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Financing a remodel: The case of a McDonald's franchisee

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ABSTRACT

This study requires students to analyze the investment and financial decisions relating to the remodel of a McDonald's restaurant in a small college town. Specifically, the case offers students an opportunity to consider three different financing options offered by McDonald's to franchise operators considering a remodel. The case also employs the restaurant remodel framework to consider multiple applied issues, which includes facility upgrades, introduction of specialty product lines, employee turnover, the impact of Federal Reserve interest rate policy, and economies of scale for both the franchisor and franchisee.

Key Words: Corporate Finance, Federal Reserve, Franchisee, Investment, McDonald's

INTRODUCTION

Hassan Dana looked at his options. He owned the McDonald's franchise in Canyon, a small college town in Texas. Located across the street from the local college campus, business was good; however, the store was beginning to show its age. Built in the 1970's, the building simply needed to be re-imaged or replaced. Knowing he had to make that decision, Dana began to explore his financing alternatives.

BACKGROUND

Hassan Dana thought back to the morning of October 20, 1987. On that morning he stared at the *Wall Street Journal* headline, "The Crash of '87: Stocks Plunge 508.32 Amid Panicky Selling." Just days before, Dana had cashed out and walked away from his Wall Street job as a commodity trader. Amazed by the good fortune of his timing, he vowed to proceed with a plan to own his own business. Hassan and his wife Jill conducted extensive research on available franchise opportunities, becoming convinced that the training and support they would receive made McDonald's the gold standard for franchise owners. After an extensive interview process with McDonald's, the Danas were approved to own a franchise and completed three separate training experiences lasting twelve, eighteen, and twenty-four months. Training culminated with twelve days at Hamburger University; then Hassan worked in a company store for six months.

It took over a year to get an ownership opportunity; however, on March 10, 1995, he purchased his first store in Derby, Connecticut, where the company was buying a group of existing stores to retire the owner. Hassan paid $987,000 for the store and consummated the transaction without a lawyer. The Danas were pleased, feeling that McDonald's made the franchise owners feel "an equal partner" in an operation where the brand was everything.

Between 1995 and 2004, Hassan and Jill Dana added another store in Connecticut, but beyond that, there was no real ability to grow. McDonald's sent them to other states to look at stores. Hassan met the Dallas Regional Manager, who told him over the phone that in the Texas market, Amarillo had been for sale for two years with no takers. In May 2004, he decided to sell his interest in Connecticut and bought into the Amarillo market. The Canyon restaurant was purchased by the Dana's in 2007. Adding the store in Canyon, 15 miles south of Amarillo, gave the Dana's their 12th restaurant in the Amarillo market.

McDONALD'S

The McDonald's story is initially the Ray Kroc story. In 1954, while working as a multi-mixer salesman, Ray Kroc tracked a huge order for multi-mixers to a restaurant in San Bernardino, California. Dick and Mac McDonald, brothers, ran a limited menu restaurant that concentrated on burgers, fries, and beverages. Impressed by the success of this new concept and learning that the brothers were looking for a franchising agent, Kroc envisioned McDonald's restaurants all over the country. He founded McDonald's Corporation in 1955 and five years later bought the exclusive right to the McDonald's name. Kroc believed the entrepreneurial spirit of his franchise owners would get them to buy into the philosophy "In business for yourself, but not by yourself." He said his philosophy was based on a three-legged stool with McDonald's, the franchisees, and the suppliers being the legs. McDonald's expected franchisees

to follow the McDonald's principles of quality, service, cleanliness, and value. McDonald's efficient supply chain management was a true innovation at the time.

In 1961, McDonald's created Hamburger University, and the training programs eventually became the envy of the food industry. In 1965, McDonald's went public at $22.50 per share. McDonald's became a truly international company with Big Macs sold worldwide. Over the years, the original limited menu has expanded with the addition of salads, new sandwiches, a breakfast menu, snack wraps, specialty coffee drinks, and berry smoothies. Store amenities have changed over time from the original carhop concept to include drive-throughs, indoor seating, play lands, free WiFi, and TV screens.

