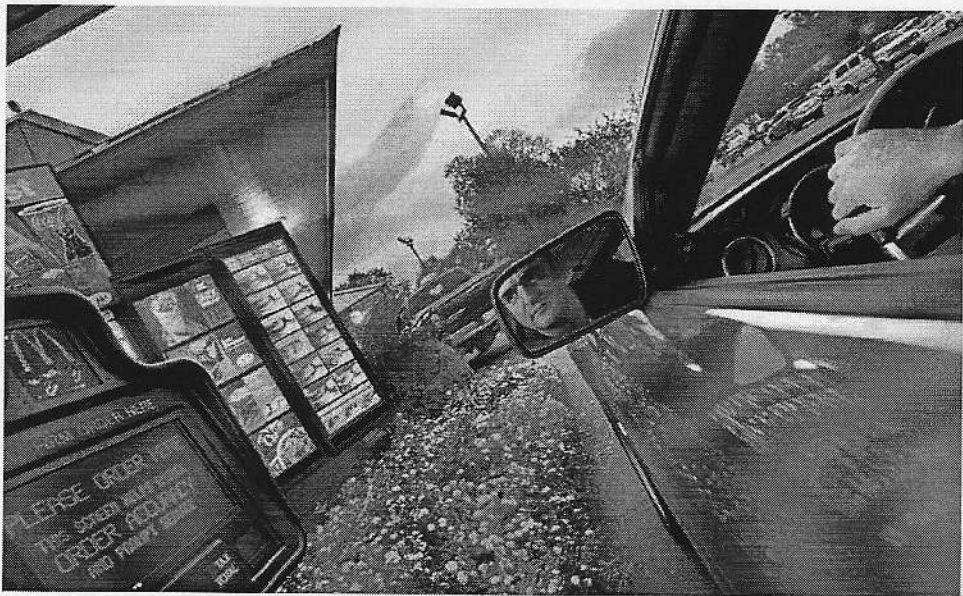


Special Report



McDonald's



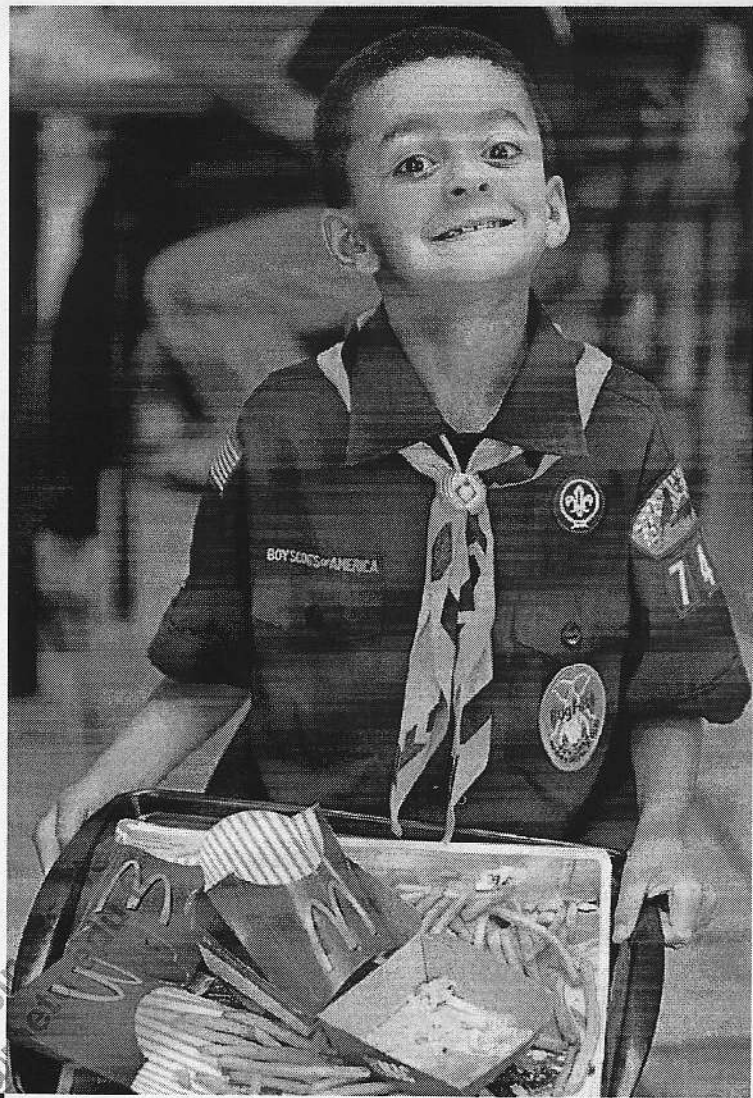
BY MICHAEL ARNDT

PHOTOGRAPHS BY KELLY CULPEPPER

IT IS 3:36 A.M. THURSDAY AT MCDONALD'S IN GARNER, N.C., a bedroom community just beyond the city limits of Raleigh. Although the town's taverns closed more than an hour ago, the last clubgoers are straggling home. Their cars barrel by ones driven by waitresses, commercial cleaners, musicians, nurses, and computer analysts heading home from work. The McDonald's sign, posted high along a commercial strip of big-box stores and chain restaurants, is one of the few still glowing.

Inside the McDonald's kitchen, Julia Diaz is mixing buttermilk biscuit dough by hand in a giant stainless steel bowl, while Silvia Roldan is grilling sausage patties and eggs for breakfast, which begins in 24 minutes. Outside, at the drive-through window, D.C. Chavis is picking up a Premium Crispy Chicken Ranch BLT sandwich and a large order of fries. Chavis, 24, has just clocked out after 12 hours at a nearby food warehouse. He used