

Franchising strategy of mcdonald's



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Globalization refers to the system of interaction among the countries of the world. It has become a significant trend in today's world economies as there is a tendency for many large corporations and business to trade internationally and compete with each other on a global scale. There are many strategies that companies can use in order to expand their business and penetrate into global markets. These strategies include; licensing, exporting, franchising, contract manufacturing, international joint venture and foreign direct investment.

We decided however to focus our report on the franchising strategy, and supported it with the case study of McDonalds.

FRANCHISING is a contractual agreement whereby someone with a good idea for a business (franchisor) sells the rights to use the business name and sell a product or service (franchise) to others (franchisees) in a given territory in a specified manner. (Nickels, McHugh, McHugh, 2010, p. 132)

Franchising has become a very popular strategy that many companies have adopted lately; they have a vast number of global outlets operated by foreign franchisees. This is a list of the world's most famous franchisors around the world as ranked in the Top 10 Franchisors for 2010;

1. Subway
2. McDonald's
3. 7-Eleven Inc.
4. Hampton Hotels
5. Supercuts
6. H & R Block
7. Dunkin' Donuts

8. Jani-King

9. Servpro

10. Ampm

The table below shows the brief advantages and disadvantages of franchising;

Advantages

Disadvantages

- Personal ownership**
- Management and marketing assistance**
- National recognized name**
- Financial advice and assistance**
- Lower failure rate**
- Large start up cost**
- Shared profit**
- Management regulation**
- Restrictions on selling**
- Fraudulent franchisor**

McDonalds

McDonald's is one of the most successful fast-food restaurants around the world today with a very established and valuable trademark; it is an example of a brand franchise. McDonalds is often "considered the gold standard of franchising". (Nickels, McHugh, McHugh, 2010, p. 132). The main drive behind this success and rapid expansion was the franchising strategy, which

helped them easily penetrate new markets and enlarge their target markets. Around 70 percent of the current McDonalds restaurants are run as independent franchisees. The first franchised outlet was opened in the UK in 1986; however there are now over 31, 000 McDonald's restaurants in over 119 countries.

Ray KrocThe initial idea of the fast-food restaurant was started by the McDonald's brothers; Dick and Mac. They opened their first restaurant in 1940 in California, but as a start they did not know that this restaurant will grow tremendously, and have such a large market share. They were extremely modest until they discovered a formula that sells an absolutely high quality product with low affordable prices attached, and quickly. However a significant role was played by Ray Kroc, an experienced business man with a talent for marketing. When he became involved in the business he realized that this formula could be very profitable and can be sold on a national basis all over the US. Therefore the main success of McDonalds is attributed to Ray Kroc because he had a vision to take McDonalds global and help achieve the highest levels success.

Procedures of starting a McDonalds Franchise

The steps taken in order to gain approval and start your own McDonald's restaurant are rather lengthy and costly. In order to be considered for a franchise and granted permission to use the McDonald's brand name; a minimum of \$300, 000 is needed strictly from the owners' personal savings and resources (i. e. not from borrowed resources such as loan or mortgages). Furthermore under the requirements of a obtaining a McDonald's franchise, McDonalds has to own or lease the restaurant premises that the franchisee

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will operate in. The franchisee will then have to purchase the fittings, the equipment and the right to operate the franchise for twenty years. To guarantee a consistent and uniform trademark internationally all franchisees must use standardized McDonald's branding, menus, design layouts and administration systems. (Franchising and Entrepreneurship, n. d.)

The franchisee managers should have certain specifications and qualities that meet McDonald's standards. These may consist of the ability to take care of the business financing, possessing good management skills in order to motivate & train the employees, be willing to peruse a comprehensive training course and finally dedicate all their time to operating the restaurant and take care of the day-to-day activities of the business. (How Much Does a McDonald's Franchise Cost, n. d.)

