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McDonald's (in 2013): How to Win Again?

FEBRUARY 24, 2013. Don Thompson looked over the 2012 Annual Report that was to be released to McDonald's shareholders the next day. This year had been a disappointment compared to the company's past success. In 2011, McDonald's had outperformed nearly all of its competitors while riding the economic recovery from a deep economic recession. In fact, McDonald's was the number-one performing stock in the Dow 30 with a 34.7 percent total shareholder return.[1] But in 2012, McDonald's dropped to number 30 in the Dow 30 with a –10.75 percent return. The company went from first to last in just 12 brief months (see Exhibit 1). As Thompson read the report, he wondered how McDonald's could win again.

This was not good news for Don Thompson, who became Chief Executive Officer (CEO) in July of 2012. He replaced the popular Jim Skinner, who had been with the company for over 40 years. Skinner had guided McDonald's through the last decade with his "Plan to Win," which was fundamental to McDonald's continued growth in a challenging economic environment. Breaking from McDonald's historical emphasis on new store growth, Skinner emphasized the importance of improving the food, service, and atmosphere at existing stores.[2] Instead of accumulating real estate, he modernized McDonald's restaurants to create a more café-like ambience and introduced new menu items that appealed to a more diverse customer base.[3]

Thompson, who served as Chief Operating Officer (COO) and President of McDonald's USA under Skinner, had successfully implemented the first stages of "Plan to Win." Now as CEO, his job was to build upon Skinner's success and continue to foster McDonald's growth by focusing on three strategic goals: (1) optimizing and evolving the menu; (2) modernizing the customer experience; and (3) broadening accessibility to the brand.[4]

Thompson knew that early results were well below expectations. In October 2012, McDonald's sales growth dropped by 1.8 percent, the first monthly decline since 2003.[5] Annual system-wide sales growth in 2012 barely met the minimum 3 percent goal, while operating income growth was just 1 percent (compared to a goal of 6 to 7 percent).[6] Sales declined yet again in January and February of 2013.[7] Despite stock prices at relative highs, McDonald's was struggling to convince its cash-strapped customers to purchase more food, which was hampering the company's free cash flows. Meanwhile, the weak global economy was dragging down its meager gains in domestic sales.[8] When the dollar was relatively weak, it had been an asset for the company to generate almost 70 percent of its revenues from overseas,[9] but the dollar's current strength made McDonald's trademark products even more expensive for its international consumers.

In addition, the company faced tough competition on multiple fronts. Traditional quick-service competitors such as Burger King, Wendy's, and Taco Bell had strikingly similar strategic plans: to modernize their architecture and improve their menus. Initial reports indicated their efforts were working, even as McDonald's struggled to revitalize its brand image. Sandwich places such as Subway were well positioned in the health segment, whereas Starbucks and Dunkin' Donuts were formidable competitors in the "specialty coffee wars." Semi-upscale, fast-casual restaurants such as Panera Bread and Chipotle were also taking a cut of the fast-food market, with better

Professors Marne L. Arthaud-Day and Frank T. Rothaermel and Justin Collins (GT MBA '14) prepared this case from public sources. This case is developed for the purpose of class discussion. It is not intended to be used for any kind of endorsement, source of data, or depiction of efficient or inefficient management. All opinions expressed, and all errors and omissions, are entirely the authors'. © by Arthaud-Day, Rothaermel, and Collins, 2015.

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tasting options that were still timely and affordable enough. Premium burger chains such as Five Guys and California's In-N-Out Burger were actively redefining burger quality and value.[10]

Thompson's main response thus far had been to reassure investors that McDonald's was focused on the long term, despite these more immediate setbacks:

> We remain strategically focused on the global growth priorities that help us better serve our customers. While the informal eating out market remains challenging and economic uncertainty is pressuring consumer spending, we're continuing to differentiate the McDonald's experience by uniting consumer insights, innovation and execution.[11]

He just hoped the company's efforts would be sufficient for him to still have his job by this time next year.

A Brief History of McDonald's

McDonald's was started by the McDonald brothers in 1940 in San Bernardino, California. By limiting the menu to burgers, fries, and drinks, Dick and Mac McDonald were able to emphasize quality and streamline their operations. As a result, the popularity of the restaurant grew quickly, and the brothers started franchising McDonald's to nearby locations. Alerted to their success when the McDonalds placed a large order for eight multi-mixers, Ray Kroc joined the brothers in 1954. Together, they founded the McDonald's Corporation in 1955, with the vision of establishing McDonald's franchises throughout the United States. Kroc bought out the brothers' shares in 1961, the same year that he founded the now infamous Hamburger University (graduates receive a bachelor's degree in Hamburgerology). He continued his plans for rapid expansion throughout the 1960s and 1970s, establishing more than 700 new McDonald's restaurants.[12] In 1965, the company held its first public offering, debuting at $22.50 per share.[13]

