

# International Expansion – Trends in the Restaurant and Food Industry

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The exploitation of International opportunities for American branded food concepts is accelerating as domestic market saturation is being reached for some brands. This rapid increase is being caused partially by the scarcity, even in domestic markets where additional unit development would be feasible, of quality real estate. At the same time, many companies are experiencing reduced or slower increases in unit sales when measured on a same store basis. “There are so many locations out there that every new one has to be stealing from each other’s market. It’s a real problem.” Said Sandra Shaber – economist, WEFA Group.

Several franchisors we spoke with cited the fear of litigation due to challenges by their U.S. franchisees of encroachment and other claims based upon uncertain implied covenants, as well as lowered regulatory hurdles in most other countries as reasons for focusing their resources on overseas growth. The opportunities are there and, when structured correctly, overseas expansion can be highly profitable for franchisors.

According to Kimberly Lowe, Managing Director of Restaurants & Institutions Magazine, “Enticed by the lure of increased profits, many American restaurants are expanding beyond the U.S. Border, despite the obvious risks. Their stronger focus remains on the benefits of international expansion: huge growth opportunities, tremendous financial infusion, and worldwide exposure.”

Growing middle classes and higher disposable incomes broaden the market for U.S. products. A trend toward readily transferable currency, the opening of previously closed markets and the lower regulatory barriers make doing business outside the U.S. easier than ever before. Visitors to Moscow, since the fall of the Soviet Union have seen the dramatic changeover in life styles, disposable incomes and the rapid emergence of brand consciousness. The speed in which capitalism and entrepreneurial fervor has penetrated select markets internationally give us a good guidepost upon which to view the potential in others, like China and Vietnam.

“Stable government, favorable business climate and unburdened tax structure are requirements restaurant companies typically have of countries where they tend to expand.” According to Lehman Brothers analyst Mitchell Speiser, Southeast Asian countries are currently the “hot” markets. There he says, “U.S. products are embraced, the population base is good and economy is increasingly more capitalistic”.

Included in the benefits often stated for these markets has also been the availability of investment capital, lower labor costs, the lure of anything American and the lower occurrence of litigation as a method of dispute resolution. At present though some of these

markets in Asia are undergoing significant economic turmoil and currency devaluation. There may be some short-term effect on international expansion in this region although the long-term impact is likely to be minimal. We have noted with some of our clients that international investors are still investing in these markets due to the advantageous exchange rates and disinflation particularly in the area of real estate. While there will likely be some impact on disposable income available for non-essential purchases in these markets and local prices therefore will be under pressure, the demand for US products and services, together with other market dynamics makes the likelihood of any long-term impact negligible.

“Continental Europe, in contrast is struggling behind a sluggish economy and more mature market”, Speiser says. “The opportunities are not as strong”. – as in Asia. The formation of the European Union has though made it easier to do business in Europe. American companies can protect their trademark throughout the EU with one registration and importing products from one EU country to another is relatively hassle free. This allows companies to distribute across the continent from one or two distribution centers.

Franchising and branded products have strong appeal in the emerging Eastern European markets where Americans are revered for their entrepreneurial skills and American products enjoy a special cache. According to Chain Restaurant Industry, a study by Franchise Finance Corporation of America, “The near saturation of the U.S. market, at least in the Fast Food/Sandwich segment, has resulted in the larger chains devoting greater resources to international expansion in recent years.”

There is a significant base of anecdotal and subjective data about unit success and opportunity for American brands overseas.

- 70% of total system openings for McDonalds will be outside the United States.– Chain restaurant industry – Review & Outlook – Franchise Finance Corporation of America
- Operating margins at McDonald’s for international restaurants was 19.8% during 1996 versus 16.5% for its US locations - Chain restaurant industry – Review & Outlook – Franchise Finance Corporation of America
- 60% of McDonald’s sales and profit come from international units – Going Global by Kimberly Lowe – Restaurants & Institutions
- 4% of McDonald’s operating income come from Latin America - Going Global by Kimberly Lowe – Restaurants & Institutions
- “The international divisions of the industry’s top 100 companies are growing faster than their domestic counterparts in terms of sales and units”. Dennis Lombardi, executive vice president for Technomics
- On average, new international franchised units become profitable more quickly than international company-owned units. National Restaurant Association
- “TGI Friday plans to triple its number of internationally units by 2001” “The economic development occurring in some countries surprises many restaurant companies. The emergence of the middle class is phenomenal. Even in third world countries, billions of dollars are pouring in” – Richard Snead, EVP, T.G.I. Friday’s

Several of our clients have reported to us that sales in their international markets often exceed those in their domestic operations by over 30%. Based upon the literature, this does not seem to be unique.

According to Richard Snead, T.G.I. Friday's has more requests for overseas development than there is territory available. This is the happy lament many mature franchisors are sounding. Restaurants and other food companies leading overseas expansion include McDonald's, KFC, Burger King, Wendy's, Dave & Buster's, Hooters, T.G.I Friday's, TCBY, Mrs. Field's, A&W, Dunkin Donuts, Baskin Robbins, Winchels, Shakey's, Planet Hollywood, Hard Rock Café, Rainforest Café, Mrs. Fields, Pizza Hut, 7-Eleven and AFC to name just a few. There are few mature concepts today who are not either actively marketing their concepts internationally or are examining the feasibility and opportunity of doing so.

Even with the extraordinary opportunity overseas restaurant concepts are wise to listen to those with experience.

Our advice to our clients is that you cannot overstate the importance of who is selected as the developer overseas. The franchisor's profits, indeed the future of his brand internationally rests in how carefully he makes this critical decision. When viewing the green grass on the other side of the ocean, it is wise to remember what Dennis Lobardi said "It's not as easy as it looks, and it doesn't look easy".