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Elimination of Cost-sharing as Innovation The Case of Pizza Franchise in Mexico

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Abstract

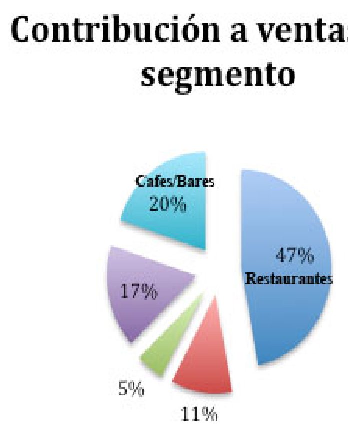
The restaurant business in Mexico is spilling about 40 million dollars a year. Domino `s Pizza is the industry leader, with a market share of 39%. His closest competitor, Pizza Hut, have the 3.9%. What do they do to compete in a market almost dominated by Domino `s Pizza? What strategy should be used Little Caesars to get a bigger market share? In the following paper, through some qualitative methods, can find that the Little Caesars strategy to eliminate the expense of delivering and the strategy to approach to the customer by opening of new stores, has gained greater market share about the franchises pizza in the ZMG.

JEL: D40,F00, M10, M30,O12,O40,O54.

Keywords: Competitive advantage, franchise, innovation, Little Caesars, pizza.

1. Introduction

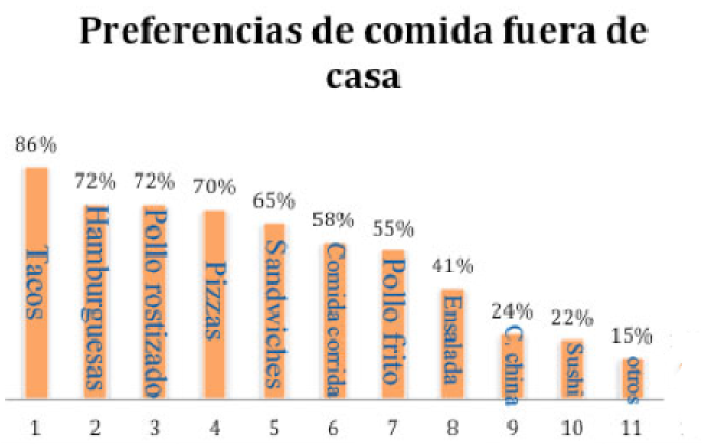
In the following paper it is proposed a comparative analysis of Domino `s Pizza and Little Caesars. It shows that Domino `s Pizza is the industry leader. It is the main reason that has been selected to compare with Little Caesars. A close look to market segments and their contributions to sales are shown in figure 1.



Source: Authors based on data from Investor Magazine (2012)

Figure 1: Contribution to sales by segment.

In Figure 1, it is observed participation rates of the main segments, such as the cafes / bars with 11% and restaurants with 47%.



Source: Authors based on data from Milenio (2009).

Figure 2: Consumer preferences away from home.

Figure 2 shows percentages of Mexican consumer preference regarding not homemade food. Be warned that the pizzas are located in the 4 site, with a percentage of 70% percent. The first place is taken by the tacos, quesadillas, burritos, etc., with 86% everything made from corn. Although Mexico is recognized as second in obesity in adulthood and childhood obesity first (Vanguardia, 2012), the Mexican consumer consumes away from home tacos 86% of the times.

Source: Authors based on data from Milenio (2009)

Figure 3: Type of food that is consumed more than once a week.

In Figure 3, it is denoted the percentage of repeated food consumption more than once a week. That's where it is centered the importance of the pizzas in Mexico. The 15% of the population in Mexico eat pizza two or more times per week. It should be clarified that Mexicans eat more than once out of their house, and has a special importance that the pizzas are the second most recurring dish in the week.

