<u>Memo to the CEO</u>:

The Potential Paths to Building a Profitable National Food Chain

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Executive Summary

Health awareness in the United States has become a huge concern in this day and age. Considering that nearly one-third of the country's population is now obese, Americans have much reason to watch their weight. Compounded by the huge influence of fashion and glamour, the incentive to slim down and stay healthy has much of America looking for alternatives to the omnipresent burger shacks and steakhouses. Restaurants such as Subway, Quiznos, and Koo-Koo-Roo's, which offer healthier products, have begun to expand the "healthy fast food" sector; and although most of these companies do not have the convenience of drive-thrus and high portability, they have gathered a steadily increasing customer base.

For the last few decades or so, the McDonald's Corporation has retained a dominant position in the market, holding a healthy 7% of total market share and with over twice the sales volume of our closest competitor, Burger King. However, the McDonald's Corporation has recently come under fire from activists and legal freelancers, causing a negative image of the corporation to be imprinted on the minds of the more health conscious consumers. Although the corporation has done well under the current revitalization plan, some of the negativity still exists in significant volume and is not expected to subside.

It is predicted that over time, given this trend, the customer base that McDonald's serves will become increasingly specialized and that McDonald's will need to rely more on its affiliated brands (e.g., Aroma Café, Boston Market, Chipotle Mexican Grill) in order to retain and grow upon its footing in the food service industry. Although McDonald's continues to be committed to bringing speedy and quality fast food to the masses around the globe, the corporation recognizes a necessity for further branching of the McDonald's brand.

A new restaurant chain can be a great way to cater to the needs of this new breed of "health-conscious" food consumers. This new brand differentiation would be more than merely a derivative of McDonald's; it would attempt to usher in a new wave of healthy consumerism and move itself away from the classical fast food market. Once again, the McDonald's Corporation, through this business plan, will be a nationwide leader and innovator in this rudimentary food market.

The new restaurant concept will be as follows:

- Individual identity (not overtly related to McDonald's)
- Greater product differentiation in restaurant offerings to suit a wider range of diets and consumers
- Informative, widely-publicized nutritional facts
- Feature a clean, sleek image that will attract a gen-X/-Y (post baby-boomer) consumer base
- Neo-contemporary styling, packaging, and service
- Eco-friendly, waste-not-want-not strategies
- Promotes individualistic freedom and expression in communion with peers while retaining a family-friendly atmosphere
- Multimedia and Internet oriented; integrates restaurant lifestyle with current trends toward the information superhighway
- Takes advantage of the McDonald's Corporation's ample financial resources and proven operation models to minimize entry time into market (e.g. existing shipping routes, packaging templates)
- Strategic placement of restaurant locations to best serve the targeted consumers, concentrating in shopping centers and airport terminals in major metropolitan areas around the nation
- Dominance of "healthy fast food" market by bringing the same style of efficient output

Vision Statement
The McDonald's Corporation has prided itself on the core values that have driven it from its nascent days under the hands of Ray Kroc to the present day. These core values, abstracted into QSCV (Quality, Service, Cleanliness, Value), have fed over 100 billion customers over the years. The McDonald's Corporation should extend these core values to the new restaurant and promise to bring a fresh, professional look to the health conscious food market. By doing so, we hope to promote and usher in a new era of healthier individuals who lead an upbeat, positive lifestyle.

Milestones
A tentative roadmap for the opening direction of this new chain:

2005	
Q2	Setup corporate establishment for new restaurant chain
Q3	Recruit current and prospective franchise owners in cities above the median family income of the US to expand with the new restaurant concept
Q4	Hold conference of committed owners to establish restaurant standards in hiring practices, food preparation, visuals, and marketing strategies as outlined in the business concept
2006	
Q1	Begin aggressive marketing of the opening of restaurant to the public
Q2	Hold conference to evaluate overall restaurant performance following the first financial quarter of business operation
Q3	Based on first and second quarter financial performance, make a decision on whether to aggressively expand the opening of new restaurants or pull back to parity
Q4	Consider continuing or revising current marketing and positioning strategies for the next year and beyond

Market and Competitive Analysis

Examination of Differentiation within the Current Market
In the current fast-paced economy, speed of service is essential in meeting the customers' needs. As characteristic of a mature industry, the fast food market is saturated with competition amongst various franchises and has expanded into a net market share of $125 billion annually. For our purposes, we can divide the fast food market can be into two categories: major burger joints (nationally prominent and extremely convenient through the use of drive-thrus) and smaller, more specialized eateries. The former is currently saturated with competition among many popular fast food chains such as McDonald's and Burger King. The franchises in this category compete for more customers through advertisements and price competition. In the Hotelling sense, in terms of taste and variety, the competing franchises end up at the center, next to each other and indistinguishable to their consumers. The only way to gain a significant market share in this category is to have existing footing. Currently, McDonald's has been able to maintain the highest position of sales in the fast food industry with net sales of 19 billion in 2004[1].

In contrast to the "burger" category, the other restaurants differ in a number of key aspects: the target consumer, food pricing, service quality, the age of this segment of the market, and the nature of competition. Almost certainly, they attempt to distinguish themselves from the major market controllers by advertising their use of higher quality or significantly healthier ingredients. This type of strategy can be applied to a myriad of different food types and services. Thus, the market segment is all-encompassing and product differentiation is great.

Changes in the Market and the Industry
It is apparent that these fast food chains have developed their businesses neglecting their customers' health. Therefore, as an increasing number of people have become more educated about health-issues, the fast-food market has suffered. McDonald's net income in 2002 was around $893 million, which is only half of the net income in 2001. McDonald's had been the number one franchise in 1997 but quickly dropped to number thirteen. On the other hand, franchises that put focus on health oriented items have flourished over the past years. The McDonald's Corporation has attempted to keep our customers loyal by offering healthier food selections such as various premium salads and whole wheat bun chicken sandwiches. Since these changes were implemented in the recent revitalization campaigns, the McDonald's sale revenue has since risen by two billion. Furthermore, on a micro scale, since the input costs for the salads are much lower than its meat items, these salad items are extremely profitable[1].

One statistical study conducted by a food marketing institute showed that the majority of people feel they can or should eat much healthier food either at home or while traveling. This number has generally decreased over the years (1997-2004), a trend likely precipitated by the opening of many more health-oriented venues.

[1] McDonald's Financial Report (03/01/2005) <http://web.lexis-nexis.com/universe/document?_m=e010d6dabe3674f23b30443f3a853348&_docnum=1&wchp=dGLzVzz-zSkVA&_md5=8021f52680017c9a332ff1018bba0483>

So, between the ground lost by the major fast food giants resulting from societal health concerns and the high specialization of the smaller, more inter-spersed fast food entities exists an opportune gap available for filling. To pick up this slack, this type of business will need to fit in as a specialized restaurant with existing corporate structure. There also currently exists no franchise which personifies healthy fast food in the same manner which McDonald's personifies typical fast food. Thus a well-prepared, newly created entrant into this market could be poised to establish itself as the industry leader and in doing so almost certainly gain a first-mover's advantage.

Major Competitors:

Baja Fresh
The Baja Fresh franchise consists of a chain of Mexican fast food restaurants. It focuses on its image as a fresh food provider by offering an assortment of salads, burritos, quesadillas, soups, and tacos. While their ingredients are fresh, they are not very healthy. Most of the items contain some form of diary, such as sour cream or cheese, drastically increasing the fat content within their menu. (e.g., one chicken quesadilla contains an amount equivalent to two of McDonald's Quarter-Pounder™ cheeseburgers in terms of fat and calorie content). Consequently, Baja Fresh's emphasis on fresh ingredients over the healthiness of its products means that it poses little threat to an entrant into the healthy fast food market.

Quiznos
The main goal of Quiznos is to deliver fast, fresh, and filling sandwiches. Quiznos' menu is somewhat expensive, due to not only the quality of its products, but also because its sandwiches are toasted, which requires time and operational cost. Quiznos also targets the health conscious through its emphasis on the Atkins diet, though a competing entrant could exploit their lack of concern for the large amount of fat in their menu[2].

Koo-Koo-Roos
Koo-Koo-Roos is an expensive fast food franchise which focuses on providing restaurant items in a fast food setting. Many of its sandwiches, burritos, and wraps are high in calories and fat content. Koo-Koo-Roos does not specifically target a particular consumer group but rather tries to compromise many of the market's needs. This lack of specificity may be the cause of their financial decline in recent years.

Subway
In recent years Subway has been perceived as the healthy alternative to fast food, regardless of actual health benefits[3]. Currently, it is the top ranked franchise in the nation, as reported by *Entrepreneur* magazine in terms of the number of restaurants[4]. Surprisingly, Subway was very successful at promoting its products' health benefits, coming up with simple but catchy slogans such as "Eat Fresh!" and using spokesperson Jared Fogle, a previously obese man that had shed pounds through an all-Subway diet. However, Subway falls short in three key areas which an entrant into the healthy fast food market could exploit: speed, variety, and healthfulness. Subway's sandwiches are all made to order, requiring additional time. Its selection is limited to deli-type sandwiches, their derivatives, and periphery food items, such as cookies and chips. Moreover, most of the franchise's food offerings are not actually that healthy[5]. Yet, because of its success and its ability to proliferate, it is primed to be the main competitor.

Proposed Venture

Overview and Mission Statement
In order to address the growing needs of the health-conscious consumer, we propose that the McDonald's Corporation develop a new franchise, Green Apple. Like the McDonald's Corporation's Chipotle franchise, Green Apple would provide quick service, quality food, and an impression of cleanliness and modernity. Its goal is not so much to rapidly convert the population to a healthier diet, but rather to obtain a large portion of the existing and future market for healthy fast food.

Target Markets and Consumers
Green Apple would not target the fanatically health-conscious, electing instead to target those who simply want to "eat better" than the current offerings. This would include health-conscious (and possibly vegetarian), middle- and upper-class consumers, who are concerned about their health

2 Quiznos Net Carbohydrates < http://www.quiznos.com/images/low_carb_graphic.gif>

3 "The Future of Fast Food, Part I" <http://www.entrepreneur.com/franzone/article/0,5847,307616,00.html>

4 "Start and Grow your Small Business" <http://www.entrepreneur.com/franzone/rank/0,6584,12-12-F5-2005-0,00.html>

5 "Official SUBWAY Restaurants' Nutrition Information" <http://www.subway.com/applications/NutritionInfo/index.aspx>

and personal appearances and would consequently be less price sensitive[6]. This demographic would consist largely of teenage girls and young adults but would also include preteens and teens of both genders as well as parents.

Nature of Competition
Green Apple's entry into the market has a number of key benefits. As stated earlier, the nature of existing competition permits Green Apple to firmly establish itself as the definition of healthy fast food, in contrast to the current leaders which have simply adapted their existing models to encompass healthiness. Furthermore, switching costs for consumers would be relatively low since there is little penalty for changing meal plans for one day. Green Apple would differentiate primarily by the healthiness of its menu and the quality of its ingredients. While the items on the menu would primarily be priced comparably to the more expensive fast food restaurants, we feel that consumers of this type of food would be willing to pay extra for the healthiness.

