

# Fast Food has slowed down

The fast-casual segment is currently outgrowing the fast food sector

**McDonald's is seen as the mother of all burger joints and together with Apple the most potent symbol of America around the globe. The US is by far the largest market for McDonald's, where it has 14,200 of its 35,000 restaurants. McDonald's is squeezed by competition; not only from a revitalised Burger King, but also from other fast-food companies such as KFC, Chick-Fil-A, Five Guys, In-N-Out, Subway and Starbucks.**

By Henk Hoogenkamp

**M**cDonald's is seriously worried about the tough competition from so-called upmarket "fast-casual" chains that offer "healthier food" and more sophisticated service. The fast-casual segment is currently outgrowing the fast food sector. There is a permanent seismic shift in the way people perceive and consume food. This shift fundamentally undermines the core business model of McDonald's.

There is little doubt that McDonald's is suffering from an identity crisis. When everything is said and done it comes down to its basic Big Macs. The core customers identify the Golden Arches for cheap and quick food. Yet during the last decennia McDonald's has tried to appeal to more finicky eaters who have moved the expectations to high-quality while still demanding cheap and fast. It is clear that McDonald's food story is no longer aligned around the consumer's definition of quality and value. Literally and figuratively, consumers have become a moving target for the food industry.

McDonald's food isn't necessarily healthy though for many years have appealed to Americans' appreciation for consistency, convenience, fast, and inexpensive. In the past 60 years McDonald's has been an amazing innovator and should be given

credit for successfully pioneering many new fast-food trends. Yet somehow along the way McDonald's has lost its luster and sidelined its entrepreneurial instincts.

For an increasing number of people, the relationship with fast food has changed and the quality expectations and environmental accountability have also risen. The change is subtle but real. The Millennials in the US comprise a demographic group of about 80 mill. people, and it is surprising that this important segment of consumers do not rank McDonald's in their top 10 most favorite restaurants (Advertising Age, 2013).

McDonald's needs to try new strategies to restore sales growth, while keeping their eyes on its core burger business. For the some 14,000 outlets in the US, same-store sales have fallen over the last five years. McDonald's has tried many tactics to reinvigorate its business including going "healthy" and a greater level of transparency. All these tactics have failed, some more than others. Perhaps the conclusion can be made that higher quality and faster serving speed don't go together. Because of the kitchen complexity, McDonald's is no longer fast and its burgers no

longer perceived as good tasting delicious. These are the main two challenges that need to be fixed before going forward. The latter is also true for the drive-thru lanes: too many cars in the line-up often translate that other cars turn around and take their business elsewhere.

## Maintaining purity for the happy few

Given the proliferation of US-dominated fast-food choices, the fast-food industry has serious ecological, ethical, and socio-economical responsibility to deliver optimal nutrition. This is most critical in cases where fast-food marketers offer water-added meat and poultry products which – unfortunately – often contain added fillers like starches, salt, and phosphates as water binders instead of formulating using premium plant protein ingredients, including extruded structured products that uniquely mimic and match lean meat sensory properties.

In principle there is nothing wrong with "exporting" originally American food and meat standards. However, to insist on 100% pure beef for regions with far less disposable income and significantly different taste preferences

is a form of ideological myopia (Fig. 1). It is difficult to comprehend why huge amounts of money are spent to promote 100% beef patties, when such product purity seems irrelevant for pork, poultry, or fish-based foods.

While most of the rapidly increasing world population remains staunchly carnivorous, the markets for meatfree and hybrid meat foods are expected to increase significantly (Fig. 2). These categories – also called lifestyle foods – are driven by the customers' greater health awareness as well as their desire to be more sustainable and ecologically responsible. Globally there will be no other choice than, at some time in the future, to actively embrace hybrid meat technology solutions.

It is fair to ask why American fast-food companies – most notably McDonald's – spend so much time and energy to assure customers that their beef burgers are formulated using 100% pure beef. There is no mention of country of origin, use of antibiotics, hormones and spraying water on the patties after freezing. What makes beef so special in comparison to chicken patties and nuggets in which the use of phosphates, salt and starchy carbohydrates is commonplace?



Fig. 1: To insist on 100% pure beef in different regions is a form of ideological myopia.



