

Individual Case Analysis: McDonald's Corporation  
Full Case Analysis

**Industry: Global Quick Service Restaurant (QSR)**

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## Introduction

In the global quick service restaurant industry, the target consumer segment is extremely price sensitive as a restaurant having the lowest price is often the number one decision criteria when choosing a restaurant. Since its inception in 1955, McDonald's Corporation has pride themselves as the market pioneer and leader in the space. Inducted as the representative of the QSR industry in the Dow Jones Industrial Average in 1985, competitions have been playing the "catch-up" game when it comes to operating leverage. But due to the consistent rise in food and labor costs, McDonald's is facing the challenge of retaining price sensitive customers as profit margins that were once well above industry average, slowly diminishes.

## Analysis

This past October, McDonald's Corporation recently reported a profit margin of 15.3% in the 3<sup>rd</sup> quarter of 2014, its lowest quarter since the beginning of the financial crisis in 2007. It is indicative to the declining efficiency in the price and cost relationship conducted by executives. The narrowing margin affects McDonald's competitive advantage in a significant way because since its inception, McDonald's has established a core value proposition in the minds of consumers that they offer the lowest price food at any restaurant. And the rise in cattle, cheese, and swine prices and the shrinking profit margin pressured top management to slowly raise prices for their customers, which is a decision that goes against McDonald's brand promise.

Since June of 2013, the average menu's prices increased by 3%. But evidently in the financials, the price hike did not compensate for the more rapid rising costs, as revenue CAGR (5.43% from 09-14) is greater than the net profit CAGR (5.26% from 09-14), signaling a decrease in the margin. The target market segment the quick service restaurant industry has carved out throughout the years are conditioned to be extremely price sensitive, influencing their demand for products and services offered by QSR to be extremely elastic.

USDA reported cattle and swine prices are at a historic high, as McDonald's suppliers are pressured to raise prices, resulting in subsequent price increases down the value chain. Cattle are currently priced at \$146.49/live cwt, compared to \$94.58/live cwt in 2009. Food prices aside, cost influencing factors such as the lobbying efforts exerted by National Restaurant Association, has failed to lower minimum wage it has increase from \$7.14/hour in 2009, to \$7.49/hour in 2014. With employees numbering 440,000 at the end of 2013, a small change of wage standards and laws magnified the losses McDonald's experienced at the bottom line.

In the QSR industry, members' products have many points of parity while limited points of differences. Thus, buyers have extremely low switching cost and a limited set of decision criteria. While rising competition like Chipotle have been focusing their brand and core competency of providing food that is fresh, organic, and local, consumers are not reluctant to spend more at rival restaurants. Loss of sales would be the first signal that competition is potentially gaining market share, as revenue growth in the 3<sup>rd</sup> quarter of 2014 is at -4.6%, while the stagnated same store sales growth of 0.2% in 2013 enforces the horrid consequences of a price hike at McDonald's. It is no longer a viable and sustainable competitive advantage to be branded as the lowest price provider in the quick service industry.

## Alternatives

### 1 Trim menu breadth and add new organic product line

The number of items at an average McDonald's has grown 70% since 2007, as management wanted to cater to a wider consumer segment to increase its market penetration. This strategy has backfired as drive thru lines is at its 15 year high. If McDonald's want to justify its price hikes, service quality should remain as their core competency by *cutting products that are prolonging its wait times*. Meanwhile, the inevitable trend of eating healthier and fresher is continuing on the rise, McDonald's can also capitalize on the growing paradigm by *implementing a new organic product line*.

By focusing its sourcing expertise on obtaining supplies from organic distributors, McDonald's may still leverage their enormous bargaining power to secure profitable contracts. By cutting the items on the current menu, a new branding initiative surrounding the new product line should be initiated to avoid brand dilution. Customer segments that are health conscious are not as price sensitive as current segment of bargain-hunters. It is a risky strategy as the new strategy is shifting away from the low price brand McDonald's have developed throughout the years.

### 2 Leverage mobile computing trends

Consumers' adoption rates of computing trends are exponentially growing, as McDonald's should capitalize on the inevitable lifestyle change. *New channels of distribution and communication would be the underlying strategy to retain current customers*. Technological communication would also decrease the need for expensive labor as communication messages may be automated. Hopefully, they would feel that the extra level of service they are receiving would justify a higher price they are paying. Launching McDelivery in cheaper labor markets and partnership with Apple through Apple Pay has demonstrated the strategy McDonald's is starting to execute. Creatingfa

native mobile applications would project McDonald's technological image onto a younger demographic, the segment that is leading the healthy eating trend. Although this may ease up the channels getting the products to consumers, it would not help widen the margins of McDonald's products.