Kroc described his management philosophy as a three-legged stool: one leg was the parent corporation, the second leg was the franchisees, and the third was McDonald's suppliers. His motto became, "In business for yourself, but not by yourself," as he built an ever larger network of store owners and an integrated supply chain management system.[14] Many new menu items, such as the Big Mac and Egg McMuffin, were developed by the franchisees. Kroc encouraged his local owners to be entrepreneurial as long as they maintained the company's four main principles: quality, service, cleanliness, and value. Because of the volume of McDonald's business, Kroc found many supply partners willing to adhere to his high standards.[15]

The company opened its first international locations in 1967 in Canada and Puerto Rico. The first McDonald's stores in Japan and Europe followed shortly thereafter in 1971.[16] Meanwhile, Kroc continued to add new items to the restaurant's menu. After the success of the Big Mac (1968), the quarter pounder debuted in 1973, and the Egg McMuffin in 1975. A full breakfast menu was available by 1977. The first Happy Meals—complete with a circus wagon theme—arrived in 1979.[17] The company's first drive-thru opened in Sierra Vista, Arizona, in 1975 to serve soldiers stationed at a nearby post, and the idea quickly spread to other locations.[18]

Competition heated up in the "burger wars" of the 1980s as Burger King and Wendy's tried to steal market share from McDonald's. Despite their advances, McDonald's continued to expand globally into more than 30 countries. Even more new products were introduced, such as Chicken McNuggets in 1983 and fresh salads in 1987. At the same time, McDonald's used efficiency and technological advances such as microwaves to gain operational advantages over its competitors. When Ray Kroc passed away on January 14, 1984, he left behind a sprawling McDonald's empire with more than 7,500 restaurants worldwide.[19] He stayed involved in corporate affairs up until the end, visiting the San Diego office almost daily in his wheelchair.[20] Three years later, Fred Turner, his long-time colleague and successor as CEO, likewise stepped down and left the company in the capable hands of Michael Quinlan. As the first McDonald's CEO to have completed an MBA, Quinlan was a savvy businessman who continued to grow the company aggressively both at home and abroad.[21]

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Events in the 1990s finally slowed McDonald's rapid pace of domestic expansion, though the company's international locations nearly doubled to 114 from 1991 to 1998. Several of the newer locations required unique adaptations, which McDonald's proved increasingly willing to make: kosher menus in Israel, Halal menus in Arab countries, and lamb patties for non-beef-eating India.[22,23] At home, however, the company was plagued by multiple failed attempts to add new menu items such as pizza, fried chicken, fajitas, and pasta. The Arch Deluxe sandwich line, targeted to adults, was similarly short-lived. When Jack Greenberg became CEO in 1998, he quickly took corrective action, announcing a geographic reorganization, a new food preparation system ("Made for You"), and McDonald's first job cuts ever, all while scrapping plans for numerous store openings.[24] Instead, he diversified the company's portfolio by buying different restaurant chains such as Chipotle Mexican Grill, Donatos Pizza, Boston Market, and Aroma Cafe coffee shops.[25] These purchases were later divested when McDonald's strategy shifted yet again in the early 2000s.

From 2003 to 2004, McDonald's leadership underwent a rapid string of successions that would have crippled a company with a less talented executive bench. Greenberg stepped down amidst financial woes in 2003, yielding the reins to Jim Cantalupo, who died suddenly of a heart attack the next year. The board immediately named Charlie Bell to the head position after Cantalupo's death, only for Bell to be diagnosed with colorectal cancer and relinquish the post after just a few months in office. This left Jim Skinner, previously Vice Chairman, in charge of introducing and implementing the company's "Plan to Win" starting in late 2004.[26] He wanted to focus the company on 5 P's—People, Products, Price, Place, and Promotion—believing that McDonald's success was not dependent on one product or initiative but on focused execution and innovation.[27] Skinner's new strategic mindset was reflected in the company's "i'm lovin' it"[28] advertising campaign, which featured healthier and higher-quality foods such as white-meat chicken and salads. Nutrition facts were placed on all food items. Even Ronald McDonald was given a more slimmed-down look. At the same time, restaurants were redesigned to promote a more modern experience for the customer.

Thompson's rise to the top at McDonald's is an unlikely story. Thompson, McDonald's first black CEO, was first hired by defense contractor Northrup Grumman, after graduating from Purdue University with an electrical engineering degree. After a cold call from a recruiter at McDonald's, who Thompson initially thought was calling from competing defense contractor McDonnell Douglas, Thompson joined McDonald's to design robotics for food transport and control circuits for cooking equipment. He soon changed his career focus from engineering to operations, working a wide range of jobs from fry cook to regional manager in order to understand the company's day-to-day activities.[29] After several key leadership positions, he became COO in 2010. As COO, Thompson was the driving force behind the successful McCafé campaign, which introduced hot and iced espresso drinks, real fruit smoothies, and caramel mochas to McDonald's menu lineup.[30] When Jim Skinner retired later that same year, Thompson was the obvious choice of successor. He inherited a global enterprise with 34,000 locations that serve nearly 69 million customers in 118 countries on any given day,[31] which unfortunately was starting to show signs of problems once again.

