

A STRATEGIC ANALYSIS OF THE TRENDS
IN THE FAST-FOOD FRANCHISE INDUSTRY

by

Jonell E. Schlund

B.S. University of Southern California
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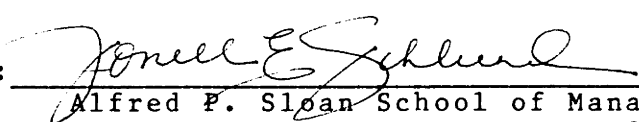
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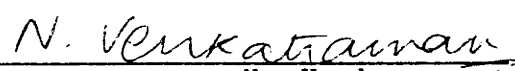
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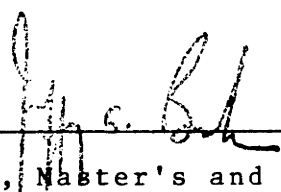
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Alfred P. Sloan School of Management
May 13, 1988

CERTIFIED BY: _____


N. Venkatraman
Thesis Supervisor

ACCEPTED BY: _____


Jeffrey A. Barks
Associate Dean, Master's and Bachelor's Programs

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ABSTRACT

Fast-food franchises have achieved a tremendous success rate in the U.S. economy in terms of sales and growth of retail units. According to experts in the industry, the outlook for fast-food franchises continues to be healthy, despite fears of an oversaturated market.

This thesis identifies and develops the long-run trends that will have a significant impact on the fast-food franchise industry, specifically, the hamburger, pizza, and chicken segments. My analysis was compiled through interviews with executives, industry analysts, managers, and workers from the various franchises.

From my research, the trends that will profoundly impact the fast-food franchises include:

- (1) consumers' increasing awareness and emphasis on the nutritional value of foods;
- (2) franchisors' expansion of menus to include lighter, healthier foods;
- (3) franchisors' increase in advertising and marketing expenditures;
- (4) combination franchising;
- (5) searching for "semi-captive" markets;
- (6) developing and designing new architectural styles;
- (7) increased recruiting of minority franchisees;
- (8) franchisors' pursuing the international market.

Thesis Supervisor: Professor N. Venkatraman
Title: Assistant Professor of Management

TABLE OF CONTENTS

	<u>Page</u>
CHAPTER I INTRODUCTION.....	5
CHAPTER II FAST-FOOD INDUSTRY ANALYSIS.....	17
CHAPTER III MARKET SEGMENT--HAMBURGERS.....	59
CHAPTER IV MARKET SEGMENT--PIZZA.....	76
CHAPTER V MARKET SEGMENT--CHICKEN.....	89
CHAPTER VI FRANCHISEE INVESTMENT PERSPECTIVES....	104
Appendices.....	117
References.....	122

DEDICATION

TO MY MOTHER, JOAN --

Whose love has encouraged me throughout my life.

CHAPTER I

INTRODUCTION

In a study commissioned by the International Franchise Association (IFA), John Naisbitt, author of Megatrends and Reinventing the Corporation, makes his predictions on franchising:

The outlook for restaurants, the granddaddy of the franchise industry, is healthy, despite fears that fast-food chains have saturated the market. Projections are for franchised restaurants to post total sales of \$49 billion in 1985--an average annual increase of 12 percent for five years since 1980. By 1990, franchise restaurants should generate more than \$86 billion.^{1/}

According to the Naisbitt study, this startling growth will take place as a result of demographic changes in our society which are likely to continue. Three emerging trends will help to accelerate the franchisor's growth during the next decade:

- o A transition from a manufacturing-based to a service-based economy. This is paramount as franchising has long been at the forefront of the service sector.

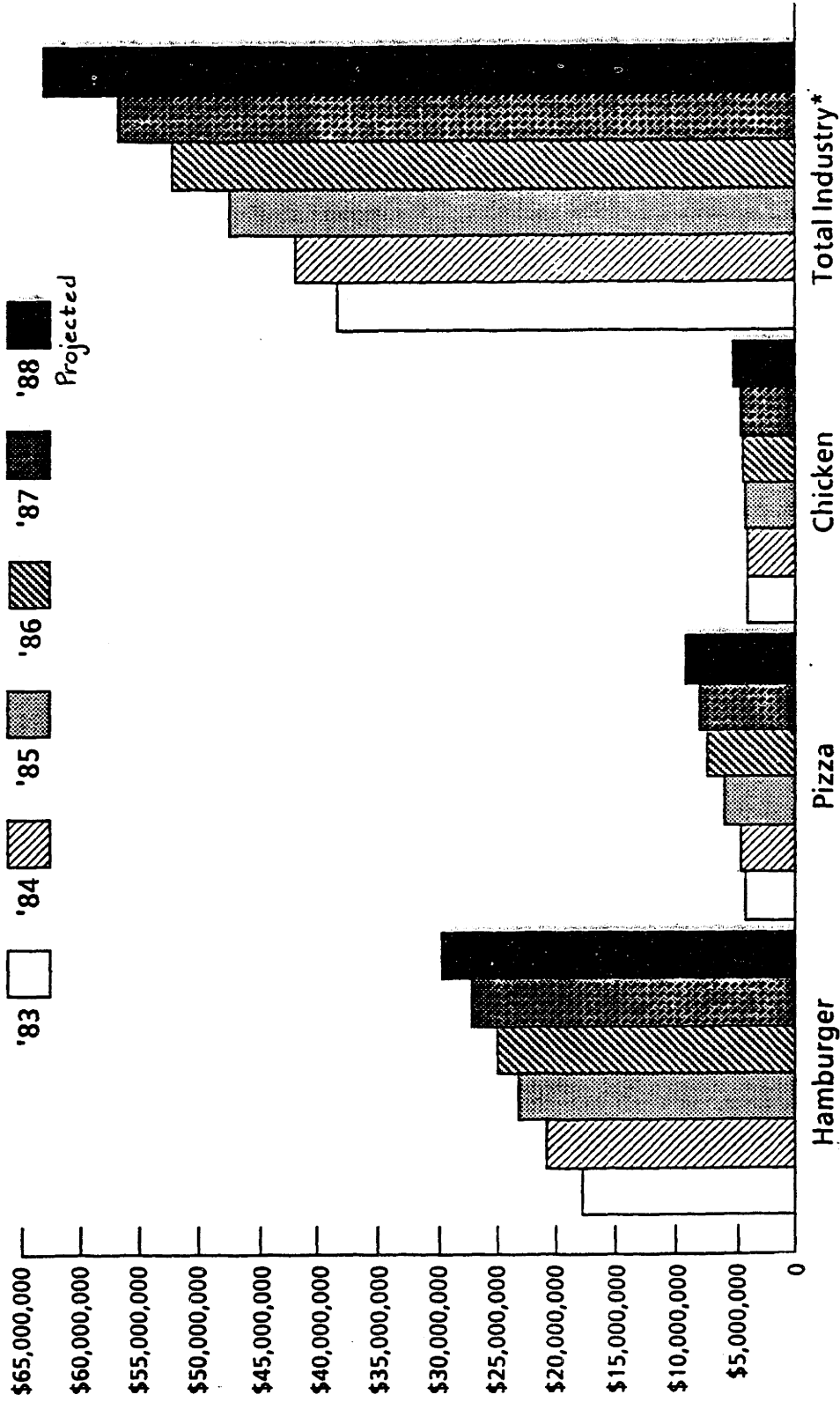
- o An increasing consumer preference for convenience and consistent quality--both principle strengths of franchising.
- o A rise in consumer demand for new specialty items. This demand has accelerated the introduction of new businesses aimed at the specialized market, and most of those businesses are franchised.

The Naisbitt Group says the largest percentage increases will occur in five fields: construction and home services, recreation, business services, non-food retailing, and fast food.

Clearly, fast-food restaurants have been the most successful of all franchises. The U.S. Department of Commerce, in Franchising in the Economy, 1985-1987, reported that the

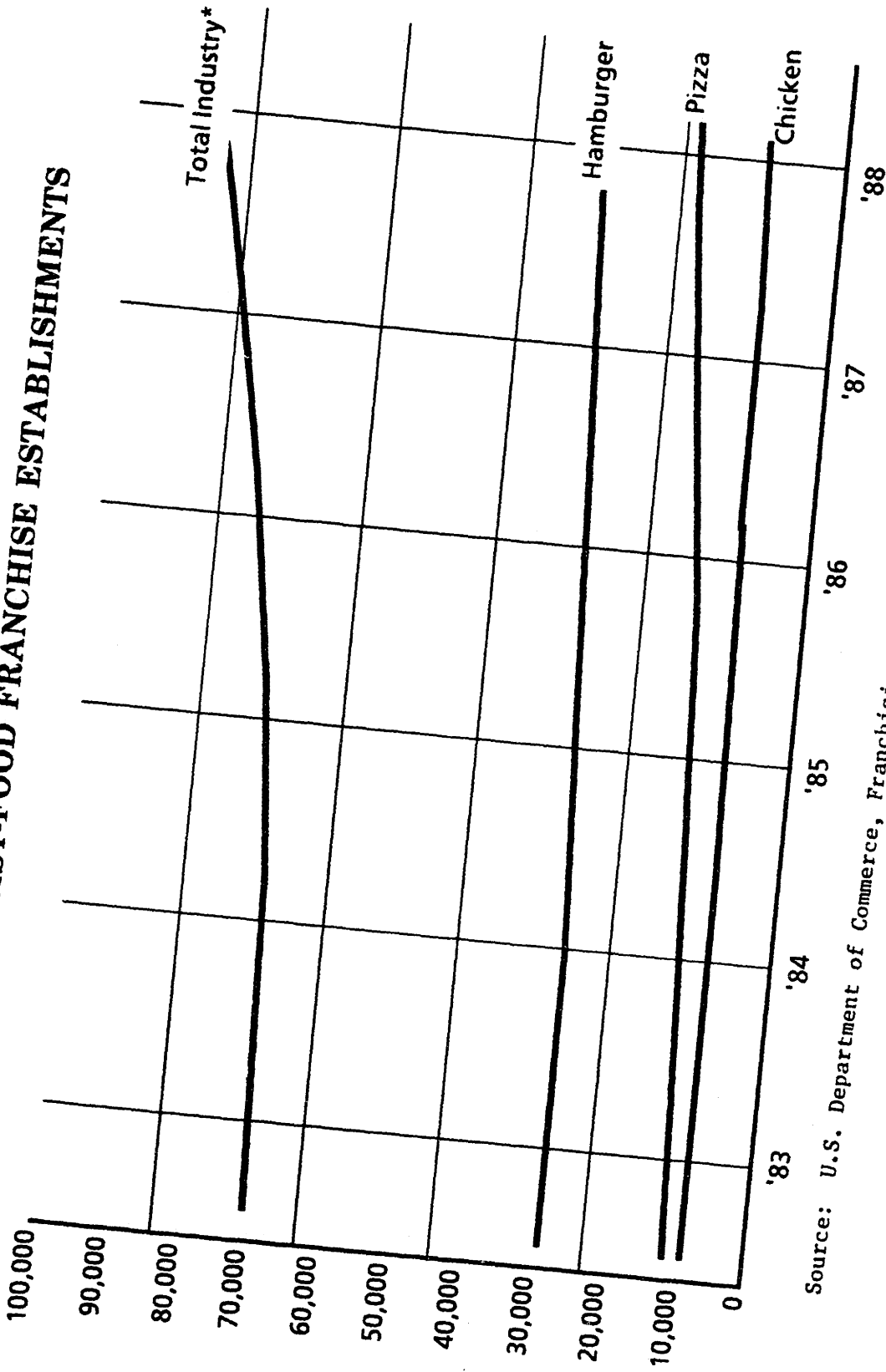
Sales of franchised restaurants of all types reached over \$51 billion in 1986, up 8 percent over a year earlier; they are expected to jump about 13 percent, to \$58 billion in 1987 (Exhibit 1). Franchised restaurants numbered 73,892 in 1985, increased to 78,288 in 1986, and are expected to rise to over 86,000 in 1987 (Exhibit 2). The highest concentration of franchised restaurants continue to be in California, Texas, Ohio, and Florida (Exhibit 3). In 1987, there were a total of 34,537 hamburger franchises, 18,113 pizza franchises, and 9,883 chicken franchises in the U.S.

EXHIBIT 1: FAST-FOOD FRANCHISE SALES (\$000)



Source: U.S. Department of Commerce, Franchising in the Economy, January 1987

EXHIBIT 2: FAST-FOOD FRANCHISE ESTABLISHMENTS



Source: U.S. Department of Commerce, *Franchising in the Economy*, January 1987

Exhibit 3

Number of Restaurants by State

State	Total	Company- Owned	Franchisee- Owned	State	Total	Company- Owned	Franchisee- Owned
Alabama	1,156	289	867	Kentucky	1,428	362	1,066
Alaska	104	5	99	Louisiana	1,220	421	799
Arizona	1,241	425	816	Maine	165	34	131
Arkansas	1,228	575	653	Maryland	979	381	598
California	7,552	2,162	5,390	Massachusetts	793	251	542
Colorado	1,248	380	868	Michigan	2,816	939	1,877
Connecticut	611	150	461	Minnesota	1,362	386	976
Delaware	152	58	94	Mississippi	717	109	608
District of Columbia	147	78	69	Missouri	1,786	622	1,164
Florida	3,853	1,494	2,359	Montana	240	4	236
Georgia	2,347	999	1,348	Nebraska	577	171	406
Hawaii	243	105	138	Nevada	328	133	195
Idaho	231	17	214	New Hampshire	138	26	112
Illinois	3,159	1,075	2,084	New Jersey	1,203	313	890
Indiana	2,188	640	1,548	New Mexico	535	88	447
Iowa	1,096	196	900	New York	2,148	454	1,694
Kansas	891	270	621	North Carolina	1,744	418	1,326

Source: U.S. Department of Commerce, Franchising in the Economy, January 1987

Exhibit 3 (continued)

State	Total	Company- Owned	Franchise- Owned
North Dakota	200	13	187
Ohio	3,850	1,320	2,530
Oklahoma	1,310	501	809
Oregon	938	231	707
Pennsylvania	2,293	794	1,499
Rhode Island	198	102	96
South Carolina	1,144	326	818
South Dakota	218	28	190
Tennessee	1,606	579	1,027
Texas	6,353	2,484	3,869
Utah	424	79	345
Vermont	59	4	55
Virginia	1,684	543	1,141
Washington	1,367	370	997
West Virginia	497	165	332
Wisconsin	1,388	389	999
Wyoming	181	20	161
TOTAL	69,336	21,978	47,358

Employment in the franchised restaurant sector was 2,441,947 in 1985, up from 2,182,143 a year earlier, a rise of 12%. Employment in this industry accounts for 39% of employment in the total franchise system and should continue to increase during the next few years. Furthermore, franchise restaurant employees accounted for an estimated 43% of all individuals employed in eating places in the U.S.^{2/}

Yes, franchising is big business in the United States! (see Exhibit 4). According to the 1988 National Restaurant Association Foodservice Forecast,

Fast-food restaurants are expected to register another year of healthy growth. Sales at limited menu restaurants are forecast to reach \$60.4 billion in 1988--an 8.5% increase over 1987. Adjusted for menu price inflation, this represents an increase of 4.3%, higher than the 4.1% pace set this year and above the 2.9% real growth forecast for the industry overall.^{3/}

Every year fast-food franchises continue to grow and command a higher portion of the consumer's dollar. But why are they so popular, and what contributes to the franchises' enormous success? These are just a few of the questions that I was interested in answering when I undertook this research. In order to understand franchising, and further comprehend the industry's phenomenal success rate, it is important to start at the beginning and answer a few precise questions.