### 3 Allocate marketing and R&D resources on high margin products

Since only beef, cheese, and pork prices are at its historic high, McDonald's may implement a strategy of *focusing on developing high margin products* such as their coffee and baked goods (McCafe brand), and their chicken offerings until prices for the expensive commodities start to decline again. This alternative would allow McDonald's to retain current customers through competitive pricing as the company may still exercise its economies of scale and offer lower prices to its consumers. But if McDonald's were to implement this strategy, brand equity dilution and operation deficiency should be a concern as the product breadth is widening to compensate for the declining profit margin the company is experiencing in current menu offerings.

## Recommendation

McDonald's should **allocate marketing and R&D resources on high margin products** in order to compensate for the lost margins due to a rise in cattle, cheese, and swine prices. As the current customer

segment is highly price sensitive, a price hike would defect them to competitors that are offering fresher foods.

By focusing on promoting and develop items such as coffee and baked goods (McCafe) and chicken items, labor efficiency would not need to decrease as current employees will not need to be retrained. Thus, operation wise, management will not need additional workers. Also, with this new strategy, McDonald's will not need to increase the menu prices further as the increase sales of high margin items would compensate for the decreasing margin for other menu items. This way, the current price sensitive customers would be retained as prices on regular menu items will not be raised.

Opening standalone McCafe may be a way to promote and to reinforce the new products. It is a strong brand statement that McDonald's would be making as it is heavily allocating resources in the café space. Standalone McCafes would also potentially attract new customers with healthy eating paradigms as the coffee shops are detaching themselves from the "unhealthy" McDonald's brand.

With this recommendation, McDonald's will need to remain a strong relationship with suppliers in those product categories. By purchasing future contracts in raw ingredients such as flour, coffee beans, and chicken would hedge and mitigate the risk of future fluctuating prices of raw ingredients.

## **External Assessment**

Industry: Global Quick Service Restaurants (QSR)

### **(E 1.0) Macro-environment**

#### **(E 1.1) Political**

- Lobbying efforts (National Restaurant Association in the US) to lower minimum wage, taxes and other factors that may hinder business operations

#### **(E 1.2) Economical**

- Countries go through different economic cycles
- Countries have different tax and exchange rates
- Global food costs rising

#### **(E 1.3) Sociocultural**

- Continuous global shift in lifestyle trends to healthier eating habits
- Eating behaviour based on cultural upbringing varies throughout the world
- Less consumers are eating out due to busy schedules and routines

#### **(E 1.4) Technological**

- Advanced Management Information Systems used for daily operations
- Data mining capabilities can gather metrics and insights to supports quantitative decisions in menus, prices, promotions, restaurant allocation, customer purchase behaviour
- Trend of the increasing use of personal mobile devices, smartphones, tablets
  - Increase customer ease of sharing dining experiences
  - Provides transparency in restaurant operations
  - Widen channels for customer touch points

#### **(E 1.5) Environmental**

- Restaurants are practicing sustainability in operations to boost corporate social responsibility (sustainable and environmentally friendly packaging)

#### **(E 1.6) Legal**

- Government regulations such as health and hygiene policies that restaurants must comply
- Possible class lawsuits against industry players
- Labor laws increasing minimum wage in top saturated market (United States)

The QSR industry has been undergoing a rapid change in the macro environment. Healthy eating habits have been on the rise and continue to demonstrate strong market penetration. While the rapid development in the technological environment has changed how consumers share positive and negative experiences. Restaurants must adapt to the ever-changing macro environment as it exerts strong relevant influences and forces.

### **(E 2.0) Dominant Economic Features Analysis**

- **Market size and growth rate:** Saturated, global \$551 billion of revenue, growing 3.5%/year since 2009
- **Number of buyers:** Extremely high number of buyers, elastic demand
- **Buyer needs and requirements:** Buyers' need changing via social, lifestyle trends, looking for healthier options
- **Number of rivals:** Concentrated and dominated by a few large companies, oligopoly
- **Scope of competitive rivals:** Global competition, imperative to have global presence
- **Product differentiation:** weakly differentiated products, rivals are becoming more differentiated, product look-alikes causes intensive price competition
- **Product innovation:** heightened competition promotes product innovation

- **Production capacity:** Advanced tech systems limits surplus of capacity
- **Pace of technological change:** Tech can further lower operation costs, strong tech capabilities is the industry norm (need it to have level playing field)
- **Vertical integration:** most global players operate in multiple stages in the supply chain
- **Economies of scale:** Very important for success, scale of purchasing, advertising, shipping
- **Learning and experience curves:** Mild to weak learning and experience effect as industry is in its maturity stage

The size and often criticized oligopoly market utilizes economies of scale of its operation advantage. From having large advertising and research and development budgets, to leverage in deal negotiations, industry players have been honing and iterating this saturated industry for many years. The nature of a weak product differentiation market, companies are creating incremental improvements just for a small marginal edge over competition.

