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Hospitality Management 26 (2007) 66–80

INTERNATIONAL JOURNAL OF Hospitality Management

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Does corporate growth really matter in the restaurant industry?

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Abstract

In this study, the authors hypothesize that growth strategies are not necessarily always performance-enhancing strategies that are sustainable. This is contrary to what industry managers tend to believe to be the outcome of growth strategies. Based on past research, a second hypothesis is developed that corporate liquidity impacts performance in a more positive way than growth strategies, and therefore, should be considered in the decision-making framework of firms before they launch into new products and/or markets. The interrelationship between corporate growth and liquidity is also tested, which further highlights the importance of pursuing corporate liquidity.
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Keywords: Corporate strategies; Growth; Liquidity; Firm performance; Free cash flow per share; Return on equity; Restaurant industry

1. Introduction

The imperative for every executive of a publicly traded firm is growth. The growth expectation is for a combination of metrics such as sales, earnings and overall returns. In the hospitality industry, this growth imperative has also been demonstrated through quest to increase the number of units and improved customer counts in existing units. To accomplish this imperative firms have used vehicles such as management contracts,

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doi:10.1016/j.ijhm.2005.09.004

franchising and various combinations of ownership and joint ventures to enter new markets, both domestic and international over the past four decades. These growth vehicles are considered attractive, as firms are able to distribute their products and services with less risk and capital investment. While growth has always been assumed to add value to the firm, it has seldom been empirically tested and/or proven in the hospitality industry context. It has just been assumed that this was the case. In part, this assumption is driven by the unrelenting pressure of industry analysts and investors for continued growth.

While no argument is made against the growth imperative, the question as to whether or not this always results in increased shareholder value must be raised. To date, little or no research has been conducted to address this question in the context of the hospitality industry. This lack of evidence has served as the underpinning for the research effort reported herein. More specifically, the primary research question is: Do firm growth strategies such as increased assets, increased sales growth, and increased potential growth necessarily lead to increased sustainable firm performance?

In the context of the hospitality industry, several situations within the restaurant industry sector can be cited wherein firms have used aggressive growth strategies when conditions are favorable, i.e., economic boom, only to have resorted to asset-retrenchment strategies during economic downturns. These include Shoney's Inc., Burger King, and recently McDonalds[1]. Although the argument that growth strategies positively impact the stock performance of firms in the short run as has been seen in cases such as Boston Market, KFC, and McDonald's, the broader question is: what impact does growth have on firm performance in the long-term[2]? This is because it is firm performance on a long-term basis that determines the sustainability of the growth strategy that was implemented in the first place. Therefore, the positive market reaction to growth strategies at the outset can turn negative if growth strategies do not necessarily impact firm performance in a positive way over a definite time interval. Thus, testing the effects of growth strategies on long-term performance is a more valid form of evaluating these strategies than just the initial reaction of the stock market when the firm announced and initiated a growth strategy. This is exemplified as seen in the case of Boston Market, which could not sustain the positive reaction of the stock market to its growth strategies through improved firm performance in the long term.

1.1. Objectives of the study

We hypothesize that growth strategies are not necessarily always performance-enhancing strategies that are sustainable. This hypothesis is contrary to what industry managers tend to believe to be the outcome of growth strategies. Based on past research, we develop a second hypothesis that corporate liquidity impacts performance in a more positive way than growth strategies, and therefore, should be considered in the decision-making framework of firms before they launch into new products and/or markets. We also test the interrelationship between corporate growth and liquidity to understand the

[1]Shoney's Inc. reported a decline in performance during the late 1990s, while McDonald's has faced downturn in the past few years (The Economist, 2004). Burger King, like McDonald's, has also been facing downturn over the past 2 years (Grow, 2005),

[2]In this study, long-term is considered as a time period of at least 5 years.

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