Strategic Management in the Foodservice Industry

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This presentation is based upon the ongoing research of my co-authors Dr. Michael Olsen and Dr. Eliza Tse with me as we begin the third revision of our book ***Strategic Management in the Hospitality Industry***. I have benefited greatly from our long collaboration.

Introduction

The foodservice industry in the United States is a pervasive and major economic force. According to the U.S. Department of Commerce and the National Restaurant Association, 46.4% of the consumer's food dollar is spent in a restaurant. In addition, the nation's 878,000 restaurants employ 12 million people which constitutes 9% of the workforce.

Restaurant sales are expected to exceed $440.1 billion in 2004; and, have averaged 7.1% annual growth since 1970. While these growth statistics may appear attractive, publicly traded table-service restaurant companies consistently are challenged by investors to outperform these averages. For example, The Cheesecake Factory has averaged a sales growth of 20.9% over the past five years while Outback Steakhouse has averaged a sales growth of 13% over that same time. Darden Restaurants(Olive Garden, Red Lobster, etc) averaged 7.3%, while Brinker International(Chili's, Macaroni Grill, etc) averaged 14.8%. In the quick service segment, Wendy's averaged 10.3% while McDonald's averaged 6.0% and Yum(KFC, Taco Bell, etc) only grew at 2.8%. As can be seen, all but McDonald's and Yum exceeded the average growth of the industry, which means that their growth came at the expense of their competition. In 2004, sales in full service restaurant sector are expected to grow by 4.6%, while the quick service sector expects 3.9% growth. As may be seen, there is growth in the industry but it is not sufficient to sustain the goals of aggressive competitors without the loss of market share by the weaker companies.

In addition to competing for additional sales growth, restaurant companies are expected to deliver on the bottom line. Analysts predictions of future earnings growth drive the stock price of publicly held companies. This requires managers to choose among various strategies for those which provide the best return on investment and have the greatest impact on earnings per share. Over the next five years analysts expect the following growth in earnings: Cheesecake 22.6%; Outback 14.2%; Brinker 14.0%; Darden 12.8%; Wendy's 12.4%; Yum! 11.5%; and, McDonald's 8.4%. It is readily apparent that to succeed corporate leaders must have a model to guide their decisions.

The Co-Alignment Principle

The goal of the strategic management process is to enable the organizational leader to achieve maximum effectiveness from their assets. As we are now more clearly understanding, it is difficult if not impossible to predict the future from the past. The environment is dynamic and discontinuous. Trends begin and end quickly. Tastes change daily. Today's leader must create a match between the forces driving change in the environment and the organization's methods in allocating resources and achieving its goals.

According to the Co-Alignment Principle, events in the firm's environment exert influences upon the firm. Major forces drive change in both the remote and task environment of the firm. These forces, often referred to as trends, create opportunities and pose threats to the firm. They shape and force change in both predictable and unpredictable patterns. Health concerns, food safety issues, the national and local economy are examples of forces that foodservice managers are forced to address.

It is incumbent upon the leader's of the firm to understand these forces and develop strategies in response to these forces. They must chose the competitive methods used by the firm to take advantage of the opportunities and counter threats in the business environment. It is important to understand that these methods should provide the firm with sustainable competitive advantage.

In order to achieve a sustainable competitive advantage the manager must develop the organizational structure necessary to implement the chosen strategies. There must be effective and efficient allocation of the firm's resources to the successful execution of the firm's competitive methods. This requires an understanding of the firm's core competencies. The leadership of the firm must match the selected competitive methods with the firm's core competencies and then support the effort with the appropriate allocation of resources. If operational excellence is selected as a competitive method, then sufficient resources must be allocated to recruiting and training employees. Successful restaurant companies such as Outback and Houston's are examples of firms which successfully support chosen strategies.

Finally, managers must develop financial measures which accurately report the firm's performance. Performance measures must track the competitive methods chosen.

