FOREIGN AND DOMESTIC PROSPECTS FOR THE U.S. FAST FOOD FRANCHISE INDUSTRY

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ABSTRACT

The U.S. fast food franchise industry, the fastest growing segment of the away-from-home eating market, was more adversely impacted by the 1974-75 recessionary period than other eating place segments. Sales volume decreased and growth rates, foreign and domestic, were considerably lower than those of 1969-73. Possible causal factors were the worldwide recession, the capital intensive nature of the industry, and market saturation. Nevertheless, this updated study finds that U.S. fast food franchise firms having foreign affiliates expect to generate $1.7 billion in foreign food and equipment sales by 1980, compared with $875 million in 1975.

KEYWORDS: Fast food, Franchising, Foreign markets, Growth rate, Growth potential, Trade barriers.

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SUMMARY

Beginning in the sixties and continuing into the early seventies, the fast food franchise industry was the fastest growing segment of the U.S. away-from-home eating market. By the late sixties, several of the largest fast food franchisers had successfully penetrated foreign markets and optimism was high for rapid expansion in these markets. Annual mail surveys of the total franchising industry by the U.S. Department of Commerce (USDC) and a pilot study of leading fast food franchisers by the U.S. Department of Agriculture (USDA) in 1974 confirmed the expansion both foreign and domestic, of the fast food industry.

However, the most recent survey conducted by USDC in 1975, and an update of the USDA study later that year, found a slackening sales volume for the fast food franchise industry vis-a-vis the rest of the away-from-home eating market during the 1974-75 recessionary period. USDA research showed a considerably lower rate of growth domestically for number of outlets and sales volume than in 1969-73. Foreign growth rates also appeared to slow. Some reasons why fast food outlets in particular suffered are the following: (1) High interest rates and land costs, to which such a capital-intensive industry as fast food service is particularly sensitive, slowed expansion plans, (2) rapid expansion in 1969-73 caused market saturation, and (3) consumers tended to swing away from convenience type foods during the recession.

Despite the recessionary slackening of domestic and foreign growth, the fast food franchise industry remains an important market for U.S. agriculture. On the foreign scene, U.S. fast food firms included in the update study expect to generate about \$1.6 billion in sales by 1980 of which about \$655 export potential for both U.S. and foreign food producers and processors. In comparison, sales volume for 1975, the most recent year for which data are available, totaled \$833 million. About \$1.1 billion additional potential by 1980 will consist of exports of nonfoods such as kitchen equipment, paper goods, and furniture.

The U.S. market potential for these firms also is impressive. A sales volume of \$16.3 billion is projected for 1980 of which about \$6.4 billion will represent the potential market for food available to agricultural producing and processing industries. This would imply annual growth rates of about 12 percent between 1976 and 1980.

Most U.S. fast food franchise firms operating in foreign markets use licensing as the principal method of ownership arrangement. Other ownership arrangements for foreign affiliates are wholly owned subsidiaries by U.S. companies and joint ventures.

Penetrating and maintaining foreign market outlets are not problem-free ventures for U.S. fast food franchise firms. Most frequently mentioned problems concern royalty remittances, copyright infringements, tariff barriers, and food and packaging regulations by host countries.

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INTRODUCTION

Previous research has established the dynamic nature of the U.S. fast food franchise industry and its growing importance in the away-from-home eating market. 1/* Fast food franchise companies also have successfully moved into foreign markets throughout the world in recent years. The industry's rapid growth, both here and abroad, has had important implications for U.S. agriculture. For example, one company which franchises fast food restaurants featuring fried chicken is the largest single producer and user of chicken in the world. Another, which owns a hamburger chain, is the largest single domestic user of potatoes.

