



UNITED NATIONS  
DEPARTMENT OF ECONOMIC AND SOCIAL AFFAIRS  
STATISTICS DIVISION

IG/11  
24 June 2008

## **Seminar**

### **Addressing Information Gaps in Business and Macro-Economic Accounts to Better Explain Economic Performance**

**New York, 23 – 24 June 2008**  
United Nations, Conference room C

**Accounting for franchises and other marketing investments**  
**Kevin Ozan**



United Nations  
Statistics Division Seminar  
June 24, 2008

# Accounting for Franchises and Other Marketing Investments

**Kevin Ozan**  
Senior Vice President  
Corporate Controller



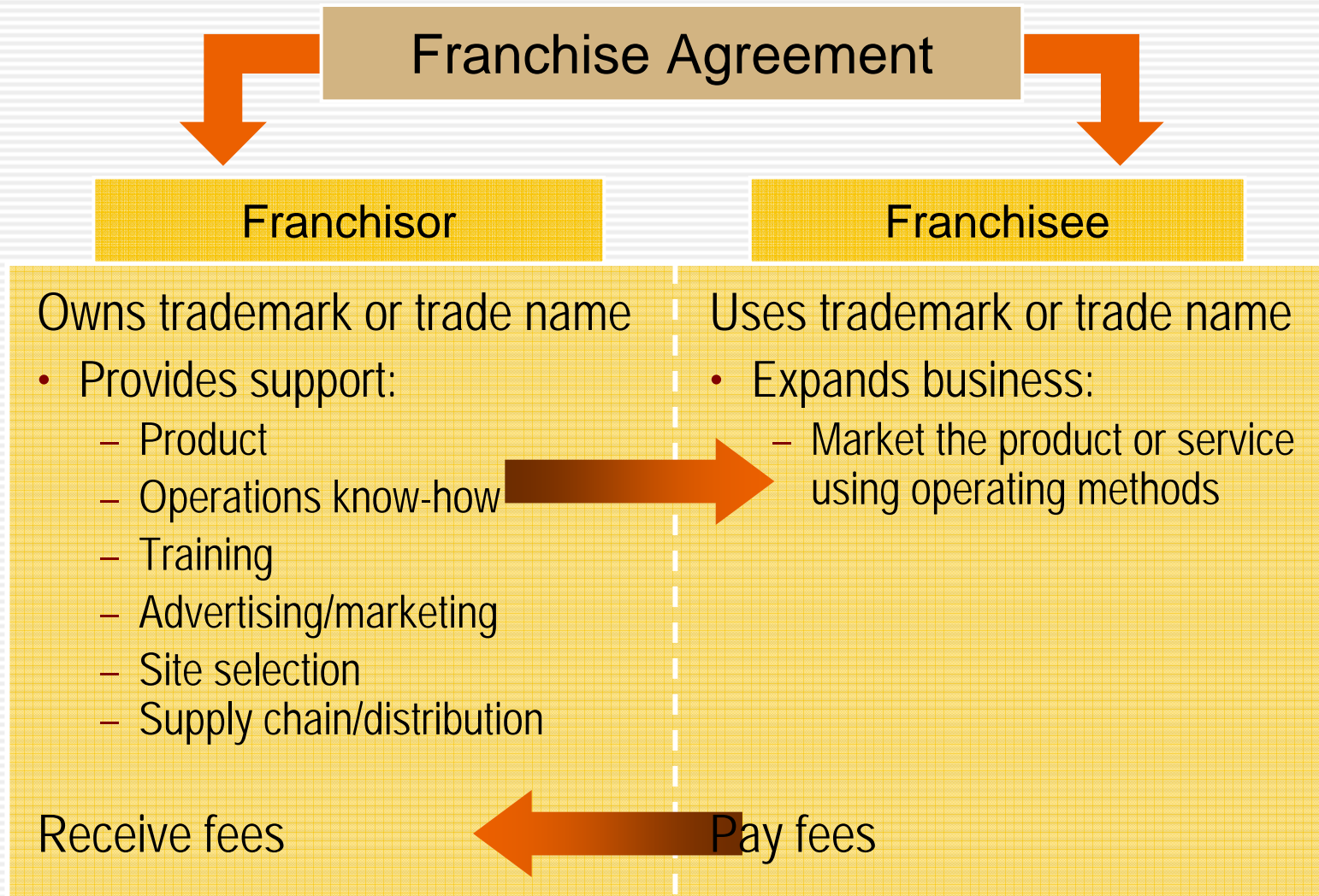
# Agenda

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- What are franchises?
- Background on McDonald's
- McDonald's franchise model
- Impact on financial statements
- Marketing investments



# What Is a Franchise?



# Two Main Types of Franchises

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Product  
Distribution



Business  
Format



# Types of Franchise Arrangements

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- Single-unit Franchise
- Multi-unit Franchise
  - Area Development Franchise
  - Master Franchise



# Advantages of Owning a Franchise

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- In business for yourself, but not by yourself
- Certain level of independence
- Established product/service with widespread brand-name recognition
- Increased chance of success
- Standards for quality and consistency
- Pre-opening and ongoing support





# Disadvantages of Owning a Franchise

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- Ongoing fees
- Attempt to balance standards of Franchisor with ability to manage business independently
- Potential negative publicity
- Term of franchise agreement is usually limited and may not be renewed



# What Types of Companies Franchise?

- Over 75 industries worldwide:

- Restaurants

- McDonald's
- Pizza Hut



- Retail

- Radio Shack



**RadioShack.**

- Lodging

- Marriott Hotels



- Business Services/Real Estate

- H&R Block
- Century 21



- Automotive Services

- Midas International



**H&R BLOCK®**



# Benefits to Company

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- More stable, reliable cash flow stream
- Lower risk
- Lower capital expenditure requirements
- Better returns



# Benefits to Customers

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- Business run by a local entrepreneur
- Better connection with local community
- A more efficiently run organization



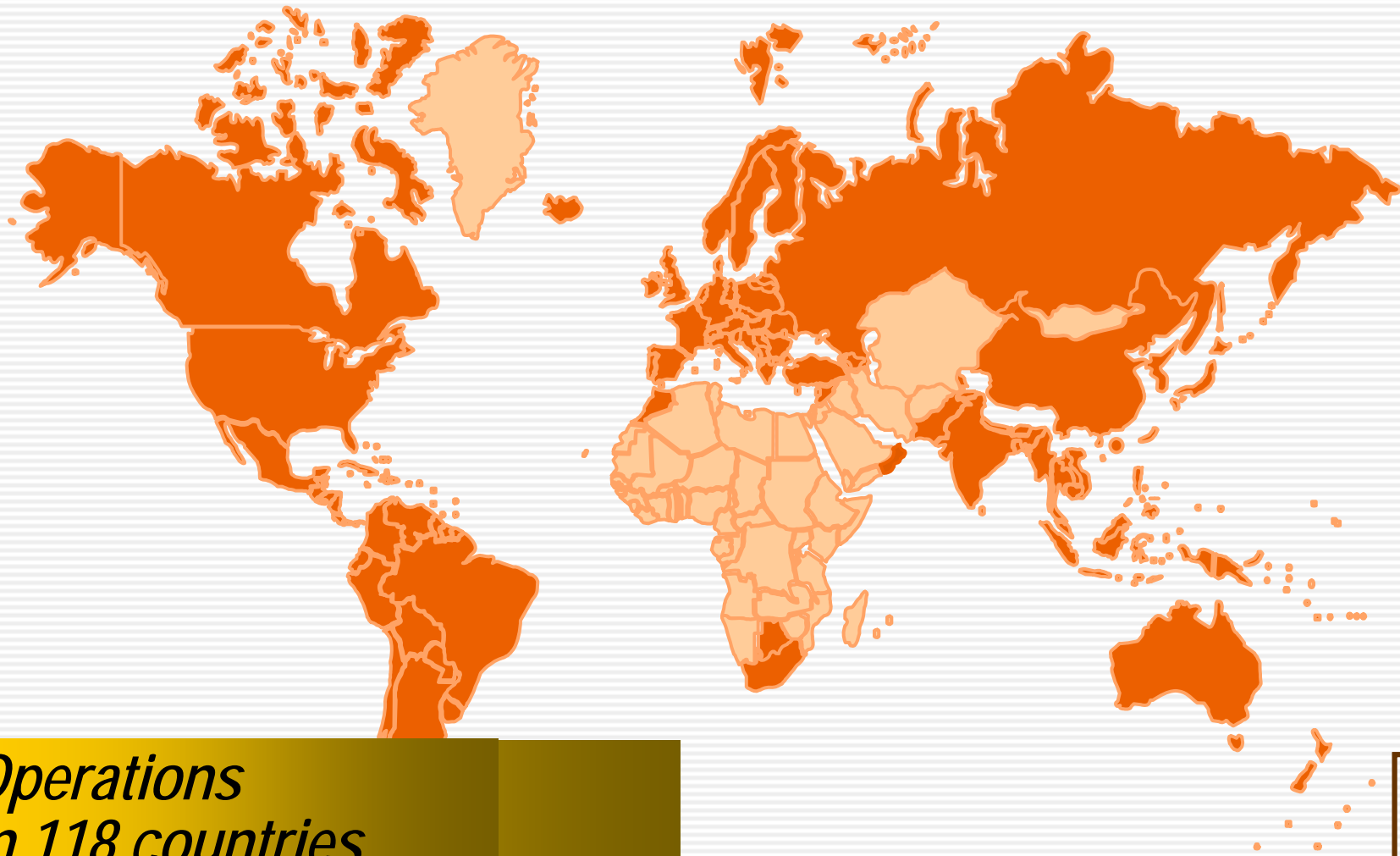
# Economic Impact of Franchised Businesses

