

## McDonald's Corporation - 2015 (MCD)

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### Abstract

McDonald's Corporation, 2015 is aiming to enlighten the "Experience of the Future" for consumers, with a special focus on the 'younger' generation. Beginning in 2015 and moving forward, McDonald's has operationalized the functions of its strategy to better serve consumers with such offerings as trial-testing a build-your-burger strategy with the order being served at the table, known as the "Create Your Taste" program. The restaurant chain has introduced the all-day breakfast menu and 'McPick 2' for \$5.00. Additionally, the company has engaged consumers by way of social media and is interested in having a smartphone application in-use. Other roll-outs include processing transactions by way of mobile-payment with such channels as 'Google Wallet, Softcard and Apple Pay.' The fast-food giant continues to test a variety of strategies at select locations aimed at increasing shareholder value as a result of both introducing and modifying the point-of-sale services and food & beverage offerings<sup>1</sup>.

**Keywords:** McDonald, Corporation, Company.

### Company History

McDonald's Corporation, founded in 1940 and based in Oak Brook, Illinois, is the world's largest fast food chain operating both franchised and company-owned locations in more than 100 countries in the United States, Europe, the Asia/Pacific, the Middle East, Africa, Canada and Latin America. As of December 31, 2014, it operated 36,258 restaurants, including 29,544 franchised restaurants comprising 20,774 franchised to conventional franchisees, 5,228 licensed to developmental licensees, and 3,542 licensed to foreign affiliates; and 6,714 company-operated restaurants<sup>2</sup>.

Historically, brothers 'Dick' and 'Mac' McDonald opened Bar-B-Q restaurant in San Bernardino, CA in 1940. By 1948 their restaurant closed for alterations and reopened in December of that year as a self-service drive-in restaurant. The offerings were limited to just nine items: cheeseburger, hamburger, potato chips, and pie coupled with beverages of milk, soft drinks and coffee. The restaurant was famous for offering a 15-cent hamburger. The company's symbol was known as "Speedee" (prior to Ronald), a miniature animated chef. In 1949 McDonald's was the first to replace the potato chips with French fries on the menu coupled with triple-thick milkshake offerings. It was in 1955 where the golden arches, designed by Stanley Meston in 1953, were applied to a location in Des Plaines, IL. By 1965, over 700 locations were opened throughout the United States<sup>3</sup>. Additional company timeline developments can be found under

<sup>1</sup><http://www.businessinsider.com/the-worlds-largest-fast-food-chain-is-floundering-2015-1> (ABSTRACT).

<sup>2</sup>Finance.yahoo.com (Introduction).

<sup>3</sup>aboutmcdonalds.com.

links located at [www.aboutmcdonalds.com](http://www.aboutmcdonalds.com).

The company has three 'ambitions,' which include: good food, good people, and good neighbor. McDonald's Company attributes their franchisees, suppliers, and employees as being the critical pillars of their success as the world's largest brand. Greater than 80% of worldwide McDonald's locations and about 90% of U.S. locations are operated by approximately 5,000 small and mid-sized business men and women. The company gives latitude to local management/owners at local markets to determine specific needs (menu, marketing, community involvement, and business management) in order to better serve the respective communities<sup>3</sup>.

Declining revenues in 2015 have left newly appointed CEO Steve Easterbrook with much to ponder about as he leads the world's largest foodservice company into 2016. Having held various roles at McDonald's over a span of 20 years, one of CEO Easterbrook's interests may be to ensure McDonald Corporation avoids declining income results, where total revenues declined from \$27.4 in 2014 to \$25.4 in 2015 (see Exhibit 1). Some strategies the company has rolled-out with success include breakfast being served all-day and McPick 2 for \$5.00.

In 2016 the company continued to trial new strategies, but it is not clear if the selections will remain and in what markets. The news of trials taking place may leave consumers pondering on the offerings in their respective markets. However, a limitation may be a lack of consistency in such trials, nationally, or globally. Looking ahead, attention may be on what the company will actually roll-out and to what degree. Additionally, will McDonald's Corporation pioneer strategies or find itself trailing competitors, which have for long offered simple menus, for example. Will the introduction of the Grand Mac and Mac Jr (national menu additions, per company news) to join the iconic Big Mac be a success for the company as it enters 2017, will remain to be seen.

