MarketLine Case Study

McDonald's Corporation Case Study

Remaining relevant in a health conscious society

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OVERVIEW

Catalyst

McDonald's Corporation is one of the world's largest foodservice retailing chains. The company is primarily known for its burgers and fries, which it sells through more than 32,000 restaurants in 117 countries. In 2010, the company served an average of 64 million customers per day. It primarily operates in Europe, Asia Pacific, and the Americas. The company is headquartered in Oak Brook, Illinois and employs about 400,000 people. McDonald’s has been able to successfully increase revenues and profits in recent years in spite of much negative publicity and an increasingly health conscious public. This case study shows how the company has achieved these goals in a difficult trading environment.

Summary

- McDonald’s has, to a great extent, defied recent difficult economic conditions and continued to experience strong sales and profit growth in recent years, as it has been able to attract diners with an improved and expanded product range while remaining competitive on price.
- McDonald’s has been the target of much criticism in recent years for serving large amounts of foods high in saturated fat, salt, sugar and calories. The 2004 documentary film *Super Size Me* brought this under the spotlight. The company responded to this criticism by introducing healthier menu choices, adjusting portion sizes and reducing salt and sugar content. It has also expanded its product range in an attempt to attract a new type of customer, most noticeably through its McCafe offering.
- McDonald’s utilizes a highly visible and innovative marketing campaign to push its offering to consumers so that they are always aware of what is on offer in its restaurants. This includes commercials on TV, radio, billboards, bus tickets, in newspapers; sponsorship of major events such as the Olympic Games and the FIFA World Cup; and sponsorship of high profile athletes. Its marketing and publicity efforts have made it one of the world’s most valuable brands.
- McDonald’s is primarily a franchisor, but also operates company-run restaurants. This balance means that it is not overexposed to any one format, and its broad geographical spread prevents an overreliance on a single market. Furthermore the McDonald’s ‘System’ – which is a chain of franchisees-suppliers-company employees – is a well-oiled machine that keeps a massive global operation running efficiently.

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McDonald's continues to perform well in the face of challenges

McDonald's has, to a great extent, defied difficult economic conditions and continued to experience strong sales and profit growth in recent years. Despite much negative press, a testing global economic climate and an increasingly health-conscious public, the company has been able to use an improved and expanded product range to attract customers. Through December 2010, the company posted 92 consecutive months of global comparable sales increases, and global comparable sales for the financial year ended December 2010 increased by over 5% on the previous year. The chain has also continued to increase its number of outlets, showing that demand for its meals remains strong. Since 2008, the growth the company has seen in its revenues has compared favorably to the global fast food industry as a whole. For example, while the fast food industry saw growth of 2.6% in 2009, McDonald's revenues increased by 5.5% and the company's revenue growth of 8.7% in 2010 easily outstripped that of the industry at 7%.

Table 1: McDonald's Corporation Key Financials ($ million)

	2006	2007	2008	2009	2010
Revenue	20,895	22,787	23,522	22,745	24,075
Net Income	3,544	2,395	4,313	4,551	4,946
Total Assets	28,974	29,392	28,462	30,225	31,975
Total Liabilities	13,516	14,112	15,079	16,191	17,341
Employees	465,000	390,000	400,000	400,000	400,000

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SOURCE: McDonald's Corporation 2010 Annual Report

Table 2: McDonald's Corporation Key Financial Ratios

	2006	2007	2008	2009	2010
Profit Margin	17.0%	10.5%	18.3%	20.0%	20.5%
Revenue Growth	9.3%	-32.4%	80.1%	5.5%	8.7%
Asset Growth	7.7%	1.4%	-3.2%	6.2%	5.8%
Liabilities Growth	8.8%	4.4%	6.9%	7.4%	7.1%
Debt/Asset Ratio	46.6%	48.0%	53.0%	53.6%	54.2%
Profit Margin	44,935	58,428	58,805	56,863	60,188
Revenue Growth	7,622	6,141	10,783	11,378	12,365