A pilot study in 1974 of fast food franchise companies having foreign affiliates, conducted by the Economic Research Service (ERS), found that they were optimistic about their domestic growth and were strongly so about their prospects for foreign expansion. 2/ Supportive of these findings were the results of a survey of all western-style fast food franchise operators in Japan and continuing surveys of the U.S. franchising industry by the U.S. Department of Commerce (USDC). 3/

After the 1974 pilot study was made, widespread economic recession affected most of the world. Since recession could have adversely affected foreign expansion plans of the fast food industry, a new survey was made to determine the degree of impact on this so-called "recession-proof" industry. 4/

This report presents the results of the survey. All major fast food companies having or planning to have foreign operations were included. This study does not purport to be representative of the fast food industry. However, the firms

* All text footnotes will appear at the end of report.

included accounted for 68 percent of U.S. fast food outlets, 70 percent of total domestic fast food franchise sales, and 86 percent of all foreign outlets owned by U.S. firms in 1975. 5/ A substantial part of the data used in the analysis of size, sales, and growth trends of these firms were assembled from secondary sources, although in some instances, direct contacts were made with individual firms.

INDUSTRY GROWTH TRENDS SINCE 1974

Growth of the fast food franchise industry, which was spectacular in the late sixties and early seventies, appears to have slackened dramatically since 1974. This slowdown is based on data from annual USDC franchise surveys. Sales volume comparisons for 1972, 1973, and 1974 show increases of at least 20 percent each year. For 1975 and 1976, preliminary estimates by USDC, from a mail survey of 259 firms, indicates that growth in sales volume slowed to a little more than 10 percent per year (table 1).

Table 1--U.S. fast food franchises: Number of outlets and sales volume, 1972-76

Year	Outlets	Volume
	Number	Million dollars
1972	32,538	6,797
1973	36,340	8,534
1974	39,796	10,351
1975 1/	43,072	11,473
1976 1/	47,311	12,923
	Percent change	
1972-73	11.3	25.6
1973-74	9.9	21.3
1974-75	8.2	10.8
1975-76 1/	9.8	12.6

1/ Estimated from trade sources.

Sources: Franchising in the Economy, 1972-74, Feb. 1974, p. 69; Franchising in the Economy, 1973-75, Feb. 1975, p. 48; Franchising in the Economy, 1974-76, p. 63, U.S. Dept. of Commerce.

This slowdown in growth also is reflected in the average sales volume per outlet for the same time period. Prior to 1975 sales per unit had increased at a rate of 11-12 percent a year. This growth has been mainly attributed to the trend toward more company-owned rather than franchise-owned outlets and an overall industry modernization program which in both cases has led to larger size outlets. In 1975 and 1976, annual growth in sales per unit fell to only 2-3 percent (table 2). Some of this decrease, according to the USDC survey, can be attributed to the entry of a number of fast food chains featuring small carryout sales units.

Table 2--U.S. fast food franchises: Average sales per unit, 1972-76

Year	Average sales per unit	Change from prior year
	Dollars	Percent
1972	208,894	---
1973	234,838	+12
1974	260,102	+11
1975 (est.)	266,368	+2
1976 (est.)	273,150	+3

Source: See table 1.

The Bureau of the Census' recent retail trade reports further substantiate the singular impact of the recessionary period on the sales volume of fast food franchisers compared with the rest of the away-from-home eating industry. The restaurant, cafeteria, and lunchrooms subcategory (which does not include fast food sales) of the total eating places category shows sales volume increases of 13 percent for 1974 over 1973 and 17 percent for the 1974-75 period (table 3). As noted earlier, sales volume growth comparisons for the 1973-74 and 1974-75 periods from the USDC franchise survey show a drop of 10 percentage points (table 1).

It appears that the economic conditions prevailing in most of 1974 and 1975 had more of an adverse impact on the fast food industry subcategory than on the rest of the away-from-home eating industry. This is somewhat surprising in that the fast food industry generally had been considered to be recession-proof and had been growing since 1970 at a much faster rate than other segments of the food service industry.

Table 3--Sales volume of U.S. eating places, 1973-75

Year	Total eating places	Restaurants, lunchrooms, and caferterias 1/
	Billion dollars	
1973	30.33	23.8
1974	34.14	27.01
1975	39.51	31.48
	Percent change	
1973-74 ...	+13	+13
1974-75 ...	+16	+17

1/ Restaurants, lunchrooms, and cafeterias are a subcategory under "Eating Places" and fast food sales are not included in that subcategory.
Source: Monthly Retail Trade: Sales and Accounts Current Business Reports, Bureau of the Census, USDC, Feb. 1976.

