

Kyiv National University of Trade and Economics

The Department of World Economy

FINAL QUALIFYING PAPER

on the topic:

**«ORGANIZATION OF FRANCHISING OPERATIONS AT ENTERPRISES OF
RESTAURANT INDUSTRY»**

(based on the data of McDonald's Ukraine LTD)

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Introduction

Regarding the continuing globalization processes in the world economy, successful enterprises possessing powerful know how and efficient business concepts are looking for introducing their businesses in the international markets. In modern life, with the global division of labor, the working population, given the acute shortage of free time, is extremely interested in restaurant business.

The modern economy of developed countries is a service economy. Gross domestic product, for example, of the countries of the European Union and the USA, today is 70% formed in this area. But the modern economy inherited high standards of efficiency from the previous industrial stage of development of society and this means that the stage of existence of the service sector, in which each of the enterprises was the result of singular entrepreneurial work, is over. Modern entrepreneurs seek high quality and predictability in services, i.e. standardization. Franchising became the answer to all these challenges, which is why the topic of this final qualifying paper is relevant.

That is why the overview of global franchising market as well as the best practice example of the leading franchising company such as McDonald's Corporation can lead to an understanding of the opportunities of a franchising as an entry mode into Ukrainian restaurant industry.

Analysis of recent research and publications. The research of franchising is carried out by such prominent foreign scholars as J. Kaufmann, P. Dant, A. Khan, A. Sherman, I. Alon. Among domestic scientists who study the phenomenon of franchising and its development should be distinguished: I. Boychuk, A. Vinoradska, N. Kovalchuk, T. Grygorenko, S. Melnychenko, T. Tkachuk. Due to countries' franchise associations, there is an access to the newest analytical and statistical data. However, research on the development and implementation of franchising in today's business environment continues to be relevant and requires a more detailed study.

The purpose of this study is to analyze the current state of franchising development in restaurant industry worldwide. To achieve this goal it is necessary to solve the following tasks:

1. To specify the essence of franchising as an effective method of doing business.

2. To present an overview of global market of franchising operations.
3. To analyze the most representative examples of franchising in leading countries in geographical regions of the world.
4. To define advantages and disadvantages of franchising from both franchisor and franchisee's point of view.
5. To analyze the current state of the "McDonald's Ukraine LTD's activity on the Ukrainian market".
6. To substantiate the choice of franchising as an effective method of doing business.

The object of this final qualifying paper is a process of performance of international franchising operations in the domain of restaurant business.

The subject of the research is a theoretical and methodological study of preconditions and rationale for franchising operations' establishing by McDonald's Ukraine LTD in the Ukrainian market.

Methods of research - research was carried out with the help of general scientific methodical techniques; axiomatic (reliance on existing general theoretical propositions); methods of theoretical knowledge (characterization of the essence and basic principles of organization of franchising operations); comparison and generalization (analysis of financial and economic activity of the enterprise); methods of economic forecasting (evaluation of the effectiveness of the proposed measures).

The structure of the final qualifying paper is determined by the purpose of the research. The work is set out on 50 pages of the main text, consists of an introduction, three parts, conclusions, contains 20 tables, 15 figures and 2 annexes.

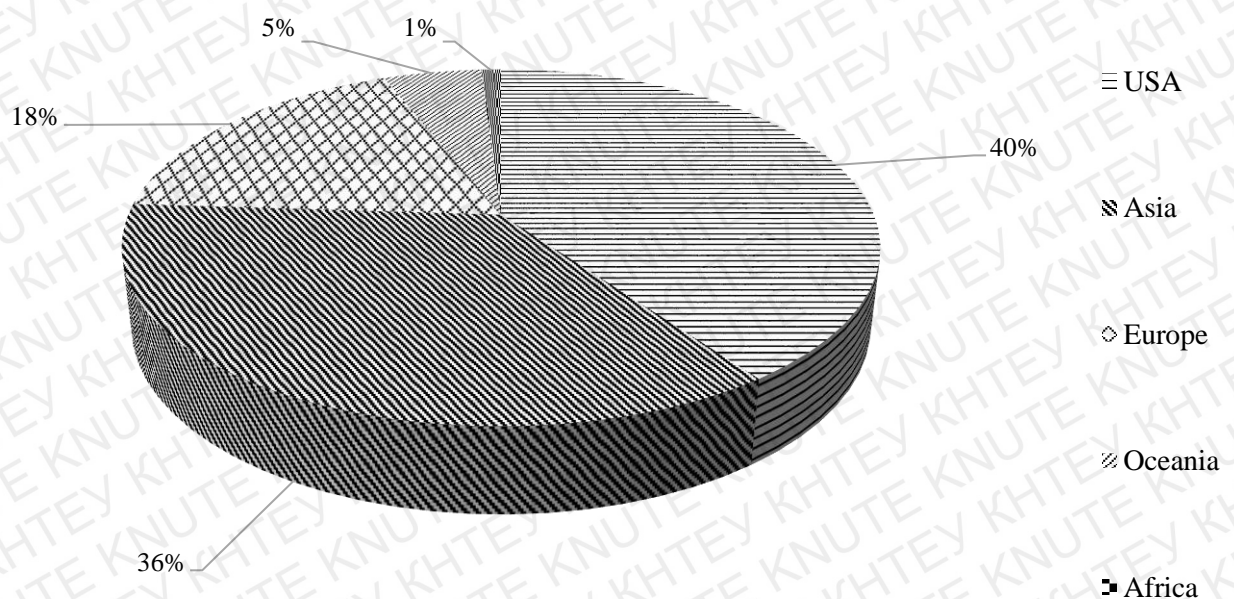
The introduction describes the urgency, the degree of scientific elaboration of the problem, the theoretical and methodological basis of the study, defines the purpose, object and subject of the study. The main part consists of three parts. The main conclusions of the study are summarized and practical recommendations are made.

PART 1 ANALYSIS OF CURRENT PERFORMANCE OF MCDONALD'S UKRAINE LTD

1.1 Assessment of the global market of international franchising operations in the domain of restaurant business

Franchising is a research object of many foreign and domestic authors. Goldstein states, that franchising occurs when the franchisee markets a product or service developed by the franchisor under an agreement. Steinhoff and Burgees state that franchising is an agreement between the parent company and entrepreneur. It allows an entrepreneur to use all the knowledge and experience of the parent company, such as the name, logo, production technique, training methods et cetera. Grygorenko offers to define franchising as a set of business entities operating on the market under the same trademark on a franchising basis and consists of the franchisor's own commercial object and franchise entities. Through the lens of economics, franchising is the method of entering foreign markets with minimized risks and expenditures [1].

Current state of the global franchising market can be analyzed using the International Franchising Association data. The regional structure of the global franchising market is presented in the Figure 1.1.



*Fig. 1.1 Regional structure of the global franchising market by the number of franchise entities, 2018
Source: International Franchising Association [12]*

As figure shows, the USA franchising market has the biggest share in the global franchising market – 40%. The Asian region is also one of the leading franchise markets with the 36% share. Europe has the 18% of the franchise market. Oceania and Africa have the smallest share – respectively 5% and 1% of the global franchise market.

The industrial structure of the global franchising market is diversified. The main industries participating in the franchising process are fast food, retail, services, as well as hotel business and real estate. According to the International Franchising Association data, the industrial structure of the global franchise market is following: fast food entities – 42%, retail – 21%, services – 17% , hotel business and real estate respectively 14% and 6%.

The industrial structure of the global franchise market is represented in the Figure 1.2.

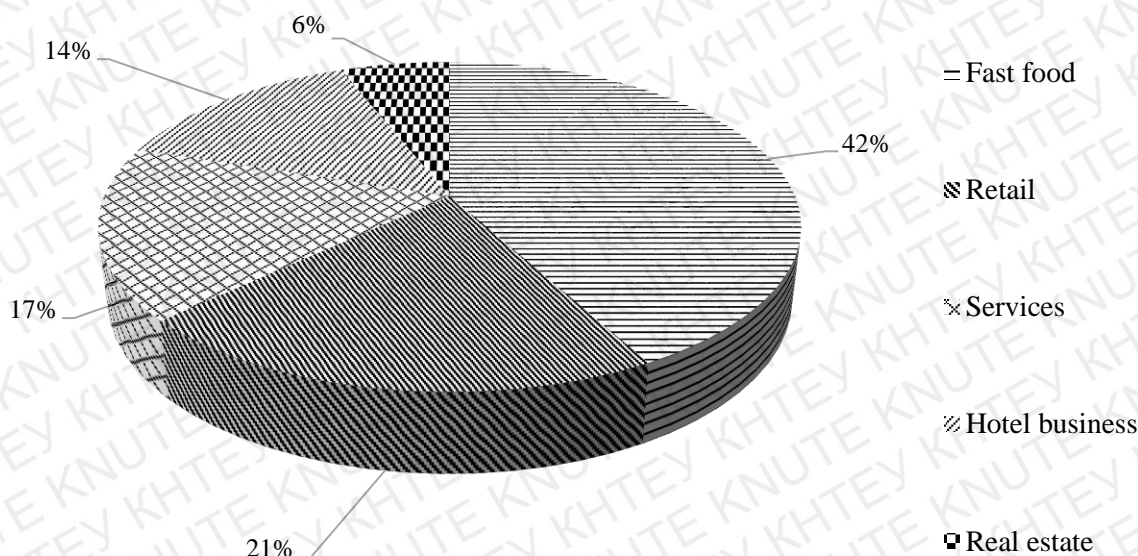


Fig. 1.2. Industrial structure of the global franchising market, 2018

Source: International Franchising Association [12]

As the figure shows, the fast food industry has biggest share – 42% mostly because it reflects basic market need in food and wide spreading of the most successful food franchises. The retail industry represents 21% of the global franchising market because of the significant goods diversification. Services industry, that include both personal and business services has 17% share and is expected to increase because of the growing demand on services. 14% share of hotel business explains the consumers' want to get

unified concept of the same brand of accommodation in various countries. Real estate represents 6 % of share and is composed of different activities other than buying and selling property. The complexity of one does not always allow to run independent business.

It is reasonable to start the analysis of the global franchising market players from a market's leader. On a global franchising map, the United States of America is currently one of the most extensive franchising markets [8]. In accordance with the statistics of the International Franchise Association, in 2018, there were 759 236 enterprises that operated in the USA under the franchising system, which provided jobs for more than 9.0 million people [4]. The dynamics of franchise establishments' number are in the Figure 1.3.



Fig. 1.3. Dynamics of the number of franchise entities in the United States of America, 2014 - 2018

Source: International Franchise Organization [12]

Since the 2014, there is a stable growth of the franchise entities' number in USA. In 2015 there was a 1.59% growth compared to 2014, in 2016 the number of franchise entities increased by 1.75% compared to 2015. The growth also had the 2017 – 1.61% compared to 2016. In addition, in 2018 a growth of the franchise entities' number is estimated as 1.84% compared to 2017. For the 5 years of estimation, there is a positive dynamics of increased 6.62% of the total number of franchise entities in the United States of America. The industrial structure of the American franchise market is rather diversified, as seen in the Figure 1.4:

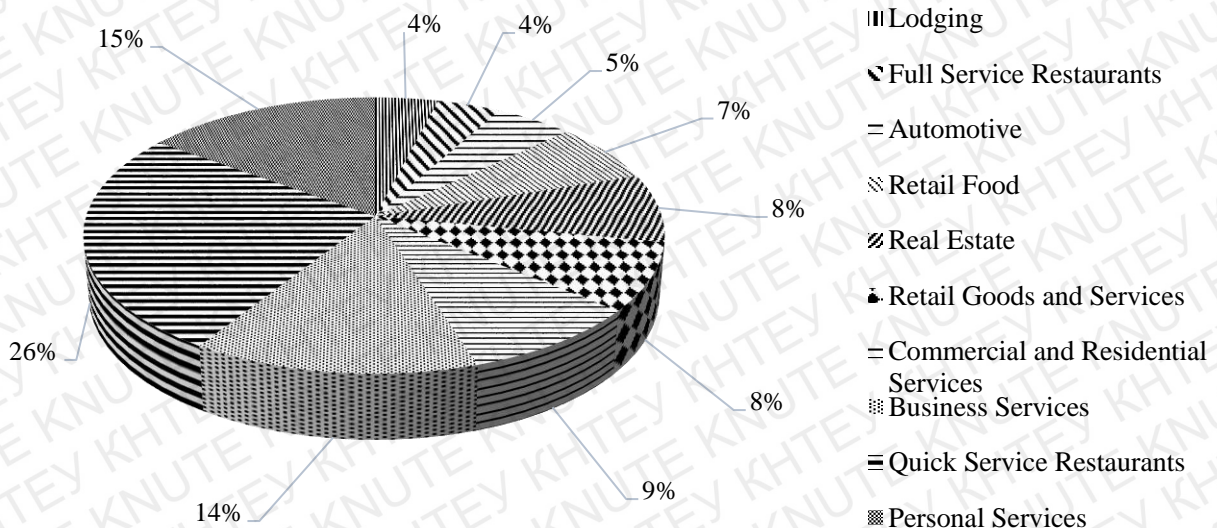


Fig. 1.4. The industrial structure of the American franchise market, 2018

Source: International Franchise Association [12]

As the figure shows, the smallest share has lodging (4%) and full service restaurants (4%), as well as automotive (5%) and retail food (7%) industries. Middle position belongs to real estate (8%), retail goods and services (8%), commercial and residential services (9%) and business services (14%). The quick service restaurants segment – 26% and personal services sector with 15% of the market occupy the biggest share.

All the activity regulate both state and federal laws. USA is traditionally associated with the fast food sphere. According to the top 100 global franchises list, 7 out of the first 10 places belong to American fast food franchises [13]. That is because franchising, by its essence, provides franchisee the right to use the company's trademark, policies and standards and to use special offerings adopted to the local market. Such giants of the industry as McDonald's, Burger King, KFC, Pizza Hut, Subway and Dunkin' keep expanding and operate all over the world serving millions of customers every day.