### **(E 3.0) Porter's 5 Forces**

#### **(E 3.1) Industry Rivalry: Strong**

- Industry life cycle in maturity stage (slow annual growth rate) ignites fierce battle for market share
- Extremely low cost for customers to switch brands
- Restaurants have limited competitive advantage over competition, low differentiation
- Increasing competitive diversity creates volatile and disruptive business environment

#### **(E 3.2) Threats from new entrants: Weak**

- Requires substantial startup capital to run franchise model, global expansion
- Competitive cost and pricing due to economies of scale industry players have
- Brand equity among established brand is recognizable around the world
- New entrants require extensive distribution and supplier network

#### **(E 3.3) Threat of substitute products or services: Strong**

- Buyers extremely price sensitive
- Substitutes are readily available and are attractively priced (low priced)
- Weak competitive advantage among businesses, product attributes perceived very similar in eyes of consumers
- Extremely low cost for buyers when switching to substitute

#### **(E 3.4) Bargaining power of suppliers: Moderate**

- Rising food costs would leave suppliers no choice but to raise prices, even to network partners
- Nature of industry players have networks of restaurants, thus, obtain negotiating leverage, accounts for a large part of suppliers' sales
- An abundance of suppliers would cut prices for contract deals with industry players, strong competition in suppliers' industry
- Items supplied are generic and can be obtained easily on the market

#### **(E 3.5) Bargaining power of customers: Weak, slowly getting stronger**

- Industry players have system-wide standards such as prices and menu options across its corporate and franchise locations, customers have no influence
- Customers are demanding more transparency in industry practices from businesses, becoming well informed regarding prices and costs
- Buyers are small in number (individuals), and large in numbers, losing one customer is not a big deal for industry players

The forces exerted by industry rivals and their products proved to be the strongest competitive forces. The high threat of substitute products pressure industry members consistently to allocate a significant portion of their market research budget for competitive intelligence. As consumables such as food is classified as a generic and low-cost product, switching costs for consumers are extremely low.

#### **(E 4.0) Driving Forces Analysis**

##### **(E 4.1) Changing societal concerns, attitudes, and lifestyle**

- Global trend of consumers eating fewer calories, eating out less as supplier costs are on the rise
- Frequent studies and medical tests links fast-food to weight gain and obesity, so consumers are more wary of the drawbacks of quick service restaurants

##### **(E 4.2) Diffusion of knowledge**

- Although there are intellectual property strategies (ingredients, operations etc.), every industry player has their own limited portfolio of proprietary practices
- Industry best practices are well known as turnovers in high level management often results in joining a former competitor

##### **(E 4.3) Emerging new Internet capabilities and applications**

- Rise of mobile computing allows consumers to interact with industry players in multiple magnitudes that directly affects operation efficiency, and customer service
  - Delivery services, menu browsing, social media, crowd sourced reviews
- Interconnectedness between stores and headquarters allow real-time data synchronization (menu prices/options) and instantaneous feedback (POS)

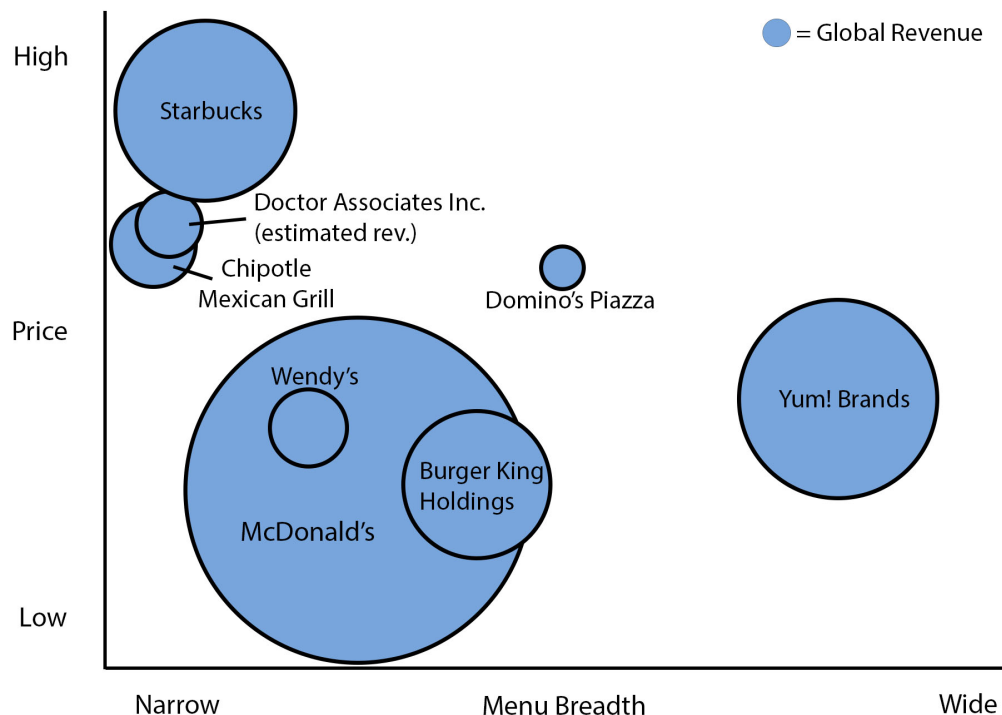
##### **(E 4.4) Increasing globalization**

- Maintain a consistent experience for customers through their internal standards, despite many different suppliers of raw ingredients
- Different countries have different cultures, eating habits, style, and routines varies throughout the world

The ever-changing societal lifestyle toward healthy routines is pressuring QSR industry members to innovate their menus. Global quick service restaurants carry a negative stigma of unhealthy, high fat, high sodium food; an image leading players must leave behind. As the industry crawls through its mature stage, best practices are well known, as proprietary processes are limited. Restaurants may take advantage of emerging new Internet capabilities to entice new customers as a means of a (innovative competitive advantage) different experience, service, and communication channel.