A possible explanation comes from some Wall Street analysts who have been predicting a slowdown in fast food growth for several years on the basis of market saturation. A more likely explanation involves a more complex scenario: (1) The fast food industry, which is more capital intensive than other types of feeding operations, probably curtailed its expansion plans more in response to high interest rates, land prices, and building costs, (2) the recession-induced swing away from more costly convenience foods offered by grocery retailers could also have affected sales of convenience meals and snacks offered by the fast food industry, and (3) saturation of markets may have actually materialized in some fast food markets.

Yet, the past performance of the fast food industry and the fact that its sales grew more than 10 percent annually in the recessionary period (still high in comparison to performance of other industries) leads one to believe that the dip in the growth rate can be treated as a temporary aberration.

The latest data on the structural characteristics of the fast food industry do not appear to show any strong shift to greater concentration in the number of firms. Relating the size of firms to number of outlets and sales volume reveals that firms with more than 1,000 outlets increased their industry shares of both characteristics by about 4 percent between 1972 and 1974. Furthermore, these largest firms were the only ones to show any increase in concentration comparisons (table 4). However, the significance of these changes in terms of concentration cannot be properly assessed until more annual data are available.

GROWTH AND EXPANSION PLANS FOR U.S. OPERATIONS 6/

As indicated earlier, all major fast food companies having foreign fast food affiliations, including those participating in the original 1974 pilot study, were contacted to determine current and future company growth trends.

Growth for 1975 in the number of outlets and in sales volume of sample firms contacted remained similar to that of the total fast food industry. The USDC franchise survey showed a recession-induced decline in growth rates for the total fast food industry (table 1). The growth rate for U.S. outlets, established by the pilot study for the period 1969-73, was around 12 percent per year. The update survey found a much lower growth rate, 3 percent, for the 1974-75 period undoubtedly because of the recession (table 5). However, sample firms, when questioned about their U.S. outlet expansion plans for 1975-80, reported an anticipated 62-percent growth, close to the 54-percent growth for the 1974-79 period projected in the 1974 pilot study (table 6). Thus, if the industry expectations are realized, the slowing of the growth rate of the fast food industry in the 1974-75 period was in fact only a temporary setback.

Sample firms' growth in outlets for the 1974-75 period were related to size in terms of sales volume and number of outlets. In each instance, the largest firms (sales of over $500 million or 1,000 units and over) showed the least amount of growth on a percentage basis. The firms in the smallest category ($100 million or less or 500 outlets or less) had the greatest percentage increases. In most instances, similar patterns held for expansion expectations for 1980 (tables 7 and 8). Although these USDA data and those of USDC in table 4 are not fully comparable, the two sets give some idea of the differences in structural impacts brought on by two recent growth and recessionary periods.

Table 4--Distribution of fast-food companies by number of outlets, 1972 and 1974

Size group	Franchising companies		Outlets				Sales			
	1972	1974	1972		1974		1972		1974	
	Number		Number	Percent	Number	Percent	1,000 dollars	Percent	1,000 dollars	Percent
Over 1,000 ...	5	7	14,278	43.9	18,750	47.1	2,867,224	42.2	4,807,362	46.4
501-1,000	6	8	4,952	15.2	5,913	14.9	1,331,949	19.6	1,894,342	18.3
151-500	28	29	7,318	22.5	7,869	19.8	1,487,576	21.9	2,025,658	19.6
51-150	45	52	3,775	11.6	4,627	11.6	668,610	9.8	949,354	9.2
11-50	77	95	1,936	5.9	2,262	5.7	386,538	5.7	591,994	5.7
10 or less ..	53	68	279	0.9	375	0.9	55,508	0.8	81,857	0.8
Total	214	259	32,538	100.0	39,796	100.0	6,797,405	100.0	10,350,567	100.0

Source: See table 1.

