



The Cup That Kroc Built

Is McDonald's stealing your coffee sales?

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It's irritating, really. Business people are told to have patience, that success often involves failure, humility, persistence and countless trips to the drawing board, right?

Then McDonald's comes along and, in less than two years, pushes the lid off our coffee programs. It's not enough that Micky D's ratcheted up its regular cup of joe, but the global giant had the nerve to

usher in a line of frappes, mochas, lattes and cappuccinos. It even had the chutzpah to call it a café.

And it worked.

It's estimated that McDonald's in fewer than 20 months stole upwards of 10% of the away-from-home coffee market. In July, the Oak Brook, Ill.-based company reported a same-store sales increase of 4.5% for U.S. stores in the

second quarter ending June 30. U.S. operating income rose 6%, with sales fueled primarily by the McCafé lineup.

And guess where that growth is coming from? You got it—your customer. And not just yours: Starbucks and other specialty coffee brands are feeling the hit, too. But the McDonald's core consumer is your customer, the one who prefers spending \$1 to \$2 for a coffee drink.



TO THE VICTOR: Express Convenience Centers' partnership with local roaster Victor Allen's has helped draw a loyal customer familiar with the brand.

But all is not lost. A look at sales figures for c-store coffee indicates that McDonald's hasn't stolen your coffee customer completely. A recent study by Chicago-based Technomic shows that 57% of c-store retailers say coffee sales have increased over last year; only 7% said it decreased.

What that data does not—and probably cannot—tell is how much more your coffee program might have grown were it not for Ronald and friends. The best thing a retailer can do is to understand McDonald's strategy, then respond with something authentic yet different.

HOW THEY DID IT

The 2008 economic downturn couldn't have been a better time for McDonald's to test its McCafé program. Starbucks was faltering, consumers were pinching pennies, and the burger giant was realizing it didn't need to charge \$3.50 for a latte to make strong margins.

Coffee Benchmarks

- ▶ Hot dispensed beverages accounted for \$6,939 in monthly average sales per store in 2010, a 2.1% increase over the year prior.
- ▶ Hot dispensed beverages generated \$3,676 in monthly average dollars per store in 2010; that's 53% gross margin and a 0.1% increase in margin dollars over the year prior.

Source: Preliminary numbers from the NACS State of the Industry Report of 2010 Data

Ed Engoron, president and CEO of Los Angeles-based Perspectives/The Consulting Group Inc., boils McCafé's success down to human behavior.

"When we're talking about habits, the two big things we have is the way people shop and the way people eat," he

says. The most brand-loyal time of day is breakfast, when customers are robotic in their routines.

"What McDonald's saw happening was people were coming through their drive-thru and into their stores while only selling about 20 cups of coffee a day," says Engoron, "and all these people had Starbucks and other big, branded coffee companies' cups in their hands. And they were paying more for a cup of coffee than they were for their breakfast. That was the impetus that got things started."

McDonald's meteoric McCafé is tied to several built-in advantages, Engoron says:

▶ **Size:** More than 32,000 locations guarantees market penetration, which is the key to convenience and therefore loyalty in the coffee channel.

▶ **Commitment:** "They had senior executives in that company who were dedicated to doing coffee correctly," says Engoron.

MATCH POINT: Express' Dashboard Jo brand matches its Dashboard Dining foodservice brand, which is also executed in partnership with a local company, grocer Festival Foods.



► **Quality Halo:** Just the gesture of having espresso machines improved the perception of McDonald's regular coffee.

► **Iced Drinks:** Engoron estimates McDonald's has increased sales of coffee by more than 20 times since its national rollout in 2009, and even more so for its iced coffees and frappes. Neither McDonald's nor Starbucks is making money on espresso shots or drip coffee, he says; the cash cow is the espresso-based drink line.

► **Consistency and Convenience:** The company set strict quality-control protocol that eliminated free pouring of sweeteners or creamers, leaving little room for human error. Meanwhile, the drive-thru made it a very convenient offer.

► **Food Factor:** As Engoron says, customers were already stopping at McDonald's for an Egg McMuffin. While c-stores often leverage their beverages to sell more food, McDonald's popular food helps sell more drinks.

If you're a c-store retailer who didn't have a loyal coffee following, you likely felt McPunched.

