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SUMMARY INDUSTRY MARKET PROFILE

FRANCHISING IN MEXICO

THE OPPORTUNITY

Changes in Mexico's legal environment have rapidly established franchising as a major vehicle for exporting to Mexico. Significant franchising activity began in 1988 with the formation of the Asociación Mexicana de Franquicias, (AMF) Mexico's franchise association. However, Mexican corporate and intellectual property laws worked against the franchisor and some apparent franchises were actually joint ventures. New laws provide protection to franchisors similar to that in Canada and the U.S. The result has been an explosion of franchises, particularly in the fast-food area. According to the AMF the franchise sector grew by 37 percent in 1992 alone. Fast-food franchises may have already grown to the saturation point, at least in the major cities, but there are continuing opportunities for Canadian companies in many franchise areas.

For additional information on Mexico and business opportunities in Mexico contact the Department of Foreign Affairs and International Trade at:

InfoEx Centre

Tel: 1-800-267-8378 or (613) 994-4000
Fax: (613) 996-9709

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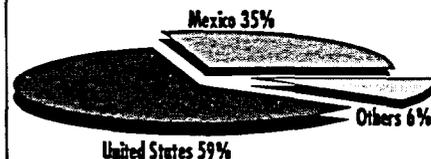
DISMANTLING THE BARRIERS

Until recently, Mexico was a poor prospect for franchising. Traditionally, Mexicans considered franchise agreements as sales with strings attached, which they regarded as foreign interference. The 1982 Transfer of Technology Law gave SECOFI (the Department of Commerce and Industrial Development) authority to closely regulate franchises. The government approved royalty rates, set the duration of franchises, and monitored the overall process. Franchisees were given substantial rights beyond those specified in the franchise agreement. Intellectual property, such as trademarks and industrial secrets, were not adequately protected. For example, under the 1982 law trademarks reverted to the franchisee at the end of the franchise agreement. Barriers to trade and the repatriation of profits compounded the problem.

The government began to change its policies in January 1990 by allowing foreign franchisors more control. Thirty-eight U.S. franchisors and about a dozen from other countries entered the market that year.

In June 1991, the Promotion and Protection of Industrial Property Law went into effect. The new law recognized franchises as a form of licensing, and all of the earlier restrictions were repealed. Government regulation of

NATIONALITY OF FRANCHISORS IN MEXICO



Source: U.S. International Trade Commission

franchises was discontinued and the parties are now free to make their own arrangements, which are binding on the franchisee. Industrial secrets and intellectual property are fully recognized in Mexican law.

By the end of 1991, franchisors had doubled to 100, and another 50 entered the market during 1992. According to the U.S. International Trade Administration, the franchise market in Mexico was worth more than U.S. \$5 billion in 1992 and was projected to grow at 20 percent per year through 1994. The FTA gave Mexico's franchise market its highest ratings for "receptivity" to U.S. products and for lack of barriers to entry. Nonetheless, enforcement is still a potential problem, and the franchise association is working with the government and international organizations to develop effective regulations.

HIGHLIGHTS

Mexico offers many opportunities for Canadian franchisors:

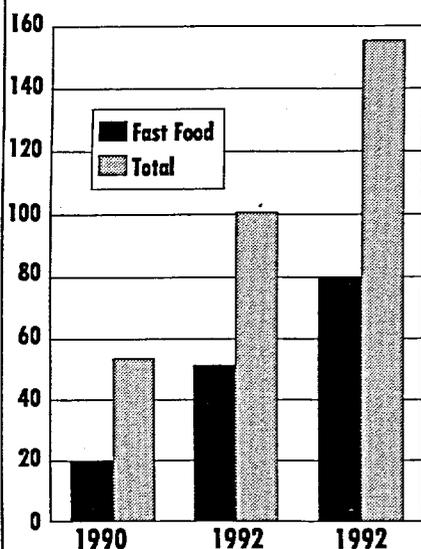
- Legal changes, beginning in 1990, eliminated government regulation of the industry and established franchising as a legitimate means of business development.
- Rising incomes are making franchise products more accessible to Mexican consumers.
- International brand names and products are attractive to Mexican consumers.
- Franchises offer wealthy Mexicans a way of protecting their assets in an economy that is rapidly being transformed by foreign competition.
- Mexican banks have begun to recognize franchises and are offering customized financial packages.
- Mexican family businesses which have traditionally dominated the retail scene are converting to franchises in order to gain the brand recognition and management expertise they need to stay competitive.



