L.E.K.

EXECUTIVE INSIGHTS

VOLUME XVI, ISSUE 45

Go Big or Stay Home: How Restaurant Brands Should Approach International Growth

For many restaurant companies, the menu of international expansion opportunities triggers a strong appetite. Yet that experience all too often leaves them with indigestion. Over the years, these brands have invested significant resources into countries, supply chains and management teams, as well as restructuring their organizations and bringing on board members with international experience. In most cases, the ROI has been dismal and overall results have fallen short of expectations.

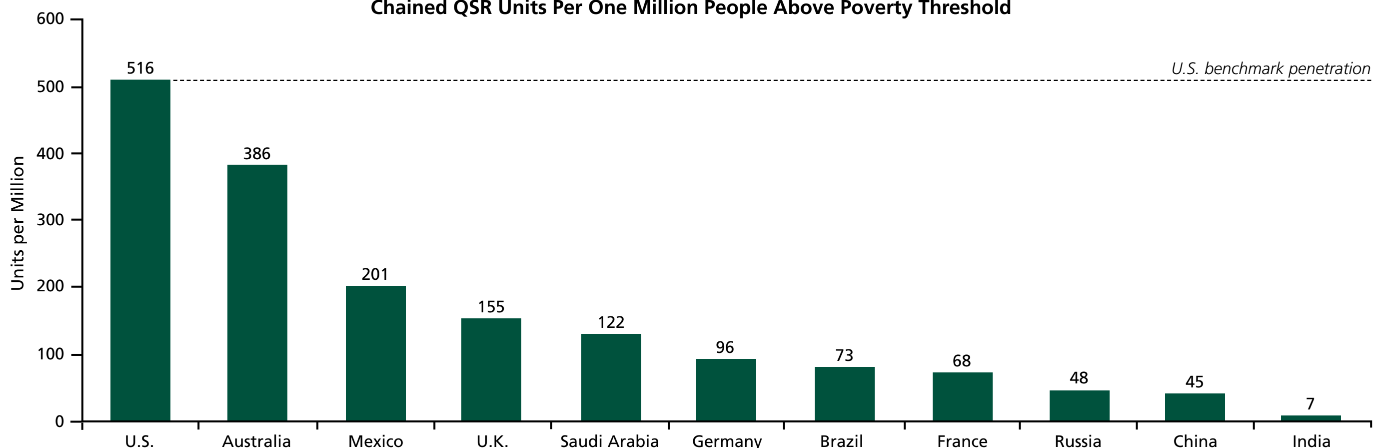
Not surprisingly, a number of leading restaurant chains now treat their international business as a side dish rather than an entrée – an ancillary business rather than a sizable source of growth. What follows is a well-intended but half-hearted attempt to venture abroad. Even in the face of limited domestic growth options, most mature restaurant chains continue to shy away from the true level of commitment required to expand and succeed in international markets.

Enticing Opportunities but Few Successes

The scale of international opportunity is impossible to ignore. There are now more than one billion middle class consumers globally, and the vast majority is outside North America. Yet most countries remain sharply underpenetrated by chained quick service restaurants (QSRs) (see Figure 1) and casual dining restaurants (CDRs).

Figure 1

Chained QSR Units Per One Million People Above Poverty Threshold



Source: Euromonitor, World Bank, L.E.K. analysis

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To be sure, category-leading QSR brands like McDonald's, Subway and KFC have been highly successful internationally. McDonald's now has higher QSR market share in the rest of the world than it does in the U.S. and generates more of its revenue outside the U.S. KFC has more than 4,500 units in China alone.

Yet almost without exception, second-tier QSR brands have enjoyed far less success abroad, where international markets typically account for less than 20% of revenue (see Figure 2), and their international portfolios consist of a long "tail" of sub-scale businesses in many markets. We see this trend consistently across categories, despite the fact that the #2 and #3 brands all enjoy strong share positions in the U.S. Again, take China as an example where the combined total units of chicken brands Chick-fil-A, Popeyes and Church's Chicken is immaterial, and pales in comparison to the more than 4,000 total units that bear their names in the U.S.

