

Leadership is not bestowed in perpetuity.

It must be earned every day.

# Creating and Managing our Cycle of Success



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PERFECTION IN GDANSK, POLAND.

Leadership requires more than an unparalleled *past*, and more than accomplishments in the *present*. Leadership requires ongoing growth and innovation to shape the *future*.

McDonald's is the global food service leader. As such, we expect a great deal of ourselves . . . and we are not satisfied with past achievements or the status quo!

To extend our leadership position into the future, management must constantly satisfy customers; seize opportunities presented by constantly changing markets; and continually challenge the McDonald's System to do better.

Management is positioning the System to capitalize on our unique global strengths and is creating change designed to drive growth and increase shareholder value. In the following pages, we will examine some of the changes taking place to fortify our foundation and expand our "cycle of success."

**W**e manage our business as a portfolio of 109 countries in various stages of development and profitability... each creating a cycle of success for long-term growth in sales and profits.

Each cycle of success is built on a foundation of McDonald's management expertise. That expertise extends to the many aspects of our business—from site selection and restaurant development... to restaurant systems and financial management... to the most critical, our customers' experience.

When customers are pleased with their experience, they generate repeat sales, which foster expansion. Both, in turn, create economies of scale that translate into improved profits.

Those profits are then reinvested to deliver greater customer satisfaction through everyday low prices, promotions that add value to their experiences, and improved service. This further stimulates demand and results in sales growth.

Consider that today, within the U.S.—our most developed country—there are 46 McDonald's restaurants for every million people... and they generate \$64 in annual sales per capita. Yet, there are, on average, less than three McDonald's restaurants for every million people in the countries we serve outside the U.S.... and per capita sales are only \$4 each year. That difference represents a world of potential... and so the cycle continues.

The true power of McDonald's cycle of success is that as increasing economies of scale are created by sales growth, levels of profitability increase as well.

For example, our 11 *major* markets—Australia, Brazil, Canada, England, France, Germany, Hong Kong, Japan, the Netherlands, Taiwan and the U.S.—have achieved the kind of market penetration and customer satisfaction that allows us to enjoy meaningful economies of scale today. Together these 11 countries generated 87 percent of our sales and 92 percent of our operating income in 1997.

Another 25 or so countries in our portfolio—nations such as

Austria, New Zealand, Singapore and Sweden—represent profitable, *established* markets that have small populations and are fairly well penetrated.

Another group of about 25 countries is *emerging* markets for McDonald's. These are countries where we have been in operation for more than five years, and have relatively low penetration and significant near-term growth potential. They include Argentina, China, Italy, Mexico, the Philippines, Poland, Spain and Turkey. These countries are expected to grow much more rapidly than our established markets.

And then there are the more than three dozen *new* countries, where in many cases we are actually creating the quick-service restaurant (QSR) industry. These countries include

those that opened within the past five years, such as Bolivia, Ecuador, Egypt, India, Saudi Arabia, South Africa and Ukraine.

We manage this portfolio of global businesses so that *new* and *emerging* countries steadily progress and improve their contribution to operating results. In fact, last year, these countries generated a 68 percent increase in their operating income!

Although we do not expect these countries to maintain this high a level of growth, management

is focused on harnessing our unique strengths to continue the cycle and increase shareholder value.

It's a compelling story of people—franchisees, joint-venture partners, suppliers and employees—working as independent yet interdependent partners in the constant pursuit of a *culture of excellence* and *innovation* in delivering Quality, Service, Cleanliness and Value (QSC&V).

## Our reach encompasses the globe

In a business driven by impulse, convenience is paramount. So, McDonald's has created a worldwide restaurant development system that extends our brand's reach around the globe. We already have a significant convenience advantage over the competition, and our goal is to become even more convenient.

We're able to grow efficiently because of our efforts to lower the cost of building restaurants during the 1990s. We're also



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using new tools that better analyze the customer dynamics of each trading area around the world to select the ideal location and size for each restaurant.

Last year, we increased convenience with the addition of 2,110 restaurants, about 85 percent of which were outside the U.S. We expect to add a similar number this year.

## Universal brand acceptance

McDonald's leadership position is powered by our universal appeal to customers around the world. The Golden Arches are a welcome sign to people from all walks of life and age groups.

We earned our reputation as one of the world's most powerful brands because of our consistency in delivering a customer

experience that has value far beyond good food at a great price. We are a brand people know and trust.