- Direct contribution to the US economy\*
  - Jobs – Provide more than 11 million jobs or 8%
  - Payroll – Over \$275 billion annually or 5%
  - Output – Produce goods and services worth over \$875 billion per year or 4%
  - Establishments – Approximately 900,000 businesses are part of the franchise system

\* All percentages above are based on the US private-sector workforce



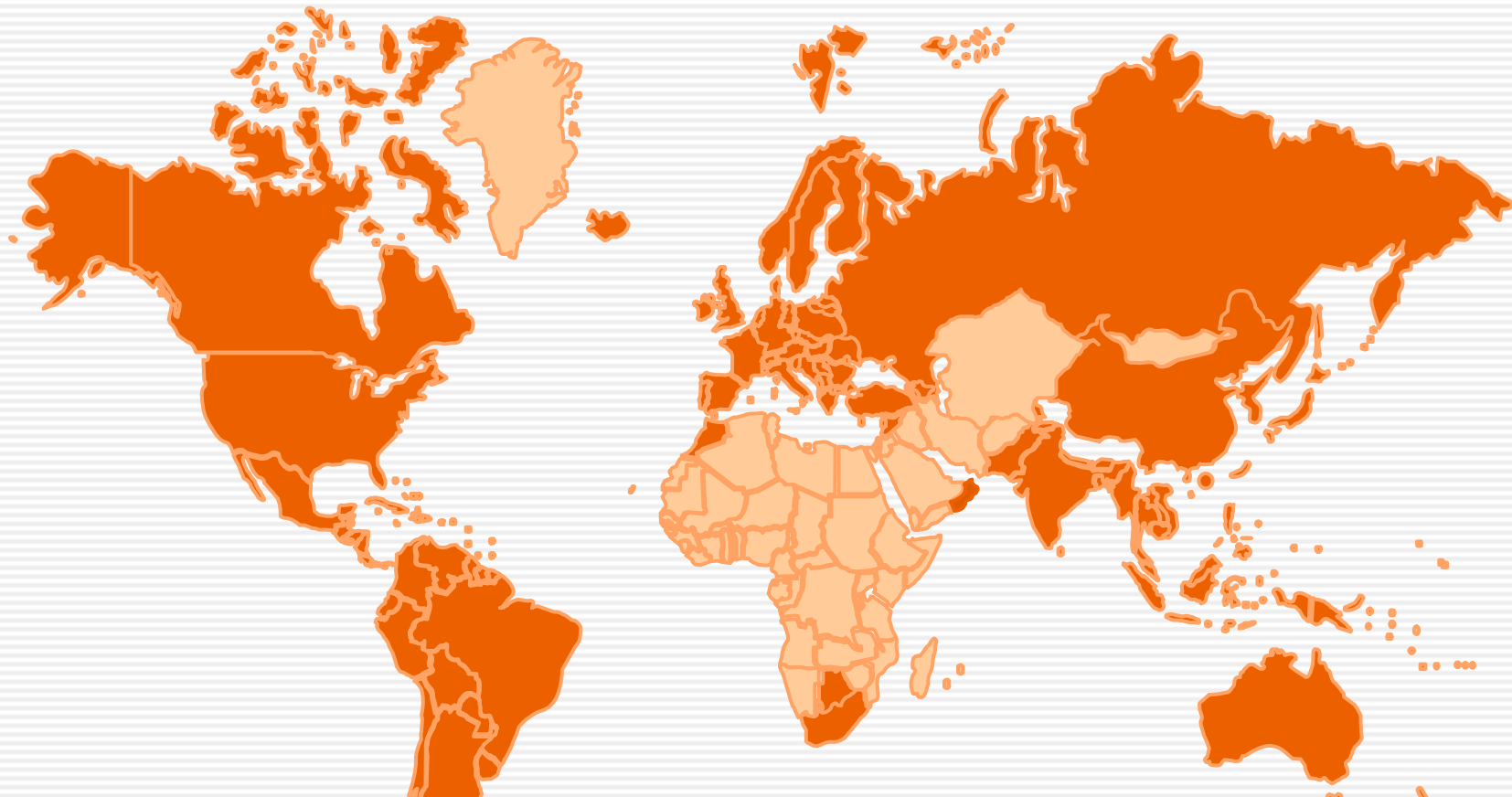
# McDonald's Corporation Global Structure, Local Restaurants



