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McDonald's Corporation

SEPTEMBER 1, 2015. Steve Easterbrook walked into his office in McDonald's corporate headquarters. He had finally achieved his dream of becoming chief executive officer (CEO) at a major Fortune 500 company, but somehow he had expected it to feel better than this. Don Thompson, the former CEO who had recently "retired" had not been just his boss, but his friend. They had both started their careers at McDonald's early in the 1990s and had climbed the corporate ladder together. He had not taken personal joy in seeing either his friend or his company fail. Rather, Easterbrook had fantasized about inheriting the company at its peak and taking it to new heights—not finding the corporate giant on its knees in desperate need of a way to get back up.

The company's troubles had snowballed quickly. In 2011, McDonald's had outperformed nearly all of its competitors while riding the 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 12 brief months (see **Exhibits 1 and 2**). In October 2012, McDonald's sales growth dropped by 1.8 percent, the first monthly decline since 2003.[2] 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).[3] Sales continued to decline over the next two years. Net income in 2014 fell almost 15 percent to $4.76 billion, representing the company's first annual drop in "like-for-like" sales since 2002.[4] By early 2015, McDonald's shares had dropped below their 2012 price point, while the overall market was up by 50 percent.[5]

Things were not much better overseas. The weak global economy was a further drain on domestic sales.[6] When the dollar was relatively weak, it had been an asset for the company to generate almost 70 percent of its revenues from other countries, but the dollar's current strength made McDonald's trademark products even more expensive for its international consumers.[7] Asian sales were still recovering from a 2014 scandal, where a major Chinese meat supplier had been accused of selling expired meat to McDonald's restaurants. European sales were also soft due to political problems in Russia. Several McDonald's outlets had "failed" inspection and been shut down in retaliation for U.S. sanctions against the Russian invasion of Ukraine.[8]

Thompson had already tried revitalizing the menu (e.g., the McWrap), eliminating poorly selling items, increasing customization, and restructuring U.S. operations to give local franchises greater autonomy. He had named Deborah Wahl the new chief marketing officer in March 2014 and brought Mike Andres in as president of the U.S. division in October that same year.[9] Yet customers still seemed

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confused by the complex menu offerings, distrustful of the quality of ingredients, frustrated at how long it took to get their food, and angry at the company's "exploitative" labor policies.[10, 11] According to analysts, "[Thompson] got fatally behind the last couple of years" and "wasn't inspiring people the way he needed to be."[12] But could Easterbrook do any better?

Easterbrook came to the top spot having turned around McDonald's UK and European operations, which were now among the best performing in the company. He had worked his way up to McDonald's top brand officer by 2010, then left to head two British restaurants (PizzaExpress Ltd. and Wagamama Ltd.), before returning to his former position in June 2013. Under Thompson, he subsequently assumed responsibility for corporate strategy and the restaurant solutions group. While some questioned whether another inside succession could provide the shake-up that McDonald's needed, others argued that Easterbrook had the right expertise in branding and media and willingness to focus on the menu, the areas with the greatest need of improvement.[13] In his first press conference as CEO, Easterbrook had presented himself as an "internal activist" who was "comfortable making the big decisions that are required to get the turnaround going."[14] Now it was time to deliver on his promise to turn McDonald's into a "modern, progressive burger company."[15]

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 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.[16] In 1965, the company held its first public offering, debuting at $22.50 per share.[17]

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.[18] 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.[19]

The company opened its first international locations in 1967 in Canada. The first McDonald's stores in Japan and Europe followed shortly thereafter in 1971.[20] 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.[21] The company's first drive-through opened in Sierra Vista, Arizona in 1975 to serve soldiers stationed at a nearby post, and the idea quickly spread to other locations.[22]

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.[23] He stayed involved in corporate affairs up until the end, visiting the San Diego office almost daily in his wheelchair.[24] 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.[25]

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.[26, 27] 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.[28] 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.[29] These purchases were 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.[30] The plan was based on the three pillars of "brand direction, freedom within a framework, and measureable milestones" and had 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.[31]

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.[32] 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.[33] To compensate, existing stores started to stay open longer, extending their hours into the late night and early morning. By 2007, roughly 40 percent of McDonald's locations were open nonstop, and some even experimented with staying open on holidays.[34, 35]

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.[36] Headquarters provided grants of up to $600,000 per site, with some projects costing as much as $1.5 million.[37] By the time all of the renovations were completed, the company had invested over $1 billion in the belief that "nicer-looking stores attract more business."[38]

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 and other failures such as the McPizza, McHotDog, and McSalad Shaker. [39, 40] McDonald's also lagged significantly behind its competitors in purging trans fats from its recipes.[41] 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.[42] This more rigorous approach led to the development of the "Oven Selects" sandwiches, a southern-style fried-chicken biscuit for breakfast, and of course, the McCafé line of coffees, smoothies, and other beverages. [43, 44, 45]

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. Meanwhile, the company continued to invest in time- and cost-saving technologies such as more efficient drive-through windows and computers.

By the time Don Thompson became CEO in 2012, most of the low-hanging fruit had already been plucked. Thompson graduated from Purdue University in 1984 with a degree in electrical engineering, and he was recruited to McDonald's four years later 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.[46] Ascending to serve as Skinner's COO, Thompson spearheaded the successful McCafé campaign and seemed a natural selection to produce the next "McHit." [47] Unfortunately, McDonald's struggled with weakening sales under Thompson's reign (see **Exhibit 3**) despite his efforts to optimize the menu, improve the customer experience, and make McDonald's more accessible to a broader market base.[48] Unable to produce the desired turnaround, Thompson retired in January 2015 to make room for new leadership.[49]

Trends in the Quick-Service Restaurant Industry

The U.S. quick-service restaurant industry is expected to grow by 22 percent to reach a value of $224 billion in 2017 (see **Exhibit 4**).[50] Yet despite expectations for growth, several environmental trends suggest challenges ahead.

ECONOMIC TRENDS

The U.S. economy continues to bounce back from the 2008–2009 economic recession. The civilian unemployment rate has been cut in half from its 2009 peak at 10.0 percent to just 5.1 percent in summer 2015 (see **Exhibit 5**) and per capita real disposable income is near record highs (see **Exhibit 6**).[51, 52] These data present both good and bad news for the fast food industry. On the one hand, more customers are working and have more money to eat out; on the other hand, customers with more disposable income are likely to "trade up" to higher quality and higher priced food options. Recent data on dining trends bear this out: For the first time ever, American spending on dining out exceeded grocery sales in April 2015. A closer look, however, reveals key differences among market segments. Older consumers (51- to 69- year olds) actually reported spending more on groceries and less on restaurant dining compared to last year. The overall upward trend is due to the vast number of millennials who view dining out as a social event and are more willing to pay for food outside of home. According to the Restaurant Association, millennials tend to favor quick service, deli, and pizza joints over more traditional casual and high-end dining; ethnic foods are also viewed as new and interesting.[53]

