SHAKE SHACK®

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Evaluation of the Future State of the Industry

Boundary of the Industry

Quick Service Burger chains are ubiquitous in contemporary society, from highway exits to downtown street corners. This industry has seen massive consolidation and disruption in the last half-century, with a few powerful brands emerging. The focus of this investment is on quick service hamburger-oriented corporations that are public, nationwide restaurants in which customers order from a self-service style counter. With these boundaries, the analysis excludes specific brands (such as Burger King) that are subsidiaries of larger corporations, as it is impossible to do systematic strategic analysis. Furthermore, hamburger-oriented sit-down restaurants (e.g., Red Robin), chicken-oriented QSRs (e.g., Chick-Fil-A), and privately-owned hamburger-oriented QSRs (e.g., In-N-Out) have been excluded. These boundaries presented four main incumbents in the industry: McDonald's, Wendy's, Shake Shack, and Jack-In-The-Box. Through rigorous external and internal analysis of the firms with five main criteria: Quality, Variation, Price, Speed, and Size, it is evident that Shake Shack would yield the highest returns in this industry.

External Environment Analysis of the Industry

Immense external pressures are forcing the industry to meet contemporary customer's tastes and adapt to the changing times, as seen through the PESTEL analysis in *Appendix A*. Most pressing is increasingly negative socio-cultural attitudes towards "fast food." Once viewed as a dinner staple, public sentiment considers traditional fast food highly processed and unhealthy (Specter et al.). Another important sociocultural change is consumer's increasing interest in food quality when dining out, as education on food and nutrition has become commonplace (Murray). This education has translated into eating habits, as empirical studies show that food quality and variation directly correlate to the purchase and continued loyalty of consumers in the fast-food industry (Namin). Ingredients have come under scrutiny by consumers, who are increasingly inclined to eat at a restaurant where organic produce and ethically sourced-proteins without antibiotics are staples on the menu.

As a result, "Fast Casual" restaurants have emerged as disruptors to the fast-food industry. These establishments highlight the quality and the ambiance of the restaurant, with carefully sourced ingredients and a refined environment that invites customers to enjoy their meals. Consumers have flocked to these restaurants, seeing a twofold increase in revenue from \$19 billion in 2009 to \$47 billion in 2018 (Crescimbeni). This drastic increase indicates that Fast Casuals are becoming popular with consumers and will be a difficult competitor for Quick Service Hamburger-Oriented Restaurants to overcome.

Internal Trends of the Industry

These external changes have upended industry incumbents, forcing investments in brand refreshes to present their restaurants as newer and fresher to attract customers. As seen in

Appendix B, incumbents have begun upscaling and adopting a dominant design to offer natural lighting, comfortable seating, wood panels, and the removal of children's play structures (Adams). This modern architecture signals to consumers a contemporary refresh evocative of the industry adapting to their changing tastes without impacting customary menu items. This trend focuses on retaining customers in restaurants for longer periods to drive sales through multiple orders during one trip. This process is currently underway for the incumbents, with Wendy's having the most restaurants remodeled by 2020 at 44% of total restaurants.

Moreover, technological improvements have changed how customers interact with the industry's brands. Incumbents are adopting kiosk ordering and cell phone apps that allow a contactless experience and shorten ordering wait time. Furthermore, these systems improve the customer flow throughout the restaurant, as ordering time per customer is decreased by offering more kiosks (Kelso). Self-service kiosks are being adopted throughout the industry, with McDonald's adding ~1,000 each quarter.

Future State of the Industry

The industry faces dramatic changes as it reacts to the external environment and internal trends and will converge towards the fast-casual business model. As consumers begin to look for higher quality and variation in menu items, the industry will invest in ingredient quality as the main component of competitive advantage. Furthermore, restaurants will begin expanding their variation through new menu items, whether with chicken-based or vegetarian-based entrees, to increase order frequency amongst existing customers (McDowell). This competition for quality is only in its infancy, with Wendy's highlighting its "Fresh, Never Frozen" meat and Shake Shack introducing Chick'n Bites.