Exhibit 4

The Largest Franchised Restaurant Chains

<u>COMPANY</u>	<u>1985 Sales (millions)</u>	<u>Restaurants</u>
1. McDonald's	11,000	8,901
2. Burger King	3,990	4,225
3. Kentucky Fried Chicken	3,100	6,396
4. Wendy's	2,700	3,459
5. Hardee's	2,200	2,411
6. Pizza Hut	2,100	4,912
7. Dairy Queen	1,572	4,822
8. Taco Bell	1,140	2,173
9. Big Boy	1,135	870
10. Domino's Pizza	1,097	2,816
11. Arby's	814	1,545
12. Church's	739	1,647
13. Ponderosa	681	641
14. Long John Silver's	637	1,359
15. Jack-in-the-Box	612	822
16. Dunkin' Donuts	577	1,447
17. Shoney's	576	488
18. Roy Rogers	507	540
19. Sizzler	443	465
20. Baskin-Robbins	423	3,305
21. Bonanza	421	542
22. Western Sizzlin'	420	500
23. Popeye's	355	540
TOTAL	\$37,239 billion	54,826 units

NOTE: Figures include overseas outlets.

Source: Restaurant Business, March 20, 1986.

What is franchising? A franchise is a legal and commercial relationship between the owner of a trademark, service mark, trade name, or advertising symbol and an individual or group seeking the right to use that identification in a business. The franchise governs the method for conducting business between the two parties.^{4/} A former president of the International Franchise Association described franchising as a "convenient and economic means for the filling of a drive or a desire [for independence] with a minimum of risk and investment and maximum opportunities for success through the utilization of a proven product or service and marketing method."^{5/}

In the U.S., franchising was introduced during the Civil War. Franchising has since grown tremendously from that time and is expanding and entering new areas. Why have the franchises been so enormously successful? What factors and life-style issues will contribute to their endurance?

"Let's eat out" have become the by-words for the American public, and more individuals are eating at fast-food restaurants than ever before. Fast food appeals to people of all ages; it's inexpensive, tasty, and convenient. "A Gallup study revealed that about one-third of those individuals polled had eaten out the day before.

Approximately a quarter of the respondents had eaten at a fast-food restaurant."^{6/} Each day 40 million Americans eat in fast-food restaurants.^{7/} The fast-food industry is indeed big business! In 1987, \$58 billion was spent on fast food and the food that is offered at these restaurants is, as the saying goes, "anything from soup to nuts."

Why are people eating out more? Lifestyles have changed; there are more working mothers, more one-parent households, more singles who do not want to spend time preparing a meal.^{8/} Carl De Biase, a partner in the research firm of Restaurant Trends says, "People eat out because they are out of the home more." Figures that were compiled by the National Restaurant Association show that the average American family spent 39.5% on its food dollars in restaurants in 1983, up from 33.1% in 1970. In 1985, the typical American family ate out 3.7 times a week.^{9/} And that figure is rising!

There are noticeable changes and new trends evident in the fast-food industry. In my research, I will expand upon the trends that will have long-run strategic implications for the fast-food franchisors. Janet Lowder of Laventhol and Horwath cautioned me in my research to be aware of "fads"--ideas that are only popular for a short

amount of time--and concentrate on "trends"--of long-standing value. I have attempted to do this throughout my research. And now, a peek into the future.

Fast-food restaurants will continue to grow by responding to changes in the market. As they struggle to expand existing territories, franchisors are exploring options such as mobile units, double drive-thru units, combination joint ventures and international expansion. To satisfy the more sophisticated palates of their consumer, fast-food operators are test marketing new menu items including salads and lighter, healthful entrees to provide customers with more variety. Renewed emphasis is being placed on the quality of food served and on fast and efficient service.

My research is divided into three sections: first, an industry analysis which thoroughly explains those trends which I note will have long-run implications for the fast-food franchisors; second, a look at those franchising segments that I have found to be most innovative and interesting--the hamburger, pizza, and chicken segments; and finally, a chapter on researching and selecting a fast-food franchise for personal investment.

FOOTNOTES

1. Ashman, R.T., "Born in the U.S.A.," Nation's Business, Vol. 74, No. 11, November 1986, pp. 41-44.
2. Kostecka, A., Franchising in the Economy, 1985-1987, U.S. Department of Commerce, Washington, DC, January 1987, p. 16.
3. National Restaurant Association, 1988 National Restaurant Association Foodservice Forecast, Washington, DC, 1988.
4. Kostecka, A., op. cit., p. 1.
5. Hotch, R., "Finding the Right Franchisor," Nation's Business, September 1985, pp. 34-38.
6. Davis, T., "Facts About Fast Foods," Consumer Research, August 1984, p. 11.
7. Barmash, I., "Fast-Food Restaurants--How They Grew and Grew," Good Housekeeping, November 1982, p. 114.
8. Ibid.
9. Ibid.

CHAPTER II

FAST-FOOD INDUSTRY ANALYSIS

A major interest in studying the fast-food franchisors is derived from their tremendous success rate and growth in the U.S. economy. My research develops the long-run trends that will have an impact on the fast-food franchise industry in years to come. This analysis was compiled through interviews with key individuals in the industry (see Appendix 2), researching and referencing trade journals: Advertising Age, Restaurants and Institutions, National Restaurant News, Restaurant Business and talking with over fifty managers and workers in fast-food restaurants.

I argue that the following trends will have a significant impact on the fast-food franchise industry:

- (1) the consumer's increasing awareness and emphasis on the nutritional value of foods;
- (2) franchisors' expansion of menus to include lighter, healthier foods;
- (3) franchisors' increasing their advertising and marketing expenditures;
- (4) combination franchising;
- (5) searching for "semi-captive" markets;
- (6) developing and designing new architectural styles;

- (7) increased recruiting of minority franchisees;
- (8) franchisors' pursuing the international market.

2.1. NUTRITIONAL VALUE OF FAST FOODS

Are fast foods really nutritious or are they, as some critics complain, merely stomach fillers that stuff consumers with many calories and no nutritional value? Dr. Michael F. Jacobson, a microbiologist, founder/ executive director for the Center for Science in the Public Interest (CSPI) and author of The Fast-Food Guide, has collected extensive nutritional information from the fast-food restaurants. (The CSPI is an independent consumer advocacy group supported by membership dues and foundation grants.) In his book, Dr. Jacobson devised the Gloom Factor:

This number, rates the overall nutritional value of foods. Excesses of fat, sodium, and sugar are the biggest dietary bugaboos for most Americans, so our formula gives the most weight to them. The Gloom Factor also considers the calorie, vitamin A, vitamin C, iron and calcium content of a food. The more fat, sodium, refined sugar, and calories a certain food contains, the greater the Gloom score.^{1/}
(see Exhibit 2.1)

Dr. Jacobson singled out Wendy's triple cheeseburger as the worst food, because of its fat content and its high amount (1,848 mg) of sodium. The five worst fast foods identified were: Wendy's Triple Cheeseburger, Burger King

EXHIBIT 2.1

Fast Foods with the Highest Gloom Factors

<u>Company/Product</u>	<u>Gloom Factor</u>
Wendy's Triple Cheeseburger	85
Burger King Double Beef Whopper with Cheese	76
Burger King Double Beef Whopper	66
Dairy Queen Triple Hamburger with Cheese	59
Carl's Jr. Super Star Hamburger	59
Jack-in-the-Box Supreme Nachos	59
Jack-in-the-Box Bacon Cheeseburger Supreme	59
Burger King Speciality Chicken Sandwich	58
Jack-in-the-Box Swiss and Bacon Burger	57
Roy Rogers RR Bar Burger	57
Burger King Whopper with Cheese	56
McDonald's Biscuit with Sausage and Egg	56
Roy Rogers Breakfast Crescent Sandwich with Ham	56
Jack-in-the-Box Scrambled Eggs Breakfast	56
Jack-in-the-Box Sausage Crescent	55
Carl's Jr. Western Bacon Cheeseburger	54
Roy Rogers Bacon Cheeseburger	54
McDonald's Mc D. L. T.	54
Roy Rogers Egg and Biscuit Platter with Sausage	53
Dairy Queen Chicken Sandwich	53
Dairy Queen Super Hot Dog with Cheese	53
Jack-in-the-Box Supreme Crescent	52
Jack-in-the-Box Jumbo Jack with Cheese	52

*An excellent diet for adults should contain no more than 75 to 105 Gloom points a day. Active teenage boys could handle up to 120 points and teenage girls 95 points. Most of the highest Gloom foods are loaded with fat.

Source: The Fast-Food Guide, p.79

Double Beef Whopper with Cheese, Burger King Double Beef Whopper, Dairy Queen Triple Hamburger with Cheese and Carl's Jr. Super Star Hamburger.

How did the fast-food chains respond to the ratings? Wendy's public relations department said that the triple cheeseburger is their poorest selling product--less than one percent of sales, and the meat that is used is less fatty than the average housewife uses. Burger King's John Weir said the company's motto is "Have it your way," and if you want to save calories on the Whopper, cut the mayonnaise.^{2/}

In an article featured in the March-April 1981 Dietetic Currents, three nutrition experts used nutrient information from eleven fast-food chains for determining the contribution of fast foods to the U.S. Recommended Daily Allowances established for young adults by the FDA for nutrition labeling purposes.^{3/} They found:

- (1) fast-food meals ranged from 900-1800 calories, 45-90% of the total daily calories recommended;
- (2) fast-food meals had a sodium content from 1,000-2515 milligrams--the Food and Nutritional Board recommends 1100-3000 milligrams as being safe;

- (3) fast-food meals contained fat that provided 51% of the calories--experts say fat should contribute no more than 35% of a person's calories;
- (4) fast-food meals contributed 50-100% of the protein and 30-60% of the iron and calcium needed by young adults; and
- (5) fast-food meals provide a very low amount of vitamins A and C.

Refer to Exhibits 2.2 - 2.4 for the fat, sodium, and calorie ratings for the hamburger, chicken, and pizza fast foods.

With such disastrous nutrition results, what then is the outlook for the fast-food industry? Will fast food eventually become more nutritious in the years to come? I believe the answer is Yes!

A 1983 Gallup survey showed that six out of ten consumers had changed their eating habits at home by eating more fruits, vegetables, and whole grains and decreasing their intake of refined sugar, animal fats, and salt. Four out of ten adults said they sustained those dietary changes when eating out. More than half of the consumers interviewed considered nutrition as an important aspect of fast food.^{4/}

Since 1983, a tremendous amount of additional data has revealed a direct link between poor nutrition and the diseases such as cancer that kill most Americans. It is highly unlikely that the number of individuals watching their nutrition intake has decreased since this poll. On

Exhibit 2.2 Fast Food-- Hamburgers

COMPANY/PRODUCT	CALORIES	FAT (sp.)	SODIUM (mg.)	GLOOM	COMPANY/PRODUCT	CALORIES	FAT (sp.)	SODIUM (mg.)	GLOOM
D'Lites Jr. D'Lite	200	2	210	9	Hardee's Bacon Cheeseburger	556	7	888	42
Wendy's Kid's Meal Hamburger	200	2	265	11	McDonald's Quarter Pounder with Cheese	525	7	1220	43
D'Lites 1/4 lb. D'Lite Burger	280	3	240	14	McDonald's Big Mac	570	8	979	45
McDonald's Hamburger	263	3	506	16	Dairy Queen Double with Cheese	650	8	980	46
Burger King Hamburger	275	3	509	17	Burger King Whopper	626	9	842	47
Wendy's Hamburger, Multi-Grain Bun	340	4	290	20	Wendy's Double Cheeseburger, White Bun	630	9	835	48
Wendy's Hamburger, White Bun	350	4	410	22	Jack in the Box				
Hardee's Hamburger	276	3	589	22	Ham & Swiss Burger	638	9	1330	51
Jack in the Box Cheeseburger	323	3	749	22	Dairy Queen Triple Hamburger	710	10	690	51
Burger King Whopper Jr.	322	4	486	22	Jack in the Box				
McDonald's Cheeseburger	318	4	743	23	Jumbo Jack with Cheese	630	8	1665	52
D'Lites Double D'Lite	450	5	290	24	McDonald's McD.L.T.	680	10	1030	54
Carl's Jr. Old Time Star	450	5	625	26	Burger King Whopper with Cheese	709	10	1126	56
Dairy Queen Single with Cheese	410	5	790	28	Roy Rogers RR Bar Burger	611	9	1826	57
McDonald's Quarter Pounder	427	5	718	31	Jack in the Box Bacon Cheeseburger Supreme	724	10	1307	59
Roy Rogers Hamburger	456	6	495	34	Carl's Jr. Super Star	780	11	785	59
Burger King Double Cheeseburger	478	6	827	35	Burger King Double Beef Whopper	887	13	922	66
Jack in the Box Mushroom Burger	477	6	906	36	Burger King Double Beef Whopper with Cheese	970	15	1206	76
Hardee's Big Deluxe	503	7	903	38	Wendy's Triple Cheeseburger	1040	15	1848	85
Burger King Bacon Double Cheeseburger	510	7	728	38					
Carl's Jr. Famous Star	530	7	705	40					
Wendy's Double Hamburger, White Bun	560	8	575	40					

Source: The Fast-Food Guide

Exhibit 2.3 Fast Food---Pizza

COMPLETE NUTRITIONAL VALUES¹		WEIGHT (gm.)	CALORIES	PROTEIN (gm.)	CARBOHYDRATES (gm.)	ADDED SUGAR (gm.)	FAT (gm.)	FAT % CALORIES	SATURATED FAT (gm.)	CHOLESTEROL (mg.)	SODIUM (mg.)	VITAMIN A (% U.S.RDA)	VITAMIN C (% U.S.RDA)	IRON (% U.S.RDA)	CALCIUM (% U.S.RDA)	GLUCOM
12" Cheese Pizza, 2 slices	140	340	18	52	0	6	16	-	10	660	4	0	20	30	12	
12" Pepperoni Pizza, 2 slices	140	380	20	48	0	12	28	-	30	880	0	0	20	30	21	
16" Cheese Pizza, 2 slices	160	400	24	58	0	8	18	-	40	800	4	0	30	40	15	
16" Pepperoni Pizza, 2 slices	170	440	24	56	0	14	29	-	60	1080	4	0	20	40	24	