Trends in the Quick-Service Restaurant Industry

Despite expectations for growth, the economic trends for the quick-service industry suggest challenges ahead.

ECONOMIC TRENDS

The U.S. quick-service restaurant industry grew by 12 to 15 percent from 2007 through 2012, and is expected to grow another 22 percent to reach a value of $224 billion in 2017 (see Exhibit 2).[32]

Yet despite its overall positive trajectory, the quick-service restaurant industry faces several challenges. The slow pace of recovery from the economic recession continues to exert a negative influence on discretionary income and consumer spending habits. With unemployment rates still hovering around 8 percent (and another

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15 percent of the population underemployed), people are eating out less[33] and looking for increased quality and value when they do venture outside the home for meals.[34] In a survey of people who had eaten at a fast-food restaurant in the past month, 36 percent of respondents indicated they were spending less compared to last year, 46 percent indicated their spending levels remained comparable, and only 17 percent reported an increase in spending.[35] Moreover, a large proportion (60 percent) of these patrons are ordering exclusively from the value menu.[36] As shown in Exhibit 3, customers in the lowest income category tend to purchase single value menu items, while those in the $25K to $49.9K income bracket piece together meals from the value menu, completely avoiding the higher-priced options.[37]

In fact, value for the money (59 percent) appears to be the primary determinant of restaurant selection, followed by convenience (53 percent), and only then by taste of food (50 percent), as shown in Exhibit 4.[38]

HEALTH CONCERNS

At the same time, customers are looking for healthier menu items. While beef still comprises the highest proportion (58 percent) of meat consumed in the United States, consumer preferences are shifting toward poultry and other lean meats.[39] The gluten-free movement is pressing restaurants to offer more items for the 30 percent of Americans who are gluten intolerant.[40] The Patient Protection and Affordable Care Act, which was signed into law in March 2010, stipulates that calorie counts must be displayed on all food service menus of chains with at least 20 units, and that restaurants must provide additional nutritional information upon request.[41] All of these trends place considerable pressure on a fast-food industry that is still dependent on hamburgers for the main portion of its income. McDonald's has actually been sued (unsuccessfully) for making its customers fat and was featured in an unflattering documentary *(Super Size Me)*, in which Morgan Spurlock grew increasingly ill and gained 25 pounds after eating only McDonald's food for one month.[42]

INCREASING SUPPLY COSTS

Healthier and more diverse menu items mean increased supply costs for restaurants, even as customers remain very price sensitive. In addition, fuel costs started rising in the first half of 2012, making it more expensive to raise agricultural products and transport them to market. This was further compounded by a severe drought later the same year, which prompted the USDA to pronounce the corn crop a disaster.[43] Not only is corn one of the main products used to feed both cattle and chickens, but corn oil, meal, and other byproducts are a significant component of many grocery items.[44] The resulting price increases for supplies ranging from bread to eggs to meat are squeezing already tight operating margins. Beef prices are expected to increase another 4 to 5 percent in 2013, as farmers reduce their herds to control their own costs of production.[45]

Current Competitors

Traditionally, McDonald's main competition has come from other quick-service restaurants such as Wendy's, Burger King, and Yum! Brands' Taco Bell. McDonald's is roughly twice the size of its next largest global competitor (all three Yum! Brands combined), but has slightly fewer stores.[46] It controls almost half of the U.S. hamburger market, which is more than three times larger than the market share held by either Wendy's or Burger King.[47] Yet, each of these competitors' stock outperformed McDonald's in 2012, a worrying trend for the company's future.

WENDY'S

Wendy's recently superseded Burger King as the number-two burger chain,[48] with more than 6,500 locations in 28 countries.[49] Wendy's strives to differentiate itself as "a cut above" its competitors, with higher-quality food that is made fresh-to-order.[50] Its current strategy is to focus on long-term brand development by redesigning its

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stores, offering an expanded menu including breakfast, and a new advertising campaign. At a price tag of up to $700,000 per store, the remodeling was estimated to cost the company $225 million in capital expenditures in 2012 alone. The good news for Wendy's is that the physical upgrades appear to be associated with an increase in same-store sales of 5 to 25 percent (i.e., the stores are generally recouping their expenses).[51] Recent additions to Wendy's menu such as its sea-salt French fries, a new collection of salads, and Dave's Hot 'N Juicy burgers have proven quite popular,[52] helping to generate several consecutive quarterly sales increases for the corporation.[53] The company's decision to sell 425 company-owned stores to franchisors, reducing the level of corporate ownership from 22 percent to 15 percent, has also been greeted warmly by investors, causing its stock to rally.[54]

