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A Strategic Audit of Chipotle Mexican Grill, Inc.

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A STRATEGIC AUDIT OF CHIPOTLE MEXICAN GRILL, INC.

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Abstract

Food is a part of every person's life, and in today's society people are looking for ways to get quality food in a quick and easy manner. Chipotle Mexican Grill is a fast-casual Mexican restaurant that aims to provide "Food with Integrity" quickly while providing a positive dining experience. Within the competitive restaurant industry, Chipotle has done many things to stand out. This leaves the question: What strategies does Chipotle use to successfully compete in such a hectic industry and what strategies will Chipotle employ to grow in the future? This paper analyzes Chipotle by looking at its background, products, financials, and competitive advantage. It also goes into an internal and external analysis by using Porter's 5 forces, SWOT Analysis, and PEST analysis. The information laid out in these analyses are then used to create strategy recommendations and develop an implementation plan for the most effective strategy.

Key Words: Chipotle, strategic audit, restaurant, fast-casual

Background

Chipotle Mexican Grill, Inc. is a publicly traded corporation that runs the Chipotle Mexican Grill, commonly known as Chipotle, chain of restaurants. It was founded in 1993 in Denver, Colorado when the original Chipotle was opened by founder and culinary student Steve Ells. Ells' original goal was to make enough profit by selling burritos to open up a fine dining restaurant. However, once he began selling nearly ten times the amount needed per day to remain profitable, he began to put all of his focus into expanding his company.

A big milestone in Chipotle's history was the investment received from McDonald's in 1998. Interest from the fast food industry giant allowed Chipotle to quickly expand the number of restaurants in operation. By 2001, McDonald's had actually become Chipotle's largest investor. In the seven years following McDonald's initial investment in 1998, the number of stores grew from just 16 to over 500. However, the next year McDonald's completely divested as McDonald's decided to focus in solely on its own chain of restaurants. Following McDonald's divestment, Chipotle began buying out the independent Chipotle franchises and making all restaurants company-owned. Shortly thereafter, Chipotle went public in 2007 (Daszkowski, 2018). As of December 31, