# Tim Hortons in 2013: Can its success in Canada be exported globally?*

The iconic brand Tim Hortons is considered part of Canada's culture. The friendly restaurants are located in almost every sizable town in Canada and all appear to be busy, day and night. This is whether Canadians crave a coffee with breakfast on the way to work or school, a hearty lunch, or a snack or quick meal after hours. In many instances, the same customers visit multiple times in a day. Tim Hortons' (n.d.) "About Us" web page states its beginning and progress this way:

> The Tim Hortons chain was founded in 1964 in Hamilton, Ontario. The chain's focus on top quality, always fresh product, value, great service and community leadership has allowed it to grow into the largest quick service restaurant chain in Canada specializing in always fresh coffee, baked goods and home-style lunches. The first Tim Hortons restaurants offered only two products - coffee and donuts.... But as consumer tastes grew, so did the choices at Tim Hortons.

The chance to operate a franchise represents a "golden ticket" or a sure way for people living in Canada to make money, and those already involved are often the envy of those who are not. The concept of Tim Hortons was refined not so much by co-founder Tim Horton, the Toronto ice hockey legend, but by his successor Ron Joyce who saw its potential and had an eye to detail. Joyce continually improved the Tim Hortons franchise concept and he expanded the chain across Canada, town to town, city to city. By 2002 Tim Hortons overtook McDonald's Canada in terms of greater number of outlets and market share (Hunter, 2012).

Tim Hortons is phenomenally successful in Canada. Yet, Tim Hortons does not enjoy similar success in United States and global markets (Hunter, 2012). This raises the question in the case title: Can the Tim Hortons concept and culture be successfully exported globally?

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* This Tim Hortons case was written by senior undergraduate students Jeremy Adduono and Lailak Sulhi, with assistance of Sean Derkson and Lindsay Woodruff. Supervision was provided by Bryan Poulin, Associate Professor of organizational strategy, leadership and ethics at Lakehead University, Canada. All information contained in the case is based upon secondary, publicly available sources and, in a few instances, from our personal observations. As student-authors, we began with Douglas Hunter's (2012) excellent book, *Double Double: How Tim Hortons became a Canadian Way of Life, One cup at a time*, for which we are grateful. The case draws from other sources that corroborate and/or augment Hunter (2012). Acknowledge and thanks are also due to Eric Kaufman, Associate Professor of leadership at Virginia Tech, United States for his review, suggestions and questions; Associate Professor Bob Isotalo for his comments and suggestions, unnamed students in our class who offered their insights and questions; Karen Bishop and Mike Dohan for their check on referencing and Morna Toderash and Arlene Smith for their administrative support. The case is for education purposes only; it is not to illustrate either effective or ineffective handling of a leadership or administrative situation. The case is aimed at senior undergraduate and graduate students of leadership and business strategy. 15 Sept. 2013.

## Background

The actual beginning of Tim Hortons has a vague origin. Tim Horton, the restaurant namesake and great Toronto Maple Leaf ice hockey player of the 1950s and 1960s, attempted many different businesses as his retirement neared. These attempts included a failed automobile dealership, a failed hamburger business and a failed coffee and donut business, all near or in Toronto, Canada. Although Tim Hortons did officially begin in 1964, it began unofficially in 1963 when Tim Horton partnered with Jim Charade, a former jazz drummer from Montreal who had worked for Vachon Bakery, a Quebec maker of nationally distributed baked goods.

Charade was looking to recover from his failed "Your Do-Nut" shop and realized he needed a recognizable brand. Charade's solution was to tie in with Tim Horton, a famous ice hockey star who also was interested in the business. Charade's Your Do-Nut Toronto became "Tim Horton's doughnut" (Hunter, 2012, p. 71). It served donuts, coffee and hot chicken that could be delivered. It also failed within the year. Charade was not through gambling.

Undaunted, in 1964 Charade decided to relocate to Hamilton, Ontario, an industrial Canadian port city south of Toronto. The store would only sell coffee and donuts, 24 hours a day, 7 days a week. It was a winner. Close-by industrial and factory workers from Hamilton visited in the droves, stopping by to pick up coffee and donuts before early morning and late night shifts. This single 1964 outlet in Hamilton, Ontario sparked the beginning of Tim Hortons' successful fast food franchise business. The original Tim Hortons "baked" donuts (actually deep fried) on site, and offered fresh, quality coffee and donuts at attractive prices. In 1964, coffee was priced at $0.25 a cup and a dozen donuts at $0.69. Soon there would be two stores and two franchises.

The missing piece to the Tim Hortons' puzzle – someone who could steer the franchise business to success – appeared in the person of Ron Joyce, a former policeman who had operated a Dairy Queen franchise. Ron Joyce became the third Tim Hortons' franchisee, although it was to be a shaky relationship at the start. Soon Ron Joyce had issues with paying royalties to Tim Donut Ltd., the franchisor company owned by Charade and Horton. Joyce believed that Tim Donut Ltd. offered too little franchisor support, and he could not easily appeal to Tim Horton who by now had left Toronto and was playing professional hockey in the United States. Joyce quit.

Struggling to keep the chain alive, Tim Horton had to inject more money into Tim Donut Ltd. (Hunter, 2012). By the end of 1965, Tim Horton asked Charade to leave and Tim Horton's wife, Lori Horton, became his partner. This did not work out. In1966 Tim Horton invited Ron Joyce to return. Joyce then bought out Lori Horton's stake in Tim Donut Ltd. for $12,000.

From 1966 to 1974, Ron Joyce developed and refined the franchise model and made it more vertically integrated. This meant franchisees purchased more and more supplies through the franchisor, Tim Donut Ltd. This benefitted the franchisor since it received volume discounts and rebates for bulk purchases. In turn, franchisees received needed operational, promotional and product support. All appeared to go well until 1974 when Tim Horton had a fatal car accident. It was alleged Tim Horton had been speeding while being under the influence of amphetamines and alcohol. This was after a late night of discussing his restaurant business with Ron Joyce. Tim Horton was 44 years old when he died. Following Horton's death, Joyce bought out Horton's share that had gone to his widow, Lori Horton, for one million dollars.

With Ron Joyce solely in charge, Tim Hortons grew rapidly. Over the next 20 years, Tim Hortons expanded the number of outlets. Franchisees were now able to offer an ever greater variety of new products for sale. In 1976 the Timbit was introduced (from the by-product of making holes in doughnuts); value-priced muffins followed in 1981; cookies in 1984; soups and chili in 1985; and sandwiches in 1993. In all this, Joyce took pains to ensure the brand received a positive image despite the unfortunate circumstances of Tim Hortons' death. However, Tim Horton's close affiliation with ice hockey and sports activities was kept to help children.

While Tim Horton was hardly perfect in his lifetime, he was always particularly interested in the well-being of kids who lacked opportunity. After Horton's death, it seemed fitting that Ron Joyce and Lori Horton together oversaw the establishment of a summer camp for dis-advantaged children. As explained later in this case, the operation of the summer camps is supported by the franchisees. As franchisor, Tim Hortons sponsors 300,000 kids who play minor ice hockey, calling the program "Timbits Hockey" after the name of its popular Timbit donut-holes. A major ownership change occurred in 1995 when Tim Hortons merged with Wendy's hamburger chain, partly out of friendship between Wendy's founder Dave Thomas and Ron Joyce, and partly as a way for Tim Hortons to enter the United States' market (Hunter, 2012).

## The 1995 Wendy's Merger

On August 8, 1995, Tim Hortons (under the name TDL Group Ltd., a name inspired by the original Tim Donut Ltd.) was acquired by Wendy's International. Tim Hortons became an American company registered in Delaware, "operating as a distinct subsidiary of Wendy's International, with a head office still in Oakville, Ontario" (Hunter, 2012, p. 188).

By 2005 Wendy's had 6,699 outlets worldwide but faced a 3.7% decline in same-store sales. That same year, Tim Hortons accounted for 70% of operating income for the combined company in the first quarter with 2,738 outlets. As Tim Hortons continued to gain momentum, pressure was put on Wendy's to separate Tim Hortons to benefit shareholders. With the 2006 separation, Tim Hortons launched an Initial Public Offering (IPO) of its stock; "a complete break would not come until 2009 when the company was repatriated as a Canadian Corporation" (Hunter, 2012, p. 196). Reporter Robert Thomson (2006) of Canada's *National Post* describes how exciting this news was for many in Canada at the time:

> It's a typical mid-winter morning at Gary O'Neill's Tim Hortons restaurant on Mountain Road in Moncton, N.B. Outside the snow is falling, and the cars are lined up at the drive-thru as people stop by to pick up their morning coffee on the way to work. Indoors, the regulars are clustered around the tables, chatting over their doughnuts and double-doubles. One of them, a middle-aged man, notices O'Neill behind the counter and calls out a greeting. On this morning, however, he offers more than the typical salutation. "In March," the man announces, "I'm going to own part of this store!" O'Neill laughs. As one of Tim Hortons' largest and most successful franchisees -- he opened his first Tim's franchise here more than 30 years ago and today owns 40 restaurants across Canada and in the United States -- he's heard that comment a lot in recent weeks. Everybody, it seems, is angling to get a piece of Canada's coffee-and-doughnut king when it goes public.

## Tim Hortons' Surprising Rise to Success and Fame

In the 1960s, Tim Hortons' offering of coffee and donuts seemed to have little future, mostly because the fast food industry of the 1960s and 1970s was dominated by the "big three" offerings of chicken at just over 30%, hamburgers at about 30%, and ice cream at about 25% of the market (Hunter, 2012). With 85% of fast food restaurants involved in these three offerings, the others selling pizza, *donuts*, hot dogs, and fish had to split the remaining 15%. Tim Hortons was a niche player, at least at first. By competing in a niche market that sold coffee and donuts, Tim Hortons was able to avoid major competition from rivals selling the "big three" offerings of chicken, hamburgers and ice-cream. The fact that Tim Hortons' menu items were different from the big chains allowed the company to stay out of their notice, even in locations that were close to them. Tim Hortons' early focus on its niche market also gave the company the platform to establish a large chain of outlets in Canada in the right areas, enabling it to build loyalty among a growing number of customers, town by town and city by city. Even in 2013, small towns such as Sioux Lookout, Ontario (population 5,500) announce the arrival of a Tim Hortons with great fanfare, as an opportunity for employment that supports the local economy. Tim Hortons has acquired a stellar reputation by offering great value and exceptional service in quality products that people buy often. By the mid-1980s, when the company made the decision to expand its menu by offering "main-meal" selections, Tim Hortons had already acquired strong customer loyalty across the most sought-after locations in Canada in all parts of the day. As Hunter's (2012) book makes clear, Tim Hortons had the know-how of doing good business in every part of the day, right from its very beginning in 1964.

