

# THE ANALYST

November 2007

The Icfai University Press

Rs. 60

## 'Big Mac' Returns

# Healthy and Better

**Snapping a lean patch of horrible performances that began in 2003, McDonald's, the world's largest fast food restaurant chain, continues to consolidate its revival, thanks to a revved up menu and its new campaign, 'Plan to Win', aimed at rejigging the focus of being better, and not just bigger.**

It was not long ago that the only thing McDonald's—the world's largest chain of fast food restaurants selling hamburgers, chicken, and French fries—seemed good at was making people fat (read: unhealthy). And this appeared to have a rub-off effect on its own financial health as well. In 2003, the company's shares crashed to a historic low (by March 2003, the firm's shares were trading at their lowest level in eight years) as losses accumulated amidst bad management and rise of rival fast casual restaurants. The company reported a loss in the fourth quarter of 2002, its first ever quarterly loss in the last 47 years. Its CEO was ousted by the board at the end of 2002. Consumer activists and nutritionists criticized McDonald's for exploiting workers, treating animals cruelly, polluting the environment and simply for being American. "We are clearly living through the death of the mass market," *BusinessWeek* quoted a top company official as saying then. "The restaurant chain aims to save itself by going back to basics. But the company needs more than a tastier burger to solve its problems," the *BW* remarked in its March 2003 issue.

After more than four years, the Oak Brook, Illinois-based company, with more than 30,000 local restaurants serving 52 million people in more than 100 countries each day, could finally turnaround its sagging sales and also its fortune. Its business is booming again like never before with new

menus, better marketing, and skillful management. The Oak Brook, Illinois-based restaurant chain, is a symbol of America-led globalization and is one of the world's most well-known and valuable brands. However, after years of losses, the fast-food chain is surging forward with a combination of improved menu variety, better marketing and management measures. While McDonald's rebound has taken many an expert by surprise, a section of experts feel that the recipe for success is a menu that consumers like and nothing else. According to Lakshman Krishnamurthi, Professor of Marketing at the Kellogg School of Management at Northwestern University, "Consumers' attention span is pretty short. As long as you have a good product that people like, people are going to go and eat it." The company's latest sales figures vindicate that its "Plan to Win" plan is indeed on track. McDonald's reported that its global comparable sales (which represents sales at all McDonald's restaurants in operation at least 13 months including those temporarily closed, excluding the impact of currency translation) rose 8.1% in August, while system-wide sales (which includes sales at all McDonald's restaurants, including those operated by the company, franchisees and affiliates) worldwide increased 12.3% for the month. Amongst regions, its US comparable sales grew by 7.4% during the same month on the strength of its breakfast business, beverages and new food of-

ferings, whereas sustained positive sales growth in France, the UK and Germany drove Europe's comparable sales up by 6.1% for the month. Special summertime menu offerings, along with relevant marketing, resonated with customers, the company said. In Asia-Pacific, Middle East, and Africa too it notched up a healthy growth of 12.4% in terms of comparable sales led by robust sales in Japan, Australia and China. The company attributed this to a combination of factors that included locally relevant menu promotions, extended hours, and breakfast. Jim Skinner, CEO, McDonald's, said, "Our worldwide sales momentum continues, thanks to our customer-focused emphasis on menu variety and value, convenient service, innovative marketing and contemporary restaurants. It is clear that customers are looking for a simple, easy and enjoyable restaurant experience, and we are pleased that more and more customers are finding that experience at McDonald's."

### The right combo

McDonald's, which primarily franchises and operates McDonald's restaurants in the food service industry, reached a low point in 2001, when customer-satisfaction surveys showed McDonald's was falling well behind its direct rivals, Wendy's and Burger King. Margins were shrinking and customers were switching to healthier offerings, such as Subway's freshly filled sandwiches. McDonald's spent lots of money opening more stores, but complaints about dirty restaurants and indifferent staff were growing. McDonald's ended 2002 with its first quarterly loss since 1954 and the firm's philosophy of QSC&V—Quality, Service, Cleanliness and Value—just was not working any more.

# INTERVIEW

## There is far too much food available in Western countries—3,900 calories per person per day in the US—about twice the average needed.