BURGER KING

Burger King is currently the third-largest quick-service restaurant chain in the United States based on sales volume. It was acquired by private equity firm 3G Capital in 2010, taken private, and then went public again in mid-2012. Changes made by the new ownership appear to be positive, as the company reported a 6.4 percent growth in sales during its first quarter back on the stock market.[55] The chain boasts some 12,700 outlets in 73 countries, with over 60 percent of its restaurants concentrated in the United States; only 5 percent of Burger King restaurants are company owned.[56] Burger King likewise continues to aggressively attack McDonald's market share, by adding a variety of new menu items and modernizing its stores.[57,58]

TACO BELL

Taco Bell (a division of Yum! Brands) is the most widely recognized Tex-Mex option in the quick-service restaurant category, with approximately 5,800 restaurants (80 percent of which are franchises) in the United States. After a string of food contamination and quality issues from 2006 through 2011, the company has started to rebound, posting a 13 percent increase in same-store sales in the second quarter of 2012. Taco Bell's leadership credits its comeback to the successful introduction of its new, healthier Cantina Bell product line and the popular "Doritos Locos Tacos." It is currently experimenting with breakfast options in several states, with a nationwide rollout planned for 2014.[59] The chain plans to double its revenues from $7 billion to $14 billion over the next 10 years.[60]

SUBWAY

A different sort of quick-service competitor that challenges McDonald's dominance is Subway. Known for its healthier menu items and fresh ingredients, Subway recently surpassed McDonald's in the number of total restaurants (39,618 globally, including 25,936 in the United States).[61] The chain has become a popular lunchtime destination for many Americans who value convenience but do not want to compromise their health. For those customers who might still crave an occasional ground beef fix, however, Subway is testing a new line of Angus Melt sandwiches in limited markets.[62] In 2012, Subway's sales totaled $18.1 billion; Subway's co-founder envisions that the chain could expand to 100,000 locations by 2030.[63]

In the meantime, boundaries between quick-service and other restaurant segments have become increasingly blurred. Fast-casual restaurants provide high-quality food without table service, in a comfortable atmosphere, at prices that are "low enough." Due to this successful combination of high quality and relatively low prices, the fast-casual segment is one of the few areas in the restaurant industry that is experiencing steady growth.[64] Restaurants such as Panera Bread and Chipotle are changing the expectations of customers, which is causing traditional fast-food chains to change as well. Even traditional sit-down restaurants are looking at ways to move into the fast-casual arena by offering selected scaled-down dishes that appeal to value-seeking diners.[65]

A sub-segment of the fast-casual restaurant industry is the premium burger segment. Customers have been flocking to burger chains such as Five Guys, In-N-Out Burger, Shake Shack, Smashburger, and Fatburger for higher-priced, higher-quality burgers, while fast-food joints such as McDonald's, Burger King, and Wendy's

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have scrambled to counter with their own premium offerings. But much like the Arch Deluxe in the 1990s,[66] McDonald's one-third pound Angus burger was short-lived. Customers could not justify paying $4 to $5 for a single burger when there were sandwiches on McDonald's Dollar Menu for much less.[67] In light of the rising price of beef, the company has decided to offer three new Quarter Pounders with whole grain buns[68] as well as non-beef items like the brand new chicken McWrap instead.[69]

STARBUCKS

McDonald's expansion into specialty coffee drinks with the McCafé line means that it also competes with more traditional coffee shops such as Starbucks and Dunkin' Donuts. Starbucks answered the introduction of McCafé by distributing its Seattle's Best brand to other quick-service restaurants such as Burger King and Subway, as well as by adding new food offerings.[70]

DUNKIN' DONUTS

Dunkin' Donuts, which has served coffee for more than 60 years, recently made a failed bid to trademark its brew as the "Best Coffee in America."[71] It plans to triple its presence to 15,000 shops and is likewise expanding its warm breakfast options to compete more effectively.[72] As coffee shops sell more food and restaurants dispense specialty coffees, competition between these once distinct market segments is becoming much more intense.

Target Market

Market research indicates that the typical American dines out five times per week. One of the main reasons so many quick-service restaurants are focusing on new breakfast items is that the early morning meal is the least saturated. For every restaurant breakfast, the NPD Group estimates that the average American consumes 2.5 lunches and almost 2 dinners outside the home.[73] Around 11 to 12 percent of these meals are eaten at McDonald's.[74,75]

A quick breakdown of a typical McDonald's franchise in a middle-class suburb of 25,000 residents provides additional market insight. Roughly 1 out of 16 or 1,500 people in town visit the local McDonald's over the course of a given day. Breakfast accounts for the largest proportion (30 percent) of sales, followed by lunch (24 percent); afternoon, dinnertime, and late night/early morning each account for another 15 to 16 percent of sales. The noon lunch hour is the busiest and most profitable time of day, bringing in $200,000 in revenues.[76] Annually, the average franchise can be expected to bring in about $1.7 million in sales, with an operating profit of around $150,000.[77]

