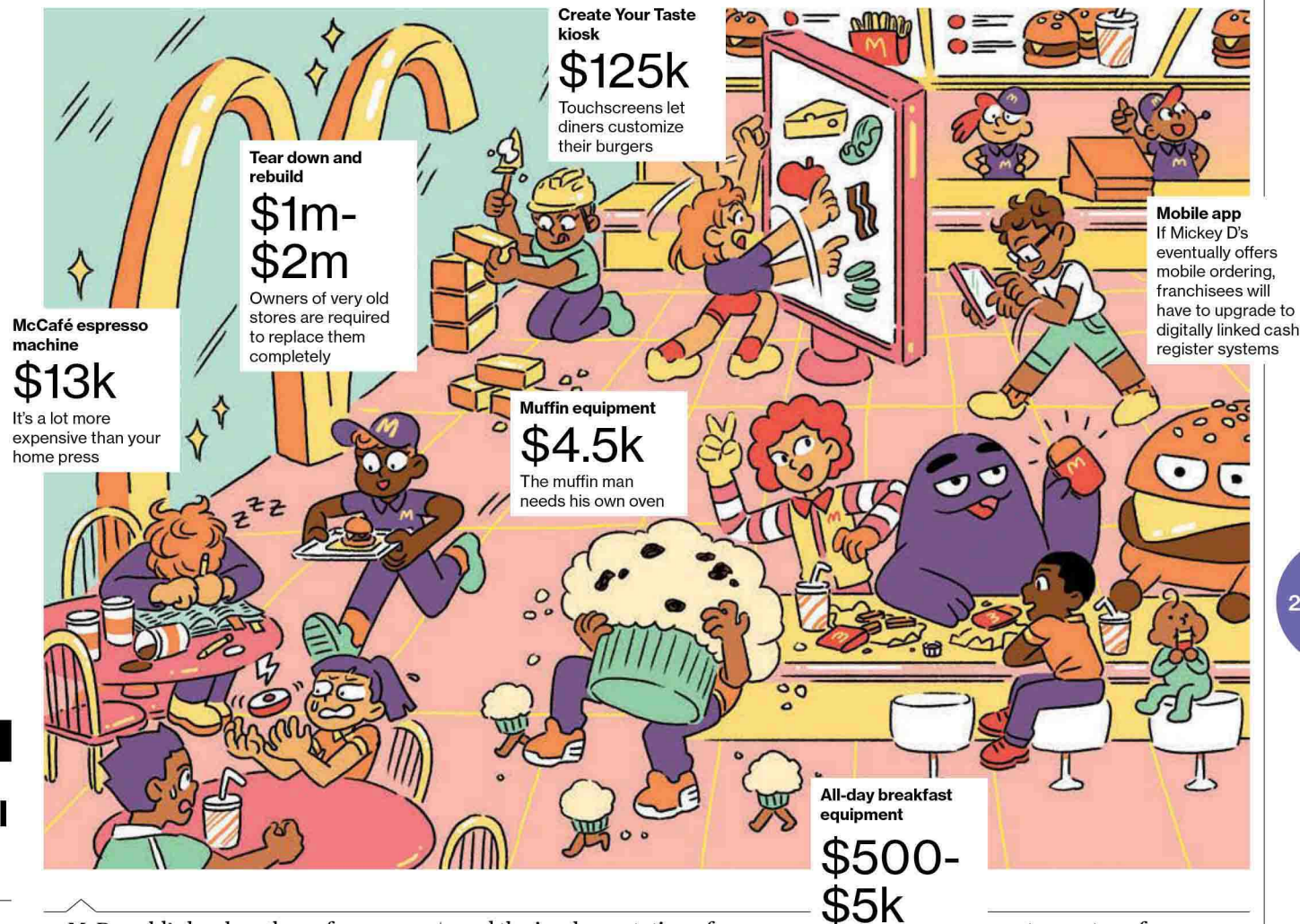


## Keeping Up With the McDonald's

Besides paying franchise and ad fees, store owners are required to make periodic upgrades to their buildings, equipment, and in-store technology. If they don't keep up, they risk not winning a 20-year renewal of their franchise. —Leslie Patton