SOURCE: McDonald's Corporation 2010 Annual Report

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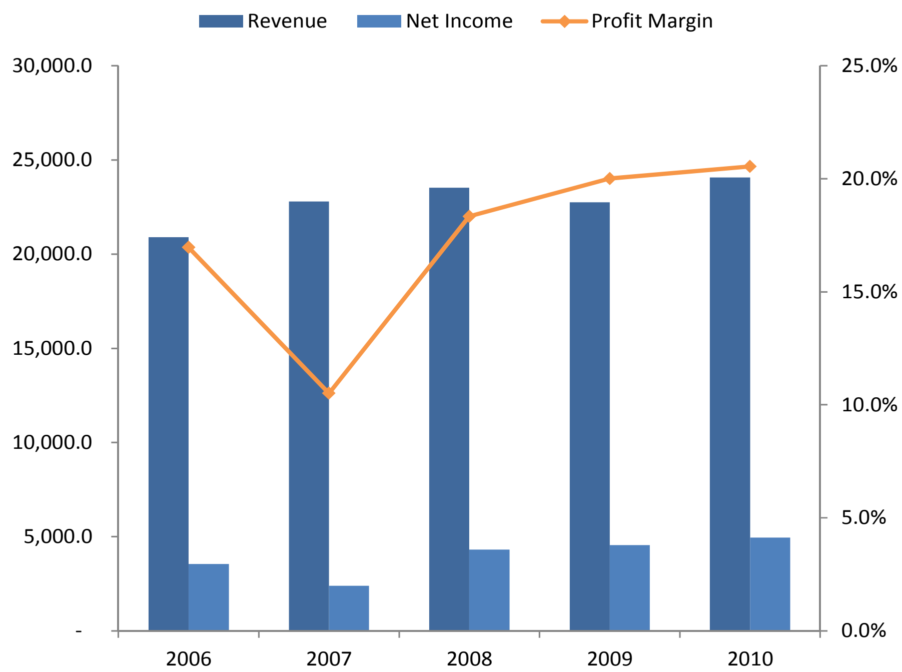
Figure 1: McDonald's Corporation Revenues & Profitability 2006-2010 ($ million)



SOURCE: McDonald's Corporation 2010 Annual Report

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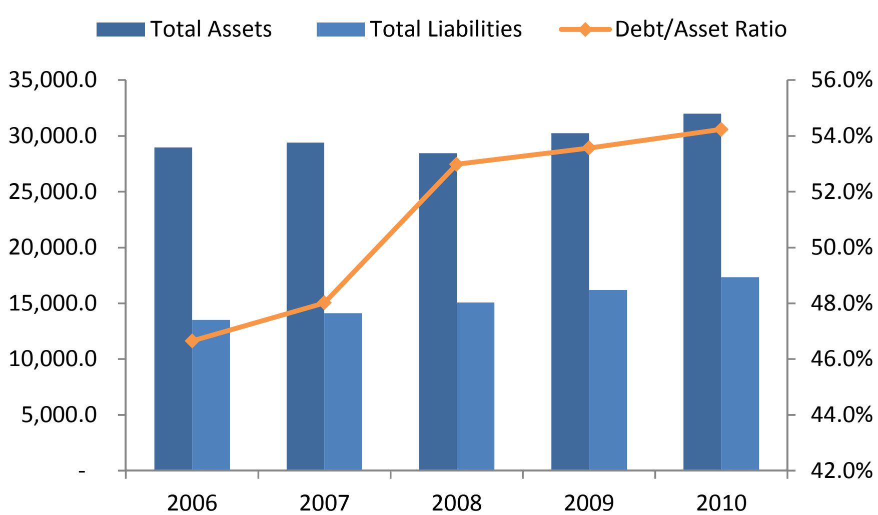
Figure 2: McDonald's Corporation Assets & Liabilities 2006-2010 ($ million)



SOURCE: McDonald's Corporation 2010 Annual Report

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McDonald’s has come under intense scrutiny in recent years

Although McDonald’s financial performance in recent years has been very strong, it has had to achieve this in the face of several obstacles. One of the challenges with which the company has had to contend is a slew of negative press. McDonald’s has been the target of a great deal of criticism in recent years, with public health officials and even high-profile public figures such as First Lady Michelle Obama weighing in with damning comments. Of particular concern has been the high level of saturated fats, salt and sugar contained in the meals, with all being named by detractors as key causes of obesity.