Just a couple of years ago McDonald's fast-food empire was not so healthy, but after more than four years of a lean phase Big Mac has made a resounding comeback. What are the factors that you attribute to McDonald's successful makeover?

It is a very smart company that stays on top of trends and is willing to respond to customers' interests. I was amused to see Maharah Mac, Wrap Paneer Salsa, and Shahi McCurry Pan on the menus in Delhi, although why anyone would eat them when dosas are available is beyond me.

Though McDonald's has shown rapidity in the fast-food industry, how sustainable is the comeback in the long-run?

The US is a saturated market, which is why American companies are so interested in tapping into India's 350 million-strong rising middle-class.

By adding healthier foods with some junk foods has McDonald's really recognized that nutrition is a very important issue?

Remarkably, McDonald's business is flourishing again, and it has turned itself into the world's biggest seller of salads with all of its new lettuce, free-range eggs, bottled water and yoghurt parfaits. John Dickinson, an Analyst at Brewin Dolphin said, "As a franchise operation McDonald's has been trading very well. People like to eat out, but there's definitely more of a trend towards healthy eating, so they're going to have to keep changing the menus." However, some of its favorite foods continue to be world famous—French fries, Big Mac, Quarter Pounder, Chicken McNuggets and Egg McMuffin; and more recently it also started offering salads, fruit, snack wrap, and carrot sticks. Among the products responsible for improving sales are a new line of specialty coffee drinks that puts the restaurant chain in direct competition with Starbucks and Dunkin Donuts. Coffee sales in the US have risen 19%



**Marion Nestle**  
Professor of Nutrition and Food Studies, New York University

Nutrition is an important issue in the sense that if McDonald's pays attention to health issues, it will keep regulators and lawyers away. McDonald's core market in the US is still for hamburgers, fries, and sodas, and that's where the profits are and will continue to be.

What challenges do you foresee for McDonald's in the near-term?

Market saturation. There is far too much food available in Western countries—3,900 calories per person per day in the US, for example—about twice the average needed. In contrast, the figure for India is 2,500 calories per person per day, so there is plenty of

room for growth.

Any other comment?

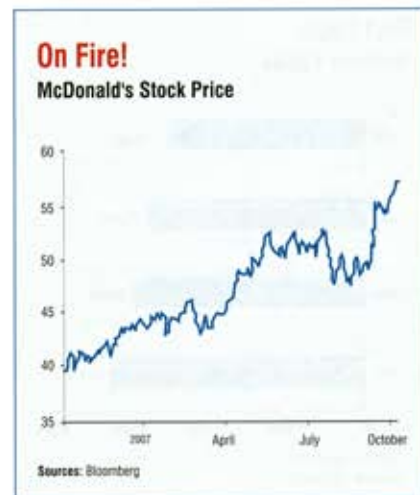
I was astounded by the introduction of junk food into remote rural villages. I'm not at all convinced that McDonald's moving into India is a good idea for anything except corporate profits.

through August since McDonald's introduced its premium drip coffee last year. McDonald's spokesperson Heidi Barker says that coffee represents about 3% of the company's total US sales.

### Revved up recipe!

Around 52 years ago, in 1955, Ray Kroc founded McDonald's and since then it has become the leading global food service retailer. The company also operates other restaurant brands, such as Piles Café and Boston Market. Experts say that the company has built its success less on the taste of its food than on the rock-solid standards and unflinchingly good service. However, the chink in its business model started appearing in the late 1990s as its sales slumped. Customers in Europe and the US were tired of burgers and moved to other food alternatives, especially Tex-Mex style (Texas & Mexican cuisine) food in the US. The company faced a lot of criticism