to pick up an after-work snack at an all-night convenience store or diner. Now he swings by McDonald's at least five times a week for the premium sandwich combo meal or, if it's later, a McGriddle and a side of hash browns. The food is a lot better at McDonald's, he says, adding that the prices are cheaper and the brand is one he trusts. Says Chavis: "I was raised on McDonald's."

McDonald's went 24/7 in Garner in April, 2005, after a push by corporate headquarters to boost profits by extending store hours. Franchisee Fred Huebner had doubts at first. He doesn't

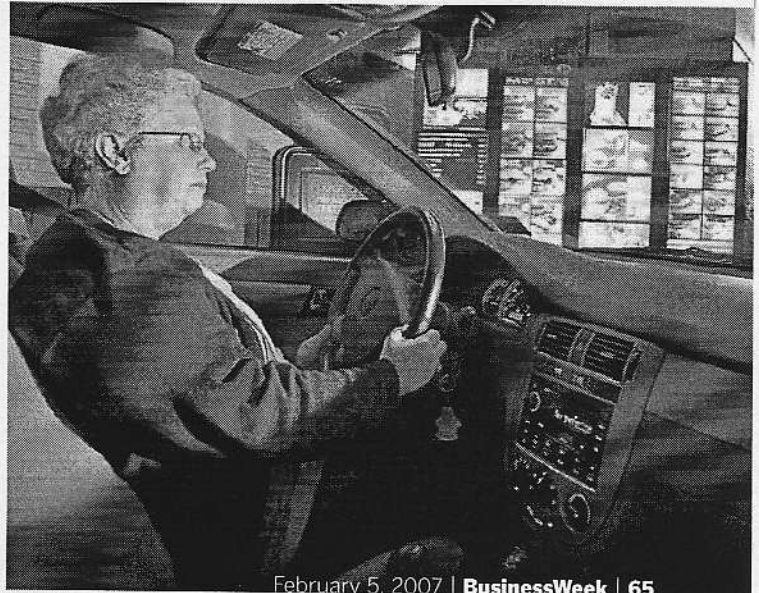


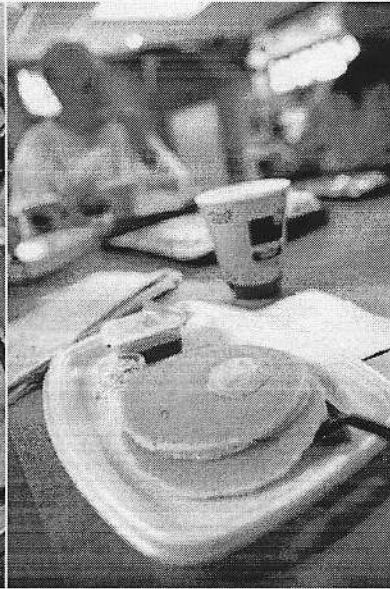
By focusing on the hours between traditional mealtimes, the fast-food giant is sizzling

anymore. By catering to the area's night owls and early birds on U.S. Highway 70, Huebner, who put on his first McDonald's uniform almost 35 years ago, figures he has increased his restaurant's revenue by 4.5%, or \$90,000, over a year. "There are so many customers out there all times of the day," he says. "We have to be out there, too."