The 2004 documentary film *Super Size Me* brought McDonald’s under the spotlight

Filmmaker Morgan Spurlock released his documentary film *Super Size Me* in 2004, in which he sought to show the negative health effects of eating excessive amounts of McDonald’s. To illustrate his point, Spurlock ate only food from McDonald’s for a 30 day period and accepted the Super Size option every time it was offered to him by a restaurant employee. Spurlock was monitored by healthcare professionals throughout the experiment to see what the effects were. The film claims that during this 30 day period, he gained 24lbs (10.9 kg), a body mass increase of 13%. It also claims that he suffered from fat accumulation in his liver and that he experienced mood swings and sexual dysfunction. These findings appeared in media across the globe, thus giving McDonald’s a great deal of negative publicity.

McDonald’s reacted in a number of ways to the criticism generated by the film

The company felt a need to react to the bad press, and the most obvious move was the discontinuation of the Super Size option, a policy that became effective just weeks after the film’s premiere. McDonald’s, however, maintains that this decision was in no way influenced by the film.

In 2005, the company announced that it was to start printing nutritional information on its packaging, including fat, salt, calorie and carbohydrate content, thus putting the information directly in the consumer’s hands and allowing them to make an informed decision about their meal choices.

McDonald’s had been under pressure to do this for some time and so it was seen as a positive step, with company CEO Jim Skinner describing it as “absolutely the easiest way to communicate it.”

The most noticeable change has been a move towards healthier menu items

Whether in response to the furor created by Spurlock’s film or otherwise, McDonald’s revamped its menus in the mid-2000s and introduced a wider range of so-called healthy options. Contrary to popular belief, salads have actually been available in McDonald’s since 1987, but following the introduction of the company’s premium salad range in 2003 the choice is now far greater. The McDonald’s menu includes 17 salads and three meals that include fruit. The change to a more balanced menu is not purely a response to the criticism McDonald’s has endured in the recent past, rather it also represents a reaction to changing customer needs and preferences, as many people become increasingly health-conscious. McDonald’s has excelled in this regard, and the company’s ability to embrace and adapt to changing consumer trends has been a key reason for its robust financial performance.

In addition to adding fruit and salad items to its menu, the company is also committed to making its existing offerings healthier. The company has imposed a deadline of 2015 to reduce the sodium content of meals (except desserts and soda) by 15% and has pledged to spend the rest of the decade reducing the amount of sugars, saturated fats and calories contained in its foods, as well as adjusting portion sizes.

Happy Meals have been afforded particular attention

According to the Centers for Disease Control and Prevention in the US, 17% of children and adolescents between the ages of 2 and 19 are obese, and the issue has been given a great deal of airtime, with First Lady Michelle Obama keen to draw attention to the problem. McDonald's has once again found itself in the firing line or, more specifically, its popular children’s offering the Happy Meal has. First introduced in 1979, the meal has become an iconic part of the McDonald’s menu, and includes a free toy often linked to popular children’s films like Toy Story and Tintin.

McDonald's critics claim that the trinkets create a clear connection between children and fast food that is difficult to break, and the city of San Francisco has gone as far as to introduce legislation stating that meals cannot include toys unless certain nutritional requirements are met. McDonald's Happy Meals fall foul of these stipulations, and so the toys are not included.

In 2011, the company announced that it was to make the Happy Meal healthier by reducing the amount of French fries by more than half and automatically including three to five apple slices. Furthermore, a fat-free chocolate milk drink will be made available as well as low-fat milk. The company is also looking into offering vegetables as a substitute for French fries in the future. The rollout of the new-look Happy Meal began in September 2011, and will have occurred in the company's 14,000 US restaurants by the end of April 2012.