On the whole, casual dining brands have even less impressive international track records – on average, only 5% of their revenue comes from outside the U.S. and "international" often means Canada. To be fair, CDRs have several attributes that make international expansion naturally harder: higher price-points, more indigenous alternatives, operational complexity and the limitations of the franchise model. Notwithstanding these challenges (nor the outperformance of a few brands like TGI Friday's and Outback), no casual dining company has truly cracked the international code.

Two Causes of International Heartburn

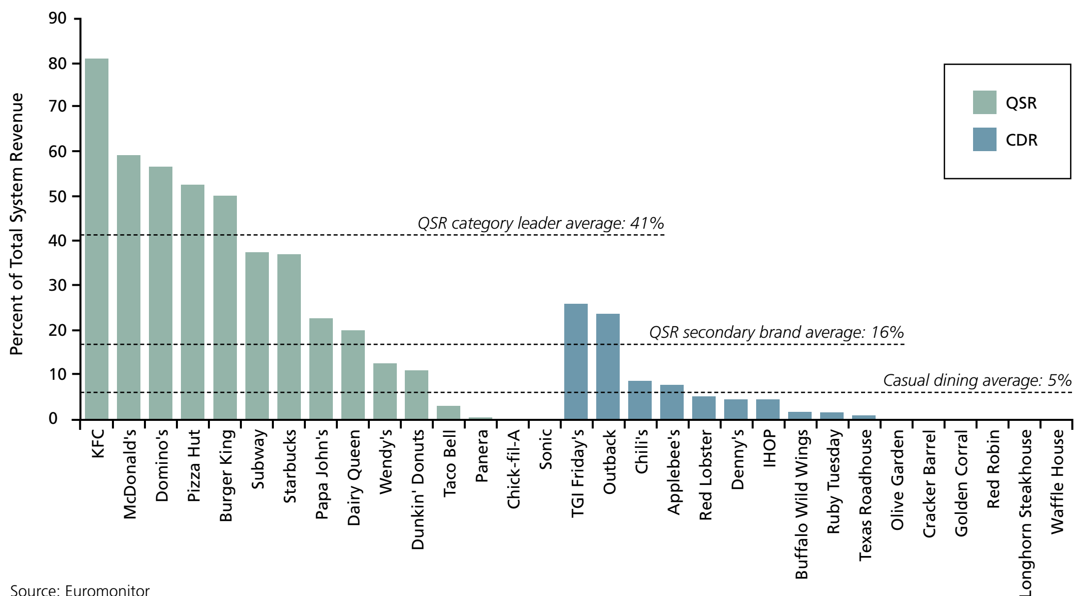
When brands struggle overseas, they typically run into two critical problems. Getting either one of these wrong can derail international growth.

1. Inadequate commitment masked by denial.
Going global requires vision, and it stands to reason that the C-suite, Board – and, ultimately, investors – must all be aligned. Even when they are, denial creeps in when executives unconsciously set the bar lower and lower and then proclaim to be content that they tried.

Success rarely comes overnight and extraordinary perseverance is needed in many markets. In France, for example, success requires highly adapted menus and a willingness to deal with difficult real estate, tax and labor law issues. McDonald's built up its huge presence over decades; Burger King ultimately withdrew in 1997, having failed to tailor its concept sufficiently.

Figure 2

Top 15 QSR & CDR brands' International Share of System Revenue



Source: Euromonitor

KFC re-entered the market in 2001 and reportedly took the better part of a decade to become profitable after years of patient adaptation and growth. Yet today, France is KFC's most profitable market on a per-unit basis, and it aims to double its unit count in the coming years.