HEALTH CONCERNS

The McKinsey Global Institute estimates that the global obesity epidemic costs $2 trillion per year in health care costs, a figure roughly equivalent to Russia's gross domestic product. Approximately one-third of the world population (2.1 billion people) is considered overweight, making obesity the third largest human-caused economic burden (see **Exhibit 7**). Obesity-related health care expenses in the United States total $663 billion annually.[54] Beef still comprises the highest proportion (58 percent) of meat consumed in the United States, but health-conscious consumers are increasingly shifting toward poultry and other lean meats.[55] To support healthier food choices, the 2010 The Patient Protection and Affordable Care Act 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.[56] These trends place considerable pressure on a fast food company that depends 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.[57]

Meanwhile, concerns over the increase in antibiotic-resistant bacteria have led to calls for the elimination of subtherapeutic antibiotic use in meat animals. Though banned in the EU and Canada, the United States still permits farmers to administer small doses of antibiotics to livestock to increase weight gain (a 3 percent increase). Exact usage data are not publicized, but doctors who study this issue estimate that as many as 15 to 17 million pounds of antibiotics are administered to food animals each year. The problem is that the bacteria in the animals' digestive tract become resistant to that antibiotic, and if a human later contracts the bacteria through contaminated meat or improper cooking procedures, they may not respond to treatment.[58] Roughly 23,000 Americans die from antibiotic-resistant bacterial infections each year. McDonald's recently followed in the footsteps of several of its competitors and announced its intent to stop selling chicken products from birds treated with antibiotics important to human health (non-human antibiotics are still permitted). Given that McDonald's claims to be the largest restaurant seller of chicken in the United States, this move is likely to reverberate throughout the poultry industry. Changes in cattle production are likely to move much more slowly due to higher beef prices, the longer life span of cattle, and the fragmented nature of the beef industry.[59]

INCREASING SUPPLY COSTS

Healthier menu items mean increased supply costs for restaurants, even as customers remain price sensitive. Beef prices began to skyrocket in late 2012 due to a severe drought in Texas (see **Exhibit 8**). Without rain, farmers were forced to turn to more expensive forms of feed such as hay and corn, to ship cattle to greener pastures in the north, or to cull their herds through sales or sending heifers to the butcher instead of breeding them. By January 2014, the number of cattle in the United States totalled just 87.7 million, the lowest since 1951. Even though the Texas drought ended in the spring of 2015, it takes years to rebuild a herd, and California (the nation's fourth largest cattle-producing state) is now experiencing extreme drought conditions. At the same time, demand for hamburger meat has soared due to high beef prices (hamburger is the new steak) and the popularity of new burger chains like Five Guys and Shake Shack.[60]

Drought conditions and high fuel costs in recent years have also made it more expensive to raise agricultural products and transport them to market (see **Exhibit 9**).[61] Not only is corn one of the main products used to feed both cattle and chickens, but corn oil, meal, and other by-products are a significant component of many grocery items.[62] Soybean meal is a main ingredient of animal feed, while the oil is used in cooking, salad dressing, mayonnaise, and baked goods.[63, 64] Wheat, of course, is the main ingredient in hamburger buns. In addition, egg prices soared in 2015 due to an outbreak of the avian flu (broilers or chickens raised for meat were not affected and remain in good supply).[65, 66] The resulting price increases for supplies ranging from bread to eggs to meat are squeezing already tight operating margins.

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.[67] 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.[68] Yet, each of these competitors' stock outperformed McDonald's in 2015, a worrying trend for the company's future.

BURGER KING

On August 26, 2014, Burger King merged with the Canadian restaurant chain Tim Hortons to form the world's third-largest quick-service restaurant chain (second largest in the United States). The combined company has annual sales of $23 billion, with over 18,000 restaurants in approximately 100 countries. Because it is headquartered in Canada, the new parent firm (a partnership dubbed Restaurant Brands International), benefits from a significantly lower corporate tax rate than its American competitors.[69] The firm denies that tax inversion was the primary motive for the merger, but tax savings could total $1.2 billion through 2018.[70] The private equity firm 3G Capital, which took Burger King private in 2010, still holds 51 percent of the shares.[71]

Changes made by the new ownership appear to be positive, as the company has recently out-performed both McDonald's and Wendy's. Analysts attribute Burger King's success to its simplicity: adding sauces, cheese, or bacon to its core burger line to create new menu items from the same list of ingredients. Coupled with successful limited time offers and attractive promotions, Burger King has been able to innovate without slowing service.[72]

In 2015, Burger King launched an aggressive attack against its larger competitor, using strategic price increases to cover the costs of aggressive promotions on popular products such as chicken nuggets.[73] The company has gained further recognition with clever advertising, such as its letter to McDonald's offering a temporary ceasefire in the burger wars, suggesting that they jointly make "McWhoppers" for international peace day, with all proceeds going to the Peace One Day organization. McDonald's spurned the proposal, earning headlines accusing them of throwing "their 'love-themed' brand idea out the window" and choosing "pride over peace."[74]

WENDY'S

Wendy's is the third largest U.S. burger chain, with more than 6,500 locations in 28 countries.[75, 76] Wendy's strives to differentiate itself as "a cut above" its competitors, with higher-quality food that is made fresh-to-order.[77] It successfully employs a "barbell" approach to products and pricing, luring cost-sensitive customers in with value-based burgers while offering higher-end, premium items like the Pretzel Bacon Cheeseburger or Bacon Portabella Melt to attract more affluent clientele.[78] Analysts offer several reasons as to why Wendy's has succeeded with this strategy while McDonald's has struggled. Not only is it easier for the smaller chain to implement short-term menu changes, but it has long specialized in custom-building sandwiches without compromising quick service.[79] Wendy's also seems to have a better pulse on its customers and bets big on just a few hit products, such as its pretzel buns.[80]

Wendy's continues to invest in long-term brand development by redesigning its 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 cost the company $225 million in capital expenditures in 2012 alone, the first year of its renovation program. 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).[81] Recent additions to Wendy's menu such as its sea-salt French fries, a new line of salads, and organic Honest Tea, have proven quite popular, helping to generate several consecutive quarterly sales increases for the corporation. [82, 83,84] At the same time, Wendy's continues to cut costs by refranchising company-owned stores, with the goal of decreasing its ownership from 15 to 5 percent of the total.[85]

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 6,000 restaurants (80 percent of which are franchises) in the United States.[86] After a string of food contamination and quality issues from 2006 through 2011, the company started to rebound in 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."

Taco Bell tries to launch eight to ten new items per year, knowing that the sales bump from major hits like Locos Tacos levels off within about two years. It rolled out breakfast nationwide in 2014 and continues to expand its offerings; breakfast now constitutes 7 percent of sales or $70,000 to $120,000 per store annually.[87] In 2015, Taco Bell released its Naked Crispy Chicken Taco (which uses batter-fried chicken as the shell) in California and a new urban-store format that serves alcoholic beverages in Chicago.[88, 89]

To appeal to millennials, the company has developed a food-ordering app (Live Mas) and is testing a new home delivery service in conjunction with Kentucky Fried Chicken.[90, 91] Managers expected the app to speed up orders and decrease errors, but they were pleasantly surprised to discover that customers spent more than $10 average per online order, a 20 percent increase over in-person transactions. Orders are not filled until the customer gets within 500 feet of the restaurant and specifies whether they plan to come in or drive through to pick up their food. The app has already been downloaded more than 3 million times.[92] The chain plans to double its revenues from $7 billion to $14 billion and grow to 8,000 U.S. locations over the next 10 years.[93, 94]

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 exceeds McDonald's in the number of total restaurants (44,000 globally, including 27,000 in the United States).[95] The chain has become a popular lunchtime destination for many Americans who value convenience but do not want to compromise their health.