#### **(E 5.0) Strategic Group Map Analysis for Global Quick Service Restaurants**

- McDonald's is by far the market leader in the quick service restaurant industry
  - Low cost leadership as its competitive advantage
- Empty space in the top right representing high price and wide menu breadth are dominated by small, independent, local quick service restaurants
- Rising food costs pressures global QSR players to pursue higher margin products such as coffee
  - Burger King Holdings' Tim Hortons acquisition, McDonald's McCafe focus



Industry is very competitive as the top 5 industry leaders have over \$2 billion dollars in global sales. Competitors take advantage of economies of scale in order to drive down low prices. In order for companies to achieve a higher product breadth without complicating operations is to have segmented business units. Yum! Brands' subsidiary brands include Pizza Hut, KFC, and Taco Bell, while Tim Hortons' parent company is Burger King Holdings.

## **(E 6.0) Framework for Competitive Analysis**

### **(E 6.1) Current strategy**

- Competition position themselves aligned with consumers' health trend, good quality ingredients, and fresh products
- Remain competitive by providing low cost products for price sensitive customers
- Positioning themselves as a brand that resonates with millennial, understand their values and beliefs and align operation and marketing initiatives to mirror the culture

### **(E 6.2) Objectives**

- Heavy transparent marketing campaigns are indicative to the emphasis of a consumer education strategy, consumers know exactly where their food is coming from
- Leveraging economies of scale to lower costs and prices
- Strong growth in sales and store expansion resulted via menu variety (product differentiation), new, unique, and novel experience at an aged QSR industry

### **(E 6.3) Capabilities**

- Brands strongly resonates with consumers, an increasingly loyal following in the industry's target market
  - Brand equity allows the tailor of menus an easier
- Upstream value chain network is increasingly stronger as it is a key ingredient to international expansion, increase negotiating buying power with international suppliers

### **(E 6.4) Assumptions**

- Consumer health trends will only escalate in the future, and those who adapt will be successful



- Competitive and risky industry, they must adapt to ever changing consumer taste to gain loyalty and remain competitive

The quick service industry is extremely competitive as factors of product differentiation are limited for industry players. Other than providing low prices, businesses have recently been focusing on differentiating themselves from competition by adapting to customers' healthy trend by iterating their core competency to having fresh, high quality ingredients while providing a low price is secondary.

### **(E 7.0) Key Success Factors Analysis**

#### **(E 7.1) Strong branding**

- Image and recognition by customers would grow loyalty and trust
- Strong advertising and integrated marketing communications to accomplish brand positioning strategies

#### **(E 7.2) System-wide standards**

- Operations must comply with strict corporate standards
  - Standardized cooking and ingredients to deliver consistent quality
  - Standardized efficient measures to minimize costs
- Customer service excellence
  - Maintain cleanliness standards for ultimate customer satisfaction
  - Effective service to solve customers' wants and needs in a timely manner

#### **(E 7.3) Willingness to adapt**

- Changing customer needs must be catered in a timely manner relative to competition
- Consumer intelligence must be researched to understand and predict future trends

#### **(E 7.4) Strong supplier network**

- Economies of scale (high volume orders) must be reached in order to minimize cost while maintaining quality ingredients
- Brands must have contingency plan in case of rising supplier costs due to macroeconomic conditions

The nature of the quick service industry provides minimal room for players to have a distinct competitive advantage. All members strive for operating efficiency by leveraging economies of scale to lower costs for its price sensitive consumers. Even though operation efficiency should be players' core competency, successful market players must also adapt to consumers' ever-changing needs.

### **(E 8.0) Industry Outlook**

- Economic inflation causing costs of raw ingredients and labor to rise
- Consumer trends shifting to a more healthier lifestyle, healthier eating habits
- Extremely price sensitive consumers, elastic demand
  - Easy and low cost for buyers to switch brands, low product differentiation
- Few market players as economies of scale operations is one of a key criteria to survive in the environment

The quick service industry's profitability has been declining because of a narrowing profit margin caused by rising food and labor costs. Other than utilizing economies of scale to provide lowest costs to customers, industry members are seeking for additional competencies to gain a marginal competitive advantage. Multiple trends such as a rise in technology and a shifting paradigm of healthier eating habits are some of the factors quick service restaurants may gain a new service advantage.

