Five forces about fast food chains

Business, Industries

TETA? 2607Exercise2 PartI: briefintroductionoffastfoodrestaurants The industry I selected isfast foodrestaurants which are also named as quick service restaurants. As a special type of restaurant, fastfoodrestaurant is characterized both by its fast food cuisine and by its self table service. The majority of fast food restaurants are part of a restaurant chain or franchise operation so that each branch could be provisioned by standardized ingredients and controlled by unified management. Within this industry, several leaders should be identified.

Founded in 1940, McDonald's Corporation is the world's largest chain of hamburger fast food restaurants, daily serving around 68 million customers in 119 countries. (mcdonalds. com & burgerbusiness. com) In the year of 2011, the net income has reached 27 billion USD with net profit of 5. 5 billion USD. In the recent five years, McDonald's revenue kept increasing and the average increase rate was 3. 1 %. (McDonald's annual report, 2011). Subway which is owned and operated byDoctor's Associate is an American restaurant franchise which mainly sells sandwiches and salads.

Subway, as the largest single-brand restaurant chain globally, keeps the fastest growing franchises in the world with 37000 restaurants in more than 100 countries. (subway. com) KFC (Kentucky Fried Chicken) is the world's largest chain of fried chicken fast food restaurants. It is also the second largest restaurant chain after McDonald's, with over 17, 000 outlets in 105 countries. (KFC. com) PartII: IndustryanalysisbyFiveForces In 1979, Michael Porter published " How Competitive Force Shapes Strategy" in theHarvardBusiness Review (HBR) which started a revolution in the strategic field.

He proposed five competitive forces which could to great extent determine the profitability of an industry and strategy's formulation. In this part, Five Forces will be utilized to analyze the fast food restaurant industry. [Typetext] Page1 TETA? 2607Exercise2 Threat of Suppliers The suppliers of fast food restaurant mostly are meat producer, vegetable retailers, beverage companies and bakeries food retailers. As meat and vegetable are hard to differentiated, it is difficult for such a supplier to stand out.

Also, most of these suppliers are local and small-sized while the quick service restaurants are international and giant; hence, it is easy for the fast food chain to be the dominant player. As for the fast food restaurants, in general, the switching costs are not high if they want to change their supplier of meat and vegetables. However, some supplier brands are quite powerful such as beverage company—Coca cola because their product is unique in the market. It is also possible for a supplier to be integrated forward such like building up corporation relationship with fast food restaurant to enlarge their supply power.

To sum up, the supplier power in the fast food restaurant is low relatively especially among non-differentiated good suppliers. Threat of Buyers There are many small operators in the fast food restaurant industry which means buyers have many alternatives to choose the most suitable quick service restaurant. Meanwhile, there is almost no switching cost for customers to change their tastes. Additionally, the buying information is also abundant and available for the customers to select the most satisfactory restaurant. It seems that buyer power in the fast food restaurant is relatively high.

However, the volume of each customer generally is not extremely important to overall sales of the companies and hence, each individual customer may not be valued much by the company. That diminishes the power of the buyer to some extent. Also, there is no threat of backward integration which means it is almost impossible for customers to build up cooperative relationship with fast food chains. Hence, buyer power would lowered by lack of possibilities of integration. The concentration of buyers is low which also reduce the power of buyer.

As for the fast food chain, the brand identity also helps them to decrease the threats from customers. To sum up, the threat from buyer is at the moderate level according to the above [Typetext] Page2 TETA? 2607Exercise2 analysis. Threat of new entrants As the threat from new entrants, the first thing to consider is cost. Obviously, the entrance costs are relatively low when compared to other industries such like mobile phone manufacturing and informationtechnologyindustry. However, the cost of brand building also plays an important role as brand identity is perceived as a significant factor of fast food restaurant’s strategy.

In the fast food industry, the existing brands are already powerful like McDonald’s and Burger Kings so it will take time and expenditure for a fast food store to stand out. All in all, the cost of new entrants is not as low as what we assume previously. Secondly, the access to supply channels is quite easy because those raw materials for the fast food restaurant are available normal goods. However, there may exist exclusive contracts with suppliers so that it may make hard for new companies to enter this industry. Thirdly, another barrier to enter fast food industry is the access of distribution.

Fast food chain always signed exclusive contracts with the college, supermarket, fuel stations and others and hence, it is much difficult for a new entrant to build its own distribution channels. The economies of scale and the access of distribution are major barriers that firms face in this industry. Additionally, it is also difficult to differentiate your product in this industry because the product is fairly similar when we divided fast food into different categories (hamburgers, sandwiches, pizzas). To sum up, the threat of new entrants is moderate as we have to consider from all aspects. Threat of substitutes

Although the switching costs of customers are quite low, the threat from substitutes is still at low level. The main substitutes of fast food restaurant are pre-cooked food, mid-range restaurants or supermarket products. However, eating in a normal restaurant is much more expensive and time consuming. Pre-cooked food is cheap while the facilities to warm it up may not be available. Hence, fast food still held [Typetext] Page3 TETA?2607Exercise2 advantages no matter from the price or comfort level. Threat of rivalry The number of competitive rivals with similar products and service for the same customer group is high.