McDonald's is one of the most successful franchises in history. Buchholz (2007) offers several explanations for the success of McDonald's. First, Kroc offered franchisee owners an opportunity to be successful by not making them overpay for the right to sell hamburgers and shakes. Kroc wanted stable partners that would follow his vision but he only cleared 1.4 percent of sales revenue. Second, McDonald's controlled the pace of expansion by allocating just one restaurant at a time after careful inspection of both applicants and location. Unlike recent trends with companies like Starbucks and Krispy Kreme, McDonald's has always appreciated the importance of quality growth and not diluting its brand. Third, Kroc insisted that franchises follow the McDonald's menu, supply chain, architecture, and the precise layout of the kitchen in order to provide consistency across restaurants. This consistency is beneficial to a franchisee because the rules control the McDonald's experience for the customer. Although restrictive, the McDonald's approach has always offered franchise owners an opportunity to invest, work hard, and make money.

THE CANYON RESTAURANT

Built in the 1970's, the McDonald's store in Canyon is across the street from what was then the Student Union Building at West Texas A&M University. With few other fast food options in Canyon, the store was a success. Today, the Canyon McDonald's offers fast food service to the 15,000 permanent residents of the city and 7,500 college students as the primary patrons.

Although the prior owners had kept the restaurant in good repair over the years, by the time Hassan and Jill Dana purchased the store, it was structurally out-of-date. The kitchen was too small and not convenient for the new menu items such as smoothies and coffees. Built with a basement for storage, employees had to leave the kitchen to retrieve replacement items. Moreover, the building did not have enough freezer space to contain the frozen food needed for an average lunch or dinner run. An additional freezer was in a small building across the parking lot, requiring employees to exit the building to retrieve food from the freezer. Not only were the stairs into the basement a safety hazard and liability concern, but the need for employees to constantly be going downstairs or outside to retrieve food made the store much more labor-intensive than comparable stores.

McDonald's is adamant about protecting the brand. The brand is, in many ways, the main driver of value. McDonald's had learned to be quick in removing poor operators to guard against any one restaurant negatively affecting the entire chain.

The Canyon store needed major remodeling or rebranding, but the previous owner, who only had the one store, had not been in a financial position to close the business for the minimum of 90 days for a remodel. Unless an owner has another form of income or has saved funds for

the construction and loss in income during the remodel, the likelihood of a remodel diminishes. Because the McDonald's brand is so important and central to McDonald's value, the franchisee with only a few stores becomes almost a liability for McDonald's because he/she does not have enough stores or cash flow to maintain the stores let alone upgrade the stores (Reeves, October 2010).

Hassan knew he needed to remodel the Canyon restaurant. The portfolio of 12 regional restaurants made a short-term closure of the Canyon location manageable with respect to cash flow. He narrowed his options on how to approach financing for the remodel.

FINANCING THE REMODEL

McDonald's encourages periodic remodels and will share the cost of construction. McDonald's has a national arrangement for financing, insurance, and distribution that allows all operators, even small operators, to pay the same marginal price. This is not always the situation with other franchises and was one of the reasons the Danas had been so interested in owning a McDonald's franchise.

The ability to participate at the negotiated price is especially important to new franchisees who do not own many stores and would not be able to negotiate lower costs on their own. The negotiated prices on many of the major costs allow all stores to have similar profitability. The similar cost structure decreases the advantage larger operators could have over smaller operators and reduces jealousy as the franchisees develop national restaurant policy.

Historically, the cost of a typical remodel for a McDonald's has been approximately $500,000. In recent years, the remodel cost for the typical restaurant has increased to $700,00 because of the new equipment and redesign of the drink area for the new premium coffees and smoothies (Ziobro, 2010). Additionally, McDonald's has updated the standard décor to reflect a more café-style interior (MSN, 2011). A complete remodel for a store that is excessively dated, which includes a teardown and rebuild, tends to cost twice as much as the basic remodel.

McDonald's anticipates that the changes will increase sales of the higher profit margin coffees and smoothies. Many franchisees balk at the increased cost of the remodel because McDonald's has not proven the coffee shop concept (Boyle, 2009). Instead, some franchisees prefer more emphasis on the breakfast and dollar menus. In essence, while McDonald's promotes product mix, volume is the real driver of sales and profits for the franchisees (Reeves, December 2010).

Because of the structural issues, Hassan had decided that he needed to completely tear down the building and build a new one on the site. He had successfully done that with a store located on Interstate 40 on the east side of Amarillo. A new Canyon store needed a bigger footprint, and he had been able to purchase the house and clear the land behind the old store, giving him the needed space.

McDonald's shares the cost of construction through three financing options, with the percentage of store sales owed to McDonald's varying based upon the option chosen. No matter the option chosen, the franchisee pays the franchise fee once every twenty years. A franchisee must consider the effect the different options have on cash flow. McDonald's will pay for more of the construction but in return, the franchisee pays McDonald's a higher percent of sales.

Depreciation is another part of the financing decision. While a non-cash expense, depreciation affects cash flow through the reduction in taxes. Typically, the owner pays for the items of quick depreciation while McDonald's keeps the long depreciation items. Short-term

depreciation items include plumbing and electrical with lives of five to ten years. Long-term depreciation items include walls and the roof with lives between ten and twenty years. Because of the remodels he had done on some of the Amarillo stores, Hassan already had a lot of short-term depreciation.

The first option was that McDonald's would share construction costs 50/50 with the franchise owner, who would then pay McDonald's 8.5% of sales. The sales fee is a function of the age of the store. The monthly fee for new stores is closer to 14%-15% of sales, but because the Canyon store is older than average, the monthly fee is lower. McDonald's owns the building and prorates the depreciation with the franchisee. The owner absorbs the cost of any upgrades.

The second option was that McDonald's would pay 2/3 of construction costs while the owner would pay the remaining 1/3 cost. In return for McDonald's paying more of the construction costs, the monthly rent is increased 1% for the next eight years. Thus, Hassan would owe 9.5% of sales. McDonald's still owns the building and prorates depreciation with the franchisee.

With the third option, the franchise owner pays all of the construction costs and owns the building. In exchange for not bearing any of the construction costs, McDonald's reduces the monthly rent for a set period. For the Canyon store, McDonald's would reduce the rent to 4.25% for six years, after which it would increase to the normal rate of 8.5%. Hassan would also take all of the depreciation on the building.

Borrowing rates were at historic lows in 2008, and Hassan determined that he would be able to lock in at a low rate no matter which option he chose. The most appealing financing option was an adjustable rate loan at an initial rate of 3.75%. The original maturity of the loan was seven years, but the borrower could increase it to ten years or pay off the loan at any time after one year with no penalty.

Because McDonald's has specialized construction, the general contractors know the requirements for the stores and are able to estimate the cost and construction time easily. The Canyon store's cost would be $1,800,000, and the time for the teardown and rebuild would be 90 days. Hassan timed it for the summer to coincide with the reduced student population at the University.

UPGRADES

McDonald's has strict construction standards, and what they will help build is tied to the demographics of the market. If the franchise owner wants additions or upgrades to the standard McDonald's building proposal, the owner absorbs those costs. Hassan knew he wanted upgrades, which cost upfront but can increase sales and add value at resale.

Initially, the store had $2,000,000 in annual sales. In comparison, the average McDonald's has annual sales of $2,400,000. McDonald's expects sales to increase 30% to 50% following a remodel. The expected sales increase is high because the consumer experience is improved. A newer, cleaner store has a better image and customers are more satisfied. Hassan and Jill knew that the remodel would only be successful if sales increased and that an increase in advertising would offset part of the increase in sales. The Danas planned to spend $60,000 on advertising and coupons in the first few months following the remodel. Coupons have an additional impact on food costs because the couponed items will have higher than normal volume. To sustain the increase in sales, they needed repeat customers, which meant that they needed to consider carefully any upgrades to the standard plan.