## Company's Internal Assessment

Key Financial Highlights						2014		
	2009	2010	2011	2012	2013	Q1	Q2	Q3
Revenue (\$mm)	22,744.7	24,074.6	27,006.0	27,567.0	28,105.7	6,700.3	7,181.7	6,987.1
Growth %, YoY	-3.3	5.8	12.2	2.1	2.0	1.4	1.4	-4.6
CAGR %	5.43							
Gross Profit (\$mm)	12,757.4	9,637.3	10,686.6	15,526.6	15,726.8	2,516.1	2,784.3	2,681.2
Margin %	56.1	40.0	39.6	56.3	56.0	37.6	38.8	38.4
CAGR %	5.37							
Operating Income (\$mm)	6,841.0	7,473.1	8,529.7	8,604.6	8,764.3	Average	31.0	
Margin %	30.1	31.0	31.6	31.2	31.2			
CAGR %	6.39							
EBITDA (\$mm)	8,057.2	8,749.3	9,944.7	10,093.1	10,349.4			
Margin %	35.4	36.3	36.8	36.6	36.8			
Net Income (\$mm)	4,551.0	4,946.3	5,503.1	5,464.8	5,585.9	1,204.8	1,387.1	1,068.4
Margin %	20.0	20.5	20.4	19.8	19.9	18.0	19.3	15.3
CAGR %	5.26							
Adjusted EPS (\$)	4.02	4.60	5.27	5.37	5.55			
Growth %, YoY	9.5	14.4	14.6	1.9	3.4			

	2009	2010	2011	2012	2013
Cash from Operations (\$mm)	5,751.0	6,341.6	7,150.1	6,966.1	7,120.7
Capital Expenditures (\$mm)	-2,097.8	-2,318.9	-2,729.8	-3,049.2	-2,824.7
Free Cash Flow (\$mm)	3,653.2	4,022.7	4,420.3	3,916.9	4,296.0

### Company-operated

Same Store Sales %	3.8	5	5.6	3.1	<b>0.2</b>
Number of Locations	6262	6399	6435	6598	6738

### Franchised & Affiliated

Number of Locations	26216	26338	27075	27882	28691
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<b>Total Stores</b>	<b>32478</b>	<b>32737</b>	<b>33510</b>	<b>34480</b>	<b>35429</b>
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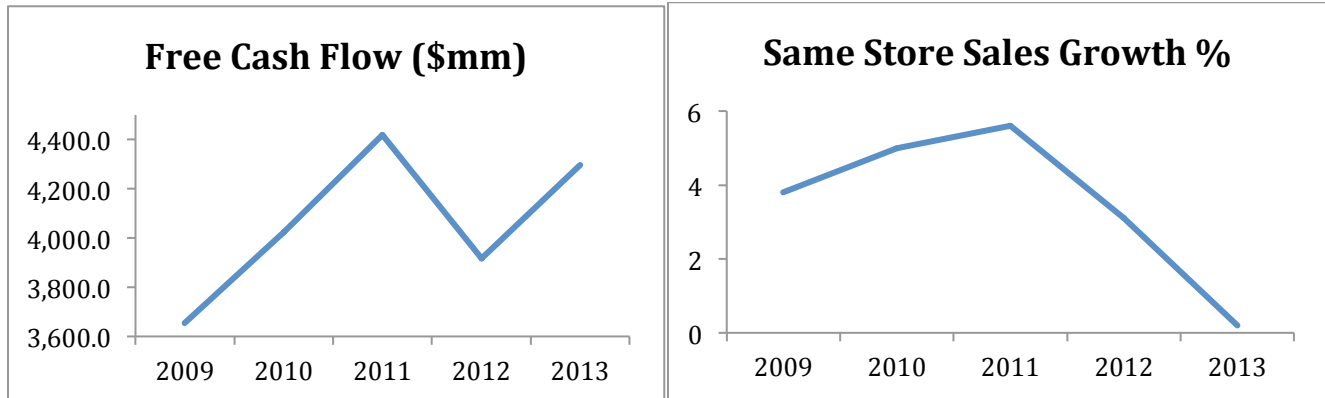
### Ratios

	2009	2010	2011	2012	2013
<b>Profitability (%)</b>					
Return on Common Equity	33.2	34.5	37.9	36.8	35.7
Return on Assets	15.5	15.9	16.9	16.0	15.5
Return on Invested Capital	19.7	20.7	21.9	20.6	20.0
<b>Liquidity</b>					
Current Ratio	1.1	1.5	1.3	1.4	1.6
Quick Ratio	1.0	1.2	1.0	1.1	1.3
<b>Leverage</b>					
Total Debt/Equity	75.4	78.6	86.9	89.1	88.3

Total Debt/Capital	43.0	44.0	46.5	47.1	46.9
Total Debt/Total Assets	35.0	36.0	37.9	38.5	38.6