Figure 3: Nutritional Information for Happy Meal with Chicken Nuggets

	Calories	Fat
Pre-September 2011	520	26g
New Happy Meal (with Low-fat Milk)	410	19g

SOURCE: New York Times MARKETLINE

It should be noted, however, that apple slices have been available as a side in the Happy Meal for some time, but a study by Yale University's Rudd Center for Food Policy & Obesity found that only 11% took advantage of the option. McDonald's argues that it can only make fruit available, and that from there it is a parental decision.

McDonald's has also expanded its menu to improve choice for customers

Although a greater availability of healthy options has been a key driver of McDonald's menu change in recent years, the company has also considered other factors when adding new items to its selection. Catering for different tastes in different geographies has been at the forefront of McDonald's thinking for some time. The company now has more local offerings than ever before, such as McWraps in Europe, Angus burgers in Australia and smoothies in the US.

It has also expanded its ranges to give diners greater choice and to adapt to evolving consumer trends. For example, in January 2011 the company introduced the BBQ Angus Third Pounder in the US, and six months later the frozen strawberry lemonade and the mango pineapple smoothie were added to the McCafe line. The company has not rolled out new products at the expense of classic menu items that continue to sell well, however, and products such as the Big Mac, Double Cheeseburger and Quarter Pounder with cheese are still available and in demand.

As mentioned earlier, moving in line with ever-changing consumer needs and preferences has been a key reason for McDonald's continued success, and this is not limited to menu changes.

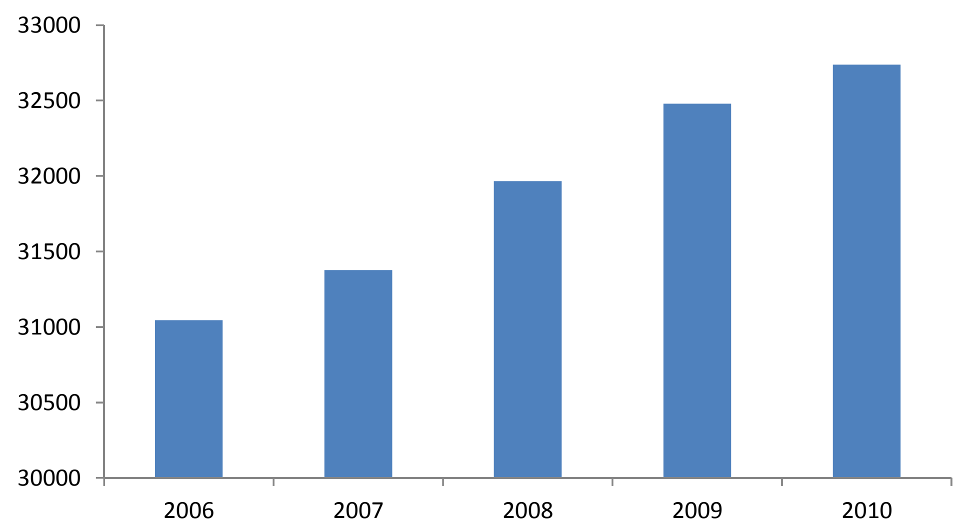
One noticeable development has been the need for more flexible opening hours as people's lifestyles have changed.

In response to this need, in 2010 McDonald's increased the number of 24 hour restaurants it operates.

Expansion has been a feature of McDonald's evolution

As of December 2010, McDonald's had 32,737 restaurants across the globe, compared to 32,478 in 2009 and 31,967 in 2008. The company continues to expand its operation, with a particular focus on growth markets. For example, it plans to have 2000 restaurants in China by 2013. However, this does not mean that expansion is limited to these geographies. The company announced, for instance, that it is to open new outlets in the UK in 2012, creating 2500 jobs in the process.

