for solving the above Human Resource management issues and considering the changes in Japanese demographics, Mr. Ichinose reached the concept of an affordable, "still cooking" steak lunch business. This was "Pepper Lunch" that started in 1994, providing popular dishes such as "Beef Pepper Rice (Special garlic butter rice topped with welsh onion and corn, sprinkled with a big helping of ground pepper and steak sauce. Besides special thinly beef are topped around the rice)" and "Shimofuri Pepper Steak (servings of premium "marbled" beef)". By applying the franchise system, PEPPER FOOD SERVICE was able to successfully open over 100 outlets in 10 years.

Reasonable and attractive concept satisfies both customers and business

Usually, steak dishes require professional and skilled chefs to prepare the meat according to the customers' requests. By developing and obtaining a patent on key kitchen tools such as original electromagnetic cookers and iron plates, Mr.

Ichinose achieved a stable high quality in cooking, without requiring special skills, at an affordable price. Using these unique equipment, most of the cooking procedures in the kitchen were no longer required. Kitchen staff could follow "still cooking" procedures, in preparing dishes by simply putting raw material on the patented, iron grill plates and taking them to customers. This takes only 2 minutes. On the other hand, customers now were able to cook the meat as they liked: rare, medium or well-done. By using the patented cooking-ware and simplified methodology, PEPPER FOOD SERVICES eliminated the traditional steak preparation process and associated labour costs.

Human network pushes Pepper Lunch to step out of Japan

Focused on enjoying the expansion in the Japanese market, PEPPER FOOD SERVICE initially had no plans of going abroad. The sudden offer came from a South Korean company who had already run "Tony Rome", a Steak and Ribs restaurant chain, as a franchisee in the economy. This South Korean company was interested in running a steak business and contacted PEPPER FOOD SERVICES through "Tony Rome", a franchisee in Japan. PEPPER FOOD SERVICES had foreseen that its service would be appreciated in a culture which had the habit of eating rice. Accepting this offer, PEPPER FOOD SERVICE believed that this would be a good opportunity for testing its overseas strategy. The South Korean franchisee has now successfully launched 5 outlets in 2 years.

Leveraged by franchise system in penetrating the overseas market

Overseas expansions were all based on an offer from potential partners, introduced by its existing network of management and stakeholders. For operations in foreign markets, PEPPER FOOD SERVICE is carefully selecting its participation level and the extent of providing its license and know-how to foreign franchisees. It usually relies on the franchisees for capital investments. PEPPER FOOD SERVICES carefully selects its foreign partners as it believes that the partner selection is one of the most significant keys for success. According to our interviewee, its executive director, one of the criteria in appointing a local partner is to find similar value and culture in that partner. In addition, this executive mentioned that in order to understand the nature and risk of an economy, exchanging information with trading companies or locally incorporated companies that are well-experienced in the local business is of great assistance.

PEPPER FOOD SERVICE also has franchisees in Chinese Taipei with 1 outlet run by a retired Japanese businessman and 2 outlets in Singapore run by an affiliate of a major Japanese beverage company, SUNTORY Ltd. Now, PEPPER FOOD SERVICE is preparing to launch their first outlet in Beijing with the franchisee of a Japanese food company utilising Chinese staff.

Due to the difficulty in estimating the feasibility of its products and services in local markets, PEPPER FOOD SERVICE basically allows the opening of 1 outlet initially, and carefully observes the outcome for understanding that market's potential. Then, the partner and PEPPER FOOD SERVICE mutually proceed with further expansion in the local markets.

While relying on the growing number of outlets and the financial powers of the franchisees, PEPPER FOOD SERVICE controls its quality and brand by being involving in purchase decisions, training service managers and staff, approving outlet design by checking trademark/logo, sending people from Headquarters to support the opening of outlets and by continued supervision.

Although Pepper Lunch outlets have made a success by applying a "counter-style" layout in Japan, PEPPER FOOD SERVICE made an attempt to open a large outlet in Taipei and Singapore in the so-called "restaurant-style", by installing and providing seats with tables. Considerations given on the local culture of spending longer time in eating and drinking and applying this outlet style led to local success. Management believes this could be a model style when running outlets in foreign markets.

Further expansion plans

Pepper Lunch consistently gained the same, favourable reputation in the 8 outlets operating in South Korea, Chinese Taipei and Singapore. Its customers were excited and enjoyed this restaurant with a new concept, serving delicious, quick steak dishes accompanied by the additional fun of being able to cook the meat yourself. Following the successful debut in Asia, it is planning to accelerate overseas expansion by launching 18 outlets (namely, South Korea 5, Chinese Taipei 5, Singapore 3, Indonesia 3, Hawaii 1, and Australia 1), all due to be opened by franchisees during 2006.

Key Learning Points :

- Developing a new concept category with efficient procedures is also attractive to other local markets.
- Adequate involvement is required in maintaining the quality of running a business when applying the franchise system for overseas operations.
- Responding to the needs and habit of the local customers in establishing outlet strategies can be effective.

PEPPER FOOD SERVICE CO., LTD.

Headquarters: Japan

Number of outlets:

- Japan 133 outlets (including 31 directly owned)
- Korea 5 outlets (franchisee)
- Singapore 2 outlets (franchisee)
- Chinese Taipei 2 outlets (franchisee)

17.5 Mister Donut: Success as a franchisee, starts overseas expansion

DUSKIN CO., LTD.

1-33 Toyotsu-cho, Suita-shi,

Osaka 564-0051 Japan

Company profile

DUSKIN CO., LTD. was established in 1964 in Osaka, Japan by Mr. Seiichi Suzuki, as a company handling cleaning brushes and mats for home-use. Duskin was a pioneer in bringing in the concept of a franchise chain into Japan by setting up a nationwide chain organisation in 1966 for its core dust control business. Importing the US cleaning business concept for over 40 years, Duskin became not only one of the largest mega-franchisees in Japan for inbound Western franchise businesses, but also a major mega-franchisor operator in Japan at the same time. The largest section within Duskin's business is the dust control section which makes up approximately 60% of its non-consolidated sales. Mister Donut represents the second largest business amounting to 30% of the sales. Mister Donut is the doughnut business led by a brand established in the US and introduced by Duskin into Japan. For the year ended 31 March 2005, combined sales of the chain stores totalled over 430 billion yen, while it contributed turnover of 176 billion yen to Duskin.

History of importing a US doughnut brand into the Japanese market

By the late Sixties Duskin had succeeded in growing its dust control business by applying the self-learned franchise system. Through this success, Duskin had established a network of franchisees whose owners were financially sound and possessed solid business capabilities. Now, Duskin was faced with a challenge to introduce a new business proposal in order to satisfy these able franchisees so that it could maintain this valuable franchise network. Duskin found a potential solution to this challenge when it attended the annual meeting of International Franchise Association. There it was introduced to Mister Donut, a doughnut chain company based in Boston, Massachusetts, which had been in search of a partner for expanding into the Japanese market. Duskin decided that the concept and the size of the business would be an appropriate choice for responding to the franchisees' needs for a satisfactory business portfolio when it received a proposal from the American company to introduce Mister Donut into Japan. As a consequence, Duskin made an important decision in 1969 to execute a master franchise agreement for operating a doughnut business in Japan for 210 million yen, approximately 2.6 times capital of Duskin at that time.

Success in spreading the foreign brand throughout Japan

The beginning of the 1970s was a time when big-name US food service brands, such as Kentucky Fried Chicken, Dunkin Donuts and McDonalds, entered the Japanese market by opening their first outlets in fairly well-known metropolitan areas, such as Ginza in Tokyo. To the contrary, Duskin started its Mister Donut business in 1971 in Mino-o, a bedroom community located near Osaka-city. There it established an outlet inside of a modern supermarket owned by Daiei. Similarly, when Dunkin Donuts, then the top-rated doughnut brand in the US supported by its Japanese partner Seibu, expanded the number of its outlet to over 10 in Japan, Duskin countered instead by building its own Mister Donut franchisee training center. This investment was equivalent to that of opening 5 new outlets, and was initially ridiculed by the market as too much, too soon for a start-up business. While Duskin had started its business slow, the training center paid out with a great reward. It became the growth power by producing a number of well-trained franchisees for the rapid growth to come. Mister Donut outlets marked a successful growth by rapidly opening 50 outlets in the next 2 years.

In another of its important strategic steps, Duskin insisted on having its franchisor grant it the right to select separate suppliers at its discretion for each of the ingredients used. By appointing one domestic supplier with high R&D abilities for one ingredient, Duskin maintained the quality of the business and won the initiative for leading the business in Japan. This changing of suppliers caused a slight change in the taste of donuts from those originally made in the US. However, Duskin made efforts to ensure that 90-95% of the original US taste was maintained – which turned out to be more than sufficient for market penetration in Japan.

From Japan into the broader Asia

By starting its Mister Donut business under a master franchise agreement, Duskin was obliged to pay 2% of their monthly gross sales as royalty in addition to an initial payment. With growth in the number of outlets to over 100, such royalty payments were becoming a hurdle to Duskin's expansion strategy for the Mister Donut business. In 1983, Duskin took advantage of the opportunity to acquire the Mister Donut license in Japan, including an exclusive use of the trademark. In 1987, the then-master franchisor offered to sell Duskin its license for the Mister Donut businesses in 11 other Asian markets. Duskin again took advantage of this for its growth strategy in those markets. Among others, this transaction included the transfer of existing franchise agreements in Thailand and in the Philippines.

After acquiring the master licensing agreements, Duskin found that it was easier for it to develop new products at its own discretion, and Duskin has successfully brought a number of popular products to the local markets since then. If the strict supervision from the US franchisor would have continued, it is uncertain that Duskin would have been as successful as it has been in developing products to match the local market.

Mister Donut's challenge to further expand into the Asian market

Expanding the Mister Donut business in the other Asian countries was not always an easy task for Duskin. After it withdrew from Australia, it was ready to take up the new challenge of spreading the Mister Donut business into Asian markets. Through a joint venture with its local partners, Duskin started its operation in Shanghai in 2000 and the number of outlets grew to 7 in 5 years. In Chinese Taipei, after working for 10 years with a local partner through the licensing of the dust control business, Duskin joined with this same partner to introduce the Mister Donut business in 2004. These operations have been a great success, with 6 outlets selling a monthly average of 20 million yen per outlet. These customers have no problem lining up in a queue for their local Mister Donut.

Duskin attributes its success in Chinese Taipei to 2 factors; the first being the existence of an inherent brand awareness in young customers through their experience of visiting Japan. The second is working with the right partner, that has a reliable food brand image itself and that has strong buying power in the area of real estate.

Focusing on providing services in Japan and in other markets under the same traditional values, Duskin believed that better communication and mutual understanding with the local partners would result in better operations and thus actively makes efforts to involve itself in the local businesses. By sending its people, including the CEO, to the joint venture in Chinese Taipei to which it has made an almost 50% investment, Duskin has been successful in obtaining an open atmosphere for engaging in discussions with the local staff, enabling it to take prompt and appropriate action in solving issues as they arise.

Although not yet having decided on a specific target market for its further challenges, Duskin is concentrating on learning from this case in Chinese Taipei for establishing a local system to procure its ingredients and is carefully analysing issues to be solved when making future expansions.

Key Learning Points (importing foreign brand):

- Attempts and efforts to reflect the original product is the base of quality and improvement.
- Training people to provide services in advance of growth.
- Existing franchise networks, including non-F&B business networks can benefit when entering a new market with a new brand.
- Being able to make local decisions in certain areas helps in localisation.

Key Learning Points (expanding into overseas market):

- A local partner who knows the market is a critical success factor
- Open communication via management sharing results in the transparency of operation and mutual trust.

DUSKIN CO., LTD.
(Mister Donut business sector)

Headquarters: Japan

Number of outlets:

- Japan 1,315 outlets (franchise)
- China 7 outlets (owned by JV)
- Chinese Taipei 6 outlets (owned by JV)
- Thailand 148 outlets (franchise)
- Philippines* 1,340 outlets (franchise)

*note: includes 1,340 outlets as satellite of convenient stores

17.6 Ajisen Ramen: Kumamoto ramen penetrates the world market

SHIGEMITSU INDUSTRY CO., LTD.
920-9, Toshima-machi, Kumamoto
862-0950 Japan

Company profile

SHIGEMITSU INDUSTRY CO., LTD started its history as a producer of raw noodles and opened its first ramen (Japanese style noodle) outlet with only 8 seats in Kumamoto in 1968. The founder who had learned the flavor of Tamana-ramen, local noodle of northern Kyushu which was introduced from Kurume, had the idea of adding fried garlic to its Tonkotsu based broth, soup made from the slow-cooking of pork ribs. This idea came from the home cooking in his homeland of Chinese Taipei and the dish eventually came to be known as “Kumamoto ramen”. With its tender flavor, not so greasy like other Tonkotsu broth, Ajisen ramen appeals to a broad range of customers.

Initially, the founder Mr. Shigemitsu did not know of the franchise system. Simply to avoid keeping his customers waiting in a long queue in front of the outlet, he provided recipes and know-how to relatives and acquaintances to increase the number of his noodle outlets. Shigemitsu Industry started applying the franchise system under the brand name of “AJISEN ramen” in 1972. Today, it is successfully operating 114 local outlets, having grown to become one of the most internationalised franchisors in Japan, establishing 91 outlets abroad in 8 markets; China, Singapore, Thailand, Indonesia, the Philippines, Australia, the US and Canada.

Lessons from a failure in Chinese Taipei

Interestingly, while Ajisen is one of the most known Japanese food operators outside of Japan, its first foray abroad met with mixed results. Ajisen expanded abroad first in Chinese Taipei, working with a noodle manufacturer through a joint venture partnership. Adjusting the Ajisen flavor to adapt to the local customers' preference without obtaining the consent from Headquarters, Ajisen's Chinese Taipei partners gradually lost the Ajisen identity and quality. Ajisen's taste was compromised which resulted in a departure from the core value of the Japanese ramen by Ajisen. As a result, after having opened 4 outlets in Chinese Taipei, all were subsequently shut down and the JV partner withdrew from the market in 2001. Ajisen learned from this case that it should have strongly requested the local partners to maintain the original flavor.

Owner should be a cook, working in the outlet

According to our interviewee who is in charge of Ajisen's overseas operation, it normally has 10 offers a week from potential overseas partners. After the lesson learned in the Chinese Taipei case, Ajisen carefully observes the how eager the candidates are in introducing Ajisen to their markets. For example, Ajisen inquires of the candidates whether they would be willing to visit Kumamoto, Japan, for the business negotiation and training. Ajisen believes one of the largest driving forces for running this business is the joy one receives in directly feeling the satisfaction from customers. Thus, Ajisen insists that owners of franchisees must also be active workers in their outlet's kitchen where they will cook for and serve their customers. Also, by training these partner/owners to become accustomed to the Ajisen taste, the owner can more accurately check the quality of the products and services itself.

Entry into China and other markets

Business in China started from a local partner's offer at the Franchise Business Exhibition held in Japan. Ajisen expanded its business in Hong Kong by first licensing its franchisee in 1996 and then stepping into China from Shanghai through a joint venture with a local partner. The basic policy of Ajisen in expanding overseas business was not to fund the local Ajisen business or the construction of outlets but to let the partner do so to the extent that it maintained the identity of Ajisen. The exception is the Shanghai JV. Ajisen has a stake in the JV, although not the majority, due to the significance of the business. Expressing its involvement in the operation by sending 2 of its staff, Ajisen licenses Shanghai JV the right to operate Ajisen business throughout China. In markets other than China, rather than providing a master license to the partner, Ajisen executes a franchise contract on a case-by-case basis with its partner. Carefully proceeding with a new license contract, Ajisen strives to become familiar with the local market by building mutual trust and relationship with its partners so that both may enjoy success together.

Outlets abroad are mostly directly run by the local partners, except in some parts of China. Ajisen understands that China is a large economy made up of various ethnic groups and cultures. In order to penetrate the local market, Ajisen opted to grant a sublicense from its Shanghai JV to Chinese local sub-franchisees in Qingdao or in Dalian.

Success factors in China

Considering the quick services provided, Ajisen can be categorised as a fast-food company. With shop interiors that are well-decorated in a Japanese style, they are able to add to the customer experience and thus positioned one rank higher than ordinary local food. In this way, Ajisen differentiates itself from other local noodle shops. Ajisen believes it has an advantage by being the pioneer of the Japanese noodle player with nearly 10 years of history, in neighbouring Asian markets. Due to the initial appreciation of Ajisen's taste, local customers have come to recognise Ajisen as one of the basic tastes of Japanese noodles, as opposed to soy- or miso-flavored ramen noodles typically seen in Tokyo metropolitan areas.

Advantages on using the franchise system in overseas expansion

Ajisen is well aware that it does not possess sufficient information or knowledge of the local markets for running businesses abroad. Besides, it has few resources to cover its overseas operations. By mitigating its risks by not making investments, Ajisen is relying on the efforts by the franchisees for increasing the number of outlets in a speedy and efficient manner.

Creating a good relationship with its local partners

Spreading its overseas outlets by applying the franchise system, Ajisen recognises the importance of mutual trust and understanding with its local partners. Strict in accurately representing the culture of Kumamoto and Japan through its products on one hand, Ajisen is taking care to remain flexible on the other. In other words, it is trying to introduce the best way to conduct business that would adapt to the local market, rather than insisting on the Japanese way of business. Ajisen has no doubt that its success in penetrating the local market will be based on these efforts.