THE ROLE OF IMPORTS

One of the main attractions of franchises is the use of brand names, and Mexicans recognize foreign brands as representing high quality. As a result, almost two-thirds of franchisors are from outside Mexico. Fifty-nine percent are from the U.S. and 6 percent are from Canada and Europe. In addition to the sale of the franchise itself, franchises provide an ongoing market for exported products and services. For cost reasons, most franchisees buy what they can locally. Low labour costs in Mexico, combined with duties of up to 20 percent on imported supplies, favour local sourcing but the high quality expected from franchises often requires significant imports. Typically, equipment and store fixtures are imported, as are key products. The large franchises like Arby's, Burger King and KFC have adequate volume to have their supplies made in Mexico under supervision. All three reportedly source more than 80 percent of their purchases in Mexico.

FRANCHISORS OPERATING IN MEXICO



Source: U.S. Foreign Trade Administration

OVERVIEW OF MEXICAN FRANCHISES

In 1992 there were about 150 franchisors, with more than 4,500 outlets operating in Mexico. They employed more than 90,000 people. About half of them are in the fast food sector.

Franchises are centred around the large cities. Mexico City, Guadalajara, and Monterrey account for 90 percent of them. Most of the rest are located near tourist centres but as these markets become saturated, regional franchises will become much more important. Presently, only 6 percent claim national coverage.

The fast food sector offers the best opportunities for a number of reasons. Mexico's population is young, with more than 60 percent under the age of 24. The 15 to 49 age group, considered the best market for fast foods, constitutes 53 percent of the population and this population segment is projected to continue to grow into the next century. Franchising was unknown in Mexico until a few years ago and young people are considered more open to new ways of doing things.

Franchising is growing rapidly in non-food areas as well. Examples include dry cleaning, rapid printing, automotive repairs, hotels and consumer electronics. Franchised convenience stores are beginning to displace small grocery and liquor stores. Although the franchises have higher prices, they also offer a wider variety of goods. Circle K, 7-Eleven and Diamond Shamrock franchises are the market leaders.

According to Mexican Franchise Association the industry grew 37 percent in 1992. The association recently surveyed its 105 members. A profile based on average responses of the two-thirds who replied, is shown in the accompanying table.

PROFILE OF THE AVERAGE MEXICAN FRANCHISE OPERATION

CONTRACT DURATION	7 years
LICENSING FEE	U.S. \$23,500
INITIAL INVESTMENT FOR THE LARGEST 70 % OF FRANCHISES.	U.S. \$237,000
PAYBACK PERIOD	18 months
OPERATING MARGIN	28 % of sales
ROYALTY FEE	3.5% of sales
PROMOTION FEE	1.8% of sales

Source: Asociación Mexicana de Franquicias

FRANCHISE CUSTOMERS

Franchises in Mexico are usually granted through a master franchise system. A master franchise covers a specific geographic area, which may be all of Mexico. The master franchisee then licenses retail franchises under the terms of the master agreement. This approach is effective in Mexico, because franchisees there usually require greater supervision than they do in the rest of North America.

One of the limitations on the purchase of franchises in Mexico has been a shortage of debt financing. For this reason wealthy individuals have been important purchasers, especially for master franchises. Franchises offer them a means of preserving their wealth in an economy that is being rapidly transformed by foreign competition. Franchises are relatively low risk and offer good return on investment. These investors often hire others with experience in retailing to manage their franchises. This contrasts with the experience in Canada and the U.S. where owner/operators are the norm.

Smaller investors are beginning to enter the market now that the banks are beginning to recognize franchises as collateral for loans. Banamex and

Bancomer have special franchising packages. Several consulting companies specialize in franchising.