Figure 4: McDonald's Number of Outlets Globally 2006-2010



SOURCE: McDonald's Corporation 2010 Annual Report

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McDonald's utilizes a highly visible marketing campaign to push its offering to consumers

The company's business strategy is known as 'Plan to Win' and consists of what McDonald's calls the five Ps, one of which is promotion. It invests significant resources in marketing and brand building. For example, the company's marketing spend for 2010 was $687 million. Its efforts have paid off, with Millward Brown ranking McDonald's as the world's fourth most valuable brand in 2011 with a value of $81,016 million, an increase of 23% over 2010.

Figure 5: World's Most Valuable Brands 2011

#	Brand	Brand Value 2011 ($M)	% Brand Value Change 2011 vs. 2010
1		153,285	84%
2	Google	111,498	-2%
3	IBM	100,849	17%
4		81,016	23%
5	Microsoft	78,243	2%
6	Coca-Cola	73,752	8%
7	at&t	69,916	N/A
8	Marlboro	67,522	18%
9	中国移动通信 CHINA MOBILE	57,326	9%
10	GE	50,318	12%

SOURCE: Millward Brown BrandZ Top 100

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The company is known for its innovative marketing strategies

McDonald's has garnered a reputation for innovative and effective marketing campaigns, often aimed at a specific demographic. Arguably the most noteworthy example is the Happy Meal, with its bright colored packaging and the toy included making McDonald's the most popular eatery amongst children.

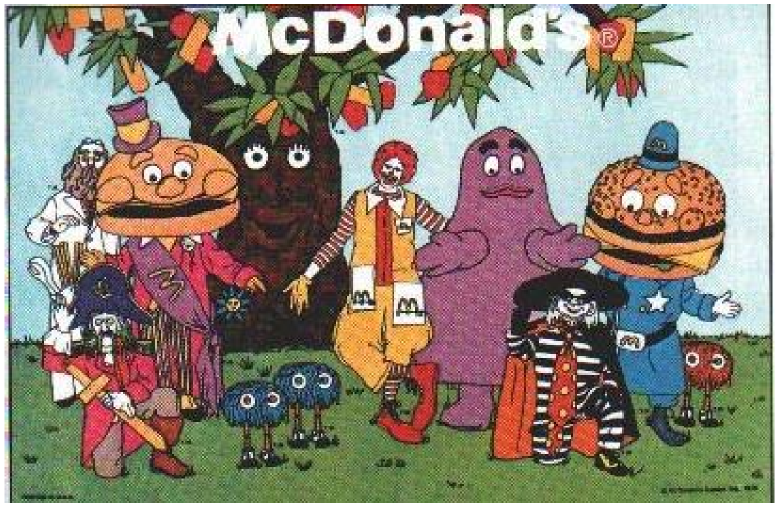
McDonald's complemented this with a fantasy world known as McDonaldland, which was home to characters with whom children could quickly identify, such as Ronald McDonald, Grimace, Mayor McCheese and the Hamburglar. This was taken a step further in the 1990s when a video game known as M.C. Kids was released (it was called McDonaldland in Europe), in which the game's characters enter the imaginary world and attempt to recover Ronald McDonald's magical bag, which has been stolen by the Hamburglar. By attracting children to its restaurants at a young age, McDonald's is aiming to make them customers for life.

It is a strategy that has come in for much criticism. The fact that it pushes fast food to young children is deemed by some to be unethical, with the city of San Francisco banning the inclusion of toys in Happy Meals. To McDonald's credit, it has responded to the criticism positively, and has to a great extent abandoned the use of McDonaldland and its associated characters in its promotional material. However, Ronald McDonald can still be seen in a limited number of adverts, and often still appears as a toy in Happy Meals.

Its slogan 'I'm loving it' has been translated into many languages including Arabic, Chinese, German, French, Portuguese, Russian, Spanish and Ukrainian.

This slogan and its associated whistled tune are now easily recognizable, and upon hearing it consumers immediately know that McDonald's is being advertised.

