# Gap - Analysis

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**Executive Summary**

McDonald’s is the world’s biggest Fast Food operator, operating more than 30.000 outlets in more than 120 countries. In the UK McDonald’s Restaurants Ltd operates 1200 stores, of which 70% are company owned.
McDonald’s generally sets the highest standard for itself, yet most are not achieved or public perception differs from that of the company’s.
McDonald’s is perusing a value strategy offering its products at relatively low prices. They differentiate their products through successful branding campaigns.
Although McDonald’s try to maintain an image of high ethical responsibility major gaps have been identified. They manage to disguise a considerable part of these gaps through effective communications. However major gaps remain in terms of working conditions and animal welfare treatment.
Great efforts have been made to create an environmental friendly image, in the outlets and on the supplier side.
The recent financial performance has poor and clearly failing their aim of ‘system growth’. Closing this gap will be one of their main priorities. Reducing all other gaps will be essential in closing the financial gap. Findings are set in respect to McDonald’s competitors.

**Terms of reference**

The Research Team of the Financial Times has been asked to conduct a Gap Analysis for the MNE McDonald’s Restaurants Ltd. The report will be handed over to Mr A. P. Davies on the 31st of March.

**Objectives**

Company aims and policies in the categories of Product & Market Strategy, ethical stance, environmental policies and financial performance are stated. Company actions to achieve goals should be recognized. Possible gaps are to be identified and their extent analysed. Recommendations to reduce or eliminate gaps should be found.

**Research approach**

To gather relevant information our team consulted McDonald’s Annual reports, relevant literature, market reports and Internet websites. Also investigated were competitors and their business, their product and market strategy, ethical stance, environmental policies and financial performance.

**Background**

‘McDonald’s is probably the best-known franchised fast food restaurant chain in the world […]. When the first outlet was opened in the US in 1955 and even when the first UK restaurant appeared in 1974, it would have been hard to imagine a worldwide network of 30,000 outlets by 2002 and 1,200 outlets in the UK. McDonald’s is easily the largest fast-food brand in the world and instantly recognisable in many countries. Across the global network, the majority of outlets are operated by franchisees but, in the UK, only a third are franchised although this percentage is increasing.’ McDonald’s has been growing organically, with new sites located in smaller towns, roadside developments and food court concepts in leisure parks and shopping centres. (Keynote, 2002)

## 2 Main Aim & Objectives

### 2.1 Product & Market Strategy

McDonalds' aim ('vision') is to be the 'world's best quick service restaurant experience. This means running and opening great restaurants and providing exceptional quality, service, cleanliness and value ('QSC&V'), so that we make every customer in every restaurant smile'.

Usually, local management teams who know its market firsthand run product and market strategies. Consequently, the strategies applied to the UK market will be investigated.

Generally McDonalds pursues a value strategy offering its products at relatively low prices. McDonalds targets primarily children (Happy Meal, toys, adverts) in the hope to build a life long customer relationship and future brand loyalty.

McDonalds focuses on maintaining a powerful brand to differentiate its core products (Big Mac, French Fries) and create barriers to enter the market.

### 2.2 Ethical Stance

*"We approach all aspects of our business with honesty and integrity. We hold ourselves to the highest possible ethical standards"*
McDonalds Social Responsibility Report

McDonalds centres its enterprise upon this statement and goes beyond mentioning ethical codes of practice within its mission statement. It has issued a Social Responsibility Report drawing attention to relations with its local community, environment, employees, and market place.

McDonalds ethical stance is its commitment towards:

- Doing what is right
- Being a good neighbour and partner in the community
- Conducting business with the environment in mind

Jack Greenberg, The Chairman and CEO of McDonalds states this within the social responsibility report, indicating the importance of ethical correctness within society.

'*McDonalds is committed to social responsibility. We are committed to doing the right thing. We want to make a positive difference in the World'*

### 2.3 Environmental Policies

McDonalds, as with most large multinational enterprises, pursues a strategy of being 'environmentally friendly' in order for consumers to view the organisation in a positive social context. In essence, being an environmentally friendly organisation can range from having a concern over the state of natural resources to being concerned over the way in which the organisational activity affects environmental pollution.

