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# Next Level International Franchising

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## Introduction

A great deal of research and literature has been devoted to the foundational legal and business concepts of international franchising, including analysis and commentary on methods, modes and structuring franchise expansion,[1] important negotiating, contractual and enforcement considerations,[2] and a variety of other legal and business concerns.[3] This is for good reason. Without a strong understanding of those underlying principles, no franchisor, and no counsel advising such a franchisor, will succeed with their international goals. But once those underlying issues have been considered, and successfully implemented, what factors continue to impact the success of an international franchise expansion program? These "next level" considerations have perhaps garnered less attention than the seminal ones, and are the subject of this paper.

Lessons can be learned from the successes and failures of "real life" international growth stories that directly employ franchising as an expansion model, or other expansion models that exhibit similarities and feature parallels with franchising. In order

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[1] See, e.g., Graefe, W., Viitre, P., and Fahmi, T. Basic Track: Expanding Internationally – The Importance of Realistic Expectations and Proper Due Diligence in Navigating International Waters. IFA, 48th Annual Legal Symposium (2015); Zwisler, C. and Krakus, B. Avoiding Common Mistakes in International Franchising. IFA, 48th Annual Legal Symposium (2015); Edwards, W., Robinson, F., and Levinson, K. The Key Tax Issues in International Franchise Transactions. IFA, 47th Annual Legal Symposium (2014); Trickey, B., Fournaris, D., Teasdale, S., and Wadell, T. Basic Track: International Expansion – Where Do I Start? IFA, 46th Annual Legal Symposium (2013); Xu, T., Hardy, T., and Harsh, B. Planning for International Expansion – Things to Consider Before Expanding. IFA, 43rd Annual Legal Symposium (2010); Gast, O., Satterlee, K, and Weinberg, L. Players on the Same Team? Whether and How to Work With Counsel in Other Countries on Cross Border Franchise Deals. IBA/IFA 30th Annual Joint Conference (2014).

[2] See, e.g., Brennan, M., Pratt, J., and Wray, D. *Negotiating an International Deal – Getting to "Yes" for Long-Term Success.* IFA, 48th Annual Legal Symposium (2015); Amaral, L.H., Edmonds, J., and Loewinger, A. *Dealing With Defaults in International Franchise Agreements.* IFA, 44th Annual Legal Symposium (2011); Lauer, R., Marzheuser-Wood, B., and Mondragon, J. *Enforcing Your International Agreement – What Can You Really Do?* IFA, 44th Annual Legal Symposium (2011); Brimer, J., Dolman, J., Lindsey, M., and Metzlaff, K. *Using Negotiation and Mediation to Resolve International Franchise Disputes.* IFA/IBA Joint Annual Conference (2013); Teasdale, S., and Susag, J. *Terminating an International Master Franchisee.* ABA, 36th Annual Forum on Franchising (2013); Hurwitz, A., Mochrie, D., and Pratt, J. *All Over The World: Mastering International Master Franchise Agreements.* ABA, 38th Annual Forum on Franchising (2015).

[3] See, e.g., DiLorenzo, S., Spearing, M., and Yaffe, E. *The Foreign Corrupt Practices Act: What Every International Franchisor Must Know.* IFA, 45th Annual Legal Symposium (2012); Lauer, R., Metzlaff, K., and Xu, T. *Foreign Competition Laws and Their Effect on Transnational Franchise Relationships.* ABA, 36th Annual Forum on Franchising (2013); Levitt, E., and Mondragon, J. *A Survey of International Legal Traps and How to Avoid Them – Beyond the Franchise Laws.* ABA, 30th Annual Forum on Franchising (2007).

to identify and examine certain important next level issues, this paper will describe and analyse the paths taken and lessons learned from international expansion efforts of the *McDonald's*, *Carrefour*, *Tim Hortons*, and *Target* brands

In addition to successful international growth, this paper will also examine some international expansions that struggled, or even failed. By analyzing unsuccessful international franchising endeavours, we highlight flaws in franchising systems in order to help stakeholders in the franchise industry avoid many common pitfalls. Further, by approaching these case studies from a legal perspective, we provide the reader with tools to implement in franchise agreements, and within the franchise relationship in general, in to encourage future success.

## Case Studies

## McDonald's Success in India

Remarkably, the *McDonald's* system – a fast-food *beef* burger chain – has managed to achieve tremendous success in India. In 1996, McDonald's entered into its 95th country, opening its first Indian franchise in Basant Lok, New Delhi. Two decades later, McDonald's presence continues to thrive in India with over 250 franchises currently in operation.