Exhibit 1: McDonald's Corporation Consolidated Statement of Income

| Consolidated Statement of Income   |                                      |                   |                   |
|--|--------------------------------------|-------------------|-------------------|
| <i>In millions, except per share data</i>                                | <i>Years ended December 31, 2015</i> |                   |                   |
|  | <i>2015</i>                          | <i>2014</i>       | <i>2013</i>       |
| <b>REVENUES</b>  |                                      |                   |                   |
| Sales by Company-operated restaurants                                    | \$ 16,488.3                          | \$ 18,169.3       | \$ 18,874.2       |
| Revenues from franchised restaurants                                     | 8,924.7                              | 9,272.0           | 9,231.5           |
| <b>Total revenues</b>  | <b>25,413.0</b>                      | <b>27,441.3</b>   | <b>28,105.7</b>   |
| <b>OPERATING COSTS AND EXPENSES</b>                                      |                                      |                   |                   |
| Company-operated restaurant expenses                                     |                                      |                   |                   |
| Food & paper   | 5,552.2                              | 6,129.7           | 6,361.3           |
| Payroll & employee benefits  | 4,400.0                              | 4,756.0           | 4,824.1           |
| Occupancy & other operating expenses                                     | 4,024.7                              | 4,402.6           | 4,393.2           |
| Franchised restaurants-occupancy expenses                                | 1,646.9                              | 1,697.3           | 1,624.4           |
| Selling, general & administrative expenses                               | 2,434.3                              | 2,487.9           | 2,385.6           |
| Other operating (income) expense, net                                    | 209.4                                | 18.6              | (247.2)           |
| <b>Total operating costs and expenses</b>                                | <b>18,267.5</b>                      | <b>19,492.1</b>   | <b>19,341.4</b>   |
| <b>Operating income</b>  | <b>7,145.5</b>                       | <b>7,949.2</b>    | <b>8,764.3</b>    |
| Interest expense-net of capitalized interest of \$9.4, \$14.7 and \$15.5 | 638.3                                | 576.4             | 527.8             |
| Nonoperating (income) expense, net                                       | (48.5)                               | 0.8               | 32.0              |
| <b>Income before provision for income taxes</b>                          | <b>6,555.7</b>                       | <b>7,372.0</b>    | <b>8,204.5</b>    |
| Provision for income taxes   | 2,026.4                              | 2,614.2           | 2,618.6           |
| <b>Net income</b>  | <b>\$ 4,529.3</b>                    | <b>\$ 4,757.8</b> | <b>\$ 5,585.9</b> |
| <b>Earnings per common share—basic</b>                                   | <b>\$ 4.82</b>                       | <b>\$ 4.85</b>    | <b>\$ 5.59</b>    |
| <b>Earnings per common share—diluted</b>                                 | <b>\$ 4.80</b>                       | <b>\$ 4.82</b>    | <b>\$ 5.55</b>    |
| <b>Dividends declared per common share</b>                               | <b>\$ 3.44</b>                       | <b>\$ 3.28</b>    | <b>\$ 3.12</b>    |
| <b>Weighted-average shares outstanding—basic</b>                         | <b>939.4</b>                         | <b>980.5</b>      | <b>998.4</b>      |
| <b>Weighted-average shares outstanding—diluted</b>                       | <b>944.6</b>                         | <b>986.3</b>      | <b>1,006.0</b>    |

Source: McDonald's 2015 Annual Report

## McDonald Corporation's "Ambitions"

The company is focusing on what they've coined as 'ambitions.' Good Food is one area with a focus on nutritional offerings without compromising taste. The company acknowledges nutritional concepts may vary, globally; however, insists eating foods representative of the food groups is universally the same across the globe. Essentially, McDonald's wishes to serve menu items representing fruits & vegetables; low-fat dairy and wholegrains. Overall, the aspirational goals by 2020 include serving 100% more fruits, vegetables, low-fat dairy and whole grains in the top 9 markets of McDonald's Corporation.

Another area is Good People. This ambition involves the 'faces' of the brand at McDonald's. Continued opportunities of training and education is widely offered, regardless of choosing to remain at McDonald's or transitions elsewhere. In McDonald's USA, as of April 1, 2015, wage increases and paid time-off for eligible full and part-time employees was offered at company-owned restaurants. Specifically, at company-owned restaurants starting July 1, 2015, minimum wages were one dollar over the local-mandated minimum wage. Full and part-time employees having at least one year of service began accruing personal paid time-off. This applied to approximately 90,000 working on company-owned restaurants, which represents about 10% of U.S. restaurants. What is available to both company and franchised-location employees is free high school completion and college tuition assistance. McDonald's also strives for adhering to the standards of business conduct and its core values, such as operating with fairness, honesty, and integrity.

The third ambition is Good Planet. The focus is to operate with a 20% increase in energy efficiency at company-owned restaurants in the top 9 markets, excluding Brazil and Japan. Also, develop franchisee goal in 2016. Also, the company has focused on increasing energy efficiency in the top 9 markets and increase the amount of in-restaurant recycling to 50% and minimize waster in top 9 markets. The overarching goal is to become a positive force in each aspect to benefit the world<sup>3</sup>.

### Strategic Vision

The company envisions and strategizes to become both a modern and progressive company with the focus of delivering a 'contemporary' experience to its customers. 'Modern' relates to ensuring the brand is reaching modern time advances, while 'progressive' aims to achieve the transitions customers will continue to expect now and in the future. In doing so, the expectation is to deliver high-quality food coupled with a world-class experience onto consumers, making them feel both welcomed and valued.

As of July 1, 2015 McDonald's organizational structure included 4 segments, which were designed to combine market needs with characteristics, challenges, and opportunities.

USA-the company's largest division, accounting for greater than 40% of the company's 2014 operating income;

International Lead Markets-Australia, Canada, France, Germany, and the U.K.

Collectively, representing approximately 40% of the company's 2014 operating income.

High Growth Markets-China, Italy, Poland, Russia, Korea, Spain, Switzerland, and the Netherlands. Collectively representing approximately 10% of the company's 2014 operating income; and

Foundational Markets and Corporate-These representing potential to operate under a largely franchised model; corporate activities represented with this segment<sup>3</sup>.