Although Subway continues to open new restaurants around the world, the former quick-serve superstar has fallen on troubled times. Sales dropped by 3.3 percent to $11.9 billion in 2014 for the first time ever, the worst among fast food chains; annual sales per store decreased from $490,000 to $475,000. Subway is no longer the cool "new kid" on the block compared to upstarts like Jersey Mike's or Firehouse Subs. While Subway remained content with being a "healthy" option, competitors started to offer organic, GMO-free, and transparently sourced ingredients. Insiders say the company has lacked strong leadership ever since its founder, Fred DeLuca, was diagnosed with leukemia in 2013. In June 2015, DeLuca promoted his sister, Suzanne Greco, to president, raising speculations about his health and a possible succession.[96]

To make matters worse, Subway's longtime spokesperson, Jared Fogel, plead guilty to possessing child pornography and having sex with minors in 2015. Although Subway had distanced itself from Fogel since introducing the $5 footlong campaign in 2008, the negative press could not have come at a more inopportune time. The company responded decisively, severing relationships before Fogel was even charged but now faces allegations that it ignored warnings about Fogel's illicit behavior when they were first raised seven years ago.[97, 98, 99]

FAST CASUAL

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 distinctive 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.[100] Combined fast-casual sales increased by 10.5 percent in 2014 compared to just 6.1 percent for traditional fast food chains.[101] 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.[102]

A sub-segment of the fast-casual restaurant industry is the premium burger segment, which grew 10 times faster than traditional fast food chains from 2008 through 2013.[103] 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 restaurants such as McDonald's, Burger King, and Wendy's have scrambled to counter with their own premium offerings. Customers have been known to wait on line for nearly an hour to get a Shake Shack burger and fries; the company's shares proved to be just as popular in its January 2015 IPO, more than doubling in price from $21 to $45.90 on the first day of trading.[104] But much like the Arch Deluxe in the 1990s,[105] McDonald's more recent efforts to compete in the premium segment have fallen flat. Customers could not justify paying $4 to

$5 for a one-third pound Angus burger when there were sandwiches on McDonald's Dollar Menu for much less.[106] The company discontinued the Angus Deluxe product line in 2013 after just four years.[107]

Other fast-casual restaurants such as Chipotle Mexican Grill, Panera Bread, and more recently even Starbucks have taken away customers from McDonald's.

COFFEE

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.[108] It purchased La Boulange Bakery in 2012 to expand its food offerings, which are now available in more than 2,500 stores.[109]

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."[110] It plans to triple its presence to 15,000 shops and is likewise expanding its warm breakfast options to compete more effectively.[111] 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.[112] Around 11 to 12 percent of these meals are eaten at McDonald's.[113, 114]

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.[115] Annually, the average franchise can be expected to bring in about $1.7 million in sales, with an operating profit of around $150,000.[116]

McDonald's three main target market segments are mothers, children, and young adults.[117] Moms view McDonald's as a quick, easy, and affordable meal for families on the go, and they 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 reduced its Happy Meal calorie count by 20 percent by adding apples and halving the amount of French fries. McDonald's has reduced the sodium content of its food by 15 percent, and plans to make further reductions in calories, sugars, saturated fats, and portion sizes by 2020.[118] Even this was not enough for a nine-year-old girl who publicly took CEO Thompson to task at a shareholders' meeting, accusing the company of tricking kids into eating junk food by using toys and cartoon characters.[119] Other chains, such as Jack in the Box, have opted to eliminate toys from their kids' meals,[120] while Taco Bell has dropped its children's menu altogether.[121]

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.[122] Unfortunately, a recent study indicated that McDonald's 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 like 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, whereas McDonald's has been plagued by perceived deceptions. [123] 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.[124] 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.[125]

Current Challenges

MENU

One of Easterbrook's first major moves was to propose all-day breakfast in all 14,300 U.S. restaurants, the company's biggest initiative in six years. Testing started almost immediately after he took office, with a planned rollout in fall 2015. Consumers have long been asking for this change, but the company resisted because stores use the same equipment to cook both breakfast and lunch. All kitchens will need to be equipped with separate grills for cooking eggs and burgers, rolling carts and utensils to use just with eggs (to prevent contamination), and new toasters so that they can prepare both buns and muffins at the same time (they toast at different temperatures). The estimated cost for retrofitting each kitchen is $500 to $5,000, depending on existing equipment.[126] To make things a bit more manageable, the all-day breakfast menu will be restricted to a few popular items such as sausage burritos, hot cakes, and Egg McMuffin or biscuit sandwiches. Breakfast items will be made continuously during peak morning hours, but cooked-to-order during slower parts of the day. While the company prefers not to make firm sales projections at this time, an internal company presentation projected that extending breakfast hours could increase sales by 2.5 percent per year.[127]

Another way that Easterbrook is giving customers more choice in what they eat is by giving franchises more freedom to offer locally relevant menu items. For example, chorizo burritos are more popular in Texas and the Midwest, while mozzarella sticks sell better in New York and New Jersey. Local restaurant operators can chose items from the company's global pipeline and adjust them as needed to suit local tastes.[128] Managers will also be granted more freedom to run their own promotions to increase store traffic.[129]

As a direct competitive response to the "better burger chains," McDonald's is experimenting with "Build Your Own" tablets where customers design their own sandwich from over 30 choices of meats, toppings, and buns. They can only be ordered from inside the restaurant, cost $1.50 more than a Big Mac, and take 7 to 8 minutes to prepare because the meat is cooked fresh. It will cost each franchisee approximately $100,000 per store to install the new system and stock the required ingredients. This presents an interesting conundrum for a quick-serve restaurant that generates roughly two-thirds of its revenue from drive-through customers.[130]

To free up space for these new offerings, the company plans to phase out underperforming features such as the snack wrap and reduce the number of extra value meals. [131, 132] Still, McDonald's menu has swollen to over 120 items, many of which require specialized equipment and take more time to prepare. That represents a 75 percent increase from 2004 and is considerably more than the 33-item menu from 1990 (see **Exhibit 10**).[133] While a greater variety of menu options helps to draw new customers into stores, too many items slow down the order fulfilment process, increasing employee stress and customer frustrations. The average service time for a McDonald's drive-through has slowed to 189.49 seconds, lagging behind rival Wendy's average by almost a minute.[134] Complaints about speed of service have "increased significantly" in recent years, with the McDonald's service experience described as "chaotic."[135]