The McDonald's franchise in India is locally owned and managed by two restaurant groups – one for the Northern and Eastern Region and another for the Western and Southern Region. Of the 34,000 *McDonald's* outlets in 118 countries, approximately 80% operate through this traditional franchising model.[4] So how did the *McDonald's* brand succeed in India and overcome the differences in consumer preference between Indian and American culture in such a way that its product would be accepted by local sensibilities? A large part of the answer: *by embracing the concept of "glocalization" and overcoming the impact of market proximity*.

### Glocalization

McDonald's spent over five years studying market research and vendor development before franchising into India. The menu in India, as a result of the local culture of vegetarianism and general avoidance of beef, was the first *McDonald's* restaurant to offer an entirely non-beef and non-pork menu. The menu, which features favourite items conformed to local tastes like the *Maharaj Mac* and *McAloo Tikki*, is segregated between vegetarian and non-vegetarian from processing to serving. In 1998, McDonald's India established a local menu development team to collect

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[4] Raja, John Samuel, and Chakravarty, Chaitali. *Vikram Bakshi & Amit Jatia: A Tale of McDonald's Two Franchise Partners in India.* The Economic Times of India, September 24, 2013. Accessed online at http://articles.economictimes.indiatimes.com/2013-09-24/news/42361242_1_india-wazir-advisors-countries.

consumer feedback. This team of locals was responsible for creating the vegetarian system and gave input to local management regarding system operations. The team advised that two different menu boards would be displayed in each restaurant – one sign would be green for vegetarian products and one sign would be purple for non-vegetarian products. Further, behind the counter, restaurant kitchens had separate preparation areas with staff that wore green and purple uniforms to distinguish their roles. Employees were not permitted to work on both stations in the same day in order to ensure segregation, as well as enhancing customer trust.

As McDonald's displayed in India, understanding local tastes and markets is crucial for franchise success in foreign markets. Some business theorists have coined the term "glocalization" for this practice. Glocalization, the practice of conducting business according to both local and global considerations, can be a very effective method in international franchising as the franchising business model inherently contains a geographically dispersed customer base seeking service from a network of local franchises.[5]

The term glocalization first appeared in the late 1980's in the *Harvard Business Review*.[6] Glocalization has its roots in the Japanese term *dochakuka,* originally referring to farmer's propensities to adapt farming techniques to the local conditions. The concept was later expanded to its current use, referring to global-localization.[7] Glocalization "combines the globalization and localization strategies by emphasizing on the fact that globalization of a product will succeed when the product or service is adapted specifically to that region".[8]

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5 McDonald's is hardly alone. For example, the 7-Eleven system employs a similar approach. Its convenience stores worldwide feature products that are desirable to local consumers. On its website, 7-Eleven notes that "[e]ach store's selection of about 2,500 different products and services is tailored to meet the needs and preferences of local guests. … 7-Eleven offers consumers a number of convenient services designed to meet the specific needs of individual neighborhoods" 7-Eleven Profile, http://corp.7-eleven.com/corp/7-eleven-profile; Kentucky Fried Chicken also conforms its menus to local tastes and preferences. In China, instead of a side of coleslaw, customers can order seasonal vegetables like pickled bamboo shoots in the summer or lotus root in the spring. In India, its menus feature a vegetarian chickpea patty called the "Chana Snacker". In South Korea, as another example, Dunkin' Donuts added local twists to menu classics, like red bean doughnuts and kimchi croquettes. Subway in India did the same with their chicken tikka sandwich.

6 Sharma, Chanchal Kumar. Emerging Dimensions of Decentralisation Debate in the Age of Globalisation. Indian Journal of Federal Studies, 19 (1):47-65.

7 *Id*.

8 Prakash, Ajai and Singh, V.B. *Glocalization in Food Business: Strategies of Adaptation to Local Needs and Demands.* Asian Journal of Technology and Management Research. Vol. 01 – Issue: 01 (Jan – Jun 2011).

McDonald's adaptation of the traditional menu to conform to local tastes is glocalization in its purest form. The *Maharaj Mac*, being a local adaptation of the *Big Mac*, is a clear example of this. However, adapting to the typical differences that exist in foreign food cultures is only one example of glocalization. In order to penetrate the Indian market, the *McDonald's* brand had to go beyond adapting just a menu. McDonald's was tasked with glocalizing every aspect of the business – from the menu, to the marketing, to the management. Often, local suppliers are also one of the most important considerations for various reasons, including financial, shipment, legal, and trade law considerations.

<u>The Inherent Tension with Franchise Glocalization</u>

Glocalization conflicts with the traditional franchise model as it encourages adaptation as opposed to standardisation. The standard franchise model is based around standardization and uniformity for at least three reasons.