McDonald's three main target market segments are mothers, children, and young adults.[78] Moms view McDonald's as a quick, easy, and affordable meal for families on the go, and usually are the ones who bring the children. But with 17 percent of U.S. youth considered obese, fast-food chains find themselves in an awkward position when marketing directly to children. In response to parental demands for healthier kid meal options, McDonald's has already reduced its Happy Meal calorie count by 20 percent by adding apples and halving the amount of French fries. McDonald's has also promised to reduce the sodium content of its food by 15 percent by 2015, and to make further reductions in calories, sugars, saturated fats, and portion sizes by 2020.[79] Even this was not enough for a 9-year-old girl who publicly took CEO Thompson to task at a recent shareholders' meeting, accusing the company of tricking kids into eating junk food by using toys and cartoon characters.[80] Other chains, such as Jack in the Box, have opted to eliminate toys from their kids' meals,[81] while Taco Bell has dropped its children's menu altogether.[82]

However, the key demographic group for most fast-food restaurants is comprised of young, single professionals who earn above-average incomes. These so-called "heavy users" frequent a given chain twice or more per week, providing a steady source of sales and profit.[83] Unfortunately, a recent study indicated that McDonald's

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was not even in the top 10 of the 18-to-32-year-old age group's favorite restaurants. Instead, millennials are more likely to eat at fast-casual restaurants that emphasize ingredient quality and demonstrate an awareness of social issues such as environmental sustainability. Transparency is also important to young adults. Restaurants such as Chipotle and Panera Bread are known for demonstrating openness about their food sourcing and preparation,[84] whereas McDonald's has been plagued by perceived deceptions. Vegetarians raised an uproar once it was discovered that McDonald's had continued to use a small amount of beef tallow as flavoring when cooking its French fries.[85] It was also forced to discontinue making burgers out of "boneless lean beef trimmings" mixed with ammonium hydroxide, after Jamie Oliver exposed the company's use of "pink slime" on national television.[86]

"Plan to Win"

After McDonald's ended 2002 with its first quarterly loss ever,[87] CEO Jim Skinner introduced his original "Plan to Win," based on the three pillars of "brand direction, freedom within a framework, and measureable milestones." The plan was focused on four goals: to attract more customers, to convince customers to purchase more often, to increase brand loyalty, and to become more profitable. Skinner further distinguished five Ps—People, Product, Place, Price, and Promotion—as essential to McDonald's efforts in achieving these goals.[88]

In a saturated market, the main thrust of Skinner's plan was to shift from acquiring expensive real estate to generating increased sales from existing restaurants.[89] In the early 2000s, McDonald's was opening a new store somewhere in the world every 4.5 hours; under Skinner's watch, the pace slowed to just 50 to 100 new U.S. sites per year.[90] To compensate, existing stores started to stay open longer, extending their hours into the late night and early morning. A restaurant in Garner, North Carolina, saw its annual revenues rise by 4.5 percent ($90,000) when it converted to being open 24/7.[91] By 2007, roughly 40 percent of McDonald's locations were open nonstop,[92] in subsequent years, some even experimented with staying open on holidays.[93]

Among other things, Skinner used the money saved on aborted new openings to revamp existing restaurants. The "new" McDonald's look utilized a gentler color scheme, replaced fiberglass and steel chairs with leather seating, eliminated fluorescent lighting, and added such amenities as flat-screen TVs, free Wi-Fi, live plants, piped-in music, and the occasional fireplace.[94] Headquarters provided grants of up to $600,000 per site, with some projects costing as much as $1.5 billion.[95] By the time all of the renovations are completed in 2015, the company will have invested over $1 billion in the hope that "nicer-looking stores attract more business."[96]

At the same time, Skinner sent McDonald's chefs back to the drawing board to research new menu possibilities more in line with current health trends. The company had grown lax in its product development efforts, as evidenced by its $100 million Arch Deluxe mistake[97] and other failures such as the McPizza, McHotDog, and McSalad Shaker.[98] McDonald's also lagged significantly behind its competitors in purging trans fats from its recipes, in apparent disdain of consumer preferences.[99] Under Skinner, the company took the time to conduct extensive market research and developed a new passion for numbers. Potential new menu items had to pass a series of tests before they could move on to the next stage of development, based on an analysis of their sales, margins, costs, and time and ease of production.[100] This more rigorous approach led to the development of the "Oven Selects" sandwiches,[101] a southern-style fried chicken biscuit for breakfast,[102] and of course, the McCafé line of coffees, smoothies, and other beverages.[103]

The other half of the equation involved cost cutting by improving operational efficiency. Adamant that McDonald's would not make its burgers smaller just to save money, Skinner directed his executives to find more creative ways to increase margins. So, the company cut travel, held meetings at Hamburger University instead of expensive hotels, and increased personal usage fees on company vehicles. When McDonald's COO learned that major networks were cutting their advertising rates for struggling car manufacturers, he renegotiated for a better deal. Meanwhile, the company continued to invest in time- and cost-saving technologies such as more efficient drive-through windows and computer systems that enable stores to price items according to local demand and income level.[104]

