

How 3 clever restaurateurs turned mcdonald's into a price-simplifying worldwide p...

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One day in 1954, a fifty-two-year-old man flew from Chicago to Los Angeles. The following day, bright and early, he drove sixty miles towards the Mojave Desert. His destination was a small, octagonal building, located on a corner in a small town. The stranger wasn't impressed by the humble structure. It didn't seem to fit with what he had heard.

Shortly before eleven o'clock, employees began to file in -- men dressed in spiffy white shirts, smart trousers and paper hats. The stranger liked that. The men began to trundle trolleys laden with food and drinks into the building, their tempo picking up so much that they reminded the stranger of ants bustling around a picnic. Cars began to arrive, the parking lot soon filled up, and lines began to form as customers stepped up to the windows.

The investigator was impressed by the activity, but still dubious. He joined the line and said to the man in front of him -- swarthy but well dressed, in a seersucker suit -- " Say, what's the attraction here?"

" Never eaten here before?"

" Nope."

" Well, you'll see. You'll get the best hamburger you ever ate for just fifteen cents. And you don't have to mess around with tipping waitresses."

The stranger left the line to walk around the corner, where he found several workers sitting in the shade, gnawing on hamburgers. He approached a man in a carpenter's apron and asked him how often he came there for lunch.

"Every damn day," he said without a pause in his munching. "Sure beats the old lady's cold meatloaf sandwiches."

The stranger was Ray Kroc, a dogged drink-machine salesman. After the lunchtime rush, he introduced himself to the drive-in restaurant's bosses, Mac and Dick McDonald, and arranged to take them out to dinner.

As the brothers outlined their system that evening, Kroc became hooked by its simplicity and efficiency. The menu was strictly limited to just nine items, including drinks. The food comprised either hamburgers or cheeseburgers and fries. The burgers were all identical -- a tenth of a pound of beef, all cooked the same way. Whereas a coffee shop sold a hamburger for 30 cents, it was only 15 at McDonald's, or four cents more for a cheeseburger. The star attraction was the French fries, though -- another bargain at 10 cents for a three-ounce bag. The menu was completed by coffee at a nickel a cup, soft drinks at a dime, or a large milkshake for 20 cents. That was it.

The brothers had started their business back in 1948, when they turned their barbecue restaurant into a slick assembly-line operation they called a "speedee service line." At the time, the typical mass-market restaurant was a mom-and-pop coffee shop offering hundreds of items. The brothers' nine-item menu never changed. Food was always cooked and served in the same automated way, so customers always got their meals immediately, when

they were hot. They paid when they ordered, and cleared away their own debris after eating.

All of the food was good, especially the fries, yet Kroc stressed that the main attraction was the price. A meal at McDonald's cost about half the equivalent at a coffee shop. How had Dick and Mac McDonald managed to do this?

They added value by subtraction. By removing menu variety, they made it much simpler to procure ingredients, operate the restaurant and cook and serve the food. By simplifying and automating the whole process, persuading customers to do some of the work, and producing assembly-line food, their labor costs per serving were reduced to a fraction of those of a typical coffee shop. The levels of throughput were astounding, too. The little shop that Ray Kroc visited had sales exceeding \$400, 000 a year (around \$4 million in today's money) -- more than that of an average (much bigger) McDonald's today.

By sourcing beef and other ingredients in large quantities, a virtuous circle was created -- lower prices for hamburgers, leading to higher demand, further increasing purchasing muscle and overhead cost coverage, resulting in yet lower prices but also higher margins. Even when it was a tiny operation with just a handful of restaurants, McDonald's had great purchasing power, which allowed it to cut costs. The restaurants needed to buy fewer than forty items in total to make their nine products, unlike a coffee shop which needed to purchase hundreds of items for its far more extensive menu.

They had essentially reinvented the restaurant and proved the economics of fast-food simplicity. In addition, there were subsidiary benefits:

1. Usefulness

- High-quality food. As Ray Kroc said, “ The simplicity of the procedure allowed the McDonald’s to concentrate on quality in every step, and that was the trick.”
- Consistency and reliability -- an identical product time after time

2. Art

- Spiffy uniforms for sharp employees
- The Golden Arches
- Cleanliness and visible hygiene in the store
- The McDonald’s name and “ M” branding

3. Ease of use

- Fast service
- No tipping

Kroc negotiated a deal with the brothers whereby he would franchise the new outlets, and in 1961, he bought the whole company for \$2. 7 million (about \$21 million in today’s money).

Then he set about turning McDonald’s into a big chain. He created a universal product of high quality, and produced a uniform system that allowed no variation, making it sufficiently simple to be franchised to thousands of entrepreneurs while still retaining absolute control and consistency. He developed a proprietary system that would deliver consistency for both customers and franchisees:

- Consistent menu -- no variants allowed -- and the same methods to attain the same food quality
- Sparkling clean toilets, restaurants and parking lots. Cleanliness was one of the four principles that Kroc stressed, along with quality, service and value.
- No pay telephones, jukeboxes or vending machines of any kind
- Founding the “ Hamburger University” for franchisee and staff training
- Offering franchisees a simple product by providing them with a suitable ready site and financing
- Keeping the economics favorable, with a narrow product line, and helping the best suppliers to serve a large number of McDonald’s outlets and lower their costs, for example through bulk packaging and allowing them to deliver more items per stop

It’s clear that Kroc realized that the main purpose of his systems was to deliver a good product at an exceptionally low price. The bigger the scale of the operation, while allowing no variation in product and procedure, the lower the price. And the lower the price, the greater the customer satisfaction, sales, profits and value of the company. Kroc kept the price of McDonald’s hamburgers at 15 cents for nineteen years -- until 1967, when inflation brought about by President Johnson’s Great Society and the Vietnam War forced an increase. He authorized the increase to 18 cents reluctantly: “ If you look at it from the customer’s point of view -- which is how I do it, because this guy is our real boss -- you see the importance of every penny.” This is the credo of every price-simplifier.

Who created the greater value -- the McDonald brothers or Ray Kroc? It depends on your perspective. Financially, Kroc added far more. Yet, we could argue that the brothers created the product, the proposition, the brand, the pricing and indeed the system. The changes to their template since 1961 have been relatively minor. However, imitation is usually more vital than creation. Certainly, in this case, imitation created an extraordinarily valuable business with a global footprint. Ray Kroc added a simple, uniform, high-quality franchise system that cloned the McDonald's formula to a degree that was truly mind-boggling.

Key Points

1. McDonald's is excellent example of price-simplifying -- where subtraction and an assembly-line operation have slashed complexity and enabled costs to be halved. Could you automate an industry or service that has not yet experienced anything comparable?
2. If you work in a service business, take heart that price-simplifying works as well in a service or retail setting as it does in manufacturing.
3. With prices cut in half and the appropriate economic exploitation, world demand for fast-food hamburger meals has expanded to a degree that was unimaginable in 1948. Can you think of a pedestrian market today that could conceivably explode in a similar fashion if prices were at least halved through automation and co-opting customers and/or franchisees?
4. Once again, the simplifying firm created a new, proprietary business system, with economics quite different from those of more complex

restaurants. If you're considering price-simplifying, how might you create a dramatically better economic system than whatever exists today in your market?

5. The firm combined an exceptionally low price with greater usefulness (consistently high-quality food; play areas for children), art (especially the Golden Arches and instantly recognizable branding) and ease of use (speed). What might be the equivalent extra benefits in your industry?