There is also a need to strike a reasonable balance between the rigid application of the existing franchise formula and some flexibility to adapt the franchise formula to such local market conditions as those dictated by the taste and customs of the people.

COMPETITION

Canadian franchisors compete mainly against U.S. companies, which dominate the market. But there is increasing rivalry from Mexican corporations which have learned quickly about the potential profit from transforming successful businesses into franchises. Mexican franchisors have begun to move into the U.S. and Central America. According to Business Mexico they include Videocenter, VIPs, Pollo Loca, Maseca and Helados Bing.

Franchises have done very well in competition with established retail businesses, many of which are family owned. Although they tend to have higher prices, the franchises benefit from brand recognition as well as better management and quality control. The rapid growth of franchising has been dominated by start-up opera-

tions, but there is also a strong trend towards "franchising by conversion" where existing operators buy a franchise in order to stay competitive.

OPPORTUNITIES IN FAST FOOD

Mexicans like American-style food, and are familiar with most of the major franchise brands. But franchises have mainly catered to the well-off buyers. Until recently, only one consumer in ten had an income large enough to be considered a potential customer. Food franchise prices are typically 25 percent higher than in the U.S. Some analysts believe that prices will have to fall to 25 percent less than U.S. levels, or lower, to attract middle class consumers.

Franchisors are already working to increase their appeal to working class customers. Mexicans are used to buying takeout meals, or comida callejera, from street vendors and from torta (sandwich) shops. Local corner restaurants offer fast-service meals known as comida corrida, selected from two or three choices on a daily menu. Fast food franchises have begun to compete with these outlets by offering coupon discount programs.

MARKET ENTRY STRATEGIES

There are a variety of trade shows that cater to the franchise industry, and they are a good way to find out about opportunities in Mexico. The Franchise Association also has a list of potential franchisees. Franchisors must be sure their brand name will be accepted in Mexico, since brand recognition is the key factor in that market. It is rare for a franchise to change its name to Spanish, since English brand names are well accepted in Mexico.

The Mexican franchise industry is maturing rapidly and Canadian firms will probably have to look for regional or niche markets. Adapting the product to the Mexican market is also a consideration, although U.S.-style products tend to do well without modification. Many fast food franchises simply hand out envelopes of extra spices.

Before it entered the Mexican market, Taco Bell conducted taste and developed new products for Mexican tastes, including soft-shell tacos. Later, customer demand forced it to offer items from its U.S. menus. According to an article in International Business, company officials attribute this to the fact that many affluent Mexicans have visited the U.S. and want "un-Mexican" products, including hard-shell tacos.

The situation is more complex in non-food areas, where Mexican consumers may not be familiar with the product at all. Fast printing outlets, for example, have had to educate the consumer on how to use their services.

Once the decision has been made to go to Mexico, the first priority is to register the trademark. This is a simple procedure but it will cost up to U.S. \$6,000 and will take time. Some franchisors find that the Mexican rights to their trademarks are already owned by local companies. Burger King, for example, was forced to franchise from the local owner of that name in order to enter the Mexican market.

MAJOR FOREIGN FRANCHISORS OPERATING IN MEXICO

SIRLOIN KING
 JANIKING
 BLOCKBUSTER VIDEO
 RADIO SHACK
 WEST COAST VIDEO
 QUICK KOPY
 PETER PIPER PIZZA
 KENTUCKY FRIED CHICKEN
 SHOOTERS USA
 MIAMI SUBS
 McDONALD'S
 DOMINO'S PIZZA
 CENTURY 21
 TCBY
 TACO BELL
 YOGEN FRUZ
 ALPHAGRAPHS
 ATHLETES FOOT

PIZZA HUT
 BENETTON
 ARBY'S
 BURGER BOY
 DAIRY QUEEN
 SHAKEY'S
 WENDY'S
 JACK IN THE BOX
 CEILING DOCTOR
 BOARDWALK FRIES
 SUBWAY
 HO LE CHOW
 DUNKIN DONUTS
 DAVID'S COOKIES
 BASKIN ROBINS
 COMPUCOLLEGE
 DENNY'S
 DRY CLEAN USA