First, standardising a system minimizes costs associated with purchasing, marketing, and implementation. Second, uniformity allows for the concept of a franchise to be communicated and delivered consistently across franchise locations. Many experts discuss the reality that consumers have grown to expect the exact same product or service at every franchise location. Finally, local adaptation may actually reduce a franchise system's ability to innovate. Cox and Mason write:

> The knowledge generated by individual franchisees may be of little value to other franchisees operating in different environments. More importantly, if franchisees adapt to local conditions they decrease the similarity of operating routines across the system, which reduces the potential for cross-fertilisation of ideas for identifying and implementing new offerings.[9]

The challenge is therefore achieving predictability in the franchise systems while balancing the need for adaptation, or glocalization. One of the best mechanism to achieve this predictability is through the franchise agreement, which includes the use of the operating manual. Training programmes are another important tool in the effort for standardization. In the international context, franchise agreements, operating manuals and training programs need to be tailored for the particular circumstances in which they will be implemented. More specifically, once a franchisor has identified the extent of permissible local adaptation, the contractual framework and the dynamics of the franchise relationship need to be modified and implemented to permit the business to operate in accordance with those particular choices. And that is only the start. As

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[9] Cox, Juliet and Mason, Colin. *Standardisation Versus Adaptation: Geographical Pressures to Deviate from Franchise Formats*. The Service Industries Journal, Vol.27, No.8, December 2007, pp. 1053-1072 at 1056.

relationships and business realities evolve, the parties must allow that framework to grow with them within the confines of the parties expectations. Stagnation, rigidity and strict adherence to contractual requirements cannot foster healthy adaption.

However, franchises, especially ones operating in new and foreign regions, must remain cognizant of the geographically differentiated nature of markets. The inherent nature of diverse geographical environments with unique market and resource conditions requires a fine balance between standardization and adaptation. Geographic variations affect production cost and quality, labour, and premises. For international growth to remain successful, this becomes a dynamic for which constant vigilance is required.

Labour market conditions cannot be overlooked by franchises operating in foreign territories. In addition to the obvious differences in consumer tastes and preferences, labour market conditions should affect the ways in which franchises adapt their practices to meet local norms. From a human relations perspective, franchisees are responsible for recruiting of staff, setting wages, and operating hours. These factors can have an impact on the way in which products are produced, in addition to ways in which they are sold. [10]

> Local labour markets vary in terms of occupational skill structures. In some cases franchisees had difficulties in recruiting staff with suitable skills and had to respond with recruitment and training initiatives to combat this problem. Recruitment was a particular problem for some of the professional service-based franchise systems because of the high skill levels or specialised knowledge required of employees. Job-specific training was the usual response to such difficulties. In the case of retail and fast food firms, a combination of the low skill nature of the work, low pay and long opening hours, which necessitated unsociable shift work, created considerable recruitment and retention difficulties which franchisees attempted to respond to by means of local adaptations to standardised recruitment procedures.[11]

While the advantages of standardization are apparent, so too are the advantages to adaptation.

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10 Cox, Juliet and Mason, Colin. *Standardisation Versus Adaptation: Geographical Pressures to Deviate from Franchise Formats*. The Service Industries Journal, Vol.27, No.8, December 2007, pp. 1053-1072 at 1057.

11 *Id.*

- *First*, local franchisees have an intrinsic familiarity with local market conditions: "franchisees are the system's eyes and ears in local markets where the franchisees may have deep social and domestic roots but which remain little understood territory to the franchisor".[12]

- *Second*, and seemingly paradoxically, moderate levels of adaptation encourages adherence to the franchise agreement and discourages entrepreneurial behaviour. A franchisee is less likely to go rogue with experiments, innovations, and new strategies that are not sanctioned by the franchisor if she or he feel that his franchise agreement has been well tailored to suit local market conditions and that he has a permissible range in which he can adapt the system.

- *Third*, preventing the need for unwanted entrepreneurial behaviour from franchisees is likely to foster a more harmonious relationship with the franchisor and other franchisees. Studies have shown that if franchisees feel the need for entrepreneurial behaviour but the franchise agreements prevents this due to rigorous standardization policies, the franchisee-franchisor relationship will suffer.[13]

The findings state that "preventing franchisees from pursuing their own entrepreneurial interests may foster dissent which could be exhibited in a variety of ways – misrepresentations of costs and revenues, withholding royalty payments, refusing to participate in innovative marketing, and resisting changes needed to keep the system competitive".[14] Establishing and enforcing the appropriate balance between healthy entrepreneurial activity and conformity to standardization is therefore essential. While these observations (like most) do not represent absolute truths or a conclusion that is inexorable, they do stand for the proposition that these issues are concerns that business teams – and their counsel – need to take into consideration.