Greater than 80% of restaurants are franchised. Globally, approximately 57% are 'conventional franchisees.' Approximately 24% are licensed to foreign affiliates or developmental licensees. Approximately a little over 18% of restaurant locations are company-operated<sup>3</sup>. McDonald's net income has decreased from \$4.5 in 2015 to \$4.7 in 2014 (see Exhibit 2). Exhibit 2: Balance Sheet

Consolidated Balance Sheet

| <i>In millions, except per share data</i>   | <i>December 31, 2015</i> | <i>2014</i>        |
|---|--------------------------|--------------------|
| <b>ASSETS</b>   |                          |                    |
| <b>Current assets</b>   |                          |                    |
| Cash and equivalents  | \$ 7,685.5               | \$ 2,077.9         |
| Accounts and notes receivable   | 1,298.7                  | 1,214.4            |
| Inventories, at cost, not in excess of market   | 100.1                    | 110.0              |
| Prepaid expenses and other current assets   | 558.7                    | 783.2              |
| <b>Total current assets</b>   | <b>9,643.0</b>           | <b>4,185.5</b>     |
| <b>Other assets</b>   |                          |                    |
| Investments in and advances to affiliates   | 792.7                    | 1,004.5            |
| Goodwill  | 2,516.3                  | 2,735.3            |
| Miscellaneous   | 1,869.1                  | 1,744.6            |
| <b>Total other assets</b>   | <b>5,178.1</b>           | <b>5,484.4</b>     |
| <b>Property and equipment</b>   |                          |                    |
| Property and equipment, at cost   | 37,692.4                 | 39,126.1           |
| Accumulated depreciation and amortization   | (14,574.8)               | (14,568.6)         |
| <b>Net property and equipment</b>   | <b>23,117.6</b>          | <b>24,557.5</b>    |
| <b>Total assets</b>   | <b>\$ 37,938.7</b>       | <b>\$ 34,227.4</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                          |                    |
| <b>Current liabilities</b>  |                          |                    |
| Accounts payable  | \$ 874.7                 | \$ 860.1           |
| Income taxes  | 154.8                    | 166.8              |
| Other taxes   | 309.0                    | 330.0              |
| Accrued interest  | 233.1                    | 233.7              |
| Accrued payroll and other liabilities   | 1,378.8                  | 1,157.3            |
| <b>Total current liabilities</b>  | <b>2,950.4</b>           | <b>2,747.9</b>     |
| <b>Long-term debt</b>   | <b>24,122.1</b>          | <b>14,935.7</b>    |
| <b>Other long-term liabilities</b>  | <b>2,074.0</b>           | <b>2,065.9</b>     |
| <b>Deferred income taxes</b>  | <b>1,704.3</b>           | <b>1,624.5</b>     |
| <b>Shareholders' equity</b>   |                          |                    |
| Preferred stock, no par value; authorized – 165.0 million shares; issued – none                 |                          |                    |
| Common stock, \$.01 par value; authorized – 3.5 billion shares; issued – 1,660.6 million shares | 16.6                     | 16.6               |
| Additional paid-in capital  | 6,533.4                  | 6,239.1            |
| Retained earnings   | 44,594.5                 | 43,294.5           |
| Accumulated other comprehensive income  | (2,879.8)                | (1,519.7)          |
| Common stock in treasury, at cost; 753.8 and 697.7 million shares                               | (41,176.8)               | (35,177.1)         |
| <b>Total shareholders' equity</b>   | <b>7,087.9</b>           | <b>12,853.4</b>    |
| <b>Total liabilities and shareholders' equity</b>   | <b>\$ 37,938.7</b>       | <b>\$ 34,227.4</b> |

Source: McDonald's 2015 Annual Report

## Discussion

As of 2014 McDonald Corporation employed 420,000 employees, world-wide. Most restaurant locations offer a varied menu for breakfast, lunch and dinner. Breakfast items include egg and sausage McMuffins, McGriddles, biscuit and bagel sandwiches and hot cakes. Lunch/dinner items the following select sandwiches: Big Mac,

cheeseburger, hamburger, salads, French fries, wraps, Chicken McNuggets, Fillet-o-Fish sandwich and Quarter Pounder with cheese. Other items include soft-serve cones, sundaes, McCafé beverages along with other beverages, such as coffee and milk. The company has a very strong brand awareness among consumers. While no baby food items may be offered, the company has food items for anyone ranging from children (happy meals) to adults<sup>4</sup>.

### **Competition & Direct Global Rivals**

McDonald's competes with a variety of competitors on a national and international basis. Competition is on the basis of price, conveniences, service, menu variety, and product quality. Varied medium of food delivery businesses also compete with McDonald's, such as but not limited to kiosks, "quick-service" establishments, street stalls, cafés, home delivery/take-away businesses, cafeterias, and full-service restaurants. The 'informal eating out (IEO)' establishments serves as the primary competitive segment for McDonald's. Coffee shops and convenience stores are rivals to McDonald's as well<sup>4</sup>.

Many of McDonald's competitors are privately held companies with limited public information available, such as IN-N-OUT Burger in USA (southwest/pacific region), which started in 1948. The company is not public, owned by family. According to the company's website ([www.in-n-out.com](http://www.in-n-out.com)), \$10.50 per hour is the starting salary. Another employee benefit is the offering of part and full-time benefits, free meals, paid vacations, 401K plan and flexible work schedules to accommodate school and other commitments. As of 2015, the company operated 300 restaurant locations. Additional 'burger boutique' locations all serve as local competitors to McDonald's. The establishments (IN-N-OUT) have a very simple menu consisting of three hamburgers (double-double, cheeseburger, and hamburger) and also serve French fries, shakes and soft drinks.

### **Restaurant Brands International, Inc. (Burger King/Tim Hortons)**

As of December 1, 2015 the company owned/operated approximately 19,000 (14,000 Burger King) locations in about 100 countries, worldwide. Approximately 100% of the Burger King restaurants are franchised. Restaurant Brands International, Inc. was founded in 1954 and is headquartered in Oakville, Canada. The company is second, behind McDonald's, as a world-leader in quick-serve restaurants. The company also owns Tim Hortons restaurants<sup>5</sup>.

