CHAPTER EIGHT

Franchising and McDonald's

The onset of widespread franchising unfolded in the midst of profound changes in the economic and social life of the United States. The phenomenon brought another big jump in entrepreneurial opportunity, decentralized decision making, and consumer power after the middle twentieth century.

Modern franchising combined a centrally defined concept with decentralized execution. The decentralized organization proved to be an extraordinarily flexible way to place decision making at the spot where the best information to resolve particular problems lay. The management talent and financial clout of big business complemented the knowledge, personal drive, and sweat equity of the local operators. In that sense, it was a real milestone in the evolution of American business. It was also completely unforeseen.

That is not unusual in the history of business. Practically nobody predicted the sudden appearance of retail innovations such as department stores, mail-order houses, chain stores, supermarkets, or shopping malls. In retrospect, these formats filled a

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new societal need as the purchasing power of Americans and their living patterns changed; they also brought with them some questionable values and practices. So it was with franchising.

The Economic and Social Context of Franchising

During the 1970s the 30-year trend of high economic growth that began with World War II began to slow down. Perhaps the most important reason for the decrease in growth was the sudden increases in the price of petroleum in 1973 and again in 1979. These "oil shocks" resulted in a barrel of oil in 1980 costing about 12 times what it had in 1970, in inflation-adjusted terms. The price increase led to an average annual rise in the consumer price index of 8.2 percent between 1973 and 1983, the highest rate for any ten-year period in American history. (The consumer price index dropped to 3.8 percent from 1983 to 1993, then to less than 2 percent for the remainder of the century.)

The curious thing was that co-existing with this era of high inflation was a period of economic stagnation. Economists came up with a new term – stagflation – to describe the unprecedented situation. During this time many American industries (steel, heavy machinery, automobiles, tires, machine tools) lost their leadership in the world economy. Deindustrialization of the Midwestern "Rust Belt" stretching from western Pennsylvania across Ohio, Indiana, Illinois, and up into Michigan and Wisconsin – begun in the 1950s – picked up steam. Americans were stunned that Japan had overtaken the United States as leader of the automobile industry.

Two deficits emerged. The first was a trade deficit. During the 1980s, huge imports of oil, consumer electronics, cars, and other goods outstripped American exports; the resulting trade deficit soared and remained a problem into the early twenty-first century. The second deficit arose in the national budget. Each year from 1975 until the 1990s, the federal government spent, on average, about $200 billion more than it took in. The country seemed to be pursuing two contradictory goals at once – simultaneously cutting taxes to stimulate economic growth and spending enormous amounts on the Vietnam War and Cold War weaponry, hoping that the Soviet Union would be forced to capitulate. The Soviet Union did eventually implode, for reasons traceable to its economic system and problems stretching back decades. Beginning in 1991 it devolved into 15 separate nations. The Cold War appeared to have ended. Subsequently, reduced military expenditures and increased taxes in the United States shrank the annual budget deficit and in 1998 there was a budget surplus for the first time in a generation. Still, the extended period of low taxes and high spending left an accumulated national debt that exceeded $5 trillion. GNP in 1998 stood at about $8 trillion.

Simultaneously with the rises in petroleum prices and trade and budget deficits, real wages for Americans employed in factories and offices – the broad middle class – stopped growing altogether. This was an economic jolt of immense importance. For most of the twentieth century, real wages had risen at a steady annual rate of about 2 percent (thereby doubling every 36 years). By the mid-1990s, most blue- and white-collar employees were taking home about *10 percent less* in inflation-adjusted dollars than they had in 1973. (Had the earlier trend continued, they would have earned about *70 percent more* in the 1990s than in the 1970s.) In addition, American managers began to cut benefits packages for medical care, pensions, and so on. The shrinking of the American middle class continued into the twenty-first century.

These changes also affected the number of hours Americans worked. From 1913 to 1990, average hours worked per year by a full-time employee fell from 2,600 to 1,600. In the 1990s, however, the number of hours increased to about 1,950, the highest number for any industrialized nation. It was not unusual for an individual to work at two jobs.

Along with the rising hours worked was an increase in the number of women working. Some middle- and lower-income families, squeezed by declining wages and disappearing benefits, discovered that one job per household did not suffice. While one should keep in mind that workforce participation by married women and women with children increased every year of the twentieth century, after 1950 the numbers jumped dramatically. Women in the workforce surged from 29 percent in 1950 to almost 60 percent in 2000. Married women increased their numbers in the workforce from nearly 23 percent in 1950 to 61 percent in 2000. Women with children increased from 12 percent in 1950 to 65 percent in 2000.

Largely because of growing opportunities for (and demands on) women, then, all of these economic and societal changes promoted the rise of numerous small service companies and a big increase in franchised businesses. These new companies and franchised outlets supplied a wide range of services once done in the home, such as cooking, housecleaning, and laundry. By the mid-1990s the nation's largest source of jobs – about 9 million – was the food service industry. In a change that would have been unthinkable at any previous time in the nation's history, about half of all money spent by consumers on food now went for restaurant or take-out meals.

