

Strategic issues and history of mcdonalds



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The business began with two brothers. In 1937, Dick and Maurice McDonalds opened a small drive-in restaurant east of Pasadena, California. They served hotdogs and shakes. This led to the creation of a bigger drive-in which operated successfully and by 1948, the brothers had made a fortune they never expected. The brothers realized that hamburgers comprised of 80 percent of their sales and closed their doors to re-evaluate their business model. The same year, in 1948 the model was about affordable dining for family who wanted to eat out. The 'Speedy Service System' was also implemented that included an assembly line of sorts, a nine-item menu, and an all male staff. The operations were proven successful in 1952 and the first franchise was sold to Neil Fox who opened a restaurant in Phoenix, Arizona and created the well-known golden arches of McDonalds. Fox had huge success with the store and the brothers were reluctant at first to begin a national franchise system, but soon realized that too many copycats were creeping up and they needed an advantage and a head start. Ray Croc joined the team as the exclusive franchise agent in the United States.

Some of the problems and challenges facing the company is the increase in competition, poor management, bad marketing, and lack of response to the changes in the needs of franchises and customers. This resulted in the strategic issues that needed to be implemented to continue growing success for the company. Going global is critical in the expansion of McDonalds. Over the past couple of decades, the major chains have also begun to expand into the global marketplace and have opened franchises up around the world. McDonald's currently operates in over 120 countries around the world with over 30,000 stores.

In analyzing this company, the strengths, weaknesses, opportunities, and threats were inevitably explored to better understand the current situation. This SWOT analysis shows us that although there are numerous threats against the fast-food industry, McDonald's occupies a relatively strong position in the global marketplace. According to the five forces model, the strongest competitive force is between rival sellers in the industry. This SWOT analysis shows the many strengths that Mc Donald's employs to keep itself at the top of the fast-food industry. Although there are various weaknesses, these can all be turned around following the McDonald's Plan to Win, which was implemented with the hiring of Jim Cantalupo.

Keeping in mind, the core competencies of this company is what makes it so successful today. For the past ten years, one of McDonald's key success factors has been its franchises, taking in approximately 60 percent of total sales. Another success factor is the ' Plan to Win' strategy. It is a plan that focuses on five key drivers of success; people, product, place, price, and promotion. The first factor is McDonald's people or employees. McDonald's is striving to do a better job of staffing during busy periods as not to overwhelm and to reward outstanding employees for exception work.

Vision/Mission/Objectives

Strategic Issues, Problems and Challenges

In recent time McDonald's has underperformed in comparison to previous year's achievement. Its revenue growth has been in the decline and prior to April 2003 store sales fall for 12 straight months. It is no surprise that as a consequence McDonald's reported a loss of 343. 8 million dollars in first

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quarter of 2003. It is believed that this situation is a result of several aspects that include an increase in competition, poor management, bad marketing and lack of response to the changes in the needs of franchises and customers.

Rising Issues-Customer Service

As years have progress many issues have arisen for McDonald's but the greatest is probably its poor customer service. A customer service index done in 2003 found that McDonald's has the lowest the customer service ranking in the fast food industry and is ranked even lower on customer service than the IRS. One reason for this is a high employee turnover rate. McDonald's has the highest employee turnover rate among its competitors. Another contributing aspect to the poor customer service is slow service at the drive-through window. McDonald's currently ranks fifth in speed at the drive-through window and 19th in accuracy. If you compare its speed and accuracy to its competitors and keep in mind that McDonald's generates 60 percent of its revenue from its drive-through and assume it is losing one percent of revenue for every six seconds that its behind, than McDonald's is losing approximately 97,000 dollars annually.

Opposing Viewpoints

While McDonald's feels positive about its newly implemented changes the critics are rather skeptical. It was stated that long-term they believe that it will be tough to sustain growth and margin expansion. Specific concerns include McDonald's ability to maintain its current level of product innovation and competitors' ability to copy those ideas. The critics even went as far to <https://assignbuster.com/strategic-issues-and-history-of-mcdonalds/>

question if McDonald's recent improvement was more of a reflection of the market and the dollar rather than its newly implemented strategy. In response, McDonald's officials stated that they will need to deliver on their stated goal of sustaining increases in sales and operating income. Following with the most significant question of whether or not the new changes will sufficiently provide McDonald's with core competencies necessary to build a sustainable competitive advantage in the global fast-food industry.

Health Factor

All fast-food hamburger chains, McDonald's included, are forced to respond to the shift in customer preferences from high-calorie burger and fries to healthier items such as deli sandwiches and baked potatoes. All the chains are expected to be struggling for several years to come to meet new consumer health expectations without compromising the original menu items.

Competition

One of the major issues for McDonald's is its competitors. Burger King is the second largest hamburger fast-food chain in the world and is the number one competitor for McDonald's. Burger King has 11,400 locations in 58 countries and derives 55 percent of its revenue from the drive-through window. Burger King reported 1.72 billion in 2002 in revenue which is a 17 percent increase compared to a 4 percent increase reported by McDonald's over the same period. Burger King's distinct assets include the unique Whopper with its one-of-a-kind charbroiled taste and the company policy of preparing the hamburger any way that the customer wants it. Burger King has distinguished itself over

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the years in many ways including being the first in the fast-food industry to enclose its patio seating in 1957 thereby offering customer indoor dining experience. Burger King also differentiated itself when it installed the drive-through window in its restaurants in 1975. In addition to the Whopper Burger King also offers a few set items on its break-fast menu that differs it from its competitors including the Croissan'wiches and french toast sticks. The rest of the menu also offered the unique veggie burger and chicken Caesar salad.

Wendy's is the third largest fast-food chain with 9, 000 stores in 33 countries world wide. In 2002 they reported 2. 73 billion in revenue which is up 14. 2 percent from the previous year. Wendy's offers several unique items including the Frostys and Spicy Chicken Sandwiches as well as healthier items such as salads, baked potatoes and chili. Wendy's has also distinguished itself through the creation of the special value menu with all items on it under a one dollar. Wendy's also owns several small companies including Tim Horton's and Baja Fresh Mexican Grill. It plans on increasingly using acquisitions of smaller brands to further growth. In next decade Wendy's plans to add between 2 and 4 thousand new stores worldwide. One important weakness of Wendy's is the lack of easily recognizable product compared to McDonald's Big Mac of the Burger King Whopper.

Hardee's is the fourth largest fast-food chain in the nation. It holds 2, 400 locations in 32 states and 11 countries. In 2002 it reported 1. 8 billion in sales. Hardee's greatest strength is in its breakfast menu which brings in 35 percent of its revenue. Hardee's is currently remodeling all of its restaurants inside and out into Star Hardee's and the menu is being expanded to include several premium offerings such as the Angus beef Thickburger which has

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been well received by hamburger eaters and the innovative Six Dollar Burger. Along with these Hardee's offers a one-third, half pound and three quarter-pound hamburger. These new items were implemented to demonstrate that it is quite clear that at Hardee's it is thought that customers are willing to pay more for quality and taste rather than cheap and poorly made burgers.

Jack in the Box, another major competitor in fast-food industry, has of 1, 850 restaurants in 17 states. In the fiscal year 2002 Jack in the Box reported revenue of 2. 2 billion dollars, which is up 4. 7 percent from the previous year. While McDonald's and some of the other competitors focus on a family concept, Jack in the Box gears its menu items toward adult consumers only. Part of Jack in the Box's menu includes its innovative items such as teriyaki chicken bowl and a chicken fajita pita. Along with most of its competitors Jack in the Box offers a value menu, but the company does not to engage in the price wars stating its intended reduction of emphasis on dollar menus and instead has turned its efforts toward improving the quality of it product as well as to initiate efforts to attract women and reduce its dependency on young males which is a crowded market. Like its competitors Jack in the Box believes that success in the future relies on broadening its product offerings in order to maintain the same level with the other fast-food chains and grocery stores.

