

# **McDonald's Corporation**

**Case Writeup**

**Individual**

**Case # 2**

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### **Which characteristics of McDonald's production system have been most important in building its record of successes and growth in the industry?**

Ray Kroc, the founder of the chain, distinguished McDonald's from competitors by "(1) making sure McDonald's products were of consistently high quality, (2) establishing a unique operating system, and (3) building a special set of relationships between McDonald's corporation, its suppliers, and its franchisees."<sup>i</sup> Whereas in many restaurant franchises the company was only interested in getting a franchise fee or a lower price from a supplier, McDonald's worked to insure its franchises were profitable and built long stable relationships with its suppliers.<sup>ii</sup> This allowed the company to focus on delivering a quality product in a uniform manner.

The fact that the "same experience would greet a customer"<sup>iii</sup> in any of the McDonald's worldwide, and that it had distinguished itself "through its remarkable consistency across all units", were a cornerstone of building McDonald's record of successes and growth in the industry.<sup>iv</sup>

McDonald's operating system which guaranteed "uniform quality and service" at every McDonald's location, was critical in creating the company's record of successes and growth in the industry.<sup>v</sup>

The basis of McDonald's service model focused on a limited menu, produced in a uniform manner, in all locations.<sup>vi</sup> This not only allowed for the above mentioned consistency, but also for the company to drill deep into how each item should be made, including its ingredients and the relationship with the supplier, insuring that a high quality product would be served to all customers in all locations.<sup>vii</sup>

"McDonald's operating system concentrated on four areas: improving the product; developing outstanding supplier relationships; improving equipment; and training and monitoring franchisees."<sup>viii</sup> This quest for improvement allowed McDonald's to revolutionize the entire supply chain, from the way farmers grew potatoes to inventing efficient equipment for cooking the restaurant's products.<sup>ix</sup> McDonald's attention to detail resulted in its superior, uniform product. The company was able to spend so much time and effort perfecting its operating system since it limited its menu to ten items.<sup>x</sup>

McDonald's bold initiative with the Environmental Defense Fund was an excellent example of a "supplier" who provided more than expected, and provided a substantial contribution to the success of the company.<sup>xi</sup> When originally meeting with the EDF they had sought environmental solutions, but the end result was that McDonald's learned about efficiencies that they had never previously seen.<sup>xii</sup>

McDonald's "meticulous attention to detail and careful analysis of quality and procedures" was not a result of an "unbending need for regimentation."<sup>xiii</sup> Instead it was a result of McDonald's desire to study every component of its operations and learn "what worked and what failed, and to determine how best to offer consistently good service and food."<sup>xiv</sup>

McDonald's built strong lasting relationships with their suppliers which resulted in great supplier loyalty.<sup>xv</sup>

McDonald's strong relationships with franchisees, treating them as partners, resulted in franchise owners acting as partners, and developing such products as "the Filet-O-Fish sandwich, the Egg McMuffin, and the McDLT."<sup>xvi</sup>

"Together with corporate managers and suppliers, franchisees infused McDonald's with entrepreneurial spirit. All three partners balanced one another, just as the entrepreneurial inventiveness within each balanced their collective emphasis on disciplined standards of quality."<sup>xvii</sup>

The development of the company's French fries and the strict focus on standardizing the preparation of the potato led to unique relationships with their suppliers, most notably Jack Simplot who suggested the company use frozen potatoes and invested heavily in support of the company's move to frozen potatoes.<sup>xviii</sup> Simplot won the company over with an emphasis on quality, not price, and went from a small potato grower to a \$650 million potato processing giant.<sup>xix</sup> This is indicative of McDonald's relationship with their suppliers and the fact that the suppliers could become very successful as a result of bringing McDonald's the quality they needed.

### **What are the primary new challenges McDonald's faces in the 1990's?**

McDonald's was already serving 20 million customers a day in the 1990's, and it was difficult to see how they could attract more business.<sup>xx</sup> In addition, demographic trends were changing American eating habits.<sup>xxi</sup>

"McDonald's faced competitors poised to challenge the industry leader on all fronts".<sup>xxii</sup> Sales per unit slowed between 1990-1991 causing McDonald's management to wonder whether their vaunted operating system, "vital in guaranteeing uniform quality and service at every McDonald's outlet, was suited to the new circumstances the company faced."<sup>xxiii</sup>

"Chili's and Olive Garden cater to customers searching for full-service and greater variety."<sup>xxiv</sup> These restaurants were family style, with customers served by waiters, a wide variety of foods, and prices competitive to McDonald's.<sup>xxv</sup>

Sonic and Rally's offered drive through service only, and "specialized in delivering burgers fast."<sup>xxvi</sup> Taco bell sold Mexican food with 26 items under \$1.<sup>xxvii</sup> Taco Bell had seen the greatest increase in sales of any quick-service restaurant in the later 1980's.<sup>xxviii</sup> By learning from McDonald's they had shifted food preparation to outside suppliers, reduced kitchen space, and used a cost based strategy to compete.<sup>xxix</sup>

Consumers were changing with "an increasing, yet variable, concern for 'healthy' food" and there was a growing concern for the environment among consumers"<sup>xxx</sup> A 1989 study had found that 53% of Americans questioned had "declined to buy a product in the previous year because they were worried about the effects the product or its packaging might have on the environment."<sup>xxxi</sup>

"Consumers were becoming more conscious of nutritious and dietary options without compromising taste"<sup>xxxii</sup> While the company had loyal consumers who would not change the way they ate, it needed to evolve its offerings to increase the company's growth.<sup>xxxiii</sup>

McDonald's needed to adjust to the slowing growth in the quick-service industry during the 1990's, and adjust to the increase in meals that were eaten off site of its restaurants.<sup>xxxiv</sup> It has partially begun to respond to this change with the "double drive-thru windows", as well as new venues, "such as schools, sporting arenas, museums, airports and hospitals."<sup>xxxv</sup> It also introduced smaller restaurants, which could serve customers located between existing restaurants.<sup>xxxvi</sup>

### **How would you adapt the system to accommodate these changes in the US?**

McDonald's needs to build on their partnership with the EDF and continue to not only improve environmental performance, but grow additional efficiencies throughout their business. They should invite EDF or a similar group to work with McDonald's and its suppliers to further lower costs throughout the organization. This will also help to build a basis for future growth in the company by lowering costs.