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The Current Challenge

As Don Thompson looked over the results from the past year, he realized that most of the low-hanging fruit had already been plucked. Neither the incremental gains from the remaining store modernizations nor convincing the rest of the franchisees to remain open for longer hours would be enough to offset the troubling downward trend in profitability (see McDonald's financial data in Exhibit 5). Instead, he would have to focus on optimizing the menu to keep pace with evolving consumer preferences, improving the customer experience so that they would come back again, and making McDonald's more accessible to a broader market base.[105]

First, it was clear to Thompson that McDonald's needed a "McHit."[106] Personally, he was pinning his hopes on the universal launch of the McWrap chicken sandwich in 2013. The McWrap's predecessors first appeared in Europe as early as 2004, as variations of a chicken roll-up and kebab meat wrapped in a tortilla. U.S. versions of the sandwich were tested locally as early as 2010, but it had taken three more years to perfect the recipe, conduct a thorough market analysis, and streamline the production process. The kitchens had explored ingredients as diverse as hoisin sauce, goat cheese, and shrimp, but ultimately abandoned them in favor of flavors with more mass appeal: sweet chili, creamy garlic, and ranch. They added one new vegetable—the cucumber—to McDonald's repertoire, which required finding companies that could reliably supply the six million pounds of new produce that would be needed each year. Market researchers tested names such as the "Grande Wrap" and "Fresh Garden Wrap," only to discard them for the more recognizable "McWrap." Inside the restaurants, they had to figure out how to steam the tortillas and where to place the sauce, all while ensuring that a trained employee could assemble the sandwich in 60 seconds or less. Despite public protestations to the contrary, McDonald's was clearly looking to the McWrap as a "Subway buster" that would lure the millennials back into its stores.[107] And indeed, a recent survey showed that 22 percent of young diners would choose Subway over McDonald's if its stores did not carry the McWrap.[108] If McDonald's could not recapture the young adult market segment with this and other new, healthy menu options, then it risked losing an entire generation of restaurant-goers.

Second, the company had serious service and staffing issues that needed to be addressed if it was to improve customer loyalty. An internal report that found its way to the media showed that one out of every five customer complaints was about "rude or unprofessional employees."[109] According to a national survey of quick-service restaurants, McDonald's was ranked next to last in "friendliness," beating only Burger King. Complaints about speed of service also "had increased significantly over the past six months," with the McDonald's service experience described as "chaotic." Customers currently placed their order with a cashier and then waited off to the side as that cashier pulled the ordered items together or took care of the next person in line. Having cashiers doubling as order gatherers was inefficient and contributed to increased waiting times. Drive-through patrons did not fare much better. The average service time for a McDonald's drive-through was 188.83 seconds, which lagged behind rival Wendy's average by almost a minute. Part of the problem was that too many restaurants were understaffed during peak breakfast and lunch hours. Stressed-out employees struggled to take care of both the vehicles lined up in the drive-through and long lines of dine-in customers within the store. It was hard to be friendly while work was piling up and while customers grew increasingly irritated at how long it took to place and get their orders. Because employees were only trained to handle a few specific duties, there was little extra help available for anyone who fell behind. Consequently, the annual turnover rate in the fast-food industry was 60 percent, as frustrated workers sought to move on to less stressful, not to mention higher paying, jobs.[110]

Third, McDonald's had to continue to draw in brand new customers if it was to maintain its historical rate of revenue growth. To Thompson, appealing to a broader market base meant reaching out to new segments in current markets as well as strategically selecting which new global markets to enter. Yet this was perhaps the most challenging task of all. If customers were not already attracted by McDonald's classic combination of convenient food at a good price, what would it take to lure them into its stores? More importantly, was it something that McDonald's could afford to offer? Realistically, the only places the company could add new stores were in developing markets such as the Asia Pacific, Middle East, and Africa regions (see Exhibit 6 for a comparison of number of McDonald's locations worldwide), but these areas came with their own unique set of risks.[111] Traditional business wisdom suggested that global companies fare better than their domestic counterparts in part because they

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can diversify their exposure across multiple financial markets. However, the extent of McDonald's international presence had in some ways increased its vulnerability to the recent recession, raising the question of whether it was perhaps getting too big to be safe in today's modern, global economy.

Mr. Thompson knew that addressing all of these issues would come with a tremendous increase in complexity and cost,[112] at a time when margins were already tight. McDonald's "upscale" eateries now had 145 items on the menu, including six different types of McWraps.[113] While a greater variety of menu options was necessary to draw new customers into stores, too many items slowed down the order fulfillment process, increasing employee stress and customer frustrations. Adding one new ingredient required a near logistical miracle to ensure that six million pounds of cucumber could be found and delivered on time to 34,000 restaurants in 118 countries.[114] The need for such standardized processes and equipment vied with franchisees' desire for greater autonomy so that they could respond better to local demands.[115] If the days of mass market appeal were truly over, how could a restaurant franchise such as McDonald's build and sustain a coherent strategic identity? Mr. Thompson was no longer sure that price and convenience were enough to sustain McDonald's sprawling empire into the future. He looked at the "Plan to Win" poster hanging on his wall and thought, "How can we win again?"