McDonalds have four major aims and objectives as far as the environment is concerned:

'Conserving and protecting natural resources'
'Encouraging environmental values and practices'
'Effectively managing solid waste'
'Ensuring accountability procedures'

There are four technical ways that an organisation can be seen in, in an environmental context, and these include socially obstructive, socially obligative, socially responsive and socially contributive.

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### 2.4 Financial performance

At the end of 2001, Jack Greenberg, the Chairman and Chief Executive of McDonald's at that time, said 'we can and must do better than the 4% constant currency sales increase we generated in 2001'. By the end of 2002 sales increased only by 2% standing at $41.5 billion. He also said 'we plan to add between 1,300 and 1,400 McDonald's restaurants in 2002'. Instead, the actual figure was just over 1,000. These facts show that two important aims and objectives were not achieved.

## 3 Gap Analysis

### 3.1 Product & Market Strategy

Officially McDonalds names three elements in their strategy to be the world's best quick service restaurant: People (being the best employer), Customers (providing them excellence) and System Growth (for owners/operators, suppliers and company).

'McDonalds has always been a franchising Company and has relied on its franchisees to play a major role in its success. McDonalds remains committed to franchising as a predominant way of doing business. Approximately 70% of McDonalds worldwide restaurant businesses are owned and operated by independent businessmen and women, our franchisees'. Usually, McDonalds offers franchises to poor performing restaurants in order to sustain profitability.

Advertising is used to differentiate McDonalds' products from competitors and as a means of branding: Advertising Spend in 2001 amounted to £39m (KFC: £14m, Burger King: £8.6m, Pizza Hut: £7.4m).
Furthermore, McDonalds is involved in various high profile sponsorship schemes (e.g. major Sponsor of FIFA World Cup, 'gold' sponsor and official restaurant of the Olympic Games) that secures them favourable PR.

Recently McDonalds acquired Boston Market Chicken restaurants, the Donatos pizza chain and Chipotle Mexican Grill. In the UK, it purchased the Aroma coffee chain and 33% of Pret A Manger. This demonstrates that McDonalds has diversified into other segments of the fast food/ convenience /take away market.

McDonalds is the world's largest food service organisation. It has the greatest market share of the breakfast, lunch and dinner market and holds 67% of the UK Burger Market.
McDonalds' golden arches are the world's biggest brand with higher awareness than Coca-Cola.

McDonalds is constantly introducing new products, usually for a limited period of time. This is because management recognise that consumers like variety as well as a continuation of good products such as Big Macs and Cheeseburgers. Also, they are well aware that if McDonalds has too many products running at the same time then the speed of customer service will deteriorate.

However, McDonalds has not introduced healthier products in response to growing concerns about obesity.

It is difficult to evaluate the extent to which McDonalds fulfils customers' demands. In the 2001 consumer survey conducted by Sandelman & Associates, McDonald's was ranked as last out of 60 chains for taste. Statistics that describe McDonalds cleanliness are not available and therefore the achievement of this objective is difficult to examine, but anecdotal evidence suggests that suitable policies are in place to meet that objective. Customer service quality is difficult to assess but it is renowned for being quick.

### 3.2 Ethical Stance

McDonalds believes their ethical stance is a way of thinking, caring, and responding to issues within society, illustrating that they are a socially responsive organisation. They go beyond meeting the legal standards for corporate behaviour, whilst also addressing people's concerns. 'McDonalds goal is to utilise and leverage every opportunity to advance the level of awareness and depth of understanding of various social responsibility issues, policies and practices so that they can increase their contribution to society'. This assists McDonalds in their objectives of continuing to build a relationship with their customers and being a genuine part of the fabric of British society.

McDonalds has gone through many changes to achieve the ethical stance it holds today; for instance, they have developed global guiding principles requiring suppliers to meet and exceed government laws, regulations and industry standards helping to improve the treatment of animals and workers. Although this has been very successful in the UK and US, such abusive confinement systems have yet to be phased out anywhere else in the World. This has been reported on many occasions by the press and the Government agency 'Business for Social Responsibility' identifying that international standards are needed. McDonald's has tried to respond to many claims by introducing the corrective action plan.

McDonalds support to many charities has helped them to achieve and show their commitment to being a good neighbour and partner within communities. In addition, the set up of the Ronald McDonald Housing Charity has helped to provide a better relationship with society and enhance the McDonalds image. However, this is seen as hypocritical within society partially because of the latest issue of McDonalds food creating soaring rates of childhood obesity (see The Guardian (26. Nov 2002) Youngster sue for McDonald's for failing to warn that fast food can lead to obesity), heart disease, and diabetes, which customers are not warned about. This exerts stress on McDonalds' goal of 'doing what is right'. McDonalds' strategy to overcome this problem is to provide nutritional information about every product it sells, while also putting fruit, salads, and pasta meals onto its menu. This is helping McDonalds to move away from its junk food image. Although nutritional information is now accessible, more customers need to be made aware that this information is available.

### 3.3 Environmental Policies

McDonalds is wholly committed to sustainable environmental practices believing in thinking for the future generation and not misusing the facilities of today. In terms of facilities, McDonalds is actively involved in exploring the use of alternative refrigerants and as a result is working alongside the United Nations Environmental Programme and the US Environmental Protection Agency (EPA). This organisation wishes to open a HFC (hydrofluorocarbon) free restaurant in 2003.

In terms of these actual practices, McDonalds purchases recycled products through the McRecycle program which boasts the largest available database on recycling suppliers. This scheme has also set a guideline that a minimum of $100 million a year is to be spent on buying recycled materials of all kinds such as Happy Meal boxes, carryout bags and carryout trays. During the 1990s, McDonalds recycled more than two million tons of corrugated cardboard. The organisation also boasts that various stores located in Germany have an in-store recycling collection system where customer waste is recycled.

Wastage is another grave concern where many companies fail in terms of utilising the available resources. The Environmental Defence has a direct alliance with McDonalds and through this alliance it has allowed the organisation to make significant packaging changes, including, switching to recycled carry-out bags, unbleached napkins and tray liners, and shipping boxes with nearly half-recycled contents.

The organisation is also a member of several environmental organisations and is currently spending considerable amounts on research related to conserving and protecting natural resources. This organisation takes aggressive measures to minimise energy and other forms of resource consumption through increased conservation and efficiency. McDonalds has a strict policy which does not permit the destruction of rain forests for their cattle farming.

Although many multinational companies have many views on how they approach the issue of environmental concern, few ensure accountability procedures. McDonalds appoints environmental affairs officers and these officers are given broad based responsibilities to ensure that this organisation is fulfilling its environmental objectives. These officers are in regular contact with the board of directors and report specifically on environmental factors.

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The major issue that McDonalds has to deal with is related to developing quantifiable data for ongoing environmental performance. Essentially, because McDonalds as an organisation is related to the services industry there are little statutory requirements by law or regulation to record environmental data. Through having little quantifiable data, there is no physical evidence of actually achieving the necessary environmental aims and objectives. This organisation has just developed their own Environmental Management System and this will help monitor annually the environmental aspect of McDonalds. Through monitoring they can then improve their environmental policy on a regular basis.

### 3.4 Financial Performance

| Significant Items | |
|---|---|
| Restructuring charges | $(-266.9) million |
| Restaurant closings/asset impairment | $(-402.4) million |
| Technology write-off and other charges | $(-183.9) million |
| **Total significant items** | **$(-853.2) million** *(see Appendix A)* |

Profits were down for three main reasons: significant item costs ($853 million), poor performing sites, and economic slowdown.