It is important to underline, that despite quick service restaurants segment is traditionally the leading one, at the past few years there was a trend of explosion in personal services sector. This sector consists of diversified amount of services – health care, pet care, entertainment, education, beauty and spa, travel agencies etc. According to the Forbes, there are a number of reasons caused such growth of the Personal Services [14]:

- In consequence of medicine development the average life expectancy is increasing, and increased elderly population demand proper personal service, such as health care and home care.
- Families with both working parents. Such a common situation led to increasing demand on basic daily tasks accomplishment – dog walking, cleaning service etc.
- Popular trend of being active and healthy among young people. That is why such services as health care, beauty and fitness are also in a high demand.
- Low cost of starting business and opportunity to run it from home. It is obviously cheaper to purchase franchise in beauty sphere (for example doing lashes and nails) rather than fast food franchise.
- From an entrepreneur's point of view, personal services are a possibility to combine business activity with a hobby and to share personal experience with other people.

Entrepreneurs prefer to buy a franchise with the purpose of overcoming compliance issues appearing with the independent enterprise. Being a part of franchise system makes entrepreneur focus directly on the business activity. Also from the consumer's point of view, franchised goods often equals high quality and standards of production.

Another leading franchising market with the 36% share is the Asian region. Nowadays this region demonstrate a rapid growth, that makes it high potential on the global stage. China's market as one of the fastest growing economies in the world is very perspective. For the first time, Chinese government was skeptical about franchises, preferring to develop a business that focused on investing in stocks. However, after analyzing the opportunities of this way of doing business, the government gave a chance for franchising. For Chinese entrepreneurs, official support has a fundamental importance even if it is not accompanied with the allocation of any money from the budget. Considering the fact that today the whole world is oversaturated with Chinese goods, and the business is actively expanding in the United States and Europe, makes this market very attractive for the entrepreneurs. At the same time, they are beginning to act not only as franchisees, but also as franchisors.

In January 2019, there were 4 368 franchisors registered in the Chinese Ministry of Commerce, but unofficial statistics states that there are over 4 500 franchises with more

than 400 000 working outlets. This makes China one of the largest franchise markets in the world. Research made by China Chain Store & Franchise Association analyzed main sectors of the Chinese franchise market [15]. The Figure 1.5 shows the structure of the franchising market in China:

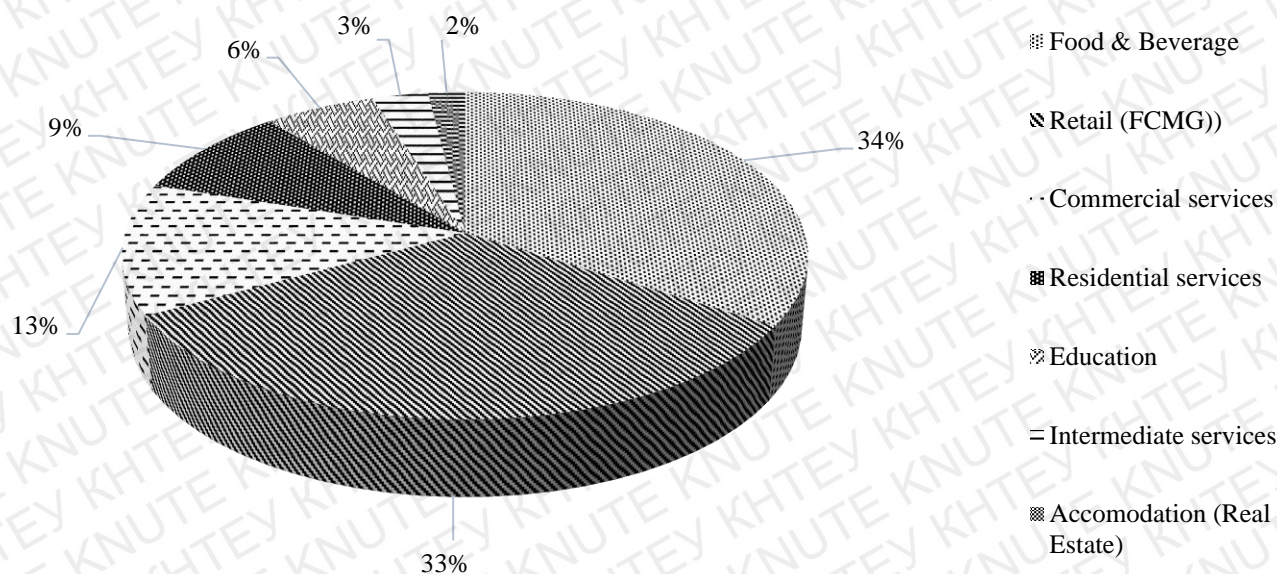


Fig. 1.5. The industrial structure of the franchising market in China, 2018

Source: China Chain Store & Franchise Association [15]

As figure shows, the biggest share of market belongs to food & beverage and retail industries— 34% and 33%, respectively— because of the global brands influence and expansion. The middle position is occupied by commercial – 13% and residential services – 9%. The least spread are sectors of education, intermediate services and accommodation –6%, 3% and 2%, respectively. As the figure shows, the leading spheres in China do not differ from the global market industrial tendencies that can testify the high level of China’s franchising market development in comparison to the world.

The key reasons that make entrepreneurs pay attention to the Chinese market are wide range of goods, relatively low cost and implementation of logistics at low prices. Chinese give more flexible conditions than other Asian franchisors. However, entrepreneurs should pay attention that some franchise agreements are short term. It can lead to problems for companies operating under a franchise agreement, because short term is sometimes not enough even for the return on investment. That is why it is necessary to explore the local specifics and legislation before entering Chinese market.

European franchise market with an 18% share of the global franchising market also has a great potential and one of the most developed markets is French one. Franchising in France began to develop at the beginning of the 20th century. In 1911, an entrepreneur Jean Prouvost gave an assignment to a young specialist to open a network of stores in the country that sell factory wool. Thus, in France, the first network appeared under the brand name “Laines du Pingouin”. Despite the emergence of “Laines du Pingouin”, the main development of franchising in France fell on the 70-80s. During this period, actively appeared companies in the services, equipment and catering sectors. According to the French Franchise Association nowadays there are 2004 franchisors and 75 193 franchisees [16]. The Table 1.1 shows the dynamics of franchise development in France from 2014 to 2018:

Table 1.1

Dynamics of the number of franchisors and franchisees in France, 2014 - 2018

Indicator	2014	2015	2016	2017	2018
Number of franchisors	1796	1834	1900	1976	2004
Number of franchisees	74 102	71 508	71 508	74 102	75 193

Source: French Franchise Association [16]

According to the analysis, the number of franchisors grows more rapidly than the number of franchisees. Since 2014, the number of franchisors increased by 10.38%, while the number of franchisees increased by only 1.45%. It can be explained by the focus on developing local franchises rather than foreign or global ones.

As France has a reputation of the country that manufactures luxury products – especially clothing and beauty products, due to this reputation, franchises in the clothing and cosmetics sector are actively expanding abroad. The “Yves Rosher” brand is in the top of the most profitable franchises not only of its segment, but also of the world rating. Also are popular such networks as “L’occitane”, “Christian Dior”, “Parisian lingerie” stores, “Hermes” and others. Another area of franchise development in France is fast food. One of the reasons was the spread of American franchises in France. More detailed

information about industrial structure of French franchise market is presented in the Table 1.2:

Table 1.2

Industrial structure of French franchise market, 2018

Industry	Franchise networks	Franchisees	Turnover, bln euros
House equipment	116	3 596	6.98
Personal equipment	378	9 203	5.37
Food	522	22 124	29.02
Various trades	195	7 731	6.16
Auto Services	94	8 581	2.86
Building	60	1 650	1.39
Cleaning	26	399	0.08
Hairstyle and Beauty	146	6 582	1.92
Other Personal services	217	5 986	2.08
Business services	127	2 573	1.08
Training	29	330	0.07
Hotels	28	2 105	2.88
Real Estate	57	3 659	1.5
Travel	9	674	0.62

Source: French Franchise Association [16]

As the data shows, the absolute leadership both in being franchisor and franchisee belongs to food industry with the biggest turnover of 29.02 billion euros. The smallest share by the number of franchise networks has the travelling segment including 9 entities. By the number of franchisees cleaning segment is represented with the smallest number of entities – 399, and the smallest turnover belongs to training segment – 0.07 billion euros.

According to top 500 European franchise rating it is necessary to mention, that 115 out of 500 franchises belong to France [17]. It is the indicator of wide French franchise spreading all over the world. The most spreading sectors are Health & Beauty, Food (both restaurants and supermarkets) and Retail (mostly clothing). Such success of this business model connected with good economic environment: a large and developed market, a good

territorial position and high standards of living of the population. In addition, franchising in France performs a social role, helping to overcome the unemployment problem in the country.

As the global franchising market keeps expanding, it requires the development, improvement and implementation of the modern trends in order to maintain a competitive position on the market. Nowadays the main trends of the franchising development are:

- the growth of the personal services demand;
- the growing macro-influencer's impact;
- the development of employee-to-franchisee programs [5].

The growing macro-influencer impact is connected with the global spreading of social media. Franchise chain have a possibility to collaborate with social influencers in order to boost their sales. The development of employee-to-franchisee programs allow employees to get enough experience to become the franchisee while working in the company. It makes a young entrepreneur to understand better the special aspects of the company's activity and to operate efficiently after becoming a franchisee.

1.2 Analysis of financial and economic activity of McDonald's Ukraine LTD

Financial and economic activity of the company is the main component of its performance. It is important to mention, that McDonald's Corporation, being one of the leading companies in the restaurant business, does not provide an access to full financial statements in order to maintain confidentiality. Therefore, further analysis of the company's activities will be made based on limited data that is freely available with the permission of the company [18]. The company franchises and operates McDonald's restaurants in the global restaurant industry. All restaurants are operated either by the company itself or by franchisees, including conventional franchisees under franchised arrangements, and developmental licensees and foreign affiliates under license agreements. Company is also a world's 2nd largest employer with 1.9 mln. employees worldwide [19]. In order to access company's performance globally, we should estimate the dynamics of restaurants number and analyze under which ownership type they are operated. The Table 1.3 presents restaurant information by an ownership type:

Table 1.3

Number of McDonald's restaurants worldwide, by an ownership type

Ownership type	31.12.2016	31.12.2017	31.12.2018
Conventional franchised	21 559	21 366	21 685
Development licensed	6 300	6 945	7 225
Foreign affiliated	3 371	5 797	6 175
Franchised	31 230	34 108	35 085
Company-operated	5 669	3 133	2 770
Systemwide restaurants	36 899	37 241	37 855

Source: [18]

As the table shows, the total amount of restaurants has a stable growth year by year. At the same time, the number of company-operated restaurants decreased at 52% since 2016 and the total amount of franchised ones are increasing – at 12% since 2016. This is an indicator of the company's franchise orientation [2]. The Figure 1.6 reflects the share of franchised restaurants in the total amount:

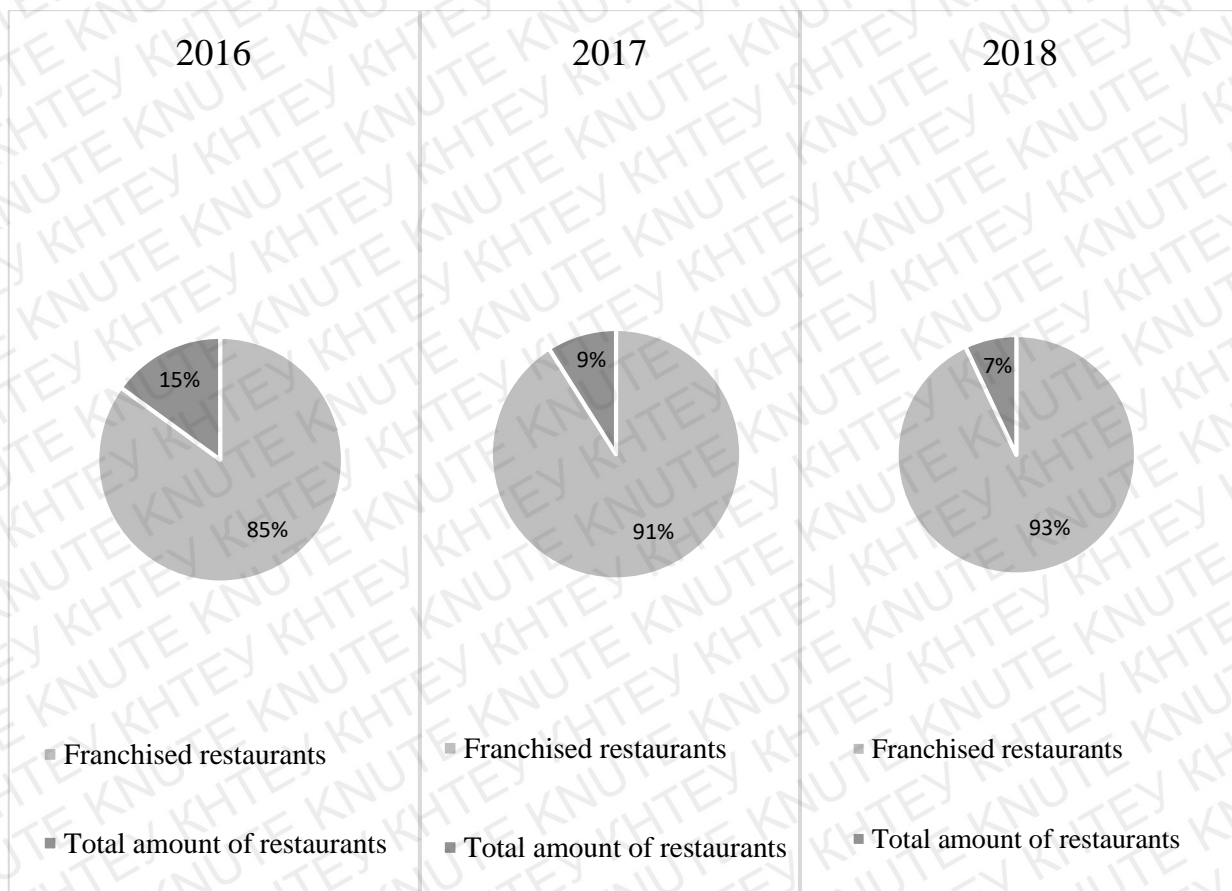


Fig. 1.6 Dynamics of the share of franchised restaurants in total amount worldwide, 2016-2018

Source: developed by the author based on [18]

Consolidated income statement of the McDonald’s company gives a general information about company’s activity worldwide. Moreover, allows analyzing the sales, revenues and income indicators. The Table 1.4 reflects company’s operations globally:

Table 1.4

Consolidated income statement of the McDonald’s company

Consolidated Income Statement, in \$ bln.	2014	2015	2016	2017	2018
Sales by Company-operated restaurants	18 169	16 488	15 295	12 719	10 013
Revenues from franchised restaurants	9 272	8 925	9 327	10 101	11 012
Total revenues	27 441	25 413	24 622	22 820	21 025
Operating income	7 949	7 146	7 745	9 553	8 822
Net income	4 758	4 529	4 687	5 192	5 924

Source: [18]

As the Table 1.4 shows, sales of company-operated restaurants decreased by 45% in 2018 compared to 2014 because of the valuable decrease of the number of such restaurants. At the same time revenues from franchised restaurants increased by 19% because of the share growth of franchised restaurants in the total amount worldwide. Total revenues decreased by 23% due to the disproportionate decrease in the company-operated restaurants and a slight increase in franchised ones. Operating income increased as well as net income- by 11% and 24% respectively. Dynamics of the consolidated income statement indicators is presented in the Figure 1.7:

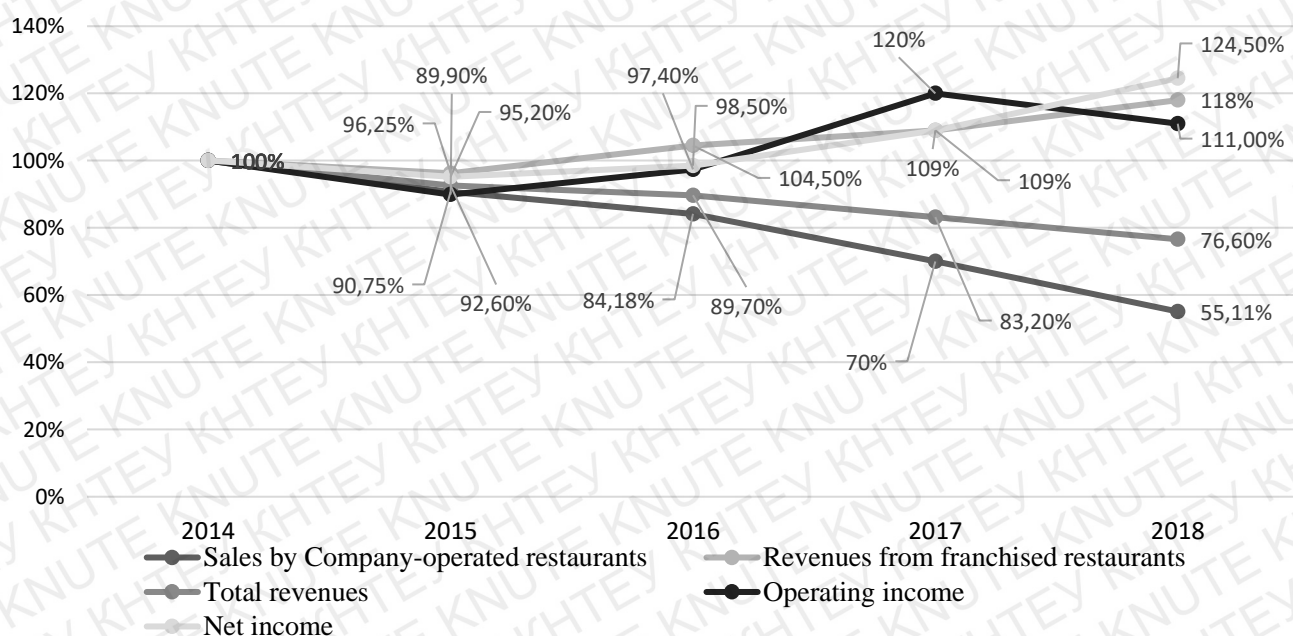


Fig. 1.7 Dynamics of the McDonald’s statement of income, 2014-2018

Source: developed by the author based on [18]

By analyzing the 5 year income statement, we can conclude that the company's total revenues decreased by \$ 6.4 billion (23%) due to a significant decrease in sales of restaurants directly managed by the company. Net income (which is actually the difference between the company's revenue from the sale of products and the cost of its production) increased by 24%, and operating income (reflecting income and expenses for the main activity directly related to the sale of goods) also increased, but not significantly (11%). It can be assumed that net profit as one of the main indicators of company performance was influenced by the following factors: increase in production volume, improvement of product quality, decrease in production cost due to more rational use of resources, etc. Speaking about the McDonalds Ukraine LTD, while analyzing the financial activity of a company, it is important to look through the income statement, which is presented in the Annex A and its dynamics, which is presented in the Table 1.5:

Table 1.5

Dynamics of McDonald's Ukraine LTD income statement indicators, 2014-2018

Indicator		Year				
		2014	2015	2016	2017	2018
Sales revenue	Deviation	50 087 976	52 907 170	60 638 971	66 815 222	66 272 547
	Deviation, %	17.8	5.6	14.6	10.2	-0.8
<i>Cost of goods sold</i>	Deviation	39 408 465	43 446 781	50 995 490	56 148 135	55 831 491
	Deviation, %	17.9	10.3	17.4	10.1	-0.6
Gross profit	Deviation	10 679 511	9 460 389	9 643 481	10 667 087	10 441 056
	Deviation, %	17.2	-11.4	1.9	10.6	-2.1
<i>Operating expenses</i>	Deviation	1 947 974	2 581 575	3 135 630	3 444 344	3 682 770
	Deviation, %	25.5	32.5	21.5	9.8	6.9
Operating profit	Deviation	8 731 537	6 878 814	6 507 851	7 222 743	6 758 286
	Deviation, %	15.5	-21.2	-5.4	11	-6.4

Indicator		Year				
		2014	2015	2016	2017	2018
Net profit before taxes	Deviation	7 114 855	4 382 842	3 711 196	6 094 940	4 288 034
	Deviation, %	14.4	-38.4	-15.3	64.2	-29.6
Taxes	Deviation, %	20%	20%	20%	20%	20%
Net profit after taxes	Deviation	5 691 884	3 506 274	2 968 956	4 875 952	3 430 428
	Deviation, %	14.4	-38.4	-15.3	64.2	-29.6

Source: calculated by the author based on Annex A

As the table shows, revenue for the entire analyzed period increased by 16 184 571 thousand UAH, or 32%. As we see, revenue exceeds cost of goods sold through all the 5 year period, that indicates not only that the company was able to offset the costs of production and sales of products, but also to receive a profit.

Operating profit in 2018 amounted to 6 758 286 thousand UAH. For the entire analyzed period, the operating profit significantly decreased (by 1 973 251 thousand UAH, or by 22.6%). The negative dynamics of this indicator shows that the losses of the company become greater than the revenue necessary to obtain a net profit. This indicator was mostly affected by a significant increase in cost of goods sold - by 42%.

A significant decrease in net profit indicates a decrease in sales, as well as an increase in costs of sales, a possible increase in prices for the company's products, as well as a decrease in labor productivity and the quality of the product.

In order to understand the situation in the company, it is also important to analyze its balance sheet, which is presented in the Annex B. The Table 1.6 presents the dynamics of the key figures of the balance sheet.

Table 1.6

**Dynamics of the key figures of balance sheet of McDonald's Ukraine LTD,
2015-2018**

Balance sheet figure	Deviation indicator	31.12. 2015	31.12. 2016	31.12. 2017	31.12. 2018
Total fixed assets	Absolute deviation	5 405 381	3 360 109	-2 741 354	407 684
	Deviation in %	29.3	14.1	-10	1.6
Total current assets	Absolute deviation	420 358	-79 389	1 658 540	-1 449 151
	Deviation in %	9.6	-1.6	35	-22.7
Total owner's equity	Absolute deviation	831 326	2 548 500	1 402 944	593 161
	Deviation in %	5	14.6	7	2.7
Total long-term liabilities	Absolute deviation	3 605 316	708 348	-4 319 775	3 012 707
	Deviation in %	635	19.3	-98.8	594
Total short-term liabilities	Absolute deviation	1 389 097	23 872	1 834 017	-4 647 335
	Deviation in %	22.6	0.3	24.2	-49.4
Balance	Absolute deviation	5 825 739	3 280 720	-1 082 814	-1 041 467
	Deviation in %	25.5	11.4	-3.4	-3.4

Source: calculated by the author based on Annex B

As the table shows, both fixed and current assets had a positive dynamics from since 2014. Analyzing the liabilities of the company, we see the situation where short-term liabilities decreased, while owner's equity as well as long-term liabilities increased. This situation may indicate that the company managers began to attract more long-term sources of funds. Increasing the volume of long-term loans is the best demonstration of confidence in the company. If company receives long-term loans, then creditors trust the reliability of the company's reputation and assess company's state as stable and promising future profits. A decrease in short-term liabilities is a reduction in financial risks associated with financing activities with unstable sources of capital. However, such a situation may indicate a completely different state of the company. First of all, the company could be denied the extension of short-term lending. If this loan was constantly renewable, the company lost its former stable source of funds. Since the balance remained

unchanged, in order to maintain the amount of funds, the company either attracted a long-term loan or increased the volume of its own sources of financing. This situation can be observed in a critical situation from the point of view of sustainability. While not being able to repay short-term liabilities on time, the company could be re-credited by receiving a long-term loan.

As the Annex 1 shows, increase in the size of the organization's assets and liabilities is mainly due to the growth of the balance sheet indicators, presented in the Table 1.7:

Table 1.7

Dynamics of balance sheet indicators, increased in the size, 2015-2018

Balance sheet indicator	Deviation in %				Total deviation during the analyzed period, in %
	31.12. 2015	31.12. 2016	31.12. 2017	31.12. 2018	
Assets					
Fixed assets	28.9	14	-10.5	1.2	32
Other fixed assets	52.8	25.1	18.4	26.1	185.6
Cash and cash equivalents	-52.6	41.7	-26.9	161.1	28
Liabilities					
Retained earnings	5.6	19.1	7.7	3	36.2
Accounts payable	11.4	9.9	5.5	-7.9	19
Estimated liabilities	4.1	43.5	-8.8	34	82.5

Source: calculated by the author based on Annex B

In addition, while analyzing the financial activity of the company we should assess the value of the owner's equity of the organization. Owner's equity is the real value of the property, the difference between the assets and liabilities of the company. The Table 1.8 reflects the dynamics of the owner's equity and the authorized capital.

Table 1.8

Dynamics of owner's equity and authorized capital, 2014-2018

Indicator	In thousands UAH				
	31.12.2014	31.12.2015	31.12.2016	31.12.2017	31.12.2018
Owner's equity	16 623 860	17 455 186	20 003 686	21 406 630	21 999 791
Authorized capital	1 693 400	1 693 400	1 693 400	1 693 400	1 693 400
The excess of owner's equity over statutory capital	14 930 460	15 761 786	18 310 286	19 713 230	20 306 391

Source: Annex B

The owner's equity of the organization as of December 31, 2018 are 13 times higher than the authorized capital. This ratio positively characterizes the financial position of the company. In addition, it should be noted an increase in owner's equity by 32% over 5 years. The excess of owner's equity over the authorized capital and at the same time their increase over the period indicates a good financial position of the organization. Figure 1.7 shows the dynamics in owner's equity and authorized capital:

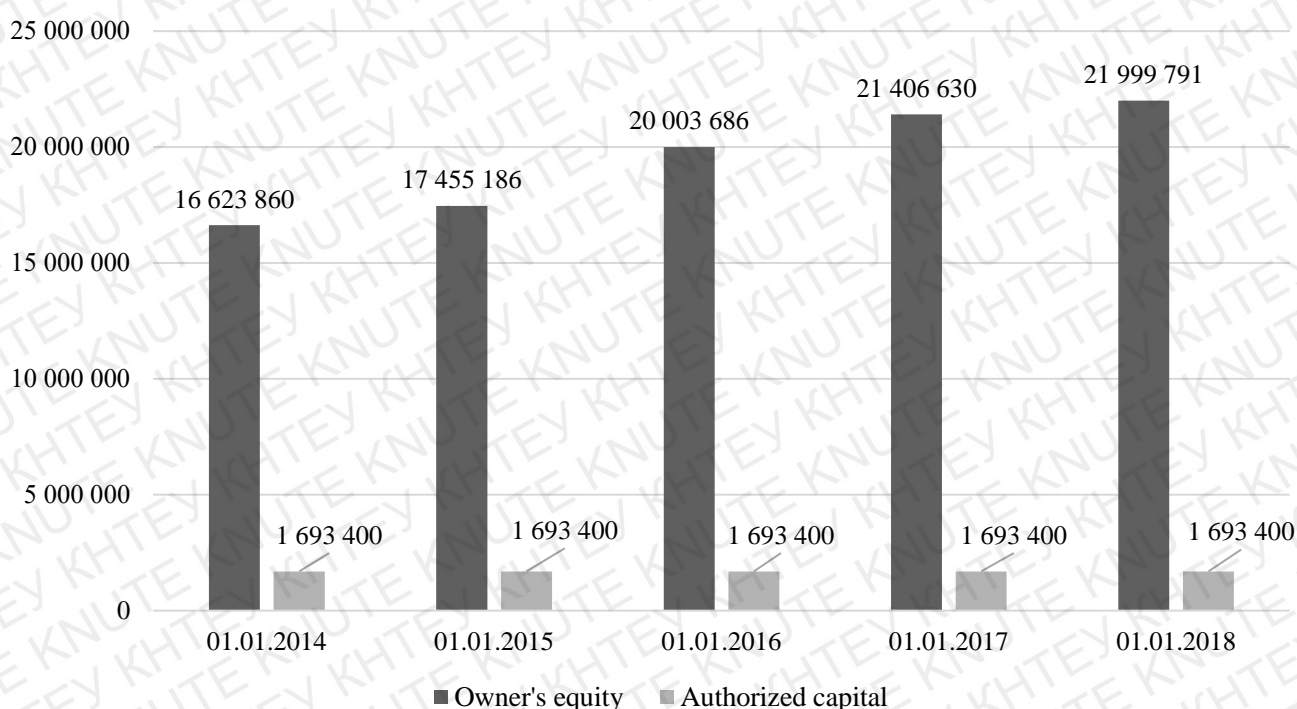


Fig. 1.7 Owner's equity and authorized capital dynamics, 2014-2018

Source: developed by the author based on Annex B

In the short-term period, the criterion for assessing the financial condition of an enterprise is its liquidity and sustainability. The liquidity of an enterprise is its ability to turn its assets into cash to repay short-term liabilities. The following Table 1.9 presents the liquidity ratios of the McDonald's Ukraine LTD:

Table 1.9

Dynamics of McDonald's Ukraine LTD liquidity ratios, 2014-2018

Ratio	2014	2015	2016	2017	2018
Current ratio	0.71	0.63	0.62	0.68	1.04
Acid test ratio	0.6	0.53	0.54	0.62	0.93
Cash ratio	0.24	0.09	0.13	0.08	0.39
Net working capital	-1 762 947	-2 731 686	-2 834 947	-3 010 424	187 760

Source: calculated by the author based on [30]

As the table shows, current ratio does not correspond to the normal value of 1.5-2, which indicates the lack of financial stability of the enterprise. This means that the company is unable to pay its obligations if the payment term for them had come right now. For these purposes, there will not be enough resources and company will have to seek additional financing by selling shares or long-term assets. The acid test ratio also does not correspond to the normal value of 1, that means that the company also can't currently pay back its current liabilities, it's the bad sign for investors and partners. Cash ratio also does not fit the normal 0.2-0.5 value that demonstrates the company's inability to repay its current liabilities from liquid current assets. Only in 2018 the cash ratio was 0.39, that corresponded the recommended value.

