



VESTED[®] For Success Case Study

McDonald's Secret Sauce for Supply Chain Success

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In matters dealing with suppliers, McDonald's does indeed have a secret sauce. But it has nothing to do with condiments and herbs. The secret sauce of McDonald's success is found within long-term transparent relationships based on the unwavering belief that everyone in the McDonald's "System" can and should win. The deep-seated culture for long-term, win-win relationships with suppliers dates back to McDonald's inception when founder Ray Kroc established a precedent of trust and loyalty. Kroc believed that if the restaurant owner/operators and suppliers succeeded, success would come to him as well. Simply put, McDonald's, its owner/operators, and their suppliers have a Vested interest in helping each other succeed.

The Vision – A System to Be Reckoned With

Kroc's "System" philosophy is often described as a three-legged stool. One leg is McDonald's employees, a second leg is the owner/operators that run the restaurants, and the third leg is McDonald's supplier partners. The stool is only as strong as the three legs. This means that the company employees...the franchise owner/operators ...and the suppliers each support the weight of McDonald's equally. For one to prosper, each must prosper. Kroc's System has stood the test of time because leaders within the System have continued to honor a "System First" approach where solutions always include the consideration, "What's best for the System?"

Kroc's insistence on What's In It for We (WIIFWe) thinking has created the world's most powerful restaurant and supply chain. WIIFWe thinking is ingrained in the DNA of McDonald's, its suppliers and its restaurant owner/operators. The results are staggering. Kroc's System has expanded to over 100 countries and 33,000 restaurants serving over 68 million customers a day and the numbers grow more impressive every day. McDonald's has also set the standards in food quality, safety, and assured supply. Customers know they will get the same consistent food and service from Arkansas to Alaska and from Argentina to Azerbaijan.

And it all started with a vision and philosophy that "None of us is a good as all of us."

Playing By The Rules

Kroc's ultimate desired outcome was profitable, individual stores serving consistent quality products. Finding suppliers who would be partners in the process was critical. Kroc was determined to work with suppliers that had the same long-term thinking.

McDonald's "System First" philosophy stands the test of time. The unique supply chain model is based on an exceptional set of operating principles that create long-term wealth and competitive advantage for the entire System by mitigating costs, preventing safety issues, and producing quality and innovative products that delight customers in a uniquely McDonald's way. The result is increased customer value, better brand health, and stronger business performance.

While individual supplier relationships call for individual solutions, the five Vested Outsourcing rules provide a consistent base for operations and a path to success. McDonald's and its suppliers closely follow the rules to find mutual success under the golden arches.



Rule 1: Focus On Outcomes, Not Transactions

McDonald's consciously decides to NOT conduct business with strategic suppliers on a transactional relationship – but instead insists suppliers have long-term relationships that drive business value and achieve McDonald's key business outcomes. Dan Gorsky, McDonald's Senior Vice President, North America Supply Chain Management, explains, “The System works because all parties build the relationships needed to infuse quality and precision into the supply chain. McDonald's deals with food – which is a very sensitive thing. The supplier takes on the accountability to meet McDonald's exacting standards – which are the highest in the world. The restaurant is able to focus on customer service and not the back door. The System just works – like it's supposed to.”

The secret to making it work is that McDonald's and its most strategic suppliers have a deep commitment to each other to continually deliver value for McDonald's System. Suppliers are confident the McDonald's business is not vulnerable to competitors' price-cutting and arbitrary change. And McDonald's is confident that its suppliers are delivering the best possible value and looking out after McDonald's interests to protect and grow the System.

Pete Richter, President, Global McDonald's Business Unit for Cargill and Chair of the United States Supplier Advisory Council, explains how a long-term relationship founded on high degrees of trust has affected how Cargill interacts with McDonald's. “The trust and confidence in the future means we shift a majority of our resources to driving innovation, quality, supply chain optimization, and investing in future growth initiatives. This takes trust on both sides of the table, but once you establish, it creates amazing leverage vs. the traditional arm's length RFP type approach.”

Rule 2: Focus on the What, Not the How

One ingredient of Kroc's secret sauce was to know McDonald's core competency versus his suppliers. While Kroc had the vision, he knew he needed to rely on the suppliers and restaurant owner/operators for implementation. When it came to suppliers, Kroc – and later Fred Turner – took the helm by setting the standards for the famed QSC&V (Quality, Service, Cleanliness & Value), and, at the same time, entrusting the suppliers to use their brainpower to determine “how” to best meet McDonald's exacting standards.

Suppliers consistently report that while McDonald's is very much tapped into the supply chain, they avoid micromanaging. One supplier summed the McDonald's approach as liberating. “McDonald's is very supportive in setting the tone for all of the suppliers to work better to make the McDonald's System better. McDonald's lives and breathes to help its suppliers be successful. It seems simple – it's easy to talk about... but hard to do.”

Today, innovations to reduce costs, improve service, or even create new products for the menu are commonplace among McDonald's suppliers. “McDonald's relies on us to constantly question how we can do things better for the System. In today's environment, sustainability and cost



reductions are very important to McDonald's," explains Ed Sanchez, CEO and Chairman of Lopez Foods.