Over the course of an average day, 1,500 people—the equivalent of 1 out of every 16 people in the middle-class suburb of 24,095—drive in to the Garner McDonald's. The clientele is every bit as diverse as the town's population. Old-timers joshing with one another over morning coffee. Office workers zipping from the pickup window for breakfast behind the wheel. Repairmen on a midshift break. Mothers taking a breather while their preschoolers scamper in the Play Place. Families ordering dinner in Spanish. And, in caravans, twentysomethings after a night of carousing.

It wasn't always like this. When Ray Kroc launched his first drive-in in 1955, McDonald's was a two-meal place, opening just before lunch and closing not long after dinner. It kept those hours





for the next 20 years. Then, with the national introduction of the Egg McMuffin in 1975, the company turned breakfast into a fast-food meal, too. Now the world's biggest restaurant chain wants to take over the rest of the day. Since 2003 more than 90% of the 13,700 McDonald's in the U.S. have extended their hours beyond the basic 6 a.m. to 11 p.m. day. Nearly 40% operate nonstop, up from 0.5% in 2002. Breakfast is busting out of its old boundaries. It now stretches up to seven hours at many locations, and the company is considering making it an all-day option. Next on the agenda: snack foods and fruit smoothies for between-meal refuelings and late-night munchies.

The all-hours offensive reflects a strategic shift at McDonald's. For most of its history, growth meant one thing: more locations. And until the late 1990s it worked.

cial results by squeezing more from the ones it has. The new focus has forced it to rethink every element of its business, from product development and marketing to restaurant design and technology. In the process, McDonald's, which seemed out of touch with consumers just a few years ago, has attempted to realign itself with contemporary tastes.

The changes are obvious at the newly refurbished McDonald's in Garner. The dark wood and glass display case of its McCafé—think Starbucks—tempts customers with its desserts and sandwich wraps. Sheryl Crow and Norah Jones play on the restaurant's piped-in soundtrack, while flat-screen TVs show cable news. Amid live plants and wrought-iron magazine racks, four leather lounge chairs round out a den. Hand-blown light fixtures cast a warm glow. And that trademark McDonald's smell of burgers and fries? There isn't even a whiff of it. The restaurant's air system whisks kitchen odors outside before they can seep into the dining room. This is a place set up to make customers comfortable. The service is still fast, but the meal itself no longer has to be.

McDonald's is, of course, much more than an ordinary fast-food chain. It is a cultural mirror. The changes at the burger company reflect the evolution of American eating habits. Traditional meals are getting pushed and pulled into nontraditional hours as longer drive times and hours on the job combine with busier after-work schedules to take up more and more of the day. The idealized vision of a family gathering for a home-cooked dinner seems as dated as *Father Knows Best*. These days, with the typical American eating out five times a week, according to market researchers at NPD Group in Port Washington, N.Y., the dining room is likely to be a car seat in the family SUV. "People don't sit down and have an organized meal today," observes Marlene Schwartz, director of research and school programs at the Rudd Center for Food Policy & Obesity at Yale University. "Eating is something you check off."

McDonald's is not responsible for the way Americans eat. But the inescapable fact is that it serves an enormous number of them. The \$21.6 billion company now feeds a record 27 million people every day, 1 million more every year since 2003. As No. 1, it is likely to remain the top target for the food police.

Mickey D's Round-the-Clock

Lunch used to be McDonald's busiest time. But now that breakfast stretches to six hours or longer, the day's first meal is No. 1. Here's the breakdown of sales at a typical restaurant in Garner, N.C.

BREAKFAST

5 a.m. to 11 a.m.

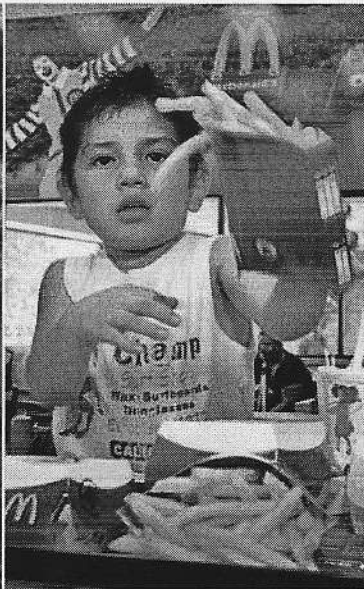
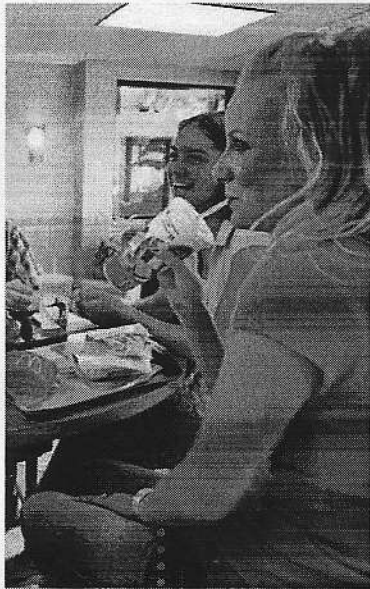
30% of the day's sales*