#### Other

Dividend Payout Ratio	48.3	48.7	47.4	53.1	55.8
Inventory Turnover	91.8	133.6	144.0	101.0	100.9
Common Equity/Total Assets	46.4	45.8	43.6	43.2	43.7
Dividend Yield %	2.1	2.3	2.5	2.9	3.1



- Net income margin has been on a decline since 2011
  - In the 3<sup>rd</sup> quarter of 2014, net income margin has decreased to a mere 15.3%, a 30% decline from last year, its lowest level since the beginning of the financial crisis in 2007
  - Rising food and labor costs are the culprits for narrowing margins
- McDonald's free cash flow has been at healthy levels at \$4.3 billion in 2013, as management may further execute its strategic operations
- The annual growth in revenue since 2011 has been declining drastically, from 12.2%, to a growth rate of 2%
  - Declining trend speeds up as it reached -4.6% growth in the 3<sup>rd</sup> quarter of 2014
- Operating income has been extremely consistent although revenue growth fluctuates (average of 31%)
  - Operating efficiency remains McDonald's competitive advantage and core competency
- EPS growth has slowed down since aggressive growth in 2011
  - Expected as net income has been in a strong decline
- Declining same store sales percentage mirrors the sharp decline of revenue growth
- Franchise and corporate store expansion has been consistent since 2009
- McDonald's liquidity has been improving as both its current ratio and its quick ratio is at its 5 year high of 1.6 and 1.3 respectively
- Percentage of dividend yield has been increasing steadily since 2009 to retain current investors while attracting new ones

## **(i2.0) McDonald's Growth Strategy**

### **(i2.1) Vision, Mission, Objectives**

- Global strategy called the "Plan to Win", centers around corporate values of QSC&V (quality, service, cleanliness and value)
- Core competency and competitive advantage of providing lowest price for food out-side home
  - Rising supplier and raw ingredient costs are compromising McDonald's operation

strategy, pressuring to raise prices while margins are dangerously narrowing

- Long-term goal of obtaining annual system-wide sales growth of 3-5%
  - Reaching a cumulated annual growth rate (CAGR) of 5.43% between the years 2009 and 2013, they obtained their growth goal
- Long-term goal of achieving annual operating income growth of 6-7%
  - CAGR of 6.39% from 2009 to 2013, achieved operating growth target

### **(i2.2) McDonald's Competitive Approach**

- Cost leadership created via economies of scale and close relations with suppliers
- Speedy delivery of their food, operations is easy for employees to execute (narrowing menu would narrow task scope to offset the nature of high turnover rates in the QSR industry), ensures low failure rate, thus, resulting in lowering operation costs
- Geographically segmented business units ensures cultural knowledge and fit
- "Plan to Win" provides frame-work that focuses on 3 global growth priorities of optimizing menu, modernizing customer experience, and broadening accessibility to "Brand McDonald's"
- Convenience, menu variety, geographic diversification, value chain efficiency
- Line-extension, menu innovations, new distribution channels to cater a wider market segment
  - McCafé expansions, McDelivery, Dessert Kiosks

### **(i2.3) Key Performance Indicators**

Identify and analyze key performance indicators (will include indicators for both financial and strategic objectives; financial results should include a summary of relevant facts from your financial analysis)

- CAGR for operating income at 6.39% from years 2009-2013 while maintaining an extremely constant margin at 31% of revenues
  - Remains as an industry leader in operation efficiency as the max deviation away the mean of 31% of revenue is at 30.1% in 2009
  - Indicative of managements' priority and focus in operation efficiency
  - Drive thru lines have the longest wait times in 15 years
- Franchise and corporate store expansion totaled to 35,429 at the end of 2013
  - Added 949 stores in 2013, down from 970 in 2012, corporate expansion slow down as management wants to mitigate startup risk toward franchisees, corporate store expansion declined 14% in 2013
- Same store sales year-to-year growth down to 0.2%
  - Price sensitive consumers are switching brands as prices increased of an average of 3% since June 2013
- Net income CAGR of 5.26% less than the revenue CAGR of 5.43% since 2009
  - Net income not growing as fast as costs are rising quicker than revenue growth
- Net income margin of 15.3% in the 3<sup>rd</sup> quarter of 2014
  - 30% decrease from 3<sup>rd</sup> quarter of 2013

Although McDonald's is currently still the market leader in the quick service restaurant industry, its poor financial performance in the recent years and quarters reflect on the potential detrimental loss in market share. McDonald's have the resources and the dynamic capabilities to modify its strategic direction.