Moreover, incumbents will complete restaurant remodels and adopt a contactless experience for their customers with kiosks and app ordering. With fresher, more relaxing spaces, a seamless ordering process allows customers to spend more time enjoying and less time in line, while also proving imperative for the customers who still want to get in and out quickly. These changes will position hamburger-QSRs to compete against other Fast Casual QSRs.

Evaluation of the Future Competitiveness of Industry Incumbents

Firms that can best adapt their supply chain and advertising strategies will be best positioned to succeed. As seen in *Appendix C*, Shake Shack is most competitive in quality but sacrifices speed and price. McDonald's and Wendy's veteran status presents them as strongest in price, speed, and size. The other factors show less differentiation amongst the largest incumbents. They have become market leaders in these factors and have established footholds likely impossible to uproot given the extent of their leadership. Variation presents the industry players an opportunity to differentiate themselves from each other and external players threatening their market dominance. However, more variation does not translate to increased customer satisfaction and better sales and requires a more nuanced evaluation.

Competitiveness Based on Price

Price sensitivity is an important factor for current customers in the industry. In the past, customers wanted a tasty hamburger for a low price. However, recent analysis indicates that contemporary customers are becoming less price-sensitive if they can identify quality ingredients in their order (Cardello). To ensure standardized analysis, the price of a cheeseburger from each incumbent was analyzed in Los Angeles, a city in which all four incumbents compete. This analysis presented a range: $1.00 at McDonald's, $1.79 at Wendy's, $3.29 at Jack-In-The-Box, $5.99 at Shake Shack.

Competitiveness Based on Speed

Research has shown 55% of consumers consider speed a value-add service element (Watrous). Furthermore, in a study conducted on major fast-food chains, it was found that 70% of sales come from drive-thru (Oches). With these data in mind, the variable for speed was drive-thru times. Wendy's and McDonald's are leaders in speed with drive-thru times of 226.07 seconds and 273.29 seconds, respectively (QSR Magazine). While the research did not provide an exact drive-through time for Jack-in-the-Box, it is not in the top ten fastest drive-thrus (Klein and Oches). Shake Shack does not currently offer drive-thru but plans for the introduction of their first in 2021.

Competitiveness Based on Size

Size was determined through the incumbent's 2020 10-Ks, with McDonald's being the largest fast-food chain in the world with over 39,000 stores globally, with 14,000 in the US. Wendy's is the second-largest with 6,814 stores globally, 5,874 of which are in the US. Jack-in-the-Box only operates domestically, with 2,241 locations in the West and South. Finally, Shake Shack is the smallest, with 292 locations worldwide, 200 of which are in the US. While the smallest, since 2016 it has doubled its store count and plans to open 50-60 new stores through 2021.

Competitiveness Based on Variation

To compare the firms' variation, burger items were counted from each firm's menus, normalizing for single/double specifications. Shake Shack, Wendy's, and McDonald's offer six distinct burgers; all three firms are consistent in that they include a basic hamburger, cheeseburger, and some version of a deluxe burger. Jack-in-the-Box offers eight distinct burgers, such as the Sriracha and Sourdough burgers, while also serving similar foundational items as the other three firms. A new popular category that can be found at these restaurants is chicken-based entrees. This addition helps incumbents gain market share from chains such as Chick-Fil-A and Popeyes. Lastly, as consumer preferences shift towards healthier eating, consumers are looking for vegetarian alternatives. Currently, McDonald's, Wendy's, and Shake Shack have all either installed or are testing vegetarian burgers (Wiener-Bronner).

Competitiveness Based on Quality

Each firm's quality was analyzed through descriptions of their basic burgers. Jack-in-the-Box presented the lowest emphasis on quality, describing the burger simply as a "beef patty." McDonald's ranked second lowest, as they highlight their burgers being made of "100% pure beef" and free of preservatives. Wendy's has built a brand reputation surrounding their "fresh, never frozen beef," also specifying their burgers being 100% pure beef. Shake Shack is by far the leader in emphasis on quality, with a menu description stating "freshly ground, never frozen, from 100% Angus beef that's pasture-raised, grain-finished—no hormones or antibiotics, ever," highlighting not just the purity of the patty, but also where it's sourced.

Evaluation of Shake Shack Relative to Future Industry

Shake Shack's Leading Position in Transition

Shake Shack is poised to yield the highest future returns having preemptively capitalized on external environmental pressures that are forcing competitors to reactively adapt and imitate. Utilizing the ERRC Framework, Shake Shack has fused elements of the traditional fast-food and the fast-casual industries to attract non-customers. As seen in *Appendix D*, Shake Shack has offered customers a leap in value, converting their dining area into an upscale community-centric space, and raising the quality of ingredients (Kim & Mauborgne). These qualities will allow Shake Shack to assume a dominant position in the industry in the future.

While all incumbents attempt to highlight their premium beef, Shake Shack is the only company whose beef is third-party quality certified antibiotic and hormone-free as part of their *Stand For Something Good* mission. The Natural Resources Defense Council (NRDC) graded all incumbents' beef sourcing, and Shake Shack was the only one to achieve an A, while all other incumbents received a D- and below (Brook). Shake Shack will maintain its competitive advantage in the future as the public continues to value food quality more and more, as its beef quality is inimitable at the incumbent's current menu prices. With these initial investments, Shake Shack has established a strong foothold that allows it to focus on advancements in variation, speed, and size, while the other incumbents are forced to continue with their imitation of quality to remain competitive in the industry.

Shake Shack's Focus on Variation and Speed Improvements

Shake Shack intends to improve both variation and speed in the future as these qualities are behind industry averages, as seen in *Appendix E*. Improvements in variation will come with increased product offerings while remaining devoted to their "Stand for Something Good" mission. To introduce alternative options and steal share from competitors, items such as Hot Chick'n and Hot Chick'n Bites are expected to feature on the menu soon, along with a Veggie ShackBurger. However, Shake Shack aims to make these variations mainstays on the menu rather than temporary additions (Klein).

Furthermore, Shake Shack plans to improve its process speed by focusing on expanded formats including drive-thru, curbside pickup windows, and digital ordering integration. As seen in *Appendix F*, digital sales represent ~60% of sales, demonstrating the importance of Shake Shack offering the most streamlined and seamless digital experience as possible (Shake Shack 2020 Q3 Earnings Supplemental), and also highlighting the company's proven ability to weather the pandemic with much of its digital infrastructure has already been in place. They plan to integrate delivery capability within the native app and web ordering channels, as well as further integrating kiosks as a part of physical Shack designs with increased pre-order and pickup formats.