The McGriddle, a pork patty between two pancakes, is McDonald's biggest hit in a generation

*Garner franchise

Like a juggernaut, McDonald's rolled over the competition and across the nation, opening hundreds of outlets each year and cranking out a run of hit products. Then the company reached a saturation point. While overall revenue kept climbing, the new sites stole customers from existing locations. Margins and same-store sales slid into 2002, reflecting diminishing returns on the \$1.2 billion a year that the company was plowing into new restaurants during this period. By spending so much time on real estate, recalls James Skinner, a 35-year veteran who was promoted to chief executive in late 2004, "we had lost our focus. We had taken our eyes off the fries."

Today the mantra is "better, not just bigger." Instead of building more restaurants, McDonald's is increasing its finan-



Although McDonald's now sells salads, its two most popular foods, the double cheeseburger and fries, are high in fat and sodium. McDonald's also seems out of sync with more recent health concerns. Wendy's has quit using trans fats in its fries and chicken, and KFC plans to purge its deep fryers of these oils in the spring, making New York City's recent trans-fat ban a nonissue for them. McDonald's says, though, that substitutes spoil the taste of its fries. "From a public health point of view," observes Michael Jacobson, executive director of the Center for Science in the Public Interest, "more people going to McDonald's means poorer health."

Meanwhile creative and aggressive competitors, including Starbucks, Wendy's, Burger King, and Dunkin' Donuts, see the same eating trends, and they're targeting many of the same customers. Starbucks Corp. and Wendy's International Inc. both are testing hot breakfast sandwiches and planning national rollouts in the next year or two, in a direct challenge to McDonald's most profitable business.

Despite the competition, McDonald's is, at the moment, triumphant. After posting its first-ever quarterly loss in 2002, it has logged 45 consecutive months of U.S. sales increases, including a 6.9% pop in December. It now commands nearly half the U.S. hamburger market—three times more than either Wendy's or Burger King—and has such a lead that even its fastest-growing rivals may never catch up. McDonald's share price, up 25% in the last year, is trading at a seven-year high of nearly \$45. John Glass, a restaurant analyst with CIBC Worldwide, sees only further gains from McDonald's new strategy. "People's days are longer," he notes. "So are McDonald's restaurant hours. This is a natural evolution to capture more business."

Skinner is all optimism. Hosting breakfast at the McDonald's restaurant inside the corporate headquarters in Oak Brook, Ill.,

the 62-year-old CEO says: "We've learned. We've evolved. We believe we've cracked the code in the United States." It's a simple secret, actually: Americans like to eat all day long. Having conquered lunch and dinner, here's how McDonald's plans to win the rest of the day.

EARLY MORNING: AT 5:50 a.m. on Thursday in Garner, CNN is on the restaurant's two wall-mounted flat-screen TVs. In the back of the dining room, a few retirees are drinking coffee. The first to arrive, David Scott, a former Raleigh police officer, had driven 14 miles to wait outside for the doors to open at 5 a.m. McDonald's is this group's social center. The men, joined sometimes by a few wives, are there every morning, each taking his usual chair.

Meantime, Julie Brown has driven up in her Hummer to fetch breakfast for her daughter, Jasmine, and the rest of the high school swim team while they practice. Brown's order includes more than \$30 worth of Egg McMuffins, sausage breakfast biscuits, egg-and-sausage bagels, hash browns, orange juice—and a peach-mango smoothie for herself. Brown, 37, loves the wider variety of foods and drinks available at McDonald's today. "I used to have to go to five different places for everyone. I'd have to go to one place to get bagels. Smoothies at another. Coffee at another," she says. "Now I can get everything here, all at once."

Thanks to icons like the McMuffin and the McGriddle—a pork patty between two syrup-infused pancakes introduced in 2003—McDonald's dominates mornings. It owns a quarter of the \$25 billion market for fast-food breakfast. In fact, morning is now the most important part of the day for McDonald's in the U.S., accounting for a quarter of domestic revenue and nearly half of profits. Those numbers roughly approximate the breakdown in Garner, a fairly typical store, where breakfast accounts for 30% of the store's \$2.5 million in annual sales. Lunch is 24%, afternoon 15%, dinner 15%, and overnight 16%. The single hour that generates the most revenue annually at the store, about \$200,000, is the traditional lunch period, from noon to 1 p.m.

LUNCH

11 a.m. to 2 p.m.

24% of the day's sales

The most popular noontime sandwich is the Dollar Menu's double cheeseburger

AFTERNOON

2 p.m. to 5 p.m.

15% of the day's sales

U.S. chicken product sales, including the new Snack Wrap, total \$4.5 billion, up from \$2 billion in 2002

SpecialReport



For all of its success at breakfast, management is confident that there's still plenty of room to grow in the morning. Why? Because it is still the meal that people in the U.S. are least likely to eat away from home. For every restaurant breakfast, the typical American orders 2.5 lunches and nearly 2 dinners, according to NPD Group. And new products attract new business. Since McDonald's rolled out a darker and stronger coffee last March, same-store sales at breakfast have increased 7.5% in the U.S., on a pace with Starbucks. To build on this momentum, the company is testing two more breakfast items: a Southern-style fried chicken biscuit and Newman's Own iced coffee.

A bigger breakthrough may come out of the company's experimental restaurant in Romeoville, Ill. Today the standard McDonald's kitchen has room for one built-in grill. As a result, restaurants have to stop serving breakfast in the late morning so crews can begin sizzling up burgers for the rest of the day. The company is working on a potential solution to this conundrum: a portable electric unit that would permit kitchens to serve breakfast all day long.

It's hard to believe that the pace in Garner could get much quicker. At the height of mealtime rushes, the place routinely serves 90 cars an hour, vs. 77 two years ago. Crew chief Todd Marsh plucks hash browns from the fryer rack and steps back to the pickup window to hand out another breakfast. He resets the wall-mounted timer that had been digitally ticking off the seconds since the order was placed. Sixty-five seconds. Store manager David Mardenborough, who charts these times hour by hour, beams.

Maintaining McDonald's mastery of the morning will not be easy. Starbucks has begun making hot breakfast sandwiches and plans to offer them to 6,500 U.S. outlets by the end of 2008. After testing its own hot breakfast sandwiches at 120 locations, Wendy's is contemplating rolling out breakfast to its 6,300 restaurants in the U.S. and Canada. Dunkin' Brands Inc. has announced plans to triple its doughnut chain, to almost 15,000 shops, while adding new products like breakfast pizza to a line that already includes its knockoff of the Egg McMuffin.

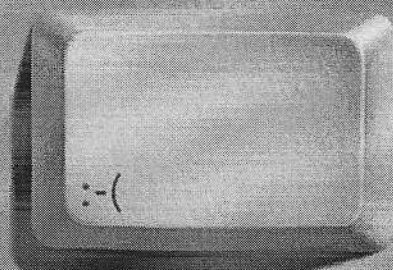
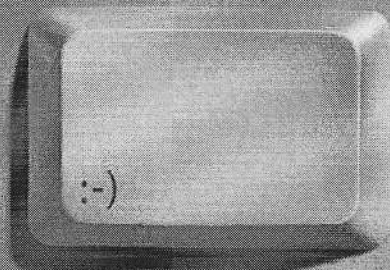
Many restaurant analysts and consultants are betting on McDonald's to win the breakfast battle. Even 22 years after introducing the Croissan'wich, they note, Burger King Holdings Inc. has never come close to matching McDonald's sales

