Chipotle Mexican Grill: A sustainability champion going global with China

Teaching Plan

This case has been tested in an undergraduate Capstone course in a hospitality management class in spring 2016 and was received very well by the participating students. The popularity of Chipotle Mexican Grill among students makes for a highly engaging discussion. This case is intended for a 90 - 110 minute discussion. It lends itself well to group presentations where pre-assigned groups may be asked to present their analysis and plans for Chipotle's expansion into China. Instructors may also use it as a final exam case. The following discussion is crafted for an instructor-facilitated open discussion of the case in class.

Discussion Questions for Class Instruction:

These questions are designed to help the faculty teaching this case by facilitating case method pedagogy. Faculty teaching case have the freedom to choose their own questions also to meet their individual needs. The authors are interested in hearing your comments and any suggestions you may have regarding case discussion.

- How did Chipotle succeed in the home market?
- Evaluate Chipotle's success using information provided in the case.
- Conduct a SWOT analysis of Chipotle. List your findings.
- What are the pros and cons of Chipotle's proposed expansion into China?
- Based on questions 3 and 4, if you were a member of Chipotle's Board of Directors, would you approve Chipotle's proposed expansion into China? Provide why and why not for your decision.
- If the Board were to approve Chipotle's expansion into China and you were hired as a consultant, craft a plan for the Chinese expansion using the 4P's of marketing strategy.

Discussion Questions with Answers:

1. How did Chipotle succeed in the home market?

Chipotle succeeded in the highly competitive restaurant industry through actively differentiating itself from its competitors. It had a unique concept, a commitment to environmentally sustainable sourcing practices, provided high quality wholesome food freshly prepared on premises using traditional cooking methods, and provided an interactive dining experience for its customers. The four pillars that became the foundations upon which Chipotle built its success in the U.S. market are captured in the Exhibit below. Instructors may choose to print this exhibit or project it on to the screen in the classroom.

2. Evaluate Chipotle's success using information provided in the case.

Each of the four pillars (displayed above) were practices that did not exist in the industry until Chipotle opened its first restaurant in Denver, Colorado on July 13, 1993. As such, Chipotle was able to garner significant first-mover advantages, which resulted in its high success, as measured by the following metrics.

A. Sales growth

B. Profit growth

C. Number of restaurants

D. Overseas expansion

E. Number of employees

F. Brand recognition

G. IPO success

H. Value created to its one-time investor (McDonald's)

I. Value created to its shareholders since its IPO

A. Sales Growth:

The case states that Chipotle was a hit from day one. On the first day of its opening, its sales were $450, followed by sales of $800 the next day, reaching $1000 a day mark shortly thereafter. Furthermore, within six months of its opening, sales per day grew to $3,000. Sales growth continued well into 2015.

- Case Exhibit 1 showed that by 2014, Chipotle's worldwide sales grew to $4.11 billion making it the fifth largest U.S quick service restaurant chains in the world.
- Case supports this trend. See annual growth rates given in the table below.

	2011	2012	2013	2014	2015
Sales	2,269,548	2,731,224	3,214,591	4,108,269	4,501,223
Annual Sales Growth		20%	18%	28%	10%

B. Profit growth:

In spite of the high food costs stemming from its sustainability strategy, known as "Food with Integrity," and cooking practices, Chipotle remained profitable.

- Case shows that the company's profits increased from $214.95 million in 2011 to $475.602 million in 2015, a 2.2x growth in profits in five years. Annual growth rates given on the next page are equally impressive.

	2011	2012	2013	2014	2015
Total Share-holders' Equity	1,044,226	1,245,926	1,538,288	2,012,369	2,127,974
Annual Growth rates	--	19%	23%	31%	6%

C. Number of Restaurants:

Chipotle grew in the U.S. through company-owned restaurants instead of franchising. As of 2015, Chipotle had a total of 2010 operating restaurants, excluding the other brands it owns, 13 Shophouse - Southeast Asian Kitchen restaurants serving Asian cuisine, and 3 Pizzeria Locale restaurants serving pizza and Italian food.

D. Overseas Expansion:

The case notes that Chipotle opened its first foreign restaurant in Toronto, Canada, in 2008. In 2010, it expanded to the U.K., to France in 2012, and to Germany in 2013. By the end of 2015, Chipotle owned a total of 23 restaurants overseas.

E. Number of Employees:

Employment data given in the case indicates that by the end of 2015, Chipotle had a total of 59,330 employees on its payroll. Details are as follows.

Employment type	**Number**
Salaried Employees	5,100
Hourly Employees	54,230
Total	**59,330**

F. Brand Recognition:

As a niche player in a highly competitive segment, Chipotle achieved the impossible. Case Exhibit 2 shows that Chipotle was ranked fifth worldwide among the most valuable brands in the industry, behind McDonald's, Starbucks, Subway, and KFC.

G. IPO Success:

According to the case, Chipotle's IPO (initial public offering) in 2006 was hailed as the "best IPO since 2000." The overwhelming demand for the company's shares on the first day of its IPO on January 25, 2006 sent the stock price soaring. In effect, the stock price on the day of the IPO doubled indicating the enthusiasm and optimism investors had for Chipotle's brand and the company's distinctive positioning.

H. Value Created to Its One-Time Investor, McDonald's:

McDonald's investment in Chipotle signals the confidence of the former in Steve Ells' leadership and the merit of Chipotle's unique business model in the industry. McDonald's would have not invested in the young company unless it saw high potential for returns on its investment. Even though the partnership between McDonald's and Chipotle lasted only from 1998 to October 2006, there was mutual value created. Chipotle gained the capital needed for rapid expansion while McDonald's initial investment of $360 million reaped an impressive 416% return.

I. Value Created to Its Shareholders Since Its IPO

Since its IPO in 2006, Chipotle created stellar returns to its shareholders. According to case, even with the declines experienced from 2014 to 2015, Chipotle's cumulative stock returns exceeded both the S&P 500 and the S&P Restaurants returns. Case indicates that the value created by Chipotle to its shareholders was superior. Earnings per Share rose from $6.89 in 2011 to $15.30 in 2015. The annual growth rates of Chipotle's Shareholders' Equity are displayed below.

	2011	2012	2013	2014	2015
Net Income (Profits)	214,945	278,000	327,438	445,374	475,602
Annual Growth rate		29%	18%	36%	7%

3. Conduct a SWOT analysis of Chipotle vis-à-vis the Chinese market opportunity. Based on the SWOT results, if you were a member of Chipotle's Board would you approve of Chipotle's proposed expansion into China?

Below is a SWOT analysis of Chipotle as it considers expansion into China. This SWOT analysis can be modified as environmental changes affect the SWOT.

Strengths:

- Clear and consistent business concept
- High position as a popular and sustainable U.S. chain brand (see case Exhibit 1).
- Strong brand image (see case Exhibit 2).
- Strong brand management practices
- Solid Sales and profit performance (see case Exhibits and discussion presented earlier).
- Good returns to investors along with high stock performance makes this company attractive to investors (see case Exhibits and discussion presented above).
- Strong track record of attracting capital from investors and the stock market.
- Management's ability to create a supply chain using local and sustainable sourcing practices
- Leadership expertise in dealing with uncertainties in the supply chain associated with dealing with local small farmers using organic and/or sustainable farming practices.
- Creating value in local communities.
- Unique culture of promoting a high performance culture as

well as environmental stewardship and social responsibility.
- Strong human resource practices, including hiring, training, and promotion from within the organization.
- Fast, healthy, and innovative eating experiences fits in the lifestyle of modern Chinese youth
- Mature restaurant chain operations
- Convenient food service systems that meets the emerging needs of the urban China
- Affordable pricing strategy of quick casual restaurant would be attractive for a large population, including the Chinese
- The menu variety provides wide choices for customers with different tastes
- Effective order line can serve more customers during the busy rush hours
- The spicy taste of Chipotle Mexican Grill is novelty to Chinese market.
- Spicy flavors are actually preferred over the bland soy sauce in some parts of China.

Weaknesses:
- The presence of two (co-) CEOs increases costs, duplication, bureaucracy, and constrains the company's ability to react quickly to changing market trends.
- Lack of proven international experience, especially in Asia, in the leadership team.
- High labor costs (as a percentage of sales): ranging from 22% to 24%. Taken in the context of the large proportion of hourly employees (91.4%) in comparison to salaried employees (8.6%), it signals the existence of a potential labor problems in the form of high labor turnover.
- The high performance culture in the organization may increase stress levels at work, thus potentially leading to the risk of high labor turnover.
- Promoting from within the ranks of the organization constrains the ability of the company to hire the staff and talent required to pursue high growth as well as hiring managerial staff with the necessary expertise and experience to seek expansion into foreign markets like China.