| **Ratios** | **McDonalds** | **Diageo** | **Yum Brands** |
|---|---|---|---|
| ROCE | 9% | 32% | 20% |
| ROSF | 21% | 35% | 857% |
| Sales per Employee | $39,003 | $272,408 | $29,229 |
| Profit per Employee | $5,349 | $51,140 | $4,243 |
| Current Ratio | 0.71 | 1.00 | 0.30 |
| Earnings per Share | $0.70 | $0.69 | $3.37 |
| Price/Earnings Ratio | 23.57 | 75.00 | 7.12 |
| Debt/Equity Ratio | 1.10 | 0.63 | 23.84 |

*See Appendix for calculation of these results.*

Performance

McDonald's return on capital employed stands at 9%, 23% less than Diageo's and 11% less than that of the Yum Brands. Their return on shareholders funds stands at 21%, 14% less than Diageo's and 836% less than that of the Yum Brands. The reason the Stock Holder's equity is so low is due to the fact that YUM has accumulated deficit and loss of income, which is clearly shown on their consolidated balance sheet. When compared with Diageo and the Yum Brands it can be said that McDonald's has not done a good job of converting their inputs into outputs.

Efficiency

If you compare McDonalds with Diageo, it's closest rival, then their Sales per Employee and Profits per Employee are significantly less at -£233,405 and -£45,791 respectively. This is largely due to them having six times more employees. However, if you now compare McDonalds with Yum Brands then they are doing much better. Sales per Employee and Profits per Employee are up by £9,774 and £1,106 respectively. Therefore, McDonalds is quite efficient at using it's assets to generate profit.

Liquidity

The Current Ratio shows the relationship between Current Assets and Current Liabilities. Respectively, a 2 to 1 ratio is good. None of the companies shown have good current ratios so their abilities to meet short-term debts are poor. However, Diageo (the company that owns Burger King and Guiness) at least has a greater value of Current Assets to Current Liabilities at a ratio of 1:1. Yum Brands (including Kentucky Fried Chicken and Pizza Hut) has the worst Current Ratio at 0.3.

<u>Investor</u>
The Earnings per share is virtually the same for McDonald's and Diageo. However, Yum's figure is $2.67 greater. The Price/Earnings ratio shows considerable variation across the three companies with Yum at 7.12, McDonald's 23.57, and Diageo 75. Diageo has the most investment potential.

<u>Gearing</u>
For McDonald's and Diageo, debt capital in relation to shareholders funds is more or less at 1:1. However, Yum has over 20 times more long-term debt to shareholders funds. Therefore, it can be said that Yum is highly geared.

*NB. The results are from three different dates, the Diageo results include those for Guiness and have been converted into dollars using $1.5: £1.*

*Debt Capital consists of all Long-term Liabilities.*
*Capital Employed is the figure at the bottom of the Balance Sheet.*

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# 4 Recommendations

### 4.1 Product & Market Strategy

To become a more desirable employer McDonalds should aim to provide better working conditions, allow the existence of unions, and increase the number of training schemes. Also, McDonalds' workforce has a high share of teenagers, although there is no requirement for employees to be of this age. McDonalds benefits from this by paying only the minimum wage but this could be seen as exploitation. However, it is a good way of keeping labour costs down.

There are constant and ongoing social changes in the population. Examples include the increased health-awareness of society. In the long term, major menu diversification to accommodate more healthy foods could be regarded as necessary if they want their customers to enjoy their food with a clear conscience.

The fact that from May 27th onwards McDonald's will start to sell fresh fruit with the established Happy Meal is a first step towards a menu more suitable to the changed environment.

### 4.2 Ethical Stance

The latest issue that McDonalds has faced is its US Chicken supplier importing illegal workers. McDonalds should have learnt from their mistake in China, where children as young as 14 have been working 16 hour days for as little as $3. And even in western countries MCD prefers to employ teenagers to benefit by paying them only the minimum wage although young age is not a requirement for this job. On the one hand McDonald's receives Government money for educating young people, on the other it encourages the industry to design kitchen equipment that affords less training. McDonald's should rather concentrate to provide a valuable skill for their people. This shows that there is still a big gap that needs to be filled by McDonalds as far as educating suppliers, and the number of visits and checks that are made. One way of reducing the gap between McDonalds' animal welfare goal and its actual achievement is by working with other companies in its industry (i.e. Burger King) helping to increase the humane treatment of animals and by ensuring their suppliers take up their ethical responsibility. Eventual gaps in McDonalds ethical stance are usually covered by positive advertising. The recent advertising campaign 'What comes first the chicken or the egg' helps to illustrate this. (See Appendix B)

Claiming to be the best employer their anti union policy rather suggests a limited influence for employees to improve their working conditions. Unions are part of a modern society and McDonald's should consider introducing unions.