For owners of the enterprise, insufficient liquidity can mean a decrease in profitability, loss of control and a partial or complete loss of capital investment. For lenders, insufficient liquidity may mean a delay in payment.

The current state of liquidity of a company may also affect its relations with customers and suppliers. Such a change may result in the inability of the enterprise to fulfill the terms of the contracts and lead to the loss of relations with suppliers.

It is also important to understand whether the company is financially sustainable. Debt ratios show a company's ability to make payments and pay off its long-term debts to creditors, bondholders, and banks.

The most common debt ratios are presented in the Table 1.10:

Table 1.10

Dynamics of McDonald's Ukraine LTD debt ratios, 2014-2018

Ratio	2014	2015	2016	2017	2018
Debt to equity ratio	0.37	0.64	0.6	0.44	0.35
Debt ratio	0.27	0.39	0.37	0.31	0.26
Equity ratio	0.73	0.61	0.63	0.69	0.74

Source: calculated by the author based on [30]

The optimal debt-to-equity ratio is the equal ratio of liabilities and equity, i.e. ratio is 1. With large values of the coefficient, the organization loses its financial independence, and its financial situation becomes extremely unstable. It is more difficult for such organizations to attract additional loans. As we can see, the coefficient over the past 5 years was within the normal range, and slightly decreased - by 0.02. A low debt to equity ratio indicates that investors fund more assets than creditors do.

Debt ratio is within a normal range – 0.4-0.6. As we have a lower debt ratio, it means a more stable business with the potential of longevity. So most of the company's assets are financed through equity.

Normal range of equity ratio is 0.5-0.6 that is lower than the McDonald's equity ratio. A higher equity ratio indicates less risk and financial strength of a company. If a company's equity ratio is high, it finances a greater portion of its assets with equity and a lower portion with debt.

The activity and profitability indicators are analyzed in Part 2 as a part of efficiency assessment of McDonald's Ukraine LTD's activity in the context of the chosen legal form of business.

CONCLUSIONS TO THE PART 1

Taking into account the results of global franchise market study, one may state that the most developed market today is the United States of America with the 40% share of the global franchising market, mostly because of the strong tactics of implementing their ideologies all over the world and significant experience of doing business. Among other markets, it is necessary to mention the Asian region with the 36% share of the global market. It is important to underline the Chinese market as one of the most quickly developing with loyal requirements to the potential franchisees. European region has 18% share of the global franchising market, despite this it has a significant potential. Such markets as French with its activity on the European Union stage, as one of the biggest distribution area are attractive for both foreign and local franchisors. According to industrial structure of the global franchising market, the absolute leader is food industry, mostly because of the international expansion of American brands all over the world.

In accordance with the calculated liquidity indicators of McDonald's Ukraine LTD, we can conclude that all liquidity indicators for the analyzed period did not meet the normal range, despite an increase over 5 years. Thus, we can say that the financial condition of the enterprise can be described as insufficiently liquid.

At the same time, analysis of debt ratios showed that the company has sufficient financial sustainability, so the company is partially able to pay off its payment obligations in time.

Since the concepts of financial sustainability and liquidity are quite close, it should be noted that the second is more capacious. Sustainability depends on the degree of liquidity of the enterprise. At the same time, liquidity characterizes both the current state of settlements and the future. The company may be sustainable, but at the same time have adverse opportunities in the future.

Thus, having analyzed the dynamics of the liquidity and debt ratios of McDonald's Ukraine LTD, we can conclude that the general financial state of the company is not sufficient.

PART 2 EVALUATION OF EFFECTIVENESS OF MCDONALD'S UKRAINE LTD'S ENTRY MODE ON THE UKRAINIAN MARKET

2.1. A comprehensive study of the McDonald's PLC franchising operations practice in international markets.

To understand the system of McDonald's franchising, it is necessary to go back to the roots and understand how this business started and what keys to success led to the worldwide spreading of the McDonald's network.

The history of the McDonald's company began with the brothers Richard and Maurice MacDonald. In 1940, the McDonalds brothers opened a fast food restaurant in San Bernardino. By 1948, the open-air restaurant industry developed at a rapid pace, competitors made themselves felt. Taking into account expenses and incomes, brothers found large losses on dishes, waiters and slow customer service, which led to the accumulation of cars that left without waiting for ordering. Glass dishes, forks and spoons were replaced with plastic plates, cups, equipped with paper bags for garbage. Hamburger size and cost were reduced. The rest of the menu was reduced by 3 times, leaving what was most in demand.

By 1955, the MacDonald Brothers' annual income was about \$ 350,000, and net revenue was \$ 100,000. They are not the first who came up with the idea of cutting costs, by shortening the menu, leaving only the most basic, but they are the first who created a "burger factory". The ability to serve a queue of 20-30 people at rush hour, for a very short period of time - no one could that.

However, the McDonald's brand became world famous because of entrepreneur Ray Crock. It was Ray Crock who suggested that owners of McDonald's expand their business with the help of a franchising system, and the company should be called "McDonald's". Therefore, we can assert that Crock is the founder of the franchising model of doing business [20].

In the 50s, the franchise price was 950 dollars, royalties - 1.9%. The contract with the franchisee was concluded for a period of 20 years.

In 1955, the McDonalds brothers sold the business to Ray Crock for \$ 2.5 million. Taking a loan, the entrepreneur became the owner of the McDonalds brand.

McDonalds franchise included:

- Drawings, building design.
- Permission to use the design and decoration, here also included the golden arches.
- Instructions for the organization of fast food.
- Internship in San Bernardino, for a period of 15 days.
- In some cases, it was allowed to use the name McDonalds.

By 1958 there were 34 restaurants, and by 1959 the number was up to 102. After a successful brand expanding in the USA, company decided to entry foreign markets. The first McDonald's outside the United States opened in 1967 by franchise owners in Canada, Richmond.

Company continued its stable growth, and the biggest one was in the 1990s, with international units increasing from about 3,600 in 1991 to more than 11,000 by 1998. The number of countries with McDonald's outlets doubled from 59 in 1991 to 114 in late 1998. In 1993, company decided to explore a new region – Middle East and opened a first McDonald's Tel Aviv, Israel.

Nowadays McDonald's main mode of entry into the international markets is the use of international franchises where over 92% of restaurants worldwide are owned and run by franchisees. In 2018 the number of McDonald's franchises around the world reported to be 35 085 internationally, and company's strategic plan is to increase the percentage of franchised restaurants up to 95% by selling franchises and with the help of "refranchising" process, which means turning company-operated restaurants into franchised one.

To become a McDonald's franchisee, entrepreneur of corporation has to meet certain requirements that vary for different countries. List of this requirements are provided in the Table 2.1:

Table 2.1

Conditions and initial requirements for obtaining a McDonald's franchise

Condition	Amount
Personal resources, \$	\$ 750.000
Initial investment	\$ 955.708 -\$ 2.290.146

Continuation of the Table 2.1

Condition	Amount
Initial franchise fee, \$	\$ 45.000
Term of training, months	9 - 18
Term of arrangement, years	20
Royalty, % of total sales	4

Source: [18]

General requirements for all potential franchisees are presented in the Figure 2.1:

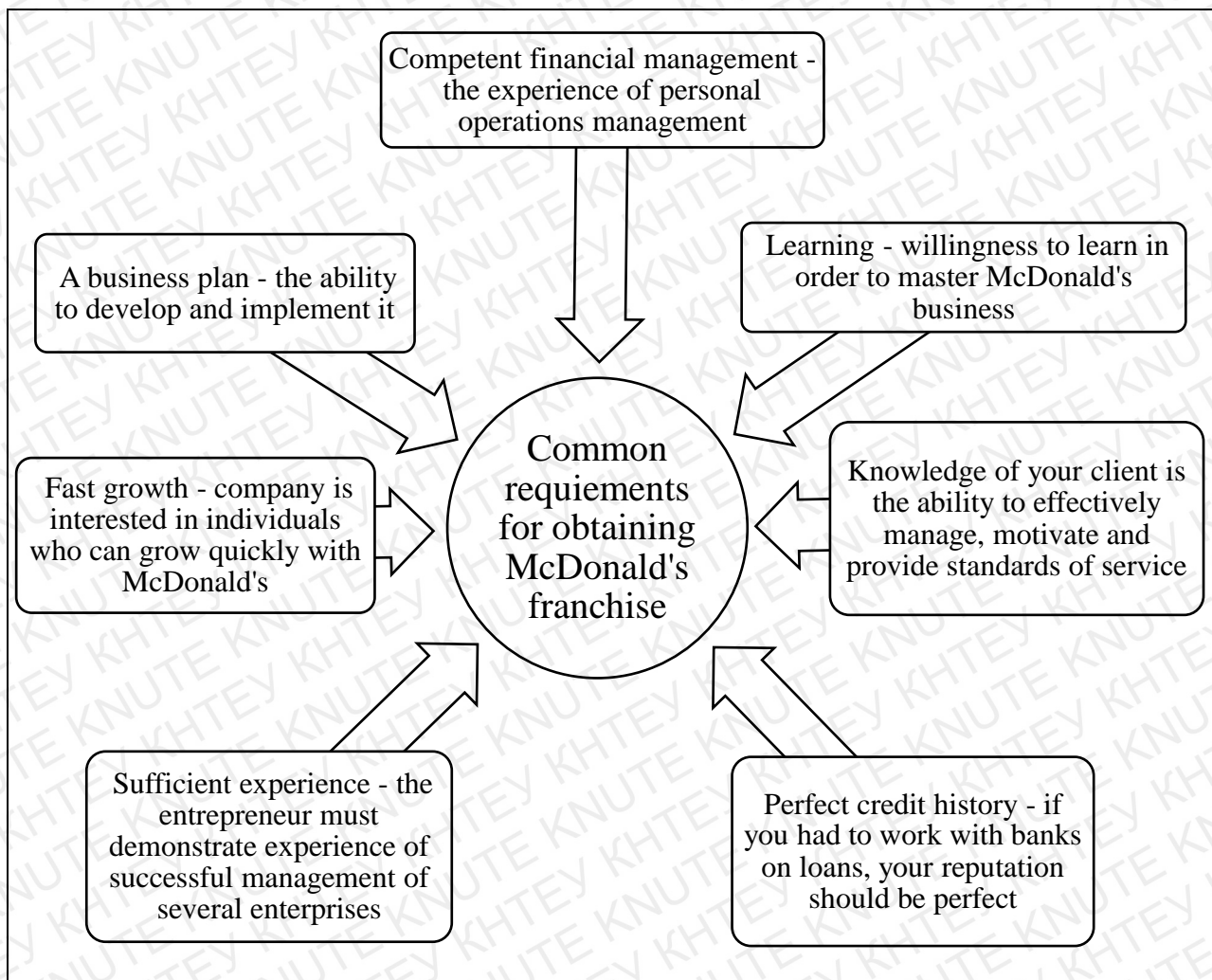


Fig. 2.1 General requirements for obtaining a McDonald's franchise

Source: [18]

As the figure shows, company is looking for an experienced potential franchisee who is able not only to buy a franchise, but also to operate under McDonald's brand name sufficiently, to respect company's philosophy, as well as standards of service.

To evaluate the practice of the McDonald's franchising activity on the international markets properly, we have to take into account different geographical regions in the

world. The main regional representatives of McDonald's company are presented in the Table 2.2:

Table 2.2

Geographical structure of McDonald's franchising operation worldwide, 2018

Region	Number of restaurants, total	Number of franchised restaurants	Share of franchised restaurants, %	Number of employees, thousand
North America				
Canada	1427	1213	85%	200.000
Europe				
Germany	1780	1638	92%	61.230
France	1463	1300	89%	70.000
United Kingdom	1370	1100	81%	120.000
Asia				
Japan	3000	2000	67%	150.000
China	2700	2600	96%	150.000
Middle East				
India	400	400	100%	34.000
Australia	970	776	80%	100.000

Source: McDonald's official sites of these countries [21-28]

As the table shows, the most important markets for McDonald's business activity are European and Asian. We can see that as the company keeps expanding on European market, the more McDonald's restaurants are located in certain country, the more of them are franchised. At the same time, among Asian countries, there are more McDonald's restaurants and, for example, in China there is 96% franchised restaurants, which indicates market attractiveness from the McDonald's point of view.

McDonald's strategy for obtaining foreign markets is to adapt menu and business plans to each culture. It shows that it respects the differences between cultures not only while developing additional items for the menu, but even in the brand name in some countries. For example in Japan, McDonald's brand name is Makudonarudo, which is more attractive for the Japanese consumers because of the direct connection to their culture.

When it comes to the operating process, it is important to understand the sequence of income and expenses generation by the McDonald's as a franchisor, and a franchisee. The Figure 2.2 describes the sequence by McDonald's as a franchisor:

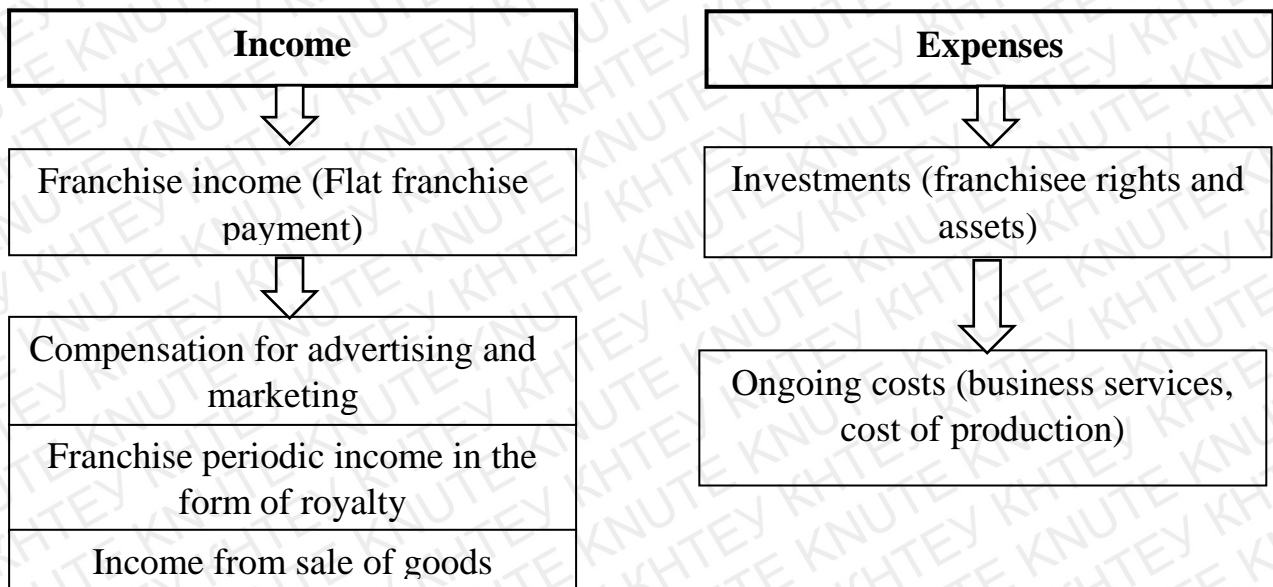


Fig. 2.2 Sequence of income and expenses generation by the McDonald's company
 Source: developed by the author based on [18]

As the figure shows, income that McDonald's company receives can greatly exceed the expenses the company carries. McDonald's as a franchisor gets passive income that comes from the franchisees. Now let's consider the same sequence, but at the franchisee's point of view in the Figure 2.3:

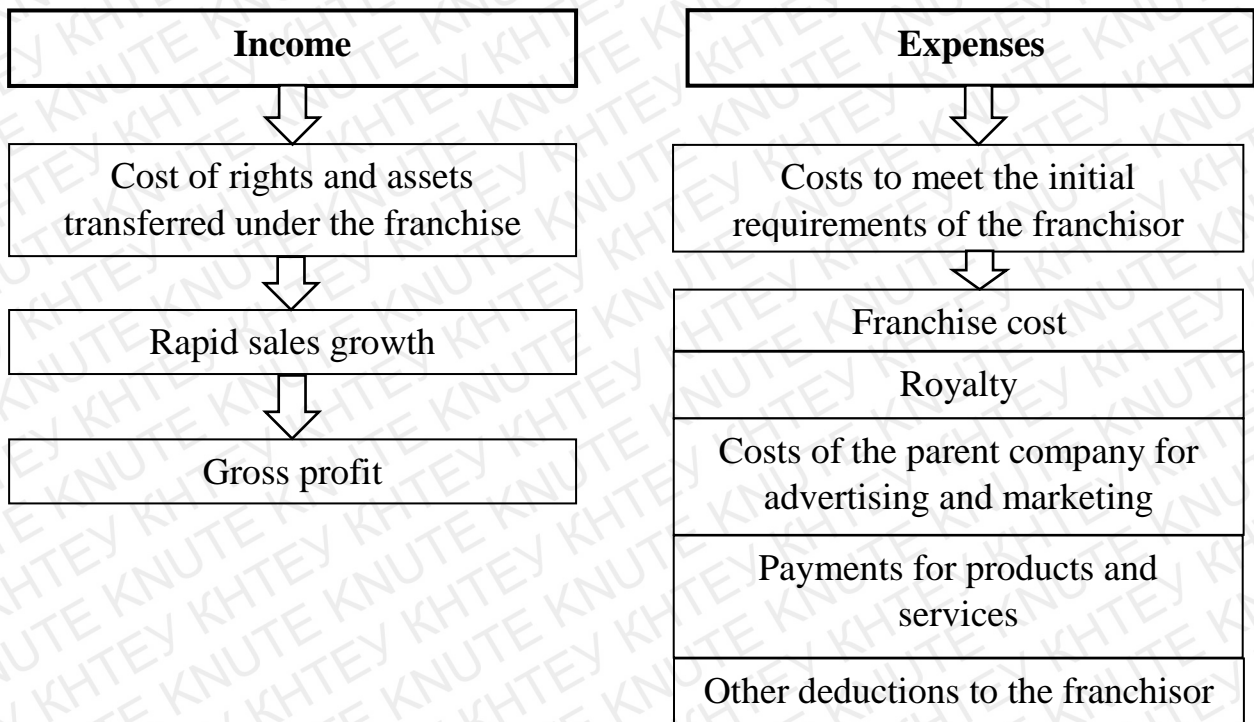


Fig. 2.3 Sequence of income and expenses generation by the franchisee
 Source: developed by the author based on [18]

As the figure shows, despite the number of franchisee's expenses exceeds its income, we can state that operating under the well-known brand guarantees sufficient income and

confirms that not every potential franchisee can meet the initial requirements of the McDonald's company.

The successful functioning of the company is greatly influenced by the organizational structure and strategy of doing business. McDonald's organizational structure reflects a linear functional management model, so functional units have the right to manage lower-level units that is reflected in the Figure 2.4:

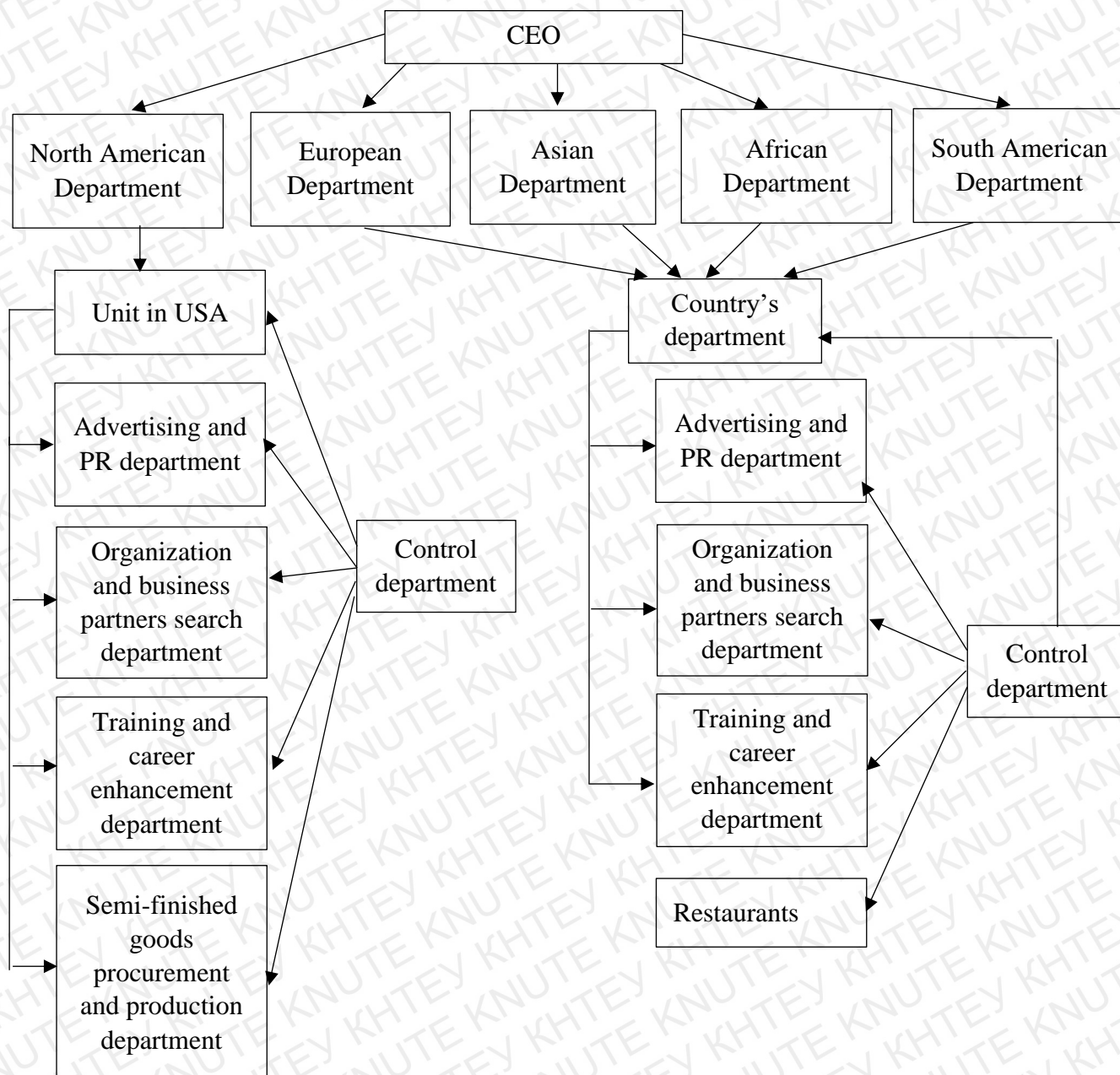


Fig. 2.4 McDonald's corporate organizational structure

Source: [18]

The importance of the role of franchising in entire McDonald's business strategy is determined in the Table 2.3:

Table 2.3

McDonald's business strategies, influencing franchising operations

Strategy	Description
Growth strategy	<ul style="list-style-type: none"> - Developing markets that are not yet covered; - Annual opening of new restaurants, both company-operated and franchised; - Obtaining and maintaining leading positions in the market; - Increasing the number of visitors by offering new and inexpensive menu items, increasing the portion while maintaining the former price; - Installation of children's playgrounds.
Franchising strategy	<ul style="list-style-type: none"> - Obtaining the franchise right only to experienced and competent entrepreneurs with good reputation; - Preparation by the company to promote the brand in the new market.
The strategy of location and construction of restaurants	<ul style="list-style-type: none"> - The location of the restaurants should be convenient for the customers and favorable for the company; - Outside the US strategy is to first open restaurants in downtowns, then arrange car service at McDrive's in remote areas, then explore other areas; - Reducing preparation and construction costs by standardizing and improving the efficiency of projects, consolidated purchases of equipment and building materials through a global supply system.
Product range strategy	<ul style="list-style-type: none"> - Limited meal offer; - Improving the taste of the offered dishes; - Quick introduction of new potentially popular dishes and quick withdrawal of those dishes that are not popular.
The strategy of organizing the work of restaurants	<ul style="list-style-type: none"> - Strict adherence to quality standards, sanitary condition of premises and equipment, organization of service, work of employees.
Marketing and sales strategy	<ul style="list-style-type: none"> - Promoting McDonald's image as an example of quality, purity and high consumer value through an active advertising campaign in the media and special events; - Promotion is funded by the profits of restaurants.

Source: [18]

As the table shows, franchising plays a vital role in the entire business strategy of a company. As McDonald's main aim is to maintain leading positions on the markets, franchising is the most suitable way to achieve this goal by having minimum costs, strong brand reputation, strict control and effective promotion.

2.2. Assessment the efficiency of McDonald's Ukraine LTD's activity in the context of the chosen legal form of business

The effectiveness of the enterprise functioning is largely based on its business activity, which depends on the markets for product sales, its business reputation, the degree of implementation of the plan on the main indicators of economic activity, the level of resource efficiency and stability of economic growth. Indicators of business activity help to understand how the enterprise efficiently and rationally uses its own resources.

Thus, the analysis of business activity is an integral part of the analysis of the enterprise. The main source of information for the analysis of business activity is the balance sheet of the enterprise and the financial results report. Business activity analysis includes investigation the levels and dynamics of different turnover ratios. The Table 2.4 presents the turnover ratios:

Table 2.4

Dynamics of McDonald's Ukraine LTD activity ratios, 2014-2018

Ratio	2014	2015	2016	2017	2018
Asset turnover ratio	0.21	0.10	0.81	0.15	0.10
Working capital ratio	1.18	0.66	0.46	0.78	0.58
Accounts receivable turnover ratio	1.99	0.98	0.62	1.15	1.13
Accounts payable turnover ratio	1.44	0.75	0.57	0.99	0.68
Stocks turnover ratio	120.2	113.6	119.4	121.1	115.5
Stocks turnover ratio, in days	3	3	3	3	3
Turnover ratio of fixed assets	0.26	0.13	0.01	0.18	0.12
Equity turnover ratio	0.32	0.17	0.12	0.20	0.13

Source: calculated by the author based on [30]

As the table shows, all the turnover ratios have decreased, that is not acceptable for proper activity of the company. Asset turnover ratio indicates that company does not use its assets efficiently and cannot generate sales from them. A valuable working capital ratio decrease shows that the company is likely to have liquidity problems in case of future ratio decreasing. Accounts receivable turnover ratio in 2014 showed that the company

collected receivables 2 times per year, and in 2018, it took approximately 10 months for company to pay obligations. As the accounts payable turnover ratio indicates the opportunity to have favorable terms of credit, we can make a conclusion that from the creditors and suppliers point of view company is not able to pay the bills quickly enough. Stocks turnover ratio gives us an opportunity to estimate the company’s effectiveness of selling goods and demand on these goods. As we see, this ratio is very high, that means that the company is able to turn its stocks into cash every 3 days. Due to this indicator, we can say that company uses the additional money to open new restaurants and increase marketing support. Turnover ratio of fixed assets as of 2018 shows, that the company is using its fixed assets not so efficient, as it did in 2014 that is also not a good indicator for company’s activity. Equity turnover ratio indicates that company does not sufficiently uses its equity to generate revenue from capital and reserves.

Graphical representation of the activity dynamics is reflected in the Figure 2.5:

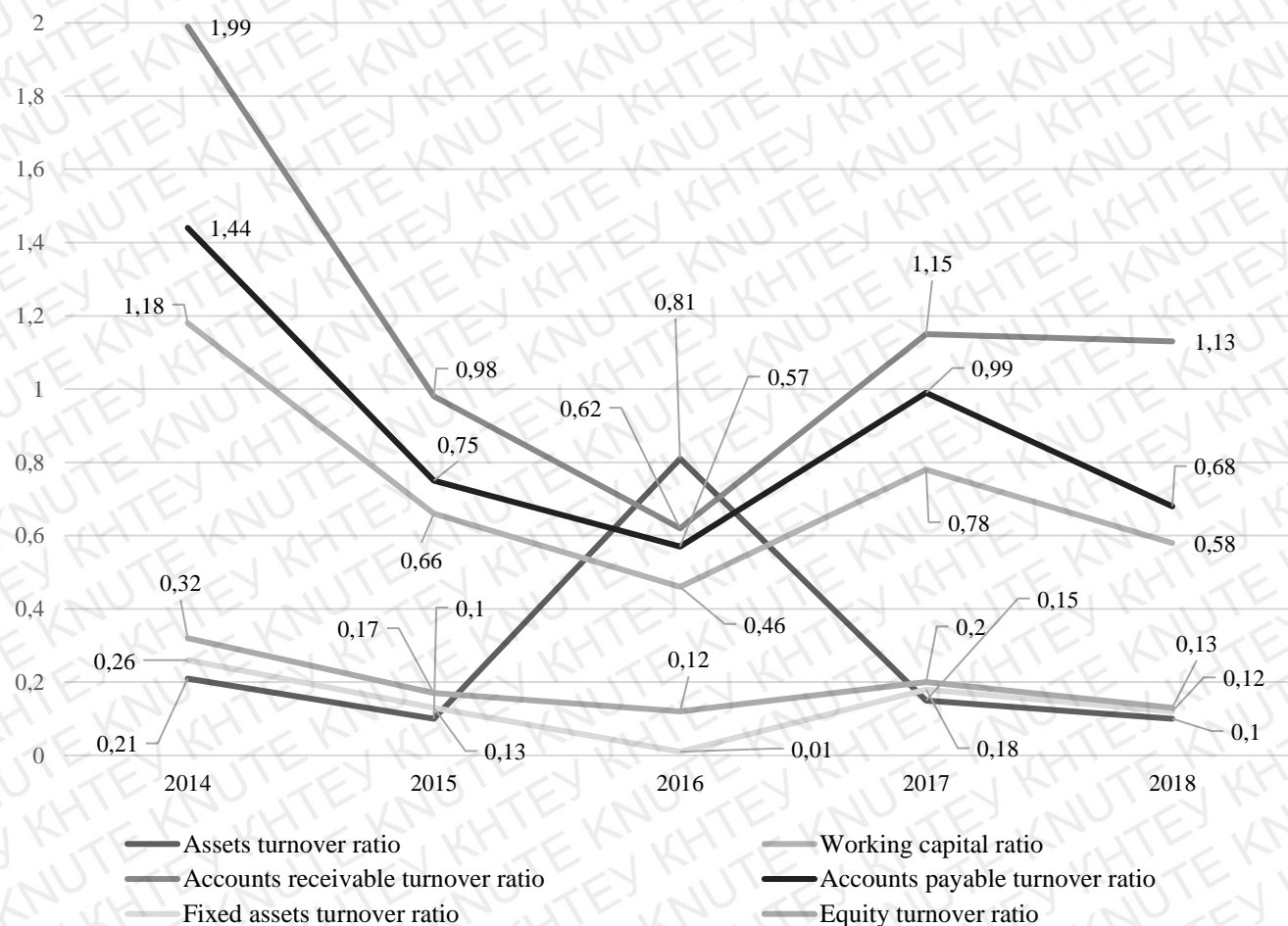


Fig. 2.5 Dynamics of activity ratios of McDonald’s Ukraine LTD, 2014-2018

Source: developed by the author based on [30]

Analysis of the business activity of the enterprise allows to study the state of its capital in the process of its circulation, to identify the ability of the company to stable functioning and development. Owners analyze financial statements to ensure the stability of the firm. Lenders and investors analyze financial statements to minimize their risks on loans and deposits [10].

The degree of effectiveness of the use of material, labor, monetary and other resources comprehensively reflects the profitability of the enterprise. The main profitability indicators are presented in the Table 2.5:

Table 2.5

Dynamics of the McDonald's Ukraine LTD profitability indicators, 2014-2018, %

Indicator	2014	2015	2016	2017	2018
Gross profit margin	0.21	0.18	0.16	0.16	0.15
Operating income margin	0.17	0.13	0.11	0.11	0.10
Return on assets	0.25	0.12	0.09	0.16	0.11
Return on equity	0.34	0.20	0.15	0.23	0.16

Source: calculated by the author based on [30]

As the table shows, gross profit margin decreased during the analyzed period that indicates that cost of goods sold increased faster than the revenue. Operating income margin slightly decreased. The value of this indicator of 0.1 means that 90 kopykas on every hryvnia are used to pay costs and only 10 kopykas cover non-operating expenses. Decrease of the return on assets indicates that the company is not making enough income from using its assets. This indicator is important for investors, because it shows if the company uses its resources efficiently. Decrease in return on equity means that the company is not very efficient in generating profit. ROE is an indicator for investors that allows them to see how effectively a company's management uses investors' money. As many investors look for a ROE of at least 20 %, we can make a conclusion, that as for 2018, company will not be profitable from the investors' point of view.

Graphical representation of the profitability indicators dynamics is reflected in the Figure 2.6:

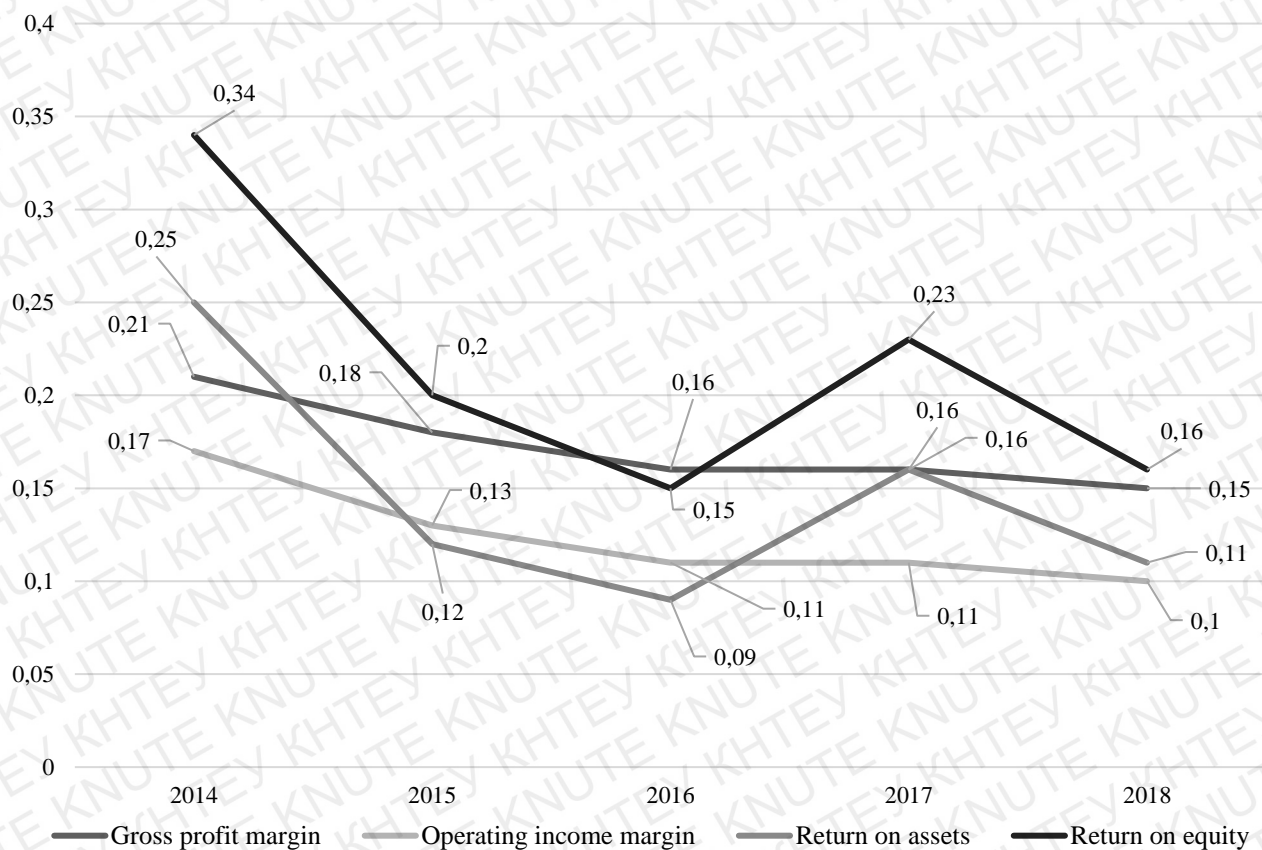


Fig. 2.6 Profitability indicators dynamics, 2014-2018

Source: developed by the author based on [30]

The profitability analysis is necessary for an assessment of the effectiveness of the enterprise. Absolute indicators, such as profit and cost, do not give a real picture of the results of the enterprise, they show only the effect of production. Profitability allows to evaluate how well the property and resources of the company are used.

Profitability that is calculated over several years reflects the dynamics of performance and can become the basis for medium- and long-term planning. Particular attention must be paid to the profitability of fixed assets, as they occupy a large share in the property of the organization and are often are used inefficiently.

Having analyzed all the indicators above, we can make a conclusion that McDonald's Ukraine LTD is not profitable enough.

In order to carry out a qualitative analysis of the internal and external environment it is reasonable to make a SWOT analysis. It is a method of assessing the strengths and weaknesses of an organization, its opportunities and threats. The McDonald's Ukraine LTD's SWOT analysis is presented in the Table 2.6:

Table 2.6

SWOT analysis of McDonald's Ukraine LTD

Strengths	Weaknesses
<ul style="list-style-type: none"> - One of the most valuable brands - Company owns real estate - Discounts - Additional services - Product quality control - Employee training - System of staff material incentive - Company presents technology innovations, for example self-service kiosks and mobile applications 	<ul style="list-style-type: none"> - Low product diversification - Interruption of supply chains - High turnover of staff - Weak marketing policy
Opportunities	Threats
<ul style="list-style-type: none"> - Rebuilding the brand image by adding more healthy menu items - Emergence of new domestic suppliers - Some restaurants can be moved to more luxurious places and a separate pricing policy can be developed for them - Profitable changes in the exchange rate - Lack of strong competitors - Cheapening of raw materials - Change in taxation in a direction that is more beneficial for business 	<ul style="list-style-type: none"> - Increasing number of competitors restaurants (KFC, Star Burger, Fresh Line) - Unstable income of population - Healthy lifestyle trend emergence - Unstable political situation in the country

Source: developed by the author based on [30]

It can be concluded that McDonald's Ukraine LTD should pay particular attention to reducing the high turnover of staff, so it will be able to reduce expenses on the training programs. If possible, to expand the product range with healthy menu items in order to support healthy lifestyle trend. Also, maintain the high quality of company's products and develop a strategy for efficient advertising campaign.

CONCLUSIONS TO THE PART 2

After analyzing McDonald's PLC's practice of franchising operations on international markets it can be concluded, that franchising itself is the most priority goal for company to enter foreign markets, to achieve the 95% share of franchise-operated restaurants. Despite that company is franchise-oriented it prefers not only to sell standardized products through franchises, but also to adapt them due to the local preferences of customers.

Investigation of McDonald's Ukraine LTD's turnover ratios showed, that company's business activity deteriorated over the analyzed period. McDonald's Ukraine LTD is not using its assets and equity effectively in order to receive revenue. Accounts payable and accounts receivable turnover ratios show, that accounts receivable exceeds payable one that is a good indicator, at the same time decrease of accounts payable indicates not an increase in the rate of payment of a company's debt, but an increase in purchases on credit.

Analysis of the profitability indicators showed, that despite the decrease of product gross margin during the analyzed period, company is suffering from increasing taxes, commercial, administrative and other expenses, which is also influencing production profitability indicators by increasing the cost of sales. The optimal way of increasing profitability as one of the main indicators of company's financial performance in my opinion is change of entry mode method on franchising. It will allow reducing various expenses that will transfer to franchisor. Despite the high cost of the franchise and strict control of standards, the payback is at an extremely high level due to the strong brand and good reputation of the company.

Assessment of internal and external environment of McDonald's Ukraine LTD through SWOT analysis showed, that the company's weak points are low qualification and high turnover of staff, as well as price competition. Franchising can benefit the company for example through reducing taxes, since tax rate for residents of Ukraine is lower, than for non-residents. It will allow company to obtain a competitive price position among business rivals.

PART 3. RECOMMENDATIONS FOR IMPROVING MCDONALD'S UKRAINE LTD BUSINESS ACTIVITIES IN THE CONTEXT OF FRANCHISING OPERATIONS

3.1. The rationale of franchising as a form of business in modern conditions

Franchising can be implemented in various forms depending on how responsibilities are distributed between the franchisor and the franchisee. That is why there are the following forms of franchising organization:

- direct;
- consistent;
- territory development;
- sub-franchising;
- master franchising [3].

Direct franchising provides direct communication between the franchisor and the franchisee, who enter into an agreement to open one outlet for the sale of a particular product or service. The franchisor himself is engaged in the supply of products, staff training, consulting, and the marketing and advertising policies of the manufacturer. Franchisor also monitors compliance of established rules for the sale of goods. This model is convenient to use when both parties are geographically close to each other, for example, within the same region or country. In the case of being at a valuable distance, it becomes more difficult to provide control. Therefore, the franchisor often seeks the help of intermediaries. For this purpose, the following franchising models are used:

- Consistent franchising provides gradual conclusion of contracts for the opening of several franchised entities, but only after the franchisee can prove on the example of one working entity conscientious fulfillment of all the conditions of the agreement.
- Territory development. This form of cooperation involves the large-scale development of a certain territory. In this case, area developer acts as a franchisee. Based on the agreement, area developer is obliged to open a certain number of outlets for the sale of franchisor products or services in a certain territory within a defined period. At the same time, area developer does not have the right to use the technologies and trademark of the

franchisor. This form of cooperation allows the franchisor to delegate management and control functions to an intermediary, but at the same time achieve the set goals for expanding sales markets.