Hassan knew that he had to be watchful of the cost structure. The fast food restaurant business has low margins and a slight change in costs can have a major impact on cash flow and profits. Typically, food costs range from about 25%-28% of sales, while cooking oil and condiments cost 3%-4%. Labor costs vary from 25% to over 30%, not including management. More labor-intensive stores such as McDonald's that are inside Walmart stores face a hurdle of a higher cost structure, and thus, are less likely to be re-imaged or have the space for the new food items. The Canyon store had labor costs that were closer to 30%. Hassan had hoped that the remodel would lower employee turnover, and thus, labor costs. Turnover is an invisible cost that drains cash flow because each new employee lower productivity for the first one to two months.

Hassan knew that the remodeled store had to appeal to the university community. Like many university towns, Canyon has numerous fast food restaurants, but the Canyon McDonald's is directly across the street from one of the main entrances. Students, staff, and faculty driving to campus can easily swing through the drive through before parking. Additionally, the store is close to several classroom buildings, making it an easy option for meals between classes. While the dormitories are located across campus and dorm students must buy a meal plan, the dormitories are not located near any restaurants forcing dorm students to drive if they want to go to a restaurant.

Hassan considered adding a second drive-through line and cameras to the drive-through lines. The additional drive-through line would allow for more traffic and faster service, while the camera reduces errors. The camera takes a picture of the car and places it on top of the menu order. Thus, as the employee hands the food out the window, he/she can verify that the blue car and not the red car had ordered the nuggets. Hassan knew he needed to make a decision on the drive-through lanes before construction started. He had learned from prior remodels to pave the parking lot first to decrease the amount of dust, which keeps the kitchen equipment cleaner.

As a university town, the store had a predictable sales pattern that matched the times the university was in session and even times during the day when classes met. There were bumps from when the high school day ended, and even patterns associated with high school and college athletic events.

While burgers and fries are the main products of McDonald's, breakfast has become a major profit area, especially drive-through breakfast items from the dollar menu. Coffee, smoothies, and other premium drinks have higher profit margins in terms of their variable cost, but the drinks require dedicated space to store ingredients and to produce the drinks on demand (Brush, 2011). Furthermore, the space must be near the drive-through window and the counter to increase efficiency and to allow for nuances to the coffee orders such as low fat versus skim milk and whether one wants whipped cream or not.

Hassan knew he needed to increase storage space in order to offer all the new menu items and to accommodate the increase in volume post remodel, especially during high-traffic times. Canyon does not have a Starbucks, but there are competitor coffee shops inside the student union and a book/entertainment store. The student union coffee shop had limited hours and was not open in the evening or weekends. The music/video store coffee shop had limited seating space but a drive-through. There is a large senior crowd in Canyon that goes for coffee during the morning. Hassan knew he needed to upgrade the icemaker for the smoothies and frappes, which had become big sellers at other stores, and to compete with the other coffee shops.

Hassan considered free WiFi. While not a huge impact in Canyon, Hassan worried that he might lose customers if he did not offer WiFi. McDonald's had been four or five years behind the competition on WiFi because of security concerns, and thus, liability and brand impacts.

McDonald's did not want an incidence of a customer committing an Internet crime while in one of the restaurants. WiFi did fit with the new coffee menu. The college and high school students seemed to want it. If there was a play area, parents could bring children and do a little work while the kids played. The morning senior crowd also indicated that they liked the idea of free WiFi.

Hassan considered the décor with input from his son, Osman. Instead of going with the standard colors, the Danas could create a cushioned sitting area for WiFi users along with fiberglass etching of local sites and an upgraded stone floor. The look would be more modern and unique to that particular restaurant.

The general contractor estimated that the additional drive-through lane, cameras, storage space, icemaker, décor upgrades, and WiFi would cost $14,000.