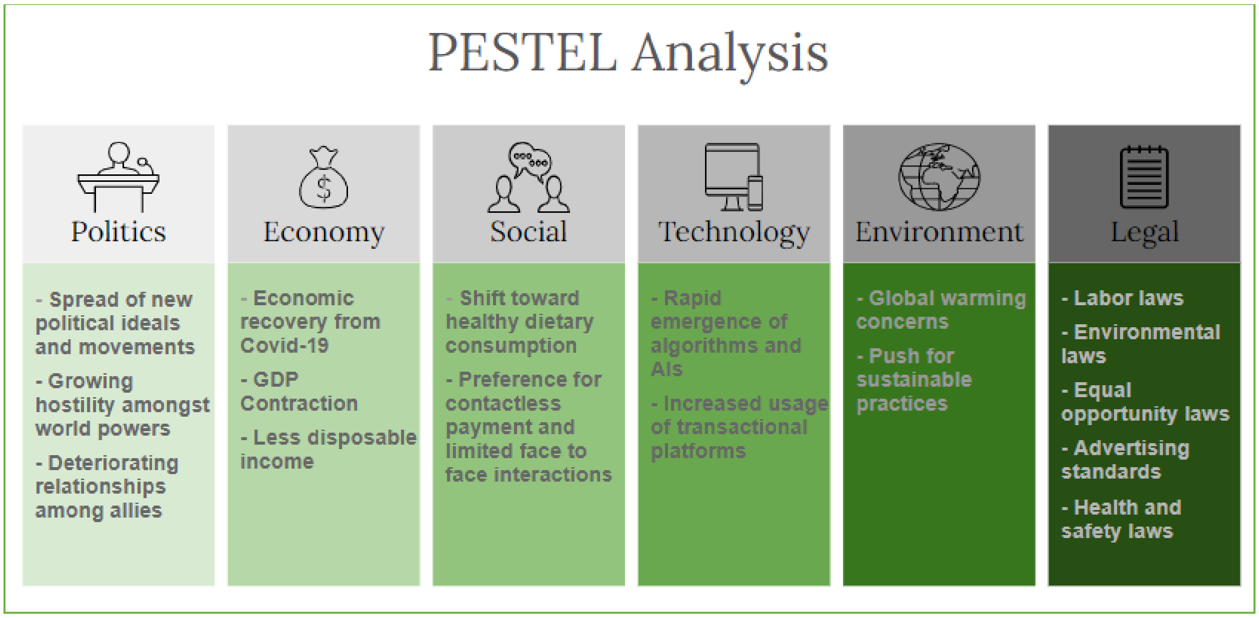
Shake Shack's Growth Strategy

Shake Shack's strategy for future growth primarily focuses on broadening and deepening its geographic footprint and culinary innovation. The company expects to open 35-40 new company-owned stores in new and existing markets, continuing their focus in existing markets in line with their strategy to build out from a market base while remaining cautious of market cannibalization. Additionally, Shake Shack uses a transnational strategy to coordinate between headquarters and other countries. These international locations do not stray far from the core menu as they aim to use American ingredients to standardize its supply chain operations as well as offer a consistent eating experience across the globe (Wiener-Bronner). Within the US, after an initial focus on menu-simplification in response to the pandemic, the company has restarted a rotating limited-time-only calendar to test consumer preferences in response to certain culinary explorations. For example, the VeggieShack was initially rolled out for testing in 2018, as an additional lighter veggie option to meet ongoing requests by consumers for more meatless options (Hoeffner). Because Shake Shack focuses primarily on quality as opposed to variety, they deploy rigorous testing for potential menu additions before officially launching product expansions into any location.

Shake Shack's clarity and decisiveness in mission and strategy positions the company best for future growth. With a strong understanding of its competitive advantages and opportunities for improvement, Shake Shack will continue to outperform and provide the best return on investment.

Appendices

Appendix A: PESTEL Analysis of the Current Quick Service Hamburger-Oriented Industry