The procedures of starting a McDonalds franchisee mentioned above, elaborate how franchising systems in general operate in world markets. It shows how careful franchisors are in selecting and recruiting the best franchisees worldwide, in order to ensure that their goodwill and business trademark are not misused by fraudulent franchisees. It also gives us a brief summary of the requirements needed by a franchisor in order to grant an individual the right to use its business idea and sell its products.

Advantages of franchising

As mentioned above, the main drive behind the success and rapid expansion of McDonalds is franchising, we will discuss the benefits of franchising in detail and show how they were applicable to McDonalds.

Franchising has enabled McDonald's to experience significantly faster expansion and growth, helping it to achieve a truly global brand identity and a well known trademark. For example McDonalds now operates in more than 119 countries world-wide, serving millions of consumers daily, the existence of the franchisee outlets globally have helped McDonalds gain popularity and customer loyalty.

McDonalds is able to gain more income and revenues from the monthly fees (5% service fee) and rent paid by its franchisees worldwide, this means they can generate more finance which can later be used to develop and expand the business. Therefore franchising gives the opportunity to franchisors to raise sufficient capital.

Franchising gives a chance to the franchisor to leverage the brand. By acquiring new franchise outlets, McDonalds was able to get in touch with a wider target market and reach more consumers globally, this in the long-run helped it achieve and maintain a high market share in the fast-food industry and it also enhanced the company's corporate image and prestige.

(Becoming a Franchisor, 2003)

When the franchisor sells the right to use its brand name to the franchisee, it is not required to intervene in the day-to-day activities of the business. When new franchise outlets commence, McDonalds is obliged to supply them with the equipment needed, raw materials and comprehensive training to the employees. However after these events have taken place, McDonalds is not responsible for the day-to-day running and management of the business. Therefore this eliminates the responsibility for direct supervision and gives

the franchisor more time to concentrate on the strategic functions of the business, such as looking for new potential markets, building strong marketing plans and advertisement campaigns and so on.

Franchisors are able to benefit from economies of scale, because as their total production levels increase, the average costs tend to decrease. These economies of scale may include marketing economies of scale; McDonalds for example will be able to have more money to spend on its advertising campaigns if its number of restaurants is higher, and it will also save the company the redundant costs of having separate national campaigns, therefore this helps reduce on the business' expenses and hence register higher profits..

By having many franchise outlets worldwide, McDonalds achieves diversification and spreads its risks worldwide. This means that a failure in any one of its restaurant will not be very disastrous to the company, because there are many other successful and profitable restaurants that can help offset or compensate for this loss. Therefore, franchising helps minimize the rate of failure and helps keep businesses stronger.

Disadvantages of franchising

Previously we have stated the advantages of franchising in terms of McDonald's, however franchising has some disadvantages as well such as:

Large start-up costs: The cost of franchise can vary from one business to the other. The more popular the business is the more fees the franchisee has to pay to the franchisor in order to have the right to use the business's specific name and sell its products. That is because businesses which possess well-

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known trademarks reduces the risks that a franchisee takes, in other words it reduces the business's possibility of failing, thus, its more expensive. A Franchisor such as McDonald's will require a very high start-up fee from the Franchisee simply because McDonalds is an extremely well-known restaurant. In order to be able to open a McDonald's franchise, a franchisee needs to have around \$506, 000 to \$1, 600, 000 of non-borrowed cash personal money. The start-up cost depends on the location on the store.

Share Profits: In return of franchise the franchisor (McDonalds) gets the start-up cost in addition, to the annual franchise fee, which is a fee that is paid for training and preparations, price of equipment, money for working capital like fried potatoes machines etc., the original franchise fee is typically \$45, 000. Besides, the franchisee is also expected to monthly pay service fee which is 4. 0% and rent fees to McDonalds, based on the sales performance. Plus the extra money they have to send on royalties on the income, it range between 2 to 10 % of the franchisor's profits. Royalties are charged on the profits a business makes before taxes and other expenses such as wages. Therefore the higher the profits, the higher the royalty. The royalty fee for McDonalds is ingoing 12. 5%. Therefore, a franchisee has to share a large amount of his/her profit with the franchisor (McDonalds).