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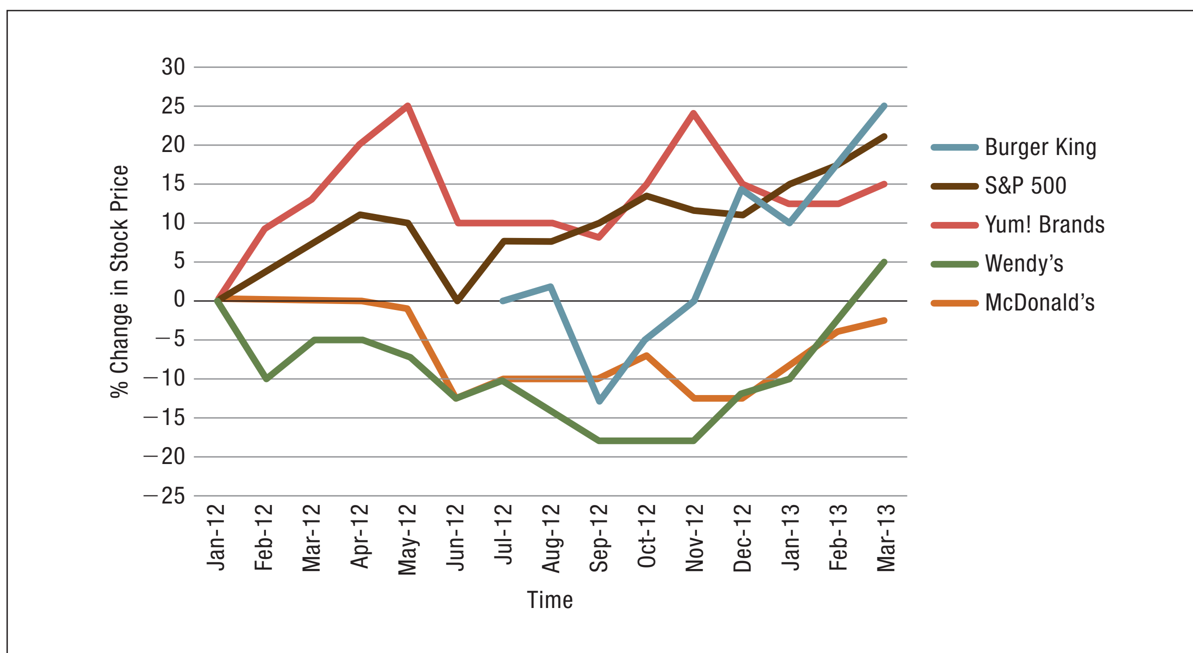
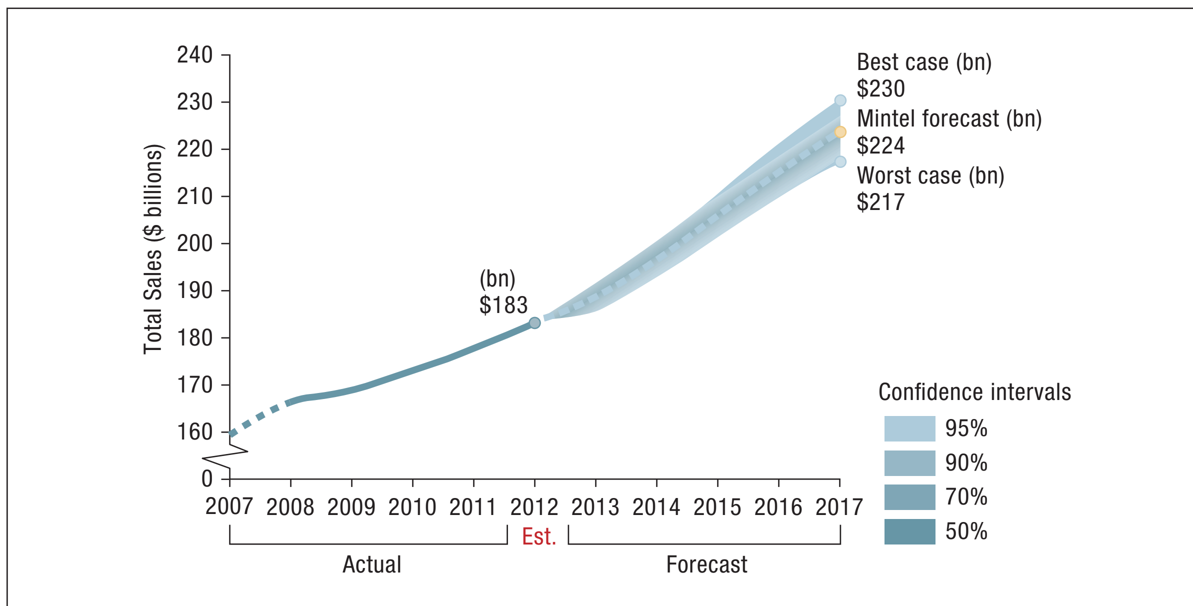
EXHIBIT 1 McDonald's Stock Performance, January 2012–March 2013



Source: Authors' depiction of data drawn from Yahoo Finance.