2. Justification

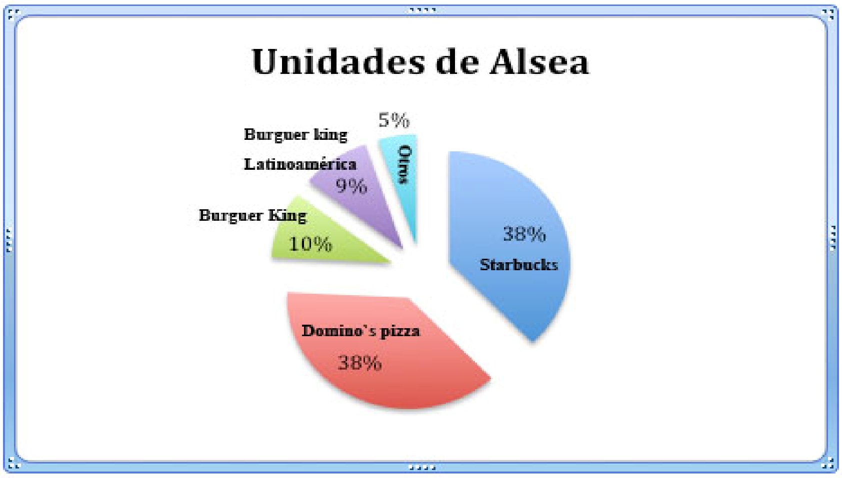
Mexico is the second largest consumer of pizza worldwide (Soitu, 2008). According to Sánchez (2008) Mexican consumers is the second most profitable in the world, just behind the United States, which is number 1, and above many other countries, such as Russia, Canada, Brazil and China. Vázquez (2006) explains that the average consumption per Mexican is the 1 family pizza per year. Espinosa (2012) reaffirms that the pizza business renders for a total of 120 million pizzas a year in Mexico, with an economic benefit of $ 1,000,000 per year.

3. Objective

To prove that removing the distribution costs of pizza, Little Caesars innovation in the sector, and gets stronger presence in the Mexican market thanks to its low prices.

4. Background of the problem

Domino `s pizza represents 37% of the market share in terms of fast food as it is concerned.



Source: Own based on Investor Magazine (2012)

Figure 4: Group Market Share Alsea.

Figure 4 shows the power of Group Alsea, where Domino `s pizza has a market share greater than 37%, also backed by Starbucks and Burger King.

Little Caesars has faced problems regarding its consumer preferences: Would the customer like a pizza that's ready in less than 5 minutes and that has a low price? Then you should go for it directly to the local. Enrique (2011) states that Little Caesars was based in 3 strengths to penetrate the market:

A. Eliminated many common ingredients of a pizza, to focus on pepperoni pizza.
B. Having only two types of pizza (pepperoni and cheese), improved delivery time to less than 5 minutes.
C. By eliminating the dealers, Little Caesars began with a store opening campaign, bringing the branches to the customer

Nelson and Winter (1982) economic analysis related decision making in the real world to understand technological change and dynamism of the competitive process. In addition, both authors suggest that there are 5 ways to innovate: (1) introduce a new product, (2) introduce a new production method, (3) open a new market, (4) open a new source of resources and (5) undertake any new industry organization.

It is noted that Little Caesars has reinvented the organization of industry pizza franchises, as the strategy that is used, eliminating the expense of distribution, and has started to open branches at strategic points, bringing the product to the customer, creating jobs and gaining more market share.

5. Assumption

Little Caesars will get larger market share if it deletes the pizza delivery expenses and convinces people to go personally for their pizza. Kor and Mahoney (2000) suggest the following list of key ideas derived from Penrose (1959):

A. The companies are institutions created by the people to serve the purposes of people. Little Caesars is a well regarded company in the United States because it has created many new jobs, which has spread to Mexico and in particular to the Guadalajara Metropolitan Area (GMA).
B. Excess capacity of productive services of resources is a factor of business growth. When Little Caesars decided to focus on its flagship product, i.e. pepperoni pizza, it was possible to specialize in that product, which allowed it to have economies of scale, which is critical to providing the pizza at cost of $ 79.
C. Diversification of the firm is often based on the powers of a company that can lead to sustainable competitive advantage. Little Caesars has developed a model to continue offering the product at a price lower than its competition. This allowing the opening of more branches and thus bringing the product to its buyers.
D. An important component of the competitive process is experimentation. Little Caesars has experienced both in removing pizza delivery and focus on a flagship product: pepperoni pizza.