One upgrade Hassan considered adding is a play place for children. It is unusual to add a play place near a university, because play places are for children under age nine. However, there are many families in Canyon, and the school district is growing. McDonald's advised against the upgrade. The play place would cost $200,000 extra and would have to be smaller than normal because of the size of the lot. The immediate return would not be there, but it would allow for growth. The $200,000 expense is somewhat tempered by the observation that adding a play place a few years after the initial remodel is cost prohibitive, with an estimated price tag of an extra $600,000. None of the restaurants in Canyon has a play place. Families take their children to Amarillo for play dates and birthday parties. A play place in the McDonald's would create an option for families in Canyon.

MAKING THE DECISIONS

Hassan was vying with the operator who owned three stores in the northern Panhandle for the opportunity to build a new store in northern Amarillo, a growing section of the city. Because McDonald's pushes franchise owners to re-image or remodel when a building becomes dated, Hassan knew he needed to make the decisions on financing and upgrades, especially if he wanted to get the new store in a high-growth area of Amarillo.

CASE QUESTIONS

1. Which of the three financing options should Hassan Dana choose?
2. Which upgrades should Hassan Dana choose? Is adding the play place a good decision?
3. Is McDonald's push into the specialty coffee and smoothie area wise?
4. What role does employee turnover play in the decision to remodel?
5. How did the Federal Reserve affect the decision on financing the remodel?
6. Why is it important that all franchisees have access to the same pricing in terms of financing, insurance, and distribution?
7. Are there an optimal number of stores for a franchisee to own?

CASE QUESTIONS AND ANALYSES

1. Which of the three financing options should the Danas choose?

Without the upgrades, the cost is $1,800,000. The Danas already had income from the other eleven stores and was a large enough operator to withstand no cash flow from the store for three months. Hassan indicated that they have enough short-term depreciation for their taxes and thus, prefer long-term depreciable items. The current annual sales are $2,000,000 or $166,667 per month.

Loan
A 3.75% loan for seven years on the three options results in the following monthly payments.
- 50/50 split: $900,000 loan results in a monthly payment of $12,199
- 2/3 – 1/3 split: $600,000 loan results in a monthly payment of $8,133
- Owner-pays-all: $1,800,000 loan results in a monthly payment of 24,398

Option 1: 50/50 split
The payment of $12,199 is 7.32% of currently monthly sales. The 7.32% is after paying McDonald's the 8.5% sales fee. The Danas get to keep 91.5%. Thus, sales need to increase by 8% to pay both the sales fee and the loan payment.
- $12,199/$166,667 = 7.32%
- 0.0732/0.915 = 0.08 = 8%

Option 2: 2/3 – 1/3 split
The payment of $8,133 is 4.9% of currently monthly sales. The 4.9% is after paying McDonald's the 9.5% sales fee, the original 8.5%, plus an additional 1%. The Danas get to keep 90.5%. Thus, sales need to increase by 5.41% to pay both the sales fee and the loan payment.
- $8,133/$166,667= 4.9%
- 0.049/0.905= 0.0541 = 5.41%

Option 3: Owner-pays-all
The payment for the owner pays all option is 14.64% of currently monthly sales. The 14.64% is after paying McDonald's the 4.25% sales fee. The Danas get to keep 95.75% of sales. Thus, sales need to increase 15.29% to pay both the sales fee and the loan payment.
- $24,398/$166,667= 14.64%%
- 0.1464/0.9575= 0.1529 = 15.29%

If sales increase by more than 15.29%, the owner-pays-all option is the best option because the Danas pay the lowest sales fee and owns the building. By owning the building, the Danas also have all the long-term depreciable items. McDonald's expects sales to increase by at least 30% following a remodel. Thus, the remodeled store should meet the 15.29% threshold.