- Sub-franchising involves transfer by the franchisor a part of the franchisee's rights. Such delegated rights may include the right to resell the franchise to third parties. This allows expanding the possible territory of coverage, as well as shift to the franchisee part of the responsibility for the development of the network in the regions. In this case, all income and royalties are divided between the franchisee and the franchisor.
- Master franchising involves transfer of all possible franchisee rights to develop a brand network in a certain territory. Sometimes entrepreneur gets all the rights and obligations in the region, receiving the status of a master franchisee, who can sell the franchise within the contractual territory without additional permissions from the franchisor. This territory may be limited to a city, region, country or even a group of countries. This form of interaction helps the brand to expand its influence in other countries in which doing business is significantly different from the usual franchisor in their country. A well-developed network helps to increase the value of a brand, and increase prices for services or goods. The general franchising scheme is reflected in the Figure 3.1:

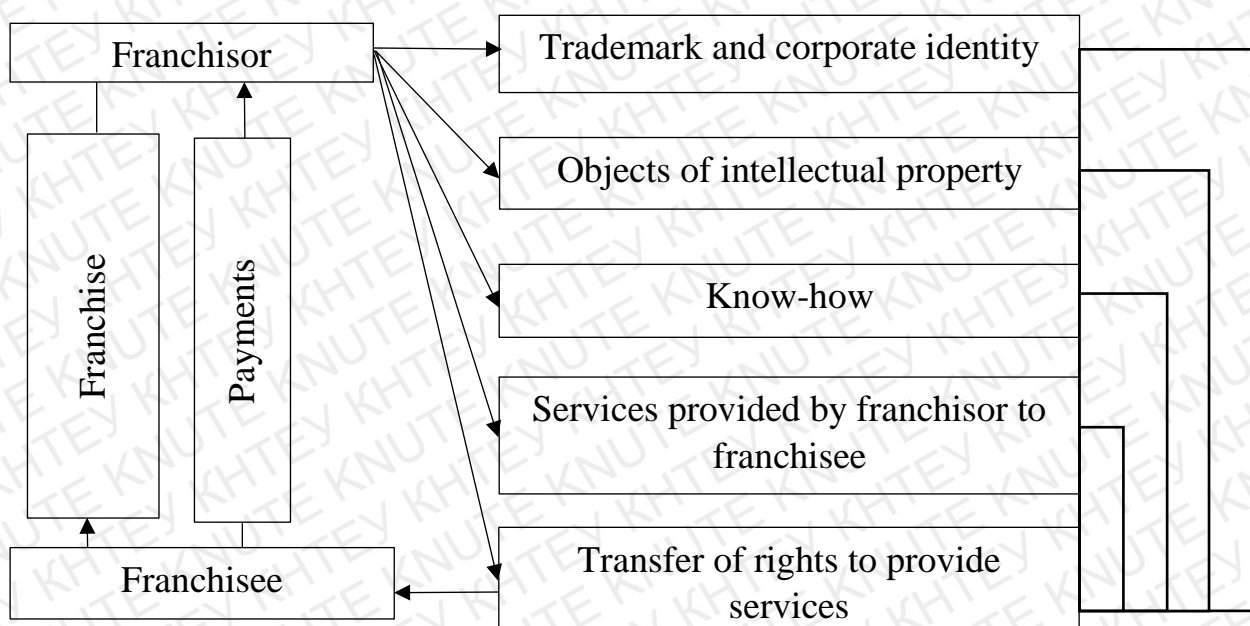


Fig. 3.1 General scheme of franchising

Source: developed by the author based on [6]

Franchise payments can be:

- franchise fee, initial payment - fixed in the agreement between the franchisor and the franchisee the purchase price of the franchise;
- royalties - periodic payments that depend on sales;
- payments for products and services provided by the franchisor;
- other payments of franchisee.

According to statistics, more than one and a half million enterprises in the world operate under franchise system. In Ukraine, this figure is more than 700 companies [29]. The franchising business model has gained high popularity due to its sustainability. Despite the financial crisis, the franchised business survived it most easily.

The main feature of doing business in the franchising system is that the franchisee must comply with all the requirements of the franchisor. However, in the conditions of fierce competition, it is still easier to follow proven business schemes that really work and make a profit.

After becoming the franchise owner, franchisees do not need to think about many organizational, legal and marketing issues. In addition, there is no need to bear the additional costs of developing a brand, corporate identity, advertising, conducting market research because these issues have already been successfully resolved and implemented by the franchisor. It is also important to mention that there is an opportunity to take part in major marketing projects, various developments to modernize and improve the quality of the brand [6].

World practice has shown that franchising is able to form a certain hierarchy of benefits from the level of state economy to the level of consumers of restaurant services.

Thus, at the state level, franchising promotes:

- growth of investments into the state economy;
- formation and enhancement of the general culture of entrepreneurship;
- creation of new jobs;
- acquisition of new ideas, methods and technologies in business;
- creation of a comprehensive system of practical training for small business.

At the industry level, franchising can provide:

- enhancing healthy competition between business entities;
- increase in the level of consumer security by the enterprises of the restaurant industry and their places;
- improvement of the restaurant business quality level;
- coverage of restaurant services in social orientation, such as: school meals, student meals, food in industrial enterprises, offices, treatment establishments, etc. [11]

Consumers of restaurant services will benefit from the development of franchising in Ukraine with the possibility of a wide choice of restaurant services that will meet their requirements in quality and price, interest in visiting restaurants of the same network as a result of the implementation of loyalty programs and enhancement of the general level of food culture through acquaintance with national cuisines, culinary traditions of foreign countries.

As a business concept, franchising has the following benefits for the franchisor:

- is an additional source of income;
- allows to expand business with minimal (due to the use of franchisor opportunities) costs;
- provides a minimal and specific (due to the content of the franchise) degree of involvement in solving the problems of the franchisee's business.

However, franchising has drawbacks. For a franchisor these are:

- less percentage of gross profit, than if the franchisee was a subsidiary;
- the problem of reporting reliability and complexity of control of franchisee activity;
- the risk of compromising the entire franchise network with the wrong actions of individual franchisees;
- the difficulty of maintaining business secrecy as the franchise network grows;
- the risk of the franchisee becoming a competitor after the development of assets and experience transferred to them.

The benefits of franchising for a franchisee are:

- fast and successful starting a business due to the franchisor's experience and assets;
- improving the efficiency and ongoing support of an existing business by leveraging the franchisor's reputation, as well as its entrepreneurial, production and intellectual potential;

- credit enhancement, since the presence of a franchise is regarded as an additional guarantee by banks;
- reducing bankruptcy risk through the opportunities of the franchisor and the franchise network;
- segmentation of business areas within the franchise network, which eliminates competition between its elements (franchisees).

The disadvantages of franchising for a franchisee are:

- ability to use the brand, experience and assets of the parent company only during the franchise period;
- obligation to observe a large number of baseline conditions and restrictions on current activities;
- costs (fine) in the case of termination of contractual relations with the franchisor;
- possibility of an unforeseen change in the conditions of the franchise in case of company's sale of its business [6].

The development of franchising in Ukraine is influenced by certain factors that can also be divided into hierarchical levels that are presented in the Table 3.1:

Table 3.1

Factors influencing the franchising development in Ukraine

Hierarchical level	Factors
State	<ul style="list-style-type: none"> • the imperfection of the legal framework of franchising; • absence of the franchise development program as a component of the state program for supporting small and medium-sized businesses; • insufficient number of consulting and marketing companies capable of providing qualified assistance to potential franchisors and franchisees; • lack of motivational mechanisms to increase entrepreneurs' interest in franchising;
Industry	<ul style="list-style-type: none"> • insufficient number of well-known brands in the restaurant business; • low level of business culture in the business environment; • lack of effective mechanisms for standardization and certification of restaurant services

Hierarchical level	Factors
Franchisor	<ul style="list-style-type: none"> • lack of professional franchisees who have the necessary knowledge, skills and experience in the restaurant business; • complexity of network strategic management; • concern about the risk of damaging the brand, reducing its reputation as the result of not effective work of franchisees, violations of quality and service standards.
Franchisee	<ul style="list-style-type: none"> • insufficient amount of equity; • the unwillingness of restrictions on the actions of the franchisor; • insufficient awareness of franchising features; • high risk of business creation in the regions of Ukraine, where despite the level of competition is lower, the level of income of the population is much lower too (than in capital of Ukraine).

Source: developed by the author based on [1]

Despite the obvious advantages, confidence in franchising is only emerging in Ukraine. However, the economy of Ukraine is dynamically developing and it is now possible to open a business based on franchising. Not every entrepreneur can afford a large marketing budget and serious investment in brand promotion. Therefore, many entrepreneurs prefer to buy franchises – the rights to use a well-known brand. In this case benefits both franchisees and franchisors who own the brand. A franchise gives the entrepreneur a way to maximize his revenue by selling a well-known brand.

The most attractive aspect of franchises to the entrepreneur is the possibility to maximize the revenue he can earn selling the same brand across different locations. However, some investors make a mistake by following a 'little known' brand, which eventually has a negative impact on business. As a result, I think that franchising can be used as an efficient solution. Typically, the value of a franchised business is linked to the brand it represents. Over time, a brand's value will grow, sometimes rapidly, and the more it can be supported by a large franchise network, the more valuable it will be.

3.2. Forecast of the effect of proposed recommendations

The analysis of McDonald's Ukraine LTD's financial activity showed that the company's performance is not sufficient as subsidiary that is why it has to change the entry mode to Ukrainian market. Transition to franchising as McDonald's Ukraine LTD's method of doing business could be done within the confines of retrenchment strategy, which allows reducing expenses in order to have more stable financial position of a company. As the parent company invested about \$ 225 million during the activity on Ukrainian market to purchase various assets – territory, real estate, farms etc., after the embodiment of retrenchment strategy the amount of these assets become available to invest into the franchising network development. The most appropriate alternative is to develop franchising restaurants in the Ukrainian cities with population less than 1 million population, at the same time to leave company-operated restaurants in those cities that have more than 1 million inhabitants. The Table 3.2 shows the amount of restaurants per city:

Table 3.2

Number of existing McDonald's Ukraine LTD's restaurants in 2018, per city

City	Number of restaurants	Population
Kyiv	40	3 000 000
Kharkiv	10	1 446 107
Dnipro	8	1 000 576
Odessa	7	1 011 494
Lviv	5	724 713
Zaporizhia	2	738 728
Kryvyi Rih	2	628 481
Vinnitsia	2	372 432
Cherkasy	2	277 082
Brovary	1	107 595
Mykolaiv	1	485 064
Poltava	1	288 324
Chernihiv	1	287 490
Zhytomyr	1	265 559
Sumy	1	266 600

Continuation of the Table 3.2

City	Number of restaurants	Population
Kremenchuk	1	219 382
Rivne	1	246 216
Ternopil	1	222 491
Kherson	1	291 428
Boryspil	1	62 838

Source: [30]

As Ukrainian market can be classified as risky one, it will be rational to first use franchising in the cities that are less strategic important for the company and at the same time to give local entrepreneurs, who know the current market situation better an opportunity to develop business. Operating under franchise in the cities with less than 1 million population will benefit both franchisor and franchisee. For parent company, it is an opportunity to test a franchise model with less risk in case of unpredictable occasions affecting company's activity, and for franchisee – an opportunity to operate under the famous brand and maintain leadership position on the local market.

Transition to franchising of the whole restaurant network of McDonald's Ukraine LTD can also take place. Operating under franchise in the big Ukrainian cities can have the following advantages:

- bigger rental payment from franchisee to franchisor;
- payback period for franchises in big cities is faster compared to small cities;
- the ability to test special menu items in some restaurants in big cities

At the same time, there are disadvantages of implementing franchising in big cities:

- consumers are more exacting;
- bigger advertising costs;
- more competitors;
- franchisor receives less profit due to transition to % of sales;
- more staff costs

That is why from the economic point of view such cities as Kyiv, Kharkiv, Dnipro, Odessa and Lviv where approximately 78% of restaurants are located, will not have

necessity to operate under franchise, because parent company receives more profit due to higher quality of local population’s life.

Parent company can use a practice of European Union market, but with smaller share of franchised restaurants in order to minimize various risks. In the case of efficient franchising model, all the restaurants of network can be transferred to this method of doing business.

In addition, we have to take into consideration that according to Ukrainian legislation, profit tax rate for non-residents of Ukraine is 20%, but in the situation of franchising activity, when franchisee has to pay royalty, the tax rate is 15%. The figure 3.2 shows the forecast dynamics of net profit before and after taxes carried by company-operated and franchised restaurants.