Hunter (2012) pointed out Tim Hortons' early success came from being a model of efficiency and effectiveness. There was the simplicity of offering a limited menu and its efficiency in purchasing, preparation, staffing, kitchen design, and food preparation. The drive-thru innovation gave people the option of not getting out of their cars to grab a coffee and a snack. Tim Hortons was a first mover in eliminating smoking in its restaurants early on, distinguishing it from its coffee and donut competitors, especially among the modern crowd. The company grew exponentially, building on its basic system that delivered attractive products in a clean and friendly facility at low costs and low prices. Tim Hortons also grew by controlling its supply chain and controlling its costs, pricing, product and process consistency, and quality – a virtuous circle. Its customers all over Canada were served by a growing number of solid franchisees. By 2012, Tim Hortons had more than 4,000 outlets (refer to Appendix A, p. 13 for locations), with 99% of its North American outlets franchised (Tim Hortons Inc., 2013).

## Franchising

Franchising requires substantial attention to detail because it involves balancing different, sometimes conflicting interests, as Hunter (2012) points out:

> Franchise systems are a delicate balancing act between …diverse …interests. There is the franchisor as an operating business, the capital behind the franchisor, the individual franchisee, and the collective interests of the franchisees … may be at odds with the interests of individual franchisees…. (pp. 186-187)

Hunter goes on to point out that even with good balance among the interests, no franchise concept is exempt from making bad decisions. Franchisors can introduce ineffective offerings, overestimate forecasts, choose unsuccessful expansion areas, overspend on ineffective

advertising, or make ownership changes that can lead to different, ill-fated priorities. Despite the pitfalls, Tim Hortons and McDonald's have the lowest-among-the-industry failure rates at less than 1%, benefitting franchisees and franchisor alike. This has occurred because offerings are regularly updated with both franchisor and franchisee interests in mind. After his retirement, Ron Joyce had this to say about this approach, "It was my philosophy to treat the franchise owners as partners" (Hunter, 2012, p.197).

## The Quick Service Restaurant (QSR) Industry

The first fast food was introduced as a hotdog stand in Brooklyn, New York in 1867 by Charles Feltman, a German Butcher. White Castle was the first fast food restaurant and opened in 1916. Its limited menu served high volumes of hamburgers fast at low price and low cost. In 1921, Walter Anderson, founder of White Castle Restaurant, then partnered with Billy Ingram to form a chain of restaurants. Franchising fast food restaurants flourished in the mid-1930s and, as today, set standard menus, signage and advertising (Farrell, 2008; Hunter, 2012).

Fast food is funded by discretionary cash spending, a fact that became more important by the mid-1940s when WWII ended and discretionary income rose fast. The drive-through innovation in the 1960s was another boon, although it only slowly caught on at first. For example, McDonald's, the leading fast food multinational, didn't implement the drive-through (or drive-thru) until 1975; drive-thru now accounts for 60% of its total sales (McDonald's, 2013).

Today technology plays an increasing role by improving the accuracy and speed of sales, especially of the drive-thru, as orders are placed on a machine at one place and transferred to another machine in the kitchen. Until the 1960s, Quick Service Restaurants were a novelty and a small segment of the food industry in North America. By 2000, the QSR was a $110 billion per year industry, a dramatic increase from the $4 billion spent in 1970 (Blair & Lafontaine, 2005; Farrell, 2008). Farrell ventured that one of the reasons for the increase in popularity of fast food was the automobile which made it more convenient for people to seek out fast food QSRs.

Innovations can change the nature of the restaurant trade. One recent innovation helping QSRs is bundling where discounted items are offered through combo or value-pricing to increase sales. Hank Cardello (2013), a senior fellow at the Hudson Institute wrote that bundling and value-pricing are not enough. Cardello reported that 58% of consumers now want the food to be both good value *and* healthy. He argues that large fast food chains need to respond more effectively in offering more healthy alternatives, in addition to nutritional and caloric information on the packaging of products. Another recent innovation threatening QSRs is fast casual restaurants that offer fancier and more expensive menus. Cardello identified the recession of 2008-13 as a reason that fast casual dining has not seriously impacted the QSRs too much for major players. Low priced fast food is attractive when more people have low levels of discretionary money.

## The Tim Hortons Franchise System

With over 99% of its restaurants franchised, Tim Hortons makes its money from franchisees in locations throughout Canada and a growing number in the United States (other locations only contribute a relatively small amount of revenue). Of Tim Hortons' $3.12 billion in corporate revenues generated in fiscal year 2012, approximately $2.23 billion came from the sales of supplies and partially or "par-baked" menu items to franchisees (Tim Hortons Inc., 2013). Another $895 million came from franchise start-up fees, rent, or royalties paid to the company. (Refer to Appendix B, p. 14, for corporate data in years 2008-2012.)

In Canada, the average cost to open a standard, full-service restaurant is between $480,000 and $510,000 (drive-thru included), plus an additional $50,000 in working capital (Tim Hortons Inc., 2013). These costs cover the equipment and machinery, as well as interior furnishings, and signage (refer to Appendix C, p. 15 for details on costs). Costs can be much more for restaurants in remote communities. The following four aspects summarize Tim Hortons' franchise and business model:

1) Franchising. Currently 99% of its stores are operated by franchisees. The company has a long-time tradition of collaborating with its franchisees to grow business and build positive connections. Franchisees often own up to 3 or 4 outlets each, which also increases their stake in the stores in which they operate.

2) Real-estate. Holding a controlling interest (either by owning or maintaining the head lease) in a substantial amount of the real-estate, the company is consistently able to protect its brand integrity and control the development of the property.

3) Vertical integration. The company has its own distribution centers and manufacturing facilities to integrate its product and supply chain to achieve economies of scale, as well as preserve product quality, and training centers to ensure exceptional customer service.