Table 5--U.S. fast food sales volume and outlets, 1974-75

Item	Outlets	Sales
	Number	Million dollars
1974	27,914	7,774
1975	28,914	8,334
	Percent change	
	+3	+7

Source: Based on 1975 survey.

Table 6--U.S. and foreign outlets of fast food companies, 1974, 1975 and planned 1980

Year	U.S. outlets	Foreign outlets	Total
	Number		
1974	27,914	2,379	30,293
1975	28,809	2,776	31,585
1980, planned ...	1/ 46,562	1/ 5,464	52,025
	Percent change		
1974-75	+3	+16	+4
1975-80	+62	+96	+65

1/ Excludes four companies which did not provide these data.
Source: Based on 1975 survey.

Table 7--U.S. and foreign outlets of fast food companies by sales of company, 1974, 1975, and planned 1980

Sales	Fast food companies	Outlets						Change			
		1974		1975 1/		Planned 1980 2/		1974-75		1975-80	
		U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
	Number	Number						Percent			
Over $500 million	4	14,668	1,464	14,584	1,696	21,452	3,390	-1	+15	+47	+99
$101-500 million	10	12,084	620	12,911	721	22,226	1,266	+6	+16	+72	+75
$100 million or less ...	6	1,161	295	1,314	359	2,884	809	+13	+21	+119	+125
All companies	20	27,914	2,379	28,809	2,776	46,562	5,464	+3	+16	+62	+96

1/ Two companies did not report the number of current foreign outlets.
2/ Two companies did not project future growth of foreign outlets.
Source: Based on 1975 survey.

Table 8--U.S. and foreign outlets of fast food companies by number of outlets per company, 1974, 1975, and planned 1980

Number of outlets	Fast food companies	Outlets						Change			
		1974		1975 1/		Planned 1980 2/		1974-75		1975-80	
		U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign	U.S.	Foreign
	Number	Number						Percent			
Over 1,000	8	22,120	1,966	22,549	2,262	35,632	4,231	+2	+15	+58	+87
501-1,000	5	4,141	100	4,439	135	6,539	405	+7	+35	+47	+200
500 or less	7	1,632	313	1,821	379	4,391	829	+11	+21	+141	+118
All companies	20	27,914	2,379	28,809	2,776	46,562	5,464	+3	+16	+62	+96

1/ Two companies did not report number of current foreign outlets.
2/ Two companies did not report number of future foreign outlets.
Source: Based on 1975 survey.

GROWTH AND EXPANSION PLANS FOR FOREIGN OPERATIONS

In the earlier pilot study optimism for foreign expansion was extremely high. The study revealed that foreign outlets increased by 100 percent during the 1969-74 period and that an increase of 250 percent by 1979 was expected. The countries most frequently mentioned as targets for expansion were Japan, Australia, European Community (EC) countries, and Canada.

The update survey found an actual annual increase of 16 percent in foreign outlets between 1974 and 1975 and a revised estimated increase of 96 percent by 1980 (table 6). While the evidence is not conclusive, since it is based on limited observations, it appears that the worldwide recession dampened foreign growth and expansion plans more than it did on the domestic front compared to the 1974 pilot study. However, there are some differences between U.S. and foreign growth, when related to two structural characteristics, number of outlets, and sales volume. Unlike the comparative lack of growth of U.S. operations for large versus smaller companies, foreign operations of these large firms showed a strong growth pattern similar to that of such operations for the smaller fast food companies (tables 7 and 8).

We can only speculate as to the reasons for the less adverse impact of world-wide recession on foreign growth and expansion plans of the largest U.S. fast food companies. Perhaps one explanation might be that many of these firms already had leases, agreements, or contracts with foreign groups which had to be honored regardless of the prevailing economic climate.