EXHIBIT 2 U.S. Quick-Service Restaurant Sales and Fan Chart Forecast (in $ billions)



Source: Mintel; based on Bureau of Labor Statistics, Consumer Expenditure Survey.

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EXHIBIT 3 Dollar/Value Menu Behavior, by Household Income, May 2012

"When you order off the dollar/value menu, which of the following do you typically do?"

Household Income Level:	All	$25K	$25K–49.9K	$50K–74.9K	$75K–99.9K	$100K+
Base: adults aged 18+ with Internet access who have been to a fast-food restaurant in the past month and order off the dollar/value menu	1,066	219	248	243	141	215
	%	%	%	%	%	%
Order dollar/value menu option with other dollar/value menu items	36	29	40	39	38	36
Order dollar/value menu option alone	24	31	25	20	19	24
Order dollar/value menu option in addition to a combo meal	20	19	18	21	26	18
Order dollar/value menu option with other regular menu items, not combo meals and not other dollar/value menu items	20	21	17	20	18	23

Source: Mintel, http://academic.mintel.com/display/636768/.

EXHIBIT 4 Quick-Service Selection Factors, by Age, May 2012

"When picking any restaurant that offers quick service and does not have a wait staff, which of the following are important to you?"

	All	18–24	25–34	35–44	45–54	55–64	65+
Base: adults aged 18+ with Internet access who have been to a fast-food restaurant in the past month	1,774	244	332	338	349	247	264
	%	%	%	%	%	%	%
Best value for the money	59	61	56	62	64	59	52
Convenience	53	53	48	55	54	58	48
Best-tasting food	50	54	52	48	49	49	49
Fresh food	45	43	40	43	49	49	48
Specific kind of sandwich/burger I really like	35	27	32	38	36	39	41
Dollar menu	35	41	37	39	34	29	29
Good variety of food and beverage options	30	25	26	32	34	28	35
Healthy food	30	30	30	23	30	35	35
Combo meal offerings that I like	27	24	28	33	30	23	22
Easy to customize my order	23	20	24	21	23	30	23
Self-serve fountain beverages	14	14	16	15	14	12	15
Good coffee	11	7	10	8	8	11	21
Free Wi-Fi	7	14	11	5	5	5	2
Online ordering or an order-in-advance feature	4	5	7	3	3	2	3
Programs/offerings that demonstrate it is environmentally responsible	4	6	6	3	3	2	2

Source: Mintel.

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EXHIBIT 5 McDonald's Financial Data (in $ millions, except EPS data)

Fiscal Year	2008	2009	2010	2011	2012
Cash and short-term investments	2,063	1,796	2,387	2,336	2,336
Receivables–total	931	1,060	1,179	1,335	1,375
Inventories–total	112	106	110	117	122
Property, plant, and equipment–total (net)	20,255	21,532	22,061	22,835	24,677
Depreciation, depletion, and amortization (accumulated)	10,898	11,909	12,422	12,903	13,814
Assets–total	28,462	30,225	31,975	32,990	35,387
Accounts payable–trade	620	636	944	961	1,142
Long-term debt	10,186	10,560	11,497	12,134	13,633
Liabilities–total	15,079	16,191	17,341	18,600	20,093
Stockholders' equity–total	13,383	14,034	14,634	14,390	15,294
Sales (net)	23,522	22,745	24,075	27,006	27,567
Cost of goods sold	13,722	12,792	13,237	14,990	15,349
Selling, general, and administrative expense	2,356	2,234	2,333	2,394	2,455
Income taxes	1,845	1,936	2,054	2,509	2,614
Income before extraordinary items	4,313	4,551	4,946	5,503	5,465
Net income (loss)	4,313	4,551	4,946	5,503	5,465
Earnings per share (basic) excluding extraordinary items	3.83	4.17	4.64	5.33	5.41
Earnings per share (diluted) excluding extraordinary items	3.76	4.11	4.58	5.27	5.36

Source: Compustat.

EXHIBIT 6 Number of McDonald's Outlets in Selected Countries

Country	# of McDonald's
U.S.	13,381
Japan	3,598
Canada	1,400
Germany	1,276
UK	1,250
China	660

Source: Authors' depiction of data from IndexMundi Blog (http://bit.ly/17EPmjo).

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