PRODUCT QUALITY

Another item on Easterbrook's to-do list was to improve public perceptions of the McDonald's brand. McDonald's size made it a convenient target, and more than a decade of negative press including the 2001 book "Fast Food Nation," the 2004 documentary "Supersize Me," and Jamie Oliver's 2012 "pink slime" exposé has taken its toll.[136] In July 2014, the Big Mac earned the dubious distinction of being America's worst hamburger, placing last out of 21 in a study by Consumer Reports.[137] McDonald's also ranked lowest among peers in the 2015 American Customer Satisfaction Index (see **Exhibit 11**). Fast food restaurants overall dropped 3.8 percent, but McDonald's fell by 6 percent from 2014, holding firm in the last spot.[138]

Easterbrook has declared improving food quality as one of his top priorities.[139] In addition to curtailing antibiotic use in its U.S. chicken supply, McDonald's plans to start selling dairy products from growth-hormone-free cattle. [140, 141] The company has also pledged to examine its product ingredients and review its food preparation procedures.[142] According to President Andres, its goal is to become more "culinary inspired" and to simplify food labels by reducing the number of preservatives.[143] There are still 19 ingredients in the French fries McDonald's serves in the United States, compared to just five in Great Britain.[144]

Easterbrook simultaneously plans to counterattack McDonald's naysayers with a media campaign highlighting positive news about the company's food and workers. The company has launched a video series entitled "Our Food, Your Questions," demonstrating how McDonald's food items are made; the company reports that it has already responded to 40,000 questions and that the increased transparency has been well received.[145] In June 2015, Easterbrook hired two external candidates to take over the company's media affairs. He tapped Robert Gibbs, former White House Press Secretary under President Obama, to serve as executive vice president and global chief communications officer, and Silvia Lagnado, previously with Bacardi Ltd, to serve as head of global marketing.[146]

APPEALING TO MILLENNIALS

One of the company's most perplexing problems is how to increase its appeal to millennials. Between 2011 and 2014, 19- to 21-year olds increased their monthly visits to fast-casual restaurants by 2.3 percent, while their trips to McDonald's decreased by 12.9 percent. Customers aged 22 to 37 increased their fast-casual outings by 5.2 percent over the same time period, while visits to McDonald's stayed flat.[147] They are consistently choosing "fresh and healthy" over "fast and convenient" and "McDonald's is having trouble convincing them it can be both."[148]

Thus far, Easterbrook's main response has been to reach out through digitization. In his words, millennials "want to buy into a brand not just from it . . .What we've got to do is find interesting and engaging ways to share that information with [them], not old-fashioned corporate lecturing."[149] He hired former Google executive Margo Georgiadis to lead McDonald's "Experience of the Future," which includes an improved social media presence, development of a smartphone app, and testing of mobile payment systems.[150,151]

LABOR

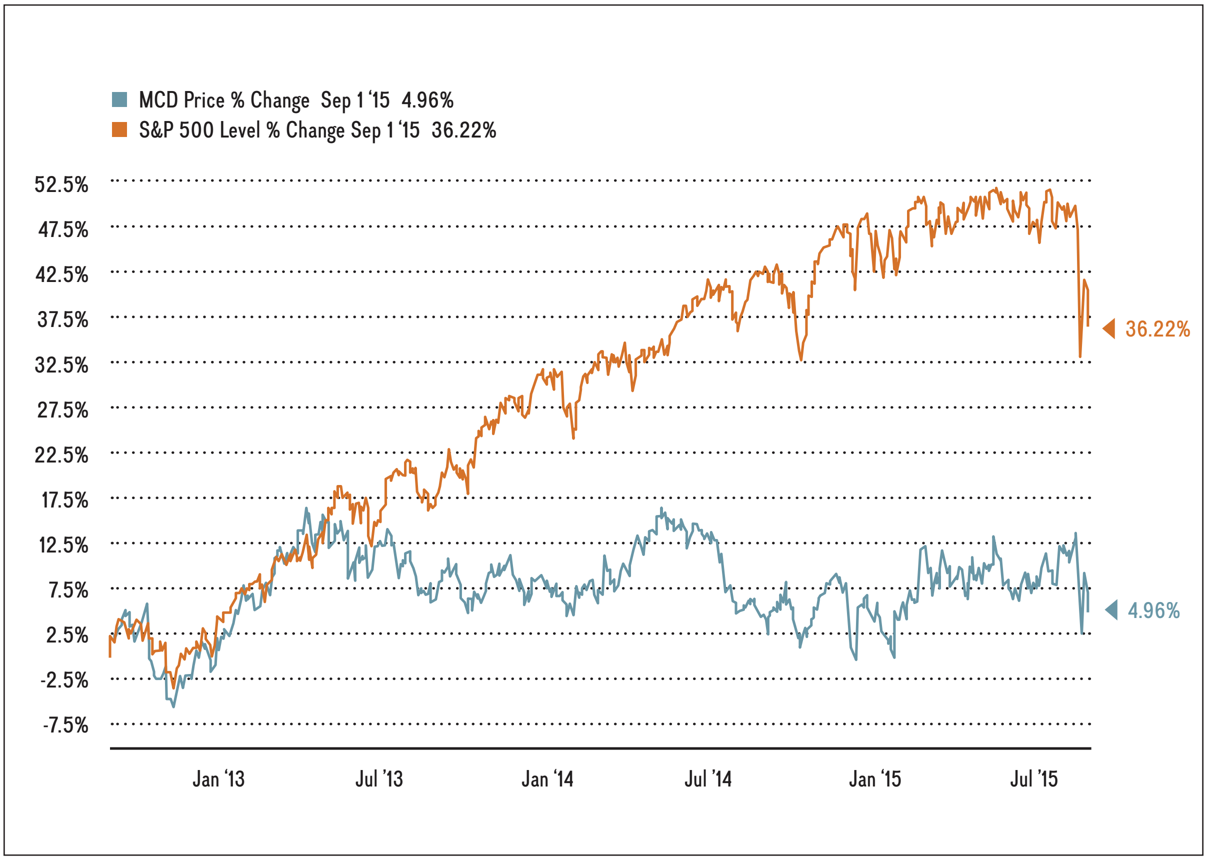
McDonald's has serious staffing issues that need to be addressed if it is to improve customer loyalty. An internal report that found its way to the media showed that one out of every five customer complaints was about "rude or unprofessional employees."[152] According to a national survey of quick-service restaurants, McDonald's ranks next to last in "friendliness," beating only Burger King. Part of the problem is that too many restaurants are understaffed during peak breakfast and lunch hours. It is hard to be friendly while work piles up and customers grow increasingly irritated at how long it takes to place and get their orders. The annual turnover rate in the fast food industry is 60 percent, as frustrated workers seek to move on to less stressful and higher-paying jobs.[153]