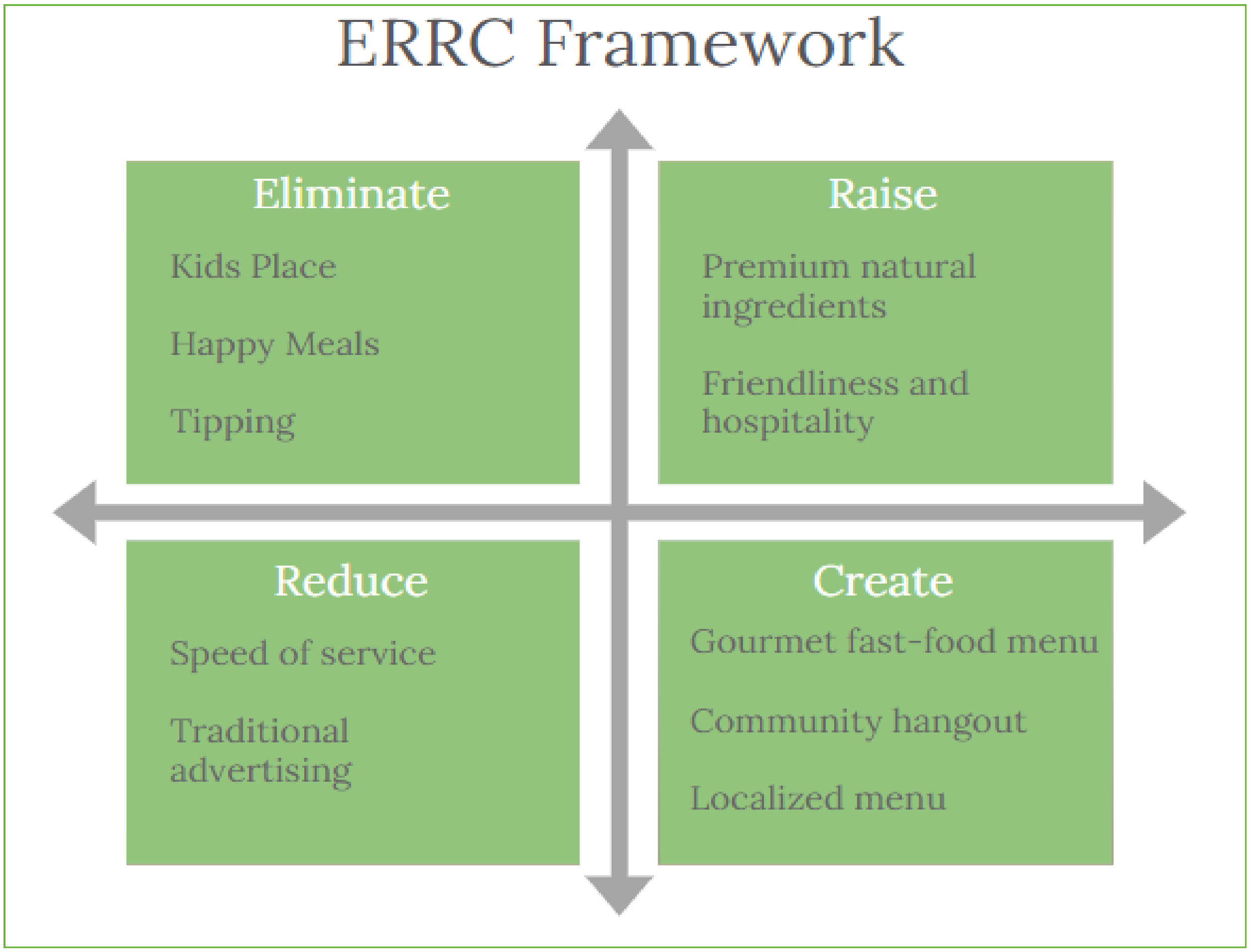
Appendix B: Design of Stores

Typical Traditional Style of Fast Food Restaurants during the Early 21st Century

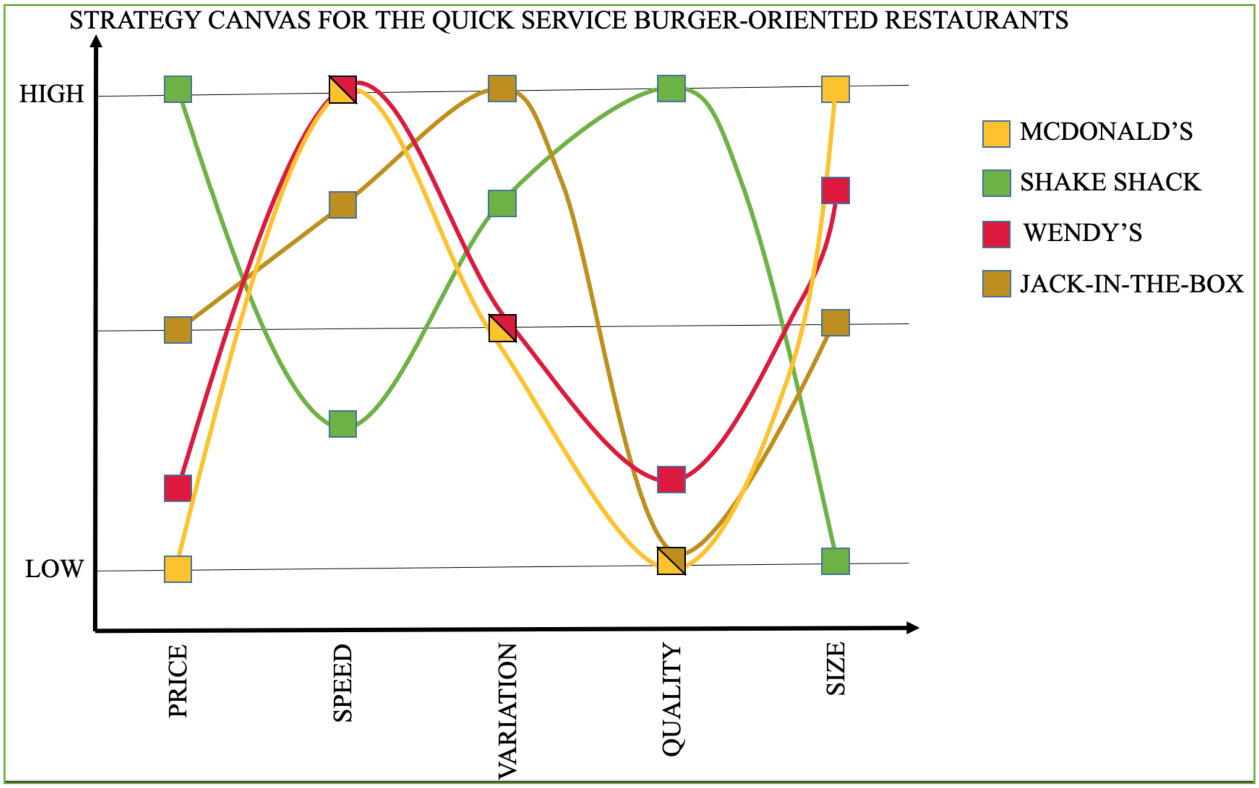