Source: The Fast-Food Guide

Exhibit 2.4 Fast Food--Chicken

COMPANY/PRODUCT	CALORIES	FAT (sp.)	SODIUM (mg.)	GLOOM COMPANY/PRODUCT	CALORIES	FAT (sp.)	SODIUM (mg.)	GLOOM
Roy Rogers Chicken Leg	117	2	162	8 Arthur Treacher's Chicken	369	5	495	27
Kentucky Fried Chicken Original Recipe Drumstick	147	2	269	11 Arthur Treacher's Chicken Sandwich	413	4	708	28
D'Lites Litley Breaded Chicken Fillet	170	2	430	11 Church's Fried Chicken Thigh	305	5	448	28
Church's Fried Chicken Leg	147	2	286	12 Carl's Jr. Charbroiler Chicken Sandwich	450	3	1380	28
Roy Rogers Chicken Wing	142	2	266	13 Kentucky Fried Chicken Extra Crispy Thigh	343	5	549	30
Long John Silver's Chicken Plank, 1 piece	152	2	515	14 Roy Rogers Chicken Thigh & Leg	399	6	667	33
Kentucky Fried Chicken Extra Crispy Drumstick	173	3	346	15 Kentucky Fried Chicken, Extra Crispy Side Breast	354	5	797	34
Wendy's Chicken Sandwich, Multi-Grain Bun	320	2	500	15 Hardee's Turkey Club	426	5	1185	34
Arby's Chicken Breast, roasted	254	2	930	15 Roy Rogers Chicken Breast & Wing	466	6	867	37
Burger King Chicken Tenders, 6 pieces	204	2	636	16 Hardee's Chicken Fillet	510	6	1307	38
D'Lites Chicken Fillet Sandwich	280	3	760	19 Arby's Chicken Breast Sandwich	592	6	1340	42
Kentucky Fried Chicken Original Recipe Side Breast	276	4	654	24 Arby's Chicken Club Sandwich	621	7	1300	46
Roy Rogers Chicken Breast	324	4	601	24 Jack in the Box Chicken Supreme	601	8	1582	52
Church's Fried Chicken Breast	278	4	560	24 Dairy Queen Chicken Sandwich, fried	670	9	870	53
Arby's Turkey Deluxe	375	4	850	25 Burger King Specialty Chicken Sandwich	688	9	1423	58
Roy Rogers Chicken Thigh	282	4	505					
McDonald's Chicken McNuggets	323	5	512					
Arby's Chicken Salad Sandwich	386	5	630					
Kentucky Fried Chicken								
Kentucky Nuggets, 6 pieces	276	4	840					
Church's Fried Chicken Wing	303	4	583					

Source: The Fast-Food Guide

the contrary, nutrition consciousness and exercise among Americans have increased.

Another aspect that will have an effect on making consumers more aware of the nutritional content of their food is product labeling. San Francisco is the first city in the nation that requires its fast-food franchisors to label ingredients and nutrition content. Other cities and state legislators are likely to follow soon. Consumers are demanding to know about sulfates and preservatives in their food.

Government agencies acknowledged in the late 1970s that the restaurant industry was changing. At that time the Food and Drug Administration (FDA), the U.S. Department of Agriculture (USDA), and the Federal Trade Commission (FTC) were studying food labeling in a growing number of fast-food restaurants, food is generally served in individually wrapped portions, such as foil-encompassed sandwiches, potatoes in bags, and pies in boxes. In these circumstances, the application of labels is a realistic possibility.^{5/}

These two factors--consumers becoming more nutrition conscious and product labeling-- will, I believe, affect consumers fast-food choices and ultimately the fast-food franchisors' menus in the years to come.

2.2 MENU EXPANSION TO INCLUDE LIGHTER, HEALTHIER FOODS

The U.S. Department of Agriculture projects U.S. per capita consumption of beef will fall to 73.8 pounds in 1987 from 79 pounds in 1986. In contrast, per capita consumption of poultry is projected to increase to 78.6 pounds in 1987 from 73.4 pounds in 1986. The increased popularity of seafood and salads poses another challenge to the fast-food segment.^{6/}

Reflecting the current trend in America, fast-food chains are stressing lighter, fresher, and more healthful menu options for the consumer. There is a trend toward healthier food because the public is developing a concern and active awareness of health and nutrition, but that doesn't appear to be the only reason why consumers are demanding the freshest and widest variety of ingredients possible. Consumers like the look, the taste, and the texture of fresher, lighter, and more nutritious foods. The increased demand for these foods is directly tied to their interest in exercise and health consciousness, and fast-food chains will continue to offer lighter foods and change their cooking techniques (see Exhibit 2.5).

Exhibit 2.5
Percent Change in Orders for Menu Items
 (1982-1985)

<u>ITEM</u>	<u>Percent Change</u> <u>1982-1985</u>
<u>All breakfast foods</u>	17.0%
Breakfast Sandwich	101.4
Omelette	21.4
<u>All Sandwiches</u>	N.C.
Hamburgers	-3.8
Cheeseburgers	19.1
Steak Sandwich	-32.5
Fried Fish Sandwich	7.9
Heroes/Sub	7.9
<u>All Beef</u>	-6.5
Steak	-14.5
Prime Rib/Roast Beef	7.9
<u>Ham</u>	-4.1
<u>Pork</u>	-13.7
<u>Total fish/seafood</u>	-2.5
<u>Fried</u>	-3.6
Not Fried	51.1
<u>Total Chicken/Poultry</u>	18.2
Fried	23.3
Other	2.8
<u>Pizza</u>	32.3
Thick Crust	43.9
Thin Crust	24.2
<u>Spaghetti</u>	7.9
<u>Other Pasta</u>	7.9
<u>Mexican Foods</u>	14.7
<u>Chinese/Oriental</u>	25.0
<u>Main Dish Salads</u>	37.6
Salad Bar	85.0
<u>French Fries</u>	4.2
<u>Rice</u>	36.7
<u>Fruit</u>	31.9
<u>Total Desserts</u>	-1.9
Other desserts	11.8
<u>Total non-alcoholic beverages</u>	8.4
Coffee	-6.2
Decaffeinated Coffee	100.4
Regular Colas	3.7
Diet Cola	43.0
Non-diet, no-cola	52.4
Diet no-cola	-32.5
Shakes/Malts	-5.1
Milk	-9.6
Juice	12.2

Source: CREST Household Report, Annual data 1982-1985,
 GDR/CREST Enterprises.

Franchisors are particularly attuned to this trend because it is predominantly the "baby boomers" who express the greatest concern with the foods they eat. This fact was discovered by the National Restaurant Association (NRA) in a series of consumer focus groups it conducted in the fall of 1986. Franchisors realize that fast food is particularly suitable to the "non-stop" lifestyle of this group. According to Susan Mills of the NRA,

Those in the baby boomer age category display much more of a concern in terms of keeping themselves healthy and active, and are aware of the foods served to them in restaurants, than are those younger or older. Many claim to be "semi-vegetarians," they restrict their intake of red meat, but don't entirely shun it. They also show concern about additives, preservatives, and frying.^{7/}

There is, however, a great deal of speculation among the fast-food franchisors concerning the willingness of consumers to adhere to a rigidly "healthy" diet.

In early 1986, the Washington D.C.-based NRA contracted with the Gallup Organization to poll customers about what they liked to eat when they eat out at fast-food franchises. More customers reported making an effort to eat more vegetables, less fats, and less meats, and to avoid fried foods in 1986 than they did the last time Gallup conducted a survey in 1983.^{8/}

Consumers say they want more low-calorie, nutritious foods, but what they actually order are perceived-- healthy menu items--that's the paradox.^{9/}

Fast-food franchisors (McDonald's, Burger King, Wendy's, Carl's Jr.) are responding rapidly to this "healthy food" phenomenon with the introduction of salads, salad bars, pasta dishes, baked potatoes, tempura vegetables, yogurt, and skim milk. As early as 1979, Wendy's began to move into a wider selection of menu items for customers who preferred a change from hamburgers. Wendy's was the first chain to introduce the salad bar. Wendy's executives credited that decision as a determining factor in increasing their female customer base from 10% to 50%.^{10/} Burger King, Carl's Jr., and Kentucky Fried Chicken quickly followed by introducing salad bars in their restaurants. "Salads are definitely here to stay," says Janet Lowder of Laventhol and Horwath, "but the trend is away from the extremely costly salad bars to the pre-packaged fresh salads." McDonald's is currently successfully marketing its pre-packaged salads throughout the U.S., and Domino's Pizza is also test marketing pre-packaged salads in several locations, says Pat Lacoste, Assistant to the Director of Marketing at Domino's Pizza. Greg Reynolds, Vice President of Public Affairs for Kentucky Fried Chicken, stated, "Our salads have always been perceived by the consumer as both tasty and nutritious."

Baked potatoes with assorted toppings, tempura-style vegetables, and pasta salads are other menu additions that have done very well during the past two years. Wendy's, Burger King, and Carl's Jr. have successfully marketed baked potatoes and deep-fried vegetables.

As consumers request fewer and fewer fried foods, fast-food franchisors are also experimenting with new and different cooking techniques. Kentucky Fried Chicken is presently testing broasted and honey-broiled chicken across the nation; the chicken is not fried and KFC would like to have an endorsement by the American Medical Association. The AMA recently recognized El Pollo Loco's chicken as being both nutritious and low in calories and cholesterol. El Pollo Loco's pollo (Spanish for chicken) is marinated, splayed flat, and charbroiled without breading or oils.

If America takes to pollo, the dish could create ominous competition for fried fast food. But many observers feel it could give hamburger chains a new product to offer franchisees whose territories are saturated. Burger King, which already promotes the health qualities of its broiled burgers, would be a natural pollo franchiser, suggests Chairman Lipson of El Pollo Asado, and that would surely make fried chicken chains squawk.^{11/}

All of the interviewees that I spoke with agreed that the fast-food franchisors will continue to test and market those foods that are perceived by the customer as being

lighter, healthier, and more nutritious. Diet-oriented foods, low-calorie, low-sodium, and low-sugar products are already commonplace in the supermarket and they will be increasingly available by the fast-food franchises. High-fiber hamburger buns, pizza dough, and multi-grain products will be utilized. In the future, customers will place an increased emphasis on foods for nourishment and foods for fun. As consumers become more knowledgeable about the nutritional content of foods, they will clearly distinguish between foods of nutritional significance and those which are frivolous. With the heightened interest and importance of calcium, consumers will be seeking products that are calcium-fortified. With a growing concern about obesity, strokes, heart attacks and other medical ailments, consumers will order fewer foods with high sodium and fat content. It is clearly evident that the fast-food customer of the future will have a wider selection of lighter, healthier, and more nutritious foods.

2.3 INCREASING ADVERTISING AND MARKETING EXPENDITURES

Advertising in today's competitive fast-food industry is an extremely costly exercise aimed at getting the customer's attention. However, in an era where customers are literally bombarded with many different types of

advertising media, it becomes very difficult for franchising marketing departments to determine if their advertising budgets have been properly allocated. For fast-food chains, standing out ahead of the pack of competitors is vital. In 1985, advertising expenditures passed the \$1 billion mark, and in 1987, the chains increased their TV advertising by as much as 47% (Domino's)(Exhibit 2.6).

With so much money at stake, a memorable ad campaign is critical for advertisers," according to Video Storyboard's Tests Inc.'s annual survey of some 30,000 viewers who rated their favorite TV commercials. Five restaurant chains whose television ad campaigns made the top 25 most popular list with consumers were McDonald's, which ranked second in popularity behind Coca Cola; Burger King, which ranked eighth; Wendy's which ranked 16th; Taco Bell, 18th; and Pizza Hut, 23rd. McDonald's spent almost \$1 million a day, or a hefty \$64.67 for every 1000 burger buyers who remembered its ads. In comparison, Wendy's had a cost efficiency rating of \$40.26 for every 1000 burger buyers who recalled its ads; Burger King had a cost efficiency rating of \$43.40, while Pizza Hut spent \$53.52 to be recognized by 1000 consumers of pizza. But the most expensive price for a restaurant TV commercial was Taco Bell's which spent a whopping \$102.76 for every 1000 Mexican food eaters who remembered its ads.^{12/}

Exhibit 2.6

Television Budgets for Fast-Food Franchisors
Total TV Ad Dollars Spent
(\$ millions)

	<u>1986</u>	<u>1987</u>	<u>% Change</u>
McDonald's	\$160.0	\$160.3	.0002
Burger King	73.1	80.2	10.0
Kentucky Fried Chicken	38.7	44.5	15.0
Pizza Hut	37.5	40.8	9.0
Wendy's	36.2	38.4	6.0
Taco Bell	24.2	29.9	23.0
Red Lobster Inns	16.2	20.0	24.0
Domino's	13.4	19.7	47.0
Hardee's	12.5	16.1	29.0
Long John Silver's	14.1	14.4	2.0
Sizzler	7.3	9.6	32.0
Dairy Queen	8.6	8.9	4.0
Jack-in-the-Box	8.7	8.2	-6.0
Arby's	6.7	5.4	-20.0
Roy Rogers	5.2	5.4	2.0

Source: Television Bureau of Advertising from Broadcast Advertisers Reports data.

Although fast-food chains have enormous advertising budgets, capturing and retaining the customer's attention is of strong importance. With the large number of fast-food commercials, advertisements must be "catchy" to be remembered by the viewers' short attention span. According to an Advertising Age survey, most people are exposed to more than 10,000 advertising impressions on a daily basis. Therefore it is vital to simplify the advertising message to get across exactly what you want to convey to the consumer. In essence, the visual impact of advertising can be more important than the wording of the advertisement.

"Differentiation from the competition has always been the basic element of effective advertising," notes Scott Hume, Chicago Bureau Chief for Advertising Age magazine. The importance of differentiation by the major fast-food chains can be analyzed in the way each of the chains has tried to carve out a particular niche in the industry through the marketing of its various fast-food products (i.e., nutritious, ethnic foods, etc.). The relevance of the niche strategy is, I believe, paramount to the fast-food industry. The fast-food franchisors of the future will have to be extremely creative in advertising and marketing a previously untapped niche. Domino's Pizza was successful in tapping a previously undiscovered niche in

the pizza industry. By positioning itself in the home delivery market and promising a freshly baked pizza within a 30-minute time frame, Domino's has become tremendously successful. Fast-food franchisors of the future will explore what the consumer wants, while trying to avoid fads, and research their competitors strategically to be the first or superior concept in a particular niche.

