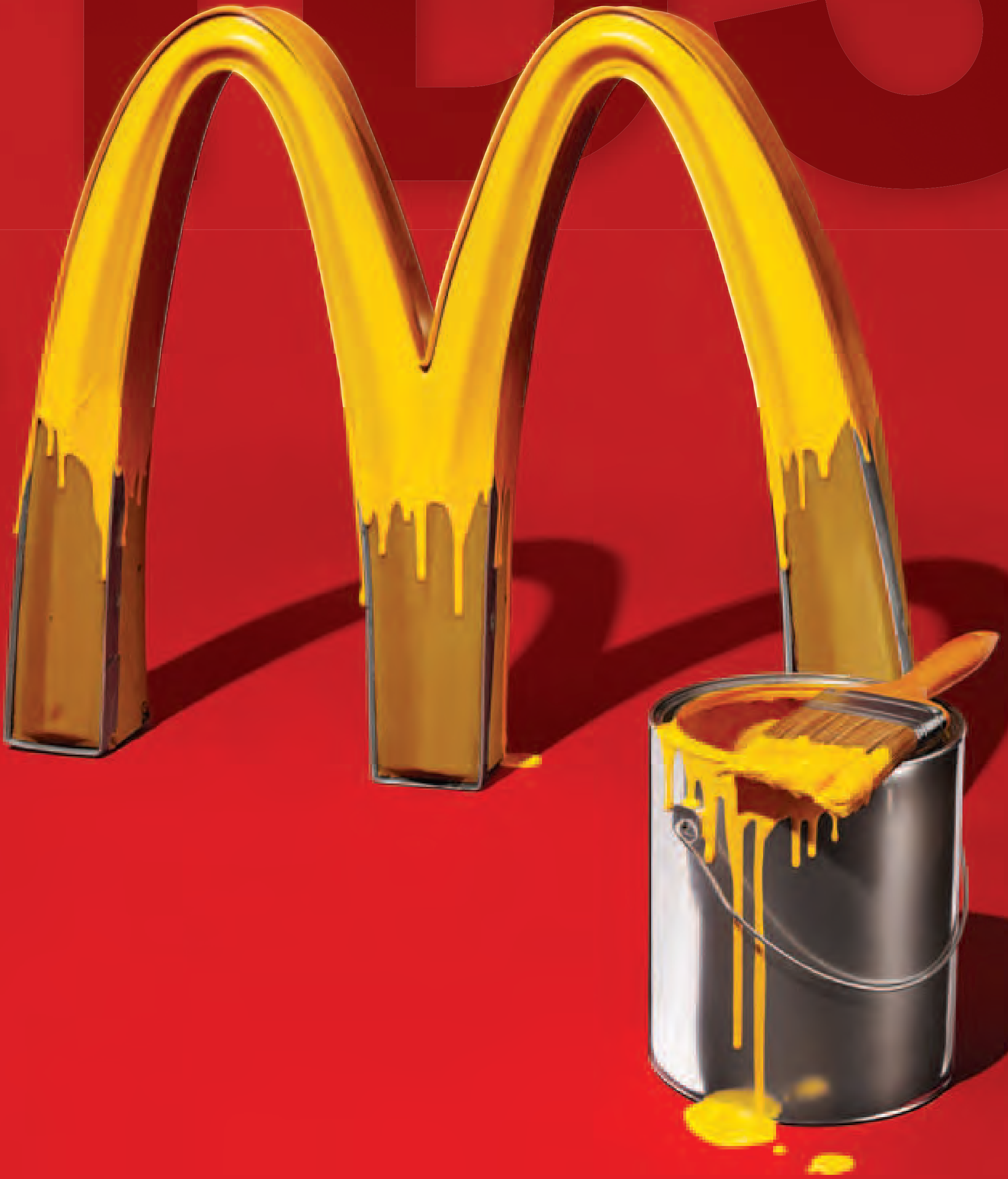
HBS
Alumni Bulletin

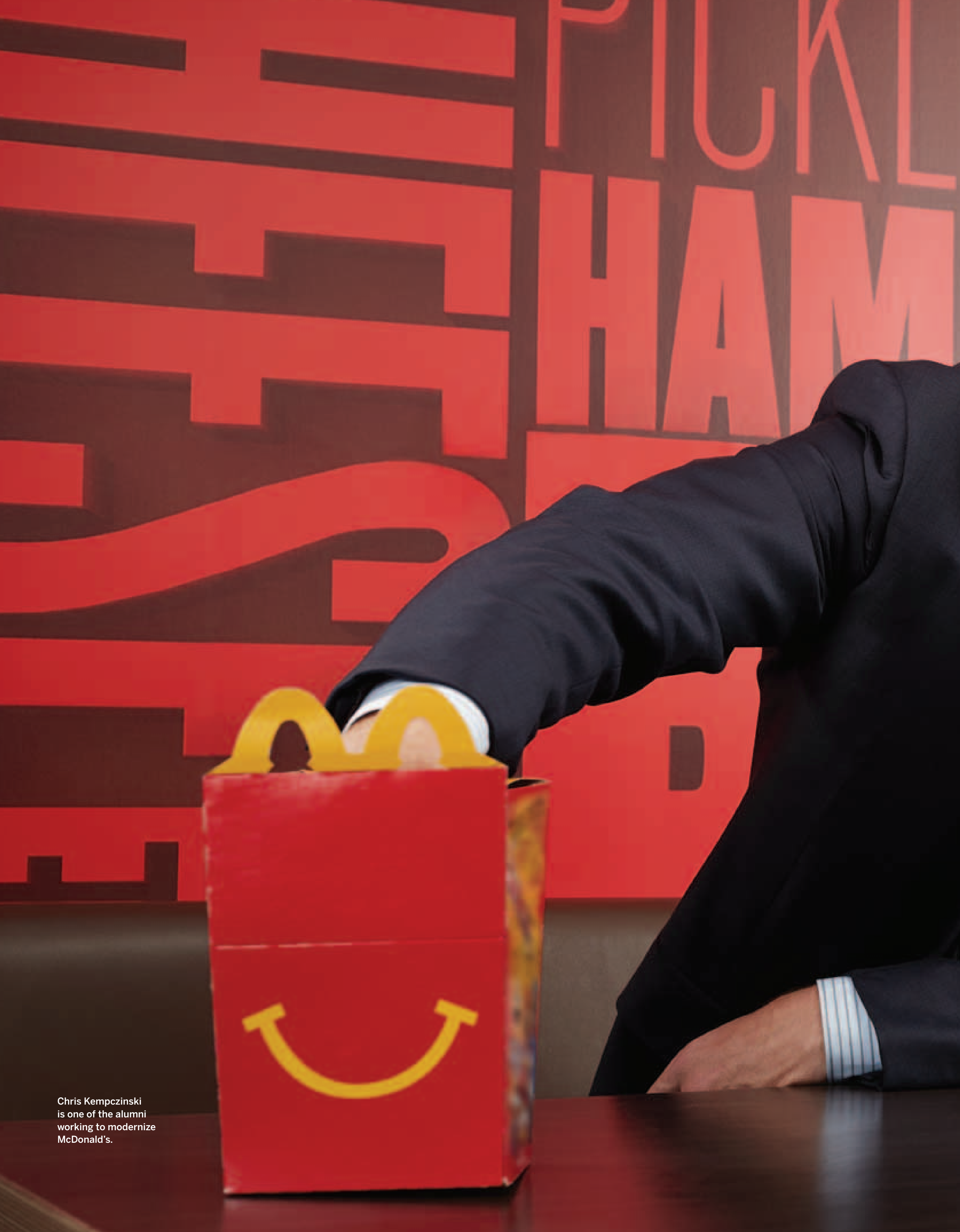
DECEMBER
2017



McMAKEOVER
—54—
Redefining McDonald's for the modern era

YEAR IN REVIEW
—40—
2017's most important takeaways

HARVARD | BUSINESS | SCHOOL



Chris Kempczinski is one of the alumni working to modernize McDonald's.

Happy Meals (ARE HERE AGAIN)

The McDonald's turnaround isn't about reinvention—it's about remembering what made the Golden Arches a global icon in the first place

BY DAN MORRELL

PHOTOGRAPHED BY SAVERIO TRUGLIA

Nick Karavites owns 24 McDonald's restaurants in the Chicago area and the surrounding suburbs, and when he visits them, he always keeps his eye out for a surefire sign of trouble: A customer talking to a manager. It means there was a complaint—about the food, about the service, some negative thing that had escalated to the point that a manager had been called on to straighten things out.