Restrictions on selling: Some franchisees face restrictions on re-selling their business. The franchisor has to first choose the new owner and assure that they meet the standards required for this business, with the intention of controlling the quality of their franchisee. MacDonald's for example requires a franchisee that has a business plan, good management skills, training, and

mostly significant business experience. From 10, 000 franchisees only 1000 are accepted and only 200 are chosen from the 1000 to operate.

Coattail effects: Franchisors usually keep in mind that the actions taken by the franchisees can affect their profits and future development. Franchisees must also beware of their competitions from other franchisees. For instance, McDonalds has to look out from other fast food restaurants such as KFC, Burger kings, even other McDonald's franchisees. MacDonald's franchisees criticized that as a result of McDonald's cooperation persistent growth principles, some of the new stores have been taken away business at existing locations, limiting franchisees profits per outlet.

Management Regulations: Management regulations such as the fund restrictions in MacDonald's, which states that when a franchisee has funds, he/she can, increase these funds through business loans from banks or small business administrations. However, the franchisee can only finance the cost for seven years or less. This might make the franchisee feel that he/she is not their own boss anymore and that they do not own their own business management regulations often make the franchisees feel pressured and burdened by the franchisor.

Adapting to different cultures

One of the limitations of expanding your business globally is adapting to the different cultures around the world, this is a problem many companies fail as they decide to operate in foreign countries. Living in a multi-cultured society, firms should learn how to adapt their strategies and products to suit and satisfy the needs of the local population. McDonalds has been one of the

most effective companies in flexibly adapting to different cultures and societies. It has been very successful in identifying the local consumer's tastes and preferences and then altering their menus and dishes to satisfy these preferences. As an article states, " In the markets in which it operates, McDonalds listens to customers and adapts to their culture and preferences" (Sun never sets on Mickey D's, 2010).

India:-In order to adapt to the Indian society, McDonalds had to offer vegetarian food and had to ensure that the all the food provided contained no beef ingredients in them. This is because the Hinduism religion prohibits eating meat products mostly beef; therefore they introduced new menu items like the McVeggie and McAloo Tikkie.

Israel: - In Israel, all meat served is 100 percent kosher beef (Sun never sets on Mickey D's, 2010) which means that the food is pure clean with no organic materials added. Israeli's demand more healthy food with no chemical preservatives therefore McDonalds uses Canola oil which has no trans-fats to prepare the meals.

Middle East: - In order to adapt to the Islamic religion of the Arab countries, McDonalds introduced " Halal Meat" in its menus which encouraged Muslims to eat more frequently from McDonalds and this increased the company's sales. They also introduced a menu called " Mc-Arabia"

Lawsuits

McDonalds has faced a number of lawsuits over the previous years in many different countries. This can be looked one of the short-comings of franchising, because as many independent owners use the company's brand

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name and trademark they may damage the reputation of McDonalds and destroy its corporate image. The following are examples of lawsuits encountered by McDonalds;

A lawsuit was filed by a former franchise manager in Brazil accusing McDonalds for making him gain 65 pounds during the period of his twelve years of employment at the corporation. He claimed that he was forced to sample the food everyday in order to make sure it is of standard quality. The Brazilian court ruled in favour of the manager and held McDonalds Corporation liable for the manager's obesity ordered it to pay \$17, 500 as a compensation fee. (Benson, 2010)

A Vegetarian Resource Group also filed a law suit against McDonalds, accusing it of purposefully using an animal ingredient in its French fries. They blamed the fast-food restaurant for not notifying vegetarians that the French fries and hash browns had beef in them. A \$10 million settlement was agreed later agreed upon on April 2002. (Akers, n. d.)

Tony Cosgrove, the director of the Cleveland Clinic also got into a conflict with the McDonald's restaurants, claiming that fast food restaurants such as McDonalds that offer junk food should not be allowed to operate in medical institutions. This is because it is rather absurd to offer foods that are inconsistent with the health and dietary advice, doctors give their patients and this puts the patient's health at stake. (Adams, 2005)

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Original Case study

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