Fig. 2: The markets for meatfree and hybrid meat foods are expected to increase significantly.

Ultimately, the fast-food companies will have to accept reality that beef prices will increase to the point that affordability and sustainability become controversial. There is little doubt that ecological sustainability of increased beef production, primarily to serve pure beef burgers to the happy few that can afford it, will suffer by huge amounts of human food redirected to feed animals and also contributes to the depletion of fresh clean water.

### Corporate culture

Arrogance and complacency has found a stronghold into the McDonald's business organisation and especially mid-level executives at the Ivory Towers in Oak Brook Illinois have created an inward-thinking culture which

stalled or severely slowed down innovation as well as adequately addressing emerging environmental issues and underestimating the changing socio-dynamics of the young generation. For example, an intimate relationship between McDonald's executives and their exclusive (meat) suppliers often caused a hostile environment for experts who brought ideas to adapt menu-board philosophy in order to stay ahead of the curve.

Senior management likes to portray the image that change is part of their business culture in order to keep up with customer expectations and demands. Burgers, fries, shakes, sodas are still synonymous for their core business. Prior to the world recession that started in 2008, McDonald's predominantly catered to the so-called "heavy users" of customers



Fig. 3: Even suppliers of new ingredients have a very compelling story to tell: no unhealthy components added, rich in valuable nutrients, environmental-friendly produced.

who ate full-meal selections several times in a week.

### Millennials

For the US, these demographics have changed considerably for the 18 to 34-year-old consumers. Millennials – or Generation Y – is the last generation born in the 20<sup>th</sup> Century. This generation, born from 1980 onward through 2004, has been raised using digital technology and social media. Millennials are the demographic group that reached adulthood in the early years of the 2000s, are moving away from McDonald's in part because outdated and harsh design ambience, the source of ingredients, unhealthy fat and calories, including oversized meals and sodas. It seems that McDonald's is in need to tell a better story and an invigorated company culture.

The Millennials are the children of the Baby Boomers (1946-1964) and value work-life balance more than other generations.

Although the Millennials are expected to be less economically successful than their parents, it has been argued that they have a higher degree of confidence, spilling over in entitlement and even narcissism. The Millennium generation tends to be skeptical about conventional promotional marketing and is more likely to listen to their social media Facebook friends. It is a different way to connect with friends and define one's food personality. Millennials clearly favour "apron-like" foods, a terminology to qualify foods that are made by a chef, rather than "lab-coat foods" that are perceived as overprocessed and have lost the touch of nature.

Actually, McDonald's problems to communicate and capture solid business with the many people under the age of 35 are not unlike what US carmakers are experiencing. Several studies show many Millennials are part of the rising popularity of car-free urban living. As Millennials grow older there is evidence they are favouring a life without the idea of car ownership. Young people are more likely to take public transport and favour technology instead of cars as a cultural touchstone.

### Ineffective Marketing

Perhaps it can be concluded that McDonald's continued their conventional marketing strategies too long and on hindsight can be seen as ineffective keeping pace with the changed food preferences of the younger consumers. In that sense it may be concluded that the biggest factor appears to be the absence of an emotional connection to McDonald's. There is a whole generation of kids growing up in the US who are embarrassed to be seen at McDonald's. They have outgrown the "kids-meal" age and McDonald's marketing brass have misinterpreted social media and are now clueless what has hit them. For a growing number of people the slogan translates into "I'm not loving it". No wonder some large investors are calling for a shake-up of the McDonald's Board of Directors.

For generations McDonald's was a favorite place for hungry people looking for simplicity, speed, consistency and affordability. Not any longer. It now seems that the younger generations are attracted towards chains like Chipotle, Five Guys, Chick-Fil-A, Shake Stack, Panera, and In-N-Out. Chick-Fil-A continues to evolve from a regional to a national chain that lives by the image of "fast food done right". These fast-casual restaurants offer a simplified menu-board; yet provide more freshness, customisation, quality, ambiance and (perceived) superior nutrition.

Competitors aren't necessarily healthier but they certainly have a more compelling story to tell: 100% "all-natural", no-water added, no hormones, no antibiotics, and preferably locally-sourced produce (Fig. 3). The younger customers are applauding commitment to freshness, animal welfare, and a restaurant standing by its business principles.