Research indicates that customers feel a unique emotional bond with us – the prospect of a visit to McDonald's triggers a feeling of anticipation and excitement unlike any other restaurant.

Customers come to McDonald's for signature products they can't find anywhere else, such as Big Mac and Egg McMuffin sandwiches, Chicken McNuggets and our World Famous Fries.

In addition, many families visit our restaurants because of our unique ability to put smiles on their children's faces. Happy Meals combine wholesome food with a fun premium; Ronald McDonald is a special friend; PlayPlaces provide safe and fun recreation; and our alliance with The Walt Disney Company brings a little of the magic of Disney into our restaurants.

We differentiate ourselves with teens and adults by asso-

ciating with sports events relevant to them. Affiliations with organizations such as the International Olympic Committee, the National Basketball Association, World Cup Soccer and NASCAR auto racing add to the excitement and enjoyment of their McDonald's experience.

Many also are drawn to McDonald's because of our unflagging support of our neighbors around the world. This begins with franchisee involvement in their communities and extends to Ronald McDonald House Charities.

And for some, the raising of the Golden Arches within their country's borders symbolizes a new freedom or an achievement of economic maturity.

But whatever the reason people visit our restaurants, it's our ability to consistently meet or exceed their expectations that creates loyalty. We call it "Food, Folks and Fun." And we nurture our brand through careful attention to all the details that contribute to our customers' experience.

In 1998, we are extending our brand presence and reaching millions of customers through sponsorship of the World Cup Soccer championships in France and the Winter Olympic Games in Nagano, Japan. As worldwide sponsor of the Winter Games, the McDonald's restaurant in the Olympic Village served our familiar hometown taste to athletes from around the world.

McDonald's is also sponsoring the Dinoland exhibit at Disney's new Animal Kingdom in Florida and has two showcase restaurants on Disney's Orlando property.

## Partners in leadership

Brand McDonald's attracts more than just billions of customers. It attracts quality employees, franchisees, joint-venture partners and suppliers.

More than 5,000 individual entrepreneurs own and operate McDonald's restaurants worldwide.

Maintaining a strong and healthy relationship with franchisees and affiliates has led to our recognition as the leading franchise organization by a number of independent sources.

Our continuing commitment to franchising is embodied in our unique two-way relationship with our diverse family of owner/operators. *Our* success is dependent on *their* success. We have always worked together to make their businesses successful – through menu management, operating system enhancements, training systems, marketing initiatives, purchasing efficiencies, etc.

In return, our franchisees help finance the growth of the brand. They share in the investment in new restaurants and



### JAPAN GROWS WITH VALUE

**McDonald's Japan has been using value to drive sales despite operating in a fiercely competitive market beset by economic problems.**

**By consistently building upon a value program featuring low prices since 1994, Japan has created a value rating that's 25 points higher than our closest QSR competitor.**

**Also, over the past three years, we have added more than 1,250 restaurants using a low-cost development approach, which incorporates small, convenient restaurants.**

**The result: of the major QSRs, we have about 40 percent of the restaurants and about 70 percent of the visits.**

reinvest in existing restaurants. In addition, they contribute their full-time, hands-on efforts to satisfying their customers.

Indeed, franchisees have always been critically important in developing and testing innovations in products, marketing and production. Their customer-focused input and challenging attitude are integral to maintaining McDonald's leadership position.

The men and women who are McDonald's owner/operators represent a real competitive advantage. They are the foundation of our success, and those who do the best job satisfying customers will continue to drive our growth.

## Supplier network

Our global network of suppliers adds yet another dimension to McDonald's leadership position, providing an assured supply of high-quality products at competitive costs.

Our relationship with suppliers encompasses more than typical business arrangements.

They represent a proud tradition of innovation and research that improves our respective operations. More importantly, they provide dedicated production lines devoted to maintaining McDonald's strict food-safety and quality standards.

In many cases, suppliers invest their own capital by establishing operations to support McDonald's continued expansion. They expect that their businesses will grow as McDonald's grows.

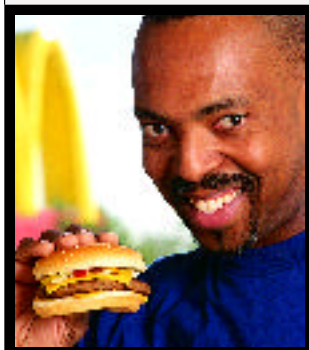
The Coca-Cola Company is a supplier which has contributed to our success around the world. Last year, McDonald's experienced a great loss with the passing of Roberto Goizueta, whose leadership and vision as chairman of Coca-Cola enhanced our relationship. We will miss him.