Because the expected increase in sales is greater than the 15% threshold, one could wonder under what circumstances would an owner choose to have McDonald's pay part of the cost. The Danas are different from some other franchisees in that they have other restaurants that provide cash flow during the down months and to fund the remodel. Additionally, the low interest rates make the cost of the larger loan very affordable. The 50/50 and 2/3-1/3 options are appealing for those franchisees that are not able to afford the higher payment and who are not confident on how much sales will increase following a remodel.

2. Which upgrades should Hassan Dana choose? Is adding the play place a good decision?

There are two decisions concerning upgrades. For $14,000, Hassan can add a second drive-through, cameras at the drive-though, increased storage space, icemaker, WiFi, and upgraded décor. Because the total of $14,000 is so small, less than 1% of annual sales, Hassan should clearly choose to do these upgrades.

The play place is not as obvious of a decision. Clearly, $200,000 in the rebuild is substantially less than $600,000 in a later remodel. Thus, Hassan needs to decide whether he thinks the city of Canyon will continue to grow as a city and with the growth, the number of families with children. In addition, more and more college students are nontraditional, meaning that they are older and may have children.

Numerically, the question is two-fold. Will sales increase enough to offset the cost of a play place? Is it better to build the play place in the rebuild for $200,000 or wait for a larger population and spend $600,000 in a remodel?

The $200,000 cost adds 11.1% to the cost of the remodel. The $200,000 cost is 10% of current sales. If Hassan expects sales to increase by 30% and sales increase instead by 40%, the play place will pay for itself in the first year. While we do not know what percent the play place will increase sales, it is unlikely that sales will decrease because of the play place.

- $2,000,000 in sales * 30% increase = $600,000 additional sales
- $2,000,000 in sales * 40% increase = $800,000 additional sales
- The $200,000 increase in sales offsets the $200,000 cost of the play place

An additional point is that at a low interest rate of 3.75% over seven years, the cost of the $200,000 play place is just $2,711 per month. The old sales of $2,000,000 correspond to $166,667 per month. As long as sales rise more than 2% per month because of the play place, it pays for itself. If the average parent-child user of the play place spends just $10, the store needs nine more visits per day to generate the $2,711 payment. Obviously, any average amount greater than $10 reduces the number of new daily visits needed.

- $2,711/$166,667 = 1.63%

3. Is McDonald's push into the specialty coffee and smoothie area wise?

McDonald's reputation is for burgers and fries along with Happy Meals and the dollar menu. The dollar menu works on volume. A buyer of the dollar burger may buy fries and a soda. The margin is higher on fries and soda. Thus, a customer who buys a burger, fries, and a soda is more profitable than a customer who buys just five dollar-menu burgers is.

Premium coffees and smoothies have higher margins; however, they require more equipment, storage, inventory, and more space in the kitchen. Even though the margins are higher on the drinks, volume is still important because of the increased fixed cost to produce the drinks.

It is unlikely that McDonald's can compete for the loyal Starbuck's customer. However, the café-style décor along with free WiFi fits with the Gen Y generation, which is constantly online and has a penchant for coffees and smoothies over sodas.

For the Canyon store, there is no strong competition from a national coffee chain. McDonald's offers a price-conscience student a viable alternative from buying coffee in Amarillo while on the way to Canyon for classes. Additionally, the premium drink prices are low enough to maybe convince some customers to buy a smoothie over a soda.

4. What role does employee turnover play in the decision to remodel?

Hassan Dana says that new employees are not productive for the first one to two months as the employee is learning the process. Additionally, new employees are more likely to make mistakes, which costs the store explicitly in slower service and wasted product and implicitly in upset customers and tarnished reputation. Employees prefer newer, cleaner stores, especially if it allows the employees to be more efficient.

For the Canyon store, employees tired of going outside to the freezer or having to constantly go downstairs for replacement product. Customers expect fast service and the time wasted obtaining product frustrated employees.

Employee turnover affects not just the productivity of that employee but all of the employees working the shift. A seasoned employee must train the new employee, cover for mistakes, and help with customers, all things that lower the seasoned employee's productivity.

