

ORGANIZATION OF MONITORING OF FINANCIAL FLOWS OF A FRANCHISEE TRANSPORTATION COMPANY TO MINIMIZE RISK

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Abstract

The article examines the situation in the franchising market in Russia. The authors emphasize peculiarities in establishing relations on a franchise basis in the transport industry; give instances of the most successful franchise networks. The paper reveals the problems of optimizing the structure of financial flows of franchisees in the field of express delivery of goods on the example of a specific organization. The authors state that there is always a conflict of interests between the franchisor and the franchisee, which manifests itself in financial risks. The company that implements the franchise is focused on maximizing sales. The financial condition of the receiving party depends most of all on the prompt payments from customers, which is possible due to the terms of the contract, the solvency of firms provided transport services. The result of this kind of relationship is the presence of stable accounts receivable from the franchisee and the risk of accumulation of overdue obligations. The authors examine the ways of reducing accounts receivable in transportation companies and propose a step-by-step algorithm for creating a service to monitor liabilities of the company's contractors to minimize legal and financial risks. The article looks upon the issue of a change in the debtors' contractual policy, subject of their financial stability and ranking.

Keywords

Franchise; franchisee; financial flows; accounts receivable; risk.

Introduction

The popularity of franchising forms of business has been gathering pace in Russia. Such forms of business relationships are widely employed overseas which are considered to be an important strategy for those firms that would like to expand their business

(Rajagopal, 2007). Franchising as an organizational form is used in many industries (Felício et al., 2014b; Michael, 2009), especially in retail and service chains (Gillis et al., 2014; Gorovaia and Windsperger, 2013; Asgharian, 2015). Franchising forms create a favorable environment for small, medium, and large businesses under the leadership of the International Franchising Association (IFA). “Currently, there are 16,500 franchisors and over 1.2 million franchisees across the world; the sales volume of the franchise networks totals almost 1.5 billion USD, the employment nearing 12 million people. Franchise firms create some 13 percent of gross domestic product (GDP). A few large franchise firms have a thousand or more franchisee partners each”, the association says (Russian Franchising Association, 2020).

The use of franchising reduces a significant number of risks when starting a business, increases the level of management, provides high-quality marketing and franchiser support. The relationship in franchising is built based on the franchisor’s granting the right to the franchisee to conduct special commercial activities on the franchisor’s behalf for a certain fee (franchise) (Katkova, 2017). Such a system of relationship will involve training in business technologies and established standards for its conduct, advertising and marketing strategy, supervision over the activities of the franchisee (as protection), the supply of goods and equipment, and the protection of the “area” within the franchise.

However, the franchising system is not free from internal contradictions that affect the increase in financial risks that the franchisee must take into account (Asgharian, 2015). The profitability of the franchisor depends on the expansion of the network scale, on the increase in revenue received by the franchisee in the chosen type of business activity (Senatorov & Kuskov, 2020). The focus on maximizing the volume of work has led to the fact that the largest number of successful franchise networks are developing in the service sector. As an object of research on the problems of financial flows, we considered road transport that provides the delivery of oversized cargo. In our opinion, the formation of a system of relationship with customers arouses the particular interest and concern for franchisees. Providing services allows expanding the client base when using the payment that follows the realization of the transport service, which leads to the formation of accounts receivable. The stability of the franchisee’s financial position depends on timely payments and quality control of overdue obligations. Monitoring financial flows is becoming the most important tool for reducing financial risks.

The article proposes a project containing a mechanism for monitoring the state of accounts receivable of franchisees. In the course of its implementation, a working group is created with the authority to monitor the timeliness of payments, which ranks contractors by the level of their payment discipline. A system for motivating staff members of the group to minimize overdue accounts receivable of franchisees has been developed.

The prospects for the franchising development are based on the use of new information technologies, subject to the territory scale of the the Russian Federation, the need for online interaction between contractors. Examples of the most successfully developing franchisors are organizations that use their own websites and software to remotely attract a client, describe their own advantages, and familiarize themselves with the initial conditions for obtaining a franchise. Consulting and training services offered by the franchisor are perfectly combined with supervision over financial flows in the event

of the introduction of digitalization elements and the use of big data when expanding the franchise network.

Peculiarities of the situation on the franchising market in Russia

Currently, the Russian legislation lacks the concept of “franchising” which creates certain difficulties in building networks. Business entities have to use agency and licensing agreements, conclude contracts of supply. Legally, the closest to the franchise agreement is a commercial concession agreement (CCA). It fully regulates relations when shaping a franchise network and allows the protection of the interests of all parties involved. CCA provides for the transfer of a set of exclusive rights, allows to establish certain restrictions, especially in the field of pricing and competition.