Another aspect of structure investigated concerned the types of ownership arrangements U.S. fast food companies employed in their foreign operations. As was true in the earlier findings, the ownership trend is still toward more local participation and ownership. Almost three-fourths of all U.S. affiliated foreign outlets were owned by local entrepreneurs through license or technical tie-in. Twenty-three percent of the sample firms' foreign outlets were wholly-owned by the U.S. parent companies. A small proportion, 5 percent, was classified as joint ventures (table 9).

The locational pattern for foreign expansion by fast food companies has changed very little in recent years. The earlier survey established Canada, Japan, EC countries, Australia, and New Zealand as the prime areas of penetration. In the update survey, the patterns were similar except for a larger number of outlets in Japan and a smaller number in the United Kingdom (table 10).

Table 9--Ownership arrangements for foreign outlets of sample fast food companies

Type of foreign outlet ownership	Number	Percent
Foreign-owned, franchised, technical tie-ins, or licensed	1,711	72
Wholly-owned by U.S. companies	559	23
Joint ventures	109	5
Total	2,379	100

Source: Based on 1975 survey.

THE FAST FOOD INDUSTRY IN 1980, SIZE AND EXPORT POTENTIALS

Using a weighted average sales per unit and a weighted food cost component of these sales, export potentials which could be generated by the U.S. fast food industry were estimated. 7/ U.S. fast food firms expect to have about 5,500 foreign units in place by 1980. This is almost 1,000 units less than estimated by the 1974 pilot study. Much of the shrinkage probably can be attributed to more conservative expansion estimates of some fast food firms which reflected their recessionary experience of the last 2 years.

In spite of this more conservative number it is still nearly double the 1975 outlets. Foreign sales units of U.S. fast food franchisers might possibly generate $1.6 billion in sales by 1980, compared with $833 million in 1975. Application of the food cost component to 1980 total sales would leave about $655 million as an approximate measure of expenditures for food in this market segment and a rough approximation of the food export potential. 8/ Thus, foreign sales opportunities of this magnitude could be available to U.S. and foreign suppliers of raw and processed products such as meat, dairy, vegetables, grain and oilseeds--the major food groups used in foreign fast food menus. 9/ Since most foreign fast food firms' food purchasing procedures appear to adhere closely to franchise quality specifications, U.S. food exporters should have an initial advantage in competing for this market. 10/ The export potentials for U.S. products in the

Table 10--Estimates of number of foreign outlets of U.S. fast food companies, distribution by country, 1974

Country	From ERS pilot study 1/		From Update survey and other sources 2/	
	Number	Percent	Number	Percent
Canada	880	48	1,062	45
Mexico & Central America	58	3	97	4
Caribbean	52	3	70	3
Continental Western Europe	56	3	76	3
United Kingdom	265	15	113	5
Australia, New Zealand	209	12	214	9
Southeast Asia	23	1	49	2
Japan	245	13	499	21
South America	2	3/	2	3/
Middle East	5	3/	10	3/
Africa	38	2	54	2
Soviet Bloc countries	0	0	0	0
Not ascertained			4/ 133	6
Total	1,833	100	2,379	100

1/ Estimates from 1974 pilot study reported in Fast Food Franchises: Market Potentials for Agriculture Products in Foreign and Domestic Markets, ERS-596.

2/ From update survey and from secondary data sources such as, Institutions/Volume Feeding, 1975; Restaurant Hospitality Third Annual Chain Directory Dec. 1975, and Chain Report, 1975. Country distribution data were not available for 1975.

3/ Less than 1 percent.

4/ Three companies did not provide country totals.

fast food market also could include many nonfood items such as paper goods, kitchen equipment, furniture, display cases, and decor items.

In the study of Japan's fast food industry, the gross export potential for all food products imported for Japanese fast food outlets was estimated at a level of $170 million by 1979, whereas estimated nonfood sales to Japan's fast food industry was substantially higher, $279 million. If this ratio holds true for other foreign countries, the total nonfood export potential generated by U.S. style foreign fast food franchise firms could total 1.64 (ratio of nonfood to food) times $655 million (total food export potential by 1980) or an amount equal to $1.07 billion. Thus, the total export potential by 1980, food and nonfood, created by U.S. style fast food operations in foreign countries could be as much as $1.7 billion.

