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Comparative Analysis of Chain Business Model in Catering Industry: Evidence from McDonald's and Starbucks

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ABSTRACT

This paper aims to summarize the impact of company-operated model and franchise on enterprises which is important for chain operation companies to choose appropriate strategy. This paper chooses McDonald’s and Starbucks as samples and uses 4Ps model and data comparison from company’s financial statements to conclusion the characteristics of company-operated model and franchise. The analysis shows that franchise can increase the expansion speed and lower the cost while the company-operated model can build better brand image and strengthen management. This paper provides implications for companies to deepen the understanding of franchise and company-operated model and make corresponding adjustments according to their own situation to obtain better development.

Keywords: *McDonald’s, Starbucks, Company-operated, franchise, marketing mix*

1. INTRODUCTION

Chain operation is a common form of business organization used by modern enterprises. Under the overall coordination of the Headquarters, we adopt standardized and modernized management methods to link individual business activities in order to achieve economies of scale. According to the management model and the relationship between the legal subjects, the chain business model can be divided into two types of franchising and company-operated.

To be more specific, according to the FASA, Business format franchising “is defined as a distribution network operating under a shared trademark or trade name with franchisees paying the franchisor for the right to do business under that name for a specified period of time” [1]. The core of franchising is the transfer of franchise rights, and the franchisor and the franchisee sign a franchise contract, which is a franchise relationship. This is a contractual relationship between independent subjects, where the personnel and financial relations of each franchise are independently accounted for and the franchisor has no right to interfere. The franchisee needs to pay the agreed form of remuneration for the franchise granted by the franchisor and the services provided. In the company-operated mode, the headquarters has ownership of each branch, the branch operation of the specific matters have the right to decide, the branch manager as an employee of the headquarters, acting entirely according to the will of the headquarters.

According to The QSR 50 [2]: The Fast-Food Industry's Leading Annual Report 2021, McDonald's and Starbucks achieved sales growth despite the backdrop of the COVID-19. As franchise pioneers and company-operated representatives, the two stores have adopted a strategy of rapid expansion and steady expansion, respectively.

In essence, that is to study the difference between two different chain forms company-operated form and franchised form. The company-operated form means company headquarters invest and manage each store directly while the franchised form is that company licenses its own business resources and business model to the franchisee in the form of contract. In practice, Starbucks does help licensed stores with design, menu, equipment, training, and support, and the location must be in a spot Starbucks wants to open. In other words, the Starbucks’ control over the licensed party has been extended to the scope of the whole business model. ---McDonald’s and Starbucks both adopt the company-operated model and franchised models, but the dominant models of McDonald’s and Starbucks are different. Previous studies studied the operation modes of McDonald’s or Starbucks separately that can only show the benefits of a company-operated or franchised model. In order to summarize the advantage of company-operated operation and franchised operation simultaneously, this paper compares the models of McDonald’s and Starbucks. Furthermore, this paper will put forward appropriate suggestions on the choice of model for different fast food enterprises.

This paper first introduces the franchised model on McDonald's from two different aspects. From the company's business data aspect, this paper summarizes advantages of franchised model and the characteristic of McDonald’s franchised model – rental income is the main profit. Form the marketing mix and target audience aspect, this paper summarizes characteristics of companies that are suitable for franchised model. Then this paper states the company-operated model of Starbucks also from two aspects. From company’s business data aspect, this paper introduces the expansion strategics of Starbucks based on different segments markets and the characteristic of company-operated model. From the marketing mix and target audience aspect, this paper concludes the features of enterprises that are suitable for company-operated model. Based on the above results, this paper discusses whether Starbucks' model that uses franchised model first to expansion then turns to company-operated stores is effective for all enterprises.

In this study, there is a special circumstance to explain: in addition to company-operating, the second chain operation mode adopted by Starbucks is licensing rather than franchising. There are some differences between the two modes of operation. In franchising, the resources authorised by the franchisor to the franchisee include business resources such as registered trademark, enterprise logo, patent and proprietary technology, as well as a set of standardized enterprise internal system and business model such as production, marketing and distribution. The franchisee shall operate under a unified business model in accordance with the contract. Before providing franchising, the franchisor must form a mature business model through the operation of its company-operated stores, and then copy it to the franchisee; When selecting franchisees, franchisors also need a long-term and thorough investigation process, a large number of legal documents are required to carefully design the franchise contracts. After the establishment of the franchise relationship, the franchisor will take the initiative to exercise "active rights" and have sufficient control over the franchisee's operation, products and services, price, etc. at the same time, the franchisee will also provide a lot of support in training, site selection and sales, and finally enhance the mark's goodwill by franchising. In licensing, the Licensor only authorizes its own brand to the operator, who will produce and sell the products of the authorized brand according to the agreed conditions. The process of providing licensing does not require a careful business plan, and often only a relatively simple trademark or patent licensing contract is required. The Licensee's interest is normally limited to supervising the proper use of the license, in order to limit their licensee’s ability to modify the trademark or reduce its value through use in connection with symbols or products that will lessen the mark’s goodwill. [3]