The Russian franchising market has been on the rise: of 2,600 franchises available in the country in 2019, no more than 30 percent are active. “Last year’s figure is quite high for the Russian market, despite the economic situation in the country and business behavior. On average, from 10 to 12 percent of growth is considered as standard, as compared to the results shown in previous years,” Nina Semina says (RBC Pro, 2020). The franchising market grew by 16 percent in 2019, rose by 19 percent in 2018, and up by as much as only 5 percent in 2017.

Figure 1 shows the ranking of the most popular franchises in Russia in 2019 according to the information obtained from the Federal Service for Intellectual Property (Rospatent). (TopFranchise.ru, 2019)

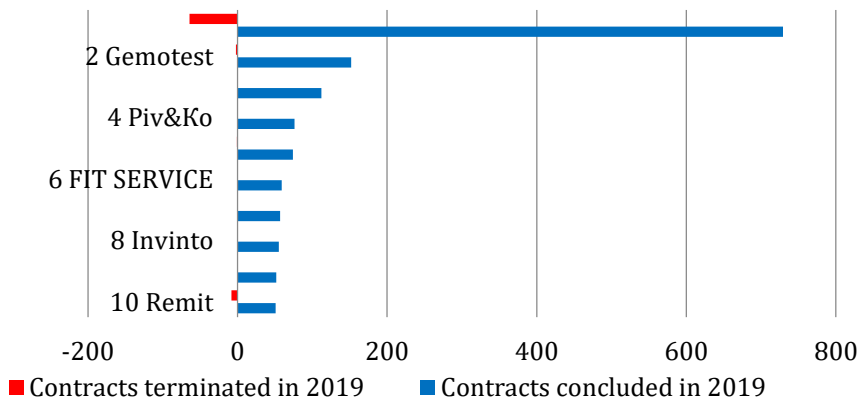


Figure 1. List of the top 10 most popular franchise networks in Russia in 2019
(TopFranchise.ru, 2019)

The 1C company stays the most popular and rapidly growing franchisor which provides software services in the field of financial reporting and consulting. The number of franchise agreements concluded by the company hiked by 8 percent in 2019 (Figure 1). The top ten list also involves organizations that provide medical laboratory services (Invitro, Gemotest, Helix), repair services for various equipment (FIT SERVICE, Pedant.ru), food industry enterprises (Piv&Co, Remit), and organizations offering

teaching services to children (AMAKids, SunSchool). The list of the top 10 most popular franchises is unstable, being subject to significant changes. It depends on the volatility of business environment conditions.

Let us now pass on to the positive aspects of starting a franchise business. They are as follows: a strong brand, a ready-made business model, the provision of goods for sale, an active advertising campaign from the franchisor, etc. As to negative aspects of franchising, there is a risk to acquire a non-working business model, serious competition in the industry, dependence on the franchisor's reputation, adherence to franchisor standards, monthly payments (royalties).

To shape the company's financial flows, franchisees adhere to payments to the franchisor. Such payments are reflected in the franchise agreement (Patrusheva, 2016), namely:

- a lump-sum payment, i.e. payment for the right to use a brand name including consultations on doing business and monitor the business activities;
- a royalty, i.e. monthly payments made for the right to use the franchise. The royalty is determined by the franchisor independently and it involves the costs of training of employees, analyzing the franchisee's performance rate and the franchisor's profit;
- an advertising payment - payment to the franchisor company for advertising, creating a brand image, developing a marketing strategy and tactics, etc.

In addition to the aforementioned franchise payments, the franchisee will pay the equipment supplied (if provided for by the contract), the supply of goods for sale, the loan repayment amount (funds borrowed by the franchisee), rental and lease payments (if any), payments related to the outlet buy-out, payments for additional services offered by the franchisor (assistance in personnel recruiting, consulting services), etc.

Franchising is accompanied by several risks to be taken into account when choosing this form of business. In the case of acquiring a franchise, choosing a franchisor, it is necessary to preliminary analyze information about possible risk situations:

- to determine the sector for the company activity: one needs to choose a business sector in accordance with his interests, skills, and knowledge, and never getting down to the business of "someone else's success";
- to assess the reliability of the franchisor: one should check the information with the existing franchisees and turn to clarify it with the franchisor;
- expectations of "elusive profits": one needs to make his effort and not evade the control of the franchisor who is interested in providing the franchisee with support and protection;
- identification of legal errors: each clause of the franchise agreement must be carefully studied and checked; all disputed points require additional approval;
- human factor: any company head must be responsible for checking all documents and steps of the contractors; consultations with professionals; "double-check" his own opinions (TopFranchise.ru, 2019).