For three years, beginning in 1982, Burger King led the "battle of the burgers" in advertising--spending \$172 million annually. Burger King claimed in its television commercials that its hamburgers were "bigger, beefier, and broiled, not fried."^{13/} Burger King also bragged that the Whopper had beaten McDonald's and Wendy's in a national taste test. Both McDonald's and Wendy's sued, saying the claims were false. Burger King withdrew those commercials and replaced them with commercials comparing its broiled patties to its competitors' fried patties. Currently, the executives at Burger King believe it is important to depart from the comparative type of ad and instead focus on the quality of food served in their restaurants. Time alone will tell if this is a wise move! In the book Marketing Warfare, co-authored by Al Ries, comparative advertising is lauded. Janet Lowder of Laventhol & Horwath stated, "We will always have the 'Burger Wars' type of commercials, as advertising goes in cycles." With

the heightened competition among major fast-food chains, successful franchisors must communicate to consumers a real difference in their products. Therefore, I believe there will be a trend in advertising and marketing toward price/value comparisons, new cooking techniques, taste differences, and new niche strategies.

Advertising will be increasingly aimed at three target markets: the "baby boomers," children, and minorities. According to the U.S. Bureau of the Census, many baby boomers, who make up the 25- to 44-year-old age segment have finally decided to settle down and have children. Now that parenting has become a priority for those born after World War II, franchisors and restaurateurs can look for those individuals to change their eating habits away from the trendier nightclubs and restaurants they frequented as singles. "These baby boomers are expected to increase the number of preschoolers from a 1980 low of 16 million tots to a total of 19 million by 1990."^{14/}

For the past decade, major franchisors have targeted children, as it is clear that children play a significant role in making family dining choices in certain segments. Franchisors will continue to target these "little consumers" during Saturday morning programs, prime time shows, and visually with "theme" play-parks at fast-food

restaurants. Several franchisors are also test marketing toys and clothing at the retail level. Domino's Pizza has signed several contracts to license its "Noid" character to doll, clothing, and T-shirt manufacturers. The pizza chain is creating a clothing line with its colorful domino logo, and the Noid doll will be available in toy stores this year. Patricia Lacoste of Domino's stated that these licensing agreements will provide a fun product for the consumer, create brand loyalty, and bring additional brand awareness to the public.... Could a Ronald McDonald, Burger King "King", or Wendy's doll be in the making? With further emphasis on the children's market in the late 1970s, McDonald's opened its Ronald McDonald's Houses, arranging accommodations for families of children awaiting cancer treatment. This philanthropic marketing decision has heightened public awareness of McDonald's altruism for its "littlest consumer." I believe it is only a matter of time before other fast-food franchisors adopt similar philanthropies.

The franchisors are also trying to capture a relatively new minority market and are advertising aggressively to blacks, Hispanics, and other ethnic groups. McDonald's was one of the first advertisers to produce commercials directed at the black consumer on a large scale. It used talented black singers and musicians

to zero in on the black community and this advertising campaign has paid off handsomely.^{15/} In 1978, a survey revealed that blacks eat more chicken more frequently than Caucasians.^{16/} Kentucky Fried Chicken, through an active advertising campaign, has also directed its attention to the black community in a subliminal manner. KFC's ad states, "Doing it right means more than just good food--it means hiring people from the community, it means putting money back into the community."^{17/} McDonald's and Domino's are also hoping to attract the Hispanic market in the U.S. and are developing a coordinated approach to this market. The potential market "numbers 23 million potential burger buyers, including almost 10 million under the age of 18."^{18/} Hispanics are indeed a good target market for fast food. McDonald's refers to the 1980s as the "decade of the Hispanics." To reach this market, McDonald's has utilized the Latino pop musical group, the Menudos. Franchisors are developing print and radio ads that will appear in the West Coast, Southwest and southern Florida. I am certain that with the tremendous growth rate of various ethnic groups in the U.S., a substantial amount of advertising and marketing dollars will be spent on targeting these markets during the next decade.

Advertising promotions will also become increasingly important as franchisors seek to aggressively market and differentiate their products from competitors (see Exhibit 2.7). Grand openings, special events, coupons, price-off deals, and discounts will encourage consumers to taste various entrees and build repeat business. Carl's Jr. executives have found that discount coupons on new products during grand openings encourage repeat business. Coupons are, and will continue to be, an excellent medium for new product introductions. However, George Rice, a consultant to fast-food franchisors, believes that coupons don't really build market share because consumers start wondering why meals don't cost less all the time. "You can get into real trouble by discounting your main products. A company must maintain the integrity and value of the flagship items."^{19/}

With a rising consumer interest in fast and efficient service, and increased competition from convenience and grocery stores, fast-food chains must alter their future marketing strategies to survive. Burger King President Charles Olcott said,

... fast-food restaurants must rethink their traditional reliance on media advertising to build sales. With consumers' renewed interest in convenience, the quality of in-store execution and service must be considered the cornerstone of restaurant marketing.

Exhibit 2.7

Distribution of Promotions Used

	<u>Coupons</u>	<u>Special Event</u>	<u>Reduced Price</u>	<u>Other</u>
All Restaurants	42.3%	24.2%	12.3	21.2%
<u>Restaurant Type</u>				
Quick Service	48.8	16.9	13.0	21.3
Mid-Scale	27.0	44.0	11.0	18.0
Upscale	24.3	37.2	8.8	29.7
<u>Meal Occasion</u>				
Breakfast	30.8	34.7	12.1	22.4
Lunch	28.7	26.6	13.2	21.3
Dinner	49.0	20.6	10.8	19.6

- o Coupons are the most popular type of promotion used at restaurants 42.3% of the deal occasions.
- o Most promotions used at quick service places involve a coupon, while special event promotions are more popular at midscale and upscale restaurants.
- o Most promotions used at dinner involve a coupon.
- o In contrast, most deals used at breakfast involve a special event.

Source: Foodservice Numbers--A Statistical Digest for the Food Service Industry, NRA, Research and Lit. Services Dept., Washington, DC, September 1986.

Echoing Mr. Olcott's sentiments was Burger King Corp. Chairman Jeff Campbell, who warned that, "restaurant marketing must change advertising and promotion to a total concept."^{20/} Burger King executives and other fast-food executives agree, the best marketing strategy epitomizes what the fast-food concept is all about--good fast food, convenient location, and speedy service.

2.4 COMBINATION FRANCHISING

As real estate becomes increasingly expensive, a solution for fast-food franchising chains is to co-build with other chains or to add additional food concepts in existing restaurants. This new trend, known as combination franchising, will strongly affect the fast-food franchises. Andrew Kostecka of the U.S. Commerce Department and a specialist in the franchising industry, believes that combination franchising is a fast-growing trend which is currently being tested by more than twenty franchises.^{21/} Industry specialists from Laventhol & Horwath say, "site sharing by two or more restaurant concepts will continue to increase as an answer to high real estate and building costs and the dwindling number of prime chain locations."^{22/}

The benefits of combination franchising are numerous: lower building costs, higher ROI for each franchise, lower labor costs, lower advertising/marketing costs, and increased customer traffic. Combination franchising is the "hottest" trend among franchisors across America and is currently being tested between fast-food chains, among hotel and fast-food chains, and between fast-food and convenience stores.

The fast-food chains are building joint concept restaurants as test projects across the U.S., and many have been quite successful. The food combinations are always complementary and appear in malls and boutique-type shopping centers; pizza and chicken, hamburger and ice cream, pizza and ice cream. The fast-food franchisors select complementary operations, such as ice cream and yogurt, which do not "cannibalize" their sales. For example, Wendy's and Baskin-Robbins Ice Cream share a unit in Richmond, Virginia, but maintain separate counters for each concept. Simultaneously, fast-food franchisors and convenience store chains are starting joint ventures where hamburgers, pizza, and chicken can be purchased along with a newspaper or other convenience items. Several hotel chains have started testing fast-food restaurants on their premises. These combination franchising arrangements yield benefits for both parties: reducing advertising

costs as the two concepts share an ad, helping to eliminate the "peaks and valleys" of the business day as each franchise has its strongest sales at different times; penetrating new target markets. Combination franchising can create a unique synergy as it gives the franchisee an opportunity to make a higher ROI with a minimal additional investment.

The synergies that are created with the fast-food chains and convenience stores are very similar to those created by two restaurant chain combinations. Convenience stores, because of their numerous locations and easy accessibility, attract a very large customer base with repeat business. For the past five years, convenience stores have been selling microwaved hamburgers and hot dogs, but these products lacked brand name recognition. By joining forces, the convenience stores can now bring customers the brand name quality they recognize of their favorite fast foods and convenience of the store. Southland Corporation's 7-Eleven is testing the following four fast-food operations: Church's Fried Chicken, Hardee's, The Works, and Ricky Rococo Pizza. If the 7-Eleven combination franchising test proves successful, 7-Eleven could become one of the biggest fast-food giants in the U.S.

For the hotel operator, having a familiar fast-food franchisor on the premises can be beneficial for several reasons: it is convenient for the customer, provides the hotel with food service expertise, and ensures a consistent degree of quality which the customer recognizes and enjoys. Currently, Days Inn of America, Inc., has franchise agreements with Wendy's and Arby's. In the budget and economy sector, where many of the hotel/fast-food combination franchising agreements occur, the customer is looking for a recognized fast-food name, not a fine dining experience. Consequently, for the hotel/franchise link to be successful, both franchising concepts must be recognized by their shared target market.

From my research, it appears that combination franchising is a substantial trend of the future. Many companies have or are planning to test these types of joint ventures.

2.5 SEARCHING FOR "SEMI-CAPTIVE" MARKETS

With the prime real estate properties already being utilized, franchisors are rapidly evaluating alternatives and searching for new innovative locations--"semi-captive" markets. Fast-food restaurants are appearing in places

"far removed from major highway intersections and shopping centers--preferred locations that are now full."^{23/}

The following "semi-captive" markets are currently being explored:

- Military installations: Burger King opened a hamburger outlet at Pearl Harbor Naval station; McDonald's has a contract with the Navy. Burger King has contracts with the Army and Air Force. Carl's Jr. is currently negotiating with several military bases in the West.
- Private colleges and Universities: Carl's Jr. opened a 1000 square foot takeout unit at the University of Southern California in Los Angeles;
- Hospitals: Roy Rogers opened a chain operation at St. Francis Hospital in Pittsburgh.

The fast-food franchisors are researching all possible franchise locations: truck stops, toll roads, bus terminals, museums, airports, and even little towns that have been overlooked. Interestingly, when researching towns, a new fast-food frontier is appearing in Las Vegas--Del Webb's Mint Casino has opened Burger King, Godfather's Pizza, and Haagen-Daz franchises. The Barbary Coast Casino has opened a McDonald's. Casino operators explain the success of the casino/fast-food franchising

concept: "In a casino you have a captive audience. People come to Las Vegas to gamble and casino operators want people gambling, not eating at elaborate buffets. With the fast-food restaurants, customers can eat quickly and have an additional 40 minutes of gambling time."^{24/}

Although industry analysts view the fast-food franchising industry as being mature and oversaturated, franchisors will continue to research and pursue untapped, "semi-captive" markets in the future.

2.6 DEVELOPING AND DESIGNING NEW ARCHITECTURAL STYLES

For 36 years, McDonald's restaurants retained the same architectural design. The chain's fast-food restaurants had the same roof, red brick walls, and colonial-styled windows. At the urging of David Bersnant, a mall owner in Berwyn, Illinois, McDonald's sought a new look. In seeking a different architectural design, three New York designers (Alison Sky, Michelle Stone, and James Winis--known as SITE) were chosen. The "new look McDonald's" is in a shopping center near Chicago, and is a radical reversal of McDonald's standard design. The roof floats above the rest of the building and customers have a view of the sky. This new design has been called the "floating McDonald's" and has even attracted tourists

--not only hamburger lovers but architectural zealots as well.^{25/}

Wendy's and Burger King are also attempting to improve their ambience with the use of softer lighting, additional plants, and even carpeting. Carl's Jr. is sporting a different look in its new franchises. With elegant French doors leading into its building and flower boxes at the windows, a new upscale look has been achieved. KFC is also attempting to depart from its established design to attract middle and upper middle-class families.^{26/}

In New Orleans' old historic district, the Wendy's is painted a subtle gray and fitted with red awnings. Wrought iron secures the stairways and balconies. On the Chisholm Trail in Round Rock, Texas, the Wendy's restaurant is built of rough-hewn cedar and limestone. At Rockefeller Center, in New York City, McDonald's customers can choose marble tables on carpeted platforms.

All over America, fast-food restaurants are changing their designs. The attempts toward tasteful design reflect two significant changes in the fast-food market. First, fast-food patrons are becoming more sophisticated, career families. And as competition in the industry increases, franchisors must attract new customers to keep

their sales up. New upscale designs are attracting a broader range of people, "especially those customers who have traditionally said, 'I don't go into those kinds of restaurants.'"

At Burger King, a massive redecorating effort has been undertaken. Over 30% of all the outlets have been remodeled by December 1985. "We're trying to get all that plastic out," Burger King spokesperson Joyce Myers told a Wall Street Journal reporter. "We're adding a greenhouse concept with real plants. We're using brass railings to queue the customers. Etched glass separates the dining areas and chairs and tables are made of oak."

Domino's Pizza has broken ground on a long-awaited prototype freestanding unit, designed to resemble a pizza with a slice half-removed. "The unit was inspired by Frank Lloyd Wright and is designed to enhance the corporate identity."^{27/}

In the world of fast food, restaurant design encompasses the same goals as mid-price and upscale restaurants--attractiveness and utility.

Fast-food operators consider practical matters: price, because generally dozens to hundreds of units will take on the design package; utility, because productivity is more

important in fast food than any other segment; and adoptability, because fast-food chains operate in many markets and local tasks may differ.28/

In general, chains are adding bright colors to enhance their existing decors. Windows are getting larger and light levels remain bright.

Hence, the trend toward modernization and new design will continue among the fast-food franchisors. The heated competition in the fast-food marketplace, combined with the need for older companies to upgrade and modernize their prototypical look, are forcing the chains to address new ways in which restaurant design can be used as an integral part of their overall marketing plans.

2.7 RECRUITING MINORITY FRANCHISEES

There is a long-run trend by the franchisors to aggressively seek qualified women and minority franchisees. For those minorities who have an entrepreneurial spirit, the opportunity to own a business is particularly promising in franchising.

For eager black entrepreneurs this is the best time to cash in on the franchising craze. Franchised business already accounts for more than one-third of total retail sales in the country. And while more than two-thirds of small businesses collapse within five years, only about 4% of franchises fail over the same

period. Moreover, franchisors such as McDonald's, Burger King, Wendy's, Hardee's, and Kentucky Fried Chicken have signed agreements with civil rights organizations to increase the number of minority franchisees, making this an even more auspicious time for enterprising black businesspersons.^{29/}

An organization which promotes minority participation in franchise-owning corporations is Operation PUSH (People United to Save Humanity). Rev. Jesse Jackson's organization is trying to get the fast-food franchisors to, "increase the number of black employees and to increase goods purchases from black suppliers to levels that are equal to the percentage of black customers who frequent the fast-food chains."^{30/} Burger King has signed an agreement with Operation PUSH with the expressed purpose of increasing minority participation in the fast-food chain. "The five-year, \$800 million agreement is designed to quadruple black ownership of Burger King franchises."^{31/} As part of the agreement, Burger King will increase black management training and make donations to black groups. Kentucky Fried Chicken also signed an agreement with Operation PUSH. A special minority program has been developed at KFC which allows qualified candidates to have a significantly lower amount of required liquid assets.