### **(i3.0) Market Opportunities & Nullifying External Threats**

#### **(i3.1) Strengths:**

- Largest market share in fast food industry

- Currently, lowest price and cost product
- Operating efficiency
- Operating consistency
- Supplier relationship
- Global brand recognition (\$40 billion)

**(i3.2) Weaknesses:**

- Unhealthy brand perception
- High employee turnover although minimum-wage increasing
- Menu breadth widening too quickly, 70% growth since 2007
- Drive thru lines slowest in 15 years, average of 189.5 seconds from order to pickup
- Slower adaptation to consumers' health and lifestyle trends

**(i3.3) Opportunity:**

- Increasing demand for healthy food choices
- Increasing technological adoption rates creates new communication channels
- Exploring and creating wider product breadth (i.e. success of McCafe segment)

**(i3.4) Threat:**

- Target market extremely price sensitive
- Recent higher wage and food costs, losing bargain-seeking customers
  - Rising beef, cheese, and pork prices
  - Prices were up 3% since June 2013
- Competitors' growing market share in a saturated global market through brand development and product innovation and alignment with consumer health trends
- Potential lawsuits
- Local QSR chains
- Currency discrepancies and fluctuations

McDonald's projection is not as bright as its current position in the market. Strong threats are exerting onto McDonald's as competition are focusing on deviating away from low cost leadership, to a product differentiating strategy. McDonald's strategic direction should take into account the evidence of a narrowing profit margin due to inflating raw ingredient prices by focusing on new market opportunities. McDonald's current market leadership gives them an abundance of resources to tailor its strategy in accordance to fluctuating market conditions.

**(i4.0) Value Chain Analysis**

**Key Success Factors:** Strong branding, system-wide standards, willingness to adapt, strong supplier network

**(i4.1) Primary Activities:**

- Supply Chain Management
  - Shared system approach, using e-procurement (EMAC) to create deep collaboration, joint-ownership mentality to improve and maximize efficiency
  - Rising supplier cost due to inflating raw ingredient prices (beef, cheese, pork)
  - EMAC: Aggregate supplier platform for all franchisee purchases
    - Suppliers all must pass corporate standards
- Operations
  - Quality Control
    - 600 page operation and training manual, two week Hamburger University to learn about the "Golden-arch" standard

- Efficiency
  - Strategic staff placement, real-time performance reviews to aid managers make quantitative decisions
  - Long drive thru wait times, increasing large menu breadth
- Cleanliness
  - Comprehensive cleaning procedures and schedules to ensure high level of cleanliness
- Distribution
  - Aligned with “Plan to Win”: communication effectiveness through an integrated system
  - Long-term relationship with distributors to ensure trust and reliance
  - 80% of 35,429 stores are franchise owned
- Sales and marketing
  - MacDonald’s often stresses the value they provide consumers
  - High quality of brand endorsements and partnership to widen brand image, reach, equity, and recognition
  - Growing CSR initiatives to align with sustainable business practices
  - Recent transparency campaign helped McDonald’s solve consumer problems regarding non-fresh and unethical supplier practices
- Service
  - To McDonald’s, their second most important philosophy
  - Has motto of “serve with a smile”
  - Initiated a “one minute service” campaign in various parts of the world

#### **(i4.2) Supporting Activities:**

- Product R&D, Technology, and MIS
  - To align “The System” (suppliers, customers, corporate) using EMAC with suppliers, Apple-pay with consumers
  - McDelivery mobile application to ease process of placing delivery orders in various countries
  - Uses point-of-sale data from all locations, feeds into global data warehouse
  - Simulation models, predictive tools can provide managers detailed information such as store performance at 15 minute intervals, exactly where staff should be positioned throughout the day
- Human Resource Management
  - Highly structured training program called Crew Training System provided at each restaurant, video tapes and manuals
  - Regular performance reviews and employee benefits to retain talent and lower turnover rates
- General Administration
  - Free Wi-Fi at all locations to enhance customer service
  - Strategic partnerships with global leading brands to collaborate and create comprehensive synergy

McDonald’s has honed its value proposition of providing customers the lowest prices possible for many years. Its low cost and brand development has helped the brand to retain the position of a market leader in the quick service restaurant industry. They have been able to maximize its value chain through long-term channel partnerships and have a strong bargaining position.

### **(i5.0) Representative Weighted Competitive Strength Assessment**

#### **Competitive Strength Assessment**

**s = strength, ws = weighted score, 1 = very weak, 10 = very strong**

Key Success Factor	Importance	McDonald's		Yum! Brands		Starbucks		Burger King Holdings		Chipotle	
		S	WS	S	WS	S	WS	S	WS	S	WS
Strong Branding	0.2	10	2	9	1.8	9	1.8	6	1.2	6	1.2
System-wide Standards	0.2	9	1.8	8	1.6	7	1.4	7	1.4	8	1.6
Willingness to adapt	0.3	7	2.1	7	2.1	7	2.1	9	2.7	10	3
Strong supplier network	0.3	7	2.1	7	2.1	8	2.4	7	2.1	6	1.8
<b>Sum of Importance Weight</b>	<b>1</b>										
<b>Overall Weighted Competitive Strength Rating</b>		<b>8</b>		<b>7.6</b>		<b>7.7</b>		<b>7.4</b>		<b>7.6</b>	