Figure 6: McDonaldland Characters



SOURCE: McDonald's

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The McDonald's brand and its famous golden arches have become ubiquitous

Much of the company's significant marketing budget is aimed at making the McDonald's brand ubiquitous, and in this regard the company has succeeded to a great extent. It strategically places adverts on television, billboards, bus tickets, radio, flyers and also uses product placement in films and TV shows. In addition to this, it sponsors many major events. For example, it is an official partner of both the Olympic Games and the FIFA World Cup, and sponsors the UEFA European Championship and All-American High School basketball. Additionally, McDonald's also pays high profile athletes such as Michelle Wie (golf) and LeBron James (basketball) vast sums of money to act as spokespersons for the company and star in television ad campaigns.

Under its Corporate Social Responsibility activities, the company sponsors and funds junior development programs such as Swimming Queensland and the South Australian National Football League development program in Australia.

All of these activities ensure that the McDonald's brand is highly visible and very much at the forefront of the consumer's mind when they think of fast food restaurants.

McDonald's has embarked on an ambitious program of restaurant reimaging

Although McDonald's continues to do much to attract children, it is also dedicating significant resources to shaking the image of a restaurant that is primarily the domain of under 16 diners. The company's number one stated aim is to 'run better restaurants' and a key part of this is to provide its customers with an improved dining experience. McDonald's is striving to provide diners with a 'modern and inviting' atmosphere, and so has embarked on an ambitious program of restaurant reimaging – particularly in Europe – which is currently ongoing. The company is aiming to refurbish 90% of restaurant interiors and 50% of exteriors by the end of 2012.

The changes can already be seen, with plastic chairs replaced by bright colored cushioned stools and comfortable booths. Modern, wood-effect tables have also been installed, giving the restaurants a more contemporary, café-style feel.

The McCafe format is an attempt to attract a different demographic

Closely linked to the reimaging drive is the rollout of the company's café-style 'McCafe' concept. Realizing the current trend for so-called gourmet coffee, and the ever-increasing popularity of coffee culture in general, McDonald's has introduced a range of café-style drinks including mocha, latte, cappuccino, hot chocolate, smoothies and shakes. In the US, McCafe is simply the name given to this particular product line, but things have been taken a step further in Europe, where McCafe is generally a separate area of the restaurant that resembles a café rather than a typical McDonald's outlet. In addition to teas, coffees, smoothies and shakes, European McCafes also sell desserts and light snacks. As of December 2010, the company operated 1300 McCafe establishments on the continent. In doing this, the company is directly competing against existing powerhouses such as Starbucks for a more mature, drink-oriented demographic in an attempt to expand and diversify its customer base.

Figure 7: McCafe Interior and Products

SOURCE: Internet

MARKETLINE

The addition of coffees, teas, and smoothies and the introduction of the McCafe format is yet another example of McDonald's ability to identify a consumer trend and quickly accommodate it through evolutionary development of its product offering.

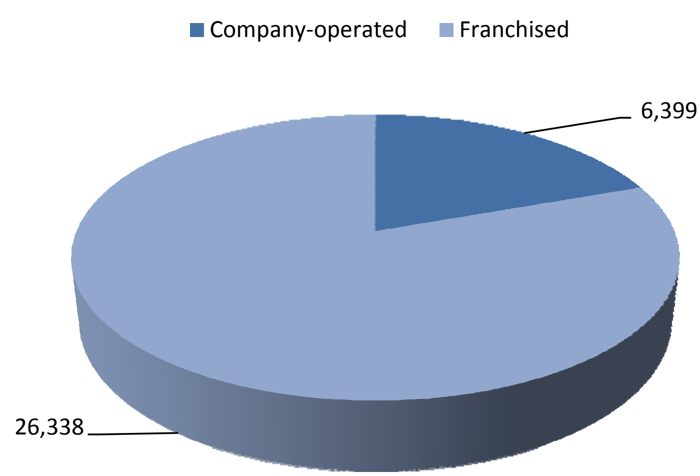
McDonald’s balanced business model of franchised and company-operated restaurants is key to its ongoing success

With over 32,000 outlets across the globe, McDonald's is the world’s second largest restaurant chain. Running so many restaurants across such a geographical spread entails a great degree of risk, both financial and operational. Franchising allows the company to mitigate these risks to some degree, and so it employs a business model that provides balance between franchised and company-operated restaurants.