Rule 3: Agree On Clearly Defined & Measurable Outcomes

While food safety and quality are at the top of what McDonald's measures with suppliers, it's only part of the picture. In 2004, McDonald's Senior Leadership team led an effort to revitalize McDonald's core business objectives and create "Plan to Win." The Plan to Win outlines four key supply chain priorities that drive value for McDonald's System and ultimately the customers eating at McDonald's. Today, McDonald's and its suppliers align their supply chain operations to the Plan to Win priorities

McDonald's Plan to Win is a strategic blueprint that helps all parties in the System focus on the core drivers of McDonald's business. McDonald's objective of Plan to Win is to keep the McDonald's brand relevant and meet the evolving needs of consumers in a dynamic business environment. The customer-focused Plan concentrates on being better, not just bigger. It provides a common framework for global business while it still allows for local adaptation.

The Supplier Performance Index is an in-depth evaluation tool used by McDonald's and its suppliers to assess levels of success. Typically, the SPI covers six categories – management, System First, Assured Supply, Quality Systems, Innovation, and Predictable Competitive Pricing. The scores are secondary to the conversation that ensues. The SPI leads to insight, calibration, alignment and benchmarking.

Rule 4: Pricing Model/Incentives for Cost/Service Trade-Offs

The pricing system comes back to the concept of the three-legged stool. McDonald's, store owner/operators and suppliers each must secure a profitable, long term financial picture – one that keeps the company first and, as such, secures stable futures for all.

The pricing protocols themselves are highly transparent and contain the variables to help all parties understand the business. The goal is optimization across the System. The protocols were developed to help show tradeoffs on the total costs. Shifting suppliers can save a penny, but the finished goods could end up costing more based on location and transportation. McDonald's pricing protocols try to reduce the total cost – not the price. It is a transparent approach that works with suppliers to dig into the overall cost structures while preserving supplier margins.

Another McDonald's goal is to ensure price stability for the restaurants. Frequent changes to menu price result in owner/operator worry about the price of beef or profit pressure. For this reason, McDonald's and suppliers usually revise pricing protocols every 1-3 years based on the category and the region. When pricing is revisited, it is not done in the conventional vicious cycle of bidding and deal renegotiation. Suppliers don't worry about the security of their business or profitably – but rather spend their energy aligning pricing protocols that provide a competitive advantage for the System and remain fair for all three legs of the stool.



Pricing disputes are rare. McDonald's commitment and long-term view makes suppliers comfortable about not fighting over a penny when they know there is likely a nickel in the future. Simply put – it is neither in McDonald's nor the suppliers' best interest to focus on the lowest price or the natural short-term fluctuations in the market.

Rule 5: Govern For Insight, Not Oversight

McDonald's and its suppliers do business the old-fashioned way – with a handshake instead of a formal agreement. When you have a “no contracts” philosophy with suppliers, values matter when it comes to governance, or as Kroc wrote, “The basis for our entire business is that we are ethical, truthful, and dependable. It takes time to build a reputation. We are business people with a solid, permanent, constructive ethical program that will be in style...years from now even more than it is today.”

McDonald's uses a peer-to-peer relationship between supplier and McDonald's for each level – from operational to executive. The peer-to-peer alignment is a proactive approach to managing the business. To McDonald's – suppliers are part of the planning and execution of their Plan to Win. It's not just business – it's personal.

To manage the process and ensure a proper rhythm of the business, McDonald's initiates communication through multiple tools that provide 360-degree feedback in both formal and informal settings. These include monthly metrics reports, quarterly business reviews, site visits, ad hoc and social gatherings, formal and informal supplier events, and the SPI.

Providing a meaningful voice to suppliers is accomplished through Product Category Councils, comprised of suppliers of the commodity, plus representatives from the owner/operators' association and McDonald's corporation. The objective is to establish an open debating culture that struggles with important issues and, ultimately, writes business models and strategies for a certain commodity. It is a working group, committed to the advancement of the System and achieving the Plan to Win.

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Together, McDonald's, its owner/operators, and its suppliers have created a System to be reckoned with—a System that continues to set records after 50 years. Many have credited McDonald's with transforming the food industry. But ask anyone at McDonald's and they will tell you they could not do it alone. The trust in the System inspires collaboration unparalleled in other supplier relationships that drive process and product innovations regularly.

When you look back at McDonald's success – the results are simply staggering. In 2011, Fortune Magazine named McDonald's the No. 10 Most Admired Company in the World, No. 1 among all companies for Management Quality, “Global Competitiveness,” “Use of Corporate Assets,” and No. 2 among all companies for “Best Long-Term Investment.”

The list of awards goes on and on.



Acknowledgments

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About the Authors

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The University of Tennessee is highly regarded for its Graduate and Executive Education programs. Ranked #1 in the world in supply chain management research, researchers have authored seven books on the Vested business model and its application in strategic sourcing.



We encourage you to read the books on Vested, which can be found at most online book retailers (e.g., Amazon, Barnes and Noble) or at www.vestedway.com/books.

For those wanting to dig deeper, UT offers a blend of onsite and online courses including a capstone course where individuals get a chance to put the Vested theory in practice. Course content is designed to align to where you are in your journey ranging from Awareness to Mastery. For additional information, visit the University of Tennessee's website dedicated to the Vested business model at <http://www.vestedway.com/> where you can learn more about our Executive Education courses in the Certified Deal Architect program. You can also visit our research library and download case studies, white papers and resources. For more information, contact kvitasek@utk.edu.



* Prerequisites for *Creating a Vested Agreement* class are:

Five Rules, Is Vested Right?, Getting Ready, and the Vested 3-Day Executive Education Course



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