It is too soon to tell whether McDonald's pledge to raise pay to at least $1 more per hour than the local minimum wage will be enough to attract and retain motivated workers. The company also granted employees the ability to accrue up to five days of paid vacation annually after one year of employment. However, this new HR policy applies only to the 90,000 employees of company-owned stores, and risks upsetting franchisees who are likely to feel pressured to match corporate's offer without equivalent financial resources. Meanwhile, activists continue to lobby for an even larger pay raise (a $15-per-hour minimum) as well as the right to unionize without retaliation. In an effort to force McDonald's to the negotiating table, the National Labor Relations Board's general counsel has filed a suit claiming that the company has enough control over franchise operations to be considered a joint employer.[154] If the case proves successful, McDonald's could be held liable for working conditions at individual stores, making national-level labor bargaining (and increased concessions) more likely.[155]

Dilemma

The host of issues facing McDonald's and its CEO Mr. Easterbrook is daunting. The company is in the midst of its most serious identity crisis to date, and it desperately needs to define a clear vision of what it wants to be and a plan for how to get there.[156] In trying to be all things to all people, it has ceded ground on every front to its competitors. Fast-casual restaurants are winning on taste and image, but the only way to catch them seems to be to sacrifice speed, which at least used to be one of McDonald's core competencies. Millennials want higher product quality (and are willing to pay higher prices), but the company can ill afford to alienate its value-driven customer base.[157] Menu variety brings a wide range of consumers through its doorways, but the added complexity comes with increased costs and service delays. And after all this time, 30 percent of the company's sales still derive from just five main items: Big Macs, hamburgers, cheeseburgers, McNuggets, and fries.[158] Other fast food restaurants are not only faster but (according to the polls) also have better food. Instilling "stronger financial discipline, faster decision-making, and hard-edged accountability" are good first steps, but none of these actions matter if Easterbrook fails to carve out a viable strategic identity for McDonald's in the 21st century.[159]

EXHIBIT 1 McDonald's Stock Performance vis-à-vis S&P 500 Index, 2012-2015



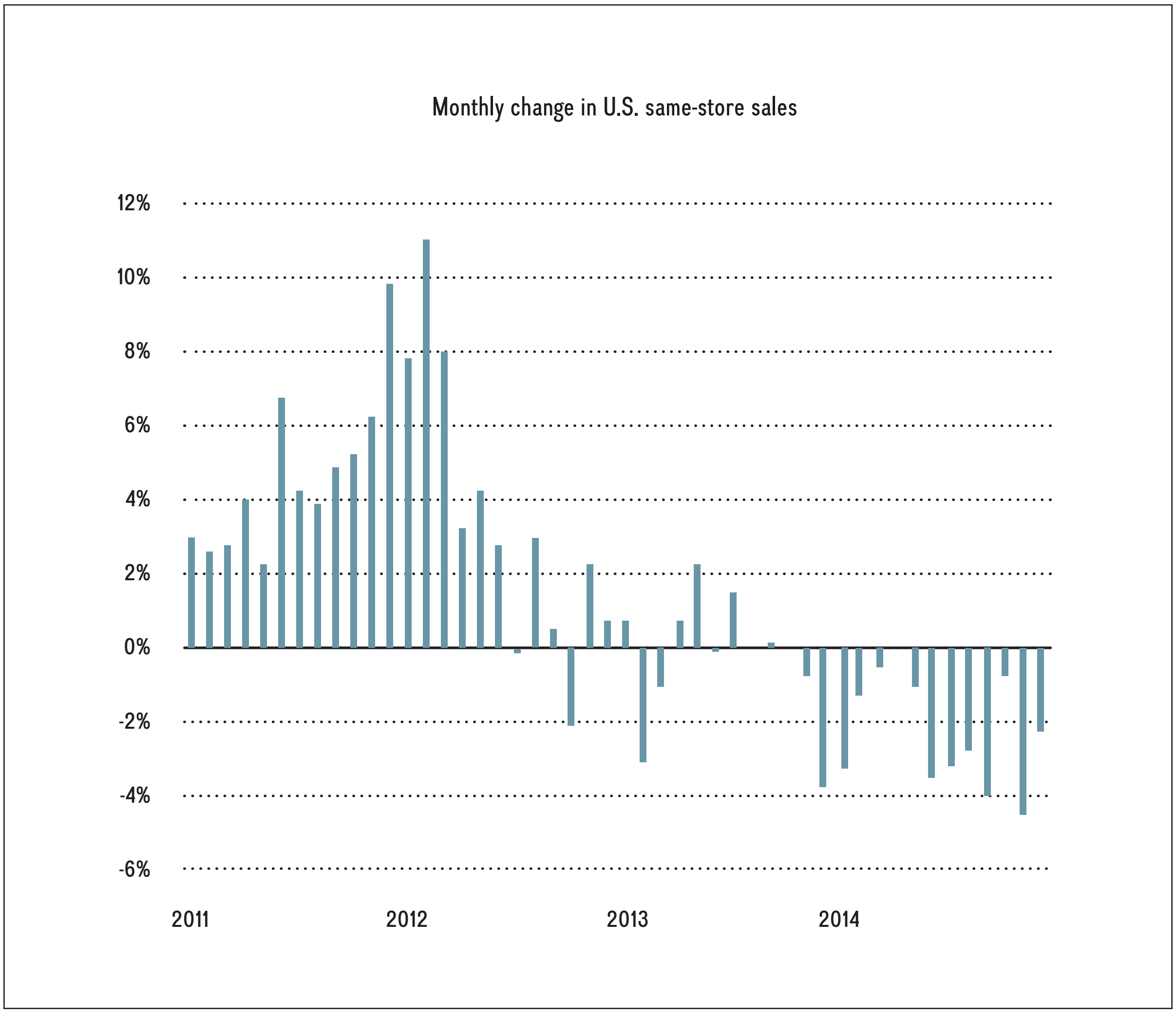
Source: Depiction of publicly available data from Ycharts, www.ycharts.com.

EXHIBIT 2 McDonald's Financial Data ($ millions, except EPS data)

Fiscal Year	2010	2011	2012	2013	2014
Cash and short-term investments	2,387	2,336	2,336	2,799	2,078
Receivables (total)	1,179	1,335	1,375	1,320	1,214
Inventories (total)	110	117	122	124	110
Property, plant, and equipment (net total)	22,061	22,835	24,677	25747	24,558
Depreciation, depletion, and amortization (accumulated)	12,422	12,903	13,814	14,608	14,569
Assets (total)	31,975	32,990	35,387	36,626	34,281
Accounts payable (trade)	944	961	1142	1086	860
Long-term debt	11,497	12134	13,633	14,130	14,990
Liabilities (total)	17,341	18,600	20,093	20,617	21428
Stockholders' equity (total)	14,634	14390	152,94	16,010	12,853
Sales (net)	24,075	27,006	27,567	28,106	27,441
Cost of goods sold	13,237	14,990	15,349	15,704	15,446
Selling, general, and administrative expense	2,333	2,394	2,455	2,386	2,488
Income taxes	2,054	2,509	2,614	2,619	2,614
Income before extraordinary items	4,946	5,503	5,465	5,586	4,758
Net income (loss)	4,946	5,503	5,465	5,586	4,758
Earnings per share (basic) excluding extraordinary items	4.64	5.33	5.41	5.59	4.85
Earnings per share (diluted) excluding extraordinary items	4.58	5.27	5.36	5.55	4.82