These measures must be diverse. They must report the overall financial performance of the firm such as earnings per share, cash flow per share, sales per seat, net profit, etc. However, there are other important factors which must be monitored. For example, the return on investment of the various competitive methods utilized. Managers must understand the economic results of all the strategic decisions they make. When it became apparent to McDonald's executives in 2003 that their non-McDonald's brands were not performing as desired, they took action. By the end of the year they had sold Donato's Pizza and discontinued development of other brands outside of the United States. These actions enabled McDonald's to exceed analyst's expectations in the first quarter of 2004. The measures chosen to monitor depend upon the firm's strategic choice and would probably include other non-financial measures such as customer satisfaction, market share, etc.

Strategic Management Model Competing for the Future

It is important to understand the Co-alignment Principle and how it can assist firm managers to develop sustainable competitive measures. It is also important to propose a model which will enable managers to compete for the future. In our strategic management model the relationships developed in the Co-alignment Principle are clearly defined and their relationships which each other demonstrated.

Events in the firm's environment provide the stimulus for the selection of competitive methods. The selection of these competitive methods are guided by the Mission and Domain Definition of the firm. Strength and weakness analysis provides the basis for the development of the core competencies necessary to support the competitive methods selected. Short term and long term objectives are developed to measure the performance of the firm. Performance is evaluated by the leaders of the firm and form the feedback necessary to continue to support strategic efforts or begin the necessary action to modify the strategy.

I would like to briefly discuss the most important aspects of our strategic management model:

I. Environmental Scanning

Environmental scanning is one of the most important activities that managers should perform. In my research on restaurant performance I have found that those firms whose top management actively scanned the environment performed at higher levels regardless of the strategy chosen than those who did not.

Changes in the environment create uncertainty. Are sales declining because of a slowdown in the local economy or are customers being lost to other competitors who are providing better perceived value? Is the low carbohydrate diet a fad or something that will influence customer choices for a long time? Environmental change is discontinuous it is impossible to predict. In addition, the environment is increasingly complex and unforgiving as more competitors enter and offer consumers more choices.

Because the environment is changing in ways almost impossible to predict, managers must stop thinking about the past and compete for the future. The past is no longer a predictor of the future. Some of the most innovative restaurant firms of the past are now no longer the major forces in the industry. Today's foodservice manager must possess creative thinking ability which enables them to respond to the unique opportunities available in the environment. Outback, McDonald's, and The Cheesecake Factory are examples where the founders responded to environmental opportunities that were not understood by their competitors. In scanning the environment, managers must be able to understand the forces driving the market which lead to both opportunities and threats. If managers are unable to identify the forces driving the market, the firm may keep reacting inappropriately until it ceases to exist. If the forces are identified and understood, managers are able to develop plans and strategies to either protect against the negative impact or take advantage of the opportunities presented. The Parable of the Boiling Frog is illusive. The story goes that if you place a frog in a pot of boiling water they will jump out immediately. However, if you place them in comfortable water and slowly raise the temperature, they will adapt until it becomes too hot and they die. They don't understand that while the environment is changing slowly, the force that is driving the change will eventually destroy them. This occurs in the restaurant industry. All we must do is look at the restaurant firms which keep re-inventing themselves as the environment changes and those that failed to do so and are no longer in existence.

II. Domain Definition

The domain chosen by the firm's managers also plays an important role in the success of their efforts. The domain explains the context within which the firm chooses to exist and function. It establishes various parameters: geographic market, industry segment, target customer, and primary competitors to cite a few. It establishes the patterns of relationships that must be maintained and monitored for change. It provides input into the selection of competitive methods to be developed.

It is important to identify the firm's primary competition. Frequently, foodservice manager's fail to understand against whom they are competing. Competition is defined by the target market. The target market establishes the subset of competition based upon what is important at the moment. McDonald's understands this. Their research has revealed that their customers make the purchasing decision within 5 minutes of the purchase and that convenience is an important choice driver. McDonald's understands that their competition is any restaurant within

those parameters and responds by placing stores in venues which provide them with the greatest potential to capture sales.