6. Theoretical framework

Peng (2006) speaks of a strategy as 4-step plan:

A. Strategy formulation.
B. Implementation of the strategy.
C. SWOT
D. Replica.

6.1 Theory of the firm's growth.

According to Nelson and Winter (1982) some forms of innovation are:

1) Enter a new production method. The way Little Caesar introduced an innovative production method, was when it began to have pizzas ready before the customer came by them. What it did basically was to prepare pepperoni pizza, put it in the box and put it in an oven that would keep the pizza hot, so when it got the client, could remove from oven and turn it in 30 seconds.
2) Open a new market. Little Caesars reinvented a new market, as people in Mexico, were used to order a pizza and that received at home. The downside was the wait time (30 min approximately). Instead, Little Caesar promised a pepperoni pizza in less than five minutes, so people started to go straight for their pizza getting lower the price for the pizza and improve delivery times. In addition, Little Caesar has had success with this strategy that has allowed it to open new branches, bringing the product to the customer.
3) Nelson and Winter (1982) look at two cases: (1) The companies are motivated by money, profitability. (2) Companies are seeking ways to increase those

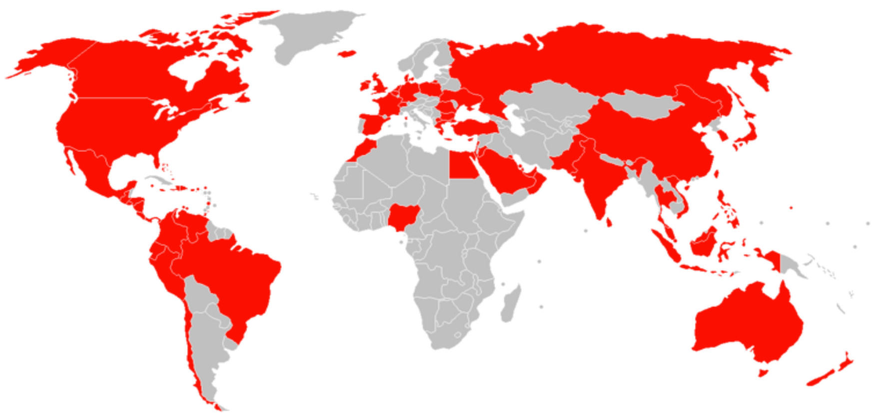
profits. The market is what determines which firms are profitable and which are not, bringing the latest. The companies formulating strategies are taking into account: uncertainty, bounded rationality, the large corporations, institutional complexity and the dynamics of adjustment.

6.2 Theory of competitive advantage (Porter, 1979).
Barriers to entry. Domino `s pizza does not put a major entry barrier: The price. How the price could affect potential competitors? Simple. If Domino `s pizza had set a low price for their products, to have economies of scale, would have prevented other participants may enter the market because they could not afford at that price. However, Little Caesars took that putting its price to $ 79 and opted to open franchises in bulk, thus bringing the product to customers and eliminating the dealers.

6.3 Real options (Trigeorgis, 1997).
Option to expand, stop and restart operations. If market conditions are more favorable than expected, the company can expand the scale of production or accelerate resource utilization. Although Little Caesars has been since 2006 in Mexico, however it was from the year 2012 when it won some popularity and acceptance by customers. It was placed the franchise in this real option, because from that year and to date has expanded like no other pizza franchise in the GMA.

7. Contextual Framework

Domino `s Pizza was founded on June 10, 1960 in Ann Arbor, Michigan, in the United States.



Source: Wikipedia (2013)

Figure 5: International presence of Domino`s pizza in the world.

Domino `s Pizza: It is established in Mexico since 1989. In Mexico, Domino´s Pizza has 582 stores and has a presence in all 32 states. Figure 6 shows the distribution allows both pizzerias in the GMA. Count to the year 2013 with total 20 branches in the GMA. Distributed: 10 Guadalajara, Zapopan 6, Tlajomulco 1 Tonala 1, 0 in Tlaquepaque, the others distributed in malls).

Source: Own elaboration based on the website of Little Caesars and Domino `s pizza.

Figure 6: Stores of Little Caesars and Domino`s pizza in the GMA.

Little Caesars was founded in 1959 (a year before Domino `s pizza) in the city of Garden City, also in Michigan, USA. In Mexico it has established since 2006. Account until 2013, with 100 branches in Mexico. They have until 2013 with 10 branches in the GMA, distributed 7 in Zapopan, 1 in Tlaquepaque, 1 in Tonala, 1 in Tlajomulco and 0 in Guadalajara.

8. Methodological tools

A. SWOT analysis.
B. Interview with employees of both franchises (Little Caesars and Domino `s pizza).
C. Observation in both franchises (Little Caesars located in Rio Nilo; Domino `s Pizza located at Av Revolution).