Sonic yet another major competitor owns 2, 700 locations and reported in 2003, 2. 4 billion in revenue which is 6. 2 percent increase. They also reported an increase of net income by 20 percent. Its unique drive-in restaurant business is the largest in America and it broad menu and

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atmosphere along with oldies music attempt to emulate an era long past. Sonic has specialty soft drinks and frozen shakes and malts. Over the years Sonic has tried to focus on it items that are fun and novel. Since its founding the company has experienced non-stopped growth. In 2004 Sonic expects earning per share to rise 16 to 17 percent due to the addition of franchises. It also expects to open 200 new locations in 2004 and its revenue is expected to grow between 1-3 percent.

Industry Analysis

Market Size

Sales for the U. S. consumer food-service market totaled approximately \$408 billion in 2003. The 10 largest chains in America accounted for about 14 percent of these total sales according to U. S. Systemwide Foodservice Sales. The consumer food-service market is typically broken down into eight categories according to the type of food and the restaurant operations. The categories are as follows: sandwich, pizza, chicken, family, grill-buffet, dinner house, contract, and hotel. McDonald's competes with other businesses from these other categories as substitute product competitors but primarily competes in the quick-service sandwich market. Experts projected that the sandwich segment was expected to grow by two percent annually for the years ahead.

5 Competitive Forces

The quick-service sandwich industry faces competitive pressures from a number of forces. The major competitive threats originate from competing

sellers in the industry as well as firms in other industries that offer substitute products. McDonald's main competitors within the quick-service sandwich industry are continually deriving new strategies through offensive and defensive tactics in order to gain customers and market share. In 1989, Wendy's implemented the 99 cent value menu as an offensive strategy to gain customers looking for a quality product at a value price. In response, McDonald's and Burger King took a defensive approach and also instituted a value menu in their respective stores so that they wouldn't lose market share and customers to Wendy's. Firms in the quick-service sandwich industry are constantly jockeying for better market position through offensive strategies and in response to these strategies, other firms will take a defensive approach to guard against that offensive move made by the rival firm.

Substitute Products

In addition to competition from rival sellers in the industry, sandwich firms also face intense competitive pressure from firms in other industries selling substitute products. The substitute products for the fast-food industry are probably some of the most diverse in the world. These substitute products may include products purchased from the local grocery store, food from sit-down restaurants, or delivery foods such as pizza. The primary issue with these substitute products is that they are readily available to the customer and the customer tends to view them as being comparable or better in terms of the quality of fast-food products. Another issue that faces the fast-food industry is the availability of products that cater to the health-conscious lifestyle. The majority of the public tends to view fast-food restaurants as

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primarily serving foods that are high in fat content and unhealthy and as a result they are likely to look elsewhere for a healthy alternative. In response to the product offerings, buyers also exercise a great deal of bargaining ability through their purchasing power. While fast-food products may not always be associated with health and quality, fast-food restaurants to possess a major advantage over firms selling substitute products through the price of their products and the quick, convenient service.

New Entrants

The threat of potential new entrants and the bargaining power of suppliers is not a significant competitive force in the fast-food industry. Occasionally, new entrants will come along and compete with firms in the fast-food industry and offer substitute products. However, in order to compete on a large scale, it will require a great deal of capital to invest in real estate and build physical restaurant locations. In addition, the market is already so saturated that the new competitor might find it difficult to establish a customer base and become profitable. Suppliers in the fast-food industry do not have substantial bargaining power due to the fact that firms in the fast-food business tend to purchase their materials from various outlets. One company might purchase their meat supplies from a couple different meat manufacturers, then purchase their dairy needs from a number of different dairy companies, and also purchase their bakery products from a variety of sources. Since the fast-food firms divide their purchases among a diverse array of suppliers, the suppliers tend to have little or no bargaining power or leverage since there are multiple suppliers for the same products.

Driving Forces

There are a number of driving forces which have molded the current state of the fast-food industry. In the beginning, fast-food companies typically focused on being the low-cost provider and sought to expand into as many markets as possible. As these national brands have grown, the markets they are competing in have become overly saturated with restaurant options. As a result, the fast-food industry has begun to focus on the needs of the customer. The buyer has a great deal of leveraging power due to the fact that if they are dissatisfied with one brand they can easily switch or purchase from an alternate brand with little or no monetary repercussions. The fast-food firms have implemented strategies to improve the quality of customer service and the cleanliness of the restaurant locations in order to please their customers in hopes that they will become a repeat customer.