Burger King ([www.bk.com](http://www.bk.com)) serve a range of burgers and chicken sandwiches, salads, French fries, onion rings, coffee and frappes, breakfast sandwiches (croissant'wich®), biscuit and muffin sandwiches. Additionally, restaurants offer pancakes, French toast sticks, and beverages. Burger King serves as a direct burger competitor to McDonald's.

Yum Brands, Inc. (Kentucky Fried Chicken/Pizza Hut/Taco Bell)  
Yum Brands, Inc., formerly known as TRICON Global Restaurants, Inc., changing its name in May of 2002 to Yum Brands, Inc. was founded in 1997 and is headquartered

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<sup>4</sup> Annual Report McD.

<sup>5</sup><http://www.rbi.com/en/about-us> (burger king).

in Louisville, Kentucky. The company operates in five segments: YUM China, YUM India, the KFC Division, the Pizza Hut Division and the Taco Bell Division. As of October 20, 2015, it operated approximately 41,000 restaurants in approximately 125 countries. Taco Bell and Kentucky Fried Chicken serve as direct rivals, where Pizza Hut is primarily take-out or delivery, serving pizza, pasta, wings, and beverages<sup>6</sup>.

Taco Bell ([www.tacobell.com](http://www.tacobell.com)) started in 1954 as Bell's Drive-in and Taco Tia in the San Bernardino, CA area. The company went public in 1970 with 325 locations. In 1978 owner Glen Bell sold 868 Taco Bell locations to PepsiCo, Inc. and became a PepsiCo shareholder. In 1990 Taco Bell rolled-out their 59¢, 79¢, and 99¢ menu items. In 2014 Taco Bell launched Taco Bell Mobile Ordering and Payment Application. As of 2015 Taco Bell offered home deliver in select markets using DoorDash. The new Tacobell.com offers desktop ordering and The Feed. Menu items include tacos, burritos, taco salads, cheese quesadillas, cinnabon, soft drinks, coffee and freeze drinks.

Kentucky Fried Chicken ([www.kfc.com](http://www.kfc.com)) operates approximately 18,000 locations in 115 countries, globally. Locations offer chicken, various chicken sandwiches, various sides, such as corn, seasoned potato wedges, biscuits, green beans, cole slaw and mashed potatoes and gravy.

### **Starbucks Corporation**

Starbucks Corporation ([www.starbucks.com](http://www.starbucks.com)) is a roaster and retailer of specialty coffee with a net income as of September of 2015 of \$2.75 billion. Founded in 1985 and based in Seattle, Washington, the company operates approximately 23,043 locations, globally. The locations are represented in the Americas, Europe, Middle East, Africa, China and Asia Pacific. Products range from coffee to tea, water and juices. Locations offer a variety of pastries, breakfast sandwiches, and lunch items. Sandwiches offered include hot or cold, but are not burgers or made-to-order, fresh. Starbucks reported a net income of \$2.75 billion in September of 2015 as compared to Yum Brands, Inc. \$1.29 billion in December of 2015.

### **Subway**

Subway ([www.subway.com](http://www.subway.com)) is the world's largest submarine sandwich chain with more than 44,607 restaurants in 111 countries and over 250,000 employees, which is privately held. In the United States alone there are about 27,051 locations followed by 3,246 locations in Canada. The restaurant offers both hot or cold subway sandwiches, wraps, and salads. Also offered are cookies and soft drinks. Customers have their choice of vegetables and cheese, etc., where the sandwich is prepared when ordered. According to IBISWorld, Subway's 2015 U.S. segment achieved \$11.9 billion sales in 2015, down from \$12.2 billion in 2014.

### **Wendy's**

Wendy's ([www.wendys.com](http://www.wendys.com)) has over 6,500 restaurant locations, globally, with approximately 90% being in the United States. Approximately 85% of the restaurants are franchised. The company also owns an 18.5% share of Arby's sandwich business, as a result of having sold about 84.5% to Roark Capital Group in 2011. In 2014, the company earned \$2.1 billion in global revenues and employed about 37,000 employees. Over 2013-2014, Wendy's sold approximately 418 company-owned locations to franchises. Conventional menu items resemble what McDonald's and Burger King offer; however, lesser availability of healthy menu options. IBISWorld,

2015 reported Wendy's US segment being \$9.15 billion, up from \$8.98 billion in 2014.

### **Chick-fil-A**

Founded in 1946 ([www.chick-fil-a.com](http://www.chick-fil-a.com)), the company has approximately 1,900 restaurant locations in 42 states and Washington D.C. with interests to expand into the Midwest and Southern California. The privately held and family-owned company achieved nearly \$6 billion in sales in 2014. The company prides itself of achieving 47 consecutive years of positive sales growth. The restaurants are closed on Sundays due to the founder's (Truett Cathy) belief that restaurant operators and employees should rest one day a week for either practical and/or spiritual reasons, giving employees an opportunity to rest, spend time with family and friends, and worship if they chose to do so. Menu items include both healthy and chicken sandwiches/wraps, breakfast sandwiches, desserts, beverages and kid's meal.

### **Domino's, Inc.**

Domino's ([www.dominos.com](http://www.dominos.com)) started in 1960 and has since grown to nearly 10,000 locations (company-owned & franchised), worldwide. The company has store locations in all 50 states and internationally in over 70 countries, representing as the second largest pizza company, after Pizza Hut. Aside from their main menu item, pizzas, locations also offer pasta, chicken bread bowls, desserts, and oven-baked sandwiches. Approximately 40% of its sales derive from digital orders.