The purpose of this paper is to study the difference between company-operating and franchising. In essence, that is to study the difference between the chain form in which the company headquarters invest and manage each stores directly and the chain form in which the company licenses its own business resources and business model to the franchisee in the form of contract. In practice, Starbucks does help licensed stores with design, menu, equipment, training, and support, and the location must be in a spot Starbucks wants to open. In other words, Starbucks' control over the licensed party has been extended to the scope of the whole business model. Therefore, out of the principle of “Substance over Form”, we still choose Starbucks as one of the main research objects.

2. BUSINESS MODEL ANALYSIS OF MCDONALD’S

2.1.Analysis of Franchise Model of McDonald’s

From the bar chart (data source: McDonald’s annual reports from 2016 to 2020), it could be seen that the proportion of McDonald's franchise stores was expanding year by year, becoming the main mode of expanding its business territory globally.

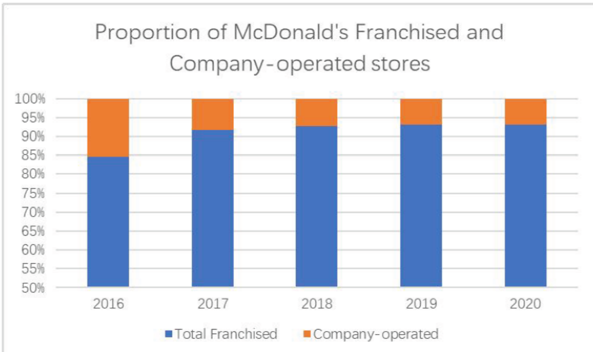

Figure 1 Proportion of McDonald’s Franchised and Company-operated stores

The chart below illustrates the profit composition of McDonald's, with franchised stores accounting for more than 70% of profits, and the same trend of year-on-year increase. The reason for this was that the costs of the company-operated stores offset the revenue: including food ingredients, store rent, staff salaries, etc.; compared to franchised stores, where the franchisee was responsible for the costs of running the store, McDonald's revenue consisted of rents, royalties and initial fees.

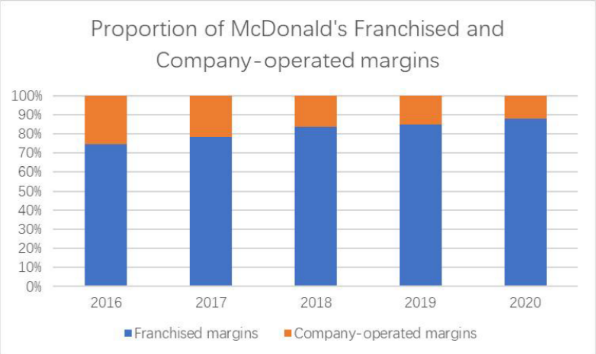

Figure 2 Proportion of McDonald’s Franchised and Company-operated margins

Of the three revenue streams for franchises, it was rental income that contributed the bulk of McDonald's revenue. Rental income as a percentage of overall franchise revenue remained stable at between 63-66% over the five-year period 2016-2020. This confirmed the subleasing strategy implemented by McDonald's—negotiating more than 20 years contracts based on strong brand equity. The company owned the rights to use or owned a large number of properties and acted as a "middleman" landlord subleasing the properties through standardized operations. Because of its brand value and the right operation and location strategy, McDonald's negotiated locations that generate significant premiums.

Table 1. Sales by Company-operated restaurants and Revenues from franchised restaurants (in details)

REVENUES						
In millions, except per share data	YEARS	2016	2017	2018	2019	2020
Sales by Company-operated restaurants		15295	12718.9	10013	9421	8139
Revenues from franchised restaurants	Rents	6107.6	6496.3	7082.2	7500.2	6844.7
	Royalties	3129.9	3518.7	3886.3	4107.1	3831.5
	Initial fees	89.4	86.5	44	48.4	49.9
	Total	9326.9	10101.5	11012.5	11655.7	10726.1

McDonald's Corporation's location and radiation effect were the core competitiveness of the company, and rental income was one of the main sources of the company's revenue. For the company-operated stores, the main purpose of their existence was for the product development and innovation of burger and fries. Although the profit margin brought by their operation was not high, it was the basis for the survival and development of the brand, which ensured McDonald's fast food business and painstakingly maintained the McDonald's restaurant culture. For the franchise model, it was the main source of his profit and was the part of McDonald's business model to achieve a leap in value.

In summary, the franchise model needed to be supported by a strong brand operating base, and companies needed to have strong brand support when choosing a franchise model. In addition, it was also necessary to pay attention to the potential risks brought by franchising to enterprises, which mainly came from franchisee behavior. For example, McDonald's China has experienced frequent food safety issues since it grew independently and became the largest McDonald's franchisee outside the United States in 2017. The high rate of store openings has led to lax personnel management and thus a lack of strict control and oversight, which has culminated in the first signs of various food safety complaints and even accidents. To build a better franchise network and avoid such problems, cooperation between franchisors and franchisees is critical. “The use of appropriate mechanisms hold greater importance in the context of developed/developing franchisor/franchised dyad, and knowledge transfer is challenging in the context of emerging economies because of knowledge asymmetries.” (Zaheer Kha,2016) [4] McDonald’s should put more emphasis on the cross-border knowledge transfer in Franchising arrangements.

2.2. Marketing Mix and Target Audience of McDonald’s

According to McDonald's official website, their products are mostly burgers, especially famous for beef burgers and chicken burgers. But considering the dietary habits and ethnicity, they also sell fish burger and veggie burger. They also sell sandwiches, chicken nuggets, bakery and dessert. In terms of drinks, they sell coffee and beverages. These products are relatively simple to make and can achieve standardized controlled production. One of the most unique features of McDonald's products is that they list the specific calories of each burger, which is attractive to bodybuilders and diet conscious people in order to control calorie intake conveniently.

Price of McDonald’s is mainly affordable and often launch packages such as family meals, children's meals and other combinations with cheaper price to attract customers. There also serve different food sets according to the time of day, such as breakfast and lunch at different prices.

McDonald’s has two different types of restaurants – directly operated restaurants and franchised restaurants. But they all have similar store designs. The stores are generally made of wooden tables and chairs, which can reduce the stay time of customers and increase the overall guest capacity. At the same time, many stores have special play areas for children, convenient for children and families. And McDonald's has its own special drivethru window that is convenient for customers in cars to get their meals quickly without getting out of their cars. Except of physical stores, McDonald's also has a delivery business, which has boosted sales as well as safety, especially COVID-19 is still severe now.

McDonald’s is good at promotion. They use advertisement in TV and internet to publicize themselves, and also use social media to enhance their influence. In some specific periods of time, such as anniversary celebrations, discounts are adopted to promote sales. They frequently cooperate with popular IP or idol to attract fans to buy and cooperation with hot IP or idol to attract fans and increase sales. For example, McDonald's launched a joint meal with a popular group BTS on a global scale in 2021 and received good feedback [5].

The target audiences of McDonald’s are children, young urban family and youth [6]. They pursue trendy and interesting things and have fast-paced lifestyle, but do not have high standard for the quality of products. In conclusion, the franchised model is suitable for this kind of low positioning products that are loved by youth. Consumers do not have high requirements for the product, and the product itself is not difficult to make, so it can be controlled to standardized production. Strong promotion will attract consumers to buy in any store which corresponds to the benefit of franchised model – rapid expansion of restaurants.

3. BUSINESS MODEL ANALYSIS OF STARBUCKS

3.1.Analysis of Company-operated Model of Starbucks

From the aspects of overall quality and development, the company-operated stores and licensed stores of Starbucks had similar trend. From 1995 to 2021, the number of company-operated stores and licensed stores of Starbucks increased at an almost similar rate. The proportion of company-operated stores gradually decreased from 90% in 1995 to 50% in recent years and remained relatively stable for a long time.

Figure 3 Number of Company-operated and Licensed Stores

Figure 4 Proportion of Company-operated and Licensed Stores

However, the company-operated stores of Starbucks represent a major source of revenue and a strong driving force for future profits. According to the data from 2001 to 2021, from the perspective of the whole company's revenue, the company-operated stores which accounted for 50% of all stores contributed almost 90% of the revenue and had a great growth with the development of the company. In contrast, although the growth of the number of licensed stores was similar to that of the company-operated stores, the overall revenue growth was much smaller. This can be confirmed by the average revenue of each company-operated store and licensed store. Over the past 21 years, the average revenue of each company-operated store had increased significantly, while the average revenue of each licensed store had remained stable or even decreased slightly.