McCafé means c-stores need more to hang their hat on than convenience. "You're never going to do anything

beyond making it the most convenient operation, so you're not competing on the same ground," says Engoron. Instead, it's time to punch back.

FIGHTING BACK

You may not be able to beat Goliath, but you can't lie down, either. And if Technomic's numbers are any indication, there's still time to hold ground.

"C-stores are still in this incipient stage of developing coffee programs that they still have that entire market to capture," says Tim Powell, director of research and consulting for Technomic, Chicago.

While McDonald's boasts popular food and convenient drive-thrus, c-stores still have packaged beverages, newspapers, cigarettes and packaged snacks.

In other words, McDonald's is not a c-store; therefore, experts advise, play to your core strengths of convenience. At the same, start thinking about your coffee bar.

Specifically, have a plan—one that goes beyond this month, this year, even the next five years. And with that plan must come a heavy dose of patience.

Who Is the C-store Coffee Customer?

A recent report from research company The NPD Group shed some light on the nature of c-store coffee customers. The Port Washington, N.Y.-based firm found that these customers often visit c-stores for the sole purpose of buying a cup of coffee, often purchasing a few other things while there.

Among the findings from this survey of more than 51,000 U.S. c-store shoppers:

► Eighty-six percent of dispensed coffee purchases are planned and 7% are purchased on a deal.

► Consumers of coffee and other dispensed beverages are high-frequency buyers who represent 68% more visits than the average convenience-store customer.

► Of all dispensed-beverage consumers, 33% are looking for coffee, 11% cappuccino or latte and 3% hot or iced tea.

► The basket size for dispensed-beverage customers averages \$6.83 a visit.

► Forty-five percent of consumers who purchase their coffee between 6 and 10 a.m. tend to also purchase doughnuts, gum, sweet rolls, sandwiches, breakfast sandwiches, snack cakes and cookies.

► Coffee buyers tend to be male, ages 45 to 65, a mix of white and blue collar, with strong military connection, smaller households and higher income.

Remember that McDonald's speedy success does not directly apply.

"I want it fresh, I want it fast and I want it mine. Those are the things that we in the c-store segment really need to be conscious of," says Engoron.

To home in on what the customer wants, he advises retailers to try a "struc-

tured benefit analysis” exercise with a group of its customers. First, create a list of attributes pertaining to your coffee program: flavors, cleanliness, Free Trade, countless creamers, etc. Then, ask customers to rank from one to 10, for each particular attribute, what they wanted and then how the store delivered. If they report the importance of creamers was an eight and the execution scored a five, you know there’s some work to be done.

“Then you find the low-hanging fruit, which is the largest need gap for the largest number of people,” Engoron says. The exercise also tells you where you might be over-delivering. “If you give a customer too much of a thing they don’t really care about, you’re maybe not really concentrating on what they do want.”

Perfecting the simple things is another vital lesson for c-store retailers. “You can do pumpkin for Halloween and peppermint for Christmas, and all those fun things, but you’ve got to be consistent and you’ve got to have a damn

good cup of coffee,” Engoron says.

One tactic some retailers are testing is coffee hosts: employees whose job it is to greet customers, help them through their coffee prep and keep the area spick-and-span. Wawa and The Pantry are among the companies who have recently

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tested this service, and opinions vary on its effect. Powell sees it as a positive move; Engoron thinks otherwise.

“What is a customer looking for when they go into a store? Are they looking to be chatted up? I don’t think so,” he says. “They want to get in and out. They want a really good, hot cup of coffee flavored the way they want, and they want to leave.”

McWHO?

The real verdict will come from the customer, and it’s up to the retailer to know who their customer is and what they want from the coffee experience. Just ask the folks at Express Convenience Centers.

McDonald’s hasn’t affected this 21-store chain based in Appleton, Wis. In fact, Kelly Chartré, sales and marketing manager, says the company is tracking a 4% increase in coffee sales this year, following an 8% increase from 2009 to 2010.

“I don’t feel like there’s any competition with the QSRs that we’re so concerned about,” Chartré says.

Express’ success isn’t serendipitous. Chartré attributes its solid coffee program to the company’s partnership with local roaster Victor Allen’s. Most of the chain’s stores are located in a 30-minute radius of Express’ corporate office, which is also Victor Allen’s backyard.