Enhancing the brand awareness of “Ajisen” by providing advertisement tools, including visual ads using DVDs, Ajisen supports its local partners. It arranged the first international conference for its franchisees for sharing ideas and lessons learned to be of benefit to the local franchisees in solving the issues they were faced with.

Ajisen is now preparing to launch a new outlet in Sydney scheduled for mid 2006 and is also eager to make a further challenge of re-entering the Chinese Taipei market.

Key Learning Points:

- Maintaining the identity of taste is the “lifeline” of expansion.
- Being a pioneer will benefit in market entry as its taste will become the base taste.
- The Franchise system is effective for a rapid expansion if the right partner is chosen, especially in the case of middle and small business.
- HQ can seek effective expansion through increasing the number of license granted, instead of only granting 1 license to 1 area.

SHIGEMITSU INDUSTRY CO., LTD..

Headquarters: Japan

Number of outlets:

- Japan 114 outlets (incl. 10 owned)
- China 76 outlets
- Singapore 10 outlets (franchisee)
- Thailand 7 outlets (franchisee)
- Indonesia 3 outlets (franchisee)
- Philippines 2 outlets (franchisee)
- US 3 outlets (franchisee)
- Australia 1 outlet (franchisee)
- Canada 1 outlet (franchisee)

18. Appendix II

18.1 *Tax*

18.1.1 Withholding Tax

Table 2: Withholding Tax Rates

Withholding taxes

Companies making certain payments are required to withhold as follows. (Note: The applicable treaty rates are effective as of May 31, 2002.)

Recipient	Dividends: Portfolio (3)	Dividends: Substantial holdings (1)	Interest	Royalties (2)
	%	%	%	%
Japanese corporations	7 or 20 (3)	20	Nil or 20 (4)	Nil
Resident individuals	10 or 20 (3)	20	Nil or 20 (4)	Nil
Foreign corporations, nonresident individuals:				
Non-treaty (5)	20	20	Nil, 15 or 20	20
Treaty (6):				
Australia	15	15	10	10
Austria	20	10	10	10
Bangladesh	15	10	10	10
Belgium	15	10	10	10
Brazil	12.5	12.5	12.5	12.5, 15 or 20 (7)
Bulgaria	15	10	10	10
Canada	15	5	10	10
China, P.R.	10	10	10	10
Czechoslovakia (former) (26)	15	10	10	Nil or 10 (8)
Denmark	15	10	10	10
Egypt (5)	15	15	Nil, 15 or 20	15 or 20 (9)
Finland	15	10	10	10
France	15	5 (10)	10	10
Germany	15	10	10	10
Hungary	10	10	10	Nil or 10 (11)
India	15	15	10 or 15 (12)	20
Indonesia	15	10	10	10
Ireland, Rep. of	15	10	10	10
Israel	15	5	10	10
Italy	15	10	10	10
Korea, Rep. of (13)	15	5 (13)	10	10
Luxembourg	15	5	10	10
Malaysia (14)	15	5	10	10
Mexico	15	Nil or 5 (15)	10 or 15	10
Netherlands	15	5	10	10
New Zealand (5)	15	15	Nil, 15 or 20	20
Norway	15	5	10	10
Pakistan	20	15	Nil, 15	Nil or 20 (16)
Philippines (17)	20	10	10 or 15	15 or 20
Poland	10	10	10	Nil or 10 (18)
Romania	10	10	10	10 or 15 (19)
Singapore	15	5	10	10
South Africa	15	5	10	10
Spain	15	10	10	10
Sri Lanka	20	20	Nil, 15 or 20 (20)	Nil or 10 (20)
Sweden	15	Nil or 5 (21)	10	10
Switzerland	15	10	10	10
Thailand	20	15 or 20 (22)	10, or 20 (22)	15
Turkey	15	10	15 or 10 (23)	10
USSR (former) (24)	15	15	10	Nil or 10 (24)
United Kingdom (25)	15	10	10	10
United States	15	10	10	10
Vietnam	10	10	10	10
Zambia	Nil	Nil	10	10

Source: PwC Worldwide Tax Summaries, 2004

The numbers in parentheses refer to the following numbered Notes.

Notes:

1. The tax treaty rates apply only to corporate shareholders. The applicable treaty should be

checked for conditions required to claim the reduced rate.

2. The applicable treaty should be reviewed, because certain tax treaties exclude, for example, film royalties and/or gain from copyright transfer from taxable income.
3. For certain dividend received from January 1, 2004 through March 31, 2008, the reduced rate of 7% (for resident individuals, additional 3% will be levied) is applied instead of 20%. Thus, the withholding rate for resident individuals is either 10% or 20% whereas the rate for resident corporations or residents in non-treaty economy is 7% or 20%. For residents in treaty markets, 7% of treaty rate will be applied.
4. Interest on bank deposits and/or certain designated financial instruments is subject to a 15% withholding tax and a 5% local inhabitants withholding tax (20% combined). Taxation of such interest is fully realised by tax withholding, so resident individuals are not required to aggregate such interest income with other income. Interest on loans made by resident individuals is not subject to withholding tax; instead, it is taxed in the aggregate with other income.
5. Dividends, interest, and royalties earned by nonresident individuals and/or foreign corporations are subject to a 20% withholding tax under Japanese domestic tax laws. An exceptional rate of 15% is applied to interest on bank deposits and certain designated financial instruments. Interest on loans, however, is taxed at a 20% rate. A special exemption from withholding tax applies to certain long-term corporate bonds issued to nonresidents in foreign markets.
6. Tax treaties with many economies provide reduced tax rates, as indicated. Some treaties, however, provide higher tax rates (e.g., Pakistan and Thailand) r do not provide rates (e.g., Egypt, New Zealand). In these instances, rates specified under Japanese domestic tax laws apply. Each treaty should be consulted to see if a reduced rate for dividends (in the case of substantial holdings) is applicable.
7. Brazil—The tax treaty with Brazil provides a 25% tax rate for certain royalties. However, the withholding tax rate cannot exceed 20% on any royalties to be received by a nonresident taxpayer of Japan under Japanese income tax law. Film royalties and trademark royalties are taxed at 15% and 20%, respectively. Other royalties are taxed at 12.5%.
8. Czechoslovakia (former)—The treaty with the former Czechoslovakia is applied to the Czech Republic and the Slovak Republic. It stipulates that cultural royalties are tax exempt.
9. Egypt—Film royalties are taxed at 20%.
10. France—Dividends received by parent companies that are “qualified residents” are exempt from withholding taxes.
11. Hungary—Cultural royalties are tax exempt.
12. India—The rate of 10% applies if the recipient of the interest is a bank.
13. Korea, Rep. of—A reduced 10% rate of withholding tax on dividends from a substantial holding is applicable up to the end of 2003, after which time the rate will be 5%. Tax sparing credit will not be applicable to the income earned by the Japanese resident in the fiscal years beginning after December 31, 2003.
14. Malaysia—Tax sparing credit will not be applicable to the income earned by the Japanese resident in the fiscal years beginning after December 31, 2006.
15. Mexico—Dividends received from their subsidiaries by parent companies that have met certain conditions are exempt from withholding taxes.
16. Pakistan—Interest on industrial bonds and loans is tax exempt.
17. Philippines—The tax treaty with the Philippines provides a 25% tax rate for certain dividends and royalties. However, the withholding tax rate cannot exceed 20% on any dividends and/or royalties to be received by a nonresident taxpayer of Japan under Japanese income tax law.

Interest on Japanese bonds and/or corporate debentures is taxed at 10%. Film royalties are taxed at 15%, and the withholding tax rate on royalties paid to designated pioneer companies cannot exceed 10%.

18. Poland—Cultural royalties are tax exempt.
19. Romania—The withholding tax rate on cultural royalties cannot exceed 10%.
20. Sri Lanka—Interest to financial institutions is tax exempt, as are film and copyright royalties.
21. Sweden—If certain conditions for beneficial owners are met, dividends are taxable only in the contracting state of which the beneficial owner is a resident.
22. Thailand—Dividends paid by a corporation that is engaged in industrial undertakings are taxed at 15%. Interest to financial institutions is taxed at 10%.
23. Turkey—Interest to financial institutions is taxed at 10%.
24. The treaty with the former USSR is applied to Armenia, Belarus, Georgia, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan; it stipulates that cultural royalties are tax exempt.
25. The existing Japan-U.K. double taxation treaty was signed on February 10, 1969 and became effective in 1970. A previous Japan-U.K. treaty, signed in 1962 and effective as of April 1963, is still applicable to Fiji, with whom the reduced rate is only applicable to royalties.
26. The treaty with the former Czechoslovakia is applied to the Czech Republic and Slovakia.

18.1.2 Corporate Income Tax

Table 3: Corporate Income Tax

Taxes on corporate income

Corporation tax/The rates are as follows.

	%
Paid-in capital of over ¥100 million	30.0
Paid-in capital of ¥100 million or less:	
First ¥8,000,000 per annum	22.0
Over ¥8,000,000 per annum	30.0

Inhabitants tax/A local tax consisting of prefectural and municipal taxes is computed as a percentage of the corporation tax. (Allocation to each local jurisdiction is based on the number of employees.) Each prefecture and municipality may elect an inhabitants tax rate within the range shown below.

	%
Prefecture	5 to 6
Municipality	12.3 to 14.7
Tokyo metropolitan (combined)	17.3 to 20.7

In addition, each local government levies equalization per capita tax on each corporation that has an office or business place in its jurisdiction. This tax varies from ¥70,000 to ¥4,600,000, depending on the sum of paid-in capital plus capital surplus and number of employees.

Enterprise tax/This tax is imposed on the corporation's income allocated to each prefecture. (Allocation is generally made on the basis of the number of employees.) The enterprise tax rate is within the range shown below.

	%
First ¥4,000,000 per annum	5.0 to 5.25
Next ¥4,000,000 per annum	7.3 to 7.665
Over ¥8,000,000 per annum	9.6 to 10.08

If the paid-in capital of a corporation is ¥10 million or more, and the corporation has places of business in more than two prefectures, the benefits from graduated rates are eliminated. The enterprise tax for utility corporations and insurance companies is 1.3% to 1.365% of net utility charges (as defined) and net insurance premiums (as defined), respectively.

Enterprise tax paid during the current period is deductible in arriving at taxable income for corporate tax purposes.

The Tokyo Metropolitan Government introduced a temporary enterprise tax applicable to all banks with liquid assets of ¥5 trillion or more. The tax, which is a 0.9% tax on gross profits, applies for fiscal years beginning between April 1, 2000 and March 31, 2004. The Osaka Prefectural Government also adopted a similar scheme applicable for fiscal year beginning between April 1, 2003 and March 31, 2004 with the applicable rate of 0.92% instead of the statutory 3% if approved in the Osaka Parliament.

From the fiscal year beginning on or after April 1, 2004, a new "size-based" tax (*Gaikei Hyojun Kazei*) is applied to the company whose paid-in capital is more than ¥100 million. Under the new tax system, factors such as the size of a corporation's personnel costs and its capital will determine the amount of tax payable whereas the existing profit-based enterprise tax will also continue to apply, although with the reduced tax rate. Thus, a loss company will be required to pay tax. The applicable rate is shown below.

	%
Profit-based tax:	
First ¥4,000,000 per annum	3.8 to 4.56
Next ¥4,000,000 per annum	5.5 to 6.6
Over ¥8,000,000 per annum	7.2 to 8.64
Additional value-based tax:	0.48 to 0.576
Capital-based tax:	0.2 to 0.24

Source: PwC Worldwide Tax Summaries, 2004

18.2 Cost Factors: Wages, Real Estate and Utilities

18.2.1 Wages[69]

Principles of wage payment

Employers must pay wages in legal tender, directly to the employee, not less than once per month, and on a specified date. However, employers are allowed to remit wages into a bank account specified by the employee where the employee agrees to that method of payment, and may also deduct social insurance premiums, taxes and similar expenses from wages.

Guarantee of minimum wage

The minimum wage is determined according to region and industry. Where an employee is subject to two different minimums, the employee is entitled to the higher of the two minimum wages. To give an example, following the latest revision in October 2005, the current minimum wage for Tokyo is ¥ 714/ hr (US$ 6).

Wage system

It is typical for Japanese companies to pay wages on a monthly basis, and to pay employees summer and winter bonuses. One characteristic of Japanese wages is the make-up: monthly wages usually include a basic wage and a range of allowances, which may include accommodation, family and transportation allowances. Another characteristic is that the amount paid in bonuses makes up a relatively high proportion of total wages paid to employees1. The typical wage system in Japan has traditionally been based on seniority, whereby employees' wages increase in accordance with the number of years of service at a company. However, recently, an increasing number of businesses are introducing ability-based and duty-based pay systems, and some are even implementing performance-based pay systems where wages are determined

[69] JETRO, Investing in Japan Website, Accessed 2005.

according to each employee's rate of achievement of set targets. As a result, more and more businesses are adopting a yearly wage system. Further information is available through the Basic Survey on Wage Structure statistics collated annually and provided by the Ministry of Health, Labour & Welfare in both Japanese and English.

Legislation on working hours, breaks and days off

Some salient points on the requirements on working hours, breaks, and paid leave in Japan are as follows:

- Working hours must, in principle, not exceed 40 hours per week or eight hours per day excluding breaks. However, restaurants businesses with less than 10 regular employees are permitted to have their employees work up to 44 hours per week at a maximum of eight hours per day.
- In the event that an employee works six hours, the employer must give that employee not less than 45 minutes' break; this increases to a one hour break where working hours exceed eight hours.
- Employers must grant employees at least one days off per week, or four days off in any four-week period. Sundays or public holidays need not necessarily be days off; employers may determine employees' days off at their own discretion.
- Any employer that requires workers to work in excess of statutory working hours or on statutory days off must submit a Notification of Agreement on Overtime and Work on Days off to its local Labour Standards Inspection Office.
- Companies must pay an increased rate of wages as set forth in the table below to employees who work overtime (between 22:00 and 05:00).

	Rate of increase
Work in excess of statutory working hours	25%
Work on statutory days off	35%
Work late at night	25%
Work late at night in excess of statutory working hours	50%
Work late at night on statutory days off	60%

- Employers must grant 10 days' paid leave to employees that worked for six consecutive months from the time of hiring and who worked on not less than 80 per cent of all schedule work days. This paid leave may be taken consecutively or separately. Where an employee's application to take paid leave will hinder the normal business operations, the employer may require the employee to take such paid leave at a different time. The number of days of paid leave available to employees increases in proportion to employees' length of service as set forth in the following table.

Years of service	0.5	1.5	2.5	3.5	4.5	5.5	6.5
Leave days granted	10	11	12	14	16	18	20

For more information on wages and human resource requirements, please refer to: http://www.jetro.go.jp/en/invest/setting_up/section4.html#44

18.2.2 Real Estate

Rentals form the largest cost component for F&B establishments. In Japan, is retail and office rents are one of the highest in the world. For example, in a recent survey across all retail locations in the world, Tokyo's Ginza street was ranked as the 5th most expensive location with rentals averaging at US$5,578/sq m annually70. Rents for retail spaces in prime spots in Tokyo are as follows:

Location	Rent/ sq m/ year (US$)
Ginza	5,578
Shibuya	3,281
Omotesando	4,266

[70] Cushman & Wakefield, Main Streets Across the World, 2005.

18.2.3 Utilities

Electricity Tariffs

Monthly electricity rates are the sum of demand charge and energy charge plus the consumption tax, etc. Demand charge will be determined by the contract ampere or contract power, while the energy charge will be calculated according to energy consumption.

Figure Demand Charges

Contract ampere	Demand charge
10A	¥260
15A	¥390
20A	¥520
30A	¥780
40A	¥1,040
50A	¥1,300
60A	¥1,560

Source: Tokyo Electric Power Company

Table 4: Energy consumption charge

Contract category			Unit	Rate (¥)
Meter-Rate Lighting B	Demand charge	10A	(per contract)	260.00
		15A	(per contract)	390.00
		20A	(per contract)	520.00
		30A	(per contract)	780.00
		40A	(per contract)	1040.00
		50A	(per contract)	1300.00
		60A	(per contract)	1560.00
	Energy charge	First 120 kWh (1st block rate)	1 kWh	15.58
		Over 120 kWh up to 280 kWh (2nd block rate)	1 kWh	20.67
		Over 300 kWh (3rd block rate)	1 kWh	22.43
	Minimum monthly charge		(per contract)	212.00
Meter-Rate Lighting C	Demand charge		(per contract)	260.00
	Energy charge	First 120 kWh (1st block rate)	1 kWh	15.58
		Over 120 kWh up to 280 kWh (2nd block rate)	1 kWh	20.67
		Over 300 kWh (3rd block rate)	1 kWh	22.43

Source: Tokyo Electric Power Company

Gas Tariffs

Gas charges consist of a "basic" monthly fee, depending on the actual usage, plus a per-cubic-meter usage charge.