4) A "we fit anywhere" attitude. The company uses this approach to allow it to adapt its brand presence in order to pursue both standard and non-standard expansion prospects (e.g., airport, school kiosks), as well as create opportunities to form strategic alliances.

The basic model at Tim Hortons is to identify the best possible restaurant locations, develop the most appropriate sites, and make the outlets available to the most suitable franchisees, often to the same franchisee in a given area with a good track record. The strategic plan to implement the model emphasizes "same-store" sales by time period, investing to expand the brand, and growing in different ways by leveraging uniquely suitable resources and competencies, including its franchise system (Tim Hortons Inc., 2013). This results in different sources of revenue streams with contribution to income from royalties, franchise rent, manufacturing and distribution sales including goods that are sold through partially baked or par-baked goods.

Tim Hortons franchisees are in two main categories: "owners" and "operators" (Hunter, 2012). "Owners" are actually independent contractors running a corporately owned store. This is because Tim Hortons typically owns the land and/or restaurant, or holds the head lease. Owners operate under licensing agreements for a term of ten years that can be renewed. Operator agreements are usually used to introduce new franchisees or to help newcomers who have less start-up capital than normally required. The main differences between the two agreements are that the operator-franchisee does not pay the initial license fee, but pays higher royalties, and the company and the operator have the right to terminate the agreement on thirty days' notice.

As franchisor, Tim Hortons collects what is called RRA fees (rent, royalty, and advertising) from each franchisee (Hunter, 2012; Tim Hortons Inc., 2013). The advantage of this method is that if a store is struggling, the amount owed in fees decreases. The approximate 15% collected from rent and royalties are counted as corporate income, made up of 8.5% to 10% of revenues taken as monthly rent, plus 3% to 4.5% in weekly royalties on gross receipts, plus an advertising charge of 3.5% to 4% which is placed into a fund for advertising and promotion.

Franchisee earnings at each restaurant are proportional to sales. Franchisee gross margins are approximately 18% of sales after paying rents, royalties and franchise fees to Tim Hortons corporate. Deducting 5%, to compensate a manager-owner for own labor, leaves an annual income before taxes of about13%. This translates to $130,000 net income, before taxes, for sales revenue of $1 million, typical of a full service restaurant in the United States, or $260,000 on sales revenue of $2 million, typical of a full service restaurant in Canada (Hunter 2012).

Franchisees are responsible for operating their outlet(s) and for hiring, training, and firing their employees. Every franchisee is given 7 weeks training at Tims' University, a special facility maintained by Tim Hortons' corporate office (Hunter 2012; Tim Hortons Inc., 2013). For a new outlet is in a remote area, a training team may be sent from Tim Hortons' corporate office to help with the start-up. Franchisees are then able to contact corporate managers for guidance, for example on handling employees and achieving profit-margins. All franchisees are required to purchase goods and supplies from the franchisor or designated suppliers that Tim Hortons selects. Franchisees are subject to quality control inspections and must make available all financial information to the corporate franchisor. Tim Hortons does not allow any of its restaurants to become outdated and agreements require a full-scale renovation every five to ten years. The franchisee is responsible for the costs of the renovations which can be up to 2% of gross receipts from the previous five years. Tim Hortons may contribute up to 50% of the costs for renovations but is under no obligation. Franchisees do not build equity and must generate profits from day-to-day sales, serving the menu items instructed by the franchisor at set prices.

Although franchisees operate locally, Tim Hortons is a multinational franchisor and must carefully manage the service and quality of its products to suit local and broader tastes (Hunter 2012). This means that license agreements first protect corporate (franchisor) interests. These agreements allow the franchisor to conduct inspections of franchisees to ensure franchisees adhere to the regulations and financial obligations set out by the parent company. In return, Tim Hortons hands over and supports the new franchisee with a "turn-key" restaurant. The all-inclusive, turn-key concept is a proven system that helps franchisor and franchisee succeed and make money. This is what makes owning a Tim Hortons' franchise an attractive venture.

## The Competition

Competition within the QSR industry is based on a number of factors including product quality, brand reputation, convenience, value to the consumer, location, personnel, location, atmosphere, effective marketing campaigns, new product development, and suitable franchisees to run the restaurants (Tim Hortons Inc., 2013). Tim Hortons, the market leader in the QSR industry based on total revenues and the number of outlets nationwide, was responsible for 78% of the brewed coffee sold in Canada during 2011, accounting for 24% of the total dollar revenue for the Canadian QSR industry. Hunter (2012) reports that, except for McDonald's, other competitors are far behind in Canada in sales. He further comments:

> Tim Hortons continues to be driven by snacking. Eighty-five percent of its traffic comes from morning and evening snacking, compared to 28 percent for the rest of QSRs; main meal traffic only amounts to 14 percent of Tim Hortons' traffic, compared to 65 percent for other QSRs. Meals appear to be the chain's relative weakness, … but also its greatest opportunity: the one sure way it can turn already healthy levels of traffic into higher revenues by bumping up average sales. (p. 177)

McDonald's Canada has taken notice of Tim Hortons in the coffee and breakfast segment and now offers free newspapers, free coffee refills, and superior coffee technology with new double lined coffee pots to keep the coffee fresher and hotter longer, all things that Tim Hortons seems not to do or do as completely. In return, Tim Hortons is going after McDonalds' lunch trade with offerings of soup, sandwich and snack specials.