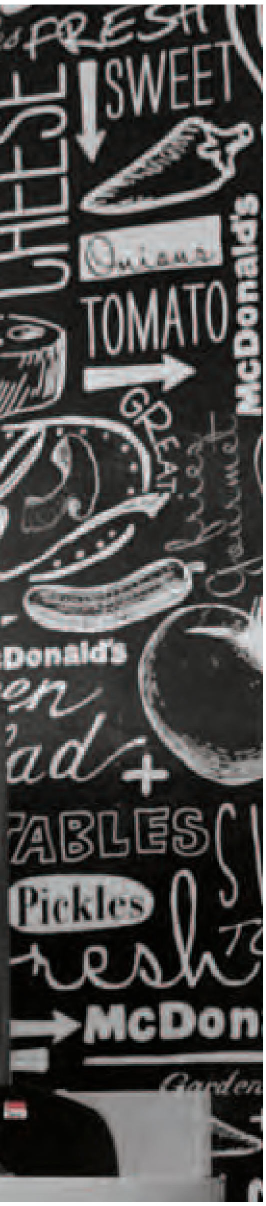
Or at least, that's what it used to mean. In fall 2016, Karavites's location on East Chicago Avenue, on the city's North Side, got a high-tech upgrade. On a warm July day at a little past 11 a.m., as the early lunch crowd shuffles in, Karavites runs through the changes: digital menu boards, a mobile ordering system, a new delivery collaboration with UberEATS, and self-order digital kiosks that allow dine-in customers to place orders and have them delivered to their tables—a service often performed by managers. "Now when I see a customer talking to a manager, it's a good thing," says Karavites, smiling.

Traditionally, the bank of cash registers that sepa-

SVP Kristy Cunningham on the rollout of all-day breakfast in 2015: "Part of the mantra we were pushing was, if it's good for the consumer, it will ultimately be good for the business."

rates the customers and the employees was like a line of demarcation. Now the workers are on the floor, delivering orders or helping customers with the new kiosks; Karavites has updated his employee training to include a focus on customer interaction. Average customer count is up at this location, he says, outpacing his other restaurants. But sales and transactions—the metrics Karavites tracks most closely—are up at all his locations.

The redesign is part of an initiative by McDonald's corporate to modernize the customer experience, which began in the US as a pilot in early 2016. The rollout has been relatively quick: By the end of this year, McDonald's expects mobile ordering to be available at all its 14,000 locations in the United States, and the self-service kiosks in 2,500 locations. Karavites had seen these technologies previewed at McDonald's corporate conferences, but figured that implementation would be a ways off. "This is a really big ship to turn," he says. "But when I started hearing real, actual time lines—that was music to my ears." It wasn't just a vision but a plan.



And just as importantly, that plan wasn't a short-term revenue push but a cohesive, multiyear strategy. Karavites, who bought his first franchise in 2000, says the new alignment made him more confident about the future.

It's an optimism about the future of McDonald's that was hard to find two years ago. In January 2015, the company released its worst earnings report in 30 years, with revenue at its more than 36,000 global locations falling by 7 percent from the previous quarter, and earnings dropping by 21 percent from the previous year. Same-store sales also had their first annual decline in 30 years. For the US market, the reported 1.7 percent drop in same-store sales marked the fifth consecutive quarter of declines. In an earnings call with investors, CEO Don Thompson and other executives outlined the challenges, which included everything from international political conflicts to "an increasingly competitive marketplace." Most observers assumed this latter challenge was a sign of America's changing tastes—that the fast-casual, more ingredient-conscious offerings from the likes of Panera and Chipotle were redefining the sector, and McDonald's wasn't keeping pace.

Five days after the call, Thompson announced his retirement. McDonald's global chief brand officer, Steve Easterbrook, was named president and CEO, and the turnaround was on. **Chris Kempczinski (MBA 1997)** had left Kraft Foods in September 2015, when he connected with Easterbrook, who was looking for someone to help him fine-tune his strategy. Kempczinski joined the global strategy team in late 2015, and was promoted to president of US operations in October 2016.

Formulating a turnaround strategy required Kempczinski and his team—which included Kristy Cunningham—to get to the heart of what exactly had happened to the 62-year-old icon.