2. A lack of focus.

Focus, pick your spots, gain critical mass. These are not new concepts. Nonetheless, we often see great brands disregarding these principles. In many cases, international strategy becomes an exercise of chasing unit counts, which often results in too many stores spread across too many markets. Brands thus end up with fragmented portfolios, which are difficult to manage and typically leave the most attractive markets underdeveloped. A good example is how Yum!, now a paragon of international success, initially struggled with having planted too many flags. At one point they were in twice as many countries as McDonald's with half as many restaurants. They reversed course after an exhaustive study of how McDonald's expanded into new markets.

At the other end of the spectrum, Chipotle has only recently begun to expand internationally, but already its 16 ex-U.S. restaurants are spread across Canada, the U.K., France and Germany. Last year, Chipotle found its awareness in London was only 1%, leading to significantly lower average unit volumes (AUVs) than in the U.S. It takes discipline, but we believe that identifying and going deeper in the right markets will deliver a stronger international portfolio than taking a peanut butter approach. If done well, this focus is much more likely to deliver what it takes to win – market insight, brand strength, operating and organizational scale, etc.

Questioning Conventional Wisdom

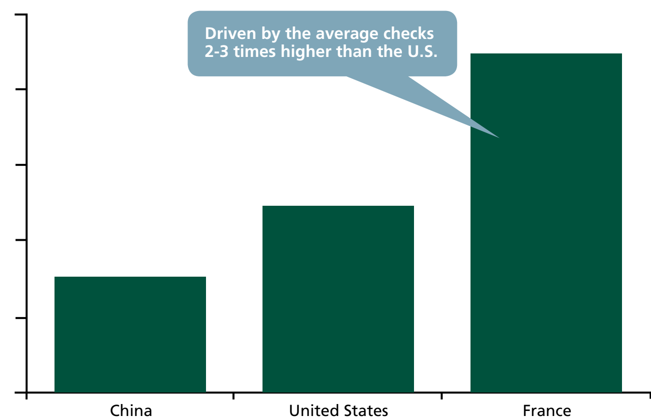
International expansion isn't easy and brands may instinctively play it safe with conventional approaches. But every company and every country is different, thereby requiring a tailored strategy for each market. There are three tenets that many brands fail to question. While each may work in some cases, it's essential to consider the alternatives.

1. Developing markets with high growth potential.

Under-penetrated markets in the BRICs, the Middle East and Southeast Asia may seem to be logical choices – until you take a closer look at challenges like cultural differences, intense price sensitivity and surprisingly high costs necessary to secure prime real estate and build the brand. Other factors, such as political risk in Russia, may be difficult to quantify, yet quite real. Alternatively, the developed economies – often with more established, favorable dining habits, higher AUVs (see Figure 3), and relative ease of doing business – may be worth a second look.

Figure 3

McDonald's AUVs in China, United States and France



Source: Euromonitor, L.E.K. analysis

2. Relying on local partners to drive growth.

When brands choose to franchise internationally, they often find that many of the best franchisees in targeted markets are already taken by the long-established leading brands. This leaves primarily B-level partners willing to take a risk on the next new entrant (or alternately, A-players for whom you would be the 3rd or 4th brand in their portfolio). Since franchisees often control many of the factors that affect your fortunes in a new market, the wrong partner can be the difference between success and failure.

3. Franchising is the only approach.

When building up a new market, franchisees often make poor pioneers – they're more concerned with immediate sales and profits than longer-term concept optimization and brand-building. In many cases, a healthy mix of company operations (which can set the standard with flagship locations and strong operational execution) and careful franchising is the better approach. Further, having some level of company stores, even if it's small, keeps you close to local consumers and market trends, which can be incorporated into business strategy to ensure success in your most important markets.

To Boldly Go…

Substantial prizes await those restaurant brands with the commitment to "go big" abroad. However, dots on the map are not a strategy, nor a measure of success. Many QSR and CDR brands spread themselves too thin across the wrong markets, over-rely on distant franchise partners, and give up too quickly before they get the formula right. We argue that real international success requires focus, perseverance and original thinking backed by detailed analysis – and then bold, structured investments. So, find the right markets, craft your own recipe for success, then go big!

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