### **Risk Factors**

As reported in the 2014 company Annual Report, McDonald's growth strategies consist of four areas of focus: opportunities to drive results serving the customers' favorite food and beverage items; creating memorable experiences; offering unparalleled convenience; and being a more trusted brand. To best ensure success, the company believes they must:

- Continue to innovate and differentiate in all aspects of McDonald's experience in a way that balances value with profitability;
- Reinvest in restaurants while identifying and developing future restaurant sites consistent with growth plans;
- Provide clean and friendly environments that deliver a consistent McDonald's experience and demonstrate a high level of service;
- Drive restaurant improvements to ensure optimization during peak mealtime hours; and
- Manage the complexities of McDonald's restaurant operations.

The company feels these are critical elements in order to ensure business success. Without proactive anticipations of addressing consumer preferences may cause the company to suffer. Other risk factors, such as food safety, is a primal concern. Foodborne illnesses is one area the company focuses to manage. For example, in 2014 food quality issues were discovered at a McDonald's supplier in China. As a result, sales were affected in China, Japan and other certain markets as a result. Customer trust needed to be rebuilt. Any such threats associated with food and beverage safety could affect the brand, reputation and profits of McDonald's<sup>4</sup>.

### **Internal Trials and Strategies in 2016**

McDonald's Corporation leadership has realized that conventional methods of operating on a global basis cannot assure steady profits. On indication of this has been declining profits and increased competition the company has experienced. Early 2016

the company introduced a popular strategy of introducing breakfast all-day. Another offering has been the McPick 2 for \$5.00. A recent Fortune Magazine article (April 22, 2016) reported U.S. sales rose 5.4%, representing as the third strongest increase after two years of slumping profits. CEO Easterbrook attributed changes made to the menu and offering of 'good deals' as two reasons customers have returned. Globally, sales have improved for McDonald's, increasing 6.2%. Select markets, such as Britain, Australia, and Canada were highlighted as increasing markets, while the company's second largest (after USA) market, France, continues to experience profit challenges. Strategically, McDonald's is continuously trialing new promotions and offerings across markets. What's been clear is the company wanting to shed unpopular menu items, which would simplify its offerings. Many boutique hamburger outfits in the United States, for example, offer simplified menus, such as In-N-Out. The all-day breakfast menu offerings has been a success in the United States. Perhaps the company may consider similar trials, globally.

Select product trials continue for McDonald's in 2016, such as offering the signature Big Mac sandwich in two sizes. Columbus, Ohio and Dallas, Texas reportedly are two markets McDonald's has experimented with offering the "Mag Jr." and "Grand Mac" sandwiches, prices ranging from \$2.39-\$2.59 for Mac Jr. and \$4.89 for Grant Mac. A trial of offering all-you-can-eat French fries was reported as being trialed at a Missouri franchise. It remains to be seen what the effects of such may be, nationally, or even perhaps, globally, as McDonald's has been known to 'export' products from one market to another in the past.

### **External Factors**

General economic factors may affect any business. McDonald's Corporation is aware of profitability being affected as a result of economic situations on a global basis. Disposable income levels, changes in consumer spending habits, unemployment, wages, credit availability, inflation and taxation all serve as possible factors affecting business.

Supplier relations and availability may serve as a potential threat to profitability on a global basis. The products McDonald's serves originate from suppliers around the world. Shortages, disruptions, price increases, and delivery delays may adversely affect profits. Information technology and/or network security may also serve as possible threats to profits. Any increase or limitation of offerings to items, such as food and beverage and physical building operation needs, such utilities and office products can adversely affect the business.

Effectively managing the business to remain free of litigation is important. Management of both McDonald's and external entities' intellectual properties can also affect costs and profits. Specifically, the use of existing trademarks and copyrights is important. Steps taken to protect and/or register trademarks and copyrights, etc. can potentially negatively affect the business. Changing tax laws and IRS pending or future adjustments also serves as a threat to McDonald's in addition to possible increases of tax rates and laws or the value of world currencies. Additional threats that may affect the company include a shortage of workforce, increase in real estate costs, and other possible government regulations<sup>4</sup>. While McDonald's net income has decreased in 2015 as compared to 2014, so has cash flow from investing activities (see



Exhibit 3).

### Fast Food Restaurant Industry Analysis in the United States (IBISWorld, 2015)

As reported in IBISWorld, the products and services segmentation of the restaurant industry is led by burgers (see Figure 1). What remains to be seen is if the burger segment will shrink or maintain as a result of a growing change in consumer preferences towards healthier foods. Fast food restaurants have prospered due to such factors as lower food prices and convenience. Various restaurant eateries serve as competitors of fast food outlets. Fast food eateries have relied on lowering prices in order to compete and lure consumers by also offering a faster and more convenient medium of obtaining food, such as drive-thru or delivery. In order to lure more health-conscious consumers, fast food outlets, such as McDonald's have offered more healthy food options, such as salads and fruits.