Products & Services

Overview of Food
The objective of Green Apple would be to provide healthy and diverse alternatives to most other fast food restaurants. Its menu would largely offer sandwiches, wraps, salads, fruits, and healthy drinks, such as juices and soymilk, and, like other franchises, Green Apple would also have combos. While food items could be somewhat customized, they should be largely preassembled for purposes of delivery speed. The pricing of the items would predominantly be on the higher end but less expensive items would also be provided for the more fiscally-conscious customers. For example, we can offer wraps, which should be priced around $1.89 to 3.49, to contain a "starter" food item at the lowest price point while offering wraps of significantly better content around the mid-$2 to $3 range. (*See* Appendix A *for more details*).

Packaging
The packaging for food items should be in line with the franchise's "good Samaritan" image by being eco-friendly. Moreover, the packaging would have short suggestions on simple exercises akin to those in women's magazines along with a link to the franchise's website for more information.

Services
As far as facilities, the franchise would largely resemble that of most existing fast food chains without drive-thrus. Since impressing the idea of health on the consumer would be an issue, facilities would have to be well-lit, kept clean, and painted with bright colors used in the interior.

Future Products and Services
The franchise would initially need to continually innovate in order to provide a menu which compromises desirability with price and healthiness. However, as time passes, the need to improve the menu will diminish and changes would become limited to seasonal promotions, such as a "fruit of the month" menu item in which different, somewhat exotic, fruits, such as papaya and mango, are offered each month in the form of a fruit salad or in slices. Such side items could provide incentives for the customer to return.

Strategy

Overview
With the trend in healthy food becoming more and more popular, McDonald's profits are becoming jeopardized, which is why the creation of a new food chain which focuses primarily health food can serve to insure the restaurant giant. Green Apple could easily draw upon the McDonald's Corporation's well developed network of food providers, to help in obtaining high-quality, yet competitively priced product inputs.

If implemented properly, Green Apple's entry into the fast food industry could almost give it a first-mover's advantage. This would require the quick establishment of a clear image of health to the public while at the same time adhering to or surpassing McDonald's own commitment to excellence in speed and employee-customer relationships.

Marketing
Since Green Apple targets a more mature, health conscious audience than traditional fast food restaurants, the marketing should reflect that. It should be informative and educate the viewer on the healthiness of the franchise: witty, but not purely comedic; suggestive rather than directing, so as not to appear propagandist or preachy; and crisp and clean, to convey the image of the restaurant as simply healthy.

[6] "The Future of Fast Food, Part 2" <http://www.entrepreneur.com/article/0,4621,308510,00.html>

Advertising

The advertisements for the franchise would be largely aimed at two crowds: teenage girls and young adults. The former should be targeted through popular magazines such as *Cosmopolitan*, *Jane*, and *Us Weekly*, as well through limited television advertisements during teenage dramas such as *American Idol*, *Gilmore Girls*, and *The O.C.* and other television programs geared toward intelligent young adults, such as *Grey's Anatomy* and *Law & Order: SVU*[7]. In addition to reaching the desired demographic, these media explicitly or implicitly address personal appearances and health, a concern we suspect our desired consumer will have. The tone of the advertisements should be comparable to that of other health and beauty products advertisements so as to emphasize the health aspect of the restaurants' offerings.

In targeting young adults, such as fresh out-of-college businesspeople and other white collared professionals who seek fast food more out of convenience than taste and would prefer a healthier alternative, possibly at a higher price, Green Apple would advertise in magazines such as *Newsweek* and *U.S. News and World Report* as well as in areas more visible to such consumers, such as on the sides of buses and billboards near workplaces.

The advertisements as a whole should be more mature and serious than most other franchises' while still being fresh, trendy, and not appearing *too* adult. They should be positive and encouraging, enforcing ideas of "a better you" and that "you owe it to yourself" and "you deserve it."

Promotions

If poorly executed, promotions could make the franchise seem profit-hungry and insincere. To counter this, promotions should be tied in with improving an individual's wellness, either through health or charity. The franchise could work with national gyms to offer free or discounted food with membership at a participating gym as well as donations to charitable organizations (such as the Lance Armstrong Foundation) with each purchase.