The process of looking for a franchisor is linked with shaping the financial flows of future activities (ATI.SU, 2018). They are aimed at ensuring a sufficient amount of financial resources in accordance with the selected sector (determination of own and borrowed financial resources), optimization of the distribution of the volume of financial resources shaped, ensuring synchronization of the volumes of receipts and expenditures made within separate periods (Grisko, 2018), maximization of the franchisee's profit at a

specified level of financial risk (subject to inflation, economic sanctions, quarantine measures to prevent COVID-19, etc.), the constant financial balance of the company, etc.

As soon as the franchisee selected the franchisor and reached a decision on whether to enter into a franchise agreement, it is necessary to analyze again: the financial history of the franchisor company; volatility of its profit; reputation among franchisees, competitors, and customers; company history as an independent business organization and its experience in franchising; the number of founders of the franchisor company; legal restrictions and trials; reasonableness of the franchise fee.

The practice of minimizing the risk of franchising payment arrears in the field of transportation services

When choosing a franchise, we took into account the proposals in the field of road haulage which the company under consideration was engaged in. The features of a transport franchise include both virtues and shortcomings. As regards the advantages, they involve the ability to call a toll-free courier, ease of placing an order thanks to the company's ergonomic website, a favorable price-to-delivery ratio. The website provides a quick calculation of the delivery fee depending on distance, weight, size, and other characteristics; offers flexible pick-up and delivery conditions (door-to-door, warehouse-door, door-warehouse); the ability to track the order on the site by the invoice number. To maximize the dispatch speed, the courier's work is fully focused on the customer's convenience. Among the shortcomings, it is important to note the violation of delivery times, the issuance of additional invoices due to the overweight of the goods in the warehouse, the non-refund of insurance in case of damage to the goods, if the client minimized transportation costs due to inappropriate packaging.

The following companies are the leaders of transport franchisors:

- Sampost. Depending on the set of services, it requires from 145,000 to 245,000 RUB of the initial investment. The payback period is from six months to a year and a half;
- SDEK. The cost of acquiring a franchise is 150,000 RUB; the amount of investments is from 450,000 RUB. The maximum payback period is 6 months;
- «Express Tochka Ru». The minimum investment amount is from 450,000 RUB; the payback period is 14 months (TopFranchise.ru, 2020).

Let us consider the financial flows of the Reliable Contract express delivery company which acts on a franchise from the SDEK limited liability company (Express-Courier Delivery Service). The Reliable Contract LLC has been operating on the Russian market of courier services since 2000. It deals with the express delivery of goods and documents across the city, Russia, as well as other countries. The company provides high-quality service to customers. By combining different types of transportation, as well as tracking them, the company ensures the speed of delivery. The SDEK courier service company has been offering franchises since 2009. The business has 27 branches. As many as 231 divisions opened by the company make services available throughout the country.

When buying a franchise from SDEK, the following conditions are implemented:

1. It is allowed to open an office in a city with a population of fewer than 50,000 inhabitants.
2. Mandatory initial payment of 150,000 RUB.

3. Start-up budget is from 300,000 to 800,000 RUB.
4. SDEK does not require royalty payments from 1 to 6 months, thereby allowing independent entrepreneurs (franchisees) to understand the whole process of activities and raise their businesses. Starting from the seventh month, the royalty is 10 percent of the receipts.
5. The payback period is about three to six months.
6. Areas of the franchise distribution are Russia, Kazakhstan, Belarus (FRmall.ru, 2020).

Upon the acquisition of a franchise, the Reliable Contract company received the following bonuses from the franchisor, namely consultations on all the issues related to the activities of the branch both before and after the launch of the project; support at all stages of cooperation; the ability to work with the entire network to attract customers; the ERP and CRM system; free training for franchisee employees; advertising campaign support; comprehensive assistance of the company's specialists (Finance-EXP.ru, 2020). The Reliable Contract company uses its vehicles for cargo transportation. Maintenance of the rolling stock is carried out promptly which allows us to avoid malfunctions and breakdowns. It minimizes the cost of vehicle repair. The economic state of the company directly depends on sales managers who increase the number of contracts with corporate clients, as well as managers of the customer services department who support the work with the company's current order portfolio. The structure of the financial records by Reliable Contract shows a very high degree of dependence on the company's solvency on the timeliness of receipts and payments. The share of the accounts receivable in the company assets exceeds 97 percent, the ratio of accounts receivable to accounts payable is 1.33. The latter indicates the urgent need to handle relations with contractors. The search for optimal methods to reduce the risks of payment arrears is topical for the enterprise. As regards the structure of accounts receivable, the main share falls on the accounts receivable from buyers and customers totaling 88 percent. It again proves the dependence of the franchisee's activities on revenues.