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Selecting franchisees, either directly or through master franchises, is more complicated in Mexico than in Canada or the U.S. Many potential investors have unrealistic expectations and little experience in business. In general, the best prospects are those who are already successful in business, have a good income and are well capitalized. Investors of this type will probably not want to manage the operation. They will be interested in master franchises, or will hire employees to handle operations. Doing business in Mexico usually involves getting to know potential partners personally, through extensive social contact, and developing solid business relationships can take time and effort.

Even the most capable Mexican franchisees need close supervision, because product and service standards are often not as high as they are in Canada. Equipment maintenance can be a problem, and extensive training will be required. This means preparing training material and product or process instructions in Spanish.

Finally, in a market such as Mexico City, high rent and the limited availability of suitable land-sites are significant obstacles for the franchise operators to overcome. One, therefore, needs to be creative in the way negotiations are undertaken for new store sites.

WHERE TO GET HELP

The Department of Foreign Affairs and International Trade (DFAIT) is the Canadian federal government department most directly responsible for trade development. The InfoEx Centre is the first contact point for advice on how to start exporting; it provides information on export-related programs and services; helps find fast answers to export problems; acts as the entry point to DFAIT's trade information network; and can provide companies with copies of specialized export publications.

InfoEx Centre

Tel.: 1-800-267-8378
or (613) 994-4000
Fax: (613) 996-9709

The **Commercial Division of the Embassy of Canada** in Mexico City promotes trade with Mexico. There are several trade commissioners at the Embassy, and there is a satellite office in Monterrey. Trade Commissioners can provide a range of services including introducing Canadian companies to potential customers in Mexico, advising on marketing channels, assisting those wishing to participate in trade fairs, helping identify suitable Mexican firms to act as agents, and compiling credit and business information on potential foreign customers.

Commercial Division
The Embassy of Canada in Mexico
Schiller No. 529
Col. Polanco
Apartado Postal 105-05
11560 México, D.F.
México
Tel.: 724-7900
Fax: 724-7982

Industry Canada (IC)

The Distribution Services Directorate of Industry Canada monitors trends and developments in international franchising and maintains contact with franchisors, associations and professionals in Canada, and selected countries such as Mexico.

Distribution Services Directorate
Distribution and Construction Industries Branch
Industry Canada
235 Queen Street
Ottawa, ON K1A 0H5
Tel.: (613) 954-2987
Fax: (613) 952-9054

International Trade Centres have been established across the country as a first point of contact to support the exporting efforts of Canadian firms. Co-located with the regional offices of Industry Canada, the centres operate under the guidance of DFAIT and all have resident Trade Commissioners. They help companies determine whether or not they are ready to export; assist firms with marketing research and market planning; pro-

vide access to government programs designed to promote exports; and arrange for assistance from the Trade Development Division in Ottawa and trade officers abroad. Contact the International Trade Centre nearest you.

The **World Information Network for Exports (WIN Exports)** is a computer-based information system designed by DFAIT to help Canada's trade development officers abroad match foreign needs to Canadian capabilities, experience and interests of more than 30,000 Canadian exporters. To be registered on WIN Exports, call (613) 996-5701.

The **Market Intelligence Service** provides Canadian business with detailed market information on a product-specific basis. The service assists Canadian companies in the exploitation of domestic, export, technology transfer, and new manufacturing investment opportunities. The intelligence is used by Canadian business in decisions regarding manufacturing, product development, marketing, and market expansion. The information includes values, volume and unit price of imports, characteristics of specific imports (e.g. material, grade, price, range, etc.), names of importers, major countries of export, identification of foreign exporters to Canada, Canadian production, Canadian exports, and U.S. imports. Two-thirds of the clientele for this service are small business. Call: (613) 954-4970.

The **Embassy of Mexico**, Mexican Trade Commissioners in Canada, and Mexican consulates can provide assistance and guidance to Canadian companies in need of information about doing business in Mexico.