Opportunities:
- China is an economically vibrant economy as shown in the data presented in case Exhibits.
- The popularity of the Chinese economy in attracting foreign direct investment (FDI), as shown in the FDI trends in case Exhibit, implies the existence of a sophisticated infrastructure and talent to support multinational corporate operations.
- China is a large market for U.S. quick-casual food; see growing population statistics shown in case Exhibits.
- Data presented in the case Exhibits suggests rising incomes, prosperity, and buying power of Chinese consumers.
- Presence cheaper labor and operational costs
- Given the declining growth in Chipotle's sales and profits seen in 2015, China offers a good avenue for Chipotle to use the Chinese expansion as a way to decrease its dependence on the U.S. market by engaging in geographical diversification.
- Large market potential that is eager to try something new from US.
- China has vast room for further development
- A well-developed agricultural sector in China can provide abundant high-quality supplies at cheaper prices than in the U.S.
- There are many potential locations for Chipotle's outlets in China beyond the urban markets
- China can act as a platform to support further Asian expansion, such Japan and South Korea
- Densely populated Chinese urban markets offer great opportunities for market domination
- Chipotle will have first movers' advantage in the Mexican food segment.
- Globalization and the westernization of Chinese youth makes them more receptive to western menu items.
- The prevalence, access, and popularity of the Internet provides unprecedented marketing opportunities through social media.

Threats:
- China is an unknown region for Chipotle.
- Chipotle faces the threat of cultural risk due to the major socio-cultural differences between the U.S. and Chinese consumers.
- The political risk emanating from the Communistic government in China and its strong controls over foreign businesses is risky for inexperienced players like Chipotle.
- Chipotle's slow overseas expansion suggests the existence of psychological barriers among Chipotle's leadership team.
- Chipotle is an unknown brand in China, thus, it may demand extensive consumer education.
- Case Exhibit suggests strong competition among leading companies in the industry as well as the difficulty of gaining market share quickly.
- Expansion into China will be slow and time-consuming
- Patience is required as Chinese slowly adapt to the joy of eating a burrito, a Mexican delight.
- A number of competitors, such as foreign and Chinese fast-food restaurant chains
- Challenges in political economy of the local governments.

- Potential food safety risks in the local supply chain.
- Uncertainty with consumer acceptance of the Chipotle Mexican concept in China.
- High real estate prices in urban locations leading to high leasing and maintenance costs.
- Rising labor costs in China have the potential for cutting into margins.
- The expansion into China would expose Chipotle to deeper foreign exchange risks. This translation risk is magnified due to the fact that Yuan, the local currency, is a soft currency.

What are the pros and cons of Chipotle's proposed expansion into China?

This question allows to bring the discussion to a conclusion by highlighting the key pros and cons of expanding into the Chinese market. Below is a summary exhibit conceptually displaying the pros and cons of the proposed opportunity discussed in the earlier question. At the end of this discussion, take a vote and record how many students are in favor of expanding into China and how many oppose it. Do not be surprised if the majority of students vote in favor of expanding into China. If you have Chinese students in the class, seek their perspective on the case. We did this in Spring 2016 semester with very exciting and insightful comments from Chinese students.

4. Based on questions 3 and 4, if you were a member of Chipotle's Board of Directors, would you approve Chipotle's proposed expansion into China? Provide why and why not for your decision.

There is no specific answer to this question. The response to this question depends on various factors including level of students (graduate or undergraduate), upper level or lower level, discipline marketing or international business or hospitality-tourism); time allowed for the case etc. But here are suggestion to help with the process of class discussion.

a. **Pros:**

- China is an attractive market to introduce a new American restaurant concept.
- China is the second largest economy thus return on investment would be very attractive for an American restaurant concept to enter.
- China can be a good gateway to other Asian markets.
- China has large middle class population with high disposable income, thus, make it a lucrative market to enter.
- The current interest rates in the USA (in 2016) are at historically low levels, thus, it is a good time to leverage and expand into new markets.
- Chipotle concept operations are very simple in set up (layout) thus it is easy to adapt to Chinese markets.

b. **Cons:**

- Chipotle is experiencing enough domestic problems in terms of food safety and sanitation etc., thus, it is not the best time to enter a new market.
- Taco Bell has tried and failed as Chinese consumers are not familiar with Mexican foods.
- Typically Chinese consumers prefer not to tortillas since bread is not part of their normal diet. iv. Chinese prefer distinct flavors that are not necessarily compatible with Mexican sauces.
- Chinese economy is currently slowing down, thus caution is necessary when entering such markets.
- Chipotle doesn't have much experience in Chinese markets.

5. If the Board were to approve of Chipotle's expansion into China and you were hired as a consultant, craft a marketing plan for China expansion.

Case instructors can take two approaches while addressing this questions:

a. **Approach One:** This question can be given as a take home assignment that will be discussed in the class. This approach bring incredible diversity of critical thinking to the class discussion. In this approach, instructors can assign this question as a group assignment or as an individual assignment depending on the size of the class and the level of the class.

b. **Approach Two:** This question can be addressed an in-class Experiential Learning Assignment. The class can be divided into small groups of 3 to 4 students each. After all other questions are discussed, each group can be given 15 minutes to develop their group plan for Chipotle to enter China. Then each group is encouraged to present their plans to the class in about 5 minutes.

Here are some more discussion points for case instructors as they present their case to the class. These discussion points are provided to the benefit of the instructors. Instructors may want to discuss 4Ps of marketing as a part answer to this question. Choosing more appropriate target customers can simplify the path of entering China's market, and provide accurate directions for strategy implementation. Chipotle can conduct a series of marketing studies based to meet the needs and wants of its target segment.

Potential Target Segment:

Some of the potential market segments may include middle class, working families, working adults / singles, youth, college students.

Some of the characteristics of these segments:

High priority on convenience to meet their busy life styles, Making a statement as innovators that adapt easily to the foreign brands; Limited dining time; Highly dependent on the Internet; Seeking symbols of modernism and urban styles; More disposable income. This fixed menu concept can be very attractive for China's market as they are already trained by McDonalds to accept limited menu choices. Additionally, Chipotle may consider menu modifications / adaptions to meet the tastes of their Chinese customers. Developing some local menu offerings in addition to the traditional Chipotle menu choices is one of the options available to Chipotle. Since tea is a popular drink in China, developing menu offerings that are compatible with traditional Chinese green tea and flavored teas is prudent option. In addition, inclusion of local delights such as duck, fish, lamb, and hot pot beef may be a good choice as Chipotle adapts to the Chinese markets. Similarly, China has an incredible option of local vegetables that can be easily adapted to Chipotle style of service. Most importantly including a wok into their food production measure may be highly desirable. Having some Chinese products on their menu, Chipotle may have a smoother transition into China.

An important point to remember is that most Chinese are lactose intolerant and cannot consume cheese products. Subway could not offer cheese on its subs since consumers rejected it. Chipotle may want to carefully consider before offering shredded cheese on its burritos. In addition, most Chinese are not familiar with Mexican flavors and foods. Thus, Chipotle may have an uphill battle in introducing Mexican foods to China.

Post Script

While the case was being developed and tested, the Chipotle Mexican Grill has experienced a major setback to its reputation and financial performance. It was the result of numerous foodborne illness reports from multiple states after eating at Chipotle Restaurants. The primary causes of the reported illnesses were E. Coli, Salmonella and Norovirus. The Center for Disease Control (CDC) has investigated these incidences but could not identify one single source of multi-state food poisoning cases. It still remains a mystery. But Norovirus can be traced easily to a human source such as a sick employee that is sneezing or coughing while working. As a result, Chipotle changed its human resource policies to address the problem of sick employees working while being sick. To address the unidentified food supply chain contamination problem, Chipotle hired a nationally known food scientist as the food safety czar for the company. In spite of its best efforts to minimize the damage to its brand reputation and stock value, the stock price of once darling of the Wall Street has dropped from nearly $900 a share to $385 a share.

Food borne illnesses are not uncommon in the foodservice industry and it is not unique to Chipotle. Earlier major restaurant chains including McDonalds, Wendy's, Jack in the Box, Taco Bell, and Sizzlers Restaurants etc. also experienced foodborne illness outbreak. But the severity of the current situation has dampened the expansion spirits of Chipotle into China. At this point, Chipotle still planning to forge ahead with its expansion plans with improved food safety programs in place. Some experts believe that since Chipotle uses various local sources promoting sustainability, thus, it is very difficult to control the standards for food safety. It is the price Chipotle has to pay to be the sustainability champion for the restaurant industry. This is one of the hidden risks of going green. At the time of this case report, July 2016, the stock price of Chipotle is showing early signs of recovery moving from a low of $386 to $395 per share. No new cases of foodborne illnesses are reported. Chipotle spent millions of dollars on free food giveaway programs to bring back the customers. It seems to work but with less than exciting results. Chipotle is expected to launch a new Ad campaign touting its sustainability champion credentials in comparison to other restaurants that serve frozen or processed foods. This could be the turning point for Chipotle for a brighter future.

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