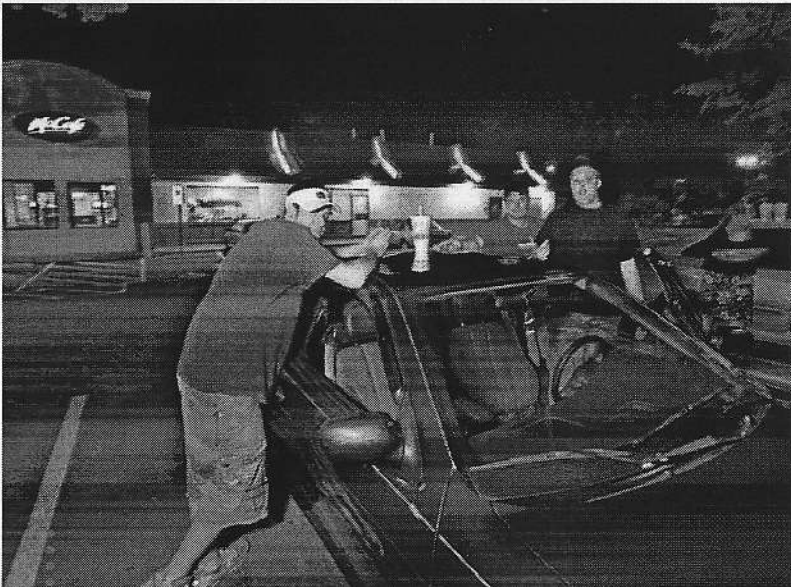
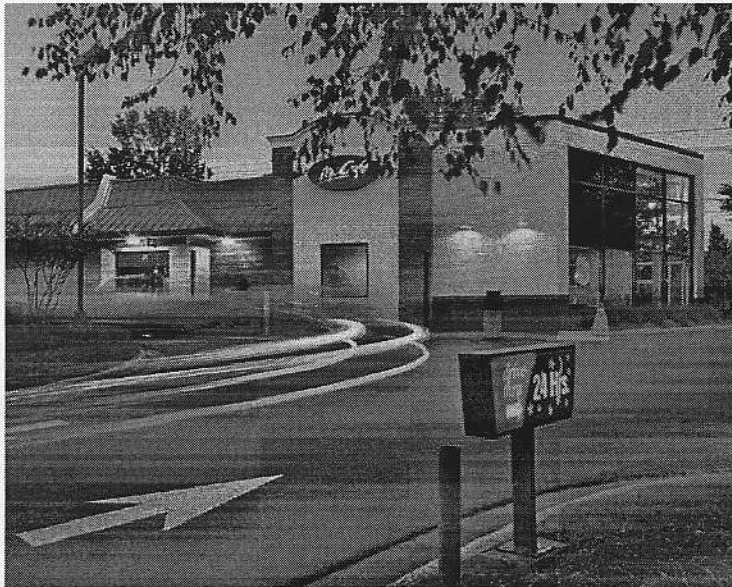
DINNER

5 p.m. to 8 p.m.

15% of the days sales

With fewer families eating dinner at home, McD's sells more beef, chicken, salad greens, and apples than any other food company





volumes at breakfast. "The breakfast habit is the hardest habit to break," says CIBC's Glass. "We're promiscuous at lunch and dinner, but we tend to be monogamous at breakfast."

AFTERNOON: MIDDAY SNACKERS MAY be the least loyal. They enjoy temptations ranging from Starbucks Frappuccino and fruit smoothies at Jamba Juice to Big Gulps at 7-Eleven. To shove its way to the front of this crowd, McDonald's has had no choice but to reinvent both its products and its store design.

The company's most important new enticement for these customers is its \$1.29 Snack Wrap, a strip of deep-fried chicken with cheese, lettuce, and a squirt of sauce tucked into a folded tortilla. Before it was introduced in August, McDonald's considered every detail in creating the wrap. Because so many consumers are on the go, the company needed something people could hold easily in one hand while gripping a steering wheel in the other. Since salsas would drip, McDonald's opted for thicker ranch dressing. To further guard against spills, it went with a larger, 8-inch-diameter tortilla. The planning is paying off: The company has attributed strong same-store sales growth in the last five months in part to the Snack Wrap. To keep the momentum

going, the company is introducing a new version, with either fried or grilled chicken and honey-mustard dressing, in late January.

Don Williams got hooked on the Snack Wrap after his first one. It is 3:27 p.m. Thursday, and Williams, 54, a self-employed electrician, has stopped by in between jobs for something to tide him over until he can have dinner at 9 p.m., after his wife gets home from work. He ceased eating McDonald's burgers some time ago to cut down on his cholesterol. But while the Snack Wrap is hardly low-fat, he figures he eats one three times a week. "I like this little quick sandwich," he says. "It gives me enough energy to carry me for another two or three hours."

One reason McDonald's is creating crowd-pleasers again is that it has become much more rigorous in product development. New ideas are generated in the company's food studio in Oak Brook by a staff of three dozen chefs, food technicians, and market researchers. Potential new products get tried out first in one market for six weeks. The company doesn't just assess sales. It also monitors costs and margins and judges how easy a new product is to prepare by a crew that is constantly changing. (The annual

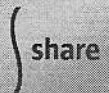
**LATE NIGHT/
EARLY MORNING**
8 p.m. to 5 a.m.