Publicity

Like promotions, flagrant publicity would give the franchise a negative image. Ideally, the franchise would prefer positive comments by well-respected, famous people in the context of an interview and not simply within a commercial or advertisement. This could be achieved through an unofficial free catering program whereby bands on tour or actors filming are offered free catering (as a gift from the franchise and not any one particular store). However, this would understandably be difficult to achieve since they would actually require exposure to the food and like it. Consequently, there would be little attempt to publicize the franchise except, perhaps, as a supporter of humanitarian and ecological activities, such as AIDSWalk or Earth Day. Nevertheless, publicity at such events could be quite useful for Green Apple, since providing free or reduced cost catering to such events could not only appear philanthropic but would also provide free samples to a group which we would expect to largely include the ideal consumer, young and health conscious.

Internet Presence

While poorly utilized by most other restaurants, Green Apple would work to make its website a web portal for health with easy access to such things as exercise regimens, nutrition and product information, and promotions. The intent of the website would be to appear professional, aesthetic but not flashy, and more health oriented than company oriented. In accordance with the targeted audience, the website should be informative and not "talk down" to the visitor or seem patronizing, particularly since the targeted consumer is smarter than those of other franchises[8].

Location of Franchises

The branches would be located mainly in areas frequented by teenagers and young adults, such as malls, movie theater complexes, and college campuses. Stores could also be placed in airports, where the selection of healthy food is typically minimal. Expansion from these types of areas to other urban and suburban locales can be expected as name recognition develops.

Threats and Risks

Nevertheless, entry into this market is not without its risks. It may be the case that the market is not as large as predicted and thus unable to sustain a new entrant. Additionally, the balance of taste, health, and price may not be to the liking of the consumer, though this risk can be minimized through taste-test studies conducted prior to the opening of the franchise as well as refining the menu as time progresses.

7 Yahoo! TV: Nielsen Ratings <http://tv.yahoo.com/nielsen/>

8 "Welcome to McDonald's Asian Pacific Islander Americans – i'm lovin' it!" <http://www.i-am-asian.com/>

Even if the market is receptive to Green Apple, it would undoubtedly face stiff competition from other franchises, namely Subway and Quiznos, which could improve the quality and healthiness of their menus, begin marketing blitzes and promotions. However, it does not seem that either franchise could easily respond by drastically changing a large portion of their menu without risking alienation of their existing customer base since doing so would require a larger menu, which would increase costs for the franchises, or replacing less healthy items, which would distance the franchise from consumers who select them simply because of taste[9].

Operations

As the pioneer in the operations field, McDonald's has a great deal of experience it can impart to Green Apple, such as McDonald's use of a well-defined hierarchy for its personnel: virtually all employees begin by washing dishes and gradually ascend toward the managerial level. This provides motivation for the personnel to work hard and makes the path towards success obtainable. It also creates incentives for some personnel to stay within the franchise and work for its image.

Another adoptable feature of McDonald's operational strategy which Green Apple could adopt is its policy of hiring young employees. While many of them have little or no experience in the field, they are often the most enthusiastic and willing to learn. Their lack of qualifications is compensated by their willingness to work lower wages and minimized by the use of simple-to-use, automated machinery. The age of these employees would also contribute to the image of Green Apple as geared toward teenagers and young adults. Like McDonald's, the operations of Green Apple would rely on young, enthusiastic, and friendly employees who work toward promotions tied to loyalty and diligence and not education level, in contrast to other franchises.

Financials

Formation of a new restaurant chain such as this one will require a large amount of starting capital. The budget should be able to absorb any unforeseen difficulties in its implementation. Thus, financial backing provided by the McDonald's Corporation should be initially assumed to be infinite. If the concept pans out, full confidence in its success comes hand-in-hand.