Numerically, turnover can be calculated by a detailed study of employee costs per unit of output. Since we do not have this information, we can only estimate a cost. At a minimum wage of $7.25, a forty-hour week costs $290, or $1,160 per month. The $1,160 is an underestimate of the cost because it only looks at the wage of the unproductive employee and ignores the effect on other employees, of incorrect orders, and of upset customers.

The $1,160 is 4.75% of the loan payment $24,398. Thus, if the remodel would reduce turnover, each full-time employee kept is worth more than 4.75% of the monthly payment. If we consider just a customer that spends $10, as we did with the play place, the $1,160 is worth 116 customers.

Clearly, any decrease in employee turnover is a benefit of the remodel, even if one is not able to easily calculate the numerical benefit.

5. How did the Federal Reserve affect the decision on financing the remodel?

At the incredibility low interest rate of 3.75%, it made sense to finance the remodel without any of McDonald's help. The Federal Reserve lowered rates in response to the 2008-09 recession. McDonald's is a defensive firm, which is able to survive recessionary conditions. Operators who have the cash to withstand no income from a store and have the ability to borrow are able to get very favorable loan conditions. The 3.75% interest rate makes the remodel inexpensive compared to historical rates.

The Federal Reserve policy of low interest rates makes the decision to add a play place much easier. For those firms who are able to borrow during a recession upgrades and additions become more affordable than during normal interest rate environments.

6. Why is it important that all franchisees have access to the same pricing in terms of financing, insurance, and distribution?

By buying financing, insurance, and distribution costs in bulk, McDonald's negotiates reduced prices due to the volume, which it passes to the franchisees. The common costs create a basis for a franchise-wide cost structure. Labor and food costs still differ across the country, but small price variations can make-up those differences.

Common costs allow for similar profitability of stores across the country. This process helps small franchisees and franchisees in high-cost areas that would not be able to negotiate such discounts. Additionally, the level profitability does not give a franchisee in a particular geographic region an advantage over another franchisee, which helps to reduce jealousy between franchisees. The common profitability also encourages franchisees to expand into new, more isolated areas because the owners know that their income will not suffer.

7. Are there an optimal number of stores for a franchisee to own?

McDonald’s wants it franchisees to be large enough to maintain the brand. Franchisees with just a few stores present a danger to McDonald’s because they may not have enough cash flow to maintain the stores, let alone upgrade the stores. Older operators with a few stores, especially those near retirement, are not interested in remodeling. They know they will sell soon and are just looking to take as much cash flow as possible before selling.

McDonald's wants to consolidate the number of franchisees. A few, larger franchisees have the cash flow from other stores to remodel or build new stores. Franchisees with just a few stores do not have the size to maintain the brand by remodeling or rebuilding. Historically, a small franchisee owned one to three stores. Today, a small operator owns six to seven stores. This shows McDonald's is a mature franchise because it is no longer trying to sell franchises to expand. Instead, it wants to pick and support the franchisees that will strengthen the brand.

EPILOGUE

Hassan Dana chose the option of paying for the entire rebuild. The low interest rates combined with the cash flow from the other stores allowed him to fund the rebuild. He also chose to add the play place, not because it would pay for itself immediately, but for the growth potential. These decisions required modifying the standard building model, and the Canyon store became the first one to use Model 38101, which other operators have used now.

The remodel was finished August 14, 2009, in only 86 days, 4 days less than planned. The sales increase after remodel was closer to the 50%. The store did more business in the 16 days it was open in August 2009 versus all of August 2008. The first few months also had record increases.

McDonald’s was pleased with the Canyon and other Amarillo stores success. The Danas bought the small operator that had stores in Dumas and Dalhart and built the new store in northern Amarillo. The Danas’ many stores had such good cash flow that they funded the next remodel entirely, requiring no loan. In 2011, the Danas remodeled the Dumas store and following the success in Canyon, added a play place. By 2011, the Dana Family owned and operated 18 McDonald’s in the Amarillo region.

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