III. Competitive Methods

Competitive methods in the foodservice industry are defined as a portfolio of products and services that generate a positive cash flow over a useful economic life. These competitive methods can range from almost totally intangible to almost totally tangible. It is the nature of the foodservice industry that our competitive methods are frequently a mix of the intangible and the tangible.

Intangible dominate competitive methods include:

- a) service attitudes
  - a. friendly
  - b. formal
- b) ambiance
  - a. comfortable, informal
  - b. formal

Tangible dominate competitive methods include:

a) signature dishes
b) speed of service
c) delivery
d) site selection

It is important to understand which competitive methods provide the firm with a competitive advantage. Equally important is the ability to successfully implement the selected competitive methods while generating positive cash flow. Competitive methods must exceed an internal rate of return (hurdle rate) which generates a return on investment which is greater than the firm's cost of capital. Offerings which fail to do so must be discontinued. To continue to invest in a competitive method which does not meet its hurdle rate is a recipe for failure. As an example, the executives of Outback have established a first year cash flow model for site selection. They will not deviate from the model they do not pay premiums for sites, they search for alternative sites rather than invest in a site which will not meet their ROI requirements.

Competitive methods must be supported by the core competencies of the firm. If managers of the firm selective competitive methods which are difficult for them to execute, they are setting themselves up for failure. How do managers discover what the core competencies of their organization are? The most common method is to conduct a Strengths and Weaknesses Analysis.

IV. Strengths and Weakness Analysis

In developing competitive methods to support chosen strategies, managers must understand the competencies required for successful implementation. This requires an honest assessment of the firm's capabilities. Areas to be examined include:

a) Functional analysis which functions are important to the strategies and how well can the firm's employees perform? Is the firm strong in marketing? Are the operational personnel capable of delivering the promised service and product to the customer consistently? McDonald's marketing strengths exceeded their operational strengths which resulted in declining sales and the replacement of their CEO;
b) Financial position does the firm possess the financial strength to develop and deliver the chosen strategies? Is cash flow adequate? Some firms choose much different financial strategies. Outback Restaurants are totally debt adverse with a debt to

equity ratio of 0.01; while Yum! is debt heavy at 1.12 debt to equity. The strategy on the use of debt obviously impacts the ability to fund strategic iniatives;

c) Labor force does the firm possess a sufficient of trained employees to implement their strategy? The restaurant industry is labor intensive. It requires 16 full time equivalents (FTE's) to generate $1,000,000 in sales in the restaurant and only 4 FTE's in the retail industry. One of the greatest challenges facing the industry is the recruiting and retention of well trained employees;

d) Competitiveness what is the firm's competitive position in the marketplace? What is its market share? Does it possess the ability to quickly match strategic moves of the competition? Is it a well-known and respected brand?

These examples of core competencies must be continually developed and renewed. If managers don't aggressively support them, they will quickly deteriorate in today's difficult operating environment.

Summary

The restaurant industry in the United States can serve as a model to executives in other countries. Over the past fifty years it has developed from a fragmented industry dominated by small firms operating locally to a huge, mature industry dominated by national and international firms. I anticipate that this scenario will be carried throughout the globe as nations expand their economic growth and local consumers become more affluent and sophisticated. The restaurant companies able to develop superior strategies while taking advantage of the opportunities in the business environment will succeed while less sophisticated firms will be hampered by their inability to understand the strategic issues of the marketplace.