Table 5: Gas Tariffs in Tokyo (Effective from January 1, 2005)

Category	Tariff Charge (¥)
Basic monthly fee for 0m^3 to 20m^3,	724.5
Per-cubic-meter usage charge	130.28
Basic monthly fee 21m^3 to 80m^3	1,083.60
Per-cubic-meter usage charge	112.32
Basic monthly fee 81m^3 to 200m^3	1,365.00
Per-cubic-meter usage charge	108.81
Basic monthly fee 201m^3 to 500m^3	2,499.00
Per-cubic-meter usage charge	103.14
Basic monthly fee 501m^3 to 800m^3	5,806.50
Per-cubic-meter usage charge	96.52
Basic monthly fee 801m^3 and up	13,786.50
Per-cubic-meter usage charge	86.55

Source: Tokyo Gas

Water Tariffs

Similar to gas charges, water utility charges consist of a "basic" rate and depending on the actual usage, plus a per-cubic-meter usage charge

Table 6: Water Tariffs Rates in Tokyo (Effective from January 1, 2005)

<table>
<tr><th rowspan="2">Pipe Diameter</th><th rowspan="2">Basic Rate</th><th colspan="9">Specific Rates/m^3</th></tr>
<tr><th>1-5 m^3</th><th>6-10 m^3</th><th>11-20 m^3</th><th>21-30 m^3</th><th>31-50 m^3</th><th>51-100 m^3</th><th>101-200 m^3</th><th>201-1000 m^3</th><th>>1001 m^3</th></tr>
<tr><td>13mm</td><td>¥860</td><td rowspan="3">¥0</td><td rowspan="3">¥22</td><td rowspan="3">¥128</td><td rowspan="3">¥163</td><td rowspan="3">¥202</td><td rowspan="3">¥213</td><td rowspan="3">¥298</td><td rowspan="3">¥372</td><td rowspan="3">¥404</td></tr>
<tr><td>20mm</td><td>¥1,170</td></tr>
<tr><td>25mm</td><td>¥1,460</td></tr>
<tr><td>30mm</td><td>¥3,435</td><td colspan="6" rowspan="2">¥213</td><td rowspan="2">¥298</td><td rowspan="2">¥372</td><td rowspan="2">¥404</td></tr>
<tr><td>40mm</td><td>¥6,865</td></tr>
<tr><td>50mm</td><td>¥20,720</td><td colspan="8" rowspan="2">¥372</td><td rowspan="2">¥404</td></tr>
<tr><td>75mm</td><td>¥45,623</td></tr>
<tr><td>100mm</td><td>¥94,568</td><td colspan="9" rowspan="5">¥404</td></tr>
<tr><td>150mm</td><td>¥159,094</td></tr>
<tr><td>200mm</td><td>¥349,434</td></tr>
<tr><td>250mm</td><td>¥480,135</td></tr>
<tr><td>>300mm</td><td>¥816,145</td></tr>
</table>

Source: The Bureau of Waterworks

C. SINGAPORE FOOD & BEVERAGE FRANCHISING

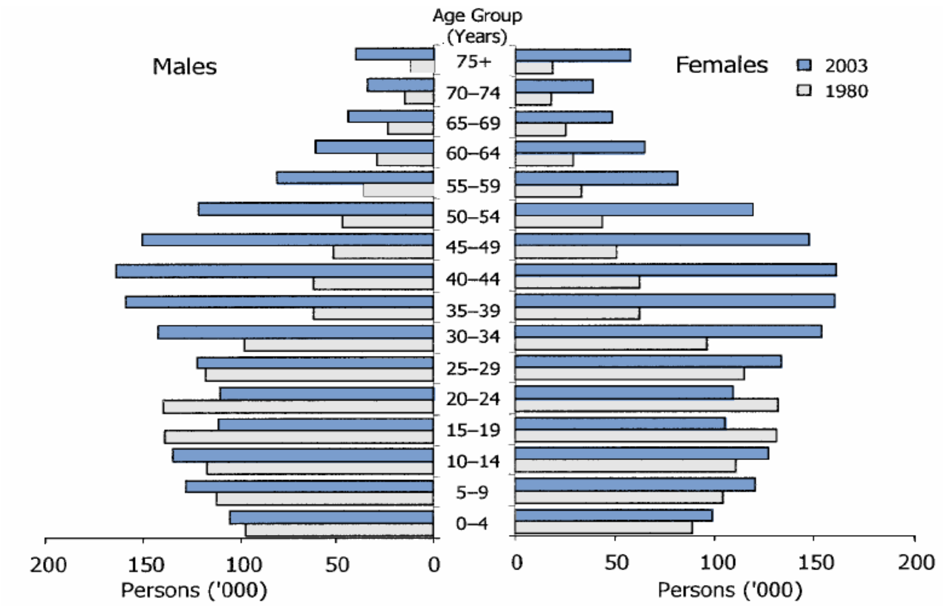
19. Singapore Overview

19.1 Singapore: Economic Overview

Singapore has an estimated total population of 4,240,300 as of end-June 2004[71]. In end-June 2004, the total population grew by 1.3% over the previous year. Singapore residents formed 3,486,900 or 82.2% of the total population. The growth of Singapore resident's population averaged at 1.7% over the last five years (*c.f. Singstat*). The most recent in-depth study on demographics trends in Singapore was for 2003.

In 2003, Singapore's demographic age structure showed an ageing population over the last two decades. In 1980, there were more children below the age of 15 compared to 2003. In the same comparison period, the proportion of the resident population of ages 15-64 rose from 67% in 1980 to 72% in 2003. Reflecting the shift in age structure, the average age of Singapore's resident population in 2003 was 35.3 years as compared to 24.4 years in 1980. Figure 1 below depicts the age structure of Singapore's resident population in 2003 and 1980.

Figure 1: Age profile of Resident Population



Source: Singapore Department of Statistics

[71] Singapore Department of Statistics, Available online [http://www.singstat.gov.sg]

Almost half of the Singapore's total population growth in the period of 1990 to 2000 was contributed by non-residents[72]. This is significant as it contributes to Singapore's diversity in population by ethnic groups. Within the resident population, there was a large increase in the number of permanent resident. The permanent residents' population saw a 10% per annum increase. This is significantly higher compared that the 1.3% growth in the number of citizens.

Singapore's population is divided into four racial categories, Chinese, Malay, Indian and Others[73]. 76.0% of the population is Chinese, 13.7% Malay, 8.4% Indian and with the balance in the "Others" category[74]. Each racial group and its ethnic sub-groups bring to Singapore their own unique taste palates and cuisine. The increasing influx of immigrants and non-residents also contributes to Singapore's diversity in population and culture.

Major world religions are present in Singapore. In the Census 2000, 42.5% of Singapore's population was Buddhists, 14.9% Muslims, 4% Hindus and 14.6% Christians74. Religious denomination is largely along racial lines, with most Malays being Muslims, Chinese largely Buddhists or Taoists and Indians as Hindus. Certain dietary requirements are unique to each religious group. Muslims require food to be prepared in a strict manner complying with Halal requirements. Hindus generally do not consume beef and some Buddhists are strict vegetarians.

19.2 Family and household structure

The average family size in 2000 was 3.7 people, down from 4.2 in 1990. 68% of the households were living in 4 room HDB flats or larger flats or private housing[75]. On average, the number of working persons per household was 1.6. This essentially means that close to half the number of persons in a household is working.

[72] Singapore's changing population trends, Singapore Department of Statistics
[73] Others include minority races such as Eurasians and Caucasians.
[74] Population Census 2000, Singapore Department of Statistics
[75] The average size of a 4-room Housing Development Board ("HDB") flat is about 90 sqm. The HDB is a public housing scheme initiated by Singapore to provide affordable houses to its populace.

Singaporeans are also getting married at a later age while remarriages are becoming more common. In 2003, the average age of the first time groom was 30.2 years and 27.2 years for the bride. In addition, 14% and 12% of Singapore's groom and bride respectively in 2003 had been previously married. Furthermore, 15% of resident males and females of ages 40-44 were still unmarried in 2003.

The increasing trend of staying single or marrying at a later age coupled with falling birth rates is contributing to Singapore's "greying population". This is expected to increase the burden on the younger population as the age dependency ratio increases. This has both social and economic implications.

The average monthly income per household has also risen. In 1990, the average monthly household income gained from salaried employment was S$ 3,076. By 2000, this figure had risen to S$ 4,943. The median monthly income per household gained from salaried employment was S$ 3,607[76]. The income level of household in Singapore is also set to rise as more young families have both spouses working.

Together with expenditure on housing, transport and communications, Singaporean's expenditure on food made up 21.3% of total expenditure in an average household in 2003. Food expenses ranked third at S$ 780, lower than the S$ 830 in 1998. Most of the expenditure on food was on cooked food products, accounting for 57% of total food expenditure[77]. This reflected Singaporean's preference for eating out over home-cooked food as well as the affordable prices of cooked food.

19.3 Singapore's Economic Overview

Singapore is considered one of the four Asian Tigers seeing strong double-digit GDP growth in the 80s and early 90s. However, following the 1997 Asian financial crisis, Singapore's economic growth has shrunk to single digit figures.

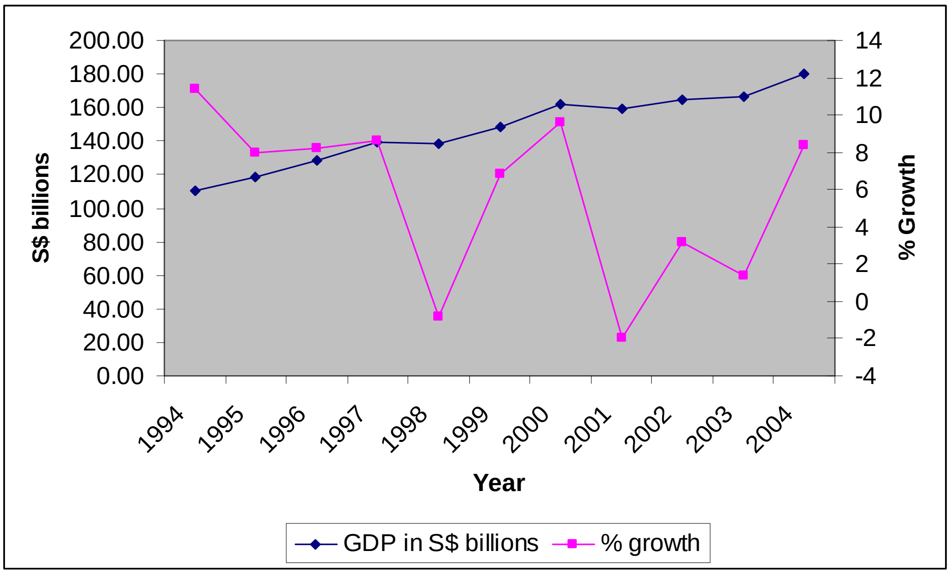
[76] Population Census 2000, Singapore Department of Statistics
[77] Household Expenditure Survey 2003, Singapore Department of Statistics

Economic growth has yet to recover to double digit levels and it is not expected to occur in the near future.

Since the 1997 Asian financial crisis, Singapore had to weather several other storms. The global economic slowdown in 2001, the Iraq war and the outbreak of Severe Acute Respiratory Syndrome ("SAR") in 2003 all contributed to a slowdown in Singapore's economy. In 2001, Singapore's economy contracted for the first time since 1998.

Fortunately, Singapore's strong and sound economic fundamentals have allowed itself to weather the storm. Singapore's GDP growth in 2004 stood at 8.4%, a healthy jump from the 1.4% growth in 2003[78]. Figure 2 below shows Singapore's 10 year historical GDP at 1995 prices and percentage growths

Figure 2 - Singapore's 10 year GDP and % growth at 1995 Prices



Source: Singapore Department of Statistics

19.4 Economic Characteristics

Since the 1970s, Singapore has pursued an export oriented economic growth. Despite its small population size, Singapore's economy has been built on the

[78] Singapore Department of Statistics

twin engines of the manufacturing industry and services industry.

The manufacturing sector has four important clusters, i.e. electronics, biomedical sciences, chemicals and engineering. Singapore is heavily reliant on the global demand for electronics. Major semi-conductor and electronics companies have manufacturing presence in Singapore. Some examples are, Seagate, National Semiconductor and etc. Oil and oil refining is also a major segment of the Singapore economy, despite the lack of its own natural resources. Jurong Island is a major oil refining centre with several world class refineries.

Another growth engine that Singapore is actively developing is the service sector. Capitalising on its educated workforce, Singapore is keen to position itself as the services hub for Southeast Asia and Asia. Banking, finance, insurance and IT services are among the services being promoted. Singapore's aim to make the city-state the financial capital of Asia has led to liberalisation in the banking sector. Comparatively, Singapore's financial services sector is more developed than its Southeast Asian neighbours.

The food and beverage ("F&B") industry is one component of the service industries. In 2003, the F&B industry employed a total of 61,100 workers in about 4,300 establishments. The F&B industry's contribution to Singapore's GDP falls under the "Hotels & Restaurants" classification. In 2004, Hotels & Restaurants contributed 2.0% to Singapore's GDP at current prices[79]. Although small, the local F&B industry forms an integral part of the Singapore economy. The industry caters not only to the local population, but also the tourists.

19.5 Trade

Singapore's export oriented economy also means that it is very dependent on trade and is sensitive to the global economy. Singapore's merchandise trade is

[79] Singapore in Brief 2005, Singapore Department of Statistics

three times that of its GDP[80]. This can be attributed to its relatively liberal trade regime that includes very low tariffs. Singapore has also been very active in pursuing Free Trade Agreements ("FTA"). To date, Singapore has signed FTAs with 8 markets. Table 7 below highlights the concluded FTAs and on-going negotiations.

Table 7 - Summary of Markets which Singapore has FTAs with

• **Concluded**	• **Ongoing**
• New Zealand	• ASEAN & China
• European Free Trade Association	• Bahrain
• Japan	• Canada
• Australia	• Egypt
• United States	• Mexico
• Hashemite Kingdom of Jordan	• Pacific Three
• India	• Panama
• South Korea	• Peru
	• Sri Lanka

Source: Ministry of Trade and Industry

[80] Singapore Brief March 2005, Australia Department of Foreign Affairs and Trade. Available online [http://www.dfat.gov.au]

Recognising its need for Foreign Direct Investments ("FDI"), Singapore strives to attract foreign companies to come and make Singapore its regional headquarters. Promoting itself as the bridge between Asia and the West, agencies such as the Economic Development Board ("EDB") and Singapore Tourism Board ("STB"), actively courts foreign companies into Singapore. Various incentives such as tax holidays and providing efficient infrastructure have proven successful over the years. Efforts are also undertaken to ensure Singapore remains nimble and ready to meet the challenges of the new global economy.

19.6 Business Environment

Singapore maintains a liberal business operating environment. Singapore's investment laws and company regulations while stringent are applied fairly to all entities, foreign or domestic. Only several industries are considered sensitive and thus face some ownership restrictions. Most notable are the broadcasting and print media industry. Some restrictions also apply on the banking industry although the laws are more liberal now compared to a decade ago.

Singapore has consistently been voted as pro-business. Among its more recent ranking were:

- 2nd place in World Competitiveness Yearbook, 2003 - *International Institute for Management Development (IMD)*
- 4th place in the Global Competitiveness Report, 2002-2003 - *World Economic Forum*
- 2nd most profitable place for investors, Investment Climate - Global, 2003 - *BERI*
- 6th best business environment in the world and top business environment in Asia - *Economist Intelligence Unit, January 2003*
- Top in Asia for Intellectual Property Rights Protection, Protection of Intellectual Property - Global, 2003 - *World Economic Forum and IMD*

Source: Economic Development Board Singapore

Transparency International in 2002 placed Singapore as the least corrupt in Asia.

However, excessive regulatory requirements and high costs have been cited by business owners as hindrances. In 2003, an international survey of business owners found that 48% of Singapore's Small and Medium Enterprises ("SME") cited red tape as an impediment to their growth. This figure was 13% higher than the global average[81].

According to the Association of Small and Medium Enterprises ("ASME"), 9 out of 10 business establishments in Singapore can be classified as SMEs. Up to half of Singapore's labour force is employed in SME organisations. The bulk of Singapore's F&B outlets falls under the SME category. In 2003, more than half of eating establishments in Singapore employed less than 10 workers[82].

Singapore's relevant agencies acknowledge the challenging business environment in which SMEs operate in. Thus several steps have been taken to help these companies. Among which is promising lesser red tape by providing one-stop centers for SMEs and budding entrepreneurs. SMEs and start-ups are also promised assistance schemes that include courses, technical assistance and for the promising start-ups, seed capital.

19.7 Economic Restructuring

Despite the above competitiveness ranking, Singapore recognises the need to evolve and adapt to the changing global economy. In view of this, the Economic Review Committee ("ERC") headed by the Ministry of Trade and Industry was established in December 2001. Its mandate was to draw up a plan to redesign the Singapore economy and keep it competitive in the long run.

[81] Grant Thornton Business Owners Surveys Singapore 2003, Available online [www.grantthornton.com.sg]
[82] F&B Economic Survey Series 2003, Singapore Department of Statistics

The committee recommended action on six areas considered critical. On the top of the list was the need to expand external ties and continue with Singapore's progress towards globalisation. The multilateral trade framework of the WTO is considered important to Singapore's economic survival.

Secondly, several steps were recommended to keep the Singapore competitive. Low tax burden on companies and individuals, reducing the burden of the Central Provident Fund on employers, a more flexible labour and wage market and the provision of efficient and cost-effective infrastructure.