16% of the
day's sales

Nearly two-thirds of its
business in the U.S. is done
at drive-through windows

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turnover among cooking crews companywide exceeds 100%, although it is about 70% for the Huebners.) If the concept passes muster, McDonald's expands its test cell to 800 to 1,000 restaurants in four to six markets.

Skinner and others say this wasn't standard operating procedure before the company embarked on its comeback in 2003. Back then the company was in all-out expansion mode, opening outlets somewhere in the world at the rate of one every 4½ hours. Ralph Alvarez, 51, McDonald's president and

it has different zones for different customers. There's the den with its wall-mounted flat-screen TV, a Play Place for kids, and a large high-top table in the middle of the store, behind a frosted glass partition. There are also decorative upgrades throughout, such as bronze sculptures and a fountain.

Their redesigned restaurant also boasts a McCafé, a separately demarcated space inside the store that sells espresso-based coffees and pastries. It is one of 45 McDonald's in the U.S. testing specialty coffees. The McCafé in Garner doesn't

have a separate seating area, but it has its own counter and a display case showing off baskets of muffins and platters of desserts, such as \$2.50 tuxedo brownies and cheesecake at \$3.25 a slice. In addition to \$3.10 cups of latte and cappuccino, the Garner McCafé offers wraps and smoothies.

Kim Borum is impressed by the restaurant's new design touches. It is 12:45 p.m., and she is leaving after joining her husband, Bennie, for lunch. The restaurant had always been conveniently located for the Borums, but she says they now eat at McDonald's two or three times a week. "The ambience of a place makes a big difference in how people feel about it," she says. "If you walk into a place and you see that it's decorated from 1975, the first thing you're going to

think is old. And that's a bad thing to think about food."

LATE NIGHT: THE HUEBNERS are a genuine McDonald's success story. The couple, who met at McDonald's in 1977, paid \$400,000 for their first store in 1986. They bought their 12th for \$1.8 million in September. Their business now generates more than \$25 million in annual revenue. They employ 710 people, including their sons, John and Frederick.

Despite their track record, the Huebners were hesitant about staying open all night. McDonald's had begun urging U.S. franchisees to extend their store hours in 2003. It offered \$1,000 per site to cover in-store promotional signs and local advertising if they went all the way and never closed. To drum up overnight traffic, headquarters also started dispatching tricked-out RVs to concerts, sports events, and bars to pitch twentysomethings with coupons and contests.

Two months after they decided to go round-the-clock with the drive-through service, Fred Huebner says, his doubts seemed confirmed. Although the outlet already had an after-hours crew that stayed as late as 1:30 a.m. to clean up and another that clocked in at 4:30 a.m. to set up for the new day, the extra hours boosted expenses for payroll and utilities. Even

THE McPLAYBOOK



Now That's Fast Food

To pump up business 24/7, McDonald's has sped up its new-product introductions. Here's its secret recipe:

Make it easy to eat

McDonald's does more than half its business at drive-through windows. That means it needs snacks and meals that can be held in one hand while the other is on the steering wheel.

Make it quick

It's called fast food for a reason. McDonald's tests all new products for cooking times so customers don't have to wait even a second longer than absolutely necessary.

Make it easy to prepare

McDonald's restaurant crews turn over entirely within a year, on average. To maintain consistency amid this churn, tasks must be simple to learn and repeat.

Make what the customers want

McDonald's prowls the market for new products and then spends months in carefully monitored field tests to ensure that people will buy its new concoctions.

chief operating officer, recalls spending six to seven days of his 20-workday month on real estate. That left scant time for things like consumer research. Little surprise that many new products bombed. Case in point: the McShaker salad. Introduced in 1999, it came in a large plastic cup designed to fit a car's cupholder. Problem: Nobody could figure out how to eat a salad while driving. "We were more willy-nilly then," says Skinner. "The attitude was, we'll make it and they'll buy it."

Today the company is adding just 50 to 100 sites a year in the U.S. The shift has freed up billions of dollars in capital, which has enabled McDonald's to quadruple its dividend to \$1.2 billion over the past four years, ramp up its share buybacks, and hand out generous subsidies to its 2,400 franchisees to refurbish their stores. Since 2003 the chain has remodeled more than 3,000 sites. Now it plans to convert every location over the next 20 years from its 1980s mansard roof design to a more upscale exterior of earth-red brick and glass accented by a yellow swoosh at the roofline. These new stores could cost up to \$1.5 million apiece to build. To help franchisees, the company has agreed to chip in as much as \$600,000 per site.