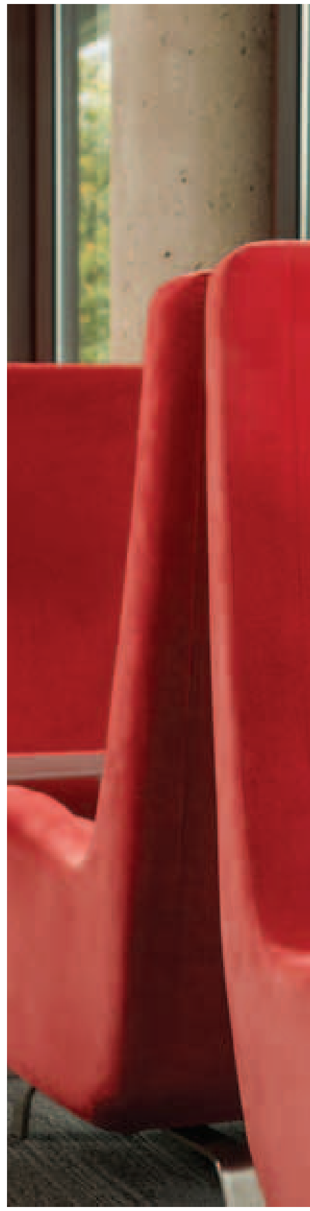
Formulating a turnaround strategy, though, would require Kempczinski and the executive team—which included **Kristy Cunningham (MBA 1998)**, who arrived in 2014 as senior vice president for strategy and insights—to get to the heart of what exactly had happened to the 62-year-old icon.

It was a massive professional challenge: **Morgan Flatley (MBA 2004)**, who was hired as chief marketing officer last April, says that part of the reason she was excited about the gig was the chance "to work on this brand that is so central to the consumer fabric and psyche of our country." Cunningham, who left the CMO role at Hess to come to McDonald's, likewise couldn't ignore the opportunity to have an impact at a massive scale.

But it was personal, too: As a kid, Kempczinski had his birthday parties at McDonald's; his grandmother would get him McDonald's gift certificates every Christmas. Flatley would usually head to McDonald's with her mom and siblings after gymnastics class—a special, happy family moment amidst the chaos of crammed schedules. Cunningham's local McDonald's was a go-to post-soccer game location.

Their experiences weren't isolated. Ascending to ubiquity from the car-obsessed America of the late 1950s, McDonald's became a common language and a cultural export—an affordable and dependable escape.

For decades, McDonald's was a place to feel good. How could they make it that place again?



The kind of updating that Karavites's store underwent—the reshaping of the experience, the modernizing—that's the fun part of the turnaround, Kempczinski says. The less-fun stuff had to come first, though: foundational things, like paring back some of the organizational layers, improving cost-efficiency structures, franchising the restaurants in China. It was all the things that investors were pressing for—moves that saved the company $200 million by the end of 2016, with a target of $500 million by the end of 2018. "It was housekeeping," says Kempczinski of the first 18 months.

And before McDonald's could even start spending money to fix the problem, it had to figure out what the problem was. Why were customers going elsewhere? What did they want?

Shortly after Cunningham arrived, she asked her team for the top three requests from US consumers. "My team said all-day breakfast, all-day breakfast, and all-day breakfast," she says. For a company the size of McDonald's, it posed a massive operational challenge. Hurdles included everything from structure—McDonald's kitchens were designed to operate in two separate "day parts," breakfast and everything else—to securing global supply networks to ensure that it could meet the massive increase in eggs orders. "That had prevented it from really even being seriously considered before," she says. But 2015 was a good time for revenue-generating ideas at McDonald's. "Part of the mantra we were pushing was, if it's good for the consumer, it will ultimately be good for the business," says Cunningham.

That April, Cunningham and her team first tested all-day breakfast in the San Diego market. It dominated. Customers who came in to buy from the "value offerings" were buying from the breakfast menu. Average checks and quality scores were up. It was even getting more of the millennial market to come into its restaurants. "It was kind of a shift in culture for us," says Cunningham. "We were ordering equipment before we fully locked and loaded the business case. It's a great example of how we are trying to shift to be customer-focused, take some of the emotion out, and let the analytics help drive it." "The genius of all-day breakfast," says Kempczinski, "was the idea of starting from the front of the house and working to the back." In other words, McDonald's was not going to ask the customer to meet its needs—it was going to have to meet theirs.

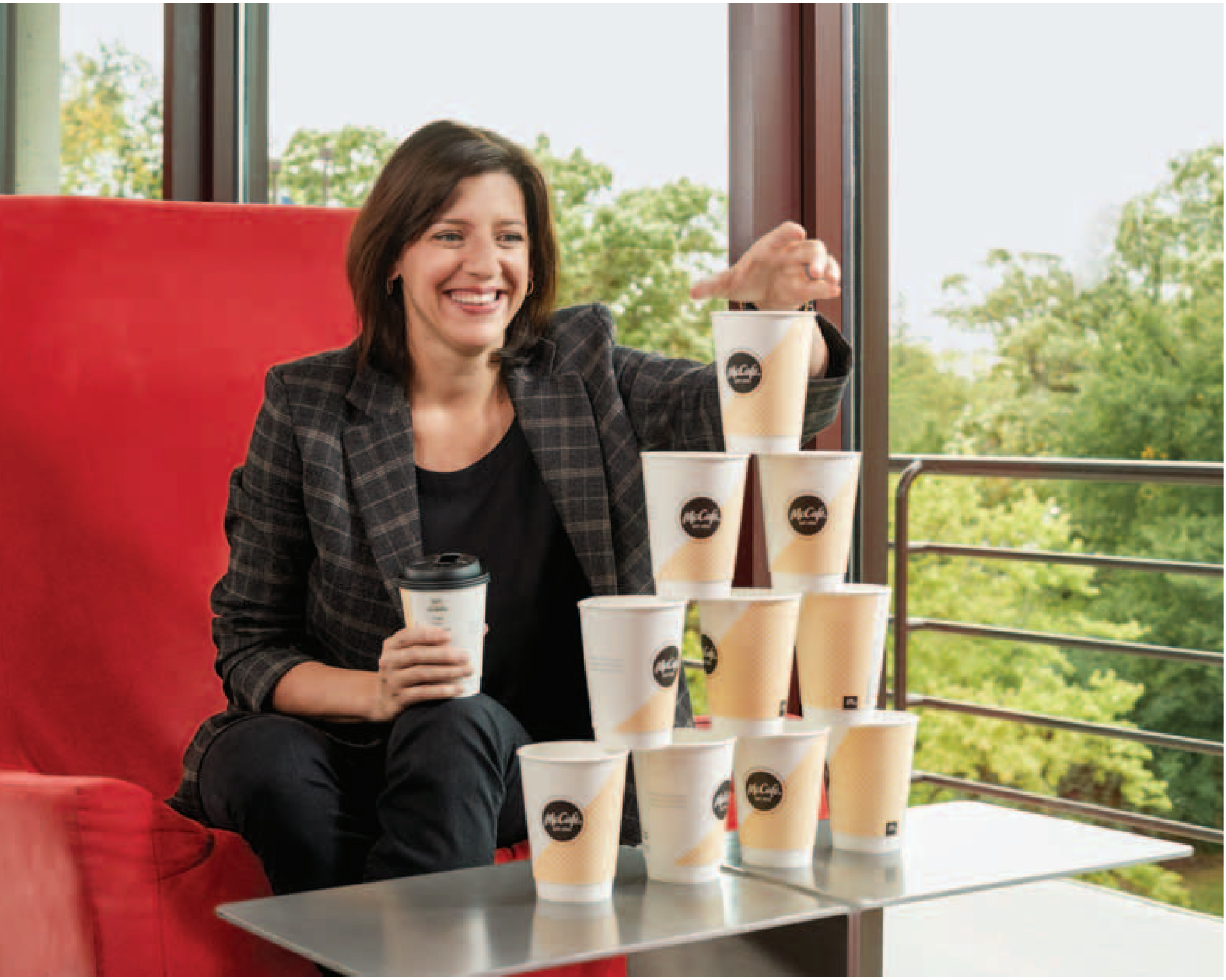
As successful as the effort was both for the bottom line and for shaping the company's culture, it wasn't enough by itself to turn the tide. Between 2012 and 2017, McDonald's estimates that it lost 500 million transactions to competitors. "We needed to understand: Was the underperformance structural? That we're in a bad spot, in the wrong part of the market? Was that driving it? Or was it that we were in a good part of the market, but we were just underperforming?" says Kempczinski.

It was a fundamental question about the company's future: Did McDonald's just need a revival? Or did it need a reinvention?