Nurturing entrepreneurship and local companies through cutting the red tape for businesses is also an area covered by the committee. While various industry programs and funds are on offer to help local start-ups and entrepreneurs get started, Singapore has warned that this does not mean that it will protect failing industries. Local companies are also urged to expand and diversify to the regional and international markets.

Another area highlighted was Singapore's twin growth engines, manufacturing and services. The ERC notes that manufacturing will remain as an important growth driver. The four core manufacturing clusters (i.e. electronics, biomedical sciences, chemicals and engineering) are urged to focus on higher value added activities including research and development.

In services, the focus is on exportable industries such as education, healthcare and IT. Singapore is also keen to attract more tourists from Asia's two rising giants, China and India. The creation of the Integrated Resorts, encompassing theme hotels and casinos, is expected to boost tourism arrivals in Singapore. Supporting industries such as retail and F&B will benefit from higher tourist numbers. Various agencies such as the Singapore Tourism Board ("STB") and the Ministry of Education are involved in the promotion of the services industry in Singapore. Notable activities include the Great Singapore Sale and the Singapore Food Festival jointly organised by STB.

The final two areas highlighted were the People and Restructuring. Singapore's labour force is encouraged to continually upgrade their skills set. Foreign talent are encouraged to seek employment in Singapore to supplement the needs of the economy. Singaporeans are also forewarned that as the economy undergoes critical fundamental transitions, unemployment and restructuring will be a recurring feature. However, with continuing education and the right attitude, the ERC believes that the workforce will be able to adapt to the realities of the new global economy.

20. Franchising in Food & Beverage Services Industry

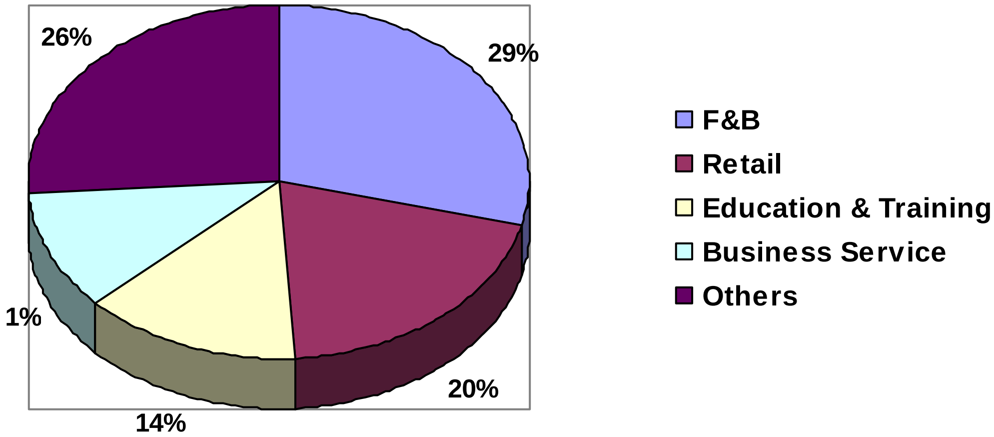
Franchising first began in Singapore back in the 1970s when major companies such as Shell, Esso, Singer and Bata operated under licensing systems that bore similar characteristics to present day franchise operations. The 1980s saw Singapore-based companies acquiring rights of international franchises such as Kentucky Fried Chicken, McDonald's, Pizza hut and 7-Eleven. In the following decade, there was a greater interest in franchising as well as more government support for the business model. Franchising was also a strategy for companies to form economic groupings for greater productivity and efficiency[83].

Franchising has become an established strategy for business expansions by businesses in Singapore. Both foreign and local business owners have taken the franchising route for market penetration and expansion. Mr. Cedric Foo of SPRING Singapore in a speech in September 2003, noted that there are more than 350 franchises and more than 2,600 franchisees in Singapore covering a range of industries[84].

The F&B industry showed a strong preference for franchising as a business format. Of the total number of franchise systems, about 30% were in the F&B trade. This was compared to the next biggest segment, retail, at 20%.

83 "Franchising in Asia-Pacific", Singapore Trade Development Board, 1997
84 "Nurturing franchising as a growth strategy for Singapore", Speech by Mr. Cedric Foo, Minister of State for Defence and Chairman, SPRING Singapore at the Franchising and Licensing Association's 10th Anniversary Gala Dinner on Thurs, 18 Sept 2003 at the Ritz Carlton, Millennia Singapore at 8.00pm, Available online [http://www.spring.gov.sg]

Figure 1 - Franchises by Trade category



Source: Feature of Productivity Digest (October 2001), SPRING Singapore

20.1 Local Franchises

Franchising of local brand first began in the 1980s with the convenience stores chains such as Econ Minimart. The early successes of these convenience store companies contributed to the popularity and recognition of franchising as an avenue for small business growth.

Several Singapore-based companies have used the franchising route to expand their businesses within the home market and overseas. Among these are Ya Kun Kaya Toast, Fish & Co. and Komalas' Restaurant.

In the Singapore Franchise Directory 2002, there were a total of 29 franchises originating from Singapore. On average, these franchisors had 4.5 franchisee outlets. Local franchisors are involved in various forms of F&B concepts including casual dining, ice-cream, ethnic cuisines (e.g. Japanese sushi and Italian cuisine) and beverages such as coffee and bubble tea.

Bubble tea was a major fad that lasted a couple of years in Singapore. The concept originated from Chinese Taipei. The low start-up costs for starting a bubble-tea kiosk saw such concept mushrooming within a short period of time. It was not an uncommon sight to see three to five bubble tea shops side by side within a single block. At its peak, it was estimated that there were over 5,000 such kiosks throughout Singapore. This led to stiff price wars and a general decline in the quality of the products. According to an independent operator of a bubble tea shop, "high overheads will drive out franchisees first as they must pay fees and security deposits, and follow the franchiser's instructions."[85]

Generally, local franchisors prefer to have their run corporate owned outlets in Singapore given the small size of the market. This allows them to retain better control over their operations. However, when expanding overseas, local franchisors will prefer the franchise system as it mitigates the risks and lowers the investment amount required.

20.2 Foreign Franchises

Singapore plays host to several foreign franchise operation. In the Singapore Franchise Directory 2002, 44 out of 73 franchises listed originated from overseas. Most of the franchises, 22 in total, were from the US. Some of these franchisors have been operating in Singapore since the 1980s. ABR Holdings has been the Master Franchisor for Swensen's since 1979.

The method of entry for foreign franchisors ranges from appointing direct franchisees to establishing their own corporate office in Singapore. McDonald's established its own corporate office in Singapore to oversee all the McDonald's fast food restaurants in Singapore. Kentucky Fried Chicken outlets however are managed by the Master Franchisor in Malaysia.

Fast-food F&B in Singapore is dominated by global players, namely McDonald's, KFC and Burger King. Other foreign franchises in Singapore include ice-cream franchises (e.g. Andersen's of Denmark Ice Cream and Haagen Dazs), beverages such as coffee (e.g. Gelare Café and Starbuck), and pizza establishments (e.g. Spageddies Italian Kitchen and California Pizza Kitchen).

[85] "Bubbling over", The Straits Times, 13 January 2002

20.3 Number of Franchise Systems

Based on Singapore Franchise Directory 2002, there are over 73 F&B franchise systems in Singapore[86]. While the number of businesses operating as franchises is increasing, the Singapore Franchise Industry Survey 2001 notes that most of the companies (72%) have only 1 franchise concept. Companies owning 2 or more franchise concepts constitute about 30% of the franchise landscape[87].

20.4 Number of franchise outlets/establishments

Of the 73 F&B systems mentioned earlier, a total of 521 F&B outlets were corporate owned and another 330 operated by franchisees. On average, there were 4.52 franchise outlets per franchisor. The franchisors ran an average of 7.14 corporate owned outlets.

According to the Directory, The largest franchise operation was Do & Me Fried Chicken with 70 outlets. KFC followed closely with 65 outlets.

[86] Note that this figure does not represent the total and complete listing of franchise operations in Singapore. There is no complete and updated listing of franchise operations in Singapore.
[87] Singapore Franchise Industry Survey 2001, MTI

21. Singapore Support in Franchising

21.1 Singapore support for franchising

There are no laws or regulation that addresses franchising specifically. The practice of franchising is covered under Singapore's Contract Law and other related laws.

Singapore has long promoted franchising as a means for internationalisation of smaller companies. Several multi-agency initiatives have been initiated to provide technical and financial support to companies who are interested in franchising. The leading agency for franchising is Standards Productivity And Innovation Board ("SPRING Singapore") and International Enterprise Singapore ("IE Singapore") for overseas expansions.

21.1.1 SPRING Singapore

SPRING Singapore offer assistance schemes to SMEs and business that are keen to grow their business. The table 7 in APPENDIX summarises the lists of schemes available as well as brief description of these schemes.

Among the schemes available to F&B companies who are keen to expand through franchise is the Local Enterprise Technical Assistance Scheme ("LETAS").The scheme help local enterprises defray cost incurred in modernising and upgrading their operations through the engagement of an external expert for a limited period of time. The scheme was launched in 1982 and to date, more than 15,000 local enterprises have benefited from the grants. In total, some 27,000 applications, with grants amounting to $500 million, have been approved[88].

LETAS is available to companies with at least 30% local equity and with fixed assets of less than S$ 15 million. The total group's employment size must also

[88] "Factsheet on Repositioning of Local Enterprise Technical Assistance Scheme (LETAS)", SPRING Singapore, Available Online [http://www.spring.gov.sg]

not exceed 200 workers in the non-manufacturing industries. LETAS offers companies assistance by subsidising up to 50% of the cost of engaging an external expert for approved short term assignments. The areas of work supported are in the IT systems and Quality Management System. Implementing a Quality Management System is obviously important to a franchise business in order to ensure a standard is kept across all franchisees.

21.1.2 International Enterprise Singapore

IE Singapore is engaged in helping local companies expand regionally and internationally. IE Singapore recognises that franchising is an avenue for overseas expansion. However as IE Singapore's mandate is to help local companies expand overseas, its programs will not be covered in this paper.

21.2 Singapore Franchise Mark[89]

The Singapore Franchise Mark ("SFM") is administered by Franchising and Licensing Association (Singapore) or the FLA. It is supported by both SPRING Singapore and IE Singapore. The certification scheme was introduced in March 2000 and is an assessment of a franchise's standards and quality programs. The scheme is aimed at helping to position Singapore as a franchise hub, raising the quality and standards of franchising and to catalyse the growth of franchising in Singapore.

The Mark helps both franchisors and franchisees. Franchisees are now able to identify franchisors that "adhere to sound and ethical franchise practises". This also helps franchisors in their efforts to recruit franchisees. The application and assessment fee for the scheme is S$ 800. There are three broad areas of assessments. These are broken down into Franchise Practices (a mandatory section), Franchisors Capability and Business Performance.

Interested parties are to contact the Franchising and Licensing Association (Singapore) at the following

[89] "Singapore Franchise Mark - Mark Of A Quality Franchise", Available online [http://www.spring.gov.sg]

Franchising and Licensing Association (Singapore)

230 Victoria Street #07-00/03

Bugis Junction Office Towers

Singapore 188024

Email: enquiry@flasingapore.org

Website: http://www.flasingapore.org/

22. Investment Climate

Singapore's investment climate has been praised regularly as conducive and pro-business. This is in recognition of the importance of foreign investments to the Singapore economy. 73% of investment commitments in 2004 were from abroad with 30% of foreign investment originating from the US[90]. In October 2004, Singapore clinched the third spot in the World Bank's study, "Doing Business 2005", which ranks an economy based on the ease of conducting business there[91]. Singapore has also been recognised as a place with transparent business climate. Singapore was ranked 12th in the annual Opacity Index that examines aspects of business practices that potentially raise the costs of business and capital, and inhibit economic growth. This puts Singapore ahead of other developed economies such as Japan, Germany and France[92]. The legal system is highly effective in dealing with business disputes, reaching decisions quickly. No favouritism is shown to domestic companies on legal matters, and contracts are easily enforceable.

22.1 Tax

22.1.1 Withholding tax[93]

Any person (including a company) who is liable to make payment of monies to a non-resident person (including a company) is required to withhold tax and remit the amount to the Comptroller by the 15th of the month following the date of payment to the non-resident.

For detailed information on the nature of payments and applicable rates, please refer to Table 15 in Appendix.

22.1.2 Corporate Income Tax[94]

A company is liable to tax on its income accruing in or derived from Singapore

[90] "Profile 2005- Singapore", The Economist Intelligence Unit
[91] "Third best place for doing business", Singapore Economic Development Board News Release, Available online [http://www.sedb.com]
[92] "Singapore's open business climate recognised", Singapore Economic Development Board News Release, Available online [http://www.sedb.com]
[93, 94] http://www.business.gov.sg

or received in Singapore from outside Singapore. A company means any company incorporated or registered under any law in force in Singapore or elsewhere.

Singapore adopts a one-tier corporate tax system. Under this system, tax paid by a company on its chargeable income is final and all dividends paid are exempt from tax in the hands of its shareholders. A company is taxed at a flat rate on its chargeable income. For detailed information on flat rate, please refer to Table 16 in Appendix.

22.1.3 Avoidance of double taxation

A resident company is entitled to the benefits conferred under the Avoidance of Double Taxation Agreements, which Singapore has concluded. A company is resident in Singapore if the control and management of its business is exercised in Singapore.[95]

An Avoidance of Double Taxation Agreement serves to prevent double taxation of income earned. It also makes clear the taxing rights between Singapore and her treaty partner on different types of income arising from cross-border economic activities between the two economies. The agreements also provide for reduction or exemption of tax on certain types of income.[96]

Singapore has Comprehensive Avoidance of Double Taxation Agreements with China and Japan.

22.2 Intellectual property rights

Branding is a critical aspect of a franchise that needs to be adequately protected through intellectual property laws, typically through trademark registration and laws recognising famous marks. Singapore has a comprehensive set of intellectual property laws which are amongst the most stringent in Asia. Several

[95] http://www.business.gov.sg
[96] Inland Revenue Authority of Singapore website

pieces of legislation have been enacted to provide for the establishment of laws governing ownership of IP, and the attendant rights and enforcement of those rights to protect business interests. These statutes include the Copyright Act (Cap 63), Geographical Indications Act (Cap 117B), Patents Act (Cap 221), Trademarks Act (Cap 332) and Registered Designs Act (Cap 266). Although there is no legislation protecting trade secrets as such, the law does protect business trade secrets and confidential information as common law rights under the law of confidence. It also provides common law protection for goodwill under the law of passing off.

Since 1 April 2001, the Intellectual Property Office of Singapore ("IPOS") has been a full fledged statutory board. This is a sign of Singapore's strong emphasis on protecting Intellectual Property. Apart from the traditional role and responsibility of running the Trademarks and Patent Registries, IPOS now takes on a more proactive role in the development of IP laws in Singapore. To further foster an environment where ideas and intellectual efforts are valued, recent amendments to the Patents Act, the Trademarks Act and the Copyright Act bring Singapore's intellectual property laws more in line with developments in the United States, Australia and Britain, jurisdictions which have a strong legal tradition of intellectual property laws.

Singapore is not only fully compliant under the WTO Agreement on Trade Related Aspects of IP Rights (TRIPs) but is also signatory to many international Conventions. These include the Paris Convention relating to protection of Industrial Property, the Berne Convention which covers copyright laws, the Madrid Protocol providing for international registration of trademarks, the Patent Cooperation Treaty which establishes an international patent filing system and the Geneva Act (1999) of the Hague Agreement concerning the international registration of Industrial Designs. Disputes on IPR issues can be brought to IPOS for mediation. The Hearings and Mediation Department at IPOS hears and mediates intellectual property disputes such as trademark oppositions and patents and designs revocations. The department also hears all interlocutory matters arising from cases brought before it.

The IP environment in Singapore is one therefore suited for exploitation of IP rights including franchising activities, as the legal infrastructure to do so is in place.

22.3 Investment promotions

Singapore maintains an open investment regime with restrictions in only several sectors such as in the financial services, professional services, and media sectors[97]. Singapore's legal framework and public policies are in general very friendly to foreign investors. There are no regulations requiring foreign investors to enter into joint ventures or give up management control to local interests. The rule of law is also applied equally to both the local and foreign investors. The Economic Development Board ("EDB"), Singapore's investment promotion agency, has a reputation for being highly responsive to changing business conditions and investor needs[98].

EDB offers various incentive schemes both for the promotion of new investments in industries and services and for encouraging existing companies to upgrade through mechanisation and automation and through the introduction of new products and services. Financially they offer a series of tax incentives which includes;

- Pioneer status (in which an income derived from an applicable pioneer industry or product is exempt from tax for up to 15 years after commercial production begins)
- Post-Pioneer Incentive
- Investment Allowance Incentive
- Expansion Incentive
- Export of Service Incentive
- Approved Foreign Loan
- Approved Royalties
- Overseas Enterprise Incentive

[97] "Singapore Commercial Guide FY 2003 - Investment Climate", Strategis.gc.ca, Available Online [http://strategis.ic.gc.ca]
[98] "Singapore Investment Climate Report', US Department of State, 23 August 2004, Available online [http://singapore.usembassy.gov]

- Warehousing and Servicing Incentive
- Overseas Investment Incentive
- Venture Capital Incentive

EDB also administers Operational Headquarters Incentive, Business Headquarters Incentive, Double Deduction Incentive for R&D expenses and Double Deduction Incentive for Overseas Investment Development Expenditure. Table 14 in APPENDIX provides a summary description of some of these schemes for businesses.