Strategic Management in the Foodservice Industry
외식산업의 전략적 경영

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2004년도에 레스토랑 판매액은 4천4백억 달러를 넘어설 것으로 예상하고 있습니다. 이 같은 판매액은 1970년도 이래로 평균 년 7.1%의 성장률을 기록하고 있습니다. 이러한 성장률은 상당히 매력적으로 들리겠지만 상장 레스토랑 회사들은 이러한 평균성장률을 넘어서도록 투자자들에 의해서 끊임없이 요구받고 있습니다. 예를 들면 Cheesecake Factory는 지난 5년 동안 평균 20.9%의 성장을 해온 반면 Outback Steak House는 같은 기간동안 평균 13%의 성장밖에 하지 못했습니다. Darden 레스토랑 그룹은 평균 7.3%의 성장을 한 반면, Brinker International은 평균 13.8% 성장을 했습니다. QSR분야에서는 웬디스가 평균 10.3% 성장한 반면, 맥도날드는 평균 6%와 Yum회사는 평균 2.8%성장에 불과했습니다. 이러한 것은 경쟁업체의 시장을 빼앗아 성장하는 것을 의미합니다. 2004년도에는 full service restaurant 의 성장은 4.6%인 반면 QSR의 3.9%였습니다. 이와 같은 성장률은 업계의 성장은 있지만 허약한 회사의 시장 손실 없이 공격적 회사의 목표를 지탱하기에는 충분하지 않은 숫자입니다. 판매성장 외에도 레스토랑 회사들은 수익률 증가에도 힘을 기울이고 있습니다. 미래의 수익증가율에 대한 분석가들의 예상치는 상장회사들의 주가에 영향을 주게 됩니다. 경영자들은 최고의 투자수익률을 제공하는 여러가지 전략을 선택해서 주식당 수익율에 긍정적 영향을 줄 수 있도록 노력하고 있습니다. 분석가들은 앞으로 5년동안의 기대수익율을 다음과 같이 예측하고 있습니다. Cheesecake Factory- 22.6%; Outback 14.2%; Brinker 14.0%; Darden 12.8%; Wendy's 12.4%; Yum! 11.5%; and, McDonald's 8.4% 입니다. 이러한 것은 분명 성공적인 업계 리더가 되기 위해서는 현명한 의사 결정을 위한 모델이 있어야 한다는 것입니다.

모델 제시는 다음과 같습니다.

상호 정열 원칙

전략 경영 모델 미래지향적 경쟁

I. 환경 분석
II. 영역 설정
III. 경쟁 방법
IV. 강점과 약점 분석

요약

미국의 레스토랑 업계는 타 국가들의 최고 경영자들의 모델일 수 있습니다. 미국의 레스토랑 업계는 지난 50여년 동안 주로 지역의 소규모로 운영하는 회사에서 거대 회사로 점유된 업계로 발전했고 또한 대규모, 국제적 기업으로 변모한 성숙한 산업으로 발전했습니다.

국가들이 경제 성장을 거듭하고 각 지역 소비자들이 윤택해 지면서 이러한 시나리오는 전세계적으로 적용 될 수 있다고 예상하고 있습니다. 허약한 회사는 시장의 전략적 핵심을 이해 하지 못해 곤란을 겪게 되는 반면 미래 환경에 기회를 이용하며 우수한 전략을 개발 할 수 있는 레스토랑 회사는 끈임 없이 성공할 것입니다.

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U. S. Restaurant Industry 2004

- $440.1 Billion in sales
- 878,000 Restaurants
- 12,000,000 People currently employed
- 7.1% Annual sales growth 1970-2004
- 46.4% Of food dollar spent in restaurants

Historic Annual Sales Growth

- 5 Year sales growth average 1999-2003
  - Cheesecake Factory 20.9%
  - Brinker International 14.8%
  - Outback Restaurants 13%
  - Wendy's Restaurants 10.3%
  - Darden Restaurants 7.3%
  - McDonald's Restaurants 6.0%
  - Yum! Restaurants 2.8%

Projected Earnings Growth

- Next 5 years analyst's predictions
  - Cheesecake 22.6%
  - Outback 14.2%
  - Brinker 14.0%
  - Darden 12.8%
  - Wendy's 12.4%
  - Yum! 11.5%
  - McDonald's 8.4%