As mentioned before, the initial expenditure to set up a fast food restaurant is not quite so high and hence, many small scale quick service restaurants may try to enter it. Also, there are no high exit barriers because it is easy to close restaurants as the relatively low fixed costs. Meanwhile, the market growth is limited because the market gets saturated with a certain amount of restaurants, fast food shop or delivery services. It seems that the threat of rivalry is relatively high in the fast food restaurant industry. All the above analysis is summarized in the following diagram. Figure 1) Figure 1 PartIII: Additionaldiscussionaboutcompetitivecondition Apart from the five forces that I have mentioned before, there are still some other [Typetext] Page4 TETA? 2607Exercise2 forces which also affect competitive condition. In the first place, cultureplays a more important part in deciding people’s food consumption than before. According to Maddock’s (2004) research, there is a correlational relationship between the number of residents per fast food restaurant and the square miles per fast food restaurants with state-levelobesityprevalence.

This result indicates that fast food restaurants do make a significant contribution to the people’s obesity level. The problem of obesity has already raised public’s attention and people concern more about the nutrition of the food rather than price and convenience. In addition, people also realize that fast food restaurant also to a great extent contribute to the problem ofchildhood obesity. Another research (Harris, Schwartz &Brownell, 2010) also reveals that Teens between the ages of 13 and 17 purchase 800 to 1, 200 calories in an average fast food meal, including 30% or more of calories from sugar and saturated fat.

As the obesity would threaten human’shealth, more and more experts suggest that people especially children should eat fast food as little as possible. Hence, there is an overall trend that the consumer group of fast food is squeezing. As the market is declining, each company within this industry has to compete harder to win more consumers. In this way, external factors like culture, healthy reports also play an important force to decide the competition level of this industry. Another limitation of five force framework is that some companies in the same industry are cooperators unlike the original assumption that there are all competitors.

For example, KFC, pizza hut and Taco Bell are operated by the same corporation—Yum!. If they are not pure competitors in the market, they increase the entry barrier through reallocating their resource and supply and distribution channels. For example, these three restaurants could share the same logistic center to enhance the efficiency of company and save the cost as well. This kind of corporation within the same industry was ignored by classic Five Force Analysis which emphasis the pure competition relationship between companies. PartIVConclusion [Typetext] Page5 TETA?2607Exercise2

Let take McDonald's as an example to analysis the whole industry. Although there is tense competition in this industry that many small fast food businesses fight with each other to improve their customer base, McDonald's still held the absolute advantage in its customer scale. Just like the above analysis, the enter barrier of this industry is not so high. But McDonald's own strong brand identity and established network and hence, the new small entrants could not threaten to McDonald's. The buyers still hold power to some extent as the switching cost is low and the buying information is abundant.

However, McDonald's still have an advantage in location and convenience. As McDonald's has already established the strong network with suppliers, (e. g. cooperated with Coca-Cola), the threats from suppliers are not so intense. Under the current trend, the down-sizing of customer group is the major problem that McDonald's has to face. McDonald's have already implemented some strategies such like launching non-fried product and enclosed the detailed nutrition information of the food. After five forces analysis, McDonald’s still should be favorable in the next several years.

However, if a new small business plan to enter this industry, it will face a large number of challenges such like establishing supply channels and distribution channels and building its own brand identity. All in all, fast food restaurant is still saturated and unfavorable for business which wants to entry. Reference: Harris, J. L. , Schwartz, M. B. & Brownell, K. D. (2010), Evaluating Fast Food Nutrition and Marketing to Youth. Fastfoodmarketing. org Maddock, J. 2004. The Relationship Between Obesity and the Prevalence of Fast Food Restaurants: State-Level Analysis. American Journal of Health Promotion: November/December 2004, Vol. 19, No. , pp. 137-143. [Typetext] Page6 TETA? 2607Exercise2 Porter, M. E. 1978. How competitive forces shape strategy. Harvard Business Review Strategy: http://polisci2. ucsd. edu/snunnari/HBR_on_Strategy_23_41. pdf#page= 25 McDonald’s official website: http://www. mcdonalds. com/us/en/home. html Burgerbusiness. com: http://www. burgerbusiness. com/? p= 9168 McDonald’s 2011 annual report: http://www. aboutmcdonalds. com/content/dam/AboutMcDonalds/Investors/Investors %202012/2011%20Annual%20Report%20Final. pdf Subway official website: http://www. subway. com/subwayroot/default. aspx KFC’s official website: http://www. kfc. com/ [Typetext] Page7