

# Dunkin' donuts case study essay



**ASSIGN  
BUSTER**

## 1. What does Tommy want?

Tommy was looking for a change, especially since he just finished putting his third and last child through school. Tommy also operated a food section that served breakfast items (other than doughnuts) and hamburgers, which he claimed generated half of the sales. He was interested in buying out the franchise from Dunkin' Donuts. He would take down the Dunkin' Donuts sign and continue to operate the shop under a new store name of his choice. He also planned to negotiate direct lease with the landlord instead of leasing the building and land from Dunkin' Donuts. However, he mentioned to Dunkin' Donuts that he was not interested in pursuing this option.

Tommy seemed to be interested in selling the business to Dunkin' Donuts for \$80000 after several negotiations. He also looked at the options of selling the business to Royce, another franchise owner, but turned them down because the deal would have fetched him a lower selling price. However, Tommy bought the store building and land from the current landlord and became its new landlord. He further doubled the price of selling the business to Dunkin' Donuts from \$80000 to \$160000. However, even after acquiring the business Dunkin' Donuts would have had to deal with Tommy as a landlord.

Bill had mentioned that Tommy told him that buying the property made good accounting sense but he was not sure whether Tommy wanted to get out of business. So, according to me Tommy wants Dunkin' Donuts to pay a heavy price and suffer for all the "so-called" atrocities which Dunkin' Donuts has done to him such as making DSM visit his store at midnight and conduct

CSG, no communication for 3 years, misuse of advertising money and rebates for own benefit and not for the franchise owners.

Tommy knows that despite maintaining poor standards for Dunkin' Donuts he is achieving a steady business and Dunkin' Donuts would not want to lose the opportunity of maintaining the Randolph store. So, he wants to make things complicated for the franchisor to tap on this goldmine. This is a classical problem of Agency Theory wherein the desires or goals of the principal and agent are in conflict, and the principal is unable to verify what the agent is actually doing. (Asymmetric Information)

## 2. What does DD want?

DD knows that despite maintaining poor standards and having a disgruntled agent/franchise, the weekly sales increased by 12% over 2005. This is because the Randolph store had good visibility from both directions of traffic, good accessibility and ample parking space. The site had population and traffic counts higher than the Dunkin' Donuts norms. So, Dunkin' Donuts did not want to lose the opportunity of even increasing the sales and taking full control of the operations by ensuring that the standards are maintained.

They tried to do this by convincing the disgruntled owner but faced issues during negotiations. With regard to the objective of maximizing revenues, DD wanted to purchase the business and operate a company-owned store or selling it to a new or existing franchise owner. DD did not want to disenfranchise him due to poor standards or avoid contract renewal after two years as it would lead to litigations. It also did not want to handle Tommy as a landlord after having purchased the business from him because Tommy

had bought out the land of business directly from the landlord. So, DD wanted to retain control of the business at Randolph but wanted to avoid dealing with Tommy due to previous issues with him.

### 3. What options are there?

Dunkin Donuts has the following options available: To Disenfranchise Tommy for maintaining poor standards but this would involve getting caught up in litigation thus increasing transaction costs.

To wait for 2 years and avoiding contract renewal with Tommy but this would also lead to a possibility of getting involved in litigations. To buy out the franchise from Tommy at \$160, 000 and open a company-owned store at Randolph. To buy out the franchise from Tommy at \$160, 000 and sell the franchise to a new or existing franchise owner. To continue with Tommy handling the franchise since the franchise was delivering increasing revenues even if they were not performing according to the Dunkin' Donuts standards. However, this will lead to increasing operational costs of handling customer complaints and might also affect the Dunkin' Donuts as a brand.

### 4. How do you evaluate the options?

The evaluation of the options can be done on the cost-benefit analysis including long-term implications. Since the first two options above involved heavy transaction costs such as litigation costs, impact on brand, fear in the minds of other franchise owners etc. This might lead to closing down on the operations of Randolph store till the litigation is settled which might lead to loss of revenues from the area where the Randolph store is situated. So,

selecting these options have minimum benefits and maximum costs involved.

The last option would also impact the brand of Dunkin' Donuts but would however have a regular stream of revenue from the franchise. However, the problem of low standards, fees not paid on time, handling of customer complaints would entail excess operational costs required to monitor using CSG and responding to customer complaints and avoiding word-of-mouth publicity by giving discounts. Again, this would lead to bringing in a temporary solution and Dunkin' Donuts would have to deal with the problem created even later.

The third and the fourth options seem more beneficial than the others. In case of both options, Dunkin' Donuts would require additional investments of \$90000 apart from \$160,000 provided to Tommy. In case of company-owned store, it would have to bear all incremental costs whereas in case of franchised store option, it would have to bear incremental costs only for leasehold improvements. The profit margin for company-operated store is 13%. Now, since the sales in the year 2012 are  $\$6150 * 52 = \$319800$   $*13\% = \$41574$ .

In case of franchised store, the initial franchise fee for new or existing franchise owners, franchise fee on sales, flat and override rental fee. So, for a new owner in the first year, the company earns  $\$32000 + 4.5\%$  of  $\$319800 + \$3000 + 7\%$  of  $154800 = \$32000 + \$14391 + \$3000 + \$10386 = \$59777$ . For the existing franchise, the company earns  $\$53227$ .

So, the fourth option of selling it to a new or existing franchise owner seems to be more beneficial option. However, the third and the fourth option do entail possible transaction costs related to having Tommy as a landlord.

#### 1. Which option is more attractive to DD?

Herman and Benito both managed Dunkin' Donuts stores before they applied for franchises. However, Herman consistently scored high on CSG whereas Benito managed to pass the CSG but not consistently and nor with high scores. From the financial stability on a personal point of view, Herman owned two apartment complexes and held a one-half interest in two more apartment complexes in the Boston area. His personal assets were believed to approach a million dollars. Benito's personal assets consists majorly of unlisted securities which were believed to approach half a million dollars.

Herman faced opposition for his location on Harvard Street ( Brookline) from town officials due to opposition from North Brookline neighborhood Association. He had applied for this location two years earlier. He then applied for another Harvard Street location in a different precinct in Brookline. Several objections were taken by the Brookline Village Work Group in the Town Hall Meeting. Also, the site was next to a Catholic Church which did not help.

Benito had purchased an abandoned gasoline station located on Harvard Street in Allston. He needed to meet the requirements to qualify as a multi-unit operator. He also did not expect any difficulty in obtaining permit from the town of Allston, where neighborhood groups were not as active as in Brookline. However, he was well aware of the pending Brookline situation

and was waiting for around 4 months since his application and his patience was running out.

From the available data, Allston store alternative seemed to indicate a lower risk in terms of financing and fixed and variable costs and highly beneficial in terms of the revenue forecasts and low break-even points.

So, with the given information, Allston store alternative i. e. Benito's option , seems to be more attractive for DD as it not only has lower operation costs but also has lower transaction costs as compared to Herman's and also provides higher revenues. Also, Benito's store maintaining standards and personal assets are decent enough to make this option viable and with minimum risks.

2. How real is the opposition from the Brookline Village Citizen's Work Group?

The opposition from the Brookline Village was primarily due to lack of information provided to them in the Town Hall Meeting. When the attorney was asked as to what prompted the company to choose a particular site he did not have answers and replied that he was not a marketing expert.

This is one of the reasons why Brookline Village Citizen's Work Group opposed the proposal by complaining about busy intersection, closeness to primary school, undesirable people attending at the night and increase in traffic. The opposition might very well be real and valid but if Herman puts up the proposal in a fashion that it takes care of most of the issues and

presents the reason behind opening the store and how it shall benefit the neighborhood then all the seemingly trivial issues can be handled.

3. What should be DD's role in dealing with the citizens' group opposition?

Dunkin' Donuts, as a principal, should ensure that it supports Herman in tackling the opposition and provide necessary support to him in terms of providing him with a team of attorney, marketing support and other experts (special task force) to handle questions and issues posed by the citizen's group. Dunkin' Donuts should discuss with Herman and discuss the possible oppositions which Herman can face and how they can with resolve them. However, company should also ensure that the associated costs are recovered from Herman in case Herman is still not able to convince the citizen's group.

With the provision of the necessary support, Dunkin' Donuts can ensure that it can use the expertise of Herman for handling other stores due to his excellent standards and even give him the opportunity to own stores in other places where it needs to expand. This is one way in which the principal can incentivize the agent and retain his expertise.