### 4.3 Environmental Policies

It can be argued that as an organisation, McDonalds is comprehensively environmentally friendly and does reach most of the stated aims and objectives. The aim in terms of 'encouraging environmental values and practices' needs to be addressed more clearly to employees and managers alike as opposed to the specialised McDonalds Environmental Management System so that all employees of this organisation are aware of its environmental duties. Applying this correctly will help the company to improve on environmental friendliness. Also, there needs to be a way of quantifying all necessary environmental data in order to ensure that all employees are accepting an environmental responsibility.

Finally, McDonalds as an environmental conscious organisation also believes in asking the right questions, challenging themselves, their system and their partners. Having looked at the environmental policy of McDonalds it can be concluded that as an organisation it can be classed as socially contributive. This essentially means that McDonalds wishes to be socially constructive in the community it serves to help protect the natural environment. Recycling is a core part of their policies and helps to avoid any unethical business actions.

### 4.4 Financial Performance

McDonald's hopes to close these gaps by a 'heightened focus on restaurant level execution and marketing'. It can be argued that a reduction in significant item costs and an improvement in worldwide economic conditions will both also help to close the gaps. Jim Cantalupo, the new Chairman and Chief Executive, believes that McDonald's priorities are 'to fix the existing business, to take a more integrated and focused approach to growth, and to ensure McDonald's has the right organisational structure and resources'. He anticipates that earnings per share growth will be somewhere between 10 and 15%. The key to McDonald's success will be a continuation of their product consistency, better location choices and improved retail business model execution, particularly with regard to the training of employees.

Outlook for 2003

'McDonald's expects sales from new McDonald's restaurants to add approximately three percentage points to sales growth in 2003'. Most of this anticipated growth will be a result of just over a thousand additional restaurants during 2002.

'Worldwide comparable sales were -2.1% for 2002 and -1.3% in 2001. McDonald's strategies for 2003 are designed to reverse that trend through a heightened focus on restaurant level execution and marketing'.

'McDonald's expects selling, general and administrative expenses to be about flat compared with 2002'. In 2002, figures were up by 3%.

Debt level is expected to decrease in 2003.

The effective tax rate for 2002 was 40.3% due to significant items 'that were not tax-effected for financial reporting purposes. We expect the effective income tax rate for 2003 to be in the range of 33.5% to 34.5%'.

'We do not plan to buy back stock for at least the first half of 2003'.

'If the Euro and the British Pound move 10%, McDonald's annual reported earnings per share would change by about 4-5 cents'.

'McDonald's current plan for capital expenditures is $1.9 billion in 2003'.

In 2003, 'net McDonald's restaurant openings will approximate 450 traditional and 180 satellites'. (www.mcdonalds.com)

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## Appendix

**Appendix A**
‘Significant items represent actions or transactions related to the implementation of special initiatives of the Company, or that are unusual or infrequent in nature’.

Restructuring charges
Restructuring charges are the costs involved in ‘restructuring markets and eliminating positions’. They can be related to the company ‘restructuring its ownership in four countries in Asia Pacific/Middle East/Africa (APMEA) and Latin America, the ceasing of operations in three countries in Latin America and the reallocation of resources and consolidation of certain home office facilities to control costs. These charges consisted primarily of asset writedowns and other exit costs related to the market restructurings plus employee severance and outplacement costs’.