| Consolidated Statement of Cash Flows                    |                               |                   |                   |
|---|-------------------------------|-------------------|-------------------|
| In millions   | Years ended December 31, 2015 |                   |                   |
|   | 2015                          | 2014              | 2013              |
| <b>Operating activities</b>                             |                               |                   |                   |
| Net income  | \$ 4,529.3                    | \$ 4,757.8        | \$ 5,585.9        |
| Adjustments to reconcile to cash provided by operations |                               |                   |                   |
| Charges and credits:                                    |                               |                   |                   |
| Depreciation and amortization                           | 1,555.7                       | 1,644.5           | 1,585.1           |
| Deferred income taxes                                   | (1.4)                         | (90.7)            | 25.2              |
| Share-based compensation                                | 110.0                         | 112.8             | 89.1              |
| Other   | 177.6                         | 369.5             | 26.8              |
| Changes in working capital items:                       |                               |                   |                   |
| Accounts receivable                                     | (180.6)                       | 27.0              | 56.2              |
| Inventories, prepaid expenses and other current assets  | 44.9                          | (4.9)             | (44.4)            |
| Accounts payable  | (15.0)                        | (74.7)            | (60.7)            |
| Income taxes  | (64.4)                        | 3.3               | (154.4)           |
| Other accrued liabilities                               | 383.0                         | (14.3)            | 11.9              |
| <b>Cash provided by operations</b>                      | <b>6,539.1</b>                | <b>6,730.3</b>    | <b>7,120.7</b>    |
| <b>Investing activities</b>                             |                               |                   |                   |
| Capital expenditures                                    | (1,813.9)                     | (2,583.4)         | (2,824.7)         |
| Purchases of restaurant businesses                      | (140.6)                       | (170.5)           | (181.0)           |
| Sales of restaurant businesses and property             | 554.2                         | 489.9             | 440.1             |
| Other   | (19.7)                        | (40.9)            | (108.2)           |
| <b>Cash used for investing activities</b>               | <b>(1,420.0)</b>              | <b>(2,304.9)</b>  | <b>(2,673.8)</b>  |
| <b>Financing activities</b>                             |                               |                   |                   |
| Net short-term borrowings                               | 589.7                         | 510.4             | (186.5)           |
| Long-term financing issuances                           | 10,220.0                      | 1,540.6           | 1,417.2           |
| Long-term financing repayments                          | (1,054.5)                     | (548.1)           | (695.4)           |
| Treasury stock purchases                                | (6,099.2)                     | (3,198.6)         | (1,777.8)         |
| Common stock dividends                                  | (3,230.3)                     | (3,216.1)         | (3,114.6)         |
| Proceeds from stock option exercises                    | 317.2                         | 235.4             | 233.3             |
| Excess tax benefit on share-based compensation          | 51.1                          | 70.9              | 92.6              |
| Other   | (58.7)                        | (12.8)            | (11.8)            |
| <b>Cash provided by (used for) financing activities</b> | <b>735.3</b>                  | <b>(4,618.3)</b>  | <b>(4,043.0)</b>  |
| <b>Effect of exchange rates on cash and equivalents</b> | <b>(246.8)</b>                | <b>(527.9)</b>    | <b>58.7</b>       |
| <b>Cash and equivalents increase (decrease)</b>         | <b>5,607.6</b>                | <b>(720.8)</b>    | <b>452.6</b>      |
| <b>Cash and equivalents at beginning of year</b>        | <b>2,077.9</b>                | <b>2,798.7</b>    | <b>2,335.1</b>    |
| <b>Cash and equivalents at end of year</b>              | <b>\$ 7,685.5</b>             | <b>\$ 2,077.9</b> | <b>\$ 2,798.7</b> |
| <b>Supplemental cash flow disclosures</b>               |                               |                   |                   |
| Interest paid   | \$ 640.8                      | \$ 573.2          | \$ 532.7          |
| Income taxes paid                                       | 1,985.4                       | 2,388.3           | 2,546.0           |

### Exhibit 3: McDonald's Cash Flow

China has been viewed by restaurant companies as a prominent growing market for eateries to enter and grow. The fast food environment is expected to grow at an annualized rate of 2.0% over the next few years, until 2020. The slow growth may be a result of consumers more aware of the health effects of greasy, fatty-foods. Possible livestock and agricultural ingredients' price fluctuations can affect profits as restaurants may find it difficult to pass the expenses onto consumers.

The fast food industry has exponentially been increasing steadily over the last 5 years until 2015. The industry heavily relies on consumer confidence levels. One possible

result of an elevation of consumer confidence may mean eating out more. One success factor for eateries has resulted from 'fast-casual' restaurants that do not offer table service, but do offer high ambience and quality of food experienced stronger growth over the last five years. Such outfits as Chipotle and Five Guys, which offer gourmet meals, have stolen market share from McDonald's and Burger King. Fast-casual restaurants are increasing, such as Shake Shack's initial public offering (IPO) in January of 2015. As a result and to remain competitive, avoiding loss in market share, Yum Brands, Inc. Kentucky Fried Chicken opened up a KFC Eleven restaurant in Louisville, KY in 2013 offering unique product-lines exclusive to this location, such as rice bowls and salads not traditionally offered by KFC. McDonald's and Taco Bell have also experimented with fast casual-concept offerings at select locations. McDonald's is testing gourmet burgers and solo McCafe similar to Starbucks offering some breakfast items, sandwiches, salads and coffee, similar to items Starbucks offer<sup>7</sup>. Overall, the slow domestic growth opportunities have shifted focus to growing overseas. Such expansions have contributed to higher international sales, such has been the case for McDonald's. Yum Brands, Inc. has focused on China for expansion, while reportedly having faced some setbacks due to increased competition; however, the move is expected to pay-off over the long-term.