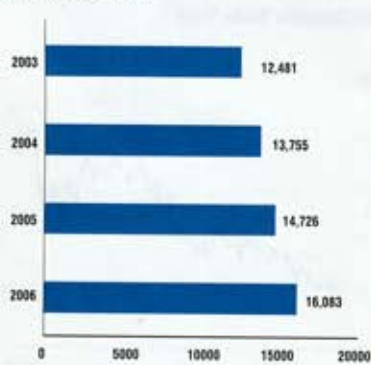
from the customers and critics alike over health grounds, environmental damage caused by its foods, and its fiercely anti-union labor practices. However, through effective brand-building, McDonald's turned around its drooping image and declining sales. The



company set out to appeal to parents by adding healthy menu options and changing its décor. The key changes initiated around 1998, when the company's reform program began, were: first, restaurants stayed open longer and second, they diversified the menu and gave prominence to breakfast items. However, Ann Northrop, a Restaurant Industry Analyst at Zacks Investment research said, "The growing strain that higher fuel and food prices are putting on consumer's budgets could also be working to McDonald's advantage as people migrate to quick-service venues from higher-cost casual dining restaurants."

Nevertheless to get a bigger share of the Asian market the McDonald's is building restaurants in China and selling curry dishes in India. The world's biggest restaurant operator is also forging an alliance with China's biggest operator of gas station, Sinopec (China petroleum and chemical corp.), to combine fast-food outlets with gas stations which will give McDonald's a number of locations of choice to expand in China, one of the fastest growing markets in the world. As a part of the tie-up in mid-January, the fast-food giant opened its first drive-through restaurant in China. Today, it has about 785 outlets in and plans to open 1,000 more restaurants selling fast-food in China by 2008 Beijing Olympics. In India, which is a more challenging market due to local

### Fast Food! McDonald's Sales\*



\* Company-operated sales  
Source: McDonald's

## Viewpoint



Lisa R Young, PhD, RD  
New York University

McDonald's really ought to shrink their portion sizes in a true effort to help fight the obesity crisis. But one of the challenges is that other fast food establishments, such as Burger King and Wendy's, offer huge portions. Instead of the message, "bigger is better," somehow we have to convey that small portions are really best for our health.

On the one hand, they have offered salads and apples showing that they recognize the importance of nutrition. But at the same time, their serving sizes are still huge – much larger than when they were first introduced in the 1950s. I

recently co-authored a research paper on fast-food portions entitled "Portion Sizes and Obesity: Responses of Fast-Food Companies" with my NYU colleague Dr. Marion Nestle in the summer 2007 issue of the *Journal of Public Health Policy*. When McDonald's first opened, its soda was 7 ounces; today, the Child size is 12 ounces, the Small 16 ounces, and the Large 32 ounces. Today's largest portion of French fries weighs 6.0 oz and is 250% larger than the 2.4 oz size in 1955. Current fast food portion sizes are 2-5 times larger than they were in the 1950s. And big portions are a really big problem. In my research on portion size trends, I found that a perfect parallel exists between rising rates of obesity and increasing portion sizes. If McDonald's really wants to make a difference, they really ought to shrink their portion sizes in a true effort to help fight the obesity crisis.

dietary preferences of non-meat dishes, the fast-food chain is cooking up new menu items to persuade consumers. Towards this, it has developed some popular vegetarian dishes such as McCurry Pan and tailored its restaurant design to suit local lifestyle. The eating out market in India is about \$128 bn a year compared to \$132 bn in China and is growing faster than in China. However, last year, the European sales figures of the world's biggest restaurant chain showed the best annual result in nearly 15 years, increased by 5.8% and the customers increased by 3.4%; Europe reported 36% of the group's profits and 28% of sales in 2006.

### Big Mac to offer more

According to John Glass, Restaurant Analyst at CIBC World Markets, "No one else really comes close to dethroning McDonald's right now. It controls over 40% of the quick service burger

market and no one else is poised to catch it." McDonald's is planning its biggest ever rollout of fancy drinks by 2009 and to sell lattes, cappuccinos and other specialty drinks in all of its 14,000 US restaurants next year. The fast-food giant predicts that the new drinks will add more than \$1 bn a year to sales. McDonald's estimates the US beverage market at \$60 bn a year and foresees largest growth opportunities in beverage business. It has recognized that its competition isn't just other fast food restaurants, but also coffee shops and convenience stores. According to analysts, "Despite its problems, McDonald's is far from dead. It has some good people on board and it has the ability to deliver consistency across its operations that's second to none." True, Big Mac has never been away from the limelight. ■

– Amit Singh Sisodiya and Neha Naithani

Reference # 01M-2007-11-06-01