Fast food franchises became the major suppliers of the food Americans ate outside the home. These restaurants spread so quickly that by the 1980s they not only prepared billions of meals each year but also accounted for five of the top ten brands of all products advertised on network TV during prime time.

Franchising in America originated in the middle decades of the nineteenth century. Companies such as McCormick Reaper and Singer Sewing Machine authorized and trained local operators to sell their products, offer financing, show buyers how to use the products, and furnish after-sale repair services. Automobile dealerships followed this path in the early twentieth century.

After World War II, however, a very different kind of franchising sprang up, one organized around service industries rather than cars and other big-ticket items. This "business-format" franchising allowed small service firms such as restaurants and dry cleaners to realize advantages previously available only to big companies. These included quantity discounts in supplies, access to proven business methods and most important, a nationally recognized brand. By the 1960s franchised outlets existed for convenience stores, motels, dry cleaners, and especially fast food restaurants.

Franchises increasingly served the mobile American society. College students, travelers, and people moving to new areas benefited from knowing what to expect from branded service operations: McDonald's restaurants, Dunkin' Donuts, Kinko's copy shops, and 7-Elevens. As a Holiday Inn TV commercial of the 1980s put it, "The best surprise is no surprise." From 162 locations in 1960, Holiday Inn increased to 1,700 in 1980.

By the 1990s, the US Census reported that at least 2,000 different franchising companies were supervising more than half a million retail units. The success rate for these outlets was higher than that for independent businesses, although how much higher remains a matter of controversy. A 1990s study by the US House Committee on Small Business put the five-year success rate for all franchised outlets at between 65 and 75 percent, with those in highly ranked ones at between 90 and 95 percent. By comparison, only 30 to 40 percent of all nonfranchized retail businesses survived for five years.

McDonald's, the top performing franchisor of all, claimed a success rate of 98 percent. Founded in 1955, the company by the 1980s was serving at least once a year 19 of every 20 American consumers between the ages of 7 and 65. The McDonald's system was the nation's largest purchaser of beef, and it used 8 percent of the nation's potato crop. With the introduction of Chicken McNuggets in 1982, McDonald's became second only to Kentucky

Fried Chicken (KFC) in purchasing chicken. McDonald's share of the US food market equaled that of the next three largest restaurant chains. The firm's clown mascot, Ronald McDonald, ranked second only to Santa Claus as the "person" most familiar to American children. The Golden Arches became a national icon, then an international one. In 1996, *New York Times* columnist and author Thomas L. Friedman asserted that "No two countries that both have a McDonald's have ever fought a war against each other."

All of this remained true in the early twenty-first century. By 2010, 13,000 McDonald's took in a total of about $30 billion annually, which came to about $100 for every man, woman, and child in the United States. The number of restaurants abroad in 120 countries pushed beyond 18,000. Over the next half decade, McDonald's continued to grow; by 2015, 14,000 McDonald's operated in the US and another 22,000 existed worldwide.

How did McDonald's, focusing initially on the humble hamburger, became the greatest franchising restaurant of all time and one of the epic stories in the history of American business? The saga includes perceptive and creative entrepreneurs open to opportunity and willing to embrace change and trust others. None of the early managers of what would become a mighty corporation, however, graduated from a business school.

The McDonald Brothers

After running a hot dog stand for a few years in the late 1930s, Dick and Maurice "Mac" McDonald opened their first Bar-B-Q restaurant in San Bernardino, CA, in 1940. It was a simple drive-in with "carhop" waitresses delivering food to customers sitting in automobiles. A few years later, the brothers shattered restaurant tradition when they knocked down the outside walls of their building and installed plate-glass windows, thus opening their kitchen to full public view. In 1948 the brothers closed down for three months, and reopened with a new building and a new service concept described by Mac McDonald as "based on speed, lower prices, and … big, big volumes." It was still a take-out operation only; there was no inside seating.

The new restaurant offered only nine menu items (down from 25): hamburgers (price cut from 30 cents to 15), cheeseburgers, potato chips (replaced by French fries a year later), pie, milk, coffee, and three kinds of soft drinks. Reflecting broader American cultural values of the mid-twentieth century, everything customers received was now disposable. After the food was consumed, the paper cups and wrappers were thrown away. There was no washing of glasses, plates or silverware because none of those items was used. McDonald's was not a teenagers' hangout but a family restaurant, as its consistent quality and low prices attracted middle- and low-income parents in San Bernardino who desired to take the entire family out to dinner.

The strategy of high-volume, standardized menu items forced the brothers to alter their kitchen operations. Reflecting Henry Ford's focus on assembly-line techniques, Dick and Mac defined a series of specific jobs: grill man, fry man, counter man, and so on. They invented high-speed custom equipment to do mundane things such as deposit both ketchup (one tablespoon) and mustard (one teaspoon) onto a bun with just one squeeze of a two-part dispenser. They let all of the carhops go and stopped hiring female workers because they wanted to discourage young men from hanging out at their restaurant. These changes attracted such a continuous customer stream that the kitchen staff could cook the food beforehand and deliver it, still fresh, almost at the moment it was ordered.