### Restaurants

## It's Tough Being a Small Fry at McDonald's

► **Costly upgrades require larger franchisees with deeper pockets**

► **"They're encouraging the smaller franchisees to sell out"**

After more than three decades of operating **McDonald's** restaurants, Ted Lezotte in 2015 sold the last of his six stores in Michigan. Lezotte says looming costly remodeling—one rebuild was estimated at \$1.9 million—helped spur his decision. "In today's financial world, it's becoming necessary to have more than a couple [of stores] to survive," he says. The chain is looking for franchisees who have 8 to 10 locations, he says: "Ten kind of gives you a good footing" in case one isn't doing so well. Of his six stores, one was closed, the rest sold to larger McDonald's operators.

McDonald's has long been famous for its small-owner-focused franchise system, in which entrepreneurs with only a store or two would sweat the details of their restaurants, yielding better customer service. Lately, however, the fast-food giant has begun shedding mom and pop owners in favor of bigger operators. Since 2014 the number of U.S. McDonald's franchise owners has dropped 2.6 percent, while the number of franchised locations has grown 1.2 percent, according to data compiled by researcher FranchiseGrade.com. The chain's biggest franchisees are getting larger, while those who own five locations or fewer are on the wane.

Getting rid of smaller franchisees allows McDonald's to speed renovations

and the implementation of new technology, such as the self-ordering touchscreens being tested in about 250 locations. Such gear can be expensive, and smaller franchisees often don't have the capital to pay up—making them less willing to embrace the company's plans.

"They're encouraging the smaller franchisees to sell out," says Rob Hunziker, owner of Advanced Restaurant Sales, a restaurant brokerage. "When you have thousands of franchisees that you need to keep monitored or updated, it's just difficult and expensive for the parent company." He says the chain has increasingly pushed the shift in the past 12 months.

There are about 1,842 domestic McDonald's franchisees who own five

restaurants or fewer, compared with 1,930 in 2014, a 4.6 percent drop, the FranchiseGrade.com data

show. There's been about a 12 percent jump, however, in the number of those operating more than 10 stores: 245 now, vs. 218 in 2014. McDonald's spokeswoman Becca Hary says that stores often end up in the hands of larger operators when smaller ones sell out, but both big and small operators are among its best franchisees.

In April, Chief Executive Officer Steve Easterbrook said the company is consolidating its restaurants to fewer operators in the U.S., where franchisees own five to seven locations on average. "Does that give us fewer, stronger operators and a stronger balance sheet

◀ and their ability to invest in scale?" he asks. "It could."

Burger King, Wendy's, Subway, and Pizza Hut all have franchisees that own hundreds of locations. But the largest McDonald's owner in the U.S., **Century Management** in Memphis, has 69 locations, according to Restaurant Finance Monitor. The nine biggest McDonald's franchisees, on average, own 40 stores, according to RFM. By contrast, **Carrols Restaurant Group**, the largest Burger King franchisee, has about 727 in the U.S. **NPC International** operates more than 1,240 Pizza Huts.

Such scale is preferable for many franchising companies, says Jeff Lefler, CEO of FranchiseGrade.com. "You manage one company vs. multiple companies, multiple views," Lefler says. "It's more of a business relationship."

Decades ago, McDonald's franchised single locations, whereas other chains sold off entire regions to one operator. "The incentive to the McDonald's franchisee was to run a great store, because that will help you get another store," says Mark Kalinowski, an analyst at Nomura Securities. Now, as the U.S. nears saturation, with more than 14,000 McDonald's restaurants, the chain is trying to draw more sales out of each store and closing underperforming locations. "How do you get more stores in the hands of your better operators?" Kalinowski asks. "What they're doing today is to achieve that." —Leslie Patton

**The bottom line** McDonald's, becoming more like its rivals, is reducing the number of mom and pop franchisees of its restaurants.