The NAACP has also been successful in negotiating "fair share" agreements with McDonald's, Wendy's, Hardee's, and Church's Fried Chicken. Black civil rights groups have concentrated a large majority of their effort on increasing minority franchisee ownership because blacks account for a large portion of the fast-food franchisor's profits. These "fair share" agreements address the following areas of franchise operations: employment, upward mobility, minority purchasing agreements, inclusion of black franchise ownership, and philanthropic contributions to black organizations. McDonald's currently has 300 black franchisees, representing 15% of the company's worldwide franchises. By 1989, approximately 100 more stores will be owned by minorities. Burt Cohex, Vice President of Licensing for McDonald's stated, "There is an explosion sweeping the country. There has never been a better time for minorities to start out in their own businesses and become the kind of risk-takers the franchise system is built upon." Andrew Kostecka, of the U.S. Commerce Department agrees, saying "Franchise companies are prospecting constantly, and the minority market is a good market." He believes that franchises are particularly suitable for the black community, whose upwardly mobile members often lack business backgrounds, and adds that a national franchisor systematizes tasks so thoroughly that a diligent neophyte can make a profit.^{32/}

During the next decade, more and more women who aspire to become entrepreneurs will be taking a closer look at the franchising industry. Because of the training programs, the ongoing assistance offered by franchisors, the reduced risk of failure, and various financial incentives offered by the Small Business Administration (SBA) and other lending institutions, franchising provides an attractive investment opportunity for entrepreneurial women.

However, despite the reduced risks and added financial assistance, women have been slow to enter the fast-food franchising field. Only 6.5% of all franchises are owned solely by women, according to a survey by Shelby D. Hunt, a marketing professor at Texas Tech University. Another 31% of franchises are owned jointly by a husband and wife, with the woman often playing the secondary role.^{33/} The International Franchise Association notes that there is a long-term trend toward more women entering the franchising field. Representatives of the SBA, which has a number of financial counseling sessions for businesswomen, notes that a number of the fast-food franchises require a fairly high capital investment and women have a hard time raising the required liquid assets. For example, to start a McDonald's, an investor needs a minimum of \$250,000 in capital and a Wendy's can require \$350,000. Of the

McDonald's franchises in the U.S., approximately 57 are owned by women. The SBA notes, however, that it is much easier for women to get financing for a franchise than a small business operation, as banks are able to check out the franchisors and the prospective franchisee's references. Surprisingly, many women are unaware that franchise doors are open to them and others are unaware of the time commitment that it takes to become a successful franchisee.

I believe that in the 1990s, more women and minorities will join the ranks of entrepreneurs in fast-food franchising as opportunities and financial inducements by the franchisors become available.

2.8 PURSuing THE INTERNATIONAL MARKET

Each year more franchised American companies are looking beyond the United States for new markets to explore. Fifteen years ago the foreign market was relatively untouched by the fast-food industry. Today, the presence of the American franchisors is in lands undreamed of only a few years ago--China and Russia. (China's new KFC opened in 1987 and a Russian Pizza Hut will open in 1988.)

Many franchisors are heading abroad with their distinctively "American" business practices. American foreign franchise investment is good news for U.S. officials monitoring the trade deficit, and it is also good news for officials in other countries who are interested in increasing employment and providing their citizens with new products and services.

For many of the fast-food franchisors who journeyed into foreign countries, there was a period of adjustment to business practices that were vastly different from those in the U.S. Overcoming formidable cultural barriers has been one of the greatest obstacles confronting the fast-food franchisors. The other problems that the franchisors faced were similar to those faced by other U.S. corporations that have attempted to move operations to foreign countries: real estate is expensive, supplies and equipment are difficult to find, and Americans are not always welcome abroad.^{34/}

Canada continues to be the dominant market for U.S. franchisors.^{35/} A top priority area for the fast-food industry is the Pacific Basin, with Japan as the number one choice because of its high-density population. Development of franchises also continues in Europe and on a smaller scale in South America.

The number of fast-food franchises in international markets will continue to grow in years to come. In 1985, there were 67 firms with 6,122 units (company owned, franchisee owned, and joint ventures) represented in international markets, as compared to 51 companies with 5,990 units in 1984.^{36/} I believe the international market holds significant opportunities for the American fast-food franchisors and the rapid development of these markets will be vital in determining the future profitability and success of the fast-food franchisors.

FOOTNOTES

1. Jacobson, Michael F., The Fast-Food Guide, Washington: Workman Publishing, 1986, p. 78.
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CHAPTER III

MARKET SEGMENT--HAMBURGERS

The hamburger continues to be America's favorite fast food. The National Restaurant Association (NRA) reported that in 1987, 5.2 billion burgers were sold by fast-food franchises. The NRA stated that of those individuals who dine out, 18.7% order hamburgers. French fries are the only fast-food item that has a higher percentage of being ordered.^{1/}

Because the hamburger is America's favorite fast-food, there are a tremendous number of fast-food chains that specialize in burgers. McDonald's is clearly the largest fast-food franchisor (see Exhibit 3.1). In 1986, McDonald's had systemwide sales of \$12.4 billion and more than 12,000 units. Executives at McDonald's estimate that during 1987, the corporation opened a new outlet every 17 hours.^{2/} McDonald's is, by all accounts, the world's largest foodservice company. The corporation estimates that 95% of all U.S. consumers eat at one of its restaurants at least once a year, and that the average customer visits the chain 20 times per year. McDonald's serves approximately 17 million U.S. customers daily--

Exhibit 3.1

Burger Segment Market Share

Top 100 Rank*		Chain	Fiscal Year Ends	Market Share (By Fiscal Year)		
1987	1986			Current	Last Full	Previous
1	1	McDonald's	Dec.	47.52%	46.40%	45.40%
2	2	Burger King	May	18.83	18.81	18.58
4	5	Hardee's	Mar	10.20	10.09	9.91
5	4	Wendy's	Dec.	9.43	10.27	11.13
16	16	Arby's	Dec.	3.20	3.31	3.36
27	26	Jack-in-the-Box	Sep.	2.17	2.20	2.42
29	28	Roy Rogers	Dec.	1.99	2.04	2.11
43	45	Carl's Jr.	Jan.	1.29	1.28	1.39
45	46	Rax Rest.Inc.	Jul	1.25	1.23	1.16
46	49	Sonic Drive-In	Aug	1.07	1.12	1.21
51	53	White Castle	May	1.01	1.04	1.03
61	62	Whataburger	Sep.	0.89	0.91	0.93
83	83	Krystal	Jan	0.63	0.65	0.69
92	90	A&W	Dec.	0.52	0.56	0.64

* Ranking refers to Top 100 Chains, ranked by systemwide sales.

Source: National Restaurant News, August 3, 1987.

providing more than 11% of all dinners and 25% of all breakfasts away from home.^{3/} McDonald's is also the largest trainer of workers in the U.S. and prides itself on having employed at one time approximately 7% of all current workers or about 8 million people.^{4/}

McDonald's tremendous success can be attributed to its innovativeness and creativeness. McDonald's created the most efficient cooking equipment the foodservice industry had seen, and it pioneered new methods of food packaging and distribution. The corporation continues to grow in size and stature--other fast-food chains admire, copy, and try to emulate its success. Sales in 1987 grew at a higher rate than in 1986 and McDonald's is solidifying its position as the undisputed "king" of the burger segment. Analysts and competitors agree--the corporation is improving in all phases of its operation--a fact that not all fast-food franchises can attest to!

Burger King (BK) ranks second among the hamburger franchises and is based in Miami, Florida. The company had \$4.5 billion in annual sales in 1987 and has 4,700 units in the U.S., approximately 80% of them are franchised. BK's parent company is Pillsbury. BK gained a large market share with its hard-hitting "Battle of the Burgers" campaign in the early 1980s. Later, however,

the campaign became ineffective and there was a decline in sales. In 1987, the operating profits dropped 12% during the third quarter and BK sought a solution for generating increased sales. Plans were made in the early part of 1988 to upgrade 145 of the company-owned BK stores and to sell or close 15 under-performing ones. An additional 50 company units operated by franchisees will be modernized or closed.^{5/} BK has had severe management problems; during the past decade, it has had five presidents. In 1986, Charles Olcott, former Chief Financial Officer, was appointed President of BK. Olcott has managed to trim costs in an attempt to improve profit margins and is currently trying to stabilize the chain's marketing approach.

Hardee's is now the third largest fast-food hamburger franchisor. It is a division of Imasco USA Inc., and enjoys a particularly strong presence in the South and Midwest. In 1986, its sales were \$2.7 billion, with 3000 units. Jerry Singer, Hardee's Director of Public Relations said the chain's sales are up considerably in 1987 over 1986, from \$802,000 to \$860,000. The chain is growing rapidly--just four years ago, it had only 2000 units. Its future is indeed promising.

Following closely behind Hardee's is Wendy's the fourth largest hamburger franchisor, which has 3800 stores and is attempting to turn around poor sales and profits. In the first half of 1987, the company reported its "first-time ever" losses. However, its third quarter showed a substantial increase in sales and a profit of \$5 million. Sales in the stores now seem to be stabilizing and are increasing. Wendy's has also had marketing problems. It needs to come up with another clever marketing campaign similar to its highly successful "Where's the beef?" campaign.

One of the top ten hamburger chains, Carl's Jr., is tremendously popular on the West Coast. On April 19, I spoke with Frank Karcher, Vice President of Franchising of Carl Karcher Enterprises, in Anaheim, California. He said the chain's 400 units are primarily located in California, Arizona, and Nevada. In 1986, the company lost more than \$7 million and revenues declined \$317 million. Carl's Jr. had attempted unsuccessfully to expand nationally, and its current emphasis is to expand only in regional areas. First quarter earnings for 1988 were considerably higher than in 1987. The company attributes its improved financial condition to the introduction of new menu items and a franchise remodeling program. The new units have substantial eye appeal.

For the fast-food hamburger franchisors, successful marketing is vital! It is a well-known fact that the hamburger segment is mature and some analysts believe there may be a slow-down in growth in terms of franchise units and total revenues. How can franchisors in a mature industry increase their sales? One very effective way is through creative marketing. In looking at the marketing expenditures of three of the top chains, (McDonald's, Burger King, and Wendy's), one can see the importance of this strategy. I believe that franchisors will continue to increase their advertising and marketing budgets as the "burger wars" ultimately escalate.

McDonald's annual advertising budget for 1986 was an estimated \$700 million, which was significantly more than Burger King's, Hardee's, and Wendy's budgets combined. One of the major reasons for the dominance of McDonald's in the hamburger segment is its emphasis on advertising and marketing. Time after time, McDonald's "top of mind" commercials are winners! "Have a Mac Tonight," was extremely successful, as was "Silent Persuasion," in which one deaf student uses signing to suggest to a friend that they visit McDonald's on the way to the beach. According to Video Storybook Tests, this particular ad was the second-most popular commercial in 1986. As a further

pronouncement of McDonald's advertising finesse, their third quarter net earnings in 1987 rose 14%.

Those closest to the industry feel the greatest challenge that Wendy's faces is getting its marketing strategy in order. Its highly successful "Where's the beef?" campaign caused Wendy's sales to soar. However, subsequent ads have simply lacked lustre! Over the past few years, management has vacillated widely between various marketing approaches.^{6/} A recent ad campaign which was scheduled to run for approximately 7-9 months was "Give a little nibble." After 7 weeks, and poor viewer marks, the campaign flopped. According to Paul Raak, Wendy's Manager of Corporate Communications, Wendy's current plans are to focus on its quality hamburger and its new Super Bar featuring soup, salad, pasta, Mexican, and Italian dishes. One can only hope that this new strategy will help the troubled chain, as Wendy's reported significant losses for the first time during the months of January-June, 1987.

It is interesting to note that several of my interviewees, who requested anonymity, stated that Wendy's is in severe trouble, and added that if the company cannot get an integrated management strategy together, they predict the company will eventually be sold.

After gaining a market share with its hardhitting "Battle of the Burgers" campaign in the early 1980s, Burger King stumbled, with a \$30 million, six-week promotion of its meatier Whopper sandwich.^{7/} David Vadehrs, who conducts consumer surveys of television ads says, "Burger King has been trying everything and not coming up with anything. There have been a string of ad disasters." During the past two years, Burger King has gone through four major ad campaigns; it abandoned the Battle of the Burgers, tossed out the meatier Whopper, put Herb to death, and boarded up Burger King Town.^{8/} With no obvious direction, Burger King's sales are flat. Its operating profits were down in 1987 to \$219.2 million from \$304.7 million in 1986.

As competition heats up among the chains, a wide variety of promotions designed to capture the consumers' attention will be launched. In 1987, McDonald's promoted its largest contest ever--a "Monopoly"-based game in which 500 million tickets were distributed and \$40 million in prizes were awarded. I remember standing in line last year waiting for my order of french fries and talking with a young woman in line. She told me that she stopped at McDonald's every night after work, because she had two cards for a condominium and she needed just one more to win. This contest reaped big rewards for McDonald's; the

company was the real winner with increased sales. Other chains have plans for similar contests which should be forthcoming in the near future.

As stated earlier, it is a well-known fact that the hamburger segment is mature. Consequently, analysts predicted a slowing pace in the number of new units being built and declining sales. Although I tend to agree with the analysts regarding the slowing pace of new units in the U.S., I believe the hamburger franchisors are exploring many new avenues, such as the addition of new menu entrees and side dishes that will help to boost sales and broaden their appeal to new consumers. As the consumer increasingly becomes more health and nutrition conscious, more light and low-calorie selections will begin appearing on various menus.

The year 1987 for the hamburger segment might be referred to as the year of menu expansion. McDonald's introduction of pre-packaged salads was tremendously successful. Its third quarter net income rose 14% and the company attributed this increase to the introduction of its new salads.

Because McDonald's venture into the salad line was enthusiastically received by the public, other burger

chains followed the leader. Wendy's added a salad bar, and later in 1987 expanded that to a "Super Bar." The Super Bar is approximately 18 feet long and includes pasta, Mexican foods, salads, fresh fruit, vegetables, and desserts. The Super Bar has increased sales by 15% and has been added to all of the 1120 company stores.

Franchisees have the option to participate in the venture if they wish. Analysts believe the Super Bar may help give Wendy's a much-needed competitive edge and help to set Wendy's apart from all the other hamburger chains.

However, after visiting a "Super Bar" at Wendy's, I can't help but wonder if the chain has overextended and forgotten its original strategic mission--to offer the very best hamburgers. I firmly believe that the pre-packaged salads are a definite trend of the future for the fast-food franchisors. Although it's true that salad bars have definite eye appeal and are tremendously enticing for the customer, I believe they will be phased out by the fast-food franchisors for three reasons: first, they are extremely costly to maintain and restock; second, there is a significant amount of food that is wasted; finally, as people become more health conscious, they want the assurance that the salad bar is kept clean and fresh.