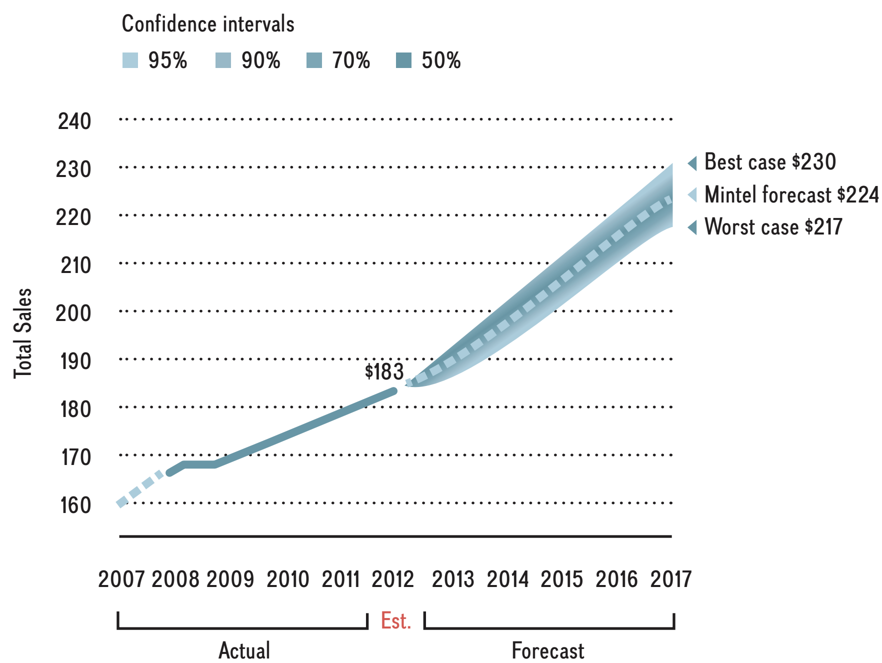
Source: Depiction of data from Compustat.

EXHIBIT 3 McDonald's Sales under Thompson's Reign as CEO



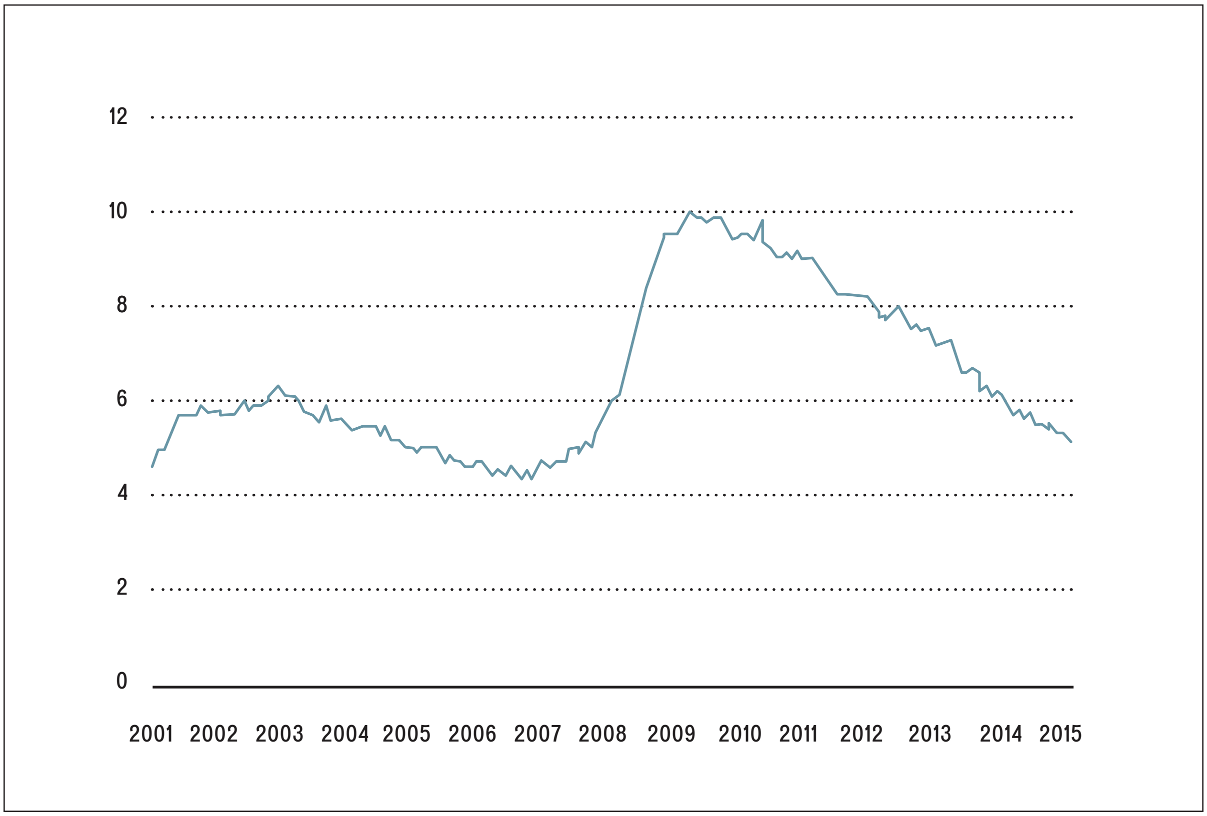
Source: Depiction of data from "McDonald's CEO Is out as Sales Decline," *The Wall Street Journal,* January 28, 2015.

EXHIBIT 4 U.S. Quick-Service Restaurant Sales and Fan Chart Forecast ($ billions)



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

EXHIBIT 5 U.S. Civilian Unemployment Rate (% of Labor Force), 2001–2015



Source: Depiction of data from Bureau of Economic Analysis. U.S.; https://research.stlouisfed.org/datatrends/net/page3.php.

