Good and hungry

More than menus need to be revamped if fast-food firms want to keep growing.

FAST-FOOD firms have to be a thick-skinned bunch. Health experts regularly lambast them for peddling food that makes people fat. Critics even complain that McDonald's, whose golden arches symbolise calorie excess, should not have been allowed to sponsor the World Cup. These are things fast-food firms have learnt to cope with and to deflect. But not perhaps for much longer. The burger business faces more pressure from regulators at a time when it is already adapting strategies in response to shifts in the global economy.

Fast food was once thought to be recession-proof. When consumers need to cut spending, the logic goes, cheap meals like Big Macs and Whoppers become even more attractive. Such "trading down" proved true for much of the latest recession, when fast-food companies picked up customers who could no longer afford to eat at casual restaurants. Traffic was boosted in America, the home of fast food, with discounts and promotions, such as $1 menus and cheap combination meals.

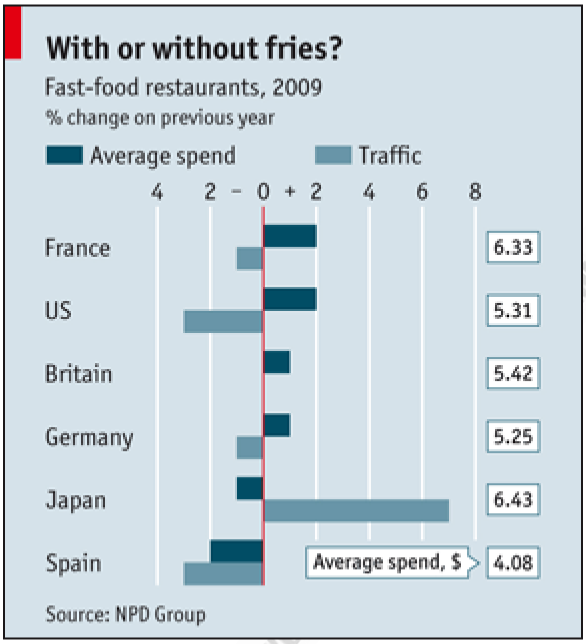
As a result, fast-food chains have weathered the recession better than their pricier competitors. In 2009 sales at full-service restaurants in America fell by more than 6%, but total sales remained about the same at fast-food chains. In some markets, such as Japan, France and Britain, total spending on fast food increased. Same-store sales in America at McDonald's, the world's largest fast-food company, did not decline throughout the downturn. Panera Bread, an American fast-food chain known for its fresh ingredients, performed well, too: its boss, Ron Shaich, claims this is because it offers higher-quality food at lower prices than restaurants.

But not all fast-food companies have been as fortunate. Many, such as Burger King, have seen sales fall. In a severe recession, while some people trade down to fast food, many others eat at home more frequently to save money. David Palmer, an analyst at UBS, a bank, says smaller fast-food chains in America, such as Jack in the Box and Carl's Jr., have been hit particularly hard in this downturn because at the same time they are "slugging it out with a global powerhouse" in the form of McDonald's, which ramped up spending on advertising by more than 7% last year as others cut back.

Some fast-food companies also cannibalised their own profits by trying to give customers better value. During the recession companies set prices low, hoping that once they had tempted customers through the door they would be persuaded to order more expensive items. But in many cases that strategy backfired. Last year Burger King franchisees sued the company over its double-cheeseburger promotion, claiming it was unfair for them to be required to sell these for $1 when they cost $1.10 to make. In May a judge ruled in favour of

Burger King. Nevertheless, the company may still be cursing its decision to promote cheap choices over more expensive ones because items on its “value menu” now account for around 20% of all sales, up from 12% last October.

Analysts expect the fast-food industry to grow modestly this year. But the downturn is making them rethink their strategies. Many companies are now introducing higher-priced items to entice consumers away from $1 specials. KFC, a division of Yum! Brands, which also owns Taco Bell and Pizza Hut, has launched a chicken sandwich that costs around $5. And in May Burger King introduced barbecue pork ribs at a hefty $7 for eight.



More cheeseburgers

Companies are also trying to get customers to buy new and more items, including drinks. McDonald’s started selling better coffee as a challenge to Starbucks. Its “McCafé” line now accounts for an estimated 6% of sales in America. Others are testing a similar strategy. Starbucks has sold rights to its Seattle’s Best coffee brand to Burger King, which will start selling it later this year. McDonald’s is now rolling out frappé coffees and smoothies.

As fast-food companies shift from “super size” to “more buys” they need to keep customer traffic high throughout the day. Many see breakfast as a big opportunity, and not just for fatty food. McDonald’s will start selling porridge in America next year. Breakfast has the potential to be very lucrative, says Sara Senatore of Bernstein, a research firm, because the margins can be high. Fast-food companies are also adding midday and late-night snacks, such as blended drinks and wraps. The idea is that by having a greater range of things on the menu, “we can sell to consumers products they want all day,” says Rick Carucci, the chief financial officer of Yum! Brands.

Yet growth opportunities in America are limited because the market is considered to be “saturated”, not so much in fats but outlets. China is the place where most fast-food chains, like so many industries, see big expansion. Mr Carucci, for one, thinks China will be “the biggest growth opportunity for the industry this century”. If so, then Yum!, which has the greatest presence in China of any Western fast-food company, will be celebrating. Already around 30% of the company’s profits come from China, and in the next five years this is expected to grow to 40%. India also looks like a succulent opportunity. Others plan to serve up more business in Russia and elsewhere in Europe. Given that around 75% of fast-food companies' revenue in Europe comes from people eating in the restaurants (compared with half in America), older European outlets are being done up to make them more attractive places.

Getting chunky

The recession also proved the importance of size in competing for customers, which means that more consolidation is likely. Wendy's and Arby's, two American fast-food chains, merged in 2008. On June 11th their shares surged following news that a buyer was interested in the company. Smaller chains may catch the eye of private-equity firms, just as CKE Restaurants did earlier this year when Apollo Management, a buy-out firm, purchased it.

But what about those growing waistlines? So far, fast-food firms have nimbly avoided government regulation. By providing healthy options, like salads and low-calorie sandwiches, they have at least given the impression of doing something about helping to fight obesity. These offerings are not necessarily loss-leaders, as they broaden the appeal of outlets to groups of diners that include some people who don't want to eat a burger. But customers cannot be forced to order salads instead of fries.

In the future, simply offering a healthy option may not be good enough. "Every packaged-food and restaurant company I know is concerned about regulation right now," says Mr Palmer of UBS. America's health-reform bill, which Congress passed this year, requires restaurant chains with 20 or more outlets to put the calorie-content of items they serve on the menu. A study by the National Bureau of Economic Research, which tracked the effects on Starbucks of a similar calorie-posting law in New York City in 2007, found that the average calorie-count per transaction fell 6% and revenue increased 3% at Starbucks stores where a Dunkin Donuts outlet was nearby—a sign, it is said, that menu-labelling could favour chains that have more nutritious offerings.

In order to avoid other legislation in America and elsewhere, fast-food companies will have to continue innovating. Walt Riker of McDonald's claims the makeover it has given to its menu means it offers more healthy items than it did a few years ago. "We probably sell more lettuce, more milk, more salads, more apples than any restaurant business in the world," he says. But the recent proposal by a county in California to ban the golden arches from including toys in its high-calorie "Happy Meals", because legislators believe it attracts children to unhealthy food, suggests there is a lot more left to do.

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