Fast Food Industry Growth

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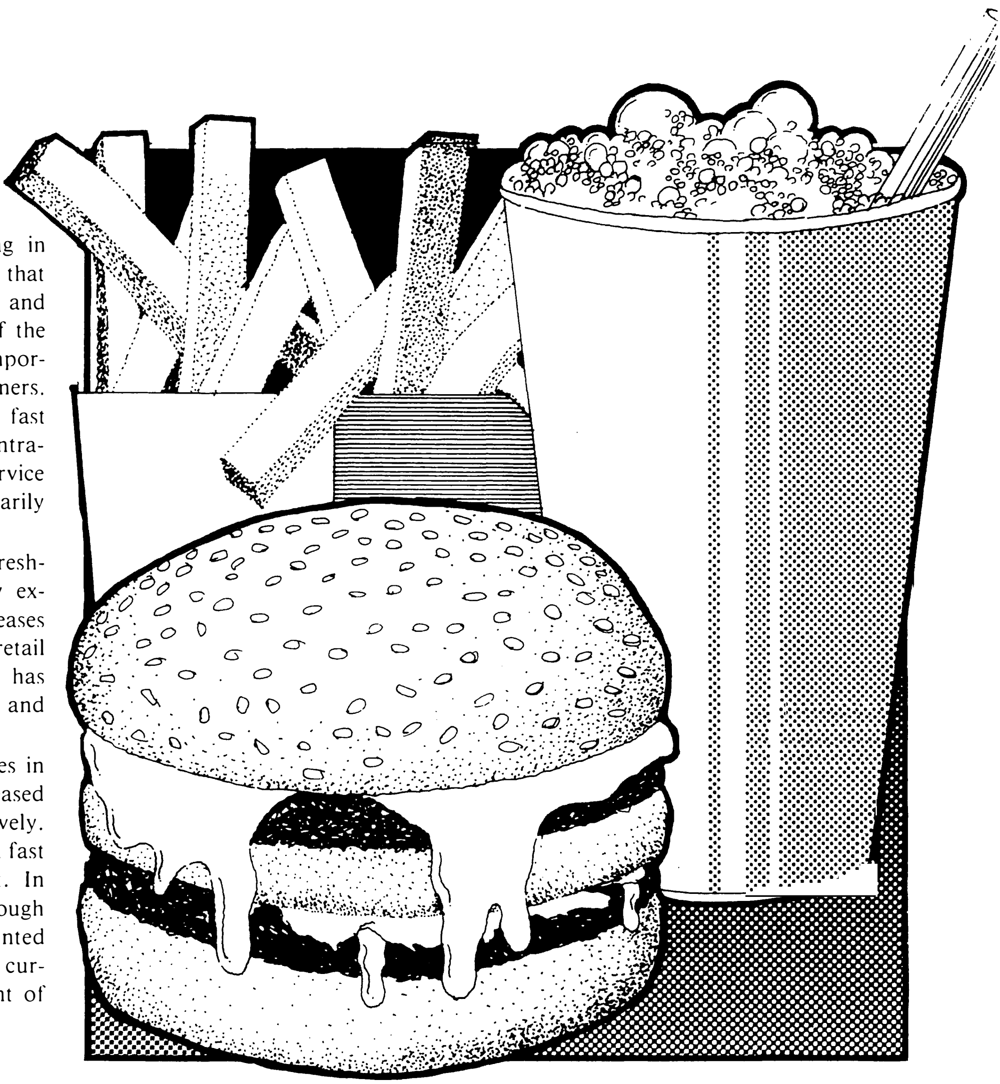

Important changes are occurring in the away-from-home food market that could affect the types of food sold and services provided, the efficiency of the food delivery system, and most importantly, the cost of food to consumers. The changes include growth of the fast food sector, rising industry concentration, and acquisitions of food service operations by large firms primarily engaged in other businesses.

The growth of fast food or refreshment place sales has substantially exceeded population and income increases and has been faster than for other retail food enterprises. This expansion has profoundly altered the structure and nature of the food service industry.

Between 1958 and 1978, real sales in foodstores and eating places increased 44 percent and 83 percent, respectively. During the same period, real sales in fast food places increased 305 percent. In 1978 dollars, sales of fast food through an estimated 100,000 outlets amounted to over $19 billion. Fast food places currently account for about 45 percent of the total number of eating places.