WE'LL SERVE FOOD  
'MADE FOR YOU'

**Based on years of research and development and extensive testing, we're introducing the next generation of quality food preparation in our U.S. and Canadian restaurants...an innovation that will support our continued industry leadership into the next century.**

**The combination of advanced equipment, sophisticated computer technology and new operating procedures will enable us to deliver food, "Made for You," at the speed of McDonald's.**

**Customers say our food tastes even better with the new system, employees find their jobs are easier, and owner/operators enjoy greater operating efficiencies. We expect the new food preparation system to be in all our U.S. and Canadian restaurants by the year 2000.**



As expansion and increasing sales drive more volume through suppliers' facilities, we'll continue to achieve greater economies of scale. Our ongoing global purchasing and cost avoidance efforts saved the System more than \$1 billion over the past five years, and will continue to allow us to control costs, supporting ongoing value for customers.

## Restaurant support systems

Attention to all aspects of QSC&V has played a major role in making McDonald's our customers' favorite QSR... and "faster, fresher, cleaner" continues to be our goal today.

McDonald's created the QSR business by developing an innovative production system that provided great-tasting food with speed and efficiency. Our more extensive menus in the U.S. and Canada have created a challenge and an opportunity to continue to innovate in this area. That's exactly what we are doing with our new food preparation system.

The drive-thru is another example of our operational expertise. It *seems* like we invented the drive-thru because we optimized the speed and accuracy of drive-thru service like no one else. We also introduced the drive-thru concept to a number of countries.

Now, we are building on our advantage as the fastest QSR drive-thru in America and expanding drive-thru service outside the U.S.

Today, all of our freestanding restaurants in South Africa feature face-to-face drive-thrus, which bring in 55 percent of their combined sales. In Australia, drive-thrus account for 52 percent of sales of restaurants with drive-thrus, and represent the majority of these restaurants' sales growth over the past few years. In



### BUILDING ON OUR LEAD IN DRIVE-THRU SPEED

**Faster drive-thru service means attracting more impulse customers who are looking for shorter lines.**

**If all our U.S. restaurants could add just 12 drive-thru transactions each day, it would equate to an additional \$150 million in annual drive-thru sales for the System! In 1997, U.S. customers spent an average of 20 seconds less in our drive-thru after placing their order.**

**Now, our restaurants are beginning to implement a new, consistent signage package that brands and helps distinguish our drive-thru experience. We're also increasing advertising that accentuates our drive-thru speed, accuracy and convenience.**

Chile, our unrelenting focus on speed and accuracy resulted in a 50 percent increase in drive-thru sales this past year.

Another strength of our restaurant support systems is our training expertise. Simplified crew training techniques make us a leader in developing people's skills and abilities. We are creating the restaurant and entrepreneurial leaders of tomorrow in every country in which we operate.

We are beginning to roll out a "Made for You" food preparation system in the U.S. and Canada, and we are building on our drive-thru advantage. In addition, we are working to develop a competitive advantage in the way we recruit, hire, train and retain the best people to manage our restaurants and serve our customers.

## Menu management

We continually examine our menus around the world in light of changing customer tastes, as well as local customs. In addition to traditional favorites, such as the Big Mac and our golden fries, customers will find special menu offerings in some countries outside the U.S. Examples of this include the popular Teriyaki Burger in Japan and Vegetable Nuggets in India. Also, in a number of markets with large Muslim populations, such as Malaysia and many Middle Eastern countries, our menu is Halal, prepared in keeping with Muslim guidelines.

In the U.S., customers have been telling us that our menu needs some updating. So, our menu management team is revitalizing our core menu.

We are reviewing our entire U.S. menu, and will make some changes this year. We will enhance the taste and price profiles of existing products with the goal of making them "best in class." Also, customers will see special product offerings across the U.S. as we employ local product promotions to meet the needs of different markets.

Internationally, we will continue to ensure our menu appeals to local tastes, lifestyles and cultural differences.

## Leadership means value

We intend to build on McDonald's global food service leadership position to continue delivering value to customers – and shareholders.

As we leverage our experience and expertise in managing our growing portfolio of countries through the cycle of success, we expect to grow our market leadership, resulting in increasing profitability in each country we serve.

This growth, in turn, generates cash flow that we invest in our future. And the cycle begins again.