

CHAPTER 1

INTRODUCTION

1.1. Overview

The foodservice industry has grown significantly throughout the world since the 1980s (Khan, 1999). The growth of this industry has been rapid due in part to the increasing prevalence of multi-unit development (Kaufmann & Dant, 1996) and international expansion (Aydin & Kacker, 1990; Shane, 1996). Today, foodservice operations can be found on almost every street or in almost every shopping center in any neighborhood. As a result of this growth, the foodservice industry is already saturated, because there are few "prime sites" for new units.

In the traditional way of thinking, location is the most important factor affecting restaurant success. The lack of prime sites could be seen as the most significant change in the foodservice industry in recent times. In most cases, this is true, but is not always the situation. For example, Outback Steak House has been known for focusing on second sites and first quality food, and is well positioned as one of the market leaders in the steak segment. In most cases, however, location has the most important role in the foodservice business. An alternative way of finding a prime site is by doing business in combination with existing businesses that already have prime sites, such as gas stations, convenience stores, hotels, and restaurants.

The most successful foodservice companies, including Pizza Hut, McDonald's, KFC, Taco Bell, Subway, Blimpie Subs & Salads, Arby's, Dunkin' Donuts, Baskin Robbins, T.G.I. Fridays, Applebee's etc., are rapidly expanding their business territories in combination with firms not formerly considered as business partners. For example, Blimpie Subs & Salads has the history and resources to help out prospective co-brand partners with more than 925 co-branded stores, including about 750 with convenience

stores (Kelly, 1998). Other examples are Best Western Inn with Country Kitchen (Walkup, 1995), and Holiday Inn with TGI Friday's (Casper, 1995).

In some cases, partnerships have formed within the same industry. For instance, some foodservice companies have made a commitment to co-branding, including Taco Bell and KFC, Wendy's and Tim Hortons, Long John Silver's and Taco Time, Carl's Jr. and Green Burrito, and El Pollo Loco and Foster's Freeze. When one looks at the lengthy lists of firms using co-branding, one becomes aware that co-branding is increasingly a significant business strategy (Tasoulas, 1999).

Every business movement requires capital investment, even though the magnitude of the investment differs according to the size of the company and the projects. In volatile markets, it is difficult to predict how a particular investment will affect a company's value. And, most projects require the sacrifice of cash and other resources before they return cash and/or resources to the firm. Therefore, a firm should not accept a project simply because it is feasible.

An answer to uncertainty in launching new projects can be found in financial markets. The markets are adept at calculating the value of an investment under uncertain conditions - exactly the challenge faced by business strategists. By applying the discipline of the markets, decision-makers can avoid basing important decisions on subjective judgments about the future. However, traditional valuation methods may be useful tools for big companies, but may not be useful for restaurant unit owners. Unit performance depends on day-to-day operation and is not controlled by the financial market, but by customer satisfaction. However, there has not been much research done by academics and professionals on the individual unit level regarding investment issues. This study will address investment practices on the restaurant unit level in the case of co-branding investments made by franchisees.

1.2. Statement of the Problem

Unusually rapid change in the hospitality industry is now a distinguishing characteristic of today's business environment. This is especially true with respect to

changing customer demands, product diversity, and production/process technology. If the trends continue, in the particular case of independent restaurants, it is difficult to have a reactive or even a proactive attitude to these environmental changes because of lack of capital, information, and management skills.

Individual restaurants have adapted technologies to continue to provide for their customers' needs, and have applied new ideas in order to regroup their systems. For example, computerized food production and inventory systems have allowed many companies to reduce the cost of a product while holding constant or even increasing its value to the customer. Reduced costs also add value to the firm, which can lead to reduced prices and increased market share, and stable prices, but increased profit margins.

Since adopting new technologies and production systems requires a large amount of capital investment, restaurant owners are looking for less risky sources of revenue. And, they have tried to increase sales by introducing special promotions (i.e., special discounts, and coupons), localization of the menu (i.e., Lamb-burger by McDonald's), and co-branding (i.e., Taco Bell with Pizza Hut and McDonald's with Wal-Mart). The co-branding strategy has been widely used in the hospitality industry. Even though this investment strategy is a significant issue on the unit level, it has not been given much attention by academics. A better understanding of the co-branding investment model would be a valuable asset for both academic and industry professionals.

Research Question 1:

What are the key factors that affect investment in the co-branding concept?

Research Question 2:

What factors make (prospective) co-branding franchisees exercise different co-branding options at different times?

1.3. Objective of the study

The objective of this study is to examine the trends in co-branding, especially when one brand is linked with another brand through a business strategy, in order to investigate the factors that lead to co-branding as a strategic option in the hospitality industry. Of primary interest is whether co-branding strategies are significant issues in the hospitality industry. This study also investigates the relationship between explicit and implicit requirements and timing of entry for co-branding investment.

1.4. Boundary of the Study

The boundary of the research is the foodservice segment of the hospitality industry, because of the interest of the researcher, and because co-branding has been widely adopted in the hospitality industry.

1.5. Organization of the Remaining Chapters

Chapter 2 initially reviews the available literature on environmental scanning, the option pricing model, real option theory, and utility theory, as well as related relevant literature. This chapter also presents a theoretical model of the market-driven strategic financial investment decision-making process, which is offered to organize discussions on existing research on the phenomenon.

Chapter 3 presents an investigation of the foodservice industry focusing on the impact of environmental changes (i.e., economic change, demographic change, and changes in eating habits). There are clear signs of environmental changes surrounding the foodservice industry; these changes have already impacted the entire foodservice system.

Chapter 4 presents the conceptual framework of the co-branding option. Definitions are given for the implicit requirements (synergy effect and performance

uncertainty) and explicit requirements (competition and resources) for investing in co-branding. Also, the relationship between real options and co-branding are discussed. In chapter 5, the research procedures for this study are discussed.

Chapter 5 presents two statistical techniques to understand recent developments in the hospitality industry. Study 1 discusses the recent trends of co-branding development in the hospitality industry by using content analysis. This study relies exclusively on publicly available information. Study 2 discusses the research procedures of the hypothesized co-branding model. Cross-sectional analysis was conducted to test the hypotheses and a mail questionnaire survey was used to collect the appropriate data set.

Chapter 6 presents the results of the various statistical tests performed on the hypotheses of the model, including descriptive statistics, two-group discriminant analysis, and logistic regression. To test hypothesis 1, that group differences exist between early and late movers in adopting co-branding, discriminant analysis was used by using the enter and stepwise methods. This test was run using two types of mover (early and late) as the dependent variable and investment requirements as the independent variable. Logistic regression was used to test the remaining hypotheses. Conclusions are presented in the chapter 7.