Interestingly, the tension outlined above between standardisation and adaptation varies in relation to the age of the franchise system. Younger franchise systems find standardisation more important in the early stages as they develop their brand identity

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12 Stanworth, J., Healeas, S. and Purdy, D. (2002) *Intellectual capital acquisition and knowledge management – new perspectives on franchising as a small business growth strategy*. ISBA National Small Firms Policy and Research Conference Proceedings, 2, at 1507–34.

13 Cox, Juliet and Mason, Colin. *Standardisation Versus Adaptation: Geographical Pressures to Deviate from Franchise Formats*. The Service Industries Journal, Vol.27, No.8, December 2007, pp. 1053-1072 at 1057.

14 *Id*.

and brand recognition. In contrast, a mature franchise system will be more resilient to "potential brand image distortion that arises from local deviations".[15]

The tensions between a franchisors' desire for consistency, quality control, and brand equity and a franchisees' desire for autonomy and localised success is apparent. There is no hard and fast answer to achieving the required balance, but rather, an appreciation of both sides' motivations will help franchisors navigate international franchise expansion in the future. The preferred approach certainly involves a technique that straddles the line between adaptation and standardisation.

<u>Overcoming the Impact of Market Proximity</u>

Historically, businesses tend to succeed and grow more quickly in markets that are similar to their home markets. The underlying explanations for this fact are: the principle of least resistance, evolutionary theory, and transaction costs.

The principle of least resistance posits that franchises choose to do business in markets that make it easier for them to do so, that facilitate the transfer of knowledge, and that help control entry costs.[16] Yet McDonald's India managed to overcome these theories, largely as a result of its glocalisation efforts which minimized the effects of market proximity.

The successful rollout of the *McDonald's* system in India arose from several factors. First, by the selection of outstanding local parties to operate the business. Second, by methodical planning, testing, and analysis of the marketplace, consumer preferences, and methods of satisfying demand. Entry strategies like McDonald's India's demonstrate that well-conceived expansion plans contemplate the local market forces and challenges inherent in international expansion will provide franchisees operating in an international market the greatest opportunity for long-term success by reducing the challenges posed from market proximity and adaptation to local market preferences.

The concept of evolutionary theory, mentioned above as a factor for why franchises have traditionally succeeded in similar markets, warrants further analysis in relation to *McDonald's* success in India. Franchising operates by licensing the format for operating the business to franchisees, in addition to the fundamental licenses for trademarks, recipes, and operating standards. By licensing in this way, franchisors maintain control over their product and its offering. As a franchisor expands, it is able to "learn which assets are truly core to their concept and, as a result, need to be preserved as well as which assets can be considered peripheral and, therefore, adapted to the

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15 *Id*.

16 Hoffman, R., Kincaid. J. and Preble J., *International Franchise Expansion: Does Market Propinquity Matter?* Multinational Business Review, Vol.16, No. 4, Fall 2008 at 26.

new market".[17] Whether this epiphany takes place early on in a franchisor's expansion or only later depends on the circumstances, but whenever this level of understanding is gained, it may be an invaluable key to success in international markets.

Traditionally, transaction costs are a huge barrier to international expansion in business. This is one of the factors for why market proximity matters in a non-franchised format. Franchising, however, overcomes this barrier due to the structure of the franchise relationship. Franchisors' implementation of a standardized business format across franchises helps keep transaction costs down as a result of: purchasing economies related to standard products and services; marketing economies of a uniform brand image or brand name; and administrative economies resulting from similar operational procedures based off of a standardized user manual and training program.[18] In the case of McDonald's India, transaction costs were also controlled by the franchisor's direct ownership in the local operations, its ability to bring its own experience to bear in that local market, and its own economies of scale.

McDonald's is just one example of a franchise achieving tremendous international success. The above analysis demonstrates that by embracing the concept of glocalization and adapting to local Indian culture, McDonald's helped franchisees overcome the impact of market proximity. And, while not all franchisors will want to invest directly in foreign franchise vehicles, as McDonald's did in India, this approach helped create the conditions for initial and sustained success with an eventual exit strategy for the franchisor.

## Contrasting Carrefour's Experience in China and Japan

Carrefour is a French retailer that has achieved global success since its doors first opened in France in 1959. The company's international expansion actually began out of necessity in 1969. French legislators, responding to violent opposition from French merchants, enacted laws regulating and limiting the expansion of "hypermarkets", as they posed a serious threat to the viability of local retailers who could not compete with competitive pricing. Hypermarkets are superstores that combine supermarkets and department stores offering a one-stop-shop solution to customers. Walmart and Target are both examples of hypermarkets. Currently, Carrefour operates in 34 different countries with over 10,000 stores, 381,000 employees, and net annual sales of approximately US$100 billion.[19] In 2011, Carrefour was the largest retailer in Europe and the second largest retailer in the world after Wal-Mart.