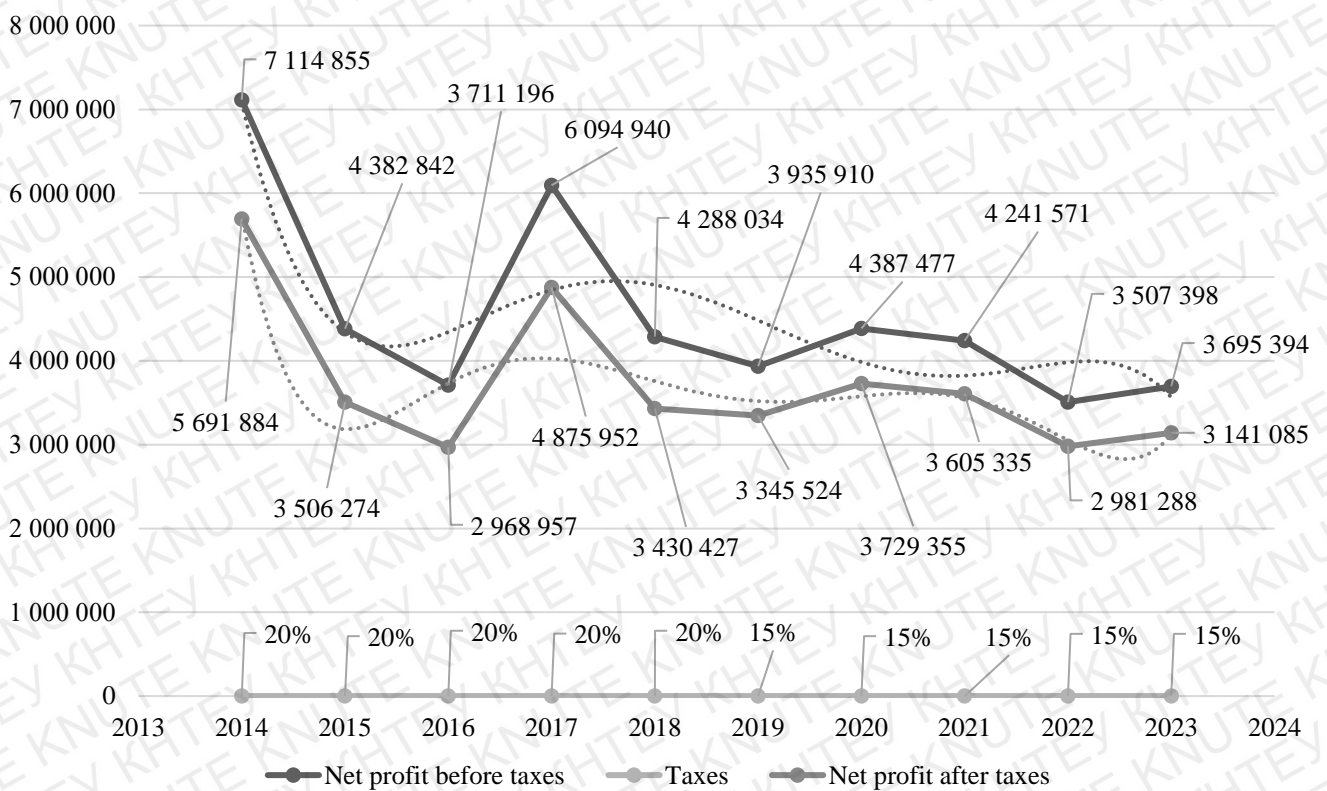


Fig. 3.2 Forecast of McDonald’s Ukraine LTD’s net profit before taxes and net profit after taxes
Source: developed by the author based on [30]

As the forecast show, with reducing taxes, net income will increase, but we have to take into consideration, that this figure shows dynamics of the entire restaurants in the situation of transition to franchising. In addition, it does not taking into account that some

expenses will transfer to franchisor as expenses are different for various cities. However, after reducing expenses, net profit is going to increase more.

In addition, it is important to understand whether it makes economic sense for actual McDonald's Ukraine LTD's activity in the Ukrainian market. The most effective indicator is the bankruptcy risk for enterprise.

To analyze the risk of bankruptcy we will use the Altman Z-score, that is one of the tools for forecasting it. In this case, we will use a 4-factor model for private non-manufacturing companies:

$$Z\text{-score} = 6.56 T_1 + 3.26 T_2 + 6.72 T_3 + 1.05 T_4$$

We will compare score of 2018 and 2023 year, data is presented in the Table 3.3:

Table 3.3

Altman Z-score indicators, 2018-2023

Ratio	T1	T2	T3	T4	Altman Z-score
Calculation	(Current assets – current liabilities / Total assets	Retained earnings / Total assets	EBIT/Total assets	Equity / Total liabilities	
Weighting factor	6.56	3.26	6.72	1.05	
Ratio value, 2018	0.006	0.680	0.148	2.815	6.21
Ratio value, 2019	-0.028	0.659	0.131	2.449	5.41
Ratio value, 2020	0.003	0.711	0.142	3.206	6.66
Ratio value, 2021	0.032	0.739	1.132	3.756	7.45
Ratio value, 2022	0.055	0.750	0.105	3.990	7.71
Ratio value, 2023	0.058	0.770	0.107	4.458	8.30

Source: calculated by the author based on Annex B

Discrimination ranges:

- 1.1 or less – “Distress” zone
- From 1.1 to 2.6 – “Grey” zone
- 2.6 or more – “Safe” zone.

According to calculations, on 2018, the Z-score equaled 6.21 for McDonald's Ukraine LTD. It means that the probability of McDonalds' bankruptcy is insignificant. At the same time, forecast for the following years till 2023 shows, that the company's Z-

score is going to increase, compared to 2018, and in 2023 is going to be 8.30 which means, that the risk of company's bankruptcy is minimal.

Another bankruptcy forecast algorithm is Taffler Model, which has the following formula:

$$Z = 0.53 x_1 + 0.13 x_2 + 0.18x_3 + 0.16x_4$$

We will also compare score of 2018 and 2023 year, data is presented in the Table 3.4:

Table 3.4

Taffler model indicators, 2018-2023

Ratio	X1	X2	X3	X4	Taffler Z-score
Calculation	Gross profit / Current liabilities	Current assets / Total liabilities	Current liabilities / Total assets	Profit from sales / Total assets	
Weighting factor	0.53	0.13	0.18	0.16	
Ratio value, 2018	2.20	0.63	0.16	0.23	1.32
Ratio value, 2019	1.53	0.60	0.20	0.18	0.95
Ratio value, 2020	1.84	0.76	0.18	0.19	1.14
Ratio value, 2021	2.17	0.88	0.15	0.18	1.32
Ratio value, 2022	2.67	0.87	0.12	0.16	1.57
Ratio value, 2023	2.53	1.001	0.13	0.16	1.52

Source: calculated by the author based on Annex B

Function values are interpreted as follows:

- Z less than 0.2 – high probability of bankruptcy risk;
- Z more than 0.3 – low bankruptcy risk.

Final score according to Taffler Model for year 2018 is 1.32, which confirms that the risk of bankruptcy is actually low for the company, during the following analyzed years score is going to increase and in the 2023 score is going to be 1.52 that indicates, that according to the forecast, bankruptcy risk is even lower.

The franchisor and franchisee do not currently operate according to the vertical scheme, in which the franchisor is at the top of the hierarchical ladder. Their relationship

is built according to horizontal scheme. An equality relationship is established between the franchisor and the franchisee, since they are interdependent. That is why the support and assistance provided by the franchisor to its franchisees is of particular importance. An effective assistance system not only helps the franchisee to be successful, but also determines the amount of royalties, received by franchisor.

Franchisers with great practical experience in the field of business distinguish the following features of relationship between franchisor and franchisee [7]:

- **Professionalism:** Franchising characterizes the growing needs inherent in emerging countries. They need high professionalism and expect the franchisor to implement a marketing strategy in business management based on the quality of goods and services;
- **Equality:** When concluding a franchise agreement, consideration must be given to the fact that the relationship between the franchisor and the franchisee is not a relationship between an employee and an employer;
- **Organization of an education system:** Franchisees seek to participate in training programs in the field of managerial and financial activities;

Marketing support: Franchisees strive to receive effectively organized advertising at the regional and local levels. They need such advertising because they cannot provide it on their own;

The constant information exchange: Franchisees strive to participate in the development of long-term plans, they want their opinions to be taken into account in the strategic planning of the company;

- **Planning of growth potential:** Franchisees strive to develop and expand their company, for this reason there is a need for innovation;

As can be seen from the above, the success of a franchising company depends largely on the stability and profitability of the business concept. The franchisor develops its business concept and proves its profitability on the example of its own stores. The franchisor shares experience with all franchisees of the system, giving them the opportunity to conduct their business.

CONCLUSIONS TO THE PART 3

It can be concluded, that franchising is an effective method of doing business, that benefit both franchisor and franchisee. It allows increasing amount of investments, creating culture of entrepreneurship, ensuring fair competition and creation of new jobs.

Choice of franchising for Ukraine as an emerging market offer advantages to franchisors. For example, unsaturated markets, existing demand on foreign goods and services and less amount of needed financial resources. From the franchisee's point of view, operating under franchise ensures cultural suitability and strong brand name, gives an opportunity to develop business very quickly. In addition, constant support of franchisor along with strict quality control creates supportive environment for the franchisee's performance on the market.

Transition to franchising by McDonald's Ukraine LTD could be done via retrenchment strategy. The most appropriate decision is the strategy of division restaurants on company-operated restaurants in cities with more than 1 million inhabitants and franchised restaurants in smaller cities. It will allow franchisor to focus on strategically important restaurants without losing other markets. Responsibility for such restaurants will transfer to franchisee, but anyway franchisor will receive benefit from these entities.

In addition, taxes on royalties for residents of Ukraine are lower, than taxes for non-residents that is another good condition for creating franchising system in our country. Taking into consideration that ongoing costs for business services will transfer to franchisor, it creates even more conducive environment for developing franchising in Ukraine.

On the state level, developing franchising in Ukraine requires effective legislation, creating efficient franchising associations to provide potential franchisees with support and consultations, increasing investment attractiveness of Ukraine on the global stage.

CONCLUSIONS

In terms of globalization, franchising becomes an effective method of doing business and expanding on the foreign markets. Franchising occurs when the owner of a franchise provides franchisee with the right to operate under its brand name.

Franchising benefits both franchisor and franchisee. On the one hand, it is an opportunity for franchisor to enter foreign markets with less amount of investments and risks, on the other hand – an opportunity for franchisee to obtain leading market positions due to strong brand recognition and unnecessary of conducting market research.

Having analyzed the global franchising market, we can make a conclusion, that it is rather diversified, the leading position maintain restaurant industry. Absolute leader on the global franchising market is United States of America, showing best franchising practices in the world, Asian market and European Union market with great potential for further development.

McDonald's franchising practice is considered as one of the most successful in the world. Company operates globally through 37 855 restaurants, 93% of which are franchised. Company's main aim is to reach 95% share of franchised restaurants by opening new restaurants and refranchising company-operated ones.

The most strategic important is European and Asian market, where up to 96% restaurants operate under franchise. It is important to mention, that McDonald's is the 2nd largest private employer in the world. Company prefers to adapt its menu items according to various country in order to fit preferences of local consumers.

To become a McDonald's franchisee, entrepreneur has to meet certain requirements that can differ in various countries. Common requirements include:

- competent financial management;
- ability to develop business plan;
- ability to grow fast;
- sufficient experience;
- ability to provide standards of service;
- perfect credit history;

McDonald's entered Ukrainian market in 1997, and nowadays there are 90 restaurants in 20 cities, that are 100% company-operated. Analysis of the financial indicators showed, that the company's activity in the company-operated form is not sufficient:

1. Liquidity ratios:

- current ratio – does not correspond normal range;
- acid test ratio – does not correspond normal range;
- cash ratio does not correspond normal range;

2. Business activity:

- Asset turnover ratio - company does not use its assets efficiently;
- Working capital ratio – company is going to have liquidity problems;
- Accounts receivable turnover ratio – the period of time to pay obligations increased;
- Accounts payable turnover ratio – company is not able to pay bills quickly enough;
- Turnover ratio of fixed assets – company does not use its fixed assets efficiently;
- Equity turnover ratio – company does not sufficiently uses its equity to generate revenue from capital and reserves;

3. Profitability ratios:

- Gross profit margin – cost of goods sold increase faster than the revenue;
- Operating income margin – company receives not enough operating income to cover non-operating expenses;
- Return on assets - company is not making enough income from using its assets;
- Return on equity - company will not be profitable from the investors' point of view;

As McDonald's Ukraine LTD's financial performance is not effective, a rational decision is to divide restaurants at company-operated and franchised using retrenchment strategy of withdrawal from unprofitable and risky markets. It is reasonable to develop franchising in cities with less than one million inhabitants because of the unsaturated market and less competition. It is also important to mention, that transition to franchising will allow reducing taxes that will have a positive impact on company's profit.

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Income statement of McDonald's Ukraine LTD

Indicator	Year				
	2014	2015	2016	2017	2018
Sales revenue	50 087 976	52 907 170	60 638971	66 815 222	66 272 547
<i>Cost of goods sold</i>	39 408 465	43 446 781	50 995 490	56 148 135	55 831 491
Gross profit	10 679 511	9 460 389	9 643 481	10 667 087	10 441 056
<i>Operating expenses</i>	1 947 974	2 581 575	3 135 630	3 444 344	3 682 770
Operating profits	8 731 537	6 878 814	6 507 851	7 222 743	6 758 286
Net profit before taxes	7 114 855	4 382 842	3 711 196	6 094 940	4 288 034
<i>Taxes</i>	20%	20%	20%	20%	20%
Net profit after taxes	5 691 884	3 506 274	2 968 957	4 875 952	3 430 427

McDonald's Ukraine LTD's balance sheet, 2014-2018

In thousand, UAH	31.12.2014	31.12.2015	31.12.2016	31.12.2017	31.12.2018
Fixed assets					
Fixed assets	18 113 854	23 342 655	26 607 481	23 816 391	24 058 038
Deffered tax assets	79 293	123 228	121 953	83 240	100 604
Other fixed assets	251 345	383 990	480 548	568 997	717 670
Total fixed assets	18 444 492	23 849 873	27 209 982	24 468 628	24 876 312
Current assets					
Stocks	313 563	375 582	455 705	441 391	483 457
Value Added Tax on Acquired Values	377 966	441 959	223 045	125 178	41 252
Accounts receivable	2 195 656	3 292 522	3 070 028	5 104 479	2 541 306
Cash and cash equivalents	1 462 621	692 211	981 158	717 429	1 873 311
Other current assets	39 162	7 052	0	0	0
Total current assets	4 388 968	4 809 326	4 729 937	6 388 477	4 939 326
Balance	22 833 460	28 659 199	31 939 919	30 857 105	29 815 638
Capital and reserves					
Statutory capital	1 693 400	1 693 400	1 693 400	1 693 400	1 693 400
Revaluation of fixed assets	39 460	36 364	34 766	29 666	28 727
Retained earnings	14 891 000	15 725 422	18 275 520	19 683 564	20 277 664
Total owner's equity	16 623 860	17 455 186	20 003 686	21 406 630	21 999 791
Long term liabilities					
Borrowed funds	0	3 625 225	4 350 00	0	3 000 000
Deferred tax liabilities	57 685	37 776	21 349	51 574	64 281
Total long term liabilities	57 685	3 663 001	4 371 349	51 574	3 064 281
Short term liabilities					
Borrowed funds	2 310 917	3 281 496	2 789 001	4 417 935	7 644
Accounts payable	3 567 184	3 974 551	4 367 086	4 608 222	4 244 329
Estimated liabilities	273 814	284 965	408 797	372 744	499 593
Total short term liabilities	6 151 915	7 541 012	7 564 884	9 398 901	4 751 566
Balance	22 833 460	28 659 199	31 939 919	30 857 105	29 815 638