Burger King has given its customers a choice of the salad bar and four prepackaged salads: chef, garden, pasta, and shrimp. When I visited Burger King, the manager said the prepackaged salads have been a very popular item and there is quite an increased demand for them. Hardee's has also joined McDonald's and Burger King by adding pre-packaged salads to its menu.

I was particularly anxious to try the salads at the various chains. I ordered a pre-packaged salad at McDonald's and Burger King in California, and at Hardee's in Washington, DC. I asked the managers at each of the locations the following questions: (1) What is the most popular salad? (2) Are the salads selling? (3) How often are the salads made?

The response at the various chains was overwhelmingly positive. The managers stated that the salad demand is so great that they are making the salads more frequently than originally expected. I also noticed the salads do have tremendous eye appeal, are packaged neatly, and displayed in an attractive case adjacent to the ordering station.

Further following the trend of menu expansion, McDonald's capitalized on the breakfast market and through the successful offering of its Egg McMuffin, found an

additional way to entice customers to its units in the morning. Because customers are usually running late, they demand quick and efficient breakfast service. Wendy's had also hoped to reach the breakfast crowd with its made-to-order omelettes. The public's reaction to the omelette was overwhelmingly positive. Unfortunately, the units could not keep pace with the public's demand and the results were disastrous--Wendy's recovered very slowly from the ill-fated breakfast attempt. However, for the hamburger fast-food franchisors, breakfast will continue to be a market worth developing. I feel that in the long run, the breakfast segment represents an area of tremendous potential. But for the franchisors to be successful in the breakfast market--efficiency, service, and quality are vital.

Capitalizing on the "White Castle" mini-burger fame, the trend of the major burger franchisors is toward smaller, finger-sized sandwiches. Both Burger King and Wendy's are now test marketing "miniature burgers." These are an attempt to bring back customers who had left because of rising menu prices. The small burgers are convenient to hold and easy to eat. Wendy's has 2-ounce burgers and Burger King's Bundles are flame-broiled, 1 ounce, and sold in packs of 3 or 6.

If pizza can be delivered successfully, can hamburgers? Burger Fresh of Ann Arbor, Michigan, is the first hamburger company to build a concept completely around the delivery of hamburgers. Using a central telephone ordering system, Burger Fresh guarantees delivery in 30 minutes. Burger King and Jack-in-the-Box are testing home delivery. Burger King, Arby's, and Carl's Jr. are also in the developmental stages of testing mobile units. These mobile units can be sent to special events--track meets, football games, college campuses, the beach, etc. Although I am not convinced on the success of home delivery of hamburgers, I feel the mobile units can be utilized strategically as the costs associated with the vans are relatively low and because of their potential to monopolize a specific event or location, the profits could be high.

As real estate prices escalate, joint venturing and dual-concept units are being increasingly utilized by the hamburger franchisors. Wendy's has a joint test with Baskin-Robbins ice cream company and Day's Inn of America. Hardees has located a number of its units below People's Drug Stores in Washington, DC, and is currently testing two of its operations in 7-Eleven convenience stores. Carl's Jr. opened a take-out unit at the University of Southern California. Burger King is in the process of planning similar dual-concept units. I feel

that the combination franchising is a definite trend of the future for the hamburger franchisors, and very soon most of the top ten hamburger chains will be active in this new marketing development concept.

As prime locations disappear in the United States, the hamburger franchisors are quickly exploring and expanding in new markets abroad. There are many factors--economic, political, and cultural--used by McDonald's to determine which countries are appropriate markets. McDonald's evaluates the elements that make a successful McDonald's restaurant: good location, local area management employees, quality suppliers, advertising media, and a large mobile population.^{9/} In each country, the McDonald's business is headed by local management. When the company franchises a restaurant it is usually to a citizen of that country. Japan has the largest number of McDonald's restaurants (575). There are a total of 2,140 foreign outlets in 42 different countries.^{10/} In the U.S., McDonald's sales rose for the first six months in 1986 by 9% to \$4.6 billion; international sales rose 37% to \$1.3 billion. In 1987, McDonald's opened 170 restaurants outside the U.S. McDonald's future in the foreign market will be continuous.

The President of Burger King's international division, Ronald Petty, believes that if Burger King is to remain a global company it must pursue international expansion. According to Petty, Burger King has a world-wide trademark, and it is imperative for the company "to operate as a global company and to expand overseas to maintain the market share. The domestic market has reached a maturation level and because of this there will be a slowdown of domestic growth." Petty's goal was to have 500 units in 26 countries by 1987. In 1986 there were 402 international Burger King restaurants in 25 countries; in 1987 there were 30 countries with a total of 473 international restaurants.^{11/}

The major hamburger chains are making the ownership of a franchise particularly attractive to both women and minorities. Many of the franchisors have signed equal opportunity agreements with the NAACP, Operation PUSH, and financial support networks.

The cost of hamburger franchises varies among the chains. If one were interested in opening a McDonald's franchise, assuming he/she passed the stringent interview process, the total investment is \$375,000 to \$400,000, which includes an initial franchising fee of \$22,500. The franchisee then pays a 12% monthly rental and service fee.

(The rental fee is paid because McDonald's owns the land.)
Two percent of the monthly sales go to national and two percent to the local cooperatives for advertising.12/

A Wendy's franchisee owns the land and the building.
The average cost in 1986 to open a unit was \$866,000.
Wendy's initial fee is \$25,000; 4% of gross sales is paid for royalties. The advertising contribution is the same as McDonald's--2% national and 2% local.13/

FOOTNOTES

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CHAPTER IV

MARKET SEGMENT--PIZZA

Hamburgers are still America's favorite fast food, but the pizza franchisors--Pizza Hut, Domino's, Little Caesar's, Godfather's, Pizza Inn, and others--are the leading forces of a multi-billion dollar segment that is perhaps the most innovative in the fast-food industry. According to the Spring 1986 RE-COUNT data, prepared by Kenilworth, an Illinois-based Restaurant Consulting Group, Inc., there are a total of 35,770 pizza restaurants in the U.S. (10.8% of the total number of restaurants). By contrast, there are 28,286 hamburger restaurants (8.5% of total restaurants).^{1/} The pizza industry is challenging the hamburger segment to become America's favorite fast food.

In 1986, the emphasis in the pizza industry was on home delivery. Domino's Pizza was the driving force behind this service. The company's idea of selling the ease and convenience of home delivery quickly caught on and Domino's sales gains were impressive. Total sales increased by 35.7%, to \$1.085 billion, as of December 1986; that increase followed a 73% increase in 1985, with

sales of \$62.6 million. In 1987 sales for Domino's Pizza reached \$1.8 billion.^{2/} Pizza Hut, the largest chain in the nation, decided in 1986 to pursue the home delivery market. At a cost of \$50 million, Pizza Hut developed an elaborate system to handle its larger markets. The system is known as COTS (Central Order Taking Stations), with centers located in Atlanta, Tucson, Indianapolis, and Washington, DC. One telephone number serves the entire city and with the aid of a central computer, the closest Pizza Hut is directed to deliver the order. With each franchisor struggling for additional market share, more companies will use centralized information systems to process orders, recognizing that home delivery is a long-term trend in the pizza segment. In 1987, there was a 117% increase in sales over 1982.^{3/} Home delivery has contributed to that growth. Paula Werne, editor of Pizza Today magazine said that 63% of the operators deliver pizza, and an additional 11% will begin home delivery soon.

The number of franchised pizza restaurants is growing rapidly; in 1986, there were 16,259--a gain of 12.8% over 1985.^{4/} At a time when the operators of other fast-food franchises are complaining of an overbuilt, saturated industry, pizza units continue to expand in number. Pizza will continue to be the fastest growing segment in the

1990s as the innovative industry continues to carve out new business and find new customers.

During 1987, the emphasis in the pizza industry was on "speed"--speed in delivery, in pizza preparation, and in service. This is an ingredient that has led to the industry's phenomenal growth in sales (see Exhibit 4.1). At Domino's company-owned stores, a free pizza is offered if delivery time is not within the thirty minute time limit. With an emphasis on speed and home delivery, Domino's has captured more than half of the pizza delivery market share in the nation.

The lunch-time segment will continue to be a prime target for the pizza franchisors. Pizza Hut has found a way to target daypart. Through various forms of media, Pizza Hut tells prospective customers that they will be served a single Personal Pan Pizza or Calizza Calzone within five minutes of entering the restaurant--or the pizza is free! Mike Jenkins, Pizza Hut spokesman, said, "We haven't given away many free pizzas, and our sales are up an average 10% per unit since the same period in 1986. In the pizza segment, speed and convenience really count." Pizza Hut also has instituted an express- lunch in 2500 of its company-owned stores. The express- lunch evolved from its quick-lunch program. Ron Paul,

Exhibit 4.1

Top Pizza Chains
Ranked by System-wide Sales

Top 100 Rank*		Chain	Fiscal Year Ends	System-wide Sales (By Fiscal Year, in Millions)		
1987	1986			Current	Last Full	Previous
6	6	Pizza Hut	Dec.	\$2,450.0	\$2,150.0	\$1,880.0
8	8	Domino's	Dec.	1,800.0	1,550.0	1,084.0
19	30	Little Caesar	Dec.	770.0	520.0	340.0
51	52	Pizza Inn	Dec.	300.0	278.7	265.5
52	54	Godfather's	May	300.0	275.0	260.0
54	59	Round Table Pizza	June	300.0	250.0	196.4
59	61	Showbiz/Chuck E. Cheese	Dec.	280.0	249.0	217.0
76	72	Shakey's Pizza	Sept.	212.6	197.0	196.3
97	93	Mr. Gatti's	July	146.0	139.2	138.3
TOTAL TOP 100 Pizza Segment Sales				\$6,558.6	\$5,608.9	\$4,577.5

* Ranking refers to Top 100 Chains: Ranked by Systemwide Sales

Source: NRN Research

President of Technomic Inc., a Chicago-based food service consulting firm says, "Pizza Hut's express-lunch program has helped position pizza as something other than just a dinner item." The express-lunch program has enabled Pizza Hut to capture a large percentage of the lunchtime market. Before the program was instituted, a large portion of Pizza Hut's business was only at dinner. Now approximately 35% of the chain's business is at lunchtime.^{5/}

Because of Pizza Hut's successful venture into the lunch market through speedy service, other chains are offering items which can be served quickly at noontime. Godfather's Pizza offers a hot-slice pizza in three minutes or your money back. Other pizza chains are shortening service time by offering pizza by the slice.

Another way the pizza chains are promoting all-day traffic is with discount promotions. Approximately 25% of all pizza sold involves some sort of a deal, most often coupons.^{6/} Pizza Hut began the "Pairs" promotion--buy one pizza and get one free. A few years ago, Little Caesar's reached the "big league" after starting a permanent promotion of "two pizzas for the price of one." In 1980, total sales for Little Ceasars were \$63.6 million compared to an estimated \$770 million in 1987. Domino's,

Pantera's and Mr. Gatti's also offer discounts with coupons. Some executives of the pizza chains fear that these promotions are offered too frequently, and that customers may come to expect these "specials" whenever pizza is purchased.^{7/} However, I feel that coupons and discounts have been established in the industry and will continue to be important consumer inducements for the pizza segment.

New innovative and creative marketing ideas will also give franchisors the competitive edge. Domino's, with their successful "we deliver pizza" promotion, has become the leader of innovative ideas in the fast-food industry. Because of Domino's desire to become "Number One" in the pizza segment, I spoke to Ms. Patricia Lacoste, Assistant to the National Marketing Director for Domino's. In our telephone conversation we discussed many issues including franchising, advertising, marketing, and international market expansion.

Domino's creative approach to employee training is also unique. The company has installed a new video satellite television network which will bring together employees at all levels and combine efficiency and uniformity in operations. This is a first for any American fast-food franchisor. The system consists of a

transportable disk that sends signals to a satellite and a television or a projection screen can be used by a viewer monitor. Jeff De Graff, Director of Domino's Education and Communications says, "The satellite network will allow us to communicate with all of our franchisees on a more consistent and continuing basis. With this system, employees can be trained who otherwise could not, because of the prohibitive cost of bringing everyone together." De Graff feels an important factor of the satellite system is teaching in the workplace. Domino's executives plan to meet with other officers from large U.S. companies to plan a joint cooperative venture using the satellite as a training tool. Domino's future plans call for discussions with various college officials whereby employees can talk to students through the network and share their work experience. De Graff feels the television network is "another step toward opening lines of communication throughout the company and continuing a decentralized philosophy in education."

Many franchisors in the pizza segment will only franchise to existing managers or franchisees to ensure quality control. Although the cost of the various pizza chains varies, a Dominos' unit averages \$85,000-140,000, with an initial franchise fee of \$5,500. Royalties are 5.5% of sales^{8/} and franchises are offered only to

supervisors or unit managers who have worked at Domino's for one year. Kerry McNulty, Domino's Media Coordinator, says that limiting franchises to Domino's employees helps the company grow more quickly because the policy guarantees familiarity and quality of the operation. By the end of 1988, Domino's plans to open 663 stores. It franchises approximately two-thirds of its stores and plans to have 10,000 units by the 1990s.

Pizza Hut limits new franchises to existing franchisees. The cost for a Pizza Hut can range from \$150,000 to \$800,000. Four percent of sales is for royalty and advertising costs are from 1-4%. Pizza Hut is a division of PepsiCo, Inc. and the company plans to maintain a ratio of 50/50 of franchised to company-owned stores. By 1990 between 7000 and 8000 new stores are expected to open.

The franchising fee for a Godfather's Pizza is \$15,000, with a \$5000 opening fee. Five percent of sales are for royalty fees and 2% are for advertising costs. A Godfather's unit costs from \$60,000 to \$300,000. Godfather's is owned by Pillsbury and in the next three years the company plans to open 100 units. Of the 610 Godfather's stores, 427 are franchised. Stores are found

in 37 states and the strongest markets are in Salt Lake City, Kansas City, Minneapolis, and Seattle.

As consumers demand convenience, pizza franchises of the future will give their customer the option of purchasing a pre-cooked pizza or one the customer can bake at home. The future trend will stress convenience for the customer. Papa Aldo's Take and Bake Pizza Shops sell fresh pizza prepared for baking at home. Papa Aldo's is headquartered in Portland, Oregon. It has 79 franchised stores and three company-owned stores. Future plans call for 40 new units to open in 1988, predominantly in Washington and California. Papa Aldo's charges 30-40% less for fresh ready-to-bake pizzas than the average pizzeria that bakes on the premises. John Price, Vice President of Advertising and Promotions, says, "Franchisees favor our units because they are small and inexpensive to operate. None of them have seats, ovens, or ventilating systems." The franchising fee for Papa Aldo's is \$17,000 and the startup costs average \$90,000. Five percent of sales are for royalties and advertising.