New entrants to the QSR industry add to the competition and Tim Hortons may be struggling to respond appropriately. Hunter (2012) reported that, in February 2009, the parent company of Cold Stone Creamery (Kahala Corporation) and Tim Hortons formed a co-branding partnership and announced opening up to 100 stores in the United States, after successfully testing two locations in Rhode Island. Canadian co-branded outlets followed. This is a case of following competitors such as Dunkin Donuts (that partnered with Baskin-Robbins ice-cream). Co-branding with Cold Stone will not significantly increase corporate profit in the foreseeable future. One reason is because few Tim Hortons locations offer co-branded outlets.

## Tim Hortons' Giving Back and Promotion of the Brand

The Tim Horton Children's Foundation is a not-for-profit, charitable organization. Its main purpose is to provide children that are less-privileged the opportunity to enter one of the high-class camps that it provides (Hunter, 2012; Tim Hortons Inc., 2013). The foundation provides children in Canada and the United States with fun-filled camp environments to improve their confidence and their futures. Donations are collected from counter coin boxes located at franchisee outlets. The biggest fundraiser is Camp Day, a one day event when franchisors of Tim Hortons' restaurants donate 100% of coffee proceeds for full 24-hour period. The children participating in the camps are chosen carefully through youth organizations and churches.

Since 1986, Tim Hortons has been running the "Roll up the Rim to Win" contest in February. It includes prizes of vehicles, televisions, and store products. It works by rolling up the rim of the Tim Hortons paper cup to reveal the prize or a polite request to try again. In 2004, 30 GMC Vehicles, 100 TVs, 500 Cash prizes of $1000, and many other store-related products were given away. Tim Hortons uses this campaign as a way of rewarding loyal customers every year. For the 25th anniversary of the campaign, Tim Hortons ran the contest for a longer period, to gain on its competitors. McDonalds tried to disrupt the contest by giving away free coffee, which only reduced sales growth of Tim Hortons by one percent (Hunter, 2012).

Tim Hortons is being socially responsible by promoting waste reduction through various in store programs: offering the option of replacing paper cups with a china mugs for in-store use, as well as offering discounts for the use of travel mugs. Placing recycling bins at every outlet helps protect the environment (CSR Business, 2010). All this makes Tim Hortons an attractive place to be, and be seen, even and especially for politicians who hope to win more Canadian votes (Hunter, 2012).

## Tim Hortons Vertical Integration

The idea of vertical integration came about during the 1970s, following the court case involving the plaintiff Jirna Ltd. versus the defendant Mister Donut Ltd. (Hunter, 2012). As the franchisor, Mister Donut had been accused of taking advantage of its franchisee (Jirna Ltd.) by keeping volume-rebates on supplies bought from suppliers. The plaintiff complained that the franchisor owed the franchisee a fiduciary duty to act for the franchisees and share the supplier rebates. The lower court decided in favor of the franchisee.

However the Mister Donut-Jira case was appealed and eventually was heard by the Supreme Court of Canada that ruled in favor of the franchisor Mister Donut on the grounds that the relationship was a "contractual matter." This case was significant because Tim Donut Ltd. was involved in similar practice of accepting discounts and rebates from suppliers (Hunter, 2012).

In response, Joyce adopted a vertically integrated system by establishing the central warehouse and distribution center that became accepted by the franchisees as of mutual benefit. It has become an integral part of the company's growth and success and Tim Hortons continues to the present time with distribution centers located in Langley, British Columbia; Calgary, Alberta; Kingston, Ontario; Guelph, Ontario; and Debert, Nova Scotia. The Guelph and Kingston sites supply about 60% of restaurants in Quebec and Ontario with both frozen and refrigerated goods. Tim Hortons corporate owns two central coffee roasting facilities, in Rochester N.Y. and Hamilton Ontario which can supply up to 75% of Tim Hortons' total coffee requirements. The company also owns a "fondant and fills" plant that supplies numerous products in the "always fresh" baking system. This integration of supply chain is considered crucial to the Tim Hortons' business model, allowing it to control costs, provide for the franchisees in a reliable manner, and contribute to profitability (Tim Hortons Inc., 2013).

## Par-baking

In 2003, Tim Hortons decided to adopt a centralized "par-baking" system (Hunter, 2012). Previously, franchisees manufactured doughnuts and baked goods at their premises. Tim Hortons claimed it was making a decision to increase quality and keep products fresh while reducing waste, or "throw-aways." The proprietary par-baked system involves a central bakery shipping partially cooked or baked goods to outlets, where the final portion of the baking is completed by simply putting the products in a specially designed oven. The company saw this as a winning solution because menu offerings would be continually be served fresh, and franchisees could save costs by not employing bakers at each site or losing on products that needed to be thrown away. Tim Hortons set up a joint venture with the European owner of the proprietary system through a company called Maidstone Bakeries that would supply the partially baked goods to be finished at franchisees' locations. A group of franchisees took the company to court, citing that the new system only benefitted the franchisor since the unit price of par-baked goods increased costs significantly, because of the special ovens. On February 24, 2012 the court ruled in favor of franchisor Tim Hortons, with the judge ruling that Tim Hortons' switch to par-baking did not entail the company taking advantage of its franchisees. However, Tim Hortons is no longer part owner in Maidstone Bakery. The European company that owned the proprietary technology behind par-baking exercised its option to buy its way out of the contract. Tim Hortons has agreed to purchase donuts and Timbits from Maidstone until 2016. This contract cancellation may represent a serious setback for Tim Hortons' effort at vertical integration, since it is committed to par-baking and loses control of part of its supply chain (Hunter, 2012).