An attempt to bring back the love of Millennials is to revamp certain main food items such as grilled chicken. Starting in the US and Canada antibiotic-free chicken breast, artificial flavours, sodium phosphate, maltodextrine, flavours, colours, preservatives and liquid margarine, which include hydrogenated oils, are a

thing of the past. For McDonald's the new way forward is to use chicken breast and many more natural and recognisable ingredients such as spices, sea salt, honey and herbs.

### Naturally free from

Antibiotic use in chicken, cattle and hogs has become a hot button issue with consumers and activists. It is a known fact that antibiotics can lose effectiveness in treating human germ-related illnesses, when the same drugs are also used in farm-raised animals. A possible move to go antibiotic-free can certainly be seen as landmark decisions, which will hugely impact the entire chicken, outgrow chain. It is estimated that McDonald's sells about 3 to 4% of all chicken harvested in the US, a number that very well can be much similar for the rest of the world.

In the rapidly changing food-world it is even plausible that quick-service restaurants will offer an all-day breakfast option as consumers demand breakfast beyond the early morning hours. Such a move could be part of a turnaround strategy aimed at improving restaurant experience for the younger generation.

It is also expected that diners will be able to substitute bottled water or soda or apple slices for fries at no additional charge, indicating McDonald's is looking to promote healthier alternatives. Forget "supersizing" – the new trend at McDonald's is to downsize and instead serve smaller or mini-meals delivering 660 to 820 calories, which will be the new normal.

Even though McDonald's has a massive global supply chain, the drawback is that their rich-choice menu-board slows down service, increases kitchen errors while prices are only markedly lower than freshly prepared foods. Consumers indeed can be overwhelmed by too many menu-board choices and – besides keeping the independent franchises happy – McDonald's need to reinvent their model to bring back relevance to its core customers.

The iconic Golden Arches now are confronted with dark clouds appearing on the horizon. In particular the younger customers have higher expectations about

quality and taste. McDonald's may be everywhere, but it no longer stands for anything. Along the way the company seems to have lost its way by trying to be all things at the same time.

Many of the "healthy food" offerings by McDonald's – including salads – have never accounted for more than a few percent of sales, not to mention the miserable failures of Mighty Wings, Lean Deluxe, McPizza, and the public relation nightmares caused by using "pink slime" (lean finely textured beef treated with ammonium hydroxide to kill off bacteria such as *E. coli*) in their "100% pure beef burgers", the HUSI China chicken scandal (2014), and by reading "Fast food nation: The Dark Side of the All-American Meal".

Over the last few years McDonald's is clearly confronted with a customer relevance problem. There are simply too many other choices that offer better taste, quality and ambiance. For a company like McDonald's perhaps the answer is to look less like McDonald's.

### Chipotle

It is clear that consumers have discovered competitors who specialise using higher quality of fresh ingredients, which nearly always translate into more perceived healthy food and better taste.

McDonald's acquired the burrito empire Chipotle in 1998, which by then had only 13 restau-

rants. Under direction of Jim Cantalupo – CEO – the Golden Arches divested its stake in Chipotle in 2006, a time at which the burrito company had grown to about 500 stores. Although McDonald's made a nice profit on its Chipotle investment, in the end it got the short end of the stick.

Unlike McDonald's, Chipotle is committed to fresh, high quality ingredients at only slightly higher prices. "Food with Integrity" is the hallmark of Chipotle. Probably it is safe to conclude that McDonald's has not timely recognised the changes in consumers' tastes and appetites. As a result, a new wave of "fast-casual" dining has emerged: Fresh, "made-to-order", and in an ambiance that is favoured by the Millennium gen-

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Fig. 4: In "Create Your Taste" burger restaurants customers will choose from a long list of buns, toppings and sauces via a tablet.

eration. If you look at food as a means of establishing one's freedom, the fast-casual food competition has gotten much stiffer.

Chipotle is accelerating new restaurant openings to boost sales. In 2015, the chain will grow from roughly 1,800 locations to 2,000 restaurants, averaging nearly US\$ 2.5 mill. each. To be fair, one of the few variables that can significantly slow down the company's profitability are increased food costs. Especially beef pricing is an uncertainty that can affect menu prices and thus influence profits.