Growth of Establishments

The number of fast food outlets tripled between 1958 and 1972 while other types of eating places decreased 12 percent. Average sales per fast food outlet rose 94 percent during the period, after adjusting for inflation. Average sales of other eating places increased, but only 45 percent.

Fast food outlets are usually smaller in size than other types of eating places, which limits product selection and lowers average sales per unit. Fast food outlets averaged approximately three-fifths the size of other eating places during the 1958 to 1967 period. However, by 1972, sales per fast food outlet had increased substantially, and the units averaged about three-fourths the size of other types of eating places. While this trend probably will continue as fast food places expand their offerings, there is some indication that real growth in establishment size may be moderating.

Growth in Firms

Many fast food chains—firms with 11 or more outlets—have become very large. Real sales of fast food chains increased 1,123 percent between 1958 and 1972 while sales of chains that operated other types of eating places increased 147 percent. Sales by fast food chains would have shown a larger increase if the chains and 255 chains that operated other types of eating places. By 1972, the number of fast food chains had increased sales of single-unit franchises had been included with those of the franchise chains. Sales of single-unit franchises accounted for up to 23 percent of total sales by single-unit establishments.

Average firm sales for fast food chains grew 362 percent during the 1958 to 1972 period, more than three times the increase obtained by other eating place chains.

In 1963, there were 104 fast food

to 173 while the number of other eating place chains had dropped to 225. The number of fast food chain outlets grew by 209 percent between 1958 and 1972, while chains that operated other types of eating places increased by 139 percent.

Concentration

Concentration in the fast food sector is already higher than that in other food retailing industries, and further increases are likely. Sales of the four largest firms as a percentage of total fast food sales were 35 percent in 1972.

Currently, the four largest firms—McDonald's, followed by Kentucky Fried Chicken, Burger King, and Dairy Queen—account for 41 percent of fast food sales. The four largest firms in 1964 had only 20 percent of the market.

Who Owns Fast Food Firms

Most fast food outlets are affiliated with a franchise firm. Franchising enables the parent firm to expand its operation with only a limited capital investment. Most franchise operations closely parallel those of large corporate chains with trademarks, uniform identification symbols, storefronts, and standardized products and prices.

Although franchises enable independent owners to enter the food service business with limited experience and managerial information, a franchise is likely to require a sizable investment. It also tends to restrict managerial discretion in procurement, products sold, and sales practices. The franchisee, who actually owns and operates the fast food outlet, agrees to maintain specific uniform products, services, and practices in the operation of the business. Some franchisers now are reducing the availability of franchises by limiting or not licensing new ones and buying back existing ones that do not meet their standards of performance or from owners who may wish to leave the business.

Acquisitions and mergers typically occur when an existing food service firm acquires a relatively small firm that specializes in a particular segment of the market. But acquisitions and mergers also occur between food service firms and firms that are not in the food service business. This type of acquisition and merger is of special interest because it involves purchases of large fast food firms by even larger nonfood service firms. For example, five of the largest eight fast food firms are now owned outright or have a large equity interest controlled by nonfood service firms.

In 1977, about 21 percent of all eating place sales were at establishments that were owned by nonfood service firms. Food processors had 10 percent; beverage firms, 5 percent; and retail grocers, less than 1 percent. Other kinds of businesses, including chemicals, insurance, natural resources, pharmaceutics, and transportation, operated food service outlets that accounted for 6 percent of all eating place sales.

Constant Dollar Sales of Eating Places with Payroll[1]

	Total Sales				Sales Per Establishment				Sales Per Firm			
Firm size[2]	1958	1967	1972	Percent change 1958-72	1958	1967	1972	Percent change 1958-72	1963	1967	1972	Percent change 1963-72
	Million dollars				Thousand dollars				Thousand dollars			
Eating places (SIC 5812)	13,238	17,955	22,359	68.9	77	95	107	39.6	92	105	125	36.2
Fast food places	1,120	3,418	6,784	505.8	45	63	87	94.1	63	71	108	71.1
Single units	826	2,603	3,989	382.9	42	67	57.0	51	56	67	30.2	
Multiunits	294	815	2,795	851.4	47	103	151	223.7	273	444	935	242.2
5 units or less	123	364	875	611.4	56	96	124	119.1	145	231	336	131.7
6-10 units	19	75	217	1135.2	64	105	134	108.1	498	622	1,024	105.5
Chains	152	376	1,703	1122.9	48	110	174	263.6	2,133	2,687	9,843	361.5
Other eating places	12,118	14,538	15,575	28.5	82	108	119	45.3	100	118	134	34.9
Single units	9,948	11,087	11,276	13.4	73	92	100	35.9	82	92	100	21.6
Multiunits	2,170	3,451	4,299	98.1	177	233	243	37.3	655	1229	1430	118.3
5 units or less	873	981	1,215	39.1	125	188	210	68.5	245	423	472	92.5
6-10 units	198	283	374	89.2	226	251	256	13.7	1,095	1,335	1,789	63.4
Chains	1,099	2,187	2,710	146.5	251	257	259	3.3	6,005	7,838	12,045	100.6