In 1952 Dick and Mac made two more changes. First they again altered their restaurant's appearance. They worked with architects to create a new store concept based around "Golden Arches." Mac wanted them to be welcoming and instantly recognizable from far away. (In 1962 the arches were redesigned to fit the "M" in McDonald's.) Second, the brothers started licensing their "Speedy Service System," plus the name McDonald's, to franchisees for a one-time fee of $1,000. They offered no operational guidance to franchisees, and did not charge royalties or monitor stores for quality. Soon, the brothers began looking for a national agent to sell their franchises more broadly.

Ray Kroc

At ten o'clock one morning in 1954, Ray Kroc (1902–1984) parked his car near the McDonald's brothers' restaurant and watched. Holding the national rights to sell Multimixer machines that could make five milkshakes at once, Kroc had been lured from his Chicago base to San Bernardino by the brothers' order for ten of the machines. How could one restaurant need so many? Watching the lines form long before lunch began, Kroc was amazed: "That night in my motel room," he remembered, "visions of McDonald's restaurants dotting crossroads all over the country paraded through my brain."

The son of Czech parents, Kroc had been a snappy dresser, talented musician, and likable though sometimes hotheaded young man growing up in the Chicago area. He dropped out of his high school and combined a daytime sales job with nighttime gigs playing piano in jazz clubs. During the 1920s, he sold real estate in the Florida land boom, then returned to Chicago. Over the next three decades he traveled widely, selling first Lily cups, then Multimixers. In this way he became familiar with the operations of soda-fountain and take-out food businesses throughout the country.

On his second visit to San Bernardino, Kroc introduced himself to the McDonald brothers, quickly won their confidence, and became their general franchise agent at the age of 52. Their contract stipulated that every person he signed up as a franchisee would pay an initial fee of $950, then a continuing royalty of

1.9 percent of gross sales. Of this, 1.4 percent would go to a company formed by Kroc (which became McDonald's Corporation), the other 0.5 percent straight into the pockets of Dick and Mac. Kroc was to pay all costs of supervising and servicing the franchisees; the brothers would have no expenses at all. This deal was very lopsided in their favor, and it took Kroc six years to work his way out of it.

Ray Kroc overturned the essence of the fast food franchise business as it existed in mid-twentieth century America. Dairy Queen and Tastee-Freez sold territorial rights to franchisees, who then sublicensed them to store operators. Territorial owners had responsibility for overseeing local stores, but they seldom discharged this task with much energy. Because most of the people who set up new systems envisioned one-time windfalls more than ongoing businesses, the world of franchising tended to attract operators out for a quick score. The big money appeared to be in selling the concept, the territory, and the equipment and supplies, not in running or supervising stores.

Ray Kroc took the opposite approach, and in the beginning made almost no money. The Multimixer business and a McDonald's he opened in a suburb of Chicago supported his family. The latter presented Kroc the opportunity to serve as a personal role model for future franchisees. He worked brutally long hours, generating what he called "sweat equity" in the enterprise; he even revealed the numbers from his own store to potential recruits. Kroc intended to provide franchisees with enough services for them to be successful. He reasoned that their success would guarantee his own success as franchisor. His pitch became "In business for yourself but not by yourself."

Meanwhile, Kroc continued to refine the McDonald brothers' original rules. He banned jukeboxes, pay telephones, and vending machines, including coin-operated newspaper boxes and cigarette machines. These brought in extra money with little costs at other stores, but Kroc wanted no clutter and no hanging out by customers.

By the late 1960s, McDonald's became eat-in as well as take-out, but Kroc discouraged loiterers by installing seats made of hard plastic, comfortable only for short periods and designed for rapid turnover of customers.

The services Kroc furnished his franchisees did not include direct sales of supplies and appliances. He specified what foods and equipment they should buy, but McDonald's was not involved in manufacturing and sales. As suppliers of beef, cheese, condiments, buns, cups, and napkins, he often chose operators who were small entrepreneurs themselves; the sole exception was Coca-Cola. The small suppliers eventually became important voices within the system, and some of them contributed advice that affected McDonald's policies. But McDonald's did not have a written contract with any of them; Kroc could cut them off at any time. Such "handshake" agreements and the spirit of this partnership tradition endure at McDonald's.

Kroc's early experience in selling franchises to his golfing buddies around Chicago turned out badly. They had other jobs, regarded themselves as silent investors, and were not willing to put in the sweat equity required. This early failure led Kroc to change the way in which he recruited franchisees. For some time he used as a model the story of Betty and Sandy Agate, who had been recruited by Kroc's secretary at Multimixer headquarters, June Martino. The Agates switched from selling Bibles door-to-door to operating a McDonald's franchise, and eventually several of them. For a time they earned four times what Kroc was making, and their story helped him establish more than 200 other restaurants across the nation. (In 1975, though, Kroc declined to renew their 20-year franchise because Sandy had attempted to substitute Pepsi-Cola for Coke in their stores.)