In 2016, McDonald's surveyed 30,000 customers in nine US markets to get to the heart of the underperformance. The results revealed hard truths: Customers were disappointed with the food and the overall experience. But the data also showed that McDonald's wasn't losing to the fast-casuals like Chipotle and Panera—the bulk of those losses, Kempczinski says, were to "close-in" competitors. (Think Wendy's, Burger King, and Taco Bell.) Part of it was that McDonald's had lost its monopoly on convenience—something the company pioneered with its drive-thrus and a core element of its brand. "We used to be one of the few folks that had drive-thrus at every restaurant. Well, lo and behold, fast-forward several years, now everybody's got a drive-thru. And because our menu had more items than some of the other folks out there, ordering became more complicated—the kitchen became more complicated." The more complicated things became, the longer the wait times got.

But there was a silver lining in the survey. Customers said they still liked McDonald's, and they wanted to come back. They just needed a reason. "There was a latent love for the brand," says Kempczinski. "We had just been

Survey data also showed that McDonald's wasn't losing to the fast-casuals—the bulk of those losses were to competitors like Wendy's, Burger King, and Taco Bell.



underdelivering on what their expectations were."

"In the end, we realized we just needed to be a *better* McDonald's," says Cunningham.

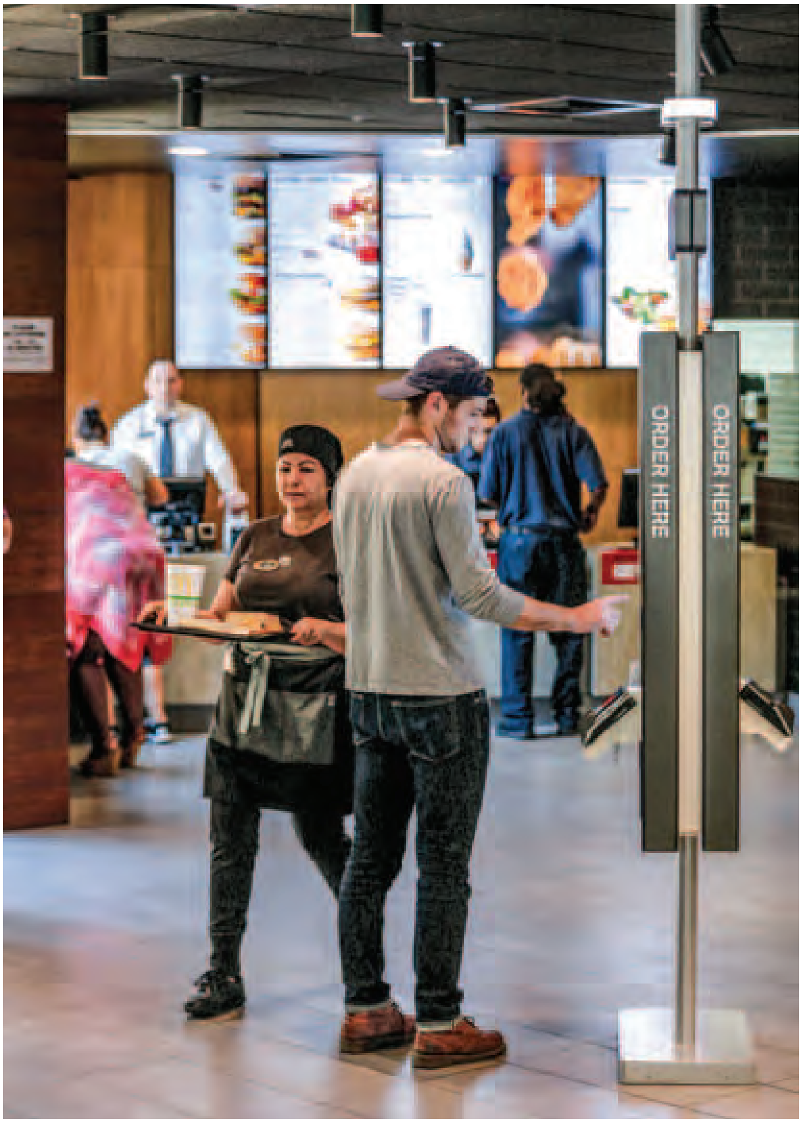
Being a better McDonald's came down to tackling the three major customer criticisms from the survey. "You're not as convenient as you used to be, you're not giving me a great value, and the food is kind of just the same as it's always been," says Kempczinski, summing up the feedback. "So why do I come to McDonald's?"

The food improvements started with its nuggets, with McDonald's announcing in August 2016 that the nuggets would no longer contain artificial preservatives. This past March, it revealed that next year it would be using fresh beef in Quarter Pounders instead of frozen patties, and in May, McDonald's unveiled its Signature Crafted Menu, featuring three upscale sandwich accompaniments: pico guacamole, sweet BBQ bacon, and maple bacon Dijon, adorning either chicken or burger. "Our strategy is to innovate around our core quarter pound burgers and chicken sandwiches with new ingredients, and also appeal to millennial customers who are seeking new taste experiences," says Cunningham.

Value was key, too. McDonald's had dropped its Dollar Menu in 2013, and the rest of the market jumped. "Just as competitors were upping their game on convenience, they took advantage of our not being competitive on value," says Kempczinski. "Our Dollar Menu clearly defined value for the industry for a good decade, and as we came off of that, we hadn't really redefined what value meant to us." Last year, McDonald's launched a lower-priced McPick 2 menu, subsequently rolling out $1 coffee and $1 soft drinks. A new, national value menu is set to roll out in January.

Improving the customer experience meant implementing the physical and digital updates that Karavites's restaurants had undergone but on a larger scale—part of a multiyear "Experience of the Future"

CMO Morgan Flatley says the good narratives about the business are there. "I think we just need to dust them off and show them in a new light to our consumers."



McDonald's self-service kiosks will be available in 2,500 US locations by the end of this month.

initiative. Of all the insights gleaned from the survey, Kempczinski says that the customers' negative ratings on McDonald's convenience were the most surprising. "We felt like we had a birthright on convenience," he says, "so that was a wake-up call."

Again, the fix was customer-focused: McDonald's had to meet its customers' definition of convenience—delivery, mobile ordering, curbside pickup. Whatever way its customers wanted to get their food, McDonald's should offer it. "People want to control their own experience," says Kempczinski.

These new digital improvements offer not only speed but also new data streams and insights for Cunningham to utilize. Recent partnerships with Applied Predictive Technologies have allowed McDonald's to speed up its analytics, helping it make menu decisions more quickly. "It's great to be able to just test and learn," she says. The all-day breakfast rollout was a perfect example of data impacting strategy, Cunningham notes, allowing her to see the cause and effect almost in real time. "I can look at the trade implications, the service time and labor hour implications, and implications for our customer satisfaction scores."

The quicker pace is both new and necessary. "In the last five years, the world has moved faster outside the business than inside," CEO Easterbrook said in a video address about the turnaround in 2015. And the push permeates the organization. CMO Morgan Flatley offers the example of a Big Mac promotion earlier this year. Three different sizes of Big Mac were unveiled: the smaller "junior," the regular size, and the larger "grand." "There was an insight that a lot of the social media chatter around the junior Big Mac was actually being driven by women. So we pivoted and developed some of the specific creative around Mac Jr to be more targeted to women, using media or social media channels to drive that." That's the kind of agility Flatley wants. "How can we real-time gain those insights, and then either pivot our media strategies or make quick changes to the creative?"

Aligning strategy with customer insights means Flatley and Kristy Cunningham are in constant collaboration. "To be truly customer-centric, Kristy and I have to be working hand in glove," says Flatley. It's something she learned as she rose through the ranks of PepsiCo: The people who own the insights, she says, are closest to the consumer. "I see her as a key partner in bringing the truth of the customer to our team, and using that to build the marketing plan," says Flatley.

It helps that they are neighbors at the company's corporate headquarters in Oak Park, about 10 miles west of Chicago. "We yell over the walls," says Cunningham. "I probably text with her as much as I do my husband." The two have been pulling their teams together to discuss future initiatives, intent on breaking down silos. Chris Kempczinski's office—once inhabited by McDonald's founder Ray Kroc—is just up the hall. "Chris has made himself incredibly available for me to bounce questions off of—and to get his gut reaction and guidance as I go," says Flatley. "It is an enormous organization, and figuring out how to navigate it quickly and not make missteps is really critical." It helps, too, that Flatley and Kempczinski have shared experience, both having worked at PepsiCo. (Kempczinski spent eight years there as a VP.) "We both speak the same language. In some ways, he's helping me translate my experience from PepsiCo and from packaged goods to this reality, which has been really helpful."

And it feels like the three have a shared mission, says Cunningham. Previous McDonald's leadership has been more fixated on operations, she says, but now it feels like their three teams are focused on the same thing: the customer.

This vision of a better McDonald's— faster, more modern, with better food—had taken hold in the front office, but it still needed to be sold to two

AP Photo/Charles Rex Arbogast

important parties: those half million former customers they had lost in the last five years and current owner-operators, impatiently awaiting a salve.

For the latter, buy-in took a bit of pot-sweetening. Historically, when McDonald's offered to partner on upgrades, it would pay up to 40 percent of the cost of renovations, the rest covered by the owner-operators. But with the Experience of the Future initiative, McDonald's said it would cover 55 percent of the costs. "If we really wanted to do what we're trying to get done in the time we were trying to get it done, we needed to think a little bit differently, so we stepped up with more partnering," says Kempczinski.

"This can't be a situation where we spend the next three years executing before we think about the strategy again," says Kempczinski. "That sort of approach doesn't work."

But with about 2,000 US owner-operators, consensus was impossible. Unveiling the plan at the end of February in a warehouse in Chicago's West Loop that had been transformed into an Experience of the Future showcase, Kempczinski was blunt with them. "There are parts of this each of you are going to hate," he told them. "The question is, 'Are there enough good things in the plan in its totality that you can at least live with the parts that you hate?'" The owner-operators ultimately approved the plan, estimated to cost about $8 billion, split between McDonald's and the franchisees.

As for convincing the customer that McDonald's is now a modern, progressive burger company—a turnaround shorthand CEO Easterbrook has often employed—Flatley says it will require new creative, but not necessarily a rebranding. Her early view is akin to the company's larger insight that it didn't need to be a totally different McDonald's, just a better one. "We just need to tell more compelling consumer stories, and continue to connect with our customers in a really inspiring, motivating way," says Flatley. The stories are already there. "I think we just need to dust them off and show them in a new light to our consumers."

Just a few miles from its corporate headquarters, in a big hangar-like facility that lacks any kind of identifiable signage, McDonald's is preparing for the next era. In a room filled with full kitchen and store mock-ups—complete with a drive-thru model—the future vision plays out like this: You approach a McDonald's, and when you are within 100 meters, the restaurant's "geofencing" technology recognizes your phone and brings up your regular Tuesday order (based on your order history) on the McDonald's mobile app. Then, the options: Add a parfait for $1 more? Some McNuggets for $2 more? Pick up in the restaurant or via drive-thru? Curbside service? Pull into a spot and enter your curb spot number. Table service? Head in and take a digital location device to your seat so that the staff will know where to deliver your order. If you come through the drive-thru, your regular Tuesday order appears on a giant digital menu board. And payment, naturally, is integrated with the app. Convenience in myriad ways, as dictated by the customer.

Taking a longer view is an important part of the turnaround, Kempczinski says. In the short term, there are indications that the plan is working: McDonald's second quarter earnings, released in July, beat expectations, with the largest global traffic growth in five years; third quarter global comparable sales, released in October, also beat expectations, rising by 6 percent. "But this can't be a situation where we spend the next three years executing before we think about the strategy again," he says. "That sort of approach doesn't work." Strategic planning has been cooked into the new corporate calendar. "There are things that you can put into what I call 'the plumbing' of how the company works that force you to have those discussions, to do that kind of thinking. The big thing for us, too, is that we're going to learn that, as we execute the strategy, the world isn't going to stand still."

It's part of the rationale behind the company's upcoming move: Next spring, McDonald's corporate headquarters will relocate from Oak Park to downtown Chicago's West Loop—a hotbed for food trends. "There's a vibrancy to it, and it's a big millennial space. That's sort of where the future is being defined," Kempczinski says.

He knows the move alone isn't enough to change the company's culture: You can't just send out a memo or have a videoconference from the corner office and say, hey, this is the new culture—this is the new way we are going to operate, he says. "You actually need to get people to role model the behavior, to buy into the behavior." You need disciples, you need evangelists—you need to create situations that make it easier to model new behaviors.

It's one of the hardest things of managing any business, he says of shifting the culture. "Changing human behavior is a very challenging thing"—an insight as true for employees as it is for the millions of new McDonald's customers they hope to serve.