EXHIBIT 6 U.S. Real Disposable Personal Income ($ thousands per capita), 1959–2015

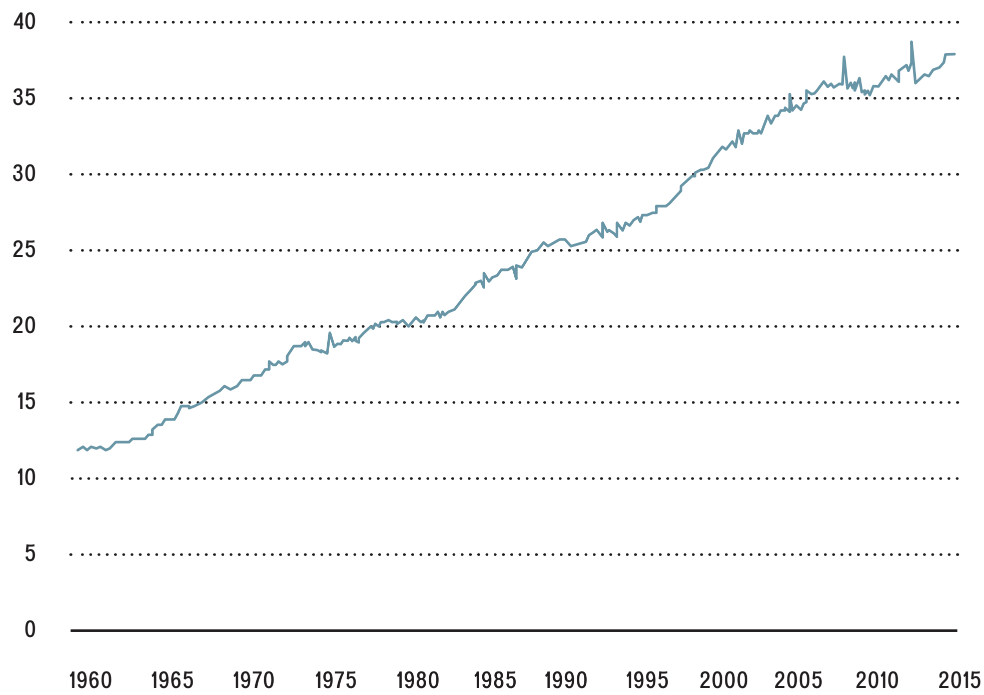


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EXHIBIT 7 Obesity Is One of the Top Three Global Social Burdens

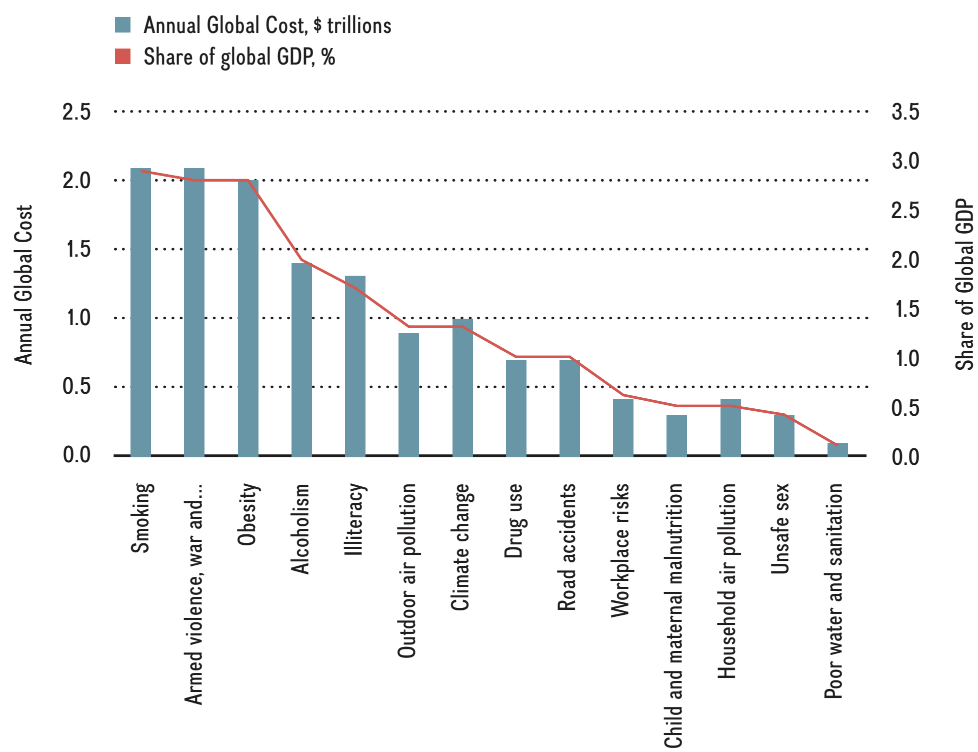

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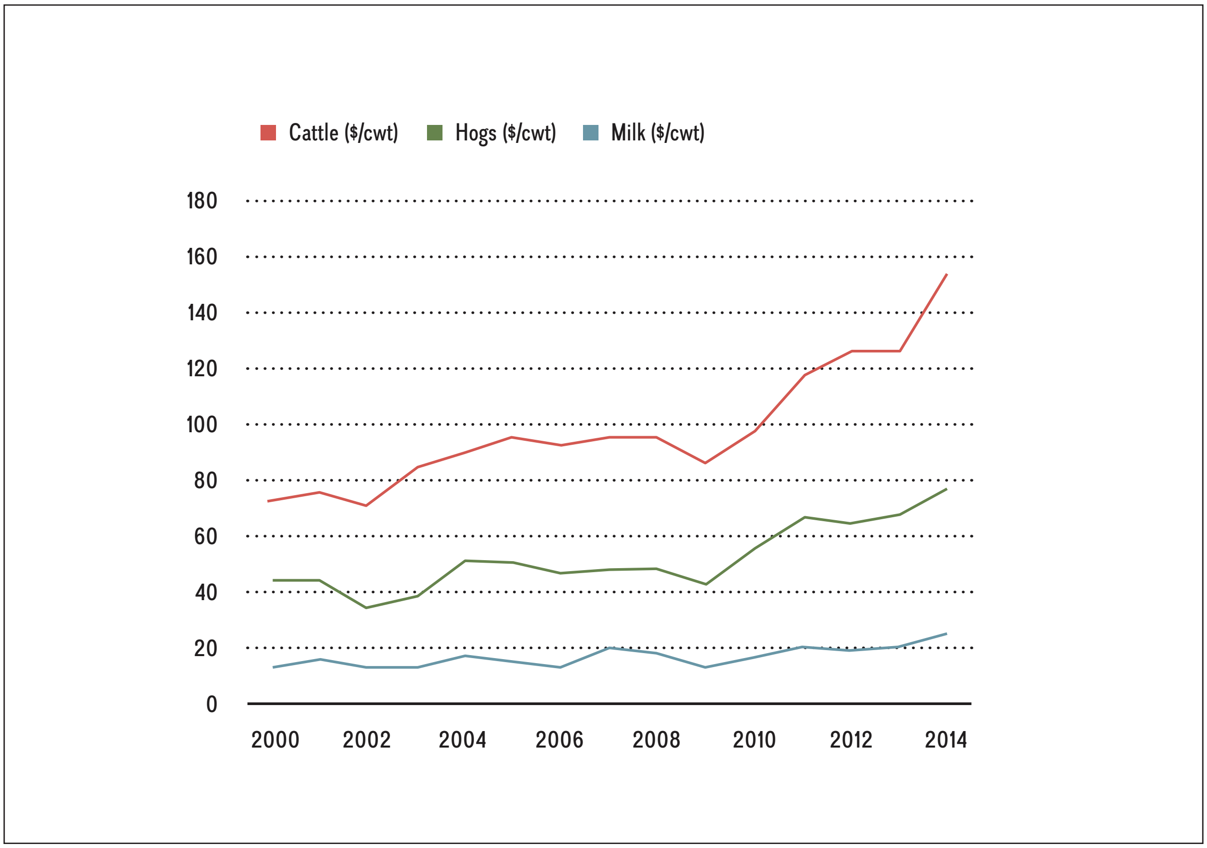
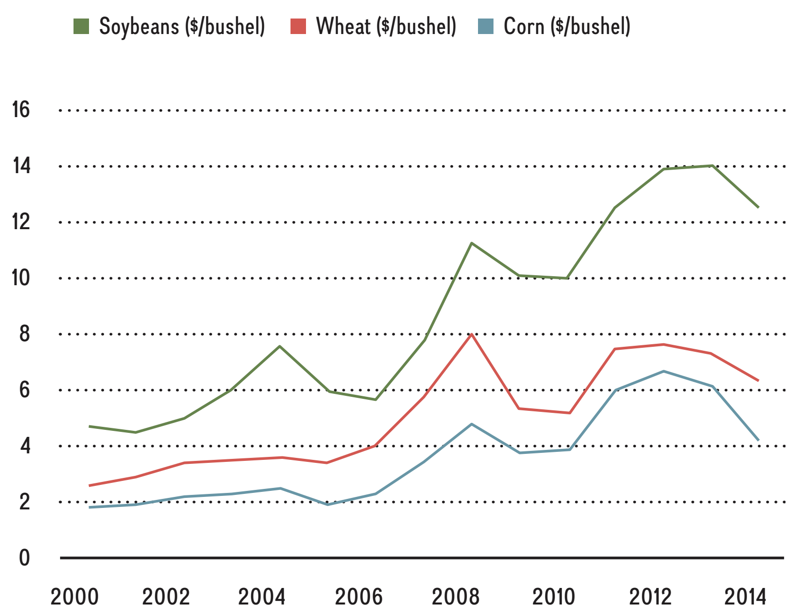
EXHIBIT 8 U.S. Animal Product Prices, 2000–2014



