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McDonald's Seeks Way to Keep Sizzling

By JANET ADAMY

OAK BROOK, Ill. -- [McDonald's Corp.](#) has been one of the world's most successful big companies during this recession. On Monday, the fast-food giant posted February sales results that most chains would envy.

But the worsening global economy has McDonald's preparing for a more difficult year. The strengthening U.S. dollar is knocking the wind out of McDonald's profit-generating power. While Americans are flocking to McDonald's as a cheap alternative to sit-down meals, that's not the case in some parts of Europe and Asia.

How McDonald's tackles these challenges falls to Ralph Alvarez, a Cuban-born former accountant who is McDonald's president and chief operating officer. Mr. Alvarez, 53 years old, has helped the Golden Arches extend a six-year success streak with his focus on improving restaurant operations, adjusting prices and keeping down costs. He is widely expected to succeed Chief Executive Jim Skinner once the 64-year-old retires.

Mr. Alvarez is pruning gas-guzzling cars from the company fleet, pressing media buyers to negotiate lower advertising rates and putting the brakes on building new outlets on street corners where nearby development shows signs of weakness. At the same time, he's overseeing big investments in the most promising aspects of McDonald's business -- coffee drinks that compete with Starbucks and improved drive-through windows that increase sales and efficiency. To check on operations, he disguises himself in a baseball cap and sunglasses and visits McDonald's outlets unannounced.

In February, McDonald's same-store sales world-wide increased 5.4%, after stripping out a calendar shift from last year's leap year. By that measure, U.S. same-store sales rose 6.8%, while sales in Europe increased 4% and rose 4.1% in the region that includes Asia Pacific, the Middle East and Africa.

Strong U.K. sales were partially offset by Germany, while gains in Australia and Japan were somewhat offset by China. The company said Monday that a significant decline in currencies in Eastern Europe will hurt first-quarter results. In places like Russia, such weakness is making it more expensive to import ingredients. About two-thirds of McDonald's revenues come from outside the U.S.

While McDonald's was one of only two Dow Jones Industrial Average stocks that ended 2008 with a gain (the other was Wal-Mart Stores Inc.), its shares have crept downward this year. Shares of

McDonald's rose 20 cents, or 0.4%, to close at \$52.32 in 4 p.m. trading Monday. Although cheap prices help draw guests in tough times, Mr. Alvarez insists the economic downturn hasn't been a boon for the company.

"It's such a misnomer that we're doing well because of that," he said in an interview at his office here last month.

Mr. Alvarez's high profile at McDonald's is partly the result of a shift in the way the company thinks about succession planning. Earlier this decade, McDonald's lost two chief executives when one died of an apparent heart attack and the other stepped down to fight cancer and died shortly after. Since then, managers at all levels have made grooming their successors a top priority, with McDonald's directors devoting one board meeting each year to succession planning.

Mr. Skinner says he has no plans to retire in the near future, and Mr. Alvarez downplays suggestions that he's the top candidate to succeed him. "There's a bunch of us that could do that job" once Mr. Skinner retires, Mr. Alvarez says. Franchisees, analysts and other people close to the company agree Mr. Alvarez appears the mostly likely successor.



McDonald's has been on a roll since 2003, when, to get out of a slump, it halted rapid expansion and instead focused on improving the food, service, atmosphere and marketing at its existing outlets. The result has been a broader menu that features items ranging from salads topped with poblano peppers to a Southern-style chicken biscuit served at breakfast, and restaurants adorned with leather seats and flat-screen television sets. McDonald's 32,000 outlets -- 14,000 of which are in the U.S. -- now feed 58 million customers a day, or two million more than a year ago.

As the global economy worsens, executives are trying to prepare for what Mr. Alvarez calls the "what ifs" that come with an uncertain environment. After several years of developing higher-priced products, such as specialty salads, the company is putting more emphasis on creating and marketing lower-priced items, and it's implementing computerized systems in more outlets that allow

restaurants to adjust prices based on customer demand. In China, some restaurants recently cut the price of certain combo meals at lunch by as much as one-third.

Behind the effort is an increased focus on examining reams of customer data measuring everything from whether customers are trading down to smaller value meals or dropping Cokes from their orders to exactly how much they're willing to pay for a Big Mac. "I love numbers," Mr. Alvarez says. "I think data used well really tells a story."

Raul Alvarez, as he was named at birth, was born in Havana and left with his family at age 5 after Fidel Castro took power. He grew up in Miami wanting to be a physical-education teacher. An uncle encouraged him to get an accounting degree, and after working for the firm now known as Deloitte, he landed a job as a budget analyst for Miami-based Burger King.

In the late 1980s, Mr. Alvarez twice tried to get hired at McDonald's, "but I couldn't get in the door," he says, since the company mostly promotes from within. He went on to work for rival [Wendy's International Inc.](#)

In 1994, McDonald's hired and trained him for a post as a regional manager, partly, he says, because the company wanted more Hispanics in management jobs. While it takes most McDonald's managers decades to climb through the ranks, Mr. Alvarez ascended to the No. 2 spot by 2006. Associates cite his competitive nature and focus on tangible results as reasons he's excelled.

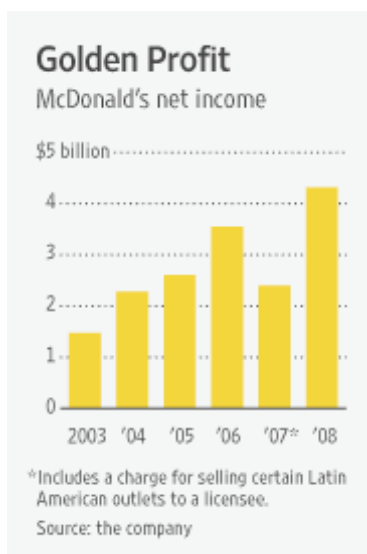
By last year, soaring commodity costs were putting intense pressure on McDonald's. Restaurant franchisees complained that the high cost of beef, cheese, buns and other ingredients, combined with a rising minimum wage and high energy costs, had flattened their profits. Some owners balked at making expensive investments to expand their beverage offerings to include lattes, smoothies and bottled drinks.

To find solutions to problems like these, Mr. Alvarez spends most of his time traveling to McDonald's outlets in 118 countries, sometimes staying at the homes of executives or franchisees. The night before his official meetings, he slips on a baseball cap and sunglasses so he can visit McDonald's restaurants incognito to see whether service is fast enough in the drive-through window and employees are being friendly, says Tom Moroch, owner of an advertising agency that creates campaigns for McDonald's.

"He's really the eyes and ears for me around the world," says Mr. Skinner, who is also the company's vice chairman. Unlike Mr. Skinner, a caustic Iowa native who sometimes bristles in the limelight, Mr. Alvarez appears more at ease in front of large groups of workers and is known for having a warmer personality.

"When Jim became the CEO, part of his style was to get good people in the job and give them room to run," McDonald's Chairman Andrew McKenna says.

Despite the high commodity costs, McDonald's posted strong profits last year.



Over the summer, Mr. Alvarez met with each department at headquarters and went through their spending seeking to trim costs. He told workers to cut travel and instead hold meetings at the company's Hamburger University in suburban Chicago. Employees who get company cars could no longer select gas-guzzling vehicles, and those that already had them must pay a higher personal-usage fee.

Toward the fall, when McDonald's began negotiations for the following year's TV advertising spots, Mr. Alvarez heard that networks were cutting deals with auto makers for lower rates because the car companies faced dire straits. "The hair on my back went up right away," he says. Mr. Alvarez says he pressed the company's media buyers to seek better rates. "We should not allow somebody else to get a competitive advantage," he says, adding that McDonald's was successful in getting better deals.

By October, Mr. Alvarez and 30 other company leaders had finalized a three-year strategic plan. But as the global financial crisis spread, the group reconvened in December.

Managers decided they must make sure no restaurants shrank the size of products in order to cut costs. They looked more closely at the markets near the 1,000 outlets McDonald's plans to build this year and

decided not to go through with some of them if, for instance, a nearby shopping center had fallen through.

By the start of this year, Mr. Alvarez was pressing managers across the world to more closely monitor labor, food and utility costs. One of his top concerns is that stores will reduce staffing so much that they will end up being understaffed for peak periods. As monthly financial reports came out, Mr. Alvarez would sometimes rise at 3 a.m. for sessions where he studied the numbers and reviewed them with managers world-wide.

"It's a feeling that self confidence is our worst enemy," says Denis Hennequin, president of McDonald's Europe.

In the U.K., Mr. Alvarez directed management to examine changes in consumer buying patterns at McDonald's, customer traffic for competitors and general economic data such as projected unemployment rates. Instead of looking at the data twice a year, as U.K. managers had been doing, they're now examining it every two weeks. Taking their cues from the data, McDonald's began running more advertisements for its Little Tasters menu, which includes a small burger on a ciabatta bun that sells for £1.49, or about \$2.

Meanwhile, Mr. Alvarez is pushing more restaurants to implement systems that allow each location to price items more in line with demand. During previous periods of inflation, Mr. Alvarez says, restaurants simply raised the price of large sandwiches by 10 cents and the price of small sandwiches, french fries and drinks by five cents. Now, one restaurant may boost the price of an item by three cents while another only adds a penny.

Don Armstrong, a franchisee who owns 14 outlets in Oregon, says he's more careful about raising prices at outlets in economically depressed areas than at ones in more affluent areas. "It doesn't do you any good to raise prices if you lose customers," says Mr. Armstrong, chairman of a council that represents U.S. franchisees.

McDonald's executives say that promoting lower-priced items and products perceived as a good value will be a top priority this year, and restaurants may have to settle for lower profit margins. But McDonald's franchisees, who operate 80% of the company's outlets, say that's getting more difficult because of rising costs and mandates from the company to buy equipment.

In a meeting with McDonald's management last month, franchisees complained their cash flow was only slightly positive last year -- a disappointment given the company's strong sales. "It's not a sustainable model," says franchisee Reggie Webb.

McDonald's executives say they're adding features that will increase sales. Mr. Alvarez showed off a self-service kiosk where customers can place orders electronically. He recently watched customers use kiosks at a McDonald's in Tours, France.

Mr. Alvarez says a top complaint of French customers about McDonald's is that they feel pressured to order, which keeps some families from coming in. Ordering at a kiosk, he says, "allows them to either control their kids or control their order."

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