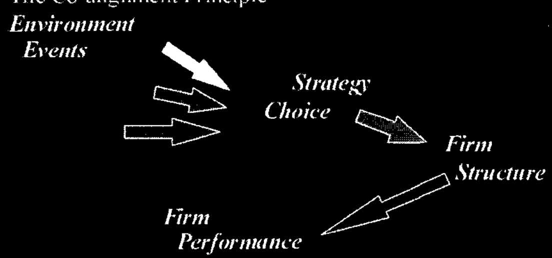
The Co-Alignment Principal

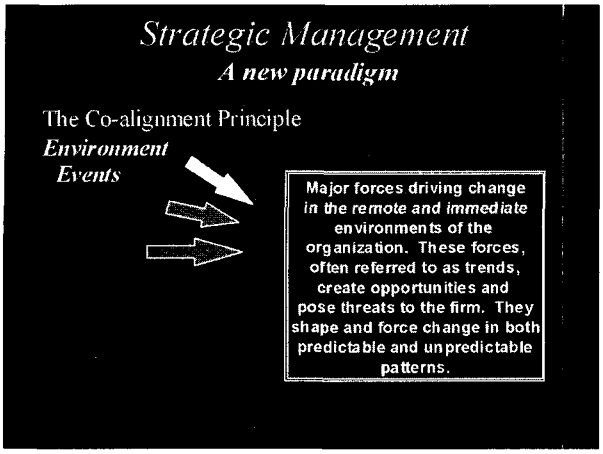
- *The goal of every organizational leader is to achieve maximum effectiveness*
- *To accomplish this, the leader must create a match between the forces driving change in the environment and the organization's methods in allocating resources and achieving its goals*