*Operations  
in 118 countries*



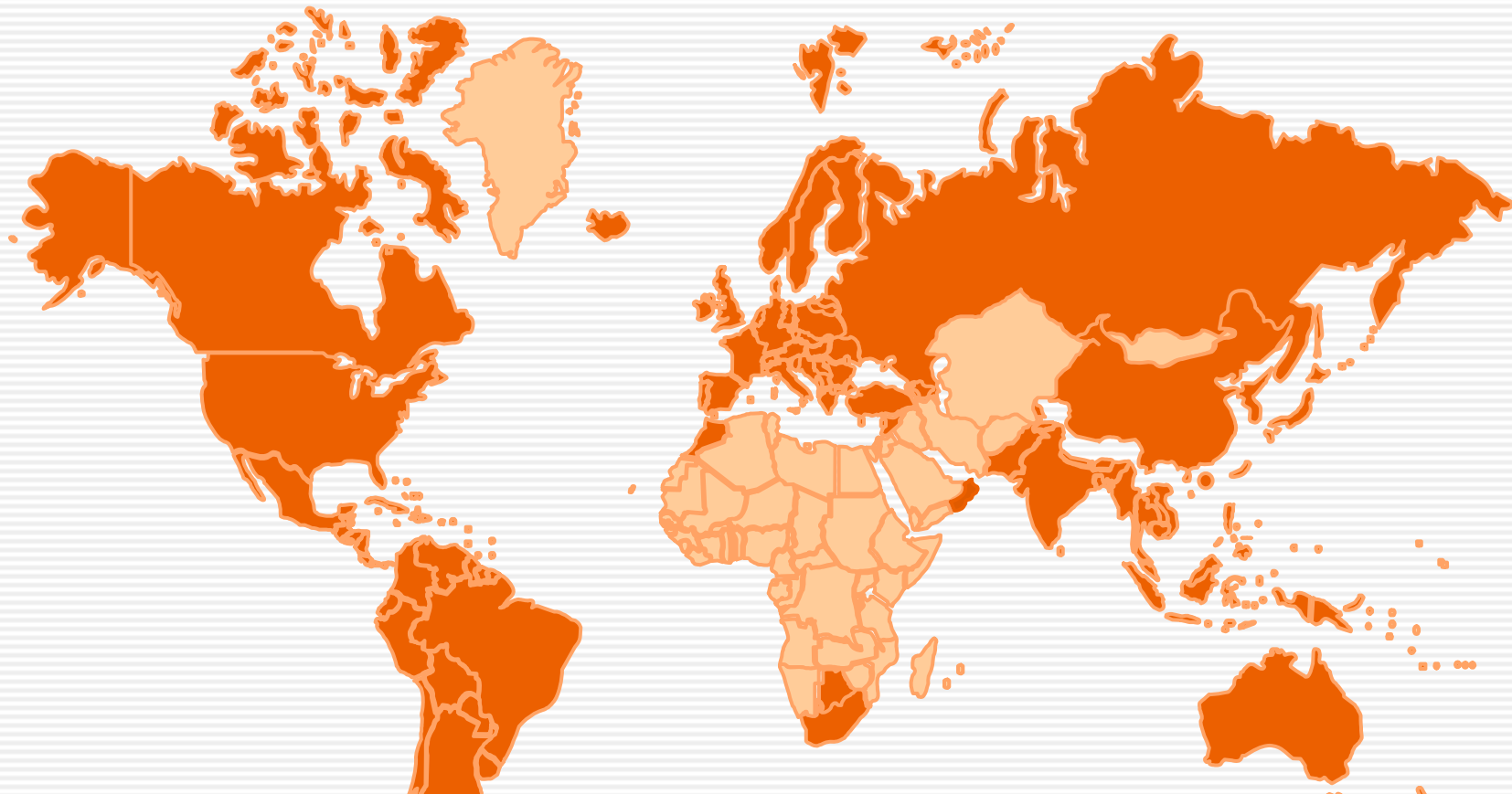
# McDonald's Corporation Global Structure, Local Restaurants