New Remodel of Restaurants, Upscaling Dining Area and removing Children's Play Place

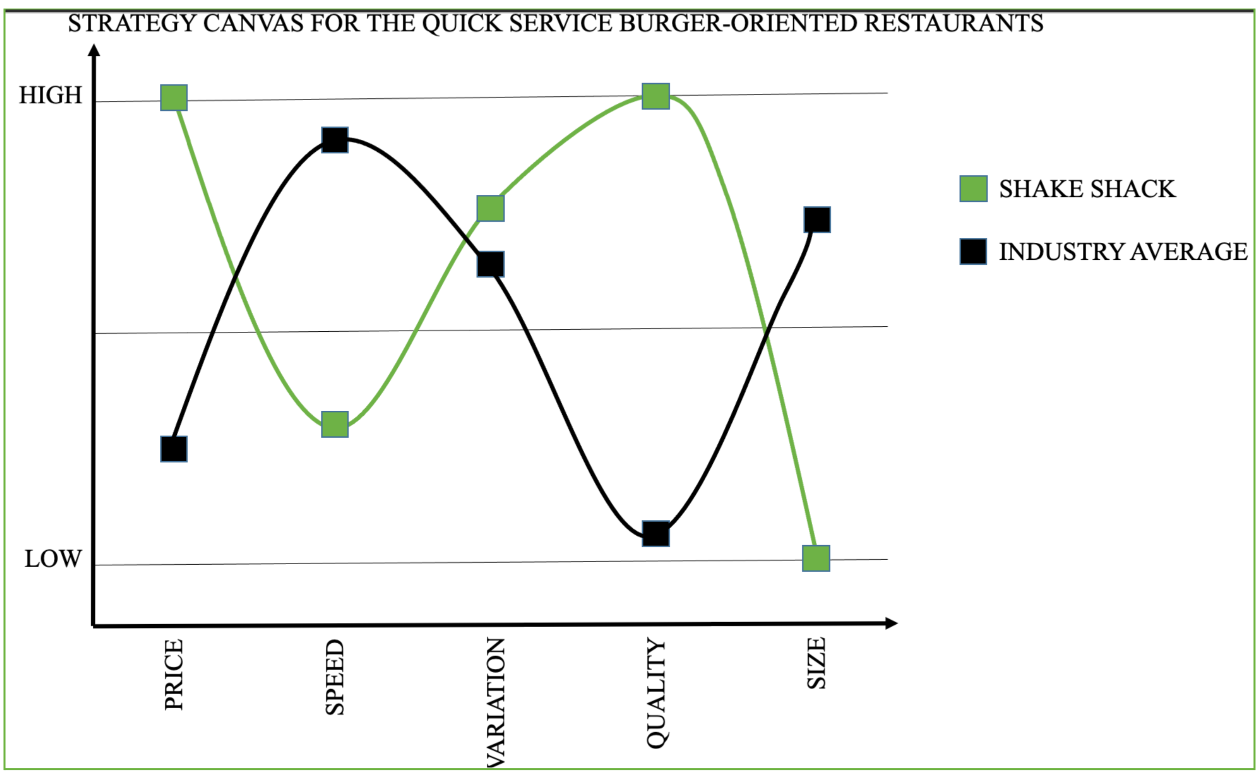
Appendix C: Positioning Chart of Incumbents in the Industry Based on Price and Quality