22.4 Infrastructure

Singapore is among the most developed Asian markets in terms of Infrastructure. Singapore is well connected to the region and the world through its air and sea links. The well developed infrastructure is critical to Singapore's economic survival given its reliance on external trade. A reliable utilities and telecommunications infrastructure also ensures that businesses are able to conduct their affairs with minimal interruptions.

22.4.1 Transportation

Changi International Airport is a constant favourite among travellers and travel magazines worldwide. Among some of the awards the airport has clinched in 2004 were, "Favourite Asian Airport" by TIME magazine, "Best International Airport" by the Telegraph Travel Awards, "Hall of Fame-Airport" award by Trade Travel Gazette, "Best Airport - World" and "Best Airport for Duty Free Shopping" awards by Business Traveller (UK Edition). The airport's status as an important regional cargo hub was also acknowledged by Cargonews Asia. The airport was won the "Best Airport-Asia" award at the 2004 Asian Freight and Supply Chain Awards held in Shanghai on 12 May 2004[99]. As of June 2005, there were 79 scheduled airlines operating from Changi International Airport serving 177 cities in 54 markets with over 3,972 scheduled flights every week.

[99] Changi International Airport News Release, Available online [http://www.changi.airport.com.sg]

Singapore's ports are also among the busiest in the world. Singapore's four ports at Tanjong Pagar, Brani, Keppel and Pasir Panjang operates as one integrate facility that is capable of handling over 60,000 containers and 60 vessel calls daily. These ports are served by over 200 shipping lines with connections to 600 ports in 123 markets[100]. Singapore's ports are also advanced in terms of its use of Information Technology for expediting trade. PORTNET® and CITOS® allow shippers and traders to seamlessly liaise with relevant authorities such as Customs, Maritime Port Authority and PSA.

Singapore's road and rail infrastructure is also well developed. Singapore has about 3,130km of paved roads including 150km of expressways[101]. Singapore is connected to Malaysia through two land links. The Woodlands Causeway in the North is a vital node of Singapore's relations with Malaysia. The Causeway consists of a bride for vehicular transport, a railway track and water pipelines. A significant amount of Singapore's food needs comes through its two land links to Malaysia. Poultry, vegetables and other food products are imported from Malaysia.

22.4.2 Telecommunications

Singapore has one of the highest densities of mobile phones and Internet penetration in the world. Figures release by the InfoComm Development Authority ("IDA") in February 2005 shows that mobile phone penetration stood at 94.0%, Dial-up Internet Services penetration was 40.6%, and Broadband access penetration rates was 44.0%[102]. There are three major telecommunications players domestically. Singtel, the largest player, provides consumers and businesses with the full range of telecommunications services.

Singapore has direct Internet connectivity to over 30 economies reaching speeds of more than 90Mbps to key regional markets such as China, Korea, Japan, Hong Kong, Australia, India and Chinese Taipei and over 1Gbps to the

[100] "Singapore Terminals", PSA Corporation, Available Online [http://www.internationalpsa.com/]
[101] CIA World Fact Book 2005
[102] "Telecoms Services Statistics for February 2005", InfoComm Development Authority, Available online [http://www.ida.gov.sg]

United States. Key features for Singapore's Internet connectivity to the world are:

- Asia Pacific Cable (APC), Asia Pacific Cable Network (APCN), South East Asia-Middle East-West Europe-2 (SE ME WE2), South East Asia-Middle East-West Europe-3 (SE ME WE3), Singapore Brunei (existing capacity of 53.36Gbps), Asia Pacific Cable Network 2 (APCN2), City-to-City (C2C), East Asia Crossing, India-to-International (I2I) and Nava Networks.

- Singapore's internet link to Europe exceeds 100Mbps and the island is connected directly to the US Internet backbone by a pipe that boasts a bandwidth that measures over 1Gbps.

- Singapore's internet infrastructure minimises latency and packet loss for network links and puts the island's businesses in touch with key regional markets such as Korea, Japan, Hong Kong, Chinese Taipei, Malaysia, India, Indonesia and Australia.

- 99% of Singapore's homes, schools and businesses can access its broadband network[103].

22.5 Utilities

Singapore liberalised its energy market in its drive to allow market forces to determine the prices. The utilities market in Singapore has been described by CIO Connect in Summer 2004 as being world-class[104]. This indicated that the electricity and telecommunications infrastructure in Singapore is stable and reliable. This is particularly important for businesses as unstable power supplies and blackouts of electricity can result in losses. The Energy Market Authority ("EMA") is the governing body in the electricity market.

The Public Utilities Board oversees Singapore's water utilities infrastructure. Singapore is not self-sufficient in water and relies on Malaysia to supply part of

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[103] "Data Centres", InfoComm Development Authority, Available online [http://www.ida.gov.sg]
[104] "Summer 2004, Risk Profile", CIO Connect, Available Online [http://www.cio-connect.com]

its water needs. In order to diversify its water resources from dependence on reservoirs and Malaysia, Singapore has embarked on several projects. Among these are the NEWater, a water reclamation project and a seawater distillation plant. Another project undergoing feasibility study is the creation of an underground reservoir in eastern Singapore.

23. Opportunities for Franchisors

Singapore's F&B service landscape has been described in the above sections. Singaporean's love affair with food certainly presents aspiring restaurateurs and F&B businesses with a ready market. The high levels of disposable income and high expenditure per household on food bodes well for the F&B industry. As the population demographic changes and the lifestyle adapts, it is expected that eating-out will become an increasingly common activity in most Singaporean households.

As for the local franchisors, foreign investors can also benefit from the well established franchise market in Singapore. Franchising is not a new business model in Singapore. New foreign entrants are likely to find master franchisees with track record in Singapore without much effort. This is especially true for the F&B service industry where franchising has been a common feature. The Franchising and Licensing Association can act as a contact point for those franchisor and franchisee.

A stable and strong support system for businesses helps to mitigate business risks. The pro-business and fair judicial processes ensures that foreign investors are given fair and equal treatment.

A cursory survey of the F&B industry in Singapore throws up some opportunities for foreign franchisors.

23.1 Exotic cuisines

The well travelled Singaporean is exposed to various cultures and cuisines from around the world. Restaurants, cafes and even hawker stalls sells food ranging from local cuisines to Japanese, Italian, French, Korean and Indian food. There is a heady mix of flavours and cuisines that is set to tantalise the hungry diners.

However, certain ranges of cuisines are not yet well represented here in Singapore. Middle Eastern food, for example, has just begun to mushroom, with Arab Street as its focal point. Another range of cuisine that is hard to find in Singapore is African food. According to Mr. Ignatius Achugbu, owner of a

Nigerian food stall in Little India, before their stall, there was no place in Singapore that serves African cuisine[105]. Other types of cuisines that are less represented here are Mediterranean and establishments using only organic ingredients.

Given the increasing health consciousnesses of Singapore consumers, F&B outlets serving organic foods exclusively may be the next trend movement. Organic foods currently are considered to be more expensive than the usual varieties. However, operating through a franchise and consolidating purchases can help these F&B outlets reap economies of scale and thus lower costs.

[105] "Looking for African food? Try Little India", The Straits Times, 2 April 2005

23.2 Franchise hub and regional expansions

Singapore is pushing itself as the regional hub for businesses. The Economic Review Committee aims to make Singapore as the test-bed for innovative F&B concepts as well as the franchise hub for F&B businesses. Given Singapore's population make-up that mirrors that of the region[106], franchisors can test run their concepts and cuisines in Singapore with the aim of regionalising it.

Singapore-based companies have a strong regional knowledge experience with franchising as a business model. Several companies have expanded their franchise network overseas giving them crucial networks and understanding of the regional markets. Examples of such companies are Apex-Pal Holdings Ltd (Sakae Sushi), OB Singapore Ltd (Fish & Co) and Wing Tai (Yoshinoya). They have been successful either as master franchisors or as franchise owners and in bringing their systems beyond Singapore. The markets include Malaysia, Indonesia, Philippines and South Korea.

23.3 Theme based Casual Dining

The Euromonitor study in 2004 found that themed casual dining is becoming increasingly popular. This is evidenced by the increasing number of casual dining outlets. In 1999, there were 471 casual dining restaurants. This figure grew by about 30% to reach 615 restaurants by 2003.

[106] Singapore's ethnic make up includes Malays, Chinese, Indians and Others. These ethnic groups are also found in neighbouring markets in Southeast Asia such as Malaysia.

24. Business Considerations in Running Franchise Operations in Singapore

There are several issues that consideration when setting up an F&B franchise operation in Singapore.

24.1 Food sources

Singapore's food need is dependent almost entirely on import. Agri-food & Veterinary Authority is the governing body which oversees the economy's food sources. The need to import food sources means that costs are higher. This is reflected in the Economic Survey Series conducted by the Singapore Department of Statistics ("SingStat"). In its survey, it was found that the procurement of raw materials was the largest cost component for all categories of F&B establishments. Franchisors that need to import specially prepared food ingredients are required to obtain necessary licenses from AVA.

24.2 Employees

Most staff in the F&B industry is transient workers, especially wait staffs. This issue was highlighted by the Economic Review Committee. In its report, it was noted while Singapore faces a shortage of labour in many domestic industries; it was most acute in the F&B industry. The low profile of the industry, long irregular working hours and the negative connotations with working as F&B service staff has led to difficulties in attracting local workforce. The high turnover of staffs makes it difficult for the F&B industry to develop a satisfactory standard of service. Innovative companies such as Cavana Holding have resorted to bringing foreign workers including students in hospitality management from China; both to overcome shortage of local staff and at the same time possibly preparing its future market development in the foreign markets.

All food handlers should be educated on food and personal hygiene, vaccinated against typhoid and have attended the basic food hygiene course. In addition, each food handler is expected to be screened for tuberculosis. This is the requirement set out and enforced by the National Environment Agency[107].

[107] http://app.nea.gov.sg

24.3 Regulatory Environment in setting up F&B business

A notable market observation in setting up an F&B business in Singapore is the amount of licenses required to begin a business. A study by The Straits Times in 2002 found that new F&B outlets may require licences from up to eight different agencies[108]. However, Singapore has undertaken several measures to address this issue. In 2004, Singapore launched an online licensing service through its www.business.gov.sg website.

However, while the online portal has helped to streamline license applications processes, the regulatory environment is still seen as stifling. The plethora of licences required to set up and operate a business. Among the regulatory issues that will affect an F&B operation includes employment policies, fire safety, and food safety and entertainment licenses.

There are however no statutory provisions that have been enacted to specifically regulate franchising activity as such.

24.4 Vibrant but highly competitive market

While Singapore does present an attractive opportunity for F&B franchising, the market is finite and limited. With a population of just over 4 million, F&B establishments are operating in a very competitive market. Among the considerations is the possibility of cannibalisation among outlets if the chain grows beyond 20 outlets. This is something Mr. Adrian Loi of Ya Kun Kaya Toast is very mindful of. In expanding Ya Kun's franchise outlets in Singapore; the strategy of Ya Kun is to never open and outlet within a one kilometre radius from each other[109]. This is to prevent poaching of the same customers.

In addition, franchises in the fast food sector are up against well entrenched and recognised players such as Kentucky Fried Chicken, McDonalds and Burger

[108] "Online licensing service for businesses kicks off", The Straits Times, 17 January 2004
[109] "Toast of the town", The Business Times, 24 June 2003

King. In a Euromonitor report, these key global brands have secured "significant value shares of fast food". The report considers the Singapore market for fast food is fully saturated with global chains. Despite this however, Carl's Jr., an American fast food chain has recently entered the Singapore market with plans to open 25 outlets in 8 years[110]. In comparison, McDonald's currently has 127 outlets, KFC with 70 outlets and Burger King with 44 outlets.

[110] "Carl's Jr to up the ante in fast-food war", The Straits Times, 9 May 2005

25. Market Entry Strategies

25.1 Type of Franchising Arrangement

There are three different general methods of franchise systems in Singapore. The various types of franchising agreement is determined by the origin of the franchise (local vs. foreign concept) and the preference and financial affordability of the franchisee and the nature of the F&B outlet.

25.1.1 Direct Franchising

In direct franchising, the franchisor grants the franchise rights directly to individual franchisees. This normally results in a number of franchisees within the economy. Direct franchising is normally used by local franchisors for obvious reasons. As owners of the rights of franchise, the franchisor is well positioned o directly grant franchise rights. They are also able to personally provide a better level of support due to geographical proximity. Some local franchisors however do not franchise all their F&B operations. Delifrance Asia Ltd for example owns and operates 58 outlets in Singapore. They however, franchised 40 outlets to ExxonMobil petrol stations and another outlet in Sentosa Island. O'Brien's Irish Sandwich Bars also have similar practices with five outlets on its own and another five franchisees.

25.1.2 Master Franchising

In this model of franchising, a franchisor grants to the master franchisor the rights to operate within the entire local economy. The franchisor would then not be allowed to set up any outlet within Singapore. The master franchisor has the choice to open its own franchised outlets or sub-franchise the rights to other franchisees.

Local franchisors are not likely to engage in master franchising within Singapore simply because they have their own corporate outlets. For foreign franchisors, master franchising gives them a more convenient and resource-efficient form of franchising than direct franchising. The casual dining restaurant, Swensen's is one of the F&B franchises operated through master franchising. ABR Holdings Ltd is the master franchisor since 1979.

25.1.3 Regional Franchising

The third general type of franchising agreement looks at awarding franchise rights for territories larger than Singapore. It deals with franchise rights for a number of other markets. Regional franchising is normally practised in two forms. In the first model, the foreign franchisor appoints a regional master franchisee for a number of economies. The master franchisee is then free to proceed to develop the franchises within these economies. This is done by opening franchised outlets either through themselves, a master franchisee or direct franchisees appointed by the regional master franchisee.

Another form of regional franchising is through the establishment of its own corporate entity by the foreign franchisor. The company will then appoint direct franchisees within Singapore. It will also appoint master or regional franchisees outside of Singapore.

Market entry strategies greatly depend on the Franchisor's needs and requirements. Several options are available.

25.2 Appointing Master Franchisor

Whilst Singapore has all along been an investor friendly market with a highly transparent set of requirements for the setting up business, foreign Franchisors who are unfamiliar with operating a business in Singapore may consider appointing a Master Franchisor in Singapore to oversee the franchising activities. As always, finding a right partner with in depth local market knowledge and financial resources are key. There are several companies who have been involved in franchising for a significant period of time. These companies may be considered for their experience with the franchising business model as well as in the F&B industry.

Furthermore, in appointing a master franchisor, the foreign franchisor may also consider using Singapore as a test bed for the region. Given Singapore's ethnic mix that mirrors the region, foreign franchisors can test the acceptance of the brand and format of the service in Singapore before regionalising it. Singapore's local franchisors have also struck out overseas and thus hold that critical knowledge and experience of managing a regional franchise operation.

25.3 Setting up corporate office

Alternatively, the foreign franchisor may establish a corporate office in Singapore to oversee the franchise operations. This is particularly useful for companies who are introducing a new brand into Singapore. Establishing its own corporate office will allow the foreign franchisor to retain better control or marketing and branding efforts within the local economy. Franchisees are also likely to feel more secure in the supporting efforts provided by the franchisor. This will also give franchisees more confidence in taking on a franchise for an unknown and foreign brand.

25.4 Outlets Mix

In establishing a franchise operation in Singapore, Franchisors should consider the wide range of types of F&B concepts. Depending on the type of cuisines, Franchisors may consider packaging their products into either Full Service Restaurants, casual dining restaurants, Fast-food kiosks, take-away or cafes. One such foreign franchisor that offers different forms of F&B concepts is Kyros Kebab. The Franchisor offers franchisees the option of establishing a Kiosk, Café or casual dining restaurants[111]. Dependence on a single model or format does not fully explore the possibilities available in Singapore.

[111] Kyros Kebab website, Available online [http://www.kyroskebab.com.my]

26. Profile of Select Franchisors in Singapore

26.1 Woman Entrepreneur: Cavana

Carona Holdings Pte Ltd

21 Tuas Bay Walk

Singapore 637763

Profile

Carona started back in 1982 as a humble food stall serving only two dishes: stewed chicken with rice and fried chicken wings. The outlet was located beside the former Capitol Cinema, a favourite hang-out place for teenage movie-goers in its heyday. The founder, a Hainanese man, subsequently sold off the business in 1996 to an entrepreneur who saw the potential in the said business.

That entrepreneur is Mr Dick Yap. He has since grown the business into a successful food & beverage chain together with his wife, Ms Jean Lee. Presently, Carona has a total of 16 outlets (13 in Singapore, 3 in Indonesia), of which half are self-owned and half are franchised. Of the 8 franchised outlets, 5 are in Singapore and the rest in Indonesia. Carona's corporate headquarters is housed in a recently acquired new building located at Tuas, which is also home to its newly set-up meat processing manufacturing plant. Today, Carona has a staff strength of over 140 people.