New Menu Items

Fast-food restaurants have, for the most part, always been related to an unhealthy lifestyle. As a result, customers who are health-conscious have tended to take their business elsewhere to restaurants that offer nutritious alternatives. In response to the health-conscious lifestyle that people have adopted, the majority of the national chains have created new menu items to cater to this demographic. Customers are the main driving force behind the daily operations of fast-food firms. They are the reason that companies have attempted to upgrade the quality of their customer service and their needs have lead to the creation of new products to satisfy their demands.

Strategic Moves

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A number of competitors in the fast-food industry have expanded beyond their traditional offering of generating revenues from their fast-food restaurants. Major chains such as McDonald's have acquired smaller chains Boston Market, Chipotle Mexican Grill, and Donato's Pizza. Wendy's has also grown by acquiring smaller companies such as Tim Horton's and Baja Fresh Mexican Grill. These acquisitions were executed in hopes of generating revenue from multiple sources and also to help support the company's growth over the long term. Over the past couple of decades, the major chains have also begun to expand into the global marketplace and have opened franchises up around the world. McDonald's currently operates in over 120 countries around the world with over 30, 000 stores. Burger King has 11, 400 stores in 58 countries and Wendy's operates 9, 000 restaurants in 33 countries worldwide. These fast-food firms have seen countries outside the U. S. as markets that have an enormous growth potential. In order to cater to the different cultures, companies such as McDonald's and Burger King have offered menu items with a distinctively local flavor.

Strategic Groups

The fast-food industry is primarily composed of national chain brands. As a result, there are just a couple of strategic groups associated with the fast-food market. The major national chain brands such as McDonald's, Burger King, Wendy's, Hardee's, and Jack in the Box compete in markets throughout the United States and around the world. Their strategies are focused on providing a product that is based on low-price convenience. Their strategic group is associated with many geographic locations and low price and quality. In competition with these large multinational firms are local fast-food

restaurants. Local fast-food restaurants focus on providing their customers with a quick, cheap alternative to the national brands. These businesses offer a low price and low quality product in few localities.

Fast-Service

Over the past couple of years there has been a growing trend in the restaurant industry to provide customers with a higher quality product in a short amount of time. These restaurants are typically referred to as 'fast casual' or 'quality quickservice.' They aim to provide freshly prepared, made-to-order meals. Their operations combine the speed and convenience of traditional fast food with the food quality and appealing d'cor of casual-dining restaurants. There are a number of national chains that fall into this strategic group of providing a high quality product in many geographic locations and there are also some businesses that function in a couple locations and provide a similar high quality product.

SWOT Analysis

This SWOT analysis shows us that although there are numerous threats against the fast-food industry, McDonald's occupies a relatively strong position in the global marketplace. According to the five forces model, the strongest competitive force is between rival sellers in the industry. This SWOT analysis shows the many strengths that Mc Donald's employs to keep itself at the top of the fast-food industry. Although there are various weaknesses, these can all be turned around following the McDonald's Plan to Win, which was implemented with the hiring of Jim Cantalupo. Obviously all fast-food chains are going to have to combat the new consumer health

expectations, but we feel that under Cantalupo's leadership, McDonald's has a strong enough consumer base to grow in the upcoming years. The financial analysis shows certain flaws in McDonald's finances, but these are largely due to the expansionary policy in place in the company.

Financial Analysis

McDonald's has gone through a large turnaround period in the previous two years. This becomes very apparent when looking at McDonald's net income between the years 1998 and 2003. Net income rose steadily between 1998 and 2000, then there was a drop-off in 2001 of over a \$300 million. Then in 2002, net income plummeted over \$700 million. This was due mainly to slower growth in total revenues, and large increases in operating costs and expenditures. McDonald's showed a marked improvement in 2003, amassing \$1.328 billion in net income, up over \$400 million from the previous year. Although this was a large gain, McDonald's is still not over its financial and operating troubles, and needs strong performance in the upcoming years to stay at the top in the fast food industry.