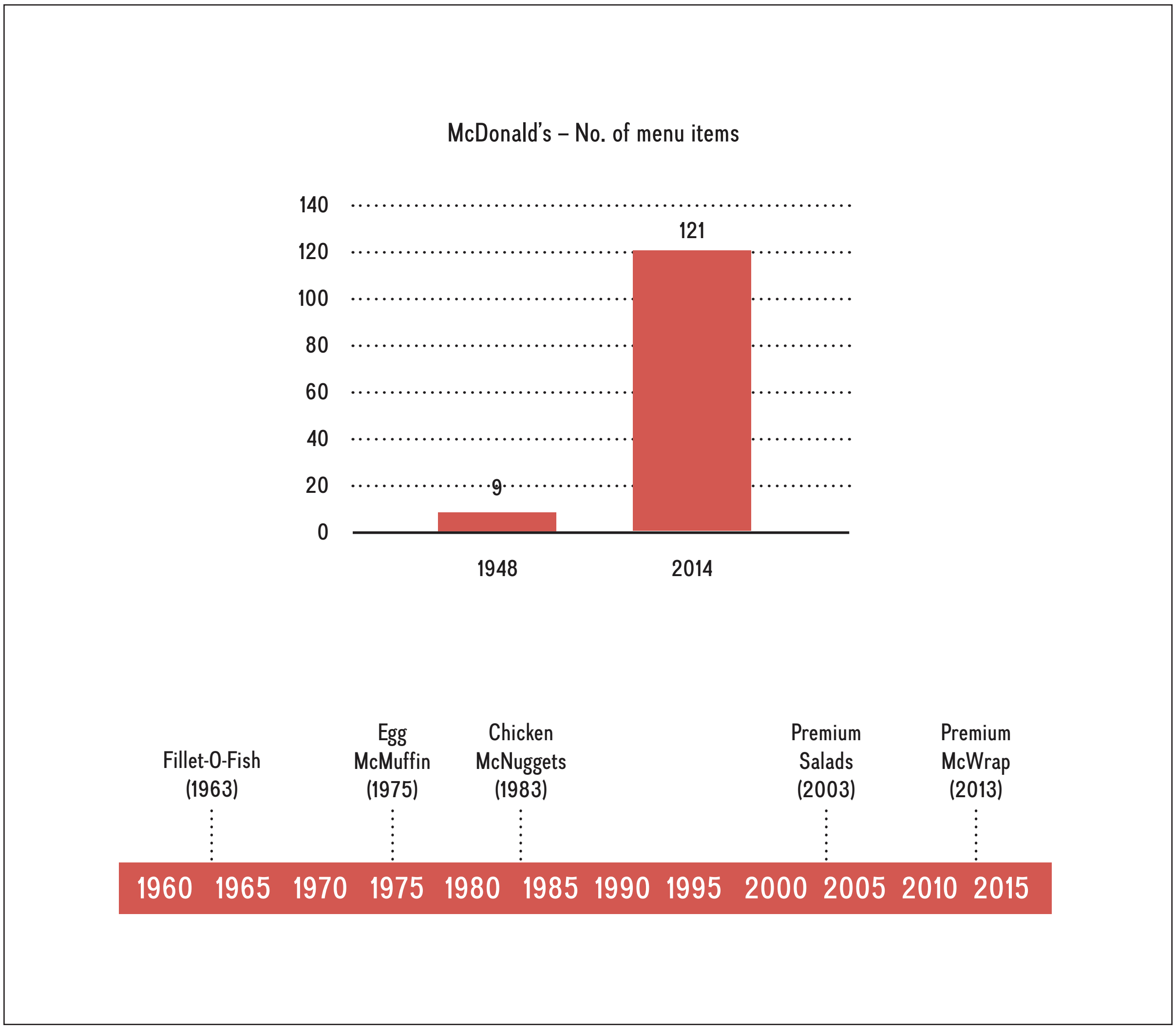
Source: Depiction of data from the University of Illinois at Urbana-Champaign.

EXHIBIT 9 U.S. Agricultural Product Prices, 2000–2014



Source: Depiction of data from the University of Illinois at Urbana-Champaign.

EXHIBIT 10 McDonald's Menu Proliferation



Source: Depiction of data "McDonald's to Pare Menu, Review Ingredients," *The Wall Street Journal*, December 10, 2014.

EXHIBIT 11 ACSI Scores for Limited-Service Restaurants

Company	2014	2015	% Change
Limited Service Restaurants	80	77	-3.8%
Chick-fil-A	NM	86	NA
Chipotle Mexican Grill	NM	83	NA
All Others	84	81	-4%
Panera Bread	NM	80	NA
Papa John's	82	78	-5%
Pizza Hut (Yum! Brands)	82	78	-5%
Dunkin' Donuts	75	78	4%
Subway	78	77	-1%
Domino's	80	75	-6%
Little Caesers	80	74	-8%
Starbucks	76	74	-3%
Arby's	NM	74	NA
Wendy's	78	73	-6%
KFC (Yum! Brands)	74	73	-1%
Burger King	76	72	-5%
Taco Bell (Ytum! Brands)	72	72	0%
Jack in the Box	NM	72	NA
McDonald's	71	67	-6%

Source: Depiction of data from ACSI Restaurant Report 2015.[160]

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