McDonald's should strengthen the current operating system, allowing it to improve the quality of its offerings and the uniformity of its product, and only then focus on adding new products and offerings to its customers. Abandoning or altering the operating system, because of challenges from other chains, would be a mistake, as it is the strength of the company. McDonald's should use this strength to better compete, and add to the operating system the new products that they need to compete with their challengers.

McDonald's needs to compete with Chili's and Olive Garden by introducing a simple full service dinner menu to compete with those firm's offerings. McDonald's needs to carefully develop this menu, just as they did with their breakfast menu, around a signature item, with the franchises and suppliers playing a critical role. It will be necessary that this process not take overly long, and that McDonald's not spend five years as they did perfecting their breakfast menu, or seven years to develop a pizza suitable for its restaurants.<sup>xxxvii</sup>

The introduction of a dinner menu would allow McDonald's to draw in customers that did not currently visit the chain, or did not visit in the evening. This draw could allow McDonald's to serve more than the 20 million customers a day that they are currently serving. However, the dinner menu, though based on a signature item, should be built on a core of the existing tried and true products and be kept simple to allow McDonald's kitchen's to meet the volume requirements of the new menu.

To compete with Sonic and Rally, McDonald's needs to add more drive in facilities to their existing locations, and also add drive in only locations. These could serve as fill locations between

existing stores, and target locations that Sonic and Rally locate in. They should learn a valuable lesson from Taco Bell and have much more of their food prepared by outside suppliers, allowing them to lower costs, increase volume, and make an increased profit (something that has not worked successfully with the value menu.)<sup>xxxviii</sup> “With the value menu, volume was critical. That made the chain’s hallmark of speed more vital than ever, yet a wider variety of menu offerings posed the risk of slowing each unit’s service. Variety and value had to be carefully balanced.”<sup>xxxix</sup> Taco Bell was able to sell 26 items for under \$1, with limited kitchen space.<sup>xl</sup> This would be a perfect opportunity to make greater use of outside suppliers, as McDonald’s did with the Chicken Fajita, which arrived precooked and seasoned and was developed by Keystone, a longtime supplier.<sup>xli</sup>

McDonald’s must respond to Americans concern for 'healthy' food as well as consumers becoming more conscious of nutritious and dietary options without compromising taste by working with their suppliers, franchises, and in house kitchens to develop tasty food that meets consumer’s desires. Again, this is critical to do quickly to combat their competition. I haven’t eaten at a McDonald’s in years, primarily because their “healthy” offerings, are so unappealing and don’t look healthy. McDonald’s loyal customers want to eat there, but they want the product to be healthy.

The continuing growth in concern for the environment among consumers is something that must be further met. As previously stated, further partnership with EDF would serve to lower costs and improve the environmental reputation of the company. More importantly they need to present this to the public, without looking phony. McDonald’s needs to make the public into a stakeholder for their environmental efforts, involving the public, so as to convince them. This is critical that they convince the public that the products and the packaging are positive for the environment.

McDonald’s needs to continue to adjust to the growth in the number of quick service meals that are eaten outside of their current locations. The companies efforts to add double drive-thru windows, as well as schools, sporting arenas, museums, airports and hospitals, need to be built upon with more locations and more non-conventional stores. These include the Rally’s and Sonic type drive ins previously mentioned, but also include additional locations, focused on carry out.

#### **How can McDonald's lay the basis for future growth?**

McDonald’s should lay the basis for future growth by continuing to work with their suppliers and franchisees. They need to introduce a new dinner menu, healthy options all day long, and value options. The key to accomplishing this would be to have suppliers do the bulk of the production offsite to keep costs down, while tapping into the innovation of suppliers and franchises.

A continued or expanded effort with the EDF would enable all McDonald’s stores and their suppliers to not only bring down environmental costs, but to continue to find efficiencies that could be spread throughout the company. The initial partnership with EDF provided benefits beyond what would be expected from a “supplier”, and the company needs to leverage that.

Competing with the wide spectrum of new chains is possible, but McDonald’s needs to focus on its operations handbook, keeping store functions simple and capable of meeting the increased volume needs, while developing innovative new products to draw customers.

These new products, such as the Chicken McNuggets are critical. This blockbuster product, developed with a supplier, was in testing within 5 months and was producing 7.5% of sales within 3 years.<sup>xlii</sup> McDonald’s needs more products like this, which will bring customers into stores, but will not take years to develop. The key is developing products with suppliers and franchises for speed and innovation, and transferring as much of the food preparation to suppliers to lower costs.

McDonald’s needs to stay committed to flexibility and growth. It achieved its “success by focusing on a simple formula: limited menu, low prices and fast service.”<sup>xliii</sup> “Uniformity and consistency” formed McDonald’s focal point for 35 years.<sup>xliv</sup> These principles should be followed in developing a dinner menu, and new products. Growing away from this foundation, could be a disaster.

McDonald’s needs to focus on new low cost products, that will meet the customers needs for healthy food that is environmentally sound, and also to outsource more of these products. By meeting these goals the company should be well positioned to continue its growth.