McDonald's bottom-line in the first quarter of 2003 was \$324.7 million. The dollar profit improved substantially over the next two quarters, netting \$470.9 million in the second quarter and \$547.4 million in the third quarter. As of the end of the 2003 fiscal year, McDonald's has enjoyed 11 months of sustained sales gains, which bode well for the future. One mention of note is that McDonald's did take a 'big bath' in 2002 and the first quarter of 2003, amassing a 135 million dollar loss as a result of accounting changes done to the books.

DuPont Analysis

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A DuPont Analysis of McDonald's financial statements shows that McDonald's is climbing out of their financial troubles of 2001-2002, yet need a continued effort to reach their goals. The profit margin is low throughout McDonald's income statements. In 2003, is .11. This means that for every dollar they sell, they are only reaping 11 cents profit. This is an increase of nearly 6 cents on the dollar over 2002 though, so this shows that the company is doing a better job of keeping expenditures down. One reason McDonald's profit margin is so low is that they are continually expanding, both domestically and internationally. They continue pouring money made from sales into new facilities and franchises. This severely depletes net income, and generally lowers the profit margin.

Asset Turnover Ratio

The asset turnover ratio shows that McDonald's is doing a poor job producing sales from its assets. This would be a cause for concern, but generally McDonald's has always had a lower asset turnover ratio, even when they were operating at the pinnacle of the industry. The return on assets, or return on investment shows again that McDonald's net income is low when compared to its level of assets. As stated earlier, this is due in large part to the expansionary policy in place at McDonalds and in turn, the growing number of assets. One interesting point is the large amount of cash that McDonald's has begun to keep. Between 1998 and 2001, the cash on hand was around \$415 million, yet in the third quarter of 2003, the company had \$647.4 million on hand. This is one reason why the asset turnover ratio is slightly smaller in 2003 than other years.

Return on Equity

The return on equity at McDonald's is again, low. This represents the profitability of funds invested by the stockholders in the business. Again, much of the reason for McDonald's low return on equity is due to the expansionary plans in the future and the fact that they are continually looking for ways to expand into foreign markets. As stated, nearly 100 percent of profits from company owned stores are re-invested into new enterprises.

The debt to equity ratio shows that McDonald's has a large amount of liabilities and debt, when compared to shareholders equity. In 2003, debt was 1.16 higher than equity. This is not generally a good sign, especially if McDonald's plans to pay dividends and give back to shareholders in the near future.

Current Debt Ratio

The current debt ratio at McDonald's shows that current liabilities are higher than current assets. This is again, a bad sign, as the company is not able to cover all of its immediate debts and loans. If creditors were to call in all debts, the company would find it very difficult to pay. As such, McDonald's has little liquidity.

The general impression we receive from McDonald's financial situation is that the company is slowly climbing out of a low period and making a turnaround. This can be seen in the financial ratios between 2002 and 2003. All show a marked improvement, and attest to the changes taking place at

McDonald's. The DuPont analysis shows major weaknesses arising from McDonald's level of debt and relatively low net income. In order to stay a stable company, we feel McDonald's will have to lower its debt levels, and strive to keep costs to a minimum. We do realize that McDonald's is continually expanding, and using all manner of capital to increase its market share, yet if McDonald's were to fall into another hole, as it did in 2001 and 2002, it would make it that much harder to make it out unscathed. (See Appendix C)

Value Chain Analysis

The value chain at McDonald's is very competitive in the global fast-food industry. The following table shows the costs and markups associated with McDonald's signature hamburger, the Big Mac, bought at a McDonald's.

The Big Mac's average price of \$2.80 compares favorably to the various signature items at other fast food retailers, such as Burger King and Wendy's. The royalties are paid by franchisees back to the McDonald's. (See Appendix B)

Key Success Factors

McDonald's short term financial objectives include cutting its capital expenditures by 40 percent, which will save approximately 1.2 billion dollars. McDonald's will use the extra money pay off debt and return some cash the shareholders by repurchasing shares and paying out more dividends. It's long term financial objectives include annual sales growth of 3-5 percent with one to three percent of this growth coming from existing

stores and two percent coming from new stores. They also include an increase in operation income capital investments.