## Tim Hortons in the United States as Compared to Canada

Competitors in the United States range from small local independent coffee and snack shops to the well-capitalized national chains such as McDonalds, Starbucks, Subway, and Dunkin' Donuts (Hunter, 2012; Tim Hortons Inc., 2013). Although most of the major chains compete in Canada, in the US each of these rivals are substantially larger and have a competitive advantage in buying power and marketing effort. Tim Hortons has 3,295 stores across Canada and 941 stores in the United States.

Rivalry was just one of the problems facing Tim Hortons with its entry in the United States. Another problem arose with Tim Hortons' partnering with the difficult Riese Corporation in entering the New York market (Hunter, 2012).

Riese was the pioneer of the New York food court concept, where limited offerings by chains are grouped together in a central location in a shopping mall. The issue facing Tim Hortons was that Dunkin' Donuts, a major competitor of Tim Hortons had pulled out of the Riese locations in New York malls because of an ongoing problem with mice in its food courts. This had been going on since 1999, ten years before Tim Hortons made its way to Riese's New York malls. As Benjamin Weiser reported in the New York Times on January 5, 1999:

> It began last week with a photograph in The New York Post of a mouse munching on a doughnut in the window of a shop in midtown Manhattan. More articles followed. Soon everyone was cracking jokes about what Mayor Rudolph W. Giuliani called a "disgusting, horrible story."

The above story went around the world and called into question cleanliness of fast food outlets. Just over 10 years later, on July 14, 2009 Libby Nelson reported in the New York Times, "The Riese Organization has ended its association with Dunkin Donuts and is converting its shops to Tim Hortons, a Canadian Chain." Unfortunately Tim Hortons soon had a similar mice problem in the Riese-controlled New York food mall locations. Fortunately, Tim Hortons developed a much more credible regional presence in other areas of northeastern United States, where most of its outlets are confined.

Store sales are lower in the United States than in Canada. For example, in 2011, $1.06 million was the average sales revenue in a regular United States' store compared to $2.13 million in Canada. Established locations in the United States remain profitable despite lower revenues. In the United States, store numbers increased at a rate of 27% and same store-sales of 6%, compared with growth rate in store numbers at 9% and same store-sales of 4% in Canada (Tim Hortons Inc., 2013). For non-standard outlets (e.g. kiosks) average revenues are $447,000 in the United States compared to $870,000 in Canada (Hunter, 2012; Tim Hortons Inc., 2013).

Kiosks are used to introduce the company's products in markets where Tim Hortons is not a familiar name. These kiosks represented 23% of all U.S. outlets, as opposed to only 4% in Canada. Tim Hortons announced in November 2010 that it was closing 36 stores in the northeastern United States, mainly in the New York area where kiosks are the dominant outlets. Competition from the large, popular brands in the United States is fierce, and some analysts feel the limited offering of kiosks is not the way to introduce a "premium brand" (Hunter, 2012).

A full service outlet offers a different experience to a kiosk outlet. Tim Hortons' struggle for brand identity in United States' markets has also seen the company entering some NCAA Football stadiums such as Ohio State, and NHL arenas like Nassau Coliseum, home of the New York Islanders ice hockey team. Recently, Tim Hortons started a franchise incentive program (FIP) that included interest free loans for equipment packages, to attract new franchisees in United States (Hunter, 2012; Tim Hortons Inc., 2013).

## Tim Hortons Goes Global

In 2001, Tim Hortons announced a master licensing agreement (MLA) with Apparel Group for a projected 120 outlets in the Arab Gulf States; by 2012 there were 19 restaurants in the UAE (Hunter, 2012). The agreement included standard and non-traditional kiosk outlets in multiple Gulf Cooperation Council (GCC) markets, such as UAE, Qatar, Bahrain, Kuwait and Oman. On November 12th, 2012 Tim Hortons publicized the opening of its second store in Sultanate of Oman, making it the second market in the Gulf Cooperation Council (GCC). However, there may be some trepidation, among the senior leadership team at Tim Hortons, on establishing more outlets in the Gulf (Flavelle, 2011).

Tim Hortons started seriously planning for global expansion in 2010 (Hunter, 2012). At that time, the first two countries considered were China and India, but there was concern regarding the large number of fast moving franchises that had already jumped into these markets. Tim Hortons' global expansion began by setting up kiosks in foreign countries, to gauge the reaction of the foreign market to the brand, setting up 290 self-service kiosks in convenience stores in Ireland and England, and also a number of locations in some military bases. Tim Hortons believed that kiosks cut the risk of losses from global expansion. The CBC News (2010) reported that former CEO of Tim Hortons, Don Schroeder, said the brand had become well-known among British and American soldiers through their store in Afghanistan and future plans included expanding the chain's presence on U.S. army. Hunter (2012) observed this: "Almost one in four U.S. outlets in 2011 was a kiosk, and the company allowed (that) they 'contribute minimally to system wide sales and operating earnings" (p. 257). The same point on kiosks may be valid for global outlets. Kiosks also do not reflect full service, all hours of the day, QSR format that made Tim Hortons successful across Canada and in parts of the United States.

## Present and Future Prospects

What has made Tim Hortons successful is a sound concept where franchisor and franchisees both benefit by carrying out Tim Hortons' vision and values (shown as Appendix D, p. 16). Tim Hortons offers customers superior service and attractive products at low prices, delivered by solid franchisors who hire employees who receive comprehensive training, competitive wages, opportunities to advance, health benefits, as well as incentive and recognition programs (Tim Hortons Inc., 2013). Tim Hortons continually revamps its restaurants to increase ambiance and appeal, as does McDonald's, its major competitor in Canada. Both QSRs now offer comfortable seating and Wi-Fi. Tim Hortons continues to thrive, in part with "roll up the rim to win," the trademarked promotional juggernaut that has been copied by others.