8.1 SWOT Analysis

The SWOT analysis focused on the advantages and areas of opportunity for Little Caesars, as it is having a growth spurt in the GMA, it is expected that will open four stores this year.

Table 1: Little Caesars SWOT analysis.

Strengths: 1. Pizza of excellent quality 2. Price for a large pepperoni pizza $ 79 3. Time in office less than five minutes	Opportunities: 1. Settling in the malls 2. Opening an office in Tlaquepaque
Weaknesses: 1. It has not an area where you can taste the pizza 2. Only 10 branches in the GMA 3. It has not a presence in southeastern Mexico 4. No negotiating with new partners for franchise	Threats: 1. 1. That competition offer your product at the same price, including delivery 2. That competition improves the price of pizza, picking at the branch

Source: Own elaboration based on Redfm podcast.

Table 2: SWOT analysis Domino `s Pizza.

Strengths: 1. Home delivery 2. Gourmet Pizzas 3. Branches in ZMG 4. Presence in the 32 states	Opportunities: 1. Acquiring the franchise Little Caesars 2. Improve its price 3. Offer a differentiated product
Weaknesses: 1. Price for a large pepperoni pizza $ 99 2. Branch delivery time 15 to 18 minutes	Threats: 1. Expansion of Little Caesars 2. That other pizzerias adopt the model of Little Caesars

Source: Own based on Redfm podcast.

8.2 Interview with employees of both franchises (Little Caesars and Domino `s pizza)

This method was chosen to test the information provided employees with information that would result in the observation, and draws attention to the results that really are very similar.

By observing about 3 hours at the branch of Little Caesars located in Tonala, it was assessed selling on average 12 to 17 pizzas per hour on a typical day. The product that the consumer demands is pepperoni pizza after pizza cheese, both at a cost of $ 79.

Regarding Domino `s pizza, it was chosen the branch that is located in the municipality of Guadalajara. It was spent about 3 hours in the franchise, and it is observed that the average number of pizzas demands on a typical day, is between 3 and 6 pizzas per hour. The product which is more demanded is the Hawaiian pizza, followed by pepperoni pizza. The price is $ 99 if picked up at the branch.

9. Results

Table 3: Comparative analysis.

Price per unit Domino`s pizza - $99 Little Caesars- $69	Dining facilities on the premises Domino`s pizza – Si Little Caesars - No
Home delivery Domino`s pizza – Si Little Caesars - No	Number of branches in the GMA Domino`s pizza – 20 Little Caesars - 10

Source: Own data based Mexican Franchise Association.

It is noted that by eliminating distribution costs and reduce the processing time of its flagship product within 5 minutes. Little Caesars obtained the following results compared against Domino `s pizza.

Table 4: Approximate daily income.

Domino`s pizza Pizzas sold on average per hour – 5 Price per unit - $ 99 Hours worked each day – 11 ► Daily income = 5 * $ 99 * 11 = $ 16, 335 a day – distribution costs

Little Caesars
Pizzas sold on average per hour – 15
Price per unit - $79
Hours worked each day – 11
▶ Daily income = 15* $79 * 11 = $ 13, 035

Source: Own elaboration.

Peng (2006) says about the question of imitability. Resources and capabilities are Valuable and scarce can be a source of competitive advantage only if competitors find it difficult to imitate. It is perceived by Table 4, which until today, Domino's Pizza is not imitating the model of Little Caesars, since neither has a flagship product at low cost, nor is opening branches to bring the product to the customer

10.Conclusions

The assumption is accepted as Little Caesars really is getting more market share. It can be measured based on the fact that they are coming to open four shops in the GMA in this year. Penrose (1959) discusses the general growth and diversification, but also about the limits that companies have on growth. Has not been known that limit, because in Mexico, this strategy had not been used

Little Caesars invites reflection about that all is said and that there is always an opportunity to innovate in a sector believed was in its peak. At first, it was a very risky bet, making people go straight to the local to get their pepperoni pizza at a price of $ 79 and in less than five minutes.

All this, in addition to which Little Caesars has not to pay the salaries of pizza delivery, because does not have this service. This has allowed them to have higher profits, and this chain is causing through franchises that are opening, the client has a branch closer so he can continue to get the product at the lowest price that Domino `s pizza.

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