Restaurant closings/asset impairment
In the first quarter of 2002, ‘the Company recorded $43 million of asset impairment charges, primarily related to the impairment of assets for certain existing restaurants in Chile and other Latin American markets and the closing of 32 underperforming restaurants in Turkey, as a result of continued economic weakness’.
In the fourth quarter of 2002, the Company recorded $359.4 million of which $292.2 million was ‘related to management’s decision to close 719 underperforming restaurants (202 were closed in 2002 and 517 will close throughout 2003) primarily in the US and Japan’. The remaining $67.2 million ‘primarily related to the impairment of assets for certain existing restaurants in Europe and Latin America’.

Technology write-off and other charges
In the fourth quarter of 2002, the Company recorded $183.9 million worth of technology write-offs and other charges. Of this, ‘$170 million related to management’s decision to terminate a long-term technology project, and $13.9 million primarily related to the write-off of receivables and inventory in Venezuela as a result of the temporary closure of all McDonald’s restaurants due to the ongoing general strike that began in early December’.

Operating Income (Loss)
‘For the year, consolidated operating income decreased $584.1 million or 22%’ to a figure of $2,112.9 million. This was largely due to an increase in significant items combined with Latin America experiencing ‘difficult economic conditions’.

## Appendix C

**Burger King** — **Year Ended 30th June 2002**

£ millions

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Return on Capital Employed | = | Profit before Interest and Tax / Capital Employed | = | 2,118 / 6,556 | x 100% | = | 32 |
| Return on Shareholders Funds | = | Profit before Interest and Tax / Shareholders Funds | = | 2,118 / 6,001 | x 100% | = | 35 |
| Sales per Employee | = | Sales / Number of Employees | = | 11,282 / 62,124 | | = | 181,605 |
| Profits per Employee | = | Profit / Number of Employees | = | 2,118 / 62,124 | | = | 34,093 |
| Current Ratio | = | Current Assets / Current Liabilities | = | 7,331 / 7,363 | | = | 1.00 |
| Earnings per Share | = | Profit after Interest and Tax / Share Volume | = | 1,532 / 3,316 | | = | 0.46 |
| Price/Earnings Ratio | = | Price of Share / Earnings per Share | = | 34.50 / 0.46 | | = | 75.00 |
| Debt/Equity Ratio | = | Debt Capital / Shareholders Funds | = | 3,760 / 6,001 | | = | 0.63 |

**Kentucky Fried Chicken** — **Year Ended 29th December 2001**

$ millions

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Return on Capital Employed | = | Profit before Interest and Tax / Capital Employed | = | 891 / 4,388 | x 100% | = | 20 |
| Return on Shareholders Funds | = | Profit before Interest and Tax / Shareholders Funds | = | 891 / 104 | x 100% | = | 857 |
| Sales per Employee | = | Sales / Number of Employees | = | 6,138 / 210,000 | | = | 29,229 |
| Profits per Employee | = | Profit / Number of Employees | = | 891 / 210,000 | | = | 4,243 |
| Current Ratio | = | Current Assets / Current Liabilities | = | 547 / 1,805 | | = | 0.30 |
| Earnings per Share | = | Profit after Interest and Tax / Share Volume | = | 492 / 146 | | = | 3.37 |
| Price/Earnings Ratio | = | Price of Share / Earnings per Share | = | 24.00 / 3.37 | | = | 7.12 |
| Debt/Equity Ratio | = | Debt Capital / Shareholders Funds | = | 2,479 / 104 | | = | 23.84 |

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| MCD | BK | KFC | MCD-BK | MCD-KFC |
|---|---|---|---|---|
| 9 | 32 | 20 | -23 | -11 |
| 21 | 35 | 857 | -14 | -836 |
| 39,003 | 272,408 | 29,229 | -233,405 | 9,774 |
| 5,349 | 51,140 | 4,243 | -45,791 | 1,106 |
| 0.71 | 1.00 | 0.30 | -0.29 | 0.41 |
| 0.70 | 0.69 | 3.37 | 0.01 | -2.67 |
| 23.57 | 75.00 | 7.12 | -51.43 | 16.45 |
| 1.10 | 0.63 | 23.84 | 0.47 | -22.74 |

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