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Emerging Trends in Restaurant Ownership and Management

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Emerging Trends in Restaurant Ownership and Management

Abstract

In a wide-ranging discussion of issues facing the U.S. restaurant industry, two major themes emerged, relating to the need to maintain a community oriented brand and to the tension between growth and the maintenance of brand values and corporate culture. One spark for examining these issues is the changing ownership structure of franchise companies, in which private equity firms have invested in various franchise systems. On the marketing side, roundtable participants considered the importance of connecting the brand to its community.

Keywords

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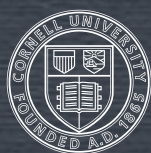
Emerging Trends in Restaurant Ownership and Management

by Benjamin Lawrence, Ph.D.

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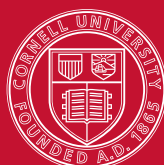
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Cornell University
School of Hotel Administration

Emerging Trends in Restaurant Ownership and Management

by Benjamin Lawrence

ABOUT THE AUTHOR

Benjamin Lawrence, Ph.D., is an assistant professor of food and beverage management at the Cornell School of Hotel Administration. Lawrence earned a Ph.D. in management from the Boston University School of Management, an MBA from Mays Business School at Texas A&M University, and a bachelor's degree from the Cornell School of Hotel Administration. His primary research interest involves channels of distribution with a focus on relationships within the context of franchising. He also studies consumers' food and beverage consumption experiences and purchasing behavior. His work has been published in the *Journal of Retailing*, *Journal of Advertising*, and *Journal of Marketing Channels*. He has presented his work at numerous academic conferences, including those held by the Academy of Marketing Science, the Association of Consumer Research, the International Society of Franchising, and the Institute for the Study of Business Markets. While at Boston University, Lawrence received the School of Management's Ph.D. awards for teaching, research, and service. He has also been honored with the Cornell School of Hotel Administration Teacher of the Year Award in 2013.



EXECUTIVE SUMMARY

Held in spring 2013 at the Cornell School of Hotel Administration, the Emerging Trends in Restaurant Ownership and Management roundtable focused on the macro issues facing restaurant owners and managers. The roundtable brought together leading practitioners and researchers to examine important and timely issues related to restaurant ownership and management. Key issues covered by participants included the role of private equity in restaurant ownership, social media and advertising, facilities and design, human resource management, and restaurant growth. Two important themes emerged from the roundtable—one around the idea of creating and maintaining a community oriented brand and the second about the tension between growth and the maintenance of brand values and corporate culture. Participants also cited the stability of corporate owners, the availability of capital, and the selection of appropriate franchise owners and managers as important variables in managing growth in the restaurant business.

The roundtable also included restaurant concept presentations by students in the school's restaurant development class. Sponsored by the National Restaurant Association, this session allowed industry leaders to provide feedback to four restaurant concepts created and presented by the students.

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In a wide-ranging discussion of issues facing the U.S. restaurant industry, two major themes emerged, relating to the need to maintain a community oriented brand and to the tension between growth and the maintenance of brand values and corporate culture. One spark for examining these issues is the changing ownership structure of franchise companies, in which private equity firms have invested in various franchise systems. On the marketing side, roundtable participants considered the importance of connecting the brand to its community.

With regard to the ownership of a franchise system, discussion revolved around the growth of private equity investments in restaurant concepts given the nature of committed capital and the economic environment in the past several years. Extensive discussion revolved around how these investments are driving up multiples, especially for fast casual concepts. As explained in this report, increasing multiples was discussed as one potential reason that ownership changes in the restaurant space may increase in the near term.