However, over the past decade, Tim Hortons – the pioneer in Canada known for more than just coffee and doughnuts – is becoming known for simply monitoring and adding similar products to its competitors, a follower more than a leader. Following in the footsteps of some of its biggest competitors, such as Dunkin Donuts (that partnered with Baskin-Robbins), by entering into co-branding with another ice-cream company may not be enough. Tim Hortons entry in the tough United States' market has also not been error-free. Tim Hortons global entry has hardly begun.

The above suggests that questions of the leadership of Tim Hortons now need to be asked. For example: How can Tim Hortons remain relevant in North America? What must Tim Hortons do to meet its own needs and the needs of people in counties beyond North America?

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(All appendices are based upon Tim Hortons Annual Report, 2012, unless otherwise noted)

## Appendix A: Company and Franchise Locations of Tim Hortons

| | Standard | | Non-Standard | | Self-Serve | |
|---|---|---|---|---|---|---|
| | Company | Franchise | Company | Franchise | Kiosks | Total |
| **Canadian Locations** | | | | | | |
| Alberta ………………… | - | 214 | 1 | 73 | 19 | 307 |
| British Columbia………… | - | 203 | - | 58 | 28 | 289 |
| Manitoba………………… | - | 61 | - | 25 | 2 | 88 |
| New Brunswick…………… | - | 101 | - | 14 | - | 115 |
| Newfoundland and Labrador | - | 45 | - | 9 | 1 | 55 |
| Nova Scotia……………… | 1 | 133 | - | 29 | 4 | 167 |
| Northwest Territories…….. | - | 1 | - | - | - | 1 |
| Nunavut………………… | - | - | - | - | 3 | 3 |
| Ontario………………… | 3 | 1,162 | 1 | 477 | 49 | 1,692 |
| Prince Edward Island….. | - | 12 | - | 7 | - | 19 |
| Quebec………………… | 8 | 386 | - | 95 | 7 | 490 |
| Saskatchewan………….. | 1 | 46 | - | 14 | 6 | 67 |
| Yukon………………….. | - | 2 | - | - | - | 2 |
| Totals for Canada……… | 8 | 2,365 | 2 | 801 | 119 | 3,295 |

**% standard to total in Canada:** 2373/3295 = 72%

| | Standard | | Non-Standard | | Self-Serve | |
|---|---|---|---|---|---|---|
| | Company | Franchise | Company | Franchise | Kiosks | Total |
| **United States' Locations** | | | | | | |
| Indiana……………...... | - | 1 | - | - | - | 1 |
| Kentucky……………… | - | 2 | - | 1 | - | 3 |
| Maine……………… …. | - | 27 | - | 1 | - | 29 |
| Maryland……………… | - | - | - | - | - | 2 |
| Michigan……………… | - | 143 | - | 18 | - | 161 |
| New York……………… | - | 132 | - | 75 | 148 | 355 |
| Ohio…………………… | 6 | 105 | - | 13 | 9 | 127 |
| Pennsylvania…………… | - | 11 | - | 4 | 13 | 28 |
| Virginia………………… | - | 1 | - | 1 | - | 2 |
| West Virginia…………… | 1 | 5 | - | - | - | 6 |
| Totals for United States… | 8 | 427 | 0 | 115 | 164 | 714 |

**% standard to total in United States:** 435/714 = 61%

| | Standard | | Non-Standard | | Self-Serve | |
|---|---|---|---|---|---|---|
| | Company | Franchise | Company | Franchise | Kiosks | Total |
| **Other Locations outside North America** | | | | | | |
| United Arab Emirates… | - | 5 | - | - | - | 5 |
| Republic of Ireland | - | 3 | - | - | 186 | 189 |
| United Kingdom | - | - | - | - | 72 | 72 |
| Totals outside North America | 0 | 8 | 0 | 0 | 258 | 266 |

**% standard to total outside North America:** 8/266 = 3%

**% standard to total overall:** 2816/4275 = 66%

## Appendix B: Selected Financial Data for Tim Hortons (Corporate)

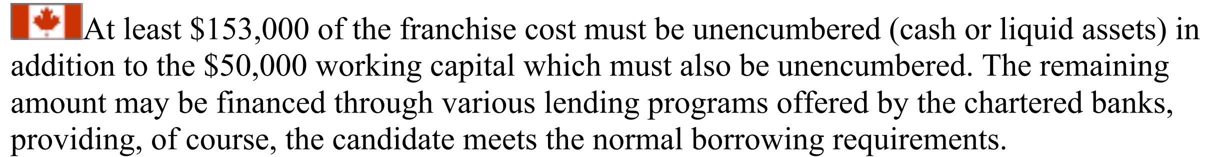
(in thousands, except for shareholding and calculated data, except as otherwise noted)