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17 *Id*. at 30.

18 *Id*.

19 Carrefour, 2014 Annual Activity and Responsible Commitment Report.

In 2000, Carrefour had 24 stores in China. By 2014, that number had multiplied to 236. Clearly, the French retailer experience tremendous growth and success in China. This success, in part, encouraged expansion into Japan. In 2000, Carrefour announced its plan to open 13 new locations in Japan as part of its expansion strategy across Asia. Unfortunately, less than five years later, Carrefour withdrew from Japan, selling the stores to Aeon, its main competitor, due to poor performance across the Japanese locations.

Carrefour's Success in China

Carrefour operates in China through both traditional franchise models and corporate owned stores. Of Carrefour's 10,000 stores globally, 1,350 are franchised.[20] Carrefour is a registered member of China Chain Store & Franchise Association (CCFA), however the details of the structure of the Chinese franchise agreement remain veiled. Regardless, the success of their Chinese stores offers insight into successful international franchise expansion. There are four main reasons credited with Carrefour's overwhelming success in China: clever competition with the local market, commitment to glocalisation, decentralized management structure, and a formulaic business approach.

Understanding local market forces is instrumental to succeeding in international franchising. For instance, Carrefour performed extensive market research into China to determine the extent of local market competition. One of the most difficult obstacles that was immediately identified was the difficulty in competing with local pricing.

Carrefour overcame the challenges faced by competitive local pricing using a twofold strategy: (1) commit to purchasing at least 90% of the merchandise locally; and (2) offer generic brand products to cut costs on licensing fees. The first element, the commitment to local purchasing, is an excellent example of glocalisation out of necessity. Not only would the local Chinese products better conform to local tastes and preferences, but it would also be far less expensive than using French products and French labour. Further, the second element, generic brands, allowed Carrefour to pass on those savings to the consumer with minimal overhead expenses. Generic brands are unbranded products that are less expensive but usually of the same quality as their branded counterparts. In fact, in 1976, Carrefour was first retailer to launch generic products to cut costs. "Produit Libres" or "free products", Carrefour's generic brand, was the original generic brand and was the catalyst for what is now a multi-billion dollar industry.

Carrefour was wise to immediately localise production and sourcing, as studies have shown the power of domestic Chinese producers to drive down pricing after

[20] *Id*.

market-entry by foreign businesses.[21] Indeed, it is more likely that a foreign retailer operating in China that utilizes local production will be able to manage and lower costs over time. As such, careful production and supply coordination must take place if franchisors and international franchisees are to adapt the supply chain to changing environments. While many franchisees traditionally feel less freedom to make those kinds of changes, success for the system as a whole may be tied to the ability to recognize changing forces and to have the proper mechanisms to allow for coordinated change.

Another reason for Carrefour's success in China was a result of its ability to appreciate local culture and preferences due to its decentralized management structure. Essentially, Carrefour either contracted with local franchisees or hired local Chinese employees to run the management of Carrefour China, to overcome the impact of market proximity and to allow local management to oversee local labour. In other words, by allowing franchisees to independently manage themselves in accordance with the basic standards of the business and system, Carrefour was able to harness the localized expertise of its franchisee community.

Jean-Luc Chéreau, President of Carrefour China, discussed the challenges in overcoming the impact of market proximity and adjusting to Chinese culture. As discussed above, one of the keys to international franchising was gradual expansion away from the home market. Chéreau agrees, commenting on how helpful Carrefour's experience in Taiwan had been for their transition into China, stated:

> In reality, though, we began our experience in China 18 years ago, in Taiwan. For the hypermarkets in the big mainland cities, we have exactly the same hypermarket style as in Taiwan... We discovered Chinese culture and the way to work with the Chinese in Taiwan when the retail sector in mainland China was totally closed...For example, you learn how to adapt. When Carrefour arrived in Taiwan, we had a very clear picture of what we wanted to do–open a 10,000-square-meter store on the ground floor, with a big parking lot in front, just as in France. But it was impossible to do that kind of store. Then we tried something different: We opened a 3,500-square-meter store in a basement in Kaohsiung, Taiwan's second-largest city, with 250 parking spaces for

21 Choi J.C. and Nailer, C. The China Market and European Companies: Pricing and Surviving the Local Competition. European Business Review, January 2005, 17(2) at 177-190.