During our up close and personal interview with Ms Jean Lee, Managing Director of Carona, she commented enthusiastically that 'key ingredient' to their success is their famous homemade recipe of crispy fried chicken and succulent stewed chicken. To keep its customers happy, Carona constantly revises its menu to add more variety and alternative dishes like for examples BBQ Beef Ribs, Sausage Cheeseball, Wingz Combo and etceteras to cater to the increasingly demanding tastes of its customers.

Branding

Seeing the potential in the wider consumer appeal of chicken meals, a sister brand, CAVANA, was set up in 1999 to cater to the savoury needs of its halal markets. At CAVANA, you can have the same piping hot and crispy chicken wings and delicious stewed chicken prepared with the same dedication.

Whilst Carona has long been established as a brand name serving chicken meals, a brand-name makeover was necessary to differentiate itself as a halal business. Carona's re-branding efforts have paid off as CAVANA is now a successful brand on its own merits. Interestingly, every alphabet of this new brand name has its meaning as follows:

C stands for Chicken: Specialising in the most flavourful style of cooking chicken right, CAVANA continuously innovates and develops ways to offer the finest tastes.

V stands for Variety: From home-stewed chicken to crispy chicken wings, delicious beef ribs to fresh seafood, CAVANA's motto is to bring customers the widest variety of culinary dishes to satisfy their unique craving.

N stands for Natural: CAVANA commits itself to bringing out the natural goodness of every dish, as they continuously perfect their cooking style, to bring out the home-grown flavours they love.

Three As in brand name "CAVANA": CAVANA constantly moves towards achieving the highest standards in Quality, Service and Ambience.

According to Ms Lee, the concept of selling chicken is more versatile as it is a universally accepted meat. Even though the items on Carona's menu have been expanded to include fish and beef, chicken remains the signature item on their menu. To keep its dishes interesting, chicken is now cooked in a variety of ways other than being fried and stewed. The company further increased its new cooking methods, which is roasting and grilling, to satisfy the diverging palate and preferences of its customers. In addition, Carona's new plant in Tuas is also capable of preparing chicken in at least 28 different ways.

Franchising Overseas

With Singapore's high rental rates, many small retailers have found it difficult to afford the rates charged by premium locations in town, regardless of the quality or consumer appeal of their products. Carona decided it was a more worthwhile venture to expand overseas as the operating costs are lower in some of the regional markets. As part of their preparatory works, several years was spent on restructuring the company first before they ventured overseas.

Franchising was one of the chosen modes for overseas expansion for Carona Holdings because of reasons such as unfamiliarity with new markets, limited manpower, capability and capital within the company, and lesser risk involved. Its "CAVANA" brand was first franchised in Singapore in 1998, and offers a proven and tested system that ensures success and continuity for its franchisees. With its first successful overseas franchised outlet in Jakarta, CAVANA was encouraged to further the expansion of CAVANA regionally. Currently, Carona has a total of 3 franchised outlets under its "CAVANA" brand in Jakarta and plans to open more in the same territory as well as other territories like Philippines, Malaysia, and Dubai.

Woman Entrepreneur

Being a woman entrepreneur, Ms Jean Lee is more patient and calm in her business dealings as compared with a businessman. She brings in the softer side of a woman and takes greater care of employees' needs and as she also maintains, "Ladies are more prudent in charting market expansion!".

As an example to show the extent she would go while looking after her staffs' welfare, she franchised 5 of her restaurants to her former managers of the company to reward them for their loyalty to the firm. All of them were with her for many years and she knew that they had wanted to be their own bosses. To help them get off on a good start, she even gave them very good franchise packages.

She is also noted for her creative ways in sourcing for staff. Noticing the high turnover rates of local staff, she decided to recruit contract workers from China, Indonesia, Malaysia and Philippines by hiring foreign hospitality school students as vacation trainees. The staff cost for this group of people are lower and they are also more willing to work longer hours. On the flipside, some of these staff can't communicate with customers because of their poor command of English. However, her compassion and belief in giving them a chance to prove themselves by slowly training them, has won her the faith and loyalty amongst her staff. Ms. Lee shared during the interview that even though it gave her much trouble to train them, she still keeps them and encourages them to work hard. Her training method of letting them work in the kitchen first and asking other staff to teach them one English sentence every day has paid off.

Ms. Lee has always maintained a prudent approach to tackling new markets. Before stepping into a new market, she will always make a trip to gain first hand information, instead of being impulsive and rushing in without conducting her due diligence. Taking the China market for example, Ms. Lee initially planned to have her first CAVANA outlet in Chengdu. Chengdu is regarded as a second tier city by many businessmen in comparison with Beijing and Shanghai. However, after completing a market study for China and a site visit, Ms. Lee concluded that Chengdu is the better choice for penetration as the operating cost is lower there, and also, CAVANA will face lesser market competition. Hence, it will be an easier market for them to penetrate and develop their brand presence.

Key Learning Points:

- Continuous improvement is the key to making customers happy.
- Conducting market study/due diligence is important to help you understand the market better.
- Trade mark protection is important for a company

Carona Holdings Pte Ltd

- Headquarters: Singapore
- Number of Outlets:
  - Singapore: 13
  - Indonesia: 3
- Royalty Fee: 5%
- Initial Base Fee: US$80, 000 – US$200, 000 (actual amount depends on territory)
- Tenure of Agreement: 5-10 years
- An additional opening fee of US$15,000 per new restaurant applies.

26.2 Singapore Franchise Success in China: Thai Village

Thai Village Holdings Ltd

Block 1002 Tai Seng Avenue

 # 01-2536, Singapore 534409

Profile

Thai Village Holdings Ltd is a restaurant chain renowned for its authentic "Teochew-styled" Thai shark's fins dishes. Established in 1991 with its first outlet in East Coast area, Thai Village rapidly grew to 5 outlets by 1997. In 1996, Thai Village's first overseas outlet was set-up in Surabaya through a joint venture with an Indonesian partner.

Thai Village's second overseas foray took them to China in 1999 through a joint venture partnership in Shanghai, with an initial investment of S$100,000. The venture reportedly achieved break-even during the first 6 months. Since then, their business in China has overtaken Singapore in terms of total sales. The year 2000 marked another key milestone in its history. Thai Village became the first Chinese restaurant to be listed on the Singapore Stock Exchange in 2000. Realising the vast potential in China, Thai Village was contemplating franchising as alternate mode for business growth and in 2001; its first franchise was awarded to a Chinese partner in Wuxi.

Under the leadership of Mr. Lee Tong Soon, Chairman and Managing Director of Thai Village Holdings Ltd, the Group has been growing rapidly. It currently has 15 self-managed restaurants, one restaurant under a management services arrangement and 16 franchised restaurants. The Group's restaurants are located in Singapore, China and Indonesia. In China, the Group has 10 self-managed restaurants and 15 franchise restaurants.

Key factors to their Success in China

- Targeting middle to upper market segment

Sharks' fins are considered as delicacy in some parts of the world. Hence, Thai Village is targeted at the middle to upper segment customers of these markets. They are performing well because of their regular customers who consist mainly of corporate customers, high ranking officials and local businessmen. As these customers usually come by car, Thai Village can be located away from the central district but should come with a big parking area, nice ambience and fine decoration.

Thai Village can achieve good profits in the China market because operation cost is low and at the same time, it caters to the middle upper segment which commands higher selling prices. Whilst the average salary of its Chinese staff is around RMB1,200 - RMB1,500 (S$240 – S$300) lower than that in Singapore, the average selling price for each shark's fin dish is higher than Singapore.

- Having the right partner

Having the right partners is a critical element for the success of Thai Village. The franchisee that started from Wuxi is doing very well in franchise business. He saw the potential of Thai Village and expanded the chain to Nanjing, Wuhan, Changzhou, Suzhou and Zhangjiagang. Now he has six outlets and all of them are making healthy profits. Similarly after experiencing initial success, the franchisee in Quanzhou also expanded to take up more unit franchises; one each in Fuzhou and Xiamen.

Sharing his experience in China, Mr Lee maintains that "Franchisors can't just sell the franchise and then do not follow up. The established relationship or brotherhood must be maintained". He added that franchisors expanding to China should know their local language, understand Chinese culture and be able to read their minds. The Chinese partners place great emphasis on relationship, so Mr. Lee visits his Chinese franchisees frequently. Thai Village also introduces new dishes and new presentation of food continuously to suit franchisees' expectation. Mr. Lee believes that all relationships must be reciprocal. "Be nice to them and they'll be nice to you", said Mr. Lee. Companies who want to deal with the Chinese should avoid sending someone who can only understand legal terms. To conduct business there, it is a matter of trust as well.

Besides franchise partners, Thai Village also values good cooperation among Singapore F&B companies. As one of the early entrants into China market, Thai Village is ready to share its experience with other companies and assist those who aspire to enter China market. It has taken the first step by helping Singapore-styled seafood cuisine enter into China market through its tie-up with Palm Beach. Its two new outlets in the outskirts of Shanghai have introduced Singapore-styled seafood cuisine, which has been well received by customers.

- Control and Deskill

"Franchisors must have something to control their franchisees with, otherwise the franchise will fail. We use our sauce to control." says Mr. Lee. "The franchise concept works well," he said. "Most importantly, we control the sauce. We have a central kitchen in Shanghai that makes this very secret and special sauce." This special sauce is vacuum-packed and sent to Thai Village's own restaurants as well as those of their franchisees. This system protects Thai Village as the franchisor from copy-cats. At the same time, the quality and consistency of the braised sharks' fin soup are maintained. Besides the sharks' fin dish, the secret sauce is also used in the preparation of many other dishes, so their franchisees are highly dependent on it. Mr. Lee mentioned that one of his franchisee had tried to make the sauce by himself but was not successful. He revealed that some of the key ingredients for the sauce are actually shipped from Singapore.

Thai Village also has a dedicated team comprising chefs and managers who regularly audit all its restaurants, both self managed and franchised. Their feedback on the quality and taste of the food as well as the level of service provided will be channelled directly to Mr Lee as well as the restaurant managements for quality control and continuous improvements.

Since its unique sauce is the heart of Thai Village's sharks fin delicacy, this removes its dependency on its chefs when it comes to maintaining consistent quality and standard across all outlets. Hence, its efforts in R&D have paid off well; allowing expediency in training new cooks, and at the same time protecting Thai Village as the franchisor.

- Being flexible and willing to learn from franchisees

Thai Village gives its franchisees the flexibility of designing the interior décor of their restaurants and modifying the menu to suit the local palate. This has resulted in a franchise network of quality Thai Village restaurants.

For instance, when one of its franchisees who is very creative in restaurant decoration decided to make every room different by designing a unique theme individually, she gets full approval from Mr Lee. "From wall color to crockery, everything is chosen to suit to the theme but yet different from other rooms. Our customers are so impressed by them." said Mr. Lee.

Thai Village is also willing to learn from franchisees. If franchisees come up with good ideas or new dishes, it will often be adopted into its self-managed restaurants. Take the sharks' fins holder as an example. In Singapore, the restaurants used aluminum holders which appear cheap. When one of its Chinese franchisees came up with a new idea of changing the holders to gold plated coppers decorated with lions' symbols to befit the premium sharks' fin within, Mr. Lee liked the idea so much it was quickly adopted in the other outlets.

Future Plans

Going forward, Thai Village will continue to expand its foothold in China and other overseas markets. It intends to open more self-managed and franchised outlets in China. Thai Village will also continue to explore opportunities to bring uniquely Singapore-styled cuisine to more cities in China. The group believes the China market will continue to be a big market for them. Barring unforeseen circumstances, the China market with its rapidly growing consumer market is expected to remain the main growth driver of Thai Village.

Key Learning Points	Thai Village Holdings Ltd
• Identifying the right market segment is the first step to success. • A good partner can help you expand successfully. • Franchisors should retain some control rights over its franchisees. • Franchisors can learn from franchisees.	• Headquarter: Singapore • Number of Outlets: - Singapore: 5 outlets - China: 25 outlets (15 franchise) - Indonesia: 2 outlets (1 franchise) • S$150,000 – S$200,000 (according to the scale of the restaurant) shall be paid to the head office in Singapore in a lump sum as the initial franchise fees. • 4% of the turnover shall be paid monthly to the head office as the royalty fees. • A training period of one month would be given to franchisee's staff, such as the managers, superiors, captains, chef and cooks.

26.3 Bringing a Chinese Franchise into Singapore: Malan Lamian

Malan Noodles Fast-Food Chain Store Pte Ltd
80 Eu Tong Sen Street #02-01
The Majestic, Singapore 059810

Profile

Malan Hand-pulled Noodle Fast-food Chain Co., Ltd. ("Malan") came into existence in 1995. Aiming to create a new concept of Chinese-styled fast-food, Malan combined traditional hand-pulled noodles (originating from Northern China) with the simple and easy presentation style of modern fast food. According to China Chain Store & Franchise Association, Malan currently has 436 chain restaurants, among which 134 outlets are directly operated outlets. The rest are franchised outlets managed by a total of 302 franchisees in China and 3 overseas franchisees in the United States, Indonesia, and Singapore. It is one of the first few local F&B brands that have successfully ventured out of China.

Malan Noodles Fast-Food Chain Store Pte Ltd ("MFFCS') is the Singapore franchisee of Malan. Mr. Yeo Kek Hui, the founder of MFFCS, first learnt about "Malan" when he was in Beijing in 2002. Attracted by Malan's store concept and fascinated by the fast growth of the brand (at that time, there were approximately 400 outlets in China), he foresaw the potential of Malan noodles in the Singapore market as he felt that Chinese Singaporeans would be a ready market for traditional Chinese food. Mr. Yeo managed to secure the Singapore franchise after negotiations with Malan's owners.

MFFCS currently has two outlets in Singapore, the first located in the heart of Singapore's Chinatown, and the second in the Expo Convention Centre.

Continuous product innovation and keeping prices competitive: The keys to remaining successful

Whilst acknowledging Singapore is a small economy, Mr Yeo maintains that there is a still a target market as 70% of Singaporeans like to eat out. Without being unduly worried about market size or competition, his main goal is to project a "value for money" image of MFFCS to its target customers – Chinese Singaporeans with a fondness for traditional and nutritious Chinese food.

To remain relevant, MFFCS spends much effort in studying customers' tastes, and creating new products. Every dish in the restaurant is thoughtfully conceived with its own unique taste, and emphasis is placed on the use of fresh and high quality ingredients. Aside from the signature hand pulled noodles, other popular dishes include crispy Mango Shrimp Rolls and succulent Shanghai Soup Dumplings. Mr Yeo is confident that MFFCS will be able to open more outlets in the future, if they can continuously innovate and come out with new products to suit customers' changing tastes.

At the same time, Mr Yeo also stresses the importance of maintaining strong business controls (such as over the procurement process) in order to keep costs in check and prices competitive.

Key Learning Points:

- Identifying the right target market is crucial to helping you shape your product strategy.
- Innovation is the key to staying relevant to your target market.

Malan Noodles Fast-Food Chain Store Pte Ltd.

- Headquarters: China
- Singapore: 2 outlets

26.4 PastaMania: From film to food

PastaMatrix International Pte Ltd
12 Jalan Kilang Barat
Globamatrix Building #05-01
Singapore 159354

Profile

PastaMania first started business in April 1998 at a corner unit of a food court in Singapore and quickly built a reputation for offering great tasting pasta at affordable prices. Slightly more than two years later, a second outlet was opened and this gave them the opportunity to develop the management systems that would later on be the key factor required to successfully manage a chain of PastaMania outlets.

As the team and reputation continued to grow, the directors realised that to fully capitalise on the strength of their system and brand, they needed to bring in an investor who could help to take PastaMania to the international arena. One such investor with the right credentials was Globamatrix Holdings Pte Ltd (GMX). GMX had the corporate strength, an extensive network of international business associates, and most importantly, the capital required for investment. With GMX's desire to get into the food business, bringing together the two entities in early 2002 quickly put PastaMania into a rapid growth path.

Shortly after, the third PastaMania store was opened with a new and stronger corporate identity. The new PastaMania store design and brand concept became a distinctive element to differentiate itself from other emerging international brands. In the same year, 3 more corporate-owned outlets as well as their first Singapore franchisee store opened.

In 2004, as testament to their rising success, they were conferred with the Entrepreneur of the Year Award. Today, 6 years into its business, PastaMania now has 14 outlets in Singapore, out of which 2 are owned by franchisees. Overseas outlets include 9 outlets in the Middle East and 3 in Indonesia.

Learning from Big Brother – where franchising becomes a core competence

While PastaMania is certainly masters of their own trade in creating pasta and pizza dishes, they are also well honed in the art of franchising. One of the reasons behind PastaMania's accelerated franchise know-how can be attributed to its parent company - GMX. GMX is an established veteran in the franchise business. It took the franchise route in 1998 as a means to expand its sun protection film business – V-KOOL. Today, V-KOOL has franchise systems in 27 overseas locations including Middle East, China, Malaysia, Australia and United Kingdom.

Within months of investing in PastaMania, GMX mobilised its franchise and creative departments to assist in expanding PastaMania's food-court concept into a quick casual dining concept, growing from two outlets to seven outlets. PastaMania was able to capitalise on Globamatrix's knowledge and network to shorten its own learning curve and expedite franchise development efforts. Key success points in V-KOOL's franchise management model were also replicated into PastaMania's own work processes. For example, one of GMX employee stationed in Middle East, for V-Kool, had also assist PastaMania in understanding their host economy and market environment better.