June Martino emerged as Kroc's "Vice-President of Equilibrium" at McDonald's. By force of will and many reversals of Kroc's impulsive firings, Martino held together the hodgepodge of personalities that comprised the original McDonald's team. In addition to the Agates, she recruited dozens of other franchisees, often having them stay at her house while they looked over local establishments. She hired a friend of her son who would later succeed Kroc as head of the firm, and she induced her husband, Lou, to leave his engineering job at Motorola to open a McDonald's in partnership with her.

Lou Martino also became a key individual at McDonald's. Having persuaded Kroc to support a lab, Lou used it to discover how to raise to legendary standards the quality of McDonald's French fries. He discovered that potatoes' chemistry changed once they were taken from the ground. If they were cured for three weeks after being harvested, their high sugar content would have transformed to starch, which prevented premature browning. Still, Martino's team had to find the perfect temperature at which to cook the potatoes. After months of frustrating work, they made their big discovery: regardless of how many degrees the temperature of the shortening fell after the introduction of the cut potatoes, the fries were cooked just right at the moment when the temperature had regained precisely three degrees. Armed with that knowledge, Martino and his colleagues created a "potato computer" that buzzed signals to the fry cook.

Meanwhile, Ray Kroc continued to recruit franchisees and, interestingly, choose where stores were located. He flew over suburban areas in small planes or helicopters, looking for neighborhoods with "schools, church steeples, and new houses." He thought that families who lived in these neighborhoods would be natural customers. Then, too, commercial land located near recently developed suburbs was usually cheaper than that in established communities, so that it would be easier for franchisees to lease or buy the property.

Even so, Kroc was not making all that much money on his franchising business. And that meant he could not borrow money for expansion. Fortunately for him, in the mid-1950s he hired a young man, who, only a few months after he came on board, began to make a little more money for the firm.

Financial Wizardry at McDonald's

Harry J. Sonneborn, who had attended the University of Wisconsin for a couple of years, learned about franchises working at Tastee-Freez. "Harry didn't know or care a damn thing about hamburgers and French fries," said Kroc. "He was a cold, calculating money man, but I needed a guy like that." Sonneborn put McDonald's into the real estate business, first by leasing and later through land ownership. By the 1980s McDonald's was the largest owner of retail real estate in the world. That position, together with a record of financial success unmatched in the industry, derived mostly from Harry Sonneborn's early strategic moves.

Sonneborn recommended that McDonald's Corporation get into real estate itself by becoming the middle element in what is known as a sandwich lease (no pun here, just a coincidence). The company would take out long-term leases, then sublease the properties to franchisees at a fixed dollar markup (initially 20 percent of the original lease fee, then 40 percent). The leasing charge was in addition to the 1.9 percent of gross sales annual franchise fee, which Kroc later raised to 3 percent. Sonneborn created a subsidiary called Franchise Realty Corporation and gave it the task of locating sites and taking out 20-year leases at fixed-rate annual payments. He then persuaded landowners to put up the leased land as collateral for a building loan. This loan, made to a McDonald's franchisee, would finance the construction of a store. The franchisee had to pay on the construction loan, the sandwich lease fee, and all taxes and property insurance costs. The sandwich lease fees greatly augmented the cash flow of McDonald's Corporation. The value of the land increased over time, which increased the franchisees' taxes. Meanwhile, Franchise Realty's only serious expense was the fixed-rate lease payments.

Sonneborn changed the terms after he saw another opportunity to increase income. Once a store's monthly receipts exceeded a certain threshold, its sublease payments to McDonald's were shifted from a percentage of the lease fee to a percentage of the store's gross sales, which came to be set at 8.5 percent. The 8.5 percent and the 3 percent of gross sales franchise fee made McDonald's extraordinarily profitable over the long run.

By the early 1960s, less than a decade after its founding in 1955, McDonald's Corporation enjoyed a reliable income stream but had little capital of its own. Then Sonneborn added to agreements with new franchisees the requirement of a "security deposit" of $7,500, half of which would be returned after 15 years, and the other half when the 20-year franchise expired. With the accumulated security deposits, Sonneborn bought land for more stores. Later on, when the original 20-year leases began to expire, McDonald's often bought existing sites as well. Most of the early purchases were bargains, given that they occurred just before suburban land prices made a big jump. Eventually about two-thirds of all restaurants in the McDonald's system sat on land owned by the Corporation. Sonneborn's sandwich leasing scheme and the purchase of land for the stores made a lot of money for the company.