The company is primarily a franchisor

The company views itself primarily as a franchisor, and believes that franchising helps it deliver a ‘great, locally-relevant customer experience.’ Under the company’s franchise agreements, franchisees inject a portion of the capital required by initially investing in equipment, signs, seating and décor for the restaurant in question, and by then reinvesting profits over time. McDonald’s owns the land and buildings or secures long-term lease arrangements, thus assuring long-term occupancy rights.

Figure 8: McDonald’s split of franchised and company-operated restaurants



SOURCE: McDonald’s Corporation 2010 Annual Report

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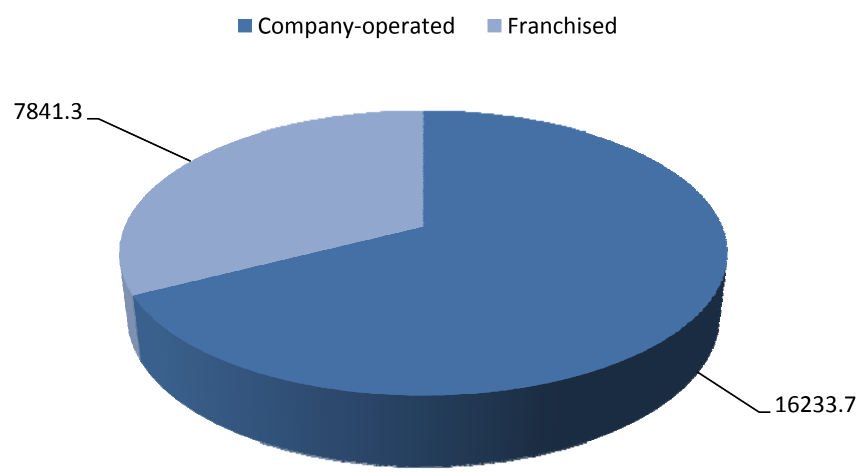
The company derives revenues from its franchised operations through rents, royalties and initial fees. These fees vary by type of site, location, amount of company investment and local business conditions. The franchise agreements are typically for a 20 year term, thereby providing McDonald’s with security and guaranteed revenue over a long period of time. In 2010, franchise revenues totaled $7,841.3 million. Of this, $5,198.4 million came from rents, $2,579.2 million from royalties and $63.7 million from initial fees.

Company-operated outlets are the key revenue driver

While franchised outlets allow McDonald’s to mitigate the risks associated with running over 32,000 restaurants, company-operated outlets are an essential source of revenue and profit. Whereas franchisees see much of the profit from the stores they operate, McDonald’s retains all profit made in its own restaurants.

Although there are almost 20,000 more franchised stores, company-operated restaurants accounted for more than twice as much revenue.

Figure 9: McDonald's split of revenue from franchised and company-operated outlets ($ million)



SOURCE: McDonald's Corporation 2010 Annual Report

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Global presence means that the company's risk is not geographically concentrated

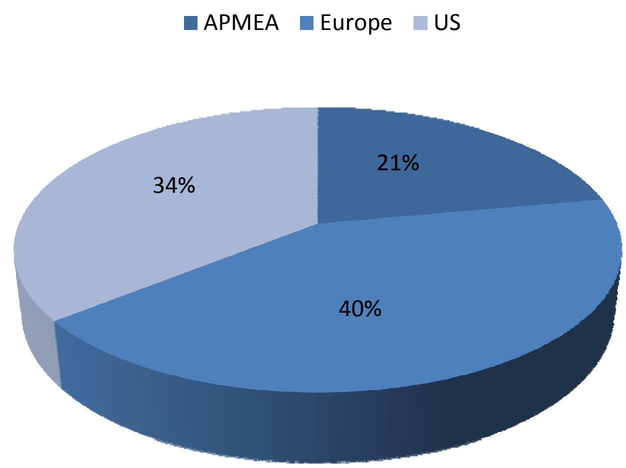
McDonald's has a presence in 117 countries across the globe, making it one of the world's most geographically diverse companies. Consequently, the company is not overexposed to the economic climate in any one market.

The company operates through three distinct geographical segments: US, Europe and Asia-Pacific, Middle East & Africa (APMEA). There is also a further operating segment known as Other Countries & Corporate, which includes the company's interests in Canada and Latin America. Although it must be acknowledged that there is some concentration within certain segments (for example, France, Germany and the UK combined account for around 50% of total European revenues, and the same is true of Australia, China and Japan in APMEA), the company's revenues are not highly concentrated in any one geographical segment. The US, Canada, France, Germany, the UK, Australia, China and Japan are what the company refers to as its 'Major Markets.'

The McDonald's empire sits atop the 'three-legged stool'

McDonald's success is built on quickly serving consumers with tasty, convenient meals they can enjoy in a comfortable environment. In order to do this, the business must run efficiently from suppliers right through to customer facing staff. The company refers to the chain of suppliers, franchisees and employees as the 'System' or, more colloquially, the 'three-legged stool.' All stages of the chain are efficiently and effectively linked, with suppliers performing the 'McDonald's Daily Miracle' and providing over 32,000 outlets with a regular supply of safe and fresh produce, franchisees investing in their restaurants and people to improve the overall customer experience, and employees acting as the friendly, helpful face of the McDonald's brand.

Figure 10: McDonald's revenue by geographical segment ($ million)



SOURCE: McDonald's Corporation 2010 Annual Report

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CONCLUSIONS

Through a combination of expanded product ranges, intense marketing efforts and operational efficacy McDonald's has been able to defy the critics and tough economic decisions

McDonald's has been forced to contend with a number of potential obstacles to growth in recent years, most notably stark criticism and a less-than-favorable global economic climate that has seen consumers reduce their discretionary spending. McDonald's has, however, employed strategies to counter these problems, and the decisions the company has taken have allowed it to maintain a strong level of growth.

The move towards a healthier menu, achieved by making changes to existing items and introducing new offerings, has helped satisfy some of its critics and attract those who are perhaps more health-conscious than the 'traditional' McDonald's customer, while new items such as the McCafe range are helping the company attract new customers. The message has been reinforced by a relentless and innovative marketing campaign, which has helped make the McDonald's brand one of the most recognized and valuable in the world.

The company continues to excel in operational efficiency through a well-integrated chain that brings together suppliers, franchisees and employees and allows them to provide diners with the best service possible. All of these factors combined are enabling McDonald's to stay ahead of the game and continue to increase revenues, profits and the number of restaurants it has globally.

APPENDIX

Sources

BBC News: McDonald's puts fat facts on food BBC NEWS | Business | McDonald's puts fat facts on food

Centers for Disease Control and Prevention US Obesity Trends

McDonald's Corporation 2010 Annual Report

McDonald's trims its Happy Meal: New York Times 07/26/2011 McDonald's Happy Meal to Get Healthier - NYTimes.com

Millward Brown BrandZ Top 100 Most Valuable Global Brands 2011

Further Reading

Global Profit Foodservice – Industry Profile

Global Fast Food – Industry Profile

Profit Foodservice in Asia-Pacific – Industry Profile

Fast Food in Asia-Pacific – Industry Profile

Profit Foodservice in Europe – Industry Profile

Fast Food in Europe – Industry Profile

Profit Foodservice in the United States – Industry Profile

Fast Food in the United States – Industry Profile

Ask the analyst

We hope that the data and analysis in this brief will help you make informed and imaginative business decisions. If you have any questions or further requirements, MarketLine's research team may be able to help you. The MarketLine Research team can be contacted at ReachUs@MarketLine.com.

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