| | Fiscal Year | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| **Consolidated Statements of Operations** | | | | | |
| Revenues | | | | | |
| Sales | $2,225,659 | $2,012,170 | $1,755,244 | $1,704,065 | $1,541,882 |
| Franchise revenues: | | | | | |
| Franchise rents and royalties | 780,992 | 733,217 | 687,039 | 644,755 | 593,483 |
| Franchise fees | 113,853 | 107,579 | 94,212 | 90,033 | 93,808 |
| | 894,845 | 840,796 | 781,251 | 734,788 | 687,291 |
| Total revenues | 3,120,504 | 2,852,966 | 2,536,495 | 2,438,853 | 2,229,173 |
| Expenses | | | | | |
| Corporate reorganization expenses | 18,874 | - | - | - | - |
| Asset impairment and closure costs | (372) | 372 | 28,298 | - | 21,266 |
| Other costs and expenses | 2,507,477 | 2,283,119 | 1,997,034 | 1,913,251 | 1,729,460 |
| Total costs and expenses | 2,525,979 | 2,283,491 | 2,025,332 | 1,913,251 | 1,750,726 |
| Operating Income | $594,525 | $569,475 | $511,163 | $525,602 | $478,447 |
| Gain on sale of interest in Maidstone Bakeries | - | - | 361,075 | - | - |
| Interest expense | 30,413 | 25,873 | 24,180 | 19,184 | 19,632 |
| Income before income taxes | 564,112 | 543,602 | 848,058 | 506,418 | 458,815 |
| Income taxes | 156,346 | 157,854 | 200,940 | 186,606 | 150,309 |
| Net income | 407,766 | 385,748 | 647,118 | 319,812 | 308,506 |
| Net income to non-controlling interests | 4,881 | 2,936 | 23,159 | 23,445 | 23,828 |
| Net income to Tim Hortons Inc. | 402,885 | 382,912 | 623,959 | 296,387 | 284,678 |
| Diluted earnings per common share | $2.59 | $2.35 | $3.58 | $1.64 | $1.55 |
| Weighted average no. of common shares | 155,676 | 162,597 | 174,215 | 180,609 | 183,492 |
| Dividends per common share | $0.84 | $0.68 | $0.52 | $0.40 | $0.36 |
| **Consolidated Balance Sheet** | | | | | |
| Cash and cash equivalents | $120, 139 | $126,497 | $574,354 | $121,653 | $124,717 |
| Restricted cash and investments | 150,574 | 130,613 | 105,080 | 80,815 | 62,329 |
| Total assets | 2,284,179 | 2,203,950 | 2,481,516 | 2,094,291 | 2,097,694 |
| Long term debt | 531,484 | 457,290 | 437,348 | 411,694 | 405,500 |
| Total liabilities | 1,094,088 | 1,049,517 | 1,039,074 | 838,605 | 865,891 |
| Total equity | 1,190,091 | 1,154,433 | 1,442,442 | 1,255,686 | 1,232,803 |
| **Gross Margin Calculation** (based on above) (Operating Income/Total Revenues) | 19.05% | 19.96% | 20.15% | 21.55% | 21.46% |

## Appendix C: Tim Hortons Franchising System and Costs

**Franchise Cost:** $480,000 to $510,000* plus all applicable taxes (includes a drive-thru)

**Additional Working Capital:** start-up costs $50,000 (unencumbered)



At least $153,000 of the franchise cost must be unencumbered (cash or liquid assets) in addition to the $50,000 working capital which must also be unencumbered. The remaining amount may be financed through various lending programs offered by the chartered banks, providing, of course, the candidate meets the normal borrowing requirements.

The specific cost of a Tim Hortons license will depend upon the Tim Hortons building size and the required furnishings and equipment to be installed. The cost of a Tim Hortons license may exceed $510,000 in certain locations due to higher development costs.

**Included in the cost of a franchise is the following:**

- All equipment, furniture, display equipment and signage
- Seven (7) week training program in the Oakville, ON, Tim Hortons University
- A restaurant opening crew to assist the opening of the Tim Hortons restaurant (for a maximum period of 2 weeks)
- The use of all Tim Hortons Manuals
- Right to use trademarks and trade names
- Support from head office personnel who have vast knowledge in the food service business

**Not included in the cost of the franchise:**

- The building (TDL Group's responsibility)
- The property on which the restaurant is built (TDL Group's responsibility)
- The term of the License agreement is usually 10 years and usually with options to renew for up to a further period of 10 years
- The Real Estate and Development Department approves and secures all locations upon which Tim Hortons restaurants are built, whether they are leased or purchased. An applicant is not expected to bring forward a site and/or concern themselves with the development of such, nor is this an option.

## Appendix D: Tim Hortons' Vision and Values

**QSR Group's vision:**

To be the Quick Serve leader or "Pioneer" the Key Results Areas of Operations Excellence, Service Excellence, Financial Excellence and People Excellence

- **Do the Right Thing:**
  We cannot write a policy or guideline for every situation our time members find themselves in. We therefore ask people to consult their gut feelings when making decisions. If it feels right, then it probably is right. No one can fault you for doing what you believe is right.

- **Treat Everyone with Respect:**
  Just be Nice and Always Fair: Some examples of this value include: Praising people in public and criticizing in private, positing schedules two weeks in advance, treating others the way you would like to be treated, and smiling! If we were able to pass on our skills then we become more valuate team members, we can take time off and our jobs actually become easier.

- **Profit is not a Dirty Work:**
  We need to have reasonable and competitive profit margins in order to grow, keep our business operating, and create new opportunities for our team members! Often this means being able to adapt to the change effectively.

- **Give Something Back:**
  It is important that we give back to the communities that have helped to make us successful. We do this in many different ways. Most notably through the Tim Horton children's Foundation and the Dave Thomas Foundation for Adoption in Canada, we always encourage our team members to be involved in the many other charitable activities that we are involved in which means so much to the communities in which we operate.

- **Have Fun:**
  We spend a great deal of our lives working. We might as well enjoy it and have fun! Smile and be engaged! You will have more fun and people around you will as well.