Market forces also helped. As McDonald's outlets rapidly multiplied from the late 1960s to the early 1980s, price inflation ran high throughout the country. While its lease payments to land owners remained steady, McDonald's income surged because of rising overall prices. By itself, inflation pushed nearly all franchisees past the threshold at which they would start paying the 8.5 percent rental. Hamburgers that sold for 15 cents in 1967 cost customers 50 cents in the early 1980s. By then about 90 percent of the profits the company earned from its franchised stores came from real estate payments. That bears repeating: real estate, not hamburgers, made the corporation really profitable.

The subleasing fee of 8.5 percent on gross sales aligned the interest of almost everyone involved. It gave McDonald's

Corporation a tremendous incentive to maximize system-wide sales through the development of new products, national advertising campaigns, and the enforcement of uniform standards. It slightly diminished the upside profit potential for franchisees, but did not put a ceiling on it. It also encouraged franchisees to follow Kroc's rigorous "QSC" formula (quality, service, cleanliness). Sonneborn remembered that "We connected the lease to the franchise so that any violation of the franchise could create termination of the lease." This strategy stretched lease law to its limits, but it held up in court against repeated legal challenges.

Not all of Sonneborn's financial schemes would pay off entirely until McDonald's had grown to truly national proportions. Lots of capital was required to grow the business, and in the early 1960s investment banks and insurance companies still regarded franchising as an often shady business. In lieu of high salaries, Kroc had given June Martino 10 percent of the stock of McDonald's Corporation, and Sonneborn 20 percent. But where would the company get the capital required for national expansion?

Sonneborn then did what good entrepreneurs often do, and began to tinker with the firm's accounting system. He calculated the amount that the company would have to invest in order to produce a stream of income equal to the franchisees' lease payments, and reported it as an asset on the balance sheet – in finance parlance, he capitalized the future lease income. "It was the greatest accounting gimmick ever devised," Sonneborn said later. "The bankers were bemused and befuddled by it because they had never seen it before, but it surely helped us get some loans." Because McDonald's net worth *appeared* so much higher than before, investors were more willing to lend money for expansion.

Sonneborn approached several lenders to obtain a very large loan. Two insurance companies – State Mutual Life and Paul Revere – each agreed to lend $750,000 in return for 10 percent of McDonald's stock. A finder's fee of 2.5 percent was also part of this deal. Ray Kroc "was madder than hell," but Sonneborn pointed out to him "that seventy-eight percent of something is a lot better than one hundred percent of nothing, and nothing is what we've got now." Financial credibility marked the beginning of McDonald's worldwide empire. It also enabled Kroc to borrow money to buy out the McDonald's brothers for $2.7 million in 1961 (the equivalent of over $21.7 million in 2016).

During the tenth anniversary year of the corporation in 1965, McDonald's made an initial public offering of its stock. The opening share price of $22.50 rose to $49 in a few weeks. Sonneborn and June Martino were rich; Kroc held stock worth $32 million. The firm listed on the New York Stock Exchange in 1968 and in 1985 became the first food service company included among the 30 premium stocks that made up the Dow Jones Industrial Average. Sonneborn had retired by that time, following a dispute with Kroc, and his name remains obscure in the annals of American business history. But he was of almost equal importance with Kroc as the architect of McDonald's success. His financiering – creating value where others had not seen any – worked because it was based on sound accounting principles.

How McDonald's Worked

The McDonald's Corporation became the leading franchiser in the world because Ray Kroc established clear, obtainable operational guidelines along with a system of decentralized management that empowered franchisees to make most of the decisions themselves and to share information throughout the firm.

A key element of Kroc's shift from a quick-kill franchise strategy to a long-term focus on growth was his aforementioned system of "QSC": quality, service, and cleanliness. Kroc installed a rigorous inspection system developed by his protégé Fred Turner, and soon the initials QSC were famous throughout the industry.

Hired in 1957, Fred Turner followed Kroc's instructions to "visit the stores" to see what was going on. He developed a report card based on letter grades (A to F) for quality, service, and cleanliness and overall performance. Turner eventually hired hundreds of "field service consultants" to make surprise visits to the company's stores. His original 15-page memo outlining QSC morphed into "the Bible," a 600-page instruction manual. It gave precise instructions on everything: 32 slices of cheese per pound, one-fourth ounce of onions per hamburger, and so on. Color photos demonstrated where on the hamburgers condiments should go. Instructional films supplemented the manual.

In 1961 Kroc and Turner opened "Hamburger University" in the basement of a McDonald's near Chicago; all new franchisees were required to attend. Two decades later the university had expanded to seven classrooms, 28 faculty members, and a 154-room dormitory. The American Council on Education approved 36 semester-hours of college credit from the curriculum. As the firm went international, students without English competency were given headphones with the instruction presented in their home language; by 2008, 28 languages were included in the instructional courses. By 2014, more than 5,000 people graduated from Hamburger U every year, and, its alumni numbered 275,000.