Looking at the issue of building and maintaining community around the brand and its customers, participants discussed how these communities are built and enhanced through facilities design, by engaging and motivating managers and staff to share and believe in brand values, and by managing social media and advertising. Steve Starr of Tobin Starr + Partners stated that “the most important thing for a community orientated brand is to connect in a relevant way with its target audience.” Greg Dollarhyde of Veggie Grill talked about how social media platforms allow his customers to engage with his brand and his employees while also allowing consumers to promote his brand to others. As discussed further below, one specific issue for restaurant owners has become maintaining a chain restaurant that has a local community feel, as explained by John Longstreet of Quaker Steak and Lube.

All restaurants rely on their employees for success. Human resources management has become a key competitive advantage for restaurant chains. The roundtable participants considered such HR aspects as lowering turnover costs of line level employees, improving the guest service experience, and retaining future leaders of the organization as key outcomes related to effective organizational management.

Private Equity and Restaurant Ownership

Private equity firms continue to be active in restaurant space, with Burger King’s buyout by 3G Capital Partners Ltd. and Roark Capital Group’s acquisition of Arby’s and Corner Bakery Café. These deals are being driven in part by the significant growth potential, reliable cash flows, and growing availability of debt financing. Private equity groups were involved in 27 percent of restaurant acquisitions in 2012.¹ These funds have not only targeted brand owners but also the large multi-unit franchisees with seasoned operators and strong brand awareness. Given the importance of this trend, the roundtable examined the role of private equity firms in the management of restaurant chains. Lead discussants were Geoff Hill, vice president, Roark Capital, and Louis “Dusty” Profumo, executive VP and CFO, Church’s Chicken. The key questions discussed in this session revolve around the impact of private equity on the restaurant chain perfor-

¹ J.H. Chapman, Chain Restaurant Merger & Acquisition Census.



Louis “Dusty” Profumo: Franchisees are most interested in the owner’s strategy and plans for the brand.

mance, the key attributes sought by private equity firms, and the changes that are driving private equity investment in restaurant chains.

The session first examined how private equity ownership influences the management of restaurant chains. Participants stated that it wasn’t private equity, per se, but the type of private equity firm that influenced management practices. One important aspect is the interaction franchising with private equity in the restaurant industry.

Profumo stated: “It depends on the type of private equity holder, whether they know franchise systems or how franchisees think. I don’t think our franchisees think negatively that our company is owned by a private equity firm. They are much more concerned about what is the strategy, what are the plans for the brand. Is this an owner that is going to invest in the brand or are they there just to milk the cash flow? It is really much more about the specific owner than the fact that private equity owns the business. The two owners that we have had have invested mightily in the brand and have put a lot of equity in the brand. They have very significant resources to invest in the brand and help the brand grow.”

Nick Vojnovic, president of Little Greek, echoed this sentiment, commenting that it really depends on the management team. “From the operator’s side, some private equity companies are good and invest in the company and others try to suck money out of the business. As long as franchisees are treated well they will be satisfied.” Added Profumo: “For those looking to partner with private equity groups—you need to realize that private equity groups can be different.



Geoff Hill: The restaurant industry has seen a substantial inflow of capital and liquidity in recent years.

When companies are performing well, private equity firms tend to leave you alone. Sometimes private equity firms put people in charge that have no restaurant or food service experience. One of the questions you have to ask a private equity firm is that if they don't have anyone with restaurant experience how involved are they going to be in running the business."

From the investor standpoint, Hill commented that "A lot of private equity firms have looked at restaurants in the last several years and have provided a lot of capital and liquidity to the industry. Some have been new investors to the space and have not been able to make the investment work. Fully understanding the concept and the industry is important to me before making the investment."

Session participants discussed the two major types of acquisitions that drive the private equity market—chains with established brands that firms think they can manage better through restructuring and the infusion of capital and smaller chains that have high growth potential. Private equity firms essentially look for growth opportunities either through increasing same store sales, development of new units, or synergistic partnerships that can increase EBITA. The roundtable participants noted a pattern in which some firms buy at too high a price and get overleveraged. At year 2 or 3 they don't see the growth, so they can either sell it and you have a period of choppy ownership, or they hold it longer and wait it out.

Participants pointed to the fact that now that financing is becoming more readily available you are going to see more turnover in ownership, as private equity firms see the time to



Nick Vojnovic: The management team is key to a franchise system's success.

exit. Participants commented on the fact that private equity firms have recently increased their investments in restaurant properties. The nature of the private equity investment cycle creates committed capital that pressures firms to invest uncommitted capital that is sitting on the sideline. Private firms are attracted to fast casual concepts that have performed well through the recession while, as stated by Gene Baldwin, director, Deloitte "Chains that can't get the sales on a growth path are being severely punished."

There was concern among roundtable participants that this buying spree has resulted in highly leveraged purchases and that prices will continue to skyrocket. Multiples have steadily increased since 2009 and private equity will pay higher multiples for franchised concepts than for corporate-owned restaurants, since they are less capital intensive to grow. David Strang, president and CEO, Chilgo LLC, commented, "Interest rates are very low and a lot of private equity is looking to invest. Therefore we see that multiples keep going up. You can finance more debt today than two years ago and that is going to drive multiples up." Participants commented on how private equity firms are looking for new businesses to invest in and are even considering large franchisees as potential investment targets. With higher multiples, participants warned that it is a real balance to manage the debt to equity ratio of chains. Though returns are much better with higher leverage, this leverage brings risk and potential default on loan covenants. Even with higher multiples, there are still deals that are beneficial to a private equity firm. Higher multiples may be a signal of a deal frenzy but they may also signal real growth potential. Companies should not



David Strang: Favorable interest rates have helped drive up multiples and increased leverage.

be afraid of higher multiples as long as there is real growth potential to justify it.

Roundtable participants also discussed what characteristics attract private equity investors to a particular restaurant system. They stated that selling your business to a private equity firm is a viable exit strategy for owners looking to monetize their investment. Those looking to attract private equity should invest in financial metrics and systems that assist in their valuation. These systems provide scalability in the future that help to fuel growth while at the same time provide operational feedback that is good for business. If you are interested in private equity in the future you need to think about how you are going to build such systems now. Longstreet stated that developing a one-page strategic plan geared towards those aspects of the business that private equity firms value can help to position your company for future growth. Another way owners can attract PE investment is signaling the health of their companies by partnering with the firm after acquisition. If the owner is not willing to invest any of his equity, that raises red flags for the PE firm. When operators partner with firms, appropriate incentive mechanisms should be in place to align the interests of the two parties. Though the operator often designs the incentive plan for the employees, private equity firms should focus on incentivizing the operator, and that incentive scheme depends on the lifecycle of the business. If the private equity firm is investing in a turnaround situation this might be a transactional bonus at the end of the relationship rather than stock. PE firms may give as much as 10-percent ownership of the company to the operations management team on an options basis.

Private Equity and Restaurant Ownership

Implications for Practitioners

- Those interested in private equity should focus on scalability of their existing operations and implementing systems that provide data analytic capabilities.
- Price-earnings ratios are increasing, fueled by past commitments of capital and the current financial environment.
- Private equity remains one potential mechanism to monetize an owner's investment.
- Following acquisition private equity often wants to partner with existing operators whom are invested in the future growth of the business.

Interesting Avenues for Research

- How does private equity influence the growth and brand equity of restaurant chains?
- How and when does ownership change influence the management and growth of franchise chains?
- Do franchise chains or corporate owned stores benefit more or less from private equity investment?

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Advertising and Social Media

Social media continues to be on the forefront of food-service operators' advertising strategies. The 2012 *Nation's Restaurant News* Restaurant Operators Survey stated that 47 percent of survey respondents highlighted social media as an important component of their advertising strategies. Restaurateurs are increasingly using social media to engage their customers using dozens of social media platforms, including industry giants Facebook and Twitter. Engagement via smartphone and mobile applications are also becoming an important component of consumer engagement, with companies like Chipotle leading the market in engaging their consumers on YouTube and investing in a social media team that engages consumers one-to-one. Given its importance in the current advertising landscape, our second session involved a discussion around advertising and social media led by Greg Dollarhyde, CEO, The Veggie Grill, Inc. Veggie Grill has seventeen outlets, the majority of which are located in Southern California. The chain serves 100-percent plant-based food in a friendly and convenient setting.

Dollarhyde stated that social media are essential for building his brand, given his consumer demographic and the medium's ability to grow the business through the acquisition of new customers who are unfamiliar with the brand. Dollarhyde uses social media to engage consumers with the brand via an online ordering system, within which the company facilitates the ability of existing customers to promote the brand to others and also invites guests to try new menu items. Dollarhyde stated, "It's all about the food in the beginning. Since our food is really cravable and the perception is that vegetarian food isn't going to be good, Veggie Grill has to get people into the store and get the food in their mouths. Our social media marketing kicks in after that."

Dollarhyde sees the purpose of social media as increasing frequency and developing a highly loyal following that will proselytize the brand to others. Veggie Grill currently uses a portfolio of distribution strategies to engage the consumer, including a propriety email list, Facebook, Twitter, Pinterest, online bloggers, and Yelp. Veggie Grill gets customers to opt in and engage via email by providing free food and discounts, including Veggie Virgin Days, when current customers are invited to bring someone new to Veggie Grill for a free meal. When Veggie Grill opens a new store they gather emails from customers by soliciting addresses and referral programs with free meal offers. The cost associated with "buying" email addresses is much higher than the cost of giving away food, and the customers Veggie Grill gains through food giveaway avenues actually exposes them to many of the signature products and the brand.

Engaging consumers online also means offering online tools to manage their lifestyle, including nutritional content



Greg Dollarhyde: Social media are critical to Veggie Grill's customer engagement strategy, including promotions that encourage new customers to try out the restaurants.

and online ordering to provide convenience for the consumer. This includes customizing consumer orders and storing preferences that promote future consumption. Consumers, Dollarhyde stated, are willing to share information as long as it provides a more convenient experience and they are in control of the communication channel. Yelp is another tool Dollarhyde uses to engage consumers. However, he warned that responses should be immediate and authentic. Twitter has become effective in connecting with consumers, but it is important to ask the questions: "who are your followers?" and "why are they following?" Veggie Grill uses HootSuite to manage the various channels of social media and hires outside social media expertise to help develop a comprehensive social media strategy. Frequent customer research helps Veggie Grill understand the consumer and their preferences related to social media.

Though Facebook is one of the top social websites, Dollarhyde stated that he finds his customers prefer to use Facebook for family activity and other sites to engage in market based activity. When asked about the most effective avenue to engage the consumer, Dollarhyde stated that his demographic at Veggie Grill prefers email. This spurred a discussion related to the fit between different demographics and social media channels. Though companies like Veggie Grill may fit an email based marketing strategy, college-age students may be more suited towards a texting-based or Facebook-based engagement strategy. YouTube was highlighted as an exciting strategy going forward as both an

employee training mechanism and a way to engage customers via consumer generated advertising.

Participants discussed the current focus on highly time-sensitive offers (timed offers that come into your phone via text, for example, with a tight expiration window). These exploding offers can use GPS-based apps to find and attract customers who are near a restaurant outlet. Some roundtable participants felt that such technology is intrusive, unless the brand is really trusted and the brand initiated contact results from a customer opt in strategy rather than an opt-out policy. In general restaurant customers want to be rewarded and recognized, and social media should focus on these core functions. Though improvements are being made to online ordering apps and systems, upselling via social media can have a downside if customers feel like they're being hustled. The roundtable and Cornell student audience had mixed feelings about company access to so much information and using that information to get you to try other things by marketing to you when you walk by the store.