Competition is extremely intense among the various pizza franchisors. Adding to that competition are the convenience store chains. In a survey conducted by Convenience Store News, Casey's General Stores makes a

pizza from scratch; Circle K sells pizzas that are ready to heat; and 7-Eleven has freshly baked pizzas. Using the idea--if you can't beat them, join them--Pizza Inn has reached an agreement with Circle K to have Pizza Inn Express sites within the Circle K Markets. Takeout and home delivery will be offered by each of the Pizza Inn Express units. Stephen E. Schwitalla, Senior Vice President of Food Service for Circle K said, "We think that Pizza Inn's brand name products and relatively high sales per transaction will prove compatible with Circle K's high-traffic, high-visibility locations and convenient quick-service format."

With the tremendous growth rate in the number of pizza franchises in the U.S., several franchisors are targeting the overseas market. Officials of Domino's Pizza predict that by 1990, Domino's will be close to its domestic saturation point. Because of this forecast, efforts will be focused on the markets abroad. Domino's Vice President of Finance, Doug Dawson, emphasizes that when the company is considering a country for expansion, the following factors are considered: labor, banking and tax laws, culture, and customs. Donald Cooper, Domino's Pizza International Controller said, "Everyone realizes that international is going to be the force in the future. The

international division is the fastest-growing business unit."

Canada has the largest number of pizza franchises outside the United States. It is interesting to note that in Japan, Domino's is adding stores at a rate of one every four weeks.^{9/} By the end of 1988, there will be 26 outlets in Japan--pizza has "caught on" in Japan.

Domino's is not the only pizza company that is expanding overseas. Pizza Hut says its overseas unit has grown at a rate of 22% over the past five years. As of August 1987, Pizza Hut Inc. had more than 775 stores overseas.^{10/} A very positive advantage for Pizza Hut is its connection with PepsiCo and their negotiations with the Russian government. Soviet official Yuri Kistenka, said the new joint venture would be "given several years of tax-free operation, complete independence from central Soviet economic planning, and the freedom to experiment with Western labor-management techniques." Western analysts have said that the joint ventures, permitting foreigners a share of the equity and management roles in Soviet industry are among the most radical economic innovations envisioned under Soviet leader Gorbachev.^{11/}

Pizza chains have become definite trend setters for the entire fast-food industry. There will be a training program in the hamburger and chicken industry, "styled after" Domino's. There will be a centralized computer system designed after Pizza Hut's to expedite "delivery items." The pizza franchisors have the desire to be the "Number One" producer of favorite fast food in America. The pizza industry is clearly on its way and it is in high gear to overtake the hamburger industry--look out--here comes pizza!!

FOOTNOTES

1. Kochak, Jacque, "Pizza Market Is On the Move," Restaurant Business, May 20, 1987, pp. 99-118.
2. Ibid.
3. Elder, Martin, "Pizza," Restaurant Business, March 20, 1988, pp. 116-120.
4. Frydman, Ken, "Pizza Chains Shift Into High Gear," Nation's Restaurant News, August 3, 1987, pp. 39-43.
5. Riell, Howard, "Business Barometer," Restaurant Business, December 10, 1987, pp. 2-5.
6. Ibid.
7. Goodwin, John, "Pizza For Coupons," Business Week, December 9, 1987, pp. 8-9.
8. Elder, op. cit., pp. 116-120.
9. Chancellor, A., Journal of Commerce and Commercial, October 13, 1987.
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International," March 20, 1987, pp. 172-178.

CHAPTER V

MARKET SEGMENT--CHICKEN

The growth in the fast-food chicken market segment during the past eight years has been steady but not spectacular. Between 1982 and 1987, the chicken franchise sector has had an increase of 64% in total sales (see Exhibit 5.1).^{1/} There is still a great increase in unit development among the top chicken chains (see Exhibit 5.2). The smaller chains, such as Mrs. Winner's and Bojangles, have suffered major losses and have closed a number of their stores. Both chains blamed overexpansion in a saturated market and the economy. The U.S. Department of Commerce reported in 1986 that there were 9,883 development units specializing in chicken which generated \$4.9 billion in sales, compared to 9256 units in 1985 with sales totaling \$4.4 billion.

Kentucky Fried Chicken (KFC) is the world's largest chicken franchisor, headquartered in Louisville, Kentucky. Sales in 1986 topped \$3.5 billion. KFC has 7,500 stores and approximately 75% are franchised. The chain commands approximately 45% of the \$5.5 billion fast-food chicken sales in the U.S. Because of its tremendous success,

Exhibit 5.1

Top Chicken Chains Ranked by System-wide Sales

Chain	Fiscal Year Ends	System-Wide Sales (By Fiscal Year, in Millions)	
		Current	Latest Full
Kentucky Fried Chicken	Dec.	\$3,286	3,100
Church's	Dec.	645	640
Popeyes	Oct.	399	335
Bojangles'	Dec.	212	210
Grandy's	June	204	200
Chick-Fil-A	Dec.	176	161

Source: National Restaurant News, December 15, 1986.

Exhibit 5.2

Top Chicken Chains Ranked by Number of Units

Chain	Fiscal Year Ends	Number of Units (By Fiscal Year)	
		Current	Last Full
Kentucky Fried Chicken	Dec.	6,729	6,396
Church's	Dec.	1,585	1,549
Popeyes	Oct.	640	521
Chick-Fil-A	Dec.	350	319
Bojangles'	Dec.	307	328
Grandy's	June	180	180

Source: National Restaurant News, December 15, 1986.

the company plans to open one new store per day for the next several years. In October 1986, KFC was acquired by PepsiCo. PepsiCo is also the franchisor of the Pizza Hut and Taco Bell chains. Greg Reynolds, Vice President of Public Affairs for KFC, in a telephone interview, stated, "PepsiCo is a company that fully understands the restaurant business and is deeply committed to it. We'll be able to grow even stronger under PepsiCo and possibly tap potential synergies with Pizza Hut and Taco Bell." With the acquisition of KFC, PepsiCo is now the largest restaurant operator in the world.^{2/} Business Month magazine voted PepsiCo one of the five best-managed companies in 1987. D. Wayne Calloway, PepsiCo's Chief Executive Officer personally runs the restaurant division. He plans to increase annual sales volume per unit by adding to the menu to broaden the restaurants' appeal.^{3/}

In March 1988, I had a lengthy telephone interview with Greg Reynolds, Vice President of Public Affairs for KFC. He stated that the chicken segment is one of the fastest-growing segments in the fast-food franchise industry. He also stressed the importance of franchisors' maintaining a clear focus and direction in their own industry. He stated that both Burger King and Wendy's have lacked a strategic direction and consequently their

sales have fallen. This, he says, will not happen to KFC. KFC is the world's leader in chicken sales and is the Number One purchaser of chicken. McDonald's is Number Two. Depending on the particular geographic region, Popeye's, Church's Fried Chicken, and Bojangle's are competitors. But, he added, "The movement of the hamburger chains into the chicken segment will heat up the business, so KFC must be the best provider of chicken to defend its sales."

Church's is the second largest chicken restaurant chain. It is based in San Antonio, Texas, and has 1600 stores, of which 1064 are company owned. Its sales in 1986 were \$577 million. During the first half of 1987, sales were off; profits had declined to \$7.7 million, which was down 50% from the previous year. It was a difficult year for Church's because many of its units were in the oil belt area where money was extremely tight. C.H. Roman, Church's Chief Executive Officer, says management plans to emphasize Church's "everyday low prices." Church's has always differentiated itself from KFC by selling larger pieces of chicken at lower prices. The slogan for 1988 is "Church's--Lower cost provider of quality chicken." In 1988 Church's plans to add 50 franchised stores and 20 company-owned stores. The

company plans to continue expanding at that rate for the next few years.

Popeye's, the number three chain of the chicken fast-food franchisors, has 800 stores. It has ambitious plans to open 105 stores in 1988, 130 in 1989, 140 in 1990, and 150 stores in 1991. Popeye's is based in New Orleans and in 1986 its sales were \$577 million. Because it is based in the oil-depressed South, its sales were also lower in 1987--with about a 1% decline. Popeye's plans to continue developing the "spicy" New Orleans, cajun-style food it is noted for. Interestingly, Popeye's has the highest unit value per store (\$750,000) of any of the "Big Three", and the second-highest sales per unit (see Exhibit 5.3).

In addition to increased domestic expansion, the chicken franchisors highly prize the international market. In the mid-1960s, KFC entered the overseas market and today it is the largest international chain with 2,650 stores.^{4/} In 1987 KFC became the first American fast-food chain to enter the People's Republic of China. The Beijing restaurant is one of the largest ever, with 12,000 square feet and a seating capacity of 500 people. The restaurant has three floors and a unique architecture.^{5/} Steven Fellingham, President of KFC International, says

Exhibit 5.3

Top Chicken Chains Ranked by Sales Per Unit

Chain	Fiscal Year Ends	Sales Per Unit (By Fiscal Year)	
		Current	Last Full
Grandy's	June	\$1,120	\$1,160
Popeyes	Oct.	720	743
Bojangles'	Dec.	690	640
Kentucky Fried Chicken	Dec.	630	595
Chick-Fil-A	Dec.	540	520
Church's	Dec.	442	433

Source: National Restaurant News, December 15, 1986.

the international group is growing in excess of 20% a year, and the outlook for the years ahead is very positive.

The international "fever" is catching on, even for the youngest of the chicken chains--El Pollo Loco. Howard Massey, President of El Pollo Loco, says they are taking a close look at international expansion.

A degree of optimism surrounds the chicken fast-food segment, as Americans are increasing their consumption of chicken at an increasing rate. Poultry consumption was expected to surpass beef consumption for the first time in 1987, reflecting a steady increase since the late 1970s. Per capita poultry consumption is projected to rise 78.6 pounds as opposed to 73.8 pounds for beef consumption.^{6/} As the trend toward consumers demanding more nutritious foods continues, the American people increasingly want to eat foods that are both low in fats and cholesterol.

The chicken segment is capitalizing on the public's growing interest in healthy foods to its strategic advantage. Interestingly, two small chains which are growing very rapidly are benefiting the most--El Pollo Loco, with 70 units, and El Pollo Asada, with 18 units.

Both chains feature a charbroiled chicken seasoned with spices and marinated in fruit juices. These new chains generate an estimated \$13 to \$47 million in annual sales, compared to the fried chicken sales of \$4.9 billion.^{7/} The American Heart Association has endorsed the chicken of these chains. El Pollo Loco and El Pollo Asada have capitalized on the endorsement and stressed the "healthful" aspects of their chicken in advertising campaigns. For example, El Pollo Loco's Valentine's campaign and coupon stated, "Valentine, You're a Healthy Habit Worth Having!"

Both chains are growing at a rapid rate throughout the Southwest. I believe the charbroiled chicken segment will achieve a significant percentage of the total fast-food chicken sales in future years.

With great interest, I called El Pollo Loco's headquarters in La Mirada, California, to obtain additional information on franchise opportunities. I was told that no franchises are available in California. Franchises can still be purchased in Arizona and Nevada.

Both KFC and Church's Fried Chicken have been keeping a watchful eye on El Pollo Loco and El Pollo Asada. KFC has an oven-roasted chicken product that is currently being test-marketed and is doing well. Church's is also

testing a non-fried chicken product. Janet Lowder of Laventhol and Horwath said in our interview that one of the problems with both Kentucky Fried Chicken and Church's Fried Chicken is their name. Both franchisors are associated by consumers as having only fried chicken; consequently, any new preparation technique will require a longer introduction period. I do believe that in a relatively short period of time, non-fried chicken will become a popular item for the chicken fast-food franchisors.

As competition within the chicken segment increases, franchisors seek new dayparts. For many years, 75% of the chicken franchisors' business was at dinnertime. As Greg Reynolds of KFC noted, "Dinner has always been KFC's main market, hence, its new focus is now on the lunchtime market." Reynolds feels that lunch is a prime opportunity target which represents a \$25 billion business, and at present the hamburger chains only command \$15 billion of that market. Reynolds stated that it is important to maintain a high price/value perception among customers. He has watched McDonald's very closely and noticed that approximately 50% of their sales are from their inexpensive burger. KFC decided to test market a sandwich which the customer would perceive as having a high price/value. There has been a tremendous response to

smaller, inexpensive sandwiches and KFC is attempting to zero in on the lunch market with its 39¢ Chicken Littles--a mini-sandwich. The Chicken Littles are one ounce chicken patties served on a bun. When KFC introduces a new menu item, the other chicken franchisors take note. Popeye's Famous Fried Chicken, in an attempt to remain competitive, introduced its own one ounce mini, 39¢ sandwich--Little Chickadees. The new sandwich item is an alternative to a hamburger, and the chicken franchisors are hoping that it will attract the lunchtime crowd.

While eyeing the tremendous success of home delivery in the pizza segment and given the potential of chicken to travel well, I believe that the chicken franchisors will also try to capitalize on the home delivery trend. However, I am not convinced that the chicken franchisors will achieve a comparable success rate. KFC has developed a system for home delivery that is very similar to Domino's. There is a single telephone number, a number of telephone operators, and a computer that transmits each order to the store closest to the call's origination. Food is packed in insulated hot and cold containers and delivered within a 30-minute timeframe. Although officials at KFC say there is potential for home delivery, they cite certain problems: (1) liability insurance for drivers who use their own cars; (2) home delivery could

become a high-cost replacement for takeout chicken. Popeye's tested the home delivery concept and found it to be unprofitable. I believe the home delivery concept would not be a long-term trend with the chicken segment because consumers do not associate the product with home delivery. Consumers prefer to jump in their car, as they always have, and pick up a box or bucket, rather than pay an extra delivery fee for the service.

With an increased emphasis by consumers on convenience and speedy service, chicken franchisors will integrate more double drive-thru units in their stores. The chicken franchisors recognize the importance of fast service and convenience. This awareness is reflected in the drive-thru systems. KFC has reduced the average service time from two minutes to one, with the new units. Church's plans to test its double drive-thru concept in 1988 which features drive-thru windows and one or two walk-up windows. It is interesting to note that there will be no inside seating in their new restaurant plans.

Because salads have become an extremely popular menu item for the burger franchisors, KFC is also test marketing the concept. KFC has introduced a green salad aimed at health-conscious consumers. Salads will also play a key role in boosting lunch time traffic. I believe

in the near future that prepackaged green salads will become a standard menu item for the chicken franchisors.

Although the breakfast market has proven extremely profitable for the hamburger franchisors, I do not feel that this market lends itself well to success in the chicken segment. KFC says, "No to breakfast! Richard Mayer, CEO, says, "It's back to basics. After testing breakfast in some markets and notcing Wendy's recent failure in attempting to compete with McDonald's, we decided to abort the plan." The only chicken franchisor serving breakfast is Bojangles. Executives at Bojangles claim that breakfast accounts for one-third of the company's sales.