Fred Huebner and his wife, Doris, redid the Garner store last year. Before, the dining room had been a single space, with fluorescent lights and hard-backed chairs and booths. Today

with a limited menu, the store was losing money on the overnight shift. But by the third month the new shift was turning a profit. These days an extra 50 to 60 cars, on average, pull into the drive-through lane every night. The Huebners believe the move probably has helped increase traffic during "shoulder hours," too, since customers no longer wonder whether McDonald's is open.

Elizabeth Williams, a pharmacy technician at a CVS store, is a new McDonald's regular. It is 2:53 a.m., and she is returning home from a bar in Raleigh. A few times a week, before she goes to bed, she says, she stops after an evening out for her nighttime snack: a Premium Grilled Chicken Ranch BLT sandwich, medium fries, and a 32-ounce sweet tea.

Amid the barhoppers, there are also people like Steve Smith. A 45-year-old truck driver, Smith pulls in at 3:15 a.m., on his way to work, for a Quarter Pounder combo meal. He has been eating at McDonald's since he was a kid, and he still comes in at least three times a week. Before the restaurant was open all night, he says, his options were pretty limited: "I'd eat cereal at the house."

The success in Garner's overnight business speaks volumes about McDonald's role today. Although it is well known for the

sameness of its food and restaurants, McDonald's is really a lot of different restaurants that cater to a lot of different people. When Huebner started working at McDonald's, there was no breakfast. No Big Mac and no drive-through window, either. Now six of the Huebners' dozen McDonald's are open 24/7, and the rest are open at least 18 hours a day. "Ten years ago we saw every customer as a transaction count," Huebner recalls, "not as a person who needed to use the restaurant in a different way." ■

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INSIDE THE WORLD'S FAVORITE FAST-FOOD COMPANY

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ONLINE: Mayor McCheese speaks. A Q&A with CEO James Skinner.

PODCAST: The story behind the story. Executive Editor John Byrne interviews Senior Writer Michael Arndt.

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Meet You for Lunch, Mom. Usual Place

ANGIE STALLINGS IS BUSY, busy, busy. When she is not working at Smith Elementary School in Garner, N.C., the first-grade teacher is driving her 13-year-old daughter, Sarah, to and from cheerleading and basketball practice, or shuttling back and forth for evening meetings at the Capital Church, or simply running errands. Constantly pressed for time, Stallings says, she brings Sarah to McDonald's at least three times a week for a quick meal.

In restaurant parlance, Stallings is a "heavy user." At McDonald's, the average customer comes in once every week, and 95% of the nation stops in over the course of a year, according to surveys by BIGresearch of Worthington, Ohio, and other consumer research outfits. But it is the heavy user—someone who frequents the same fast-food chain twice a week or more—who really accounts for the steady rise in sales and profit for McDonald's.

In general, the heavy fast-food user is a single man in his mid-20s who has a professional job that pays above-average wages. That's true at McDonald's, too. But the chain's heavy-user population also includes an unusually high number of married women with two or more



young kids at home, professional jobs, and middle-class household incomes. Moms, in other words.

Stallings, 40, says that when she was growing up in Garner, she didn't often go to McDonald's. There weren't many around. Today, there's one a mile from her job. She

STEADY DATE
Sarah and Angie hit McDonald's at least three times a week

became a regular three years ago, when she started teaching and Sarah's schedule filled up, leaving her little time to prepare meals. Usually the pair get food to go from the drive-through lane, but sometimes her husband, Bill, 43, a police officer at the state capitol in Raleigh, joins them inside for a sit-down meal. They eat at another fast-food chain two times a week as well.

For breakfast, they typically have a specialty coffee and maybe a muffin from the restaurant's McCafé section before middle school starts at 7:30 a.m. At lunch or dinner, they mix things up. Often they get double cheeseburgers or McChicken sandwiches from the Dollar Menu, or the \$1.29 Snack Wrap. But lately, Stallings says, she has been ordering more salads, a product that McDonald's added in 2003 specifically for mothers. While Sarah drinks sodas, Stallings also has switched to bottled water. "I do try to make healthy choices," she says.

Nonetheless, Stallings says weight is an issue for both her and her husband. Has she thought about cutting back on McDonald's food? Yes, she says, but she's decided against it. She eats vegetables and fruits at home. She also started exercising two months ago, walking at least one mile four times a week. Judging by her friends and family, she says, she doesn't think they eat more fast food than everyone else. Besides, she doesn't have a spare moment to do more cooking. "The convenience factor is the big selling point, with the busy lifestyle we have."

—By Michael Arndt