The sharing of knowledge and network between the two companies helped PastaMania to grow its own franchise network into a total of 14 branches managed by franchisees in Singapore, Middle East and Indonesia. Its rapid growth via franchising provided it with the economies of scale and multiple points of presence needed to excel in the competitive F&B industry in Singapore and overseas.

It is also interesting to note how GMX no longer sees itself merely as a company that markets sun protection film, but more as a company that innovates and invests in existing business models, using franchising as an effective tool for expansion.

Learning the Globamatrix way, doing it the PastaMania style

One of PastaMania's successes in franchising can be attributed to their franchise management style.

- Know the market

One such manifest is in their in-depth knowledge of the business environment that their franchisee operates in. For example, it is an option for PastaMania to station an employee in the market of interest for some years to help the franchisee in store opening, development and marketing and acquiring a foundation for understanding the feasibility of doing business within the market, after they sign-on with the franchisee.

- Extent of management support

Typically, franchisors' physical presence in the franchisees' location tend to be limited to the pre-opening stages. However in PastaMania's case, the franchisor usually deploys an employee to assist the franchisee in the setup, and this employee stays well after the restaurant operations are set up to enable them to settle any teething issues that normally occur in the initial stages of an F&B operation. In addition, PastaMania will also use their purchasing power to enlist their key suppliers to help their franchisees get competitive rates for their supplies.

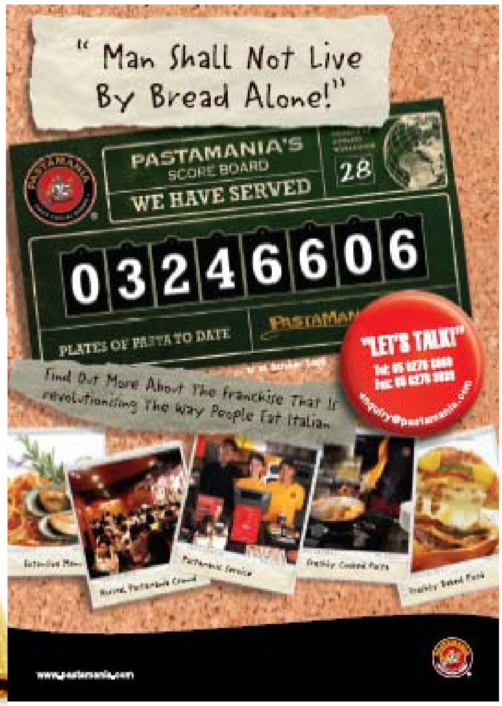
- Continuous R&D

PastaMania continue to develop new recipes and dishes to meet the ever evolving consumer taste preferences and dining habits. A Research & Development kitchen situated in the Headquarters remains a sanctuary of insiparation for the chef to explore their creativity. The objective was to have a consistent team inventing new recipes and developing new product pipelines. The team is also in charge of determining the most optimal brand of pasta that will fit in with PastaMania's operational requirements, and assisting franchisees in localising their menu.

Autonomy for local adaptation

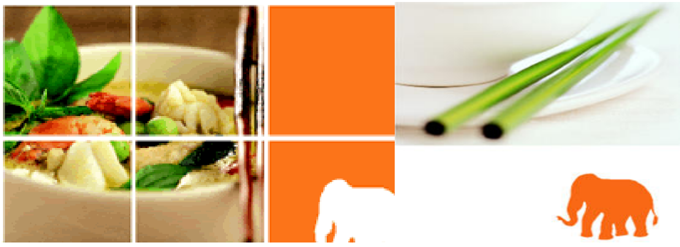
PastaMania understood the importance of customising its menu to suit the local palate while ensuring that its brand image is not compromised. Ben Tan, CEO of Pasta Mania, quotes a story of how when he went to one of the outlets in Middle East, his franchisees quickly hid the menu for fear of letting him find out about the other "unapproved" dishes they had invented to suit the local taste buds. Ben quickly reassured them and asked to try the new dishes. The result? He liked it so much that he approved it there and then on the spot – on a piece of paper napkin! The lesson learnt here is that franchisors have to learn to be flexible and that sometimes exceptions can be made to the franchise system if the end results benefit everyone.

Key Learning Points:		**PastaMania**
• Franchising allows the franchise network to reap economies of scale. • Multiple presences help enhance brand value. • Capitalise on existing support system and know–how to expedite expansion plans. • Flexibility in customising franchise system to local conditions can result in benefits for everyone.		• Headquarters: Singapore • Singapore: 14 outlets (10 corporate owned, 2 franchisees) • Middle East: 9 outlets • Indonesia: 3 outlets



26.5 Thai Express: Accelerated growth through franchising

ONYX Concept Restaurant Pte Ltd
18 Mohamed Sultan Road
#03-02, Singapore 238967



Profile

Thai Express grew exponentially in the past 3 years, from 2 outlets in the first year into 25 outlets within the last 2 years itself. It now has franchisees in Malaysia and Indonesia operating a total of 12 outlets. The success is phenomenal considering the short period of time it took to grow to its size today. Its success can be attributed to its strength in the local F&B market as well as its successful franchisee-franchisor relationships in overseas markets.

Success in Singapore

Mr. Ivan Lee, the CEO of Thai Express, was candid in his admission that the success of Thai Express today was due to his failure in his first F&B venture. In learning from his mistakes, he realised that in a fast changing F&B market, two things are critical; first, the choice of products to offer, and second, creativity in targeting the customers.

With the lessons learnt still fresh in his mind, he surveyed the market for his second chance within the F&B market. He set out looking for a product that complements the staple food of Singaporean consumers, which is mainly rice and noodles, and yet is an untapped segment. He found it in Thai cuisine and went on to create an experience that would appeal to the masses. In doing so, he became one of the forerunners of casual dining wave in Singapore – offering a restaurant ambience at economical price points.

Success in overseas market

Thai Express's overseas outlets now make up half of his total number of outlets, and there are plans to increase this even further. With the exception of two joint ventures, all of the overseas outlets run on a franchise system. Mr Lee credits his success in Indonesia and Malaysia to their successful working relationship with their partners. In fact, Thai Express had such an excellent partnership with its Indonesian franchisee that it entered into a joint venture with them to open up Thai Express chains in Australia and New Zealand.

Some key success factors as mentioned by Mr Lee during the interview:

- Trust

Thai Express believes that while it is crucial to provide support to their franchisees, there should be certain areas that Thai Express can minimise control over. For example, in Indonesia, business laws and regulations are often confusing to outsiders, thus Thai Express gave their franchisees free reign over certain operational procedures, including the sub-franchisee recruitment process.

- Adding value

Mr Lee believes that one way of securing franchisee loyalty would be to constantly add value to the relationship. For example, his franchisee in Indonesia is cash rich and looks at franchising as an investment rather than as a business. Hence, to ensure that the franchise business continues to bring the franchisee the returns he is looking for, Thai Express constantly comes up with new branding initiatives, promotions and menu items to keep it ahead of its competitors. Internal improvements to the marketing skills and operational efficiency of the franchise business are also areas being looked into. Franchisees in exchange, share their understanding of the local market with the franchisor.

In addition, when a franchisee develops a new menu item on its own, Thai Express helps them to develop standard operating procedures (SOPs) so that this item can be offered in a consistent format all across its chains in the local market. So where the franchisee is good in customising and catering to local needs, the franchisor will step in to provide its operational expertise to ensure that the quality of the menu item can be achieved.

Key Learning Points:		**Thai Express**
• Innovation and creativity is the essence for survival in the highly competitive F&B market. • Leveraging on each other's strengths will help the business to grow faster. • Ability to continue adding value to the franchisee is the key to keeping their loyalty.		• Headquarters: Singapore • Singapore: 9 outlets, all corporate owned • Indonesia: 10 outlets • Malaysia: 2 outlets • Australia: 1 outlet • New Zealand: 1 outlet

26.6 Jack's Place: Importance in Location Selection

Jack's Place Holding Pte Ltd

123 Defu Lane 10

Jack's Place Building

Singapore 539 232

Profile

Jack's Place was established in 1966 and subsequently sold off to Mr. Say Lip Hai in the following year. After 38 years, Jack's Place has become one of the oldest and most successful home-grown chains of steak house and restaurants in Singapore. Their name is synonymous with value-for-money set meals, succulent tasty steaks and a cosy dining environment with its green-checkered tablecloth.

Jack's Place has its own building which houses its corporate operations, its central kitchen (with operations such as butchery, bakery, food production) and its distribution center for its food catering arm. Currently, Jack's Place has 15 outlets across 3 markets; 12 in Singapore; 2 in Shanghai, China (1 company owned, 1 franchise) and 1 in Kuala Lumpur, Malaysia. We spoke with Mr. Jerry Lim, Business Development Manager of Jack's Place, who is responsible for their business expansion in China.

Singapore Market

Jack's Place regards their current size of 12 outlets in Singapore as optimal. Mr Lim feels that the current number of outlets is sufficient to profitably cater to its target market segment and allows them to enjoy economies of scale in terms of purchasing and manpower needs. However, the Singapore F&B market remains an attractive market to Jack's Place. They recently created a new concept, Seafood Harvest, which serves western seafood set-meals. After observing the immense popularity of seafood during its recent promotions, they decided to open a new outlet to target at seafood lovers.

China Market

Heeding the call to internationalise, Jack's Place started to expand overseas to China. According to Mr. Lim, China's F&B market can be divided into three segments; high class, middle class and popular style. High-class restaurants are doing well targeting at corporate customers and affluent people. Popular style restaurants are also enjoying brisk business because the majority of people there are earning low to middle income. Middle class restaurants consist of many brands and face severe competition but it is also the largest segment with the most opportunities. For Jack's Place, given their pricing level, their target market is the middle income level consumers.

In China, Jack's Place sources for its supplies locally for cost saving reasons. For example, while it only uses meat from US and New Zealand in Singapore, its Shanghai menu uses local meats as well. These three choices have different prices and are targeted at different customers. Even though Jack's Place tries to copy its practice from Singapore, it still undertakes some adaptation of their food in order to suit the local taste such as tenderised beef.

Lessons learnt in China

After conducting a preliminary market research and feasibility study, Jack's Place's first overseas outlet commenced operations in Time Square, Shanghai in September 2000. Time Square is a favourite shopping mall for up-market shoppers. However, Jack's Place soon realised its core offering of value-for-money meals is better suited for locations with a high density of middle class consumers such as The Grand Gateway Plaza.

During this period, Jack's Place concluded its first franchising deal. This second outlet is located in The Grand Gateway Plaza, which is perceived as a middle to upper class shopping mall. Jack's Place is the only western restaurant within the plaza. Unlike the company-owned one, the franchised outlet gained acceptance by local people and business was good. However, the franchisor soon discovered that the franchisee had tried to change some ingredients of the dishes and added other food in the menu secretly, and stopped them from doing so. They learnt the importance of continuous monitoring of its franchisees to ensure compliance with franchise standards set by the franchisor.

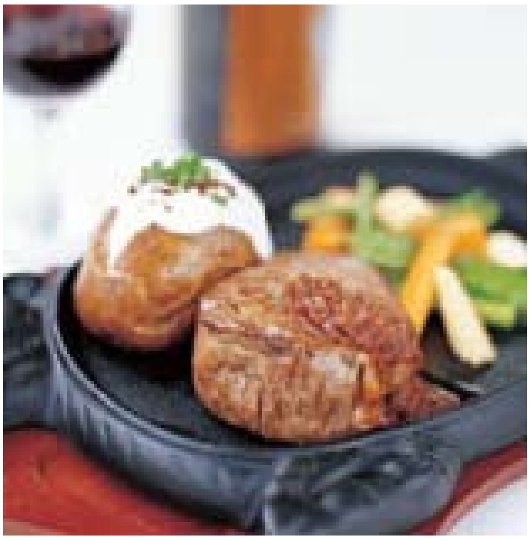
In 2003, Jack's Place closed down its non-profitable outlet in Times Square and starting searching for a more suitable location. Although Shanghai is a big city with a population of about 20 million people, a good location at reasonable rentals is very hard to come by. After spending seven months evaluating on the various sites, it reopened another company-owned outlet in Nanjing Xi Road. The vicinity has a mixture of offices, hotels and shopping malls which is more suited for the target market that Jack's Place was after. With the right location, the outlet is now on its way to achieving profitability. The new outlet is also serving as the center of excellence for training and quality management as well as a central kitchen for its network of outlets in Shanghai.

Moving forward

Jack's Place plans to have a total of 6-8 outlets in Shanghai in 5 years' time, be it company-owned or franchised outlets, to gain economies of scale for its network. This two-pronged approach is useful in tapping the various opportunities available in this vast market. For markets which they deem as unfamiliar and difficult to penetrate by themselves, they will rely on the franchising method for their expansion so that they can tap on the local knowledge and network of their franchisees.

Jack's Place believes that it is imperative for them to take more control of their franchise operations and to maintain its core value throughout its network. Lessons learnt from its earlier experiences will also guide their future foray into untapped markets.

Key Learning Points		Jack's Place Holding Pte Ltd
• Right identification of your target market will help you in choosing the right location for your outlets. • Constant vigilance is required to ensure that franchisees do not run afoul of franchise standards set by the franchisor. • Franchising is a useful method of expansion for unfamiliar markets.		• Year established: 1966 • Headquarter: Singapore • Singapore: 12 outlets • China: 2 outlets (1 franchise) • Malaysia: 1 outlet • Franchise fee structure: 3% Royalty Fees, 1% A&P and Franchise fees ranging between S$40,000 to S$80,000, 10 years



26.7 Sakae Sushi: Escalating Greater Heights through IPO

Apex-Pal International Ltd
No. 1 Raffles Place
Level 49 OUB Centre
Singapore 048616

Profile

Sakae Sushi is the flagship brand of Apex-Pal International Ltd. Being a diversified Singapore-based F&B company, Apex-Pal is listed on the Singapore Stock Exchange. It started its first F&B outlet in 1997 and has developed an impressive portfolio of 5 brands – Sakae Sushi (conveyor belt sushi restaurant), Hibiki (fine dining contemporary Japanese restaurant), Crepes and Cream (restaurant specialising in savoury and sweet crepes), Skal (Scandinavian bistro) and Nouvelle Events (catering/import & distribution).

Mr. Douglas Foo, founder and CEO of the Group, started off as a marketing executive in the Singapore office of an established Japanese department store. With the ability to sniff out business opportunities, his entrepreneurial spirit soon brought him to the land of India where he set up his own factory to manufacture garments for his ex-business associates. Sensing strong competition from Chinese garment manufacturers, he decided to diversify into the F&B industry a year later with his own brand of sushi restaurant - Sakae Sushi. Since then, he has developed Sakae Sushi into a successful brand that it is today.

According to Mr. Foo, the meaning behind their company name "Apex-Pal" is to "aim to reach the peak", and to "make friends with everyone". The company encourages everyone to perform their best and reach for the peak, whilst maintaining a warm, friendly and caring work environment. Leading by example, Mr. Foo always treats his staff as equals and always pays for his bills when he dines in his own restaurants.

With 27 outlets in Singapore, Sakae Sushi's green frog logo has become a familiar and welcome sight. Sakae Sushi's unique concept of affordably priced premier kaiten (conveyor belt sushi) dining took Singapore by storm when it first started. In the following years, it continued to surprise the market with constant stream of innovations such as interactive menus, tableside hot water dispensers, and sushi rice enriched with Vitamin E.

Capital for growth – IPO

To grow a company, capital is required. When asked about the various methods which a company can acquire capital for growth, Mr. Foo replied loan, equity and franchise. However, Apex-Pal chose not to take a business loan for reasons of risks associated with debt recalls by banks during periods of economic downturn. Instead, they chose to seek a public listing for their company to raise equity.

In August 2003, Apex-Pal made initial public offering on the Singapore Stock Exchange. The IPO raised S$3.4 million, which was allocated to fund the opening of new outlets in and outside of Singapore, developing of new brands and to set up an operational fund. After the listing, their revenue and profit before tax for 2004 was higher than in 2003 (Revenue: '03 - S$36.6m, '04 – S$45.2m, Profit before tax: '03 – S$2.68m, '04 – S$2.8m).

Capital for growth – Franchising and Grants

Besides organic growth, Mr Foo also chose franchising as a mode for expansion. He regards it as a good way to grow with limited capital and used this method to expand its Sakae Sushi business. The restaurants have a well-developed and proven franchise system. "We must do well by ourselves first then we can franchise and have something to offer to our franchisees," said Mr. Foo.

One such market which Sakae Sushi had tried to penetrate using the franchise mode was China. The lessons learnt from that experience, as shared by Mr.

Foo, was firstly, proper documentation and drafting of legal contracts. He stated firmly about the need for detailed terms and conditions being drafted into the contracts, leaving no room for miscommunication, right down to the termination clauses. Secondly, he feels that having a good partner is very important when a company wants to venture into China. Having the right partner with the same mindset as you in carrying out an honest business for the long haul, will save you a lot of trouble and headache in the long run. Even though Sakae Sushi's first try in franchising for the China did not take off as planned, they are still open to using this business model again. He believes that there is potential for growth for the franchise businesses in the Asia-Pacific region.