Joint ventures will be increasingly explored by the chicken franchisors. Currently, Church's Fried Chicken is testing the recent 7-Eleven venture which includes a chicken take-out counter in the convenience store. Greg Reynolds mentioned that at the present time, KFC is not interested in a joint venture or combination franchising arrangement. At this point, he feels that such an operation is not cost-effective unless the chain pursues the breakfast segment.

Mr. Reynolds told me that KFC is actively seeking women and minority franchise owners and also emphasized a number of easy-to-enter financial programs for individuals who qualify. Currently, the franchising costs for a KFC unit include a \$20,000 initial fee and 5% each for royalties and advertising. Total building costs run anywhere from \$600,000 to \$850,000.^{8/}

Church's units vary in price, depending on the facility the franchiser selects, from \$250,000 to \$550,000. Costs include a \$15,000 initial fee per store, a 4% royalty fee, and a maximum of 5% gross sales advertising fee.^{9/}

FOOTNOTES

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3. Hershman, Arlene, "A Keen Sense of Boom," Business Month, December 1987, pp. 34-38.
4. Elder, M., "Back to Basics," Restaurant Business, October 10, 1987.
5. Nation's Restaurant News, "China, the Next Stop," December 15, 1987.
6. Bain, Laurie, "Charbroiled Chicken Heats Up," Restaurant Business, May 1, 1987, pp. 145-148.
7. Ibid.
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9. Ibid.

CHAPTER VI

FRANCHISE INVESTMENT PERSPECTIVES

I embarked upon this research for two reasons: first, to better understand the success of franchising in the economy, and second, to evaluate the long-run trends in order to select a franchise for a possible future investment opportunity. Through my research, I have learned a great deal about the franchise mode of business operation, and the major fast-food franchisors. To facilitate my research and understand how each of the trends impacts the hamburger, pizza, and chicken segments, I have prepared a series of maps (Exhibits 6.1, 6.2, 6.3, and 6.4) which highlights those trends, the key franchise players, and the future impact the trends will have on the franchisors.

In this chapter, I will also share suggestions on franchising and selecting a particular franchise investment, and discuss the advantages and disadvantages of the franchising form of business operation.

Exhibit 6.1

Fast-Food Industry Summary

<u>TRENDS</u>	<u>PRIORITY IN SEGMENT</u>	<u>FUTURE IMPACT ON FRANCHISORS</u>
(1) Consumer's Awareness of Nutrition	High--hamburgers, chicken Low --pizza	<ul style="list-style-type: none"> o Introduction of foods that are lower in fat, carbohydrates and calorie content. o Release data on fast-foods as consumers increasingly become label and ingredient conscious.
(2) Menu Expansion	High--hamburgers Medium--chicken Low--pizza	<ul style="list-style-type: none"> o Introduction of lighter, healthier foods and new cooking techniques (i.e., salads, baked potatoes, and broasted/broiled foods).
(3) Increased Advertising and Marketing	High--hamburgers, chicken pizza	<ul style="list-style-type: none"> o Create "catchy" ad campaigns to capture consumer's attention. Emphasis placed on product differences, cooking techniques, exploring new niches & targeting new markets.
(4) Combination Franchising	High--hamburgers	<ul style="list-style-type: none"> o Complementary franchises with lower operating expenses, increased sales and ROI.
(5) "Semi-Captive" Markets	High--hamburgers Low --chicken, pizza	<ul style="list-style-type: none"> o Exploration of previously untapped markets at military bases, schools, hospitals, toll roads, and truck stops.

Exhibit 6.1 (continued)

Fast-Food Industry Summary

TRENDS	PRIORITY IN SEGMENT	FUTURE IMPACT ON FRANCHISORS
(6) New Architectural Styles	High--hamburgers, chicken Low --pizza	o New styles designed to attract a broader consumer market.
(7) Recruiting Minority Franchisees	High--chicken Medium--hamburgers Low--pizza	o Increase in number of women and minority franchisees.
(8) International Market	High--hamburger, chicken pizza	o New markets bring increased profits and growth.

Exhibit 6.2

Hamburger Segment Summary

<u>TRENDS</u>	<u>FUTURE IMPACT ON FRANCHISORS</u>	<u>KEY PLAYERS</u>
(1) Consumer's Awareness of Nutrition	o Introduction of perceived healthier, lighter foods and mini-sandwiches.	McDonald's, Wendy's, Burger King
(2) Menu Expansion	o Introduction of salads, baked potatoes, vegetables and breakfast entrees.	McDonald's, Wendy's, Burger King, Hardee's, Carl's Jr.
(3) Increased Advertising and Marketing	o Creative ads and marketing campaigns featuring promotions, contests, and special events.	McDonald's
(4) Combination Franchising	o Complementary joint ventures with other franchises, hotels, convenience stores.	Wendy's
(5) "Semi-Captive" Markets	o Potential markets on military bases, schools, hospitals, toll roads, truck stops.	McDonald's, Burger King, Wendy's, Carl's Jr.
(6) New Architectural Styles	o Attract and retain consumer base.	McDonald's, Burger King, Carl's Jr.
(7) Recruiting Minority Franchisees	o Financing and loan programs available. Active recruitment of women & minorities.	Burger King, McDonald's, Hardee's, Wendy's
(8) International Market Expansion	o Franchise in Pacific Rim, Canada, Europe and South America.	McDonald's, Burger King

Exhibit 6.3

Pizza Segment Summary

<u>TRENDS</u>	<u>FUTURE IMPACT ON FRANCHISORS</u>	<u>KEY PLAYERS</u>
(1) Consumer's Awareness of Nutrition	<ul style="list-style-type: none"> o Pizza already perceived as healthy fast-food by consumers. 	--
(2) Menu Expansion	<ul style="list-style-type: none"> o Target lunch and dinner markets. o Expand new menu options to include calzone and salads, express lunch. 	Pizza Hut
(3) Increased Advertising and Marketing	<ul style="list-style-type: none"> o Emphasis on home delivery where speed, convenience, and service are stressed. o Coupons, 2-for-1 promotions. 	Domino's, Pizza Hut Little Caesar's, Pizza Hut
(4) Combination Franchising	<ul style="list-style-type: none"> o Joint ventures with convenience stores 	Pizza Inn
(5) "Semi-Captive" Markets	<ul style="list-style-type: none"> o (At present time not a major issue among pizza franchisors) 	
(6) New Architectural Styles	<ul style="list-style-type: none"> o Stress quick service, convenience, and location in malls or centralized location for home delivery service. 	Domino's, Pizza Hut Little Caesar's
(7) Recruiting Minority Franchisees	<ul style="list-style-type: none"> o (At present time not a major issue among pizza franchisors) 	
(8) International Market Expansion	<ul style="list-style-type: none"> o Expansion to Canada, Japan, and Russia and South America. 	Pizza Hut, Domino's

Exhibit 6.4

Chicken Segment Summary

TRENDS	FUTURE IMPACT ON FRANCHISORS	KEY PLAYERS
(1) Consumer's Awareness of Nutrition	<ul style="list-style-type: none"> o Emphasis on char-broiling, broasted and roasted chicken 	El Pollo Loco, El Pollo Asada, KFC
(2) Menu Expansion	<ul style="list-style-type: none"> o Target both lunch and dinner markets, o Expand menu to include complementary items: biscuits, potatoes, cole slaw, and mini-sandwiches. 	KFC
(3) Increased Advertising and Marketing	<ul style="list-style-type: none"> o Stress healthful aspects of chicken and gain endorsement of AMA. 	El Pollo Loco, El Pollo Asada
(4) Combination Franchising	<ul style="list-style-type: none"> o Convenience store joint ventures 	Church's Fried Chicken
(5) "Semi-Captive" Markets	<ul style="list-style-type: none"> o (At present time not a major issue among pizza franchisors) 	
(6) New Architectural Styles	<ul style="list-style-type: none"> o Introduce double drive-thru units to ensure customers' convenience and speedy service. 	KFC, Church's Fried Chicken
(7) Recruiting Minority Franchisees	<ul style="list-style-type: none"> o Financial inducements and loan program. 	KFC, Church's Fried Chicken
(8) International Market Expansion	<ul style="list-style-type: none"> o Expansion to the Pacific Rim, China, and Japan 	KFC

The success rate for buying a franchise and having it succeed is greater than starting an independent business; however, success is not a guarantee when buying a franchise. The Small Business Administration and Department of Commerce statistics show there is a lower failure rate for franchise-owned businesses than for other business startups. The U.S. Department of Commerce reported during 1986, "14 franchisors with a total of 570 restaurants (346 franchisee-owned) went out of business, while 23 franchisors with a total of 952 restaurants (199 franchisee-owned) decided to abandon franchising as a method of marketing."^{1/}

In a sense, a franchisee is not his/her own boss and cannot run the business as he/she might like. The franchisee must operate the business within the sanctions laid down by the franchisor. There is not the freedom of action that an owner has in a non-franchised business. The franchisor sets certain standards and strives for uniformity which in turn reflects favorably for the organization as a whole. The franchisee must learn to operate a business within the bounds that are already established. What holds the franchise system together is an even-handed relationship. Harold Nedell, President of Houston's M&M Franchise Development Company, which invests in new franchises, says, "If the franchisee does not

perceive that he has an absolute need for the franchisor, something's wrong, because the tightest and best-drawn contract will not help the unprofitable franchisee in business."

When considering buying a franchise, is there any way that one might avoid making a mistake? In business as well as in anything else, no answer is infallible. National Alliance of Franchisees Executive Director Bennie Thayer told a group of prospective franchisees, "Franchising is like a marriage. What you want to know is the divorce rate." Without a lot of care and understanding, franchise agreements can end in disaster. Franchisors who have satisfied franchisees provide more than a business method, manuals, annual meetings, and accounting help. They also endow the franchisee with a sense of trust in the franchisor.^{2/} Irv Marshall, Chairman of the International Franchise Association said: "Franchising companies are doing a much better job today of working with their franchisees than they used to." "The number one topic" that franchisors unanimously agree on is that "the goal of good relations is a must in any successful franchise system."

A prospective franchisee must remember that much time should be devoted to a business to get it off the ground.

Franchising can be an easy business to get into, but it takes time and lots of work to keep it going. If a franchise is chosen carefully, it will have two successful ingredients: a proven management system and a business that works. It is important for the entrepreneur to find a business that is compatible with his/her interests and management style. Franchise consultants say that new franchises often fail because the franchisee has not chosen the right company or asked the "all important" questions before signing. One consultant said, "It doesn't matter whether the franchisor is McDonald's or Midas, they just aren't prepared to tell all. You have to find out. Remember the franchisor will make money even if you don't."

I believe that one of the best ways to find out if you are suited for a particular field, is to work in a franchise that is similar to the one you're considering buying. Domino's only sells stores to its employees and McDonald's requires that the prospective franchisee work in a McDonald's as part of the intensive franchisee screening process.

After a suitable business has been decided upon, much time should be spent in searching out the franchises that are of interest. Study the company's disclosure

statements. These statements contain information on twenty different subjects that may influence your decision to invest in the business. Have an attorney read the franchise agreement. Meet with the franchisor and ask leading questions: How many stores does the franchisor own? (The more stores the franchisor owns, the greater the chance the franchisor will succeed.) How many stores are owned by franchisees? What is the operating history of the company? Talk to the franchise owners. Are they happy?

Harold Nedell, a Houston franchise and financial developer suggests that anyone contemplating a franchise should:

- 1) Look for a business with a track record of at least two years.
- 2) Examine its debts to see if the business is sufficiently capitalized to implement the franchise system.
- 3) Ask about advertising and marketing expenditures.
- 4) Look at the future of the industry.
- 5) Make sure there is a demand for this franchise in the region where you plan to operate.^{3/}

There are a total of nine characteristics that a franchisor should possess:^{4/}

- 1) Responsiveness. If the franchisee needs help, he or she will get it, and quickly.
- 2) Empathy. The franchisor has been there and knows what the franchisee is going through.
- 3) Communication. The franchisor really listens--and acts on what is heard.
- 4) Dependability. When the franchisor makes a promise, it is kept.
- 5) Accessibility. The top people in the franchise system can be reached by any franchisee.
- 6) Give and Take. If there is trouble in the relationship, it is straightened out in a hurry.
- 7) Structure. The franchisor anticipates business problems and solutions and lets the franchisee know about them.
- 8) Structure. The franchisor provides business discipline and requires the franchisee to stick to it.
- 9) Open-mindedness. The franchisor encourages suggestions from a franchisee and passes on good ones to other franchisees.

Those who buy a franchise without first doing the necessary homework will find it difficult and expensive to operate, and in many cases, not what they really wanted. The key to operating a successful franchise is to investigate the franchise thoroughly before investing and

be certain the drawbacks as well as the advantages are understood.^{5/} Buying a franchise requires vigilance and diligence, but franchising has become an attractive and popular business form.

FOOTNOTES

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A P P E N D I C E S

1. Sample Letter
2. Interviews Conducted for Thesis

APPENDIX A



This correspondence is a part of
research work being
done for a Master's thesis

Massachusetts Institute of Technology
Alfred P. Sloan School of Management
50 Memorial Drive
Cambridge, Massachusetts, 02139

In reply write to:

SAMPLE LETTER

February 29, 1988

Ms. Janet Lowder, Manager
Laventhol & Horwath
3699 Wilshire Blvd., Suite 700
Los Angeles, CA 90401

Dear Ms. Lowder:

I am a second-year Master's student at the Sloan School of Management of M.I.T. One of the requirements for graduation at M.I.T. is the completion of a thesis in the student's major area of interest. I am researching, "Trends in the Fast Food Franchise Industry" with Professor N. Venkatraman. In my research on franchises, I have noticed that you are quoted frequently in Restaurant Business, and are an expert on the fast food industry.

I will be in California during the week of March 21-25 and I would like to discuss these topics with you. I will call you in a week to arrange a mutually agreeable date and time. I look forward to meeting with you.

Sincerely yours,

Jonell E. Schlund

cc: Professor N. Venkatraman

APPENDIX 2

Interviews Conducted For Thesis

Mr. Buzzy Gordon, Director of Public Affairs,
International Franchise Association, Washington, D.C.

Mr. Frank Karcher, V.P. of Franchising, Carl's Jr.
Restaurants
Carl's Karcher Enterprises, Inc., Anaheim, CA

Ms. Patricia Lacoste, Assistant to National Director of
Marketing
Domino's Pizza, Ann Arbor, Michigan

Ms. Janet Lowder, Manager, Restaurant Industries Group,
Laventhol and Horwath, Los Angeles, CA

Mr. Greg Reynolds, Vice President, Public Affairs,
Kentucky Fried Chicken Corporation, Kentucky

Mr. B. Hudson Riehle, Manager, Research Department
National Restaurant Association, Washington, D.C.

Mr. Donald Steinke, Owner of 9 KFC Franchises, Anaheim, CA

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