Garnering the confidence of franchisees is another question, however. Starting with the McDonald's model, a newly franchised restaurant will cost the franchisee a minimum of $75,000 in base investment, with additional money necessary for streamlining a location on par with company standards, which can range anywhere from $10,000 to $100,000, depending on location. Since the target locations of these new restaurants are in middle, upper-middle, high, and business class environments, along with the multimedia/Internet upgrades unique to this chain, the mean startup cost for a new restaurant is projected to be 10-15% higher than that of a typical McDonald's.

The corporation should expect to follow an aggressive expansion model similar to that of Chipotle, which will open approximately 250 new restaurants over the course of a fiscal year. Since all these restaurants will be placed in locations of high exposure, it can be fairly assured that a conservative percentage of 25-35% of restaurants will turn out profits by the end of one quarter, leaving 65-75% of newly franchised restaurants to rely on corporation support.

As long as the franchises continue to increase consistently in sales volume, absorption of sales loss in the first two years of restaurant operation should not be a large problem. The goal is to regain the initial investment within the first two years of operation so that a future expansion plan can be implemented to build up the brand. Oftentimes, successful owners will start up multiple restaurants. To make sure all areas of service are fully covered, these owners will be encouraged to open in new locations away from the existing site. These areas will be bolstered with more aggressive advertisement from the corporation. Future recruitment of potential franchise owners will depend on the performance of existing ownership. New enlistees will likely be swayed by current owners, and successful recruitment should be rewarded with financial backing from the central corporation.

Concluding Remarks

With all these implementations in place, the corporation should be able to create a highly effective entrant into the health-conscious fast food sector. Green Apple comes in with a decided advantage over the other specialized fast food

[9] "Official SUBWAY Restaurants' Nutrition Information" <http://www.subway.com/applications/NutritionInfo/index.aspx>

restaurants by having considerable corporate backing from the McDonald's Corporation, both financially and in terms of operational experience. It separates itself from the "juggernauts" of fast food by marketing toward a more specialized audience—an audience that is more than willing to pay for the products Green Apple will offer. Furthermore, through mass advertisement and the incorporation of current lifestyle trends, this venture should be able to overtake and dominate the competing specialized fast food chains in a short number of years.

Most importantly, however, is the fact that Green Apple will be the McDonald's Corporation's ticket to expanding its business reach, in its ability to regain the customers that it may have lost in recent years and its ability to attract new customers to the fast food market.

Appendix A – Sample Menu

All prices are estimates, and subject to change by region (New York, NY vs. Houston, TX) and/or location (airport terminal vs. shopping center)

Salad ($3.99-4.99)

- Caesar (Romaine Lettuce, Parmesan Cheese)
  - Grilled Chicken Caesar
  - Plain Caesar
- Chinese Chicken
- Greek
- Standard Mixed Greens
- Fruit Salad
- Rotating Special (e.g., Avocado Salad, Endive Grapefruit Salad)

Dressing

Ranch

1000 Island

Italian

Vinaigrettes

- Cranberry
- Balsamic

Wraps ($1.79-2.89)

- Chicken
- Fish (Tuna, Salmon Fillet, Cod Fillet, Mahi Mahi)
- Low Fat Roast Beef Slices

Sandwiches ($1.99-3.99)

Choices comparable to wraps but with other bread and meat choices

Soups ($0.79-1.49)

- Chicken Noodle
- Pea Soup
- Minestrone

Sides (

Fresh, cut fruits

Beverages

Fountain Drinks (expanded Diet selection, minimal Regular selection)

- Coca-Cola (Regular, Diet, C2)
- Sprite (Regular, Diet)
- Powerade
- Minute Maid (Valencia Orange Soda, Lemonade, Diet Lemonade)
- Dr. Pepper (Regular, Diet)

Bottled/Packaged

- Dasani Water
- Minute Maid Orange Juice
- Mineral Water (ordered in low quantities)
  - Perrier
  - San Pellegrino