Besides the usual route of IPO and franchising, the company also expanded with the assistance of International Enterprise Singapore (IES) and SPRING Singapore in the areas of overseas business expansion, human resource training and brand development through tax incentives, subsidies and grants. IES in particular, provided financial assistance under its International Franchise Enterprise Programme (IFEP) in January 2001 (the programme has since been terminated).

Growing through acquisitions

In its quest to "reach for the peak", Apex-Pal is also on the lookout for other profitable businesses to invest in. Wearing its hat as an opportunity buyer, the company continuously lays the foundations for entering new and lucrative markets by gathering information and seeking for potential partners. According to Mr. Foo, the investment (ROI) of the business opportunity is not the only factor they are concerned with, but also the synergy with their other businesses, as well as long term development of the business acquired.

Some of the industries which Apex-Pal is looking for include:

- F&B manufacturers/innovators
- Seafood wholesalers
- Wine
- Product Packaging providers
- Food equipment manufacturers

Key Learning Points

- Continuous innovation is required to attract and retain your customers.
- Raising of capital to fund expansion can be done via loans, public listing, franchising and grants.
- Synergies can be created through acquisition of complementary businesses

Sakae Sushi

- Headquarter: Singapore
- Singapore: 27 outlets
- China: 2
- Malaysia: 1
- Indonesia: 6 (Franchise)
- Thailand: 2 (Franchise)

27. Appendix III

27.1 Cost Factors: Wages, Real Estate and Utilities

Singapore is not known to be a cheap business location. In the previous section of the market structure of Singapore's F&B services industry, it is noted that rental and remuneration forms the second and third largest cost components.

27.1.1 Wages

Wages and staff remuneration form the 2nd largest cost component for Restaurants and Food Caterers[112]. The average monthly earnings in the Hotels & Restaurants service sector are S$ 1,312 in 2002. Table 8 below shows the average salaries of occupations related to the F&B industry in Singapore in 2002.

Table 8 - Selected average basic and gross salary of F&B related occupations in 2002

Occupation	Average Basic Salary (S$)	Average Gross Salary (S$)
Restaurants & Other Catering services Manager	2,567	2,701
Captain/ Waiter (Supervisor)	1,562	1,655
Waiter	973	1,169
Kitchen assistant	1,039	1,371
Cook	1,690	2,072
Hawker/ Stall Holder	955	1,238
Baker, pastry-cook & Confectionary maker	1,377	1,875
F&B stall assistant	784	889

Source: Singapore Yearbook of Manpower Statistics, 2003 (Ministry of Manpower)

[112] *"Economic Survey Series 2004:Food & Beverage services",* Singapore Department of Statistics

27.1.2 Real Estate

Rentals form the 2nd largest cost components for F&B establishments in the Fast Food and Others category[112]. Rents for retail spaces in prime spots such as the Orchard Road shopping belt has jumped from S$ 11 psf in 1990 to over S$ 50 psf.

According to a research publication by CB Richard Ellis, rental rates for the retail market rose in 2Q05 due to healthy leasing demand and interest. Its CB Richard Ellis prime island wide index rose by 1.6% q-o-q. It also noted that the average prime Orchard Road rent rose 1.2% to S$ 32.80 psf per month. Average prime suburban rent however rose marginally by 0.4% to S$ 26.80 psf per month[113].

In addition to F&B outlets in commercial buildings, Singapore allows the rental of open spaces for temporary or semi-permanent F&B establishments. The rates for obtaining a Temporary Occupancy License ("TOL") are listed in Table 9 below.

Table 9 - selected TOL rate table for vacant land (w.e.f. Jan 2004)

Usage	**TOL Rate * (per month)**				**Remarks**
Sector	**Central**	**Suburban**	**Outlying**	**Offshore**	
COMMERCIAL					
Outdoor Refreshment Area ("ORA")	$27 psm or 20% of gross rental rate for the main restaurant / cafeteria, whichever is higher	$20 psm or 25% of gross rental rate for the main restaurant / cafeteria, whichever is higher	$15 psm or 30% of gross rental rate for the main restaurant / cafeteria, whichever is higher	$11 psm or 30% of gross rental rate for the main restaurant / cafeteria, whichever is higher	(1) For ORA located in the outlying zone but within 500m from MRT stations/prominent commercial complexes, the rate is the same as that for ORA located within the suburban zone.

[113] "MarketView Singapore", CB Richard Ellis, Second Quarter 2005. Available online [http://www.cbre.com.sg/marketwatch/2q05.pdf]

Usage	TOL Rate * (per month)				Remarks
Sector	Central	Suburban	Outlying	Offshore	
COMMERCIAL					
					(2) The application of 20% - 30% of gross rental rate for the restaurant / cafeteria only applies if the restaurant / cafeteria is on tenancy.
Kiosk					
(a) < 3 sqm	$50 per day	$35 per day			(1) Applicable to retail and/or F&B kiosk.
(b) 3 sqm – 5 sqm	$70 per day	$50 per day			(2) Rates are on a per kiosk basis.
(c) > 5 sqm - 12 sqm	$110 per day	$75 per day			(3) For kiosk located outside the central zone but within 500m from MRT stations/prominent commercial complexes, the rate is the same as that for kiosk located within the central zone.
(d) > 12 sqm	$190 per day	$135 per day			
Notes: TOL – Temporary Occupation License					

Source: Singapore Land Authority website

27.1.3 Utilities

Utilities forms the 5th largest cost component for Restaurants and 4th largest cost component for establishments in the "Others" category. The electricity tariffs rates was raised in July 2005 in view of the rising global oil prices. It was last revised on 1 April 2005. Below is a cost table for electricity and water tariffs.

Table 10 - Electricity Tariffs

Tariff Category	Usage Charge	Rates (w.e.f 1 July 2005)	% Change
Low Tension	Residential	18.26¢/kWh	13.7
	Non-residential	18.26¢/kWh	13.7
High Tension Small (HTS) Supplies	Contracted Capacity Charge	$7.04/kW/month	0
	Un-contracted Capacity Charge	$10.56/kW/month	0
	Peak period	15.27¢/kWh	19.0
	Off-peak period	8.91¢/kWh	21.7
	Reactive Power Charge	0.59¢/kVArh	0
High Tension Large (HTS) Supplies	Contracted Capacity Charge	$7.04/kW/month	0
	Un-contracted Capacity Charge	$10.56/kW/month	0
	Peak period	15.21¢/kWh	18.6
	Off-peak period	8.90¢/kWh	21.6
	Reactive Power Charge	0.59¢/kVArh	0
Extra High Tension	Contracted Capacity Charge	$6.74/kW/month	0
	Un-contracted Capacity Charge	$10.11/kW/month	0
	Peak Period	14.29¢/kWh	19.8
	Off-peak period	8.81¢/kWh	22.0
	Reactive Power Charge	0.48¢/kVArh	0

Source: SP Services website

Table 11 - Gas Tariffs as a 1 December 2004

Category	cents / unit
General	15.7
Bulk Tariff A Minimum consumption: 1,000 units per month	14.7
Bulk Tariff B Minimum consumption : 50,000 units per month	14.2

Source: SP Services website

Table 12 - Water Tariffs as at 31 December 2002

Tariff Category	Consumption Block (m^3 per month)	Tariff (cents /m^3)	Water Conservation Tax (% of tariff)	Water-borne Fee (cents /m^3)	Sanitary Appliance Fee
Domestic	1 to 40	117	30	30	$3/- per chargeable fitting per month
	Above 40	140	45	30	
Non-domestic	All units	117	30	60	
Shipping	All units	192	30	-	-

NOTES:

SP Services Ltd collects the WCT (Water Conservation Tax) on behalf of the Ministry of the Environment and Water Resources

Water Conservation Tax

- Tax levied to reinforce the water conservation message.

Sanitary Appliance Fee and Waterborne Fees

- Statutory charges payable to the Public Utilities Board (PUB) under the Sanitary Appliances and Water Charges Regulations to offset the cost of treating used water and for the maintenance and extension of the public sewerage system.

Source: Public Utilities Board website

27.2 SPRING Singapore

SPRING Singapore offers assistance schemes to SMEs and businesses that are keen to grow their business. The table below summarises the lists of schemes available as well as brief description of these schemes.

Table 13 - Brief summary of Assistance Schemes made available by SPRING Singapore

Name of Scheme	Objective	Eligibility
Local Enterprise Finance Scheme ("LEFS")	• A fixed interest rate financing programme designed to encourage and assist local enterprises to upgrade, strengthen and expand their operations	• At least 30% local equity • Fixed assets (defined as net book value of factory building, machinery and equipment) not exceeding $15 million • Employment size not exceeding 200 workers for non-manufacturing companies
Micro Loan Programme	• A fixed interest rate financing programme designed to help the very small local enterprises gain better access to financing	• It must have at least 30% local shareholdings • It must have an employment size of not more than 10 workers • In addition, the company's group fixed assets (at net book value) must not exceed $15 million and if it is in the service industry, its group employment size must not exceed 200 workers.

Name of Scheme	Objective	Eligibility
Variable Interest Loan Scheme ("V-Loan")	• An alternative financing programme designed to provide access to financing for SMEs. • It will complement the existing Local Enterprise Finance Scheme (LEFS).	• At least 30% local equity • Fixed assets (defined as net book value of factory building, machinery and equipment) not exceeding $15 million • Employment size not exceeding 200 workers for non-manufacturing companies • In addition to the above conditions, the company must have an employment size of not more than 10 workers to be eligible for the V-Loan Micro Loan Programme.
Local Enterprise Technical Assistance Scheme ("LETAS")	• A scheme to help local enterprises defray cost incurred in modernising and upgrading their operations through the engagement of an external expert for a limited period of time.	• At least 30% local equity • Fixed assets (defined as net book value of factory building, machinery and equipment) not exceeding $15 million • Employment size not exceeding 200 workers for non-manufacturing companies

Name of Scheme	Objective	Eligibility
Loan Insurance Scheme	• The Loan Insurance Scheme (LIS) provides an alternative access to financing for local enterprises through the use of loan insurance.	• To be eligible, a company must either be a small and medium-sized enterprise (SME) or an Internationalising Singapore Company (ISC) meeting the conditions as set out by SPRING Singapore.
Domestic Sector Productivity Fund	• The objective of DSPF is to encourage companies within the industry or across the value chain to collaborate on projects that will fundamentally or radically change the operations and practices of the industry, thus leading to significant gains in productivity and competitiveness for the industry as a whole. The key deliverable of the DSPF is the doubling of productivity for participating industries within 5 years.	• All Singapore-registered business enterprises and organisations including industry associations participating in the transformation project are eligible to apply. • Several criteria must however be met first. Please refer to SPRING Singapore's webpage for greater details.

Name of Scheme	Objective	Eligibility
Enterprise Investment Incentive ("EII") Scheme	• With EII status, a start-up can issue certificates to its investors for investments of up to S$3million. Investors with these certificates can deduct any investment loss from their taxable income.	• To qualify, a start-up must: • Be an unlisted company in its initial years of existence with a paid-up capital of at least S$10,000 • Primarily be engaging in innovative and high growth activities with substantial developmental contents in relation to a specific product, process or service • Be incorporated in Singapore, though there is no restriction on the ownership profile of the company • Conduct the start-up activity wholly or mainly in Singapore. • Overseas start-ups may qualify for the scheme if there is scope for Singapore to enjoy the economic spin-offs arising from the activity.

Name of Scheme	Objective	Eligibility
SPRING SEEDS	• Non-technology start-ups can apply for SPRING SEEDS equity financing when they are in their early stages. Every dollar raised by a start-up from third-party investors will be matched by SPRING Singapore up to a maximum of S$300,000. Third-party investors must put in a minimum of S$50,000 cumulative. • Both SPRING Singapore and the third party investors will take equity stakes in the company in proportion to their investments.	• Any legal entity that has secured total debt and equity financing of no more than S$500,000 previously. • Engaged in the development of new or better products, processes and applications in the manufacturing and services sectors. • Innovation can be in the form of technology and/or business models. • Incorporated in Singapore and carrying out its core activities in Singapore. If the company globalises, the headquarters functions and the highest value-added functions, like intellectual property and top management, should reside in Singapore. • Can be owned by local or foreign shareholders, subject to the provisions of the Companies Act (Cap.50). • The start-up must not have received previous SPRING SEEDS funding (including under SEEDS administered by EDB).

27.3 EDB Incentive Schemes for Investors

Table 14 Incentive Schemes for Investors

Programme	Nature of incentive	Contact point
Pioneer Status	Exemption of corporate tax on profits arising from pioneer activity for up to 15 years.	Economic Development Board 250 North Bridge Road #28-00 Raffles City Tower Singapore 179101 Tel: (65) 6832-6832 Fax: (65) 6832-6565 Web site at http://www.sedb.com.sg
Development and Expansion Incentive	Corporate tax rate not less than 5% for up to 10 years with provision for extension.	
Investment Allowance Incentive	Exemption of taxable income of an amount equal to a specified proportion, not exceeding 100%, of new investment in productive equipment.	
Operational Headquarters Incentive	Income arising from the provision of approved services in Singapore taxed at 10% or any other reduced concessionary tax rate for up to 10 years with provision for extension. Other income from overseas subsidiaries and associated companies may also be eligible for effective tax relief.	
Approved Royalties Incentive	Full or partial exemption of withholding tax on approved royalty payments.	
Approved Foreign Loan Scheme	Full or partial exemption of withholding tax on interest payments.	
Double Deduction for R&D Expenses	Double deduction of qualifying R&D expenses against income.	

Source: EDB website

27.4 Withholding Tax Rates

Table 15

Nature of Income	Tax rate
Interest, commission, fee or other payment in connection with any loan or indebtedness	15%*
Royalty or other lump sum payments for the use of movable properties Payment for the use of or the right to use scientific, technical, industrial or commercial knowledge or information	15%# 15%#
Technical assistance and service fees	Prevailing Corporate Tax rate
Management fees	Prevailing Corporate Tax rate
Rent or other payments for the use of movable properties	15%*
Time charter fees and voyage charter fees 1. Paid to resident of an economy which has a tax treaty with Singapore which provides for: - Full exemption of shipping and aircraft profits - 50% exemption of shipping and aircraft profits 2. Paid to a resident of an economy which has no tax treaty with Singapore 3. Paid to a resident of a tax haven economy	 Nil 1% 2% 3%
Bareboat charter fees 1. Paid to resident of an economy which has a tax treaty with Singapore where: (a) treaty specifically covers bareboat charter fees under the 'Shipping & Air Transport' Article and it provides for: - Full exemption of shipping and aircraft profits - 50% exemption of shipping and aircraft profits	 Nil 1% 2%

(b) treaty does not cover bareboat charter fees 2. Paid to a resident of an economy which has no tax treaty with Singapore 3. Paid to a resident of a tax haven economy	2% 3%
Directors' remuneration	Prevailing Corporate Tax rate
Proceeds from sale of any real property by a non-resident property trader	15%

Source: Inland Revenue Authority of Singapore website

***** The withholding tax at 15% on the gross payment is a final tax. It applies provided that the income is not derived by the non-resident through its operations carried out in or from Singapore. For operations carried out in or from Singapore, they will continue to be taxed at the prevailing corporate tax rate on their chargeable income.

A reduced withholding tax rate of 10% applies for payments due and payable on or after 01.01.2005.

Where a double tax agreement is applicable, the rates specified in the agreements of the respective economies would apply.

27.5 Corporate tax rate/ rebates

A company is taxed at a flat rate on its chargeable income. The tax rate for the respective year of assessment is as follows:

Table 16

Year of Assessment	Tax Rate	Tax Rebates
1986 and before	40%	
1987 to 1989	33%	
1990	32%	
1991 and 1992	31%	
1993	30%	
1994 to 1996	27%	
1997 to 2000	26%	YA 1999: One-off tax rebate of $10% (excluding tax on Singapore dividend and tax on income subject to the final withholding tax).
2001	25.5%	Tax rebate: - 50% on first tax payable of $25,500 - 5% on balance of tax payable in excess of $25,500 (i.e. gross tax - $25,500) - Exclude tax on Singapore dividend and tax on income subject to final withholding tax
2002	24.5%	Partial Tax Exemption Exempt income: - First $ 10,000 @ 75% = $ 7,500 - Next $ 90,000 @ 50% = $45,000 $100,000 $52,500 Tax rebate: - 5% of tax payable (exclude tax on Singapore dividend and tax on income subject to final withholding tax)
2003 to 2004	22%	Exempt income per YA 2002 but without 5% tax rebate
2005 onwards	20%	Exempt income per YA 2002 but without 5% tax rebate. Full Tax Exemption for new companies: Full tax exemption can be granted on normal chargeable income (excluding Singapore franked dividends) of a qualifying company up to $100,000,

Year of Assessment	Tax Rate	Tax Rebates
		for any of its first three consecutive YAs that falls within YA 2005 to YA 2009. The first YA refers to the YA relating to the basis period during which the company is incorporated. To qualify for the tax exemption for a relevant YA under the new scheme, a company must – a) be a company incorporated in Singapore; b) be a tax resident in Singapore for that YA; c) have no more than 20 shareholders throughout the basis period relating to that YA; and d) have all shareholders who are individuals throughout the basis period relating to that YA. Any company that does not meet the qualifying conditions for any of its first three consecutive YAs falling within YA 2005 to YA 2009 would still be eligible for partial tax exemption.

Source: Inland Revenue Authority of Singapore website