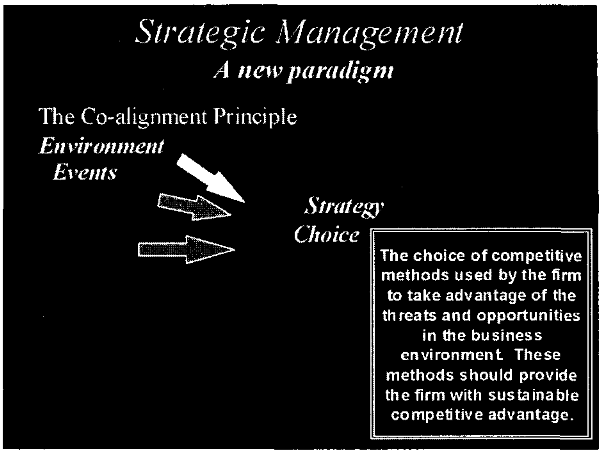
Competing for the Future

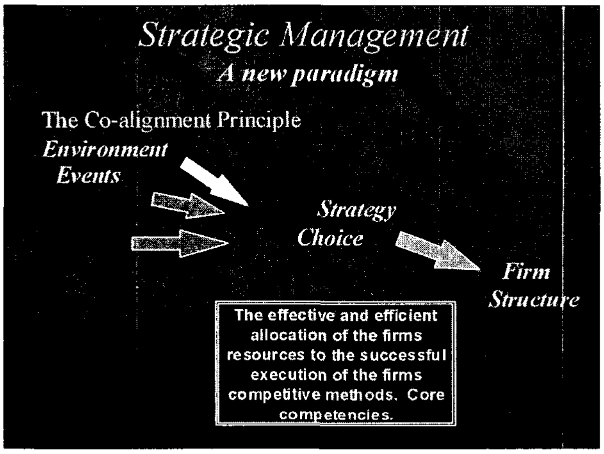
A new paradigm

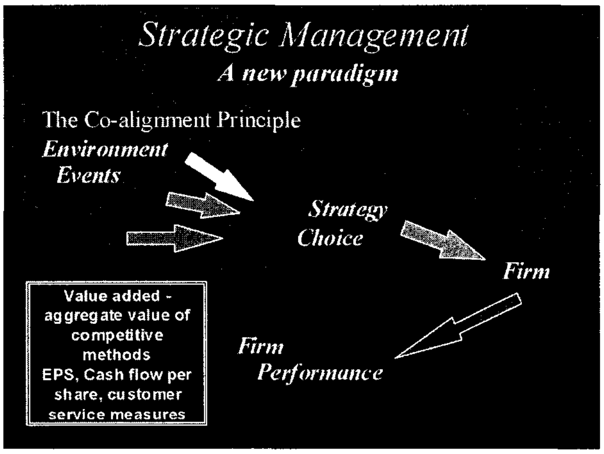
The Co-alignment Principle

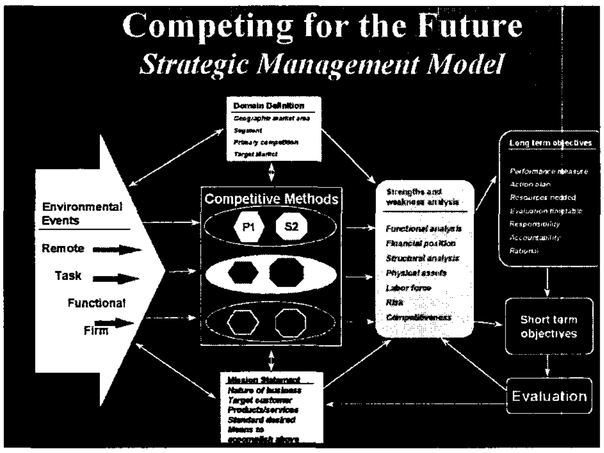


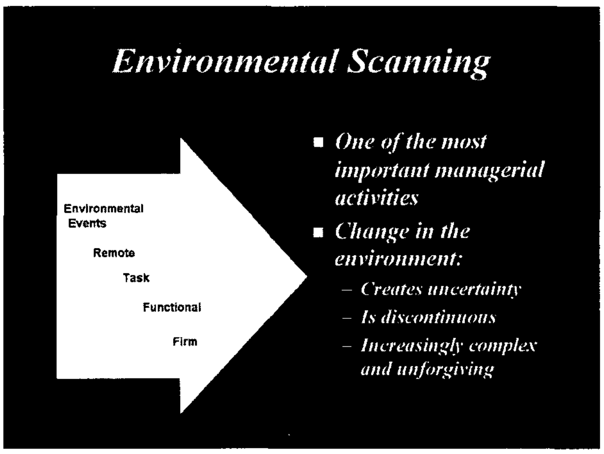

Strategic Management
A new paradigm
The Co-alignment Principle
Environment
Events
Major forces driving change in the remote and immediate environments of the organization. These forces, often referred to as trends, create opportunities and pose threats to the firm. They shape and force change in both predictable and unpredictable patterns.


Strategic Management
A new paradigm
The Co-alignment Principle
Environment
Events
Strategy
Choice
The choice of competitive methods used by the firm to take advantage of the threats and opportunities in the business environment. These methods should provide the firm with sustainable competitive advantage.


Strategic Management
A new paradigm
The Co-alignment Principle
Environment
Events
Strategy
Choice
Firm
Structure
The effective and efficient allocation of the firms resources to the successful execution of the firms competitive methods. Core competencies.


Strategic Management
A new paradigm
The Co-alignment Principle
Environment
Events
Strategy
Choice
Firm
Value added - aggregate value of competitive methods
EPS, Cash flow per share, customer service measures
Firm
Performance


Competing for the Future
Strategic Management Model
Domain Definition
Environmental Events
Remote
Task
Functional
Firm
Competitive Methods
P1
S2
Strengths and weakness analysis
Long term objectives
Short term objectives
Evaluation
Mission Statement

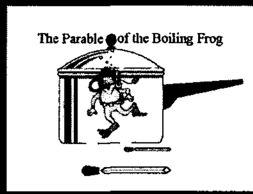

Environmental Scanning
Environmental Events
Remote
Task
Functional
Firm
One of the most important managerial activities
Change in the environment:
Creates uncertainty
Is discontinuous
Increasingly complex and unforgiving