Kroc and Turner insisted on centralized control of standards but promoted decentralized management in much the same way that Alfred Sloan, Neil McElroy, and Ferdinand Eberstadt had in other settings. In all cases, decentralization increased the flow of information both up and down within the company. For example, franchisees first suggested most of McDonald's best-known products, such as the Big Mac, Egg McMuffin, and Filet-O-Fish. (Ironically, most of Kroc's suggestions for menu items did not pan out; one of those was a Hula Burger, which included with the hamburger melted cheese and a slice of fresh pineapple.) The independent suppliers also exerted influence in streamlining procedural innovations. Kroc did not view suggestions as challenges to his authority but rather as evidence of the virtues of franchising done the McDonald's way.

During the 1960s McDonald's established regional networks to coordinate dealing with the local stores. By 1990 the company's operations had been divided into 35 areas. But the "middle managers" of classic centralized firms did not oversee these areas. Rather, Regional Operators Advisory Boards did so. Each board comprised managers from McDonald's Corporation and representatives elected by franchisees. They recommended guidelines for wages, suggested new menu items, and worked with regional advertising cooperatives.

During the late 1960s and early 1970s, Kroc ensured that franchisees had more influence over advertising expenditures. As he explained, the Operators' National Advertising Fund (OPNAD) "is supported by a voluntary contribution of one percent of gross sales by licensees and company stores that belong to the program. … What small businessman wouldn't cheerfully give up one percent of his gross to get our kind of commercials … on network television to promote his store?" By the 1980s OPNAD had 60 members; each franchisee had one vote, and each ad manager half a vote. Quarterly meetings of OPNAD oversaw McDonald's national advertising budget, which had grown to more than $1.4 billion in 2013.

One area in which Kroc and Turner exerted centralized control was in the area of franchise renewals. This issue arose in the mid-1970s, when the first 20-year licenses came up for review. The two decided that failure to attain a consistent average of C or better on the inspection scorecard would result in automatic disqualification for renewal. These reviews became an invaluable tool for disciplining lax operators and improving system performance. About 7 percent of licensees were terminated – a much larger number than in any other franchise – and numerous law suits followed. Because McDonald's won almost all of these suits, its terms of franchising became the industry standard.

By the early twenty-first century, well over 20,000 applicants made inquiries per year; one in 14 of these were interviewed and one in 14 of those interviewed received a franchise; the winners had to wait more than two years to begin operation.

Another element of centralization that intertwined with general decentralization was the emergence of "master franchisers," a pattern that emerged at other national and international franchising firms. A single operator could turn one franchise grossing $2 million annually into a medium-sized business of five stores grossing $10 million or a large one of 200 stores grossing more than $400 million. This multi-unit franchising afforded major entrepreneurial opportunities for successful franchisees and made more efficient corporate oversight. Awarding five franchises each to 20 proven managers was more practical than betting on 100 untried applicants. Kroc and Turner reserved many new stores for franchisees with outstanding records.

Internationalization

By the 1980s, McDonald's and other fast food companies faced a dwindling market in the US. During the decade about 400 American firms established nearly 40,000 stores outside the United States – a more than 70 percent increase in international fast food outlets. By 2005, more than half of the restaurants in the McDonald's system operated outside the US.

Following the pattern established by IBM and other pioneering multinationals, McDonald's tried to tailor its operations to local cultures. In Japan it offered teriyaki burgers; in India a patty containing no beef. In Germany customers could get McRibs with beer, in Norway McLaks (grilled salmon), in Uruguay McHuevos (hamburgers topped with poached eggs). In Saudi Arabia, McDonald's constructed separate sections for men and women (and children), and each store closed four times a day for prayers.

McDonald's attempted to downplay its American origins overseas. Its Canadian operation, started in 1968, was run by a Canadian. In Japan, the firm began as a joint venture between McDonald's (50 percent) and the young entrepreneur Den Fujita and the Daiichiya Baking Company (50 percent). Den Fujita soon bought out the bakery's portion, ran the Japanese system himself, and became almost as famous in Japan as Ray Kroc was in America. By 1983, the gross sales of Japanese McDonald's surpassed those of the largest indigenous fast food chain, Sushi Company, which operated more than 2,000 stores.

McDonald's became so ubiquitous across the world that *The Economist* magazine measured relative costs of living by comparing the prices of Big Macs in different nations. In 2007, for example, the average was $3.41 in the United States, $5.20 in Switzerland (the highest), and $1.43 in China (the lowest). *The Economist* drew conclusions from these figures about the degree to which local currencies were overvalued or undervalued relative to the US dollar. The magazine's annual "Big Mac Index" proved remarkably reliable in stating relative costs of living and currency values. Thus, despite McDonald's efforts, the firm remained the number-one emblem of the US consumer culture.

Marketing, Labor, Nutrition, and the Environment: The Positives and Negatives of Franchising

As successful as McDonald's has been over many decades, aspects of its system – and the fast food industry generally – have come under critical scrutiny. There are no easy analyses, however, of the firm's effect on children, labor, nutrition, and the environment; both positives and negatives abound.