Embassy of Mexico
130 Albert Street, Suite 1800
Ottawa ON K1P 5G4
Tel.: (613) 233-8988
Fax: (613) 235-9123



ADDITIONAL CONTACTS IN MEXICO

Luis Luna Neve
President
Mexican Franchise Association
Insurgentes Sur 1783-303
Col. Guadalupe Inn
01020 México, D.F.
México
Tel.: 524-7959

International Franchise Centre
Jose Ma. Rico No. 555 P.B.
Col. del Valle
03100 México, D.F.
México
Tel.: 524-3431

ADDITIONAL INFORMATION

MEXICAN MEDIA LIST

Companies considering promoting their products and services in Mexico might consider the use of these publications. The listing of a publication is not an endorsement.

Restaurantes 2000

(Monthly, published by Mexican Chamber of Restaurants)
Lic. Raquel Verduzco Espinosa
Gerente de Comunicacion y Publicidad
Talleres Graficos de CANIRAC
Camara Nacional de la Industria de Restaurantes y de Alimentos Condimentados (CANIRAC)
Nanual Payno 131-B
Colonia Obrera
06800 México, D.F.
México
Tel.: 604-0418, 688-9147, 705-5055

Nuevos Negocios y Franquicias

(Monthly franchising magazine)
Manuel Larena Lopez
Director General
Salvatierra 24-1
Colonia San Miguel Chapultepec
11850 México, D.F.
México
Tel.: 553-6600/6603/6001
Fax: 553-2102

BUSINESS MEXICO

(Monthly)
Carlos Pozos, Advertising
The American Chamber of Commerce of Mexico
Lucerna 78
Colonia Juárez
06600 México, D.F.
México
Tel.: 724-3800
Fax: 703-2911/3908

EXPANSION

(Twice monthly, Mexico's most important business magazine)
Jose Antonio de Colsa
Production and Distribution Manager
Sinaloa No. 149, 9th. Floor
Col. Roma Sur
06700 México, D.F.
México
Tel.: 207-2176
Fax: 511-6351

FRANCHISE DIRECTORY

This bilingual (English/Spanish) directory lists the currently operating franchises in Mexico

Directorio de Franquicias
Mercametrica Ediciones, S.A.
Av. Universidad 1621, Piso 3
Col. Hda. de Guadalupe Chimalistac
01050 México, D.F.
México
Tel.: 661-9286
Fax: 661-6293

EXHIBITIONS

Mexican Franchise Association (MFA)

The MFA is involved in the organization and promotion of trade shows including both regional shows and a National Franchise Opportunities Fair in Mexico City.

Asociación Mexicana de Franquicias
Insurgentes Sur 1783-303
Col. Guadalupe Inn
01020 México, D.F.
México
Tel.: 524-7959
Fax: 524-8043

Source Mexico Consultants, Inc.

Source Mexico Consultants, Inc. organizes and promotes franchise shows in locations such as Mexico City, Guadalajara, Monterrey and León.

Source Mexico Consultants, Inc.
Suite 634, 118 Broadway
San Antonio, Texas, U.S.A. 78205
Tel.: (210) 227-2502
Fax: (210) 229-9761

International Franchise Association (IFA)

The IFA organizes events to provide franchisors with a forum for reaching potential buyers of master franchises in major trade centres around the world including Mexico. Participants make presentations about their franchises at workshop sessions to interested buyers.

International Franchise Association
Suite 900, 1350 New York Avenue N.W.
Washington, D.C., U.S.A. 20005-4709
Tel.: (202) 628-8000
Fax: (202) 628-0812

Canadian Franchise Association (CFA)

The Canadian Franchise Association maintains contact with foreign franchise associations and affiliate members of the CFA, including legal firms, consulting/accounting firms and banks, and may be able to provide advice and contacts in Mexico.

Canadian Franchise Association
Building 12, Suite 201
5045 Orbitor Drive
Mississauga, ON L4W 4Y4
Tel.: (905) 625-2896
1-800-665-4232
Fax: (905) 625-9076

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