Environmental Assessment Conceptual Tools

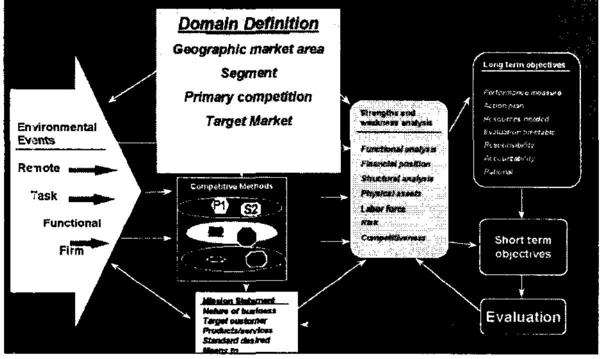
- *Companies must stop thinking about the past and compete for the future*
- *Managers must:*
  - *Possess creative thinking ability*
  - *Scan the environment*
  - *Identify forces driving the market that lead to opportunities and threats*

Why Scan the Environment?

- *If unable to identify forces driving market, the firm may keep reacting until it ceases to exist*
- *If forces known able to develop plans which ensure success*



Competing for the Future
Strategic Management Model

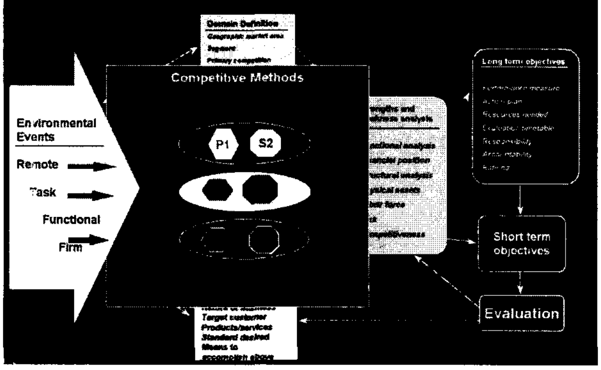


Domain Definition

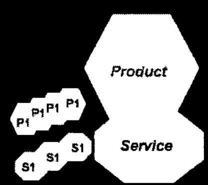
Domain Definition	
Geographic market area	
Segment	
Primary competition	
Target Market	

- *The context within which the organization chooses to exist and function*
- *Patterns of relationships that must be maintained as well as monitored for change*

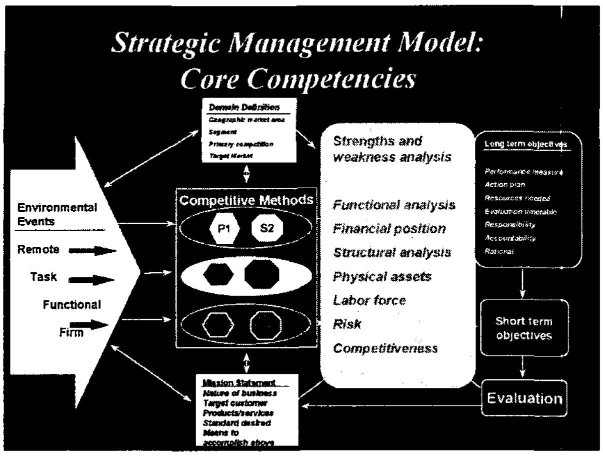
Competing for the Future
Strategic Management Model



Defining Competitive Methods



- *Portfolio of products and/or services that generate a positive cash flow over a useful economic life*
  - *Intangible service*
    - *Friendly service*
  - *Tangible product*
    - *Signature dish*


Strategic Management Model:
Core Competencies
Domain Definition
Segment
Target Market
Environmental Events
Remote
Task
Functional
Firm
Competitive Methods
P1
S2
Strengths and weakness analysis
Functional analysis
Financial position
Structural analysis
Physical assets
Labor force
Risk
Competitiveness
Long term objectives
Performance measure
Action plan
Resources needed
Evaluation timetable
Responsibility
Accountability
Rational
Short term objectives
Evaluation
Mission Statement
Nature of business
Target customer
Products/services
Standard desired
Means to
accomplish above


Core Competencies
Processes, skills and assets which provide the firm with competitive advantage
Must be continually developed and renewed
There must be a match between the firm's core competencies and the competitive methods it chooses to implement its strategy