[1] 1967 = 100

[2] Prior to 1972, firm size groups were based on all outlets operated by the same firm in the "same general" kinds of business rather than the "same" business as in 1972.

Source: U.S. Bureau of the Census, Census of Business for the respective years.

Behavior

In the past 2 years, fast food firms have been making a considerable effort to attract and keep customers. They have stepped up their use of price specials and such special promotions as discount coupons for amusement places and nonfood goods and services. In addition, firms are expanding their menu selections, changing the physical decor, and adding inside seating and some table service. Many have increased their expenditures for advertising.

Advertising expenditures by the largest 20 fast food firms in six media amounted to $225 million in 1977, about 1.8 percent of their sales.[1] In 1978, expenditures increased 23 percent to $277 million (still 1.8 percent of sales). Based on information in *Institutions*, a trade publication, a further increase in advertising expenditures of about 27 percent is indicated for these firms in 1979.

Part of this additional effort to attract and keep customers may be an attempt to serve a changing population. Teenagers made up a significant portion of the population in the sixties and were major customers of fast food outlets. But those teenagers are now in the 25 to 34 year age bracket—now the fastest growing population age group. Fast food firms have altered their menus, services, and promotions, to attract this older population segment.

Competition among large fast food firms, although intensified during the past 2 years, did not involve direct price reductions. Recently, however, McDonald's Corporation may have signaled the beginning of a new and more direct form of competition by reducing by 5 cents the price of hamburgers and cheeseburgers (from 43 to 38 cents and from 48 to 43 cents, respectively).

Although direct price competition among fast food firms will benefit consumers in the short run, long-term price competition could devastate fast food and other eating place firms whose pretax margins already have been reduced by higher food, energy, and labor costs.

Conclusions

The era of rapid expansion of fast food appears to be yielding to one of slower growth, and in some areas, saturation. Higher food, labor, and energy costs in the past several years, reflected in higher prices to consumers, are slowing the trend toward eating out. In addition, the increased costs of other goods and services which compete with food away from home for the consumers' dollar also may be slowing the growth of the fast food industry. Thus, the industry is not expected to sustain old rates of growth to which fast food firms have grown accustomed. This increases competition pressure among firms that strive to maintain past achievements. ■

[1] Includes network television and radio, spot television, magazine and newspaper supplements, and outdoor advertising in markets of over 100,000 population.

Wage and Price Standards Review

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As part of the anti-inflation effort, the Administration initiated a voluntary program of wage and price standards in October 1978. Food manufacturers, processors, wholesalers, and retailers were included in the program.

The first year of the voluntary standards program ended in September 1979. Although there is some dispute over the effects of the program on prices, many firms complied with program standards. Prices and wages increased less than would have been the case without an anti-inflation program. The program was revised, and continued for a second year as of October 1, 1979.

The First Year

The initial program limited price increases by firms voluntarily to a maximum of 9.5 percent, while wage increases were limited to 7 percent. Although the Government reserved the right to withhold contracts from firms not complying with the standards, the program was designed to be not only voluntary but also essentially self-administering. The Council on Wage and Price Stability (CWPS) was charged with the identification of firms not complying with the program standards. Large firms were requested to submit financial data directly to CWPS.

Percentage Margin Standard

A percentage margin standard was available to food wholesalers and retailers in lieu of the price standard because of the complexity of computing price changes for hundreds of products. Firms satisfied this standard if their adjusted net sales less the cost of goods sold as a percent of net sales did not exceed their margin trend, or if their margin percentage in the program year (October 1978 to September 1979) did not exceed that in the base year (October 1977 to