Advertising and Social Media

Implications for Practitioners

- Understand the types of social media that are relevant to your customer base and appropriate for business transactions.
- Restaurant customers want to be rewarded and recognized, and social media should focus on these core functions.
- Social media must be managed either internally by the corporation or externally by a third party consultant.

Interesting Avenues for Research

- What types of social media are most effective in driving restaurant sales and when?
- How do social media online referrals impact willingness to try a new product?
- How can you measure return on social media investment?
- What is the optimal mix of social media/traditional advertising expenditure?

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Facilities and Design

With increased competition, restaurant design has become a vital characteristic for differentiating your product and reinforcing your brand image. Iconic brands such as McDonald's continue to invest in design, providing a uniform product that is accessible yet reflects a growing interest in contemporary spaces that appeal to a new generation of consumers. Companies like Shake Shack customize their design aesthetic by regionalizing each store to reflect the unique surroundings of the neighborhoods they occupy. To reflect this growing interest in design the roundtable featured a session on facilities and design led by Steven Starr, partner, Tobin Starr + Partners, and Stephani Robson, senior lecturer at the School of Hotel Administration. The focus of the discussion was grounded in the design differences in a restaurant looking to reinforce a brand community versus community brand approach.

Starr started the discussion by introducing the concepts of a brand community and a community brand. A brand community-based brand, Starr stated, is “a brand that has built a community around its customer base... it is not necessarily a local brand, but a brand that creates its own community. Customers are so loyal to the brand, that a community is built around its core values. Veggie Grill is a great example—it doesn't matter where the Veggie Grill is, what matters is that the customer understands the brand itself and what it stands for.” Starr highlighted Apple as another brand community-based brand, as it has created a community around its core values and connects to its customers on the basis of these values.

In contrast to a brand community design aesthetic that focuses on a set of homogeneous core values regardless of its location, a community brand focuses on the heterogeneous localized meanings that resonate with those individual communities. A community brand seeks to connect in meaningful way to its local demographic and psychographic characteristics. A company like Anthropologie, for instance, is a community brand that customizes every single store to its local demographic and psychographic customer base. Every Anthropologie storefront and design is different and a lot of time goes into determining the customer base and the corresponding design.

Starr commented on the fact that when you say community brand it means being involved in the community: “Being involved in non-profits, raising money for the community, all those good things.” The most important thing about being a community brand or a brand community is to connect in a relevant way with your target audience. Starr stated, “We all want to be relevant to our audience. It is the holy grail. It is what everyone wants to be. The key is



Steven Starr: Some brands have built communities around them, while other brands operate as part of their community.

to decide and make a very definite decision early on which direction you want to go.”

Participants considered how scale affects a company's ability to create a strong community brand. This tension between multi-unit operations that want to obtain scalability yet retain a localized feeling was discussed by John Longstreet. He suggested that as customers “we like the stability and no surprises of a chain, but we really want to find a great local restaurant. Our customers, they've named themselves Lubes. They want to feel like their Lube is the Lube... We now have 62 locations and want to have all of the advantages of a chain...and our customers feel like it's their local restaurant.”

Stephani Robson brought up the concept of a brand lifecycle and whether there is a natural progression from community brand to brand community as brands grow in scale. Starr stated that he did not recommend switching from one branding concept to another as companies are rarely successful in doing so. The key to the proper branding strategy is to pick a design aesthetic and stick with it. Even if you don't have a clear understanding of how your brand values may be reflected in the design aesthetic you can create opportunities to add to or change design as you gain a better understanding of your customers. Dollarhyde stated that in his original design template for Zoe's they left some of the walls blank because they didn't know what to put up that would resonate with their community. “We weren't smart enough yet to know what to put up on the walls and knew we could come back later when we had figured it out.”