> motorcycles. That was the beginning of Carrefour in Taiwan.[22]

A final explanation for Carrefour's success in China is its formulaic business approach, based on its internal motto "Client-Oriented Culture, Transformation, and Innovation". Client-oriented culture refers to Carrefour's commitment to understanding its customers and learning how to best serve them. Transformation allows them to remain current, while increasing agility, execution quality, and competitiveness. The last element, innovation, strives to focus on initiative and leadership. Essentially, these concepts represent the notions discussed in the McDonald's analysis; that is, "Client-Oriented Culture, Transformation, and Innovation" is really just a commitment to adapting to local market forces using a glocalised strategy.

## **Tim Hortons' Success in the United States**

Tim Hortons, Canada's largest quick service restaurant chain, opened its first location in May 1964. The chain, specializing in coffee and doughnuts, was founded by Canadian hockey legend Tim Horton. By 1974, the franchise had opened up 40 stores across Canada, and by 1991, Tim Hortons had 500 locations across the country. Currently, there are 4,600 *Tim Hortons* locations worldwide, with over 3,700 in Canada, 892 in the United States, and 59 in the Middle East.[23]

In 1992, Daniel P. Murphy, the master franchisee for both Tim Hortons and Wendy's restaurants in the maritime province of Prince Edward Island opened franchised outlets for both restaurants in the same location. Murphy invited Ron Joyce, owner of Tim Hortons, and Dave Thomas, Wendy's Chairman, to the grand opening of the joint Tim Hortons-Wendy's location. This introduction, along with Murphy's successful joint location, led to Wendy's acquiring and merging with TDL (Tim Donut Limited) in 1995.[24] The merger lasted until 2006, when the companies decided to part ways.

In August of 2014, Tim Hortons was yet again purchased by an American burger chain. This time, Burger King Worldwide Inc. purchased Tim Hortons Inc. for $12.5

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22 Child, P. *Carrefour China: Lessons From a Global Retailer.* Forbes, 25/10/2006 accessed online at http://www.forbes.com/2006/10/25/carrefour-china-chereau-qanda-biz-cx_pnc_1025mckinsey.html

23 Sturgeon, Jamie. *Will Tim Hortons Become the 'Fastest Growing' Fast-Food Chain in the U.S.?* Global News, January 12, 2016. Accessed online at http://globalnews.ca/news/2448390/will-tim-hortons-become-the-fastest-growing-fast-food-chain-in-u-s/

24 Hemmadi, Murad. *Lessons From Burger King From The Tim Horton-Wendy's Merger*. MacLean's, August 25, 2014. Accessed online at http://www.macleans.ca/economy/business/lessons-for-burger-king-from-the-tim-hortons-wendys-merger/

billion, giving the two combined sales of $23 billion from their 18,000 locations and forming Restaurant Brands International.[25] Now, the quick service food giant has announced continued aggressive franchise expansion into the United States. The company recently announced plans to use joint ventures and master franchise deals to take Tim Hortons to international markets, just as they had done in the United States.[26]

## A Multi-Layered and Disciplined Approach to American Expansion

Tim Hortons in the United States has operated through a franchise model that was first utilized by Burger King in Brazil. The "master franchise joint venture" model involves sharing the rights to the restaurant with local partners to help run the business, while still operating under a master franchise model. The local joint venture partner is responsible for controlling the supply chain, procurement, and marketing for the franchisees within their geographic region, which is stipulated in the master franchise agreement. This model, according to Daniel Schwartz, a chief executive at Burger King who is now the CEO of the group responsible for daily management and operations of Tim Hortons, is instrumental in international expansions as it brings overhead costs down dramatically.[27]

In addition to the above model, Tim Hortons will retain elements of its traditional franchising model as well. Tim Hortons also has several Area Development Agreements and Master Licensing Agreements currently in place in many of their 892 American locations. The advantage of these deals allows Tim Hortons to rely on local partners entirely to deploy their capital and local market knowledge.

## Adaptation to American Market Forces

Tim Hortons has been involved in extensive proprietary research to both conform its business approach to American preferences, as well as increase consumer brand awareness. Tim Hortons is both adapting its menu and the technology and marketing to increase appeal and address consumer's needs with the ultimate goal of increasing order size from each individual customer.

## Conclusions from Tim Hortons' American Success

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25 Brownell, Claire. *Burger King Worldwide Inc Announces Deal to Buy Tim Hortons.* The National Post, August 26, 2014. Accessed online at http://business.financialpost.com/news/retail-marketing/burger-king-tim-hortons-deal

26 Strauss, Marina. *Tim Hortons Owner Plans Global Expansion*. The Globe Advisor, February 18, 2015. Accessed online at http://www.globeadvisor.com/servlet/ArticleNews/story/gam/20150218/RBCDTIMSFINAL

27 Nelson, Jacqueline. *Burger King, Tim Hortons Deal to Create $23-Billion in Combined Sales.* The Globe and Mail, August 26, 2014. Accessed online at http://www.theglobeandmail.com/report-on-business/international-business/burger-king-tim-hortons-deal-to-create-23-billion-in-combined-sales/article20215557/

Tim Hortons' success in the United States results from its multi-layered approach to franchising, which includes their unique "master franchise joint venture" structure, a commitment to glocalisation, and finally, the market proximity between Canada and the United States.

