STRATEGIC CROSSROADS

1.1 Will more franchise deliver super-size profits for McDonald's?

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Challenges in a Changing World
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McDonald's, the fast-food chain, was the pioneer of franchising in the US in the 1950s, and has become the world's most widely known example of franchising. However, although the bulk of the company's restaurants are franchise businesses, many, especially outside the US, are owned and managed directly by McDonald's. These wholly owned businesses have been a cause of concern due to weak financial performance. Of a global total of 30,000 restaurants, 8,000 (27%) are owned and operated by McDonald's. Of the company's 13,500 restaurants in the US, only 15% are company owned, whereas in Europe, the percentage is 38%. In the UK, its 770 company-owned restaurants saw a 71% fall in profits in 2003.

Consumer concerns over healthy eating habits have affected sales at McDonald's outlets generally. Furthermore, a growing number of new and innovative competitors have attracted consumers away from McDonald's typical menus. The company set about a recovery strategy designed to deliver new healthier menus and refurbished premises. The revitalization program has been enjoying success in the US, where franchise arrangements predominate, but its design and implementation have not been so successful in other parts of the world. Should the company convert the wholly owned businesses to franchise, in order to improve performance? One of McDonald's major shareholders has asked for just such a strategic shift, but has met resistance from McDonald's management.

McDonald's has pointed out that the strength of its brand lies in its being directly involved in the business in the same way as its franchises. It would lose this 'hands-on' involvement if it became a pure franchisor. In addition, it points out that its company-owned restaurants operate in countries which lack enforceable franchise laws, such as China and Brazil. However, the company introduced a new plan in 2006 which does represent a shift in strategy. It announced plans to sell 1,500 loss-making restaurants run by the company to local entrepreneurs in 20 countries. These would be 'developmental licenses', a type of franchise whereby the entrepreneur invests the capital to open the outlet, in contrast to McDonald's standard franchise arrangement, under which McDonald's owns the land and builds the restaurant. The developmental licensees would be provided with marketing and supply chain support from McDonald's. The hope is that these new entrepreneurial businesses will compete more effectively. However, their success will depend not just on the efforts of the new owners, but on the company's ability to meet consumer's increasingly discerning tastes in all its markets.

Questions?

- What reasons lie behind the comparative success of McDonald's franchise outlets over the company owned ones?
- How does the developmental licence fit-in with McDonald's overall revitalization program?

Postscript

The continuing depressed state of the world economy has had an interesting effect on McDonald's market-performance. Note how the McDonald's shares have almost doubled in these past 5 years, at a time when the market has barely recouped its losses!