### Stepping into the future

Back to the future: walking into a McDonald's outlet, customers do not have to queue at the counter. Instead they go to a touch screen to build their own burger. By choosing from a long list of buns, toppings and sauces they customise, pay and wait at the table until a server appears with their food and drinks (Fig. 4). It is expected that McDonald's will have these "Create Your Taste" burger restaurants in full operation at some 2,000 US locations by early 2016. It can be argued that the Millennial-friendly "Create Your Taste" platform of custom ordering via a kiosk not only is too costly for franchisees, it's irrelevant for the drive-thru lanes, which is up to 70% of McDonald's business.

"Create Your Taste" – ordered inside the restaurant from a tablet – will cost franchisees about \$100,000 per store. These costs, together with investments for espresso machines at \$24,000 and "high-density prep tables" will frustrate franchisees, especially knowing that customer waiting times will go up even more. Customisation, increased serving time, and McDonald's is not an innovation that is likely to succeed.

This new McDonald's business model seems to run contrary with the current model and its need to simplify the American menu board options, which now has almost 200 items. Many analysis and industry observers believe that the huge selections not only strain the kitchen staff and annoy franchisees, but also confuse customers.

Another option for McDonald's to ramp-up sales is to focus on regional product roll-out. This move would empower the 22 US regions with more autonomy around product development and promotion. Localising the menu-board will resonate more with the local consumer and allows to zero-in on different customer expectations. To make this strategy happen it will be essential to simplify the menu board which subsequently will significantly reduce the clutter and make it easier for improving order accuracy and drive-thru service speed.

McDonald's identity crisis – especially among younger customers – is perhaps the way for-

ward to go back to basics, offering limited range of menu choices at low prices, served freshly and quickly and stop trying to replicate all its rivals.

All of this is easier said than done. Especially being number one makes a company such as McDonald's an easy target of special interest groups ranging from food activists, animal-rights campaigners, labour activists, shareholder activists and all those people who simply dislike things that represent the values of America. In a way, special interest groups, including influencers who often have a hidden agenda and portray the image that obesity started by eating over-processed calorie-laden fast food, have hijacked McDonald's corporate image. As the *NEW YORK TIMES* pointed out, many consumers see McDonald's as "the company that made American fat".

### Too much reactive

It is time that McDonald's starts to be pro-active again and in control of its own message. In a nutshell, McDonald's can't afford to miss out on higher-quality ingredients, including embracing plant protein created foods to show its commitment to sustainable and healthy food options that interest the younger generation as well as satisfying the expectations of an informed and affluent market.

The reasons why McDonald's is slipping (and competition winning) are "fresh food-never frozen", high level of customisation, clever pricing, appealing ambience, and no corporatisation of the food. Competition is also seen as more socially responsible alternative. The March 2015 announcement by McDonald's to go antibiotics-free for their poultry foods by 2016 is a step in the right direction. It is likely that the heavy poultry users, including big-name fast food companies, now will adopt similar policies and start working toward eliminating protein produced with the use of antibiotics medically important to human health.

Consumers have wised-up to hyper-processed foods using unidentifiable additives and are now very food savvy and once accustomed to higher-quality

they are reluctant to go backward. The public is becoming more enlightened about less taste impressions, negative health and environmental consequences of their food.

To repair the Golden Arches will be a super-sized job: 2014 income fell 2.4% vs. 2013 and net income dropped 14.8%. The downward sales spiral continued over the first quarter of 2015, with no end in sight. Not just McDonald's USA, also McDonald's Japan has initiated massive restructuring after a series of food scandals and product shortages bit into the company's earning forecast. McDonald's Japan is clearly struggling to regain consumers' trust after the safety problems while strong headwinds from intense competitive pressure have compounded the financial problems.

The message for McDonald's is clear: most consumers want simple, freshly prepared food and they don't want to eat something that is manufactured or highly processed. The food future increasingly looks non-manufactured. Ideally food should have an aura of "personalised, especially made for me". The question then becomes: How do we create a brand identity that transcends food quality and enjoyment? Perhaps for McDonald's an existential crisis is looming, and few if anyone seems to know what to do about it. It is clear that McDonald's is in dire need for another hamburger breakthrough, not by trying to get more foods on their menu-board.



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