For the domestic market, the numbers are even more impressive. The sample firms could attain a sales volume potential by 1980 (46,542 units times $350,000 average sales per unit), of $16.3 billion. Similarly, if we apply the weighted average food cost component, the sample firms could represent a $6.4 billion market for food by 1980 compared to total sales of $10.1 billion in 1975 of which $3.9 billion was the cost of food.

CURRENT PROBLEMS IN FOREIGN MARKET PENETRATION

As a last item, the foreign experiences of sample firms, particularly as they relate to trade barriers and supply problems, were covered. In the earlier pilot study most of the specific problems cited could be grouped under the general headings of tariff barriers and food regulations. These kinds of problems also received prominent mention in the update study. Japan was the country most often referred to concerning the problem of import regulations, particularly with respect to food ingredients. Canada and Caribbean area countries also were mentioned, in this regard, by several U.S. fast food companies. The only relatively new problem area cited by several firms was royalty recognition and remittance. This may become a problem of growing importance since, as previously mentioned, most U.S. foreign contractual arrangements involve licensing which requires royalty fee payments. Countries where this was reported to be a problem were Brazil, Mexico, and Korea.

Other problem areas cited were: getting local suppliers to meet food supply specifications; servicing foreign outlets, and obtaining pertinent and timely data for evaluating foreign operations. However, to put these foreign problems in better perspective it should be noted that almost one-third of the companies in the update study, as was true for the pilot study, did not report having any specific foreign marketing problems.

FOOTNOTES

1/ Annual surveys of the franchise industry by the U.S. Department of Commerce (USDC). Fast food outlets are usually defined as eating establishments providing a limited menu of food, utilizing standardized food preparation and service, and equipment and management system labor-saving technologies. In this report, as is true of the U.S. Dept. Commerce franchise studies, only fast food franchise firms and some full-menu franchise chains are included. Single, unaffiliated fast food units are not included.

2/ Fast Food Franchising: Market Potential for Agricultural Products in Foreign and Domestic Markets, Econ. Res. Serv., U.S. Dept. Agr., Feb. 1975.

3/ Japan's Fast Food Industry: Export Potentials for U.S. Products, FAS M-268, For Agr. Serv., U.S. Dept. Agr., Sept. 1975. Franchising in the Economy, 1971-73, 1972-74, 1973-75, and 1974-76, U.S. Dept. Commerce.

4/ Institution/Volume Feeding, March 15, 1976, Cahners Publishing Co., Chicago, Ill. The fast food industry has been categorized as "recession-proof" mainly because of the economical price image of fast food restaurants.

5/ Based on 1975 estimates for the total industry, Franchising in the Economy, 1974-76, U.S. Dept. of Commerce, p. 63, Feb. 1976.

6/ From 1975 USDA survey.

7/ Weights were applied to each sample firm's average sales of foreign and domestic outlets and to each firm's food cost component to reflect the relative importance of sample firms in terms of number of sales units and sales volume. For foreign operated outlets, the weighted average of sales per unit came to $300,000. For U.S. operated outlets average sales per unit was $350,000. The weighted food cost component of sales averaged 39 percent. Most of the estimates for number of outlets in 1980 were obtained from fast food franchisers. Some estimates came from the following trade publications: Institution/Volume Feeding, July 1975 and 1976; Restaurant Hospitality, Dec. 1975; Service World International, March/April 1976; Chain Report I/V 400, Aug. 1975.

8/ The food export potential is probably on the high side because embedded in the food cost component are transportation costs, import duties, etc. Thus, the actual commodity dollar value would be somewhat less than the $655 million and should be used only as a ballpark estimate of commodity export potential.

9/ Specific information on commodity usage was not included in the update survey. Such data are available in the earlier USDA pilot study and the survey of Japan's western-style fast food industry (see footnotes 3 and 4).

10/ Japan's Fast Food Industry: Export Potential for U.S. Products, For. Agr. Serv., U.S. Dept. of Agr., Sept. 1975, p. 5.