While investigating the problems of organizations operating under franchising conditions, we identified the main type of risk that accompanies the production process - financial risk. To clarify the risk category, we should talk about the risk of untimely payments by counterparties, which affects the organization's liquidity indicators and indicators of its financial stability (Lyani, 2017). As a methodological tool for reducing this type of risk, we implemented a project to improve the organization of financial flows for the franchisee transport company. The essence of the proposed project is to organize a group of control over the customer payment system, clarify the powers of group members, and encourage staff to reduce overdue receivables of contractors.

The Reliable Contract limited liability company introduced a quarterly payment scheme for the rendered services in contracts concluded with legal entities. Therefore, any delay in payments creates a risk of insolvency of the franchisee itself. Since the relationship in franchising is subject to agreement, the risks of contracting parties can be partially foreseen and minimized legally. There is a conflict of interest. The franchisor is focused on maximizing its revenues due to an increase in sales. The financial position of the franchisee requires additional analysis of the clients' solvency to regulate the timeliness of financial receipts from clientele, to change the terms of contracts subject to the observance of the financial discipline by the contractors (Nihtiy, Shalova & Luskatova, 2018).

The assessment of the most significant financial and legal risks in franchising is stipulated by the use of compensation methods of risk management, namely monitoring of work with receivables of the franchisee as a company. An algorithm of actions to minimize overdue accounts receivable makes the basis for monitoring, allocation of the department responsible for this activity, and the incentives paid to the staff on their work results. To increase the efficiency of accounts receivable management, the franchisee needs to take the following steps:

- 1) create a working group for the operational management of accounts receivable in the company;
- 2) improve the estimation procedure for assessing the reliability of the debtor;
- 3) create an incentive scheme for employees involved in the accounts receivable management.

The sales director, sales managers, and the loan supervisor work with customers who require special attention. Debts are distributed among contractors and managers responsible. The actions of sales managers are regulated based on the following algorithm:

- the sales manager is to inform the debtor about the due date and amount 2 days before the time of maturity;
- the sales manager reminds the contractor of the due date and receives confirmation of the intention to fulfill the contractual obligations on the day of payment;
- if the debt is not paid off within 2 days after the due date, the sales manager is obliged to take the following steps to return the receivable: to negotiate it with the debtor; to send an official letter to agree on the payment schedule;
- should the debtor's overdue debt reaches 30 calendar days, the loan supervisor and the sales director decide to terminate the provision of services;
- if the receivable is not paid off within 60 days, the loan supervisor takes steps to clarify the reason, analyzes the current solvency of the debtor, sends a claim for payment for services;
- if the debt is not paid off within 90 days, the company is liable to sue the debtor;
- if the court rejects the claim for the collection of receivables, the debt is considered bad and is to be written off.

The company works with receivables only if the due date is nearing or has already arrived. The group responsible for work with accounts receivable must have an accountant whose job duties are as follows: keeping and verification of the register of primary accounting documents, inventory of accounts receivable, bad debt expense documents, filing of uncoordinated payment applications for explanatory purposes. The loan supervisor is not an active participant in the process for the return of receivables, but he is entrusted with the duties of a timely analysis of the reliability of a potential debtor and ranking of all debtors. Being part of the group, specialists of the sales department encourage a contracting party with a deteriorating performance to timely payment by introducing additional incentives (discounts, mutual settlements). They use the restructuring or prolongation of debt for partners who have violated the payment terms for reasons beyond control, taking into account the results of prospective solvency analysis; reduce payment terms (not once a quarter, but once a month), for violations previously committed by the contractors.

In addition to monitoring the actions taken by the group members, the sales director is responsible for establishing individual payment terms for clients, subject to their ranking; deciding to suspend the provision of services; choice of a possible option for

interaction with a client from debt refinancing to suing. Decision making on the assignment of accounts receivable to specialized organizations is within the competence of the managing director. Completing the first stage of the receivables management algorithm is to clarify the responsibility of all group members for their functional assignment to controlled financial flows. The second stage of the project is to identify the level of payment discipline of the counterparty. When assessing the reliability of potential debtors for each contractor, before drawing up an agreement, it is required to calculate the following indicators of the client's company (Kasacheva & Udod, 2018, p.257):

- quick liquidity;
- ratio of receivables and payables;
- turnover of accounts receivable;
- financial leverage.