Marketing and children

Back in 1948, a nine-year-old girl made the first purchase at Dick and Mac McDonald's newly renovated San Bernardino store – a bagful of 15-cent hamburgers. "The kids loved coming to the counter," said Art Bender, the original counterman and later Ray Kroc's first franchisee. "They would come with two bits in their fists and order a hamburger and a Coke. They could still see Mama in the car, but they also could feel independent. Pretty soon, it sinks in that this is great for the business; this is important."

From the beginning much of the company's television advertising not surprisingly focused on children. McDonald's franchisees in many cities took advantage of the reduced Saturday morning advertising rates (about one-fourth of prime time levels) to sponsor programming for kids. The Washington, DC stores developed a show featuring a costumed clown who soon became identified with McDonald's. From this emerged the notorious ad phenomenon, Ronald McDonald, the clown appearing on TV all over the world. In China he became known as "Uncle McDonald," in Japan, "Donald Maka-donaldo" (to accommodate local difficulties in pronouncing the letter "R").

There was about McDonald's advertising an easy symmetry. Kroc's fanaticism about cleanliness, McDonald's giveaways of toys based on Disney characters, and the firm's TV ads for kids' "Happy Meals" reinforced the message that everything at McDonald's would be wholesome and predictable. Clearly, McDonald's has focused on children from the very beginning. Playgrounds outside and later inside stores, and incessant giveaways with Happy Meals for children (often tied to the recent release of a Disney movie) underscored the other attractions. By the 1980s, McDonald's had captured 40 percent of the market for children under the age of seven, a full ten percentage points above its overall market share. As Kroc noted, "A child who loves our TV commercials and brings her grandparents to a McDonald's gives us two more customers." When Kroc became wealthy, one of his favorite philanthropies was the chain of Ronald McDonald Houses located near hospitals and offering relatives of seriously ill children a pleasant and inexpensive place to stay. The concept was conceived at Kroc's behest by a Philadelphia ad agency; it not only brought the company tremendous good will but also reinforced the firm's focus on children.

Depending on one's perspective, McDonald's empowered children or exploited them. The operation encouraged children to choose the menu items they wanted to eat and assured them that they would get it quickly. The children were not the most profitable segment of the customer base, but McDonald's hoped that their loyalty to the company would continue into adulthood.

Eric Schlosser's best-selling book, *Fast Food Nation: The Dark Side of the All-American Meal* (2001), is perhaps the most effective attack on the food industry since Upton Sinclair's famous 1906 novel, *The Jungle*. Schlosser writes: "Most of all, I am concerned about its impact on the nation's children. Fast food is heavily marketed to children and prepared by people who are barely older than children. This is an industry that both feeds and feeds off the young." Schlosser's book includes a lot of information on other fast food companies as well as McDonald's and the Disney Company.

Labor

Employment patterns at McDonald's also elicited discussion over empowerment versus exploitation. An academic study found that the average age of employees in the fast food industry as a whole was just over 20, the number of years of education just under 12, and the proportion working part-time 64 percent. Each store employed an average of 40 individuals, of whom 64 percent were female, 52 percent students, and 13 percent African American.

By the 1980s, the average McDonald's restaurant was employing about 65 workers and five salaried managers. More people in the US workforce were getting their first job at McDonald's than at any other employer, including the Army. By 2008, according to the company, close to 10 million Americans had worked at McDonald's. The employee turnover rate, like that of other fast food franchises, sometimes reached 200 percent per year. Many employees were either teenagers or senior citizens working part-time, recent immigrants, or high school graduates just entering the workforce.

Until 1966 the company continued the McDonald brothers' policy of hiring no women, and it did not have a good reputation as a place of management opportunity for minorities. But by the 1980s, 57 percent of McDonald's workers were women, and by the early twenty-first century women comprised about 40 percent of its franchisees, either individually or as part of a husband–wife team. As of 2015 women held one out of four of the corporate positions of vice president and above at McDonald's Corporation. In addition to a Women Operators' Network, there was also a Women's Leadership Network that operated worldwide; these were two of many ancillary organizations within the McDonald's system.

Beginning in the late 1960s, the corporation went to special lengths to help African Americans become franchisees, often allowing them lower initial investments to get started. By 2008 about 14 percent of McDonald's US franchisees were African Americans. Many of those were master franchisees, as 320 African Americans operated about 1,200 stores. In the same year, about 20 percent of the company's US workforce and 17 percent of its corporate officers were African Americans. In *Fortune's* annual list of the 50 best companies for minorities, McDonald's has consistently ranked at or very near the top.

McDonald's has supported other groups of employees as well. Beginning in 2013, the firm initiated a concerted effort to attract former service men and women as workers. Over 100,000 positions had been filled by veterans by early 2015. The corporation also focused on hiring spouses of active duty personnel. McDonald's instituted various educational support programs, including English as a second language, to assist its employees in getting ahead at McDonald's and elsewhere. These programs were established overseas, as well, including in China, Brazil, and Canada.