*Over 31,000 restaurants – more than 75%  
owned/operated by local franchisees*



# McDonald's Corporation Global Structure, Local Restaurants

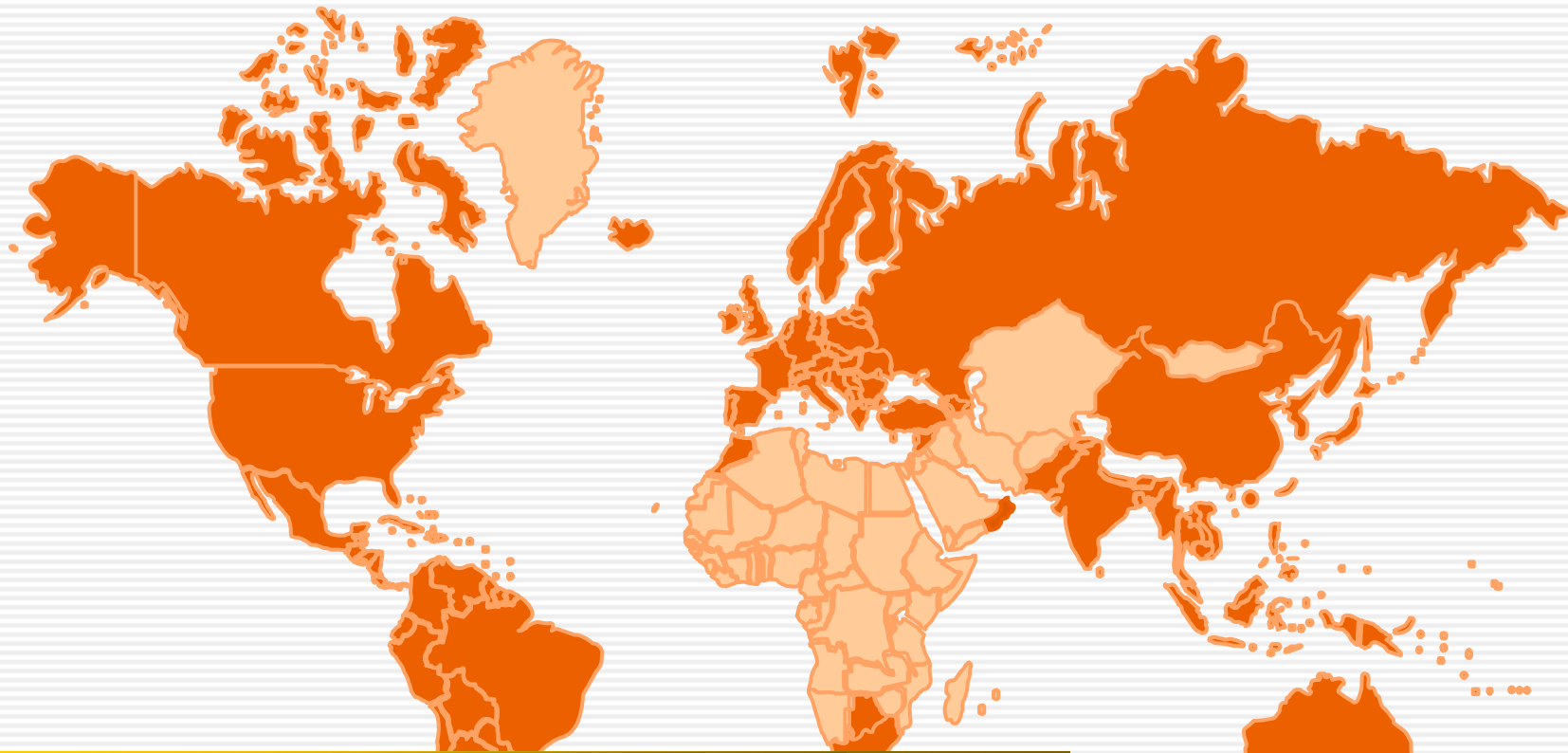


*McDonald's serves 55 million  
people worldwide EVERYDAY*





# McDonald's Corporation Global Structure, Local Restaurants



*Together with franchisees,  
McDonald's employs  
more than 1.5 million people*



# Multi-national Brand with Multi-local Operations

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- Collection of 4,000+ independent entrepreneurs who operate restaurants in their local markets
- The Franchisees' and McDonald's interests are interdependent
  - One party cannot succeed without the other party succeeding
  - Dependent on restaurant sales and business growth



# McDonald's Franchise Model

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- Franchisee
  - Assumes risks and rewards of owning and operating a McDonald's franchise
  - Earns a return on investment through operating profits
- McDonald's
  - Assumes risk of owning or leasing land and building
  - Covers costs and earns a return on investment through rent, royalties and initial fees



# Initial Investment / Responsibility

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- Franchisee

- Initial franchise fee
- Signs, seating/décor, and equipment
- Pre-opening costs (training, advertising, etc.)

- McDonald's

- Site selection
- Land acquisition or long-term lease obligation
- Site development and building construction
- Operational training and consultation



# Ongoing Investment/Responsibility

## • Franchisee

- Full-time best efforts
- Adhere to operating business model
- Training
- Reinvestment (building and equipment) to comply with standards
- Advertising contribution
- Rent and royalties
- Maintain financial stability

## • McDonald's

- Operational training and consulting
- Product and operations development
- Marketing and advertising support
- Supply chain management
- Protect proprietary rights (trademarks, logos, etc.)
- Architectural design and drawings



# McDonald's Profitability

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- Revenues from Franchisee
  - Initial (franchise) fee
  - Royalty fee – generally 4%–5% of sales
  - Rent income to McDonald's (base and percentage rent)
- Franchised restaurant expenses
  - Rent expense paid by McDonald's to landlords
  - Depreciation on buildings and leasehold improvements



# McDonald's Income Statement

(\$'s in millions)

	<u>2007</u>	
<b>Revenues</b>		
Sales by Company-operated Restaurants	\$ 16,611	
Revenues from Franchised/affiliated Restaurants	6,176	
<b>Total Revenues</b>	<b>\$ 22,787</b>	
<b>Operating Costs and Expenses</b>		
Company-operated Restaurants	\$ 13,742	
Franchised Restaurants	1,140	
G & A	2,367	
Impairment and Other Charges	1,670	
Other Operating Income	(11)	
<b>Total Operating Costs and Expenses</b>	<b>\$ 18,908</b>	
<b>Operating Income</b>	<b>\$ 3,879</b>	
<b>Company-operated Margin</b>	<b>\$ 2,869</b>	<b>17.3%</b>
<b>Franchised Margin</b>	<b>\$ 5,036</b>	<b>81.5%</b>



# Franchisee Profitability

Sales  
*less*

- Food and paper
- Labor costs
- Other operating costs (advertising, outside services, etc.)
- Rent and royalties to McDonald's

RESTAURANT CASH FLOW\*

\* Excludes debt service and selling, general & administrative expenses





# Positive Impact on Local Economies

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- Supply chain – majority locally sourced
- Employment opportunities
- Source of tax revenue
  - Social taxes
  - Sales taxes
  - Income taxes
  - Real estate/personal property taxes
- Giving back to the community
  - Over \$75 million for RMHC and other charities



# Advertising Co-ops

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- Co-ops are independent entities supported by Franchisee and Company-operated Restaurants
- Franchisees are required to spend at least 4% of restaurant sales to advertise and promote the business
  - Majority funds local/national advertising cooperatives
- McDonald's develops overall strategy for programs for the McDonald's System



# Franchising Rewards for All Parties

- Franchisees

- Cash flow
- Equity created
- Acceptable return on investment
- Growth/expansion opportunities
- Independent business owner

- McDonald's

- Growth in income
- Acceptable return on investment
- Increase in market value of stock

- Local Economy

- Employment
- Products and services sourced locally
- Source of tax revenue
- Giving back to the community