Figure 5 Revenue from Company-operated and Licensed Stores

Figure 6 Average Revenue per Store

Starbucks has shown different expansion strategies in different segment markets. In the domestic market of the United States, the proportion of company-operated stores decreased year by year from more than 90% in 1995, and finally maintained at nearly 60%, and the growth rate of the number of company-operated stores is similar to that of licensed stores. In the international market, the proportion of company-operated stores soon dropped to about 40%, meanwhile, the growth rate of company-operated stores is slower than that of licensed stores. This shows that Starbucks relies more on company-operated stores for its development at home and relies more on licensed stores overseas.

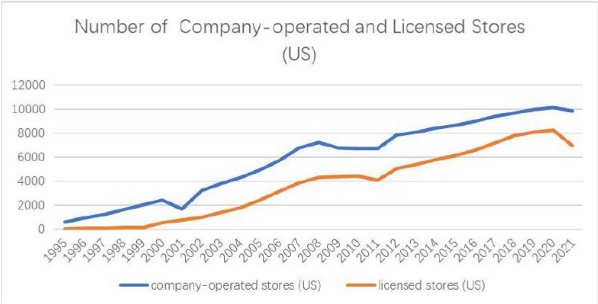

Figure 7 Number of Company-operated and Licensed Stores (US)

Figure 8 Proportion of Company-operated and Licensed Stores (US)

Figure 9 Number of Company-operated and Licensed Stores (International)

Figure 10 Proportion of Company-operated and Licensed Stores (International)

According to the data from 2005 to 2021, we selected several international markets that are most important to Starbucks for further analysis, and found that there are more differences in Starbucks' expansion strategies in different countries.

Since 2005, in the North American market, Canada (Starbucks entered the Canadian market in 1987) has shown similar characteristics to the domestic market in the United States, that is, the proportion of company-operated stores and licensed stores becomes stable. However, the proportion of company-operated stores in Canada is larger, accounting for more than 70%.

Figure 11 Proportion of Company-operated and Licensed Stores (Canada)

In the East Asian market, China (Starbucks entered the Chinese market in 1999) and Japan (Starbucks entered the Japanese market in 1996) show very different situations. At the initial stage of entering these two markets, Starbucks occupied the market in the form of licensed stores by means of franchising (without equity) and establishing joint ventures (with only a small proportion of equity). After the scale is formed, Starbucks would gradually reclaim the shares of the joint venture, strengthen control and expand in the form of company-operated stores.

Figure 12 Proportion of Company-operated and Licensed Stores (China)

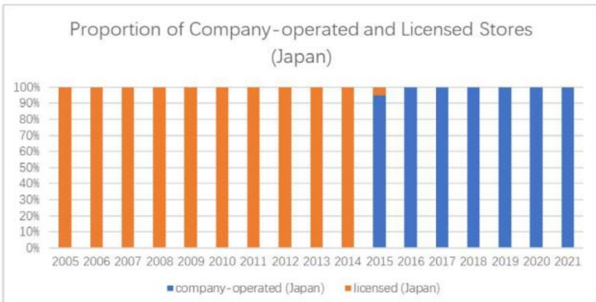

Figure 13 Proportion of Company-operated and Licensed Stores (Japan)

According to the differences above, we can make the following analysis:

From the perspective of revenue, company-operating has more profit space. With the development of brands and the increase of the number of stores, there are chances that the increment of revenue will become even greater. However, under licensing, the income of each store is basically fixed, and the increase of the overall income is highly dependent on the increase of the number of stores, so the profit space is limited, but it also means less business risk. From the perspective of cost, the cost of company-operating is greater than that of licensing. According to the financial report of Starbucks, this will lead to the operating margin of company-operating being lower than that of licensing.

But there are two points worth noting. First, the base of company-operating's revenue is much larger than that of licensing. Even if there is a smaller operating margin, it also means higher profits. Second, the company operating model will bring the unique "stored value card liability", which is worth $1.6 billion and accounts for 6% of all liabilities. It comes from the pre-stored value of coffee addicts, in essence, it is an interest-free liability, which will greatly reduce the debt financing cost of enterprises. In a word, company-operating will bring more profits than licensing.

On the choice of expansion strategy, due to the specific cultural background of coffee, Starbucks tends to give priority to company-operating when entering familiar markets or markets with a long history of drinking coffee. Starbucks would rely on its deep understanding of the market and products to ensure the quality of operation and increase brand value and popularity. When the scale is initially formed, Starbucks will gradually liberate licensed stores and quickly occupy a wider market through the less initial cost and more stable income. Finally, after ensuring that the control will be stable, the proportion of the current two modes will be maintained for a long time.