The company also created a proprietary brand for its coffee, Dashboard Jo, with a retro look and a tie-in to its proprietary foodservice brand, Dashboard Dining—also executed in partnership with a local company, grocery chain Festival Foods.

Express’ coffee selection is vast: anywhere from eight to 16 different flavors at any given store. Regular, Extreme (extra caffeinated) and Decaf Jo are accompanied by flavors such as hazelnut, Highlander grog, Southern pecan, s’mores in the summer and blueberry cobbler in the spring.

Interestingly, a wide assortment of condiments doesn’t mean much for Express customers. “We tried to do really fun and outlandish condiments like sprinkles and whipped cream and found that it wasn’t a really good fit for

Coffee Redux

As the coffee competition percolates, c-store retailers are reacting with ramped-up programs. Some recent revamps:

7-Eleven continues the rollout of its new coffee bar, averaging 60 stores per week earlier this year. Changes include urns instead of glass carafes; a redesigned bar with urns on the ends; add-ins such as creamers and syrups in the middle; and the old stainless steel replaced with granite-like Avonite in mocha brown and cream colors.

Wawa switched from glass carafes to urns as well this year, and it held a celebratory “retirement” of its 34,200 pots to make way for 14,000 thermals.

Part of its “Program Fresh” initiative, **The Pantry** has enlisted full-time coffee hosts, charged with keeping the stations clean and the coffee fresh while interacting with customers. Recent reports indicate the chain is pulling back some on the service.

Earlier this year **Quick Chek** launched its iLoveMyCoffee.com interactive microsite, which invites users to build their own coffee concoction, share it and see others’ recipes. A contest was held in the spring, with the prize a year’s worth of free coffee and the winner’s face and coffee recipe featured on Quick Chek coffee cups.

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the consumer,” Chartré says. “They’re looking for simple: ‘Give me my favorite flavored coffee, give me my creamer and sugar and call it a day.’”

Here’s the other thing about Express: It knows its customer. Fifty percent of the people walking through the door are coffee customers; half are men, and most are over 20—though more 16- to 20-year-olds are beginning to look for a low-calorie, sweet shot of energy.

“We do about double the amount of flavored coffees as any other c-store in the area,” says Chartré. “Our local consumers know if they want a good cup of flavored coffee, they’re going to our Express stores.”

Express also does well with its rewards program. Customers with a refillable

travel mug receive cheaper refill prices, plus regular days where refills are free.

In a market that also has regional powerhouse Kwik Trip, the biggest benefit Chartré sees in her coffee program is the local partnership, saying, “It helps us to differentiate in our backyard.”

PRICING PRESSURE POINT

The burger battles of the past few years should act as a warning sign for c-store retailers looking to engage McDonald’s in their deep discounting. Burger King was sued by its franchisees for its \$1 double cheeseburger promotion, and many brands continue to struggle to bring their prices back up without customer revolt.

What’s more, McDonald’s has the girth to charge bottom-of-the-barrel

prices—and consumers know that. For c-stores, this only hurts the quality perception many continue to build.

“When you go into the 99-cent battle, all you’re doing is calling attention to what’s wrong with this cup of coffee,” says Engoron. “You start to question the quality and the value of the product that you’re getting. The place to compete is in quality, innovation in equipment and different ways to flavor coffee.”

Powell of Technomic believes retailers could even increase their prices some without a major backlash: “I think there’s more price elasticity than they think. Even though they can charge those [low] prices, they shouldn’t. That’s a part of their image.”

Looking ahead, McDonald’s could try another below-the-belt blow to c-store coffee: rewards programs.

“For broader health and sanitation reasons, I don’t see them doing something like a refillable travel mug, but a loyalty program of some sort? I absolutely think they will do this,” says Joan Vieweger, Engoron’s partner at Perspectives. “Technology advances certainly allow for much more flexibility around such programs.”

In fact, reports are already coming out about McDonald’s working with mobile-based rewards programs such as Tetherball.

Some say if you’re playing a defensive strategy, you’re just prolonging defeat. Instead, c-store retailers need to deliver a high-quality, consistent cup of coffee—that’s a given—with a unique point of differentiation. Perhaps it’s partnering with a local roaster, as Express did, or testing a coffee host, as The Pantry and others have tried. Regardless, it can’t be a “me-too,” not against McDonald’s. ■