- With the most locations in the whole quick service industry, McDonald's is one of the most valuable and recognizable brands in the world
- McDonald's have retained its position as a market leader through its stringent and strict system-wide standards
  - But the diffusion of knowledge has given competitors chances to narrow in the operational gap
- Although McDonald's have been innovating due to consumers' ever-changing trends, Chipotle's branding strategy aligns with new healthier consumer eating habits and trends
- Recent acquisition of Tim Hortons (coffee market leader in Canada) by Burger King Holding demonstrates their willingness to adapt to changing market conditions as food prices have been inflating consistently
- Having a strong supplier network is essentially a requirement to be a competitive player in this global competition

While McDonald's is currently enjoying its lead against fellow competitors in terms of market share and in brand recognition, its core competitive strength of providing a low cost menu selection for their customers might be slowly slipping away. The above score shows a static picture of the immediate competitive environment but in fact, the landscape is a dynamic one that constantly changes. McDonald's should leverage its leading brand recognition ability to exploit competitors' new strategic directions.

### **(i6.0) Due to the inevitable rise of food and labor costs that subsequently leads to a rise in prices, what can management do to retain price sensitive consumers?**

- Cattle, cheese, and swine prices are at its highest level since 1990
  - Cattle priced at \$146.49/live cwt (hundredweight) in 2014 compared to \$94.58/live cwt in 2009
- National average in the United States of America for minimum wage has increased from \$7.14/hour in 2009, to \$7.49/hour in 2014
- McDonald's have increased its menu prices by 3% since June 2013 in an extremely price sensitive environment
  - Although prices increased, net profit margin has been squeezed to a mere 15.3% in the 3<sup>rd</sup> quarter of 2014 from the 19.9% margin in the year 2013
- Consumers switching brands as the brand perception of McDonald's having the lowest priced

food is no longer holds true, as their demand for McDonald's is very elastic

Don Thompson and his top executives at McDonald's must be worried since its long standing competitive advantage of cost leadership strategy is no longer a strong enough core value proposition for their customers. As operation efficiency has reached its optimal peak, any minor tweaking that would widen the net profit margin would only be minuscule beneficial for McDonald's financial health, as it would not be a sustainable strategy.

#### **(i7.0) Loosing price sensitive customers to competition deserves managerial attention**

##### **(i7.1) Why does it deserve their attention?**

- Lobbying efforts (National Restaurant Association in the US) to lower minimum wage, taxes and other factors that may hinder business operations (E 1.1)
  - National average in the United States of America for minimum wage has increased from \$7.14/hour in 2009, to \$7.49/hour in 2014 (i6.0)
- Rising food costs would leave suppliers no choice but to raise prices, even to partners (E 3.4)
- Rising food costs pressures global QSR players to pursue higher margin products such as coffee
  - Burger King Holdings' Tim Hortons acquisition, McDonald's McCafe focus (E 5.0)
- Economic inflation causing costs of raw ingredients and labor to rise (E 8.0)
- Net income margin has been on a decline since 2011 (Financials)
  - In the 3<sup>rd</sup> quarter of 2014, net income margin has decreased to a mere 15.3%, its lowest level since the beginning of the financial crisis in 2007
  - Rising food and labor costs are the culprits for narrowing margins
  - Signal for management that price and cost relationship is disintegrating
- McDonald's have increased its menu prices by 3% since June 2013 in an extremely price sensitive environment (i6.0)
  - Although prices increased, net profit margin has been squeezed to a mere 15.3% in the 3<sup>rd</sup> quarter of 2014 from the 19.9% margin in the year 2013
- Cattle, cheese, and swine prices are at its highest level since 1990, cattle priced at \$146.49/live cwt (hundredweight) in 2014 compared to \$94.58/live cwt in 2009 (i6.0)
- Consumers switching brands as the brand perception of McDonald's having the lowest priced food is no longer holds true, as their demand for McDonald's is very elastic (i6.0)

##### **(i7.2) Consequences of not proving attention on loosing price sensitive customers**

- Industry life cycle in maturity stage (slow annual growth rate) ignites fierce battle for market share (E 3.1)
- Extremely low cost for customers to switch brands (E 3.1)
- Buyers extremely price sensitive (E 3.3)
- Substitutes are readily available and are attractively priced (low priced) (E 3.3)
- Strong growth in sales and store expansion resulted via menu variety (product differentiation), new, unique, and novel experience at an aged QSR industry (E 6.2)
- The annual growth in revenue since 2011 has been declining drastically, from 12.2%, to a growth rate of 2%, declining trend speeds up as it reached -4.6% growth in the 3<sup>rd</sup> quarter of 2014 (i1.0)
- Declining same store sales percentage mirrors the sharp decline of revenue growth (Financials)
- Although McDonald's have been innovating due to consumers' ever-changing trends, Chipotle's branding strategy aligns with new healthier consumer eating habits and trends (i5.0)
- Recent acquisition of Tim Hortons (coffee market leader in Canada) by Burger King Holding demonstrates their willingness to adapt to changing market conditions as food prices have been inflating consistently (i5.0)



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