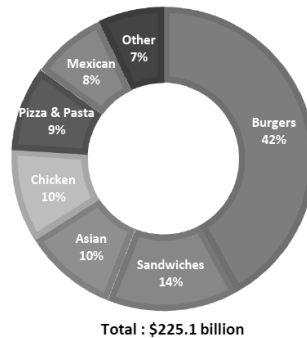
Consumers are restricting their spending to lower priced items, which limits price increases. Also, fluctuating minimum wages across the world also affects profits. Wages constitute as one of the major expense items for a restaurant/business. Over the span of 5 years until 2015, wages are estimated to increase at an annual rate of 2.4%, which is lower than revenue projected increases.

Industry revenue growth is expected to be flat, where projected eateries will be competing on price. The national unemployment rate is expected to decline, while consumer confidence level is projected to increase. Companies that will offer unique and healthy food products are projected to experience the greatest growth in the industry. Akin McDonald's, companies may be looking to expand their line of beverage lines to include more coffee-based beverages and smoothies, as they represent a quick way to increase revenues as a result of low-cost ingredients.

Intense competition may remain, which may limit the opening of new locations. Burger King's franchise-only strategy is expected to be cost-saving given the high capital investment required to open new locations. Over the next 5 years to 2020, the number of new companies is expected to increase at an average rate of 1.4% per year, according to IBISWorld Industry report, 2015.

Overall, the restaurant industry is considered as mature. Companies offering table service and high quality food items are increasing their market share over conventional locations, such as Burger King and McDonald's. Technology changes is expected to be moderate; however, use of Internet and smartphones to engage customers is expected to increase. The use of technology may help reduce labor costs and food waste. Social media, such as Twitter and Facebook are used to increase brand awareness.

Figure 1: Products & Services Segmentation, 2015



Source: Adapted from IBISWorld (2015, November)

Many companies can classify into multiple segments as they may offer chicken and burgers. The products and services segment represents \$225.1 billion. Breakfast is becoming a significant component of restaurant eateries; however, restaurants are classified within the segment based on their primal offerings by IBISWorld, 2015. While burgers represent the largest portion of the segment, it is also one of the most competitive among the segments. Over the past 5 years traditional burger chains have struggled, finding consumers preferring more gourmet burgers, with emphasis on quality.

Chicken has been a popular segment due to perceived health benefits. Burger restaurants have been adding chicken wraps and salads to their menu to combat against possible consumer unrest about unhealthy fast-food. The chicken segment is led by Chick-fil-A, having only a fraction of restaurants compared to KFC. Success has been attributed to delivering menu offerings, such as milkshakes, ice cream, wraps and breakfast items.

There are over an estimated 40,000 Asian restaurants in the United States. There is a limited number of Asian chain restaurants, with Panda Express being the largest in the United States with approximately 1,500 locations. One challenge for this segment includes the perception of Asian food equating to lower-cost food, which challenges restaurants to increase prices. This category comprises multiple ethnic cultures and regions, such as the Middle East, East Asian (Korea, Chinese, and Japan), Southeast Asian (Vietnam), Thailand and Malaysian, and South Asian (Sri Lankan, Bangladeshi and Indian, among others. As consumers in the United States are becoming more open about trying other ethnic foods, this category has experienced growth. An increase in global travel and exposure to various cultures has promoted this segment's popularity, too. California and New York remain among the most popular states with Asian food.

Mexican food and restaurants alike are well represented in the southwest regions of the United States. The growing immigration into select states, such as California and Texas has supported this segment's growth. The approximate population of Mexicans in the United States is 17%. While Taco Bell has been performing well, Chipotle, a fast-service and high-quality eatery has been the best performer based on sales in the

United States.

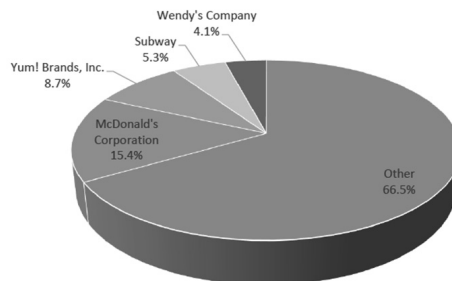
Pizza and Pasta segment includes competitors, such as Pizza Hut, Dominos, Papa John's, and Roundtable Pizza. Arranged pick-up/delivery can be scheduled, while some may offer all-you-can-eat buffet, such as Roundtable Pizza, for lunch. Menu items range from pizza to pasta, wings, and salads.

The elements of time and money coupled with health are all determinants of success in the restaurant industry. Consumer confidence levels and higher disposable income levels encourage more spending. Demanding work/life schedules may limit time to cook, whereby fast-food becomes a timely alternative. Companies focusing on price, quality and offering a healthy range of items may expect increased revenues.

In proportionate to population/demand, the southwest regions of the United States has the most franchised locations followed by the west. Much emphasis shall be on real estate factors, such as availability of location and price for restaurants. This is to include lease/rental costs and utilities. Wage requirements and work policies, both nationally and internationally, will continue to play a significant role in opening new locations and profitability for restaurants.

Competition is expected to remain fierce, while indirect competition from sources, such as supermarkets is expected to increase. One-stop-shopping, where consumers can pick-up something hot or cold to eat along with attending to shopping needs will remain significant. The industry also has internationally-based competitors that typically enter middle to upper-class markets, such as, but not limited to New York, Chicago, and Los Angeles. A sample includes Pret A Manger (based in the United Kingdom) and Freshii (from Canada).