Based on the obtained values, a rating is scored. Thus, the company is put into one of the five groups:

- I - a financially stable enterprise, the return of borrowed funds is guaranteed;
- II - enterprises with some degree of debt risk;
- III - financially unstable enterprises;
- IV - enterprises with a high degree of risk, a chance of losing the funds is high;
- V - prospective insolvents.

Based on the analysis of the debtor reliability, the loan supervisor assigns it to one of the groups. On the ground of the reliability group, the sales manager draws up a quarterly payment scheme for customers in Groups I - III. The commercial terms are set by the sales director for Group IV. As for the clients of Group V - the manager sets payments after the rendered services. The following structure of clients was identified for Reliable contract LLC: class I - III - 55%, class IV-V-45%. There is a large proportion of customers with a high risk of non-payment which explains the significant indicators of overdue receivables, up to 32% of its total value. Even though the responsibility for control over the flow of funds is distributed among the employees of the sales department, their remuneration is not related to the amount of overdue receivables. Employees are motivated only to increase sales proceeds which results in an increase in overdue receivables due to the provision of services to companies whose reputation is unverified. As for the Reliable Contract limited liability company, there is no system of motivation for those involved in working with accounts receivable which formalizes the performance of these duties. Therefore, it is necessary to introduce an appropriate incentive system for the additional workload and increased responsibility of employees. This corresponds to the third stage of the project on managing the financial flows of the franchisee.

The bonuses paid to managers of the sales department are subject to both the total revenue received from the services rendered and to the increase of the amount of repaid receivables. If the controlled overdue receivables drop by less than 20 percent of the total amount of debtors' liabilities, the number of bonuses paid increases by 20 percent. As the share of overdue accounts receivable increases to 40 percent, the amount of bonuses is not to go up by more than 5 percent. If the regulations in dealing with the contractors' obligations are violated, the incentives paid can be reduced by a quarter. The sales director, accountant, and loan supervisor are entitled to a 10-per-cent rise in the incentive if they show an overall decrease in the amount of overdue receivables.

Incentives paid to the employees of the group liable for accounts receivable are to be linked with the efficiency and quality of their duties performance, subject to the amended regulations on accounts receivable.

The implementation of the proposed project to improve the efficiency of financial flow management of The Reliable Contract limited liability company contributed to the improvement of the financial performance of the enterprise in a short period (6 months). The share of overdue accounts receivable was decreased by 25%. The total amount of accounts receivable is reduced. As a result, the ratio of accounts receivable to accounts payable has become 1.09 and the indicator of the company's financial stability increased by 11%. Thus, improving the financial condition of the transport company stimulated the reduction of the risk of untimely payments of contractors. The study confirmed that the objective criterion for risk minimization was the indicator of reducing the amount of overdue receivables of the franchisee company.

Conclusions

The main purpose of the paper was to study the problems of optimizing the structure of financial flows of franchisees to prevent a conflict of interests between the franchisor and the franchisee, which manifests itself in financial risks. In this respect, we have analyzed the situation in the franchising market in Russia. The results confirm the fact that franchising is a prospective form of business administration, an effective way of increasing the sales of goods and services. Many franchisees have achieved high-profit margins by understanding the business fundamentals in their respective field of activity, under the close guidance from the franchisor's company. However, we focused on the legal and financial risks the transport companies faced and studied the ways to minimize them and to reduce receivables. We proposed a step-by-step algorithm for creating a service for monitoring the state of debt obligations of the company's counterparties. For the efficient work with debtors, we offer a gradation of them into five classes, taking into account the risks of late payments, and a rating of franchisee clients based on this method. We suggest the personnel involved in the operational management of accounts receivable of the organization should be stimulated not only to increase sales volumes but also to minimize overdue payments of contractors. The competent formation of financial flows and timely identification of non-payment problems will allow businesses in the form of franchise networks to take a competitive position among individual commercial enterprises and significantly increase the growth of business activity in the field of transport services.

In conclusion, we consider that the competent formation of financial flows and timely identification of non-payment problems with the help of monitoring will allow businesses in the form of franchise networks to minimize risks, take a competitive position among individual commercial enterprises and significantly increase the growth of business activity in the field of transport services. The developed algorithm of actions to minimize overdue accounts receivable can be used by any organization irrespective of size and organizational-legal form, and also in case of necessity, it can be adapted and automated in various business processes.

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