Participants then talked about reflecting and reinforcing a brand's DNA through the design. A company needs to constantly focus on their core values and on who their customer is or they can lose their way. Design should reflect these core values. One suggested example of a chain that lost contact with its brand DNA in the past was TGIFriday's. Participants thought the chain lost its way and forgot its target customers because it wasn't in tune with its brand DNA. TGIFriday's in the '80s had a well defined target market, baby boomers who were single and who wanted good food and drinks. As those baby boomers changed over time, TGIFriday's needed to evolve while maintaining their particular brand DNA. TGIFriday's modeled this change on Applebee's, which had a different brand DNA, and in the process lost its focus on the theatrical bar service experience that had helped define the brand. Now, TGIFriday's is returning to a design aesthetic focused on the bar and centered on high energy.

Many consumers seek authenticity and do not appreciate the traditional cookie cutter approach that many chain restaurants have taken in the past. Regional chains seem to be successful in creating an authentic design aesthetic that reflects a true community brand. The Mellow Mushroom pizza chain was used as one example of a regional chain where each store is designed to be different from all the others. The customer message is individualized at every store and a significant amount of consumer research at the unit level is conducted to reflect the specific demographic of the consumer base. Some have a family focus, others have a business focus. Starr commented that mid-century modern design seems consistent with a community brand approach but with an individualized focus. Such individualized design, however, comes at a much higher cost. Design fees at a chain like Mellow Mushroom are often three times what they are for a typical chain.

Facilities Design

Implications for Practitioners

- Community brand and brand community branding strategies result in different design aesthetics and may result in differing design costs related to scalability.
- In developing your branding strategy it is important to think how you will grow the brand and reinforce your brand DNA.
- Authenticity may be driven through community brand strategy and brand community may reinforce consistency and familiarity.

Interesting Avenues for Research

- How can authenticity be best reflected in a design aesthetic?
- Are corporate owned or franchised outlets better suited for either a brand community or community brand strategy?
- How does consistency of design influence perceptions of consistency of service experience?

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Human Resources

Human resources management has become one key competitive advantage for restaurant chains. This session of the roundtable focused on human resources and their influence on the success of restaurant chains. The roundtable discussion was led by Jim Knight, CEO of Hospitality On Point, which is a business solutions company providing organizational expertise to the restaurant and hotel industries. Lowering turnover costs of line level employees, improving the guest service experience, and retaining future leaders of the organization are key outcomes related to effective organizational management. One company that carefully manages its organizational culture and, as a result, regularly wins awards for service excellence is Chick-fil-A. They focus on hiring operators that believe in the brand and are committed to its success. Retaining, motivating, and rewarding employees that live the brand has become an essential component of Chick-fil-A's competitive advantage in the quick-service segment.

Knight began the session talking about the top three priorities of the restaurant experience: service, product, and atmosphere. A key component of these priorities is maintaining and growing employees that are committed to the brand and its values. The people working for you have to have a positive experience and this includes an appreciation and respect for employee needs and individuality, open communication, and reception to feedback and appropriate monetary compensation. Millennials are interested in working in an environment that reflects their own identity and self-image. Creating a positive culture in your organization is difficult to do, especially early on in the business. It doesn't happen overnight. You need to develop tools and props to help amplify and transmit your culture throughout the organization. As companies grow, this becomes difficult given an influx of new employees, changes in management and new priorities including short term return on investment. As you grow, Knight commented, you need to ask: "How good are you at capturing knowledge management and knowledge capital?"

The culture must be reflected in your recruiting materials so that you can attract employees that fit the organization. New employees need to have competence, character, and a cultural fit. First, employees need the competence to do the job. Second, they need to have strong character so that you can trust them. Third, they need to have a cultural fit with the organization. Most companies, if faced with giving up one of these, keep competence for the sake of cultural fit. Knight stated that keeping all three is key to building a strong human resource capability. During the hiring process, if possible, he recommends conducting three interviews by three different people and a different set of questions to get a



Jim Knight: The restaurant experience must combine service, product, and atmosphere. For success, employees must be committed to the brand and its values.

better sense of the potential employee. He advised developing recruitment materials that reflect the unique culture of your organization: what you present to prospective employees should be as cool as what your customers see and interact with. Videos to both recruit and train employees have become critical tools in maintaining and transmitting the culture of the organization. If the culture is embedded in recruiting and hiring materials, then it won't be eliminated when cuts need to be made. Though storytelling can help to transmit the culture, you need to develop material artifacts such as training manuals and recruitment materials that will help reinforce and transmit the culture.