By approaching American expansion using both traditional and innovative franchising models, Tim Hortons was able to experiment with a multi-layered approach to increase its likelihood of success in the United States. Joshua Kobza, the CFO at Restaurant Brands International, expressed his intension to continue expand internationally in a responsible manner: "We have big hopes, and we do want to accelerate the pace of growth at Tim's all around the world over the coming years, *but it's a process that will take time*, much as it did at Burger King" (emphasis added).[28]

## **Target's Failure in Canada**

Target opened its first store in 1962 in Roseville, Minn. and by the end of that year, Target had opened additional locations in St. Louis Park, Crystal, and Duluth, Minn. Just fifteen years later in 1979, Target announced that it had achieved a billion dollars in annual sales across 74 locations. Today, with over 1,800 locations, Target is the second largest discount retailer in the United States.[29] Unfortunately, as the analysis below will demonstrate, success in the United States did not equate to success in Canada for the giant discount retailer.

In March of 2013, Target opened its first store in Canada and proceeded to open 123 more locations across the country by year-end, taking over the leases and locations of an outgoing Canadian retailer. In this way, it was able to expand into Canada and immediately capture a wide geographic reach as well as established physical retail infrastructures. It was the company's first international expansion. By January of 2015, less than two years later, Target CEO Brian Cornell announced that Target would close all 133 Canadian locations, which led to considerable economic[30] losses and the total loss of market opportunity in Canada.[31]

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28 Strauss, Marina. *Tim Hortons Owner Plans Global Expansion*. The Globe Advisor, February 18, 2015. Accessed online at http://www.globeadvisor.com/servlet/ArticleNews/story/gam/20150218/RBCDTIMSFINAL

29 Target Corporate Fact Sheet, https://corporate.target.com/press/corporate

30 In total: 17,600 employees were laid off, requiring a $70 million fund to pay their severance, US$5.4 billion pre-tax losses on discontinued operations, US$1.8 billion spent on purchasing leases from 220 Zellers locations, 22 months' total time Target operated in Canada, and a US$800 million increase in the Target stock after announcing its Canadian departure.

31 Trencer, D. *Target's Departure From Canada, By The Numbers.* The Huffington Post Canada, January 15, 2015. http://www.huffingtonpost.ca/2015/01/15/target-canada-numbers_n_6479830.html

While there were many factors Target's failed expansion into Canada, this paper will focus on two such considerations: technical errors in the supply chain and underestimation of the changing nature of competition in the marketplace.

Technical Errors in the Supply Chain

Target's Canadian supply chain was simply not ready to service 124 locations. Whether in a corporate retail or franchising model, supply chain management considerations are of obvious importance. In the case of Target Canada, employees reported empty shelves in stores, yet "bewildering volume at Target's new distribution centers".[32] One article reported, "opening 124 stores within such a short period of time led to havoc with inventory planning, causing a big problem with stock outs early on, disappointing shoppers expecting to see the same abundance they would see cross-border shopping in the United States".[33] Target's rapid growth commitments only exacerbated the problems in the supply chain.

The effect of the empty shelves created a brand perception that Target was inadequately prepared to handle the Canadian market. Adding to the negative brand perception was the disparity between the American Target locations and the Canadian locations. A survey of 1,200 Canadian shoppers found that 78% of them already had contact with the *Target* brand in the United States.[34] The strategy group that conducted the survey stated, "their expectations, not just of the product and the look of the store, but how the brand made them feel, were already established. Target was viewed as modern, confident, and a little more streetwise... It was not the same Target [in Canada]".[35] Here, market proximity worked against Target. Canadian consumers had an expectation of a certain level of quality and selection due to their experience with the brand in neighbouring United States. When the Canadian format fell short of those expectations, the Canadian consumer quickly lost interest.