For the past ten years one McDonald's key success factors has been its franchises, taking in approximately 60 percent of total sales. McDonald's own restaurants bring in less than 30 percent of its sales but at the same time that money comprises a fairly significant portion of total income because the company keeps and applies 100 percent of those profits rather than just a portion of the franchises profits.

McDonald's receives funds from its franchises in two ways. There is monthly service fee that varies but most recently in 2002 was 4 percent of total monthly sales. Another manner in which McDonald's receives funds from its franchises is in rent money. McDonald's owns all property in which a McDonald's outlet was built regardless if the location is a franchise or company owned. It is estimated that McDonald's generates more money from its rent than from its franchise fees.

McDonald's also markets excess land, property and buildings on the web.

Between rent and profits from land sales, McDonald's real estate represents a significant portion of its overall company value along with ventures in earning income will allow McDonald's to continue to be successful and profitable in the future.

McDonald's also has several restaurant affiliates that in the past years have been doing quite well for themselves. The list includes Boston Market, Chipotle Mexican Grill and Donato's Pizza.

McDonald's is currently testing new ways of raising revenue such as offering retail merchandise for sale in some stores.

One of McDonald's key success factors has been its implantation of its Plan to Win. The plan focuses on five key drivers of success; people, product, place, price, and promotion. The first factor is McDonald's people or employees. McDonald's is striving to do a better job of staffing during busy periods as not to overwhelm and to reward outstanding employees for exception work. It is also putting more emphasis on its hospitality training to ensure a friendlier and customer focused support staff.

The second factor is the customer experience. In response to a changing taste preference and growing interest in healthy foods, McDonald's introduced the McChicken and McGriddles as well as offering white meat for the chicken McNuggets. In addition McDonald's added several premium salads.

The third factor was restaurant appears, putting much focus on cleanliness and modern environment. As a part of this McDonald's has installed wireless technology and added coffeehouses in some of restaurants. These few carried premium coffee, muffins, and pastries at low price to enhance adult appeal. In addition to this McDonald's has gone as far to renovate, rebuild and even relocate some of its buildings in order to create a fresh and friendly family atmosphere.

The fourth factor was on price, putting much focus on productivity and value. McDonald's has concentrated much effort on products that appeal to price sensitive customers, thus it implantation of the dollar menu.

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The final factor was promotion and a continuing focus on building trust and brand loyalty. In its recent campaigns McDonald's has advertised using the slogan ' I'm lovin' it' which it there attempt to make McDonald's an easy choice for families. They have also started using popular or main stream music to attract an ever growing youth population.

McDonald's has chosen to enhance it focus on its core business and sell certain aspects such as Donato's Pizzeria. Along with this McDonald's has entered into a letter of intent to exit its domestic ventures activities with Fazoli's and discontinue development of non- McDonald's brands outside the U. S.

Alternate Strategies

Strategic Possibilities

1. Stay-on-the-offensive strategy ' The main goal of the stay-on-the-offensive strategy is to be a proactive market leader. The principle of this strategy is to continually stay one step ahead of your competitors and force them to play catch up. McDonald's is already the industry leader in the fast-food industry with a market share of 33 percent compared with the number two chain in the industry, Burger King at 13 percent market share. They can stay out front by implementing technological improvements in their restaurants to enhance the production methods or to improve the ordering process of the customer. In addition, they can also introduce new or better product offerings to satisfy the needs of their customers. The best approach that McDonald's can take through this strategy is to improve their customer service. McDonald's customer service ranking was the lowest in the fast-food

industry and was even lower than the Internal Revenue Service. To improve upon this substandard attribute, McDonald's should revamp their training process for newly hired employees and introduce new educational modules for currently employed personnel.

2. Fortify-and-defend strategy ' The purpose of this strategy is to make it harder for challengers to gain ground and for new firms to enter. A fortify-and-defend strategy works well with firms that have already achieved industry dominance. Since McDonald's is already the industry leader in the fast-food market, they can opt for a number of tactics using this strategy to maintain their industry position. They can continue their expansion tactics by continuing to open more stores around the world. This expansion would help defend against