The participants discussed the difficulties of transmitting and maintaining culture in a franchise organization. With so much focus on growth, many franchise systems do not focus on cultural fit when they recruit new franchisees, rather they look for competence and financial capability. Though not a traditional franchise model, Chick-fil-A was discussed as an exception to this rule. Chick-fil-A uses training material including a video, "Every life has a story... if we only bother to read it," to reinforce their brand values.² In doing so Chick-fil-A transmits the message to their employees that they're not about selling chicken, but are about something so much bigger and so much more. Knight states that everything you share with your employees should promote your culture: from training to print manuals and leaders' guides.

² <http://www.youtube.com/watch?v=2v0RhwZ3lvY>.

Creating material and hiring individuals that help to reinforce your culture does have costs, and often the rewards for such costs are not realized in the short term. Owners that have short-term goals may cut these costs to improve profitability without fully understanding the implications of such actions on organizational culture. Hard Rock Café hires staff members called VIBE hosts (visual individual behind energy). These VIBE hosts aren't hired from other restaurants or often from the hospitality business at all. Rather, they are working nights as singers or musicians in an aspiring band. The VIBE hosts' critical role at Hard Rock is to control the vibe of the restaurant—such as the music, lighting, and stories. They are in charge of the emotional hook that keeps people coming back. These positions are not directly involved in serving the customer but are vital to reinforcing the culture at Hard Rock. Hard Rock also maintains various employee incentive programs that have considerable cost to the company. These include the Hard Rock pin program that involves all 35,000 employees and recognizes employee milestones and recognitions by awarding lapel pins. In addition, Hard Rock gives all employees with ten years of service a Rolex watch. In 2012, 120 Rolex watches were given out as incentives. These artifacts become part of the story telling at Hard Rock, further reinforcing the culture and brand values.

Human Resources

Implications for Practitioners

- Recruit employees and franchisees that not only have competence and character but also cultural fit.
- Corporate culture must be reflected in your recruiting and training material so that you can attract and acculturate employees.
- Develop tools and props to help amplify and transmit your culture throughout the organization.

Interesting Avenues for Research

- How does a franchising growth strategy based on shared norms and values differ from a franchising strategy based on market penetration?
- How does brand identification influence franchisee prosocial behavior?
- How can we incentivize franchisees to invest in their employees and internalize the values of the brand?

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Restaurant Growth

Franchising continues to be a dominant form of distribution in the restaurant business. Hybrid ownership structures in which both company-owned and -franchised units coexist have become popular in the restaurant space, with most franchised chains maintaining a portion of the stores as company owned outlets. In general, franchisors attract two different types of franchisees. One model is based on large multi-unit ownership where investors or smaller corporations professionally manage a portfolio of franchise outlets. For years, multi-unit franchisees have understood that by opening several locations of the same franchise within a close geographic proximity they can grow many units with speed, and conserve both money and personnel by relying upon another person's resources, and to obtain a local presence. The other model of franchising involves attracting "Mom and Pop" operators that may grow sequentially to run multiple outlets but remain active in the day-to-day operations of their franchise outlets. In this session we focused on the important decisions that restaurateurs must face when growing their business, by examining Saxbys Coffee, a 35-unit gourmet coffee chain that has outlets in nine states and system wide retail sales of over \$15 million. Nick Bayer, CEO and president of Saxbys Coffee, led the discussion.