Appendix D: Analysis of Shake Shack based on the ERRC Framework

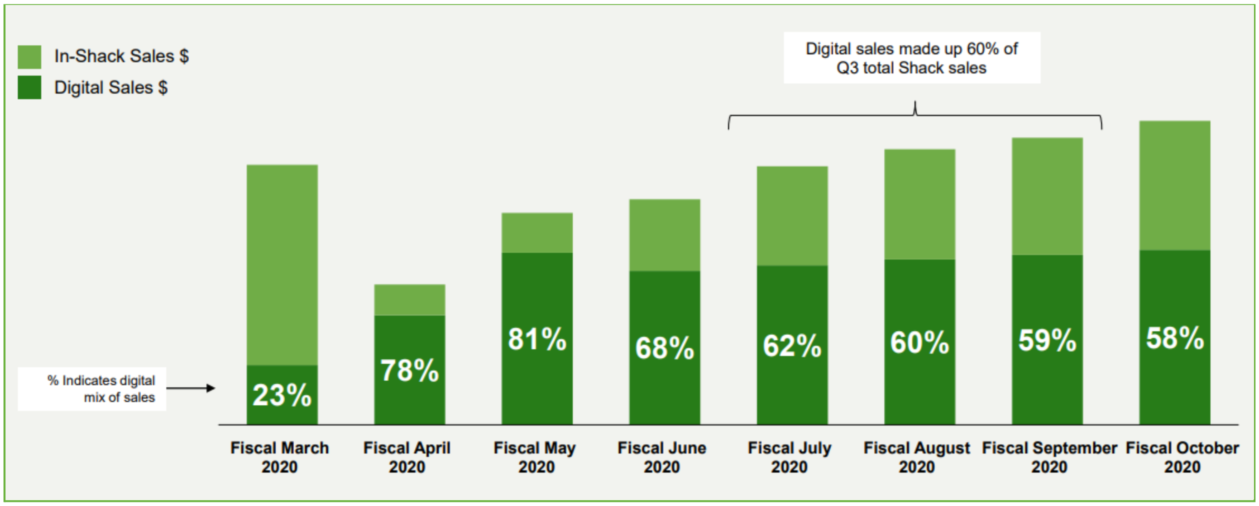


Appendix E: Strategy Canvasses





Appendix F: Shake Shack Digital Sales Mix



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