Figure 2: Market Share



Source: Adapted from IBISWorld (2015, November)

#### McDonald's Growth Opportunities

McDonald Corporation has been experimenting various business strategies. There are over 150-plus countries in the world; McDonald's currently has representation in more than 100 of them. The economic situations may differ across different countries, but quick food still remains as an alternative to home cooked meals. The fictional character of Ronald McDonald and the 'golden arches' still remain as recognized symbols, globally. The company has 15.4% of the fast food market share (see Figure 2). With lowering unemployment rates, more people are working, which creates opportunities to earn more money. As a result of working, lessens the time to cook,

which support healthy, fast-food as an option. Alternative work space is an option for restaurants to capitalize on, where mobile workers are in need of restroom breaks, Internet service, and meals. Additionally, family entertainment for children may occur with McDonald's playgrounds during mealtime.

There is over 60% of 'other' market share available to capture within the restaurant industry. There may be opportunities to offer McDonald menu items at various locations and venues, such as, but not limited to public and private locations. Birthday and company parties are just a sample of opportunities available to capture additional business. Quality is not only limited to food and beverage taste, but presentation of location, services and the food/beverage packaging. Years ago the world famous Big Mac among other McDonald sandwiches, was served in a brownish Styrofoam packaging. Same was the case for other sandwiches served at McDonald's. The decision to transfer to biodegradable packaging was attributed to alternative packaging being less harmful to the environment. Presentation of packaging, cups, and locational improvements to better serve various customers ranging in age and purpose, such as students, working professionals, children, etc. is another opportunity to capture additional interest/consumers.

The opportunity to focus on the customer at the age of birth to the 'golden years' presents a possible commitment to a restaurant for decades. Growing with not only the meal needs at various life-cycles, but also professional/personal needs with location, such as offering Internet (which is currently offered at many McDonald's locations), workstations, etc. may offer additional opportunities from open to close. Competitor Starbucks captures business from business professionals and students. During academic calendars students often meet for study and/or group learning at Starbucks. Business transactions are often conducted at Starbucks. There are opportunities available for business as a result of increasing operating hours, offering location-services to meet the needs of students and business people, alike. Intense competition and changing consumer needs may be one reason the likes of McDonald's and Yum! Brands, Inc. both achieved negative quarterly revenue growth (see Exhibit 4).

Exhibit 4: Direct Competitor Comparisons of McDonald's and Yum! Brands, Inc. with Industry

|                           | McDonald's | Yum! Brands, Inc. | Industry |
|---------------------------|------------|-------------------|----------|
| Market Capitalization:    | 108.79B    | 30.82B            | 874.12B  |
| Employees:                | 420,000    | 505,000           | 4.70K    |
| Quarterly Revenue Growth: | -0.04      | -0.01             | 0.09     |
| Revenues:                 | 25.41B     | 13.10B            | 423.34B  |
| Gross Margin:             | 0.39       | 0.27              | 0.31     |
| EBITDA*:                  | 8.91B      | 2.90B             | 65.47M   |
| Operating Margin:         | 0.29       | 0.16              | 0.08     |
| Net Income:               | 4.53B      | 1.29B             | N/A      |
| Earnings per Share:       | 4.80       | 2.92              | 0.64     |
| Price/Earnings:           | 24.68      | 25.83             | 24.34    |
| Price/Earnings/Growth**:  | 2.33       | 1.64              | 1.45     |
| Price/Sales:              | 4.22       | 2.38              | 1.68     |

Industry: Restaurants

\*(Earnings before interest, taxes, depreciation, and amortization)

Source: Adapted from [www.finance.yahoo.com](http://www.finance.yahoo.com)  
 The Future for McDonald's Corporation

In order to continue to achieve global business success McDonald's clearly understands that it needs a plan. CEO Easterbrook has shared one goal by 2018 is to franchise 90% of its locations, up from 81% currently. The company is aware consumers will be the subjects to judge the business as it reformulates key areas of its business. Fiscal 2015 concluded disappointing for McDonald's. To help recover from financial losses the company has focused on experimenting with such business strategies as customized burgers at select locations and providing table service, while offering breakfast served all-day, which began as a trial and has since become a constant availability. McDonald's will need to focus on its branding as the company continues to reposition itself and conform to changes in the industry. McDonald's is aware that in order to continue growing and being successful it must implement new business strategies. Moving forward into 2016 and beyond, McDonald's Corporation will be looking to save \$300 million annually by fiscal year ending 2017. One cost-cutting initiative is franchising some 3,500 restaurants over the next four years and possible staff cuts at headquarters. The proposed wage increases across all operations and not just company-owned outlets may be cutting into profits. Additional entrants into the quick-serve restaurant arena continues to threaten McDonald's. CEO Easterbrook has prioritized the company having plans to 'galvanize against competitive threats.' Prepare a 3-year strategic plan to help CEO Easterbrook and McDonald's Corporation overcome threats and capitalize on opportunities<sup>8</sup>.

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<sup>6</sup><http://finance.yahoo.com/q/pr?s=YUM+Profile> (YUM).

<sup>7</sup>[http://www.huffingtonpost.ca/2015/12/09/mccafe-standalone-locations-canada\\_n\\_8752188.html](http://www.huffingtonpost.ca/2015/12/09/mccafe-standalone-locations-canada_n_8752188.html).

<sup>8</sup><http://money.cnn.com/2015/05/04/investing/mcdonalds-turnaround-plan-steve-easterbrook/index.html> (Final Future Paragraph).

<sup>9</sup><http://www.thestreet.com/story/13135948/1/3-things-mcdonalds-new-ceo-just-admitted-about-the-golden-arches.html> (final future paragraph).