Bayer started the discussion by introducing Saxbys, along with two main issues related to growth of the business. Founded in 2005 and based in Philadelphia, Saxbys Coffee is primarily located in Philadelphia, Washington, DC, Dallas, and cities in Ohio. Bayer plans further growth centered in the mid-Atlantic region due to the already established brand presence. Urban college town locations have proven to be successful due to lucrative business around the clock, high foot traffic, and a relatively stable market. The Saxbys concept was founded on an owner-operator model, where the stores are connected to the community via the local franchisee. Unlike Starbucks, Bayer views the brand as a community brand that is highly localized and draws identity and strength from its local consumer base. This is why he views franchising as a vital component for distribution, given that franchisees as owner-operators have the ability, motivation, and connection to the local consumer. Each Saxbys is thoughtfully and individually designed to reflect the community it serves. "We are the anti-chain chain," he says, and the décor purposely conveys that message. Recently acquired and recapitalized by Radnor, PA-based MVP Capital, Saxby's is poised for aggressive growth.

Bayer brought up two important issues that influence his growth plans for the brand. The first issue involves geographic expansion, given the firm's nine-state distribution area. Roundtable participants commented on the risks associated with rapid expansion to new markets. Though many franchisors want to expand as quickly as possible to



Nick Bayer: Franchise growth strategies must take into account the type of franchisee, whether a multi-unit owner or an owner-operator.

capture market share, this often leads to decisions that are detrimental to the brand and its franchisees. Product distribution, for example, becomes much more complex when units are unable to share commissaries or common distribution networks. Participants argued for a growth strategy that balances speed with geographic density. Panera was cited as one example of a chain that grew with a focus on specific geographic areas they could monitor and manage from a franchisee support and a supply-chain standpoint. Panera management was deliberate in their growth strategy and did not open in locations they could not support. In contrast, Cold Stone Creamery grew by hiring development managers who overbuilt, resulting in the eventual failure and closure of a substantial number of underperforming units.

The second issue regarding growth that the roundtable discussed revolved around what type of owner should drive growth at Saxbys. Should the company target larger multi-unit operators to drive growth for the business in place of its owner-operator model? Given that Saxbys has relied on a concept that was rooted in an authentic localized experience, Bayer voiced concern about expanding with larger multi-unit operators that may not have the time to provide the personalized service the brand is used to. Currently, Saxbys franchisees operate one or two outlets at most, but the franchisor continues to explore the opportunity to license three or more locations to prospective franchisees for multi-unit franchising. Participants talked at length about the benefits of multi-unit franchising including: limiting the number of franchisee relationships, the capital afforded by multi-unit

operators and the operational expertise multi-unit operators bring the system. David Strang stated, “If you go with that single unit operator model, you’ll potentially disqualify or disinterest a lot of potential franchisees.” Multi-unit operators can also bring their resources to bear and thus run their stores more economically. Participants argued that Saxbys had relatively small units and therefore multi-unit operators may not actually need to be that large and therefore may be able to maintain the personalized service that Saxbys is known for. Reflecting earlier discussions, the culture of the organization and the brand DNA were also highlighted as important factors that influence franchisee selection. Though expansion via corporate-owned stores was mentioned as one possible route to expansion, such capital investment in corporate stores was not seen as critical for the growth of a concept that did not require extensive operational experience. ■

Restaurant System Growth

Implications for Practitioners

- Multi-unit operators may fuel growth but may not offer the personalized service experience that some brands require.
- Smaller operations can incorporate multi-unit operators that can remain owner-operators; key to such growth may require sequential unit acquisition.
- Growing geographically dispersed outlets results in higher coordination costs and regional growth provides greater localized brand awareness.

Interesting Avenues for Research

- Can large multi-unit operators fuel growth through the expansion of a community brand strategy?
- What is the optimal mix of franchised versus corporate owned properties—do these differ based on type of operation?
- Do franchise operators deliver a more personalized service experience than corporate operators?

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