Ultimately, the damage to the brand perception of Target proved fatal. The majority of shoppers will look elsewhere when faced with empty shelves, or stock-outs, as they are commonly referred to. A study conducted by the *Harvard Business Review* of over 71,000 consumers around the world looked at the effect stock-outs had on

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32 Martel, A., Ho, S., and Taylor, S. *Exclusive: Target Canada's Supply Chain Gridlock: How Barbie SUVs Snarled Traffic.* Reuters, May 21, 2014. Accessed online at http://www.reuters.com/article/us-target-canada-exclusive-idUSBREA4K03X20140521

33 Wahba, P. *Why Target Failed in Canada*. Fortune, January 15, 2015. Accessed online at http://fortune.com/2015/01/15/target-canada-fail/

34 Krashinsky, S. *Why Empty Shelves Killed the Target Brand.* The Globe and Mail, January 15, 2015. Accessed online at http://www.theglobeandmail.com/report-on-business/industry-news/marketing/why-empty-shelves-killed-the-target-brand/article22484333/

35 *Id*.

customer behaviour. The results show that retailers can lose nearly half of intended purchases when a customer encounters a stock-out. This translates to sales losses of about four percent for a typical retailer.[36] Further, 21 to 43 percent of consumers went to a different store when the product they were searching for was out of stock (OOS).[37] Target then faced the insurmountable task of convincing these customers to back.

Underestimation of Canadian Competition and Changes in Retailing

In order to remain viable as a discount retailer, it is clear that consumers must *perceive* an actual discount in pricing. Further, if there are other issues in a retailer's execution, like supply chain errors, pricing becomes a central focus of the consumer; customers can justify a sub-optimal shopping experience if they perceive that they are still saving money. Wal-Mart, the leading Canadian discount retailer, did not sit back on its laurels either in the face of Target's new competition. Wal-Mart focused on improving operations to compete with Target.

In addition to launching an aggressive price reduction plan, Wal-Mart Canada remodelled stores and expanded supercenters when Target arrived on the Canadian market.[38] Wal-Mart Canada specifically targeted weaknesses in Target's entry strategy in its attempt to undermine Target's Canadian expansion. The best example of this strategy centered on online shopping. Target Canada did not have an online shopping option, and Wal-Mart sought to exploit this. Wal-Mart Canada introduced free shipping on all online orders in 2013, just as Target entered the Canadian market. Then, just weeks after Target announced its departure from Canada, Wal-Mart reinstated delivery charges for online shipping orders under $50.[39]

Target's entry into the Canadian market thus coincided with the uptick in substantial online competition. The combination makes it that much tougher for retailers that trying to find, attract, and retain the attention, purchases, and loyalty of consumers (a task that is certainly no less challenging in a "discount" environment).

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36 Corsten, D. and Gruen, T. Desperately Seeking Shelf Availability: An Examination of the Extent, the Causes, and the Efforts to Address Retail Out-of-Stocks. International Journal of Retail & Distribution Management, Vol. 31, No. 12, 2003, pp. 605-617.

37 *Id.*

38 Townshend, M. and Dudley, R. *How Wal-Mart Beat Target in Canada: Low Prices, Long Underwear.* Bloomberg Business, January 15, 2015. Accessed online at http://www.bloomberg.com/news/articles/2015-01-15/how-walmart-beat-target-in-canada-low-prices-long-underwear

39 Strauss, M. *Wal-Mart Canada to Drop Unlimited Free Shipping as Competition Eases.* The Globe and Mail, March 30, 2015. Accessed online at http://www.theglobeandmail.com/report-on-business/wal-mart-canada-set-to-drop-free-shipping-as-competition-eases/article23686662/

Target failed in Canada (among other reasons) because of errors in executing its supply chain operations, underestimating Canadian competition, and the changing nature of the competitive landscape – all happening at once.

## Conclusion

While many observations can be drawn as to why franchise systems – like other retailers – succeed and fail in various environments, and while the maxim "hindsight is 20/20" applies here as well, there are no absolute truths in the rear view mirror, just as there is often limited clarity in the front windshield. International expansion has elements of chance and fortitude, including factors such as finding the right international franchisee, entering the market at the right time, opening at an appropriate pace, employing marketing that resonates with consumers, and having operations that deliver on the brand's promise so that consumers who experience the brand have a great experience and not only *want* to come back but convey that message to their friends and family. And as much as "luck" is a factor, the old sports aphorism also applies: "*The harder I practice, the luckier I get."*

The 'next level' challenges facing franchisors expanding internationally are abundant, as evidenced through the lessons analyzed from expansions by *McDonald's, Carrefour, Tim Hortons,* and *Target*. There are many themes present in these case studies that franchisors should bear in mind in their international expansions. A commitment to understanding local market preferences will assist franchisors and franchisees to 'glocalise' their franchise programs. Evaluating the local competition and adapting techniques to compete with local pricing is necessary. Target is an example of the perils of underestimating local competition and changes in the competitive landscape. It is clear that in order to succeed in today's competitive marketplace, franchises must understand and appreciate both the underlying principles of international expansion, in addition to 'next level' principles as well. After all, the goal is not just temporary international expansion, but rather, profitable, long-term global viability.