On the contrary, when entering the market with significant economic and cultural differences, in order to explore the market quickly, efficiently and at low cost, Starbucks will adopt the licensing mode and cooperate with local enterprises, After the end of the contract, Starbucks would reclaim the shares and turn to the mode of company-operating to strengthen the control of brands, products and services.

In addition, Starbucks' preference for company-operating can also be explained by the factors of management style and corporate culture. Starbucks CEO Howard Schultz wrote in his book, *Pour Your Heart Into It*, why he avoids franchising: he wants to maintain a "fanatical" level of control over his locations. Schultz believes that franchisees will act as a middleman to hinder the direct contact between Starbucks and its customers. Through the business model of company-operating, he hopes to "teach baristas not only how to handle the coffee properly but also how to impress to customers out passage for our products ", and let them understand the vision and value system of the company. [7]

3.2.Marketing Mix and Target Audience of Starbucks

According to official website of Starbucks, the dominant products of Starbucks are a variety of drinks based on coffee and tea. And they also sell food like sandwiches, bakery and so on. The taste of those products is very important, so the barista needs to be carefully trained to prevent differences in taste. Except for this food that can't be stored for long, Starbucks also sells coffee beans and all kinds of cups designed by themselves. And the most special product of Starbucks is gift card-Starbucks Card to increase customer loyalty while making money.

The positioning of Starbucks is relatively high-end, so the corresponding price is expansive. Starbucks also has a number of ways to promote extra spending, for example baristas promote gift cards and asking you if you want to a reusable cup.

Starbucks also has two kinds of restaurants: company-operation restaurants and franchised restaurants. But Starbucks is dominated by company-operation restaurants as it pursues the high-end positioning so most of their stores have their own unique design rather than standardized and unified. Most stores are equipped with Wi-Fi and relaxing music for business people. According to the official website, the whole design of stores reflects the concept of being a 'third place' besides home and work.

In term of promotion, Starbucks pays more attention on the word of mouth instead of the advertisement on TV or radio. The dominate methods of Starbucks' marketing is the social and moral image and effective public relations on social media [8]. The target audiences of Starbucks mainly from two groups. The first group is people between 25 and 40 years of age with high incomes and the second target group is people between 18 to 24 years old that belongs to richer families [8]. They are all from upper-middle class with college education in general. In conclusion, the company-operated model is suitable for enterprises with high positioning and high requirements for product quality like Starbucks. Especially when their promotion relies heavily on customers' word of mouth and image on social media, company-operated model will help them control their products and better maintain their image. Even though company-operated model means high cost, the Starbucks Card system can improve customer loyalty and further maintain revenue.

4. DISCUSSION

Based on the above results, Starbucks' expansion strategic that franchise in the early stage then turns into company-operated shows its benefits. As it can take advantage of the franchise's rapid expansion and high coverage to preempt a new market and raise awareness. After growth has stabilized, turning to company-operated stores can increase revenue because the income from company-operated stores is relatively higher than the fixed income from franchising.

But this model is not suitable for all enterprises and market. For those markets that are familiar with the product, entering such markets cannot start with a franchised store as franchise is difficult to control the quality, so it is easy to be rejected by consumers because the product is not qualified enough. For example, Starbucks also chooses to enter markets where coffee has a long history with the company-operated model.

Meanwhile, for those companies that do not have enough capital and staff, it is not appropriate to turn company-operated stores after franchise. Because switching to company-operated stores means that you suddenly increase a lot of workloads in management, including the management of raw materials, employees of these stores and so on. For those companies without insufficient strength and management experience, the sudden increase in the workload of management is a burden, which is easy to affect the original stable development of the stores.

5. CONCLUSION

By studying and analysing the franchising model and income structure of McDonald's, the expansion strategy in different segment markets of Starbucks and the marketing mix and target audience of both of the two companies, the study found that franchising is more conducive to pursuing expansion speed and reducing costs, but it needs the company to strengthen brand image control and standardize management system; operating is conducive to standardized management and well established brand image, but it is slightly inferior in expansion speed and cost control. Overall, the research conclusion requires companies to combine the current business situation with the future strategic development objectives, combine the enterprise life cycle with the development of the external environment, and seek an appropriate expansion model.

However, due to the limitations of case studies, our conclusions may not cover all cases. In addition, the current research on the business model of QSR industry is mostly the analysis and overview at the macro level, and there is a lack of analysis on specific financial indicators and business strategies. Therefore, this also puts forward a new direction for future research, that is, selecting more samples from QSR industry and introducing more quantitative indicators such as financial indicators, in order to draw more representative research conclusions.

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