



Franchising in China

Offering Dreams One BMT at a Time

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# Today's Presentation

- 1. Our Company & Subway**
- 2. Franchising in China**
- 3. Franchising as a Path to Growth**
- 4. Our Development Strategy**
- 5. Our Franchising Strategy**
- 6. Discussion**



# Subway & CSR – Our Structure

- **Who we are.**

- Cathay Sub Restaurants (CSR) is a foreign run restaurant operator based in China.
- Offshore BVI holding entity. Established in 2006.
- Privately held by small investor group (including management). Many investors from the US.

- **What we do.**

- We operate the best Subway stores in China.
- Management, systems and training define our path to excellence.

- **Our strategy.**

- For Subway, our initial areas of operations are Shanghai and the Jiangsu province.
- We have added additional synergistic small footprint franchise restaurant brands to our portfolio.





# Franchising in China

- **Franchise systems in operation have grown exponentially.**
  - 410 in 2000 (according to CCFA)
  - 3,200 in 2008 – making China the world’s largest such market.
- **Abundance of extremely wealthy people**
  - PRC-nationals looking for ways to invest their savings
- **Numerous people with genuine interest in entrepreneurship**
  - Numerous franchise fairs organized to attract investment
- **Many local brands have taken to franchising**
  - Local Brands will typically be more familiar to PRC-Nationals than many well-known int’l brands.
    - Initial interest in local brands may be greater than foreign.
  - Operating and support systems will be lacking compared with large international brands.
- **Global brands (all industries) are entering by the handfuls**



# Franchising Challenges

- **Sourcing Qualified Candidates**
  - Absence of the franchising business concept
  - Credit vetting still quite difficult
- **Maintaining Brand Standards**
  - Approved Equipment and Food Products
  - Keeping Subway, Subway
- **Locations Sourcing**
  - Increased number of sites required
  - Site Reviews more common
- **Lack of Effective Legal Structure**
  - Often the legal process can take years to get un-compliant franchisees out of the system.



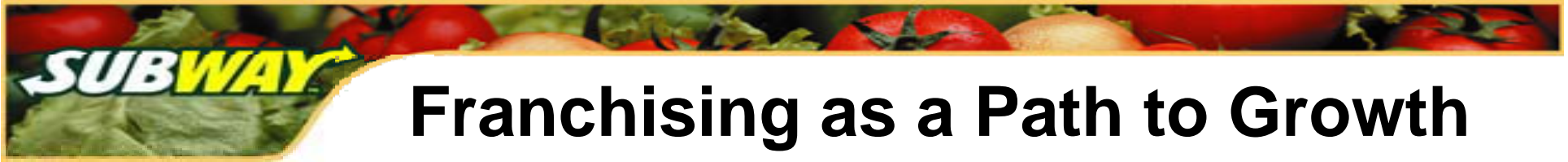
# Case Studies

## International:

- **Papa John's**
  - Built 20+ company-owned stores. Moved to franchising for development.
- **Super 8 Hotels**
  - Large balance sheet required. Franchisee focused initial strategy.
- **KFC**
  - Legacy franchisees are being squeezed out. It just gets better for Sam.
- **McDonalds**
  - Recently commenced limited franchising. High quality candidates owing to excellent unit economics and brand equity. Reverse of US franchisee squeeze.

## Domestic:

- **Malan Noodles**
  - Local brand with large store numbers, but very weak systems
- **SPR Coffee**
  - Qingdao-based. Strong Beijing ops. Appears to be taking a quality hit. Limited future?



# Franchising as a Path to Growth

**Opportunity:** Quick way to low-cost revenue growth

- **Our Model: Company-owned stores will lead to greater franchisee interest and brand consistency.**
- **More stores, more advertisements for Brand**
  - More physical and word-of-mouth visibility for brand leveraging marketing fund.
- **Franchisees may have greater knowledge of more “local” neighborhoods**
  - Understand Commercial and Residential sub-districts
  - Become multi-unit owners in those areas
- **Some franchisees will be stars and also our best advertisements**
  - Franchisee selection criteria is stringent
  - Subway-China franchisee selection has been abysmal in past
- **Some will be dogs and be a drag to our mission**
  - Some will always make it through the process

**Obstacle:** Poor stores can damage the brand quickly



## Typical Franchisee of the Past

- **Based on experience in Beijing & Shanghai, typical franchisees:**
  - Single-Unit Owners
  - Absentee Owners (10-20%)
  - Lack of Exposure to Western Business Practices
  - Poor Corporate Citizens
  - Focus mainly on cost-control
  - Lack confidence in the brand (SFP the best example)
  - Equipment – refuse to comply with required equipment upgrades
  - Evaluations & controls – regarded by franchisees only as a whipping tool
- **Problems & Obstacles regarding Candidates in Shanghai:**
  - Not familiar with Subway
  - Interested in investing but not working in store (absentee)
  - Expect guaranteed success
  - They will interview existing franchisees
- **Given the Subway system for allocating locations, these characteristics can be problematic**
  - Frequent location disputes (site review process timely)
  - Unwillingness to learn new-business practices
  - Unwillingness to accept responsibility





# Franchisee Selection Criteria

**Opportunity:** There are candidates of superior quality in Shanghai.

***They are out there!***

- **Franchising Selection Criteria:**

- Professional experience at MNC's or overseas experiences which contribute understanding of expected service experience
- English capability
- Financial wherewithal and ambition to build at least three stores. Single stores do not allow franchisees to support themselves through Subway.
- They will be required to work in-store. No absentee owners.

**Obstacle:** Even the most presentable candidates can get through the system and become undesirable ones.



# Development Strategy

- **The development schedule is our key performance indicator as DA**
- **We have to catch our biggest in-territory competitor in 7 years**
  - This is KFC – about 200+ units in Shanghai
  - 142 in Jiangsu
  - Its an aggressive target that we will need to use franchising to achieve.
- **Franchising provides us with a low-cost growth alternative**
  - Our experience suggests building our own stores initially – with systems and structure – to lay out the model
  - The greater our initial own-store success, the easier it will later be to attract high quality franchisees.



- **Phase 1: Store Rollout:**

- Purchase the existing Shanghai stores.
- Rollout 26 *new* (CSR & franchisee) stores over the first 18 months.
- All AAA locations – high-end local and expatriate.
- Focus initially on downtown Puxi & Pudong – although not exclusively.

- **Build the Brand:**

- Operations: Speed of service, quality of service.
- Pricing/Positioning: Optimize supply chain –to allow access to more competitive price points.
- Promotion: Initially local store marketing only. Beyond that, larger scale marketing once the total store footprint is large enough, and done right enough.

- **Phase 2: Deeper Penetration**

- Once the brand is established, go into more local areas.
- This is where the longer term fast and large growth will be.





## Conclusion

- **Franchising & Subway.** Subway is a franchising driven organization. Strong corporate ethos to “sell, sell, sell”.
- **Franchising in China.** Has been difficult for many including Subway. However, there have been successes, for example, Papa John’s.
- **Franchising as a path to growth.** Executing our franchising strategy successfully, can provide a low-cost path to accelerated growth and help build the brand.



Questions?