Nutrition

When Ray Kroc created the McDonald's system in 1955, most consumers were poorly informed about nutrition. American schoolchildren learned that "nature's three most perfect foods" were eggs, milk, and liver – all of which are now recognized as heavy in saturated fats. Yet obesity was not a major problem in the United States in the middle twentieth century. A consumer could go to a McDonald's and get a reasonably healthy meal consisting of a hamburger, an order of French fries, and a Coke, totaling about 500 calories. A slice of cheese added about 100 calories more. Normal portions at the time were what children's portions are today, and in some cases less. For example, the typical serving size of a Coke was seven ounces compared to today's 12-ounce child's serving.

Market forces, however, changed the dynamic. As more competitors entered the fast food industry, "portion control" spiraled wildly upward. Burger King's "Whopper," introduced in the mid-1960s, contained 680 calories, 780 with a slice of cheese. The 7-Eleven convenience stores offered "Big Gulp" cups of soft drinks containing 64 ounces – nearly ten times the size of the Coca-Cola Company's original and longtime standard of six-and-a-half-ounce bottles. A 64-ounce serving of Coke without ice totaled 776 calories. Soon, both McDonald's and Burger King were selling 32-ounce soft drinks.

Customers bought these giant servings despite the fact that McDonald's and other chains began to post nutrition data on tray liners and the walls of their stores. Even though diners could order smaller portions, most chose not to do so. An apparently reasonable meal might consist of a Big Mac (590 calories) or a Quarter Pounder with Cheese (530), a medium order of French fries (450, a large order being 540 and a super-size 610), and a medium-sized Coke or other sugared soft drink (194 calories; 133 for small, 255 for large and 388 for king size). Thus, a Big Mac, a medium order of fries, and a medium-sized Coke would total 1,234 calories. But many customers ate even more, adding a dessert item and one or two free refills of Coke. It was not unusual for a person to leave a McDonald's, Burger King, or other fast food restaurant having consumed 2,000–2,500 calories, about a full day's food allotment for an average-sized person. Most of those calories came from fat or refined sugar.

As the years progressed, Ray Kroc's successors faced an unpleasant choice between maximizing good nutrition on the one hand and maximizing competitive success on the other. They mostly chose the financial bottom line. By 2013, however, McDonald's was trying to change. As an article from FastFood.com reported: "McDonald's is attempting to ditch the fast food label in favour of 'good food served fast'. … [The firm is] introducing new menu options including fresh fruit, egg white McMuffin and … cucumber as an ingredient for the first time in the chain's history." Quality of the food – which Kroc had promoted in the 1950s – was returning in a different guise. Still, the "fast" in "fast food" remained a drawing card that conflicted with nutritional quality.

As Schlosser concluded in *Fast Food Nation*, the success of fast food was the result of overt choices: by adults because of its time-saving convenience and inexpensive prices, by children seduced by its advertising and the quick delivery and engineered tastiness of its products, and by parents who give to their children the power to make decisions about where and what to eat.

The environment

The sheer size of McDonald's makes it an easy target for activists trying to protect the environment, and over the decades the firm's managers have responded. Greenpeace publicized the damage to the rain forests in Brazil that demand for McDonald's beef had created, and in 1989 the firm began working with the activists and other consumers to avoid purchasing beef raised on land that had once been rain forest. Working with the Environmental Defense Fund, the company reduced its packaging waste by 30 percent during the decade of the 1990s. By the second decade of the twenty-first century, McDonald's has implemented a program of utilizing energy efficient machines and alternative energy sources, an effort that its managers hope will one day enable the Golden Arches to reach a sustainable level of energy consumption.

Past and Future

McDonald's tremendous growth made it harder and harder for the company to keep all of its franchisees in line. The larger the system grew, the more difficult it became to enforce the QSC formula that Ray Kroc and Fred Turner had created. Yet McDonald's continued to record by far the highest sale-per-store figures in the industry, and it was a strong testament to Kroc's original vision that his company remained the leader in fast food two generations after its founding.

Kroc's style of franchising represented another benchmark in the persistent effort by American managers to balance centralization with decentralization in the face of changing external conditions. Franchising at McDonald's and other companies proved to be an extraordinarily flexible way to place decision making at the spot where the best information was available to resolve particular problems. Useful information also poured in from the networks of McDonald's suppliers, which the central corporation sponsored but always kept independent. Management talent and the financial clout of big business complemented the local knowledge, personal drive, and sweat equity typical of small start-up firms.

Also notable was the special contribution of Kroc, June Martino, and Harry Sonneborn, ingeniously combining different methods to align the incentives of every participant so as to make the whole of the McDonald's system exceed the sum of its parts. Together, they perfected an organizational formula used successfully by thousands of McDonald's franchisees in more than 100 countries. And despite remaining problems in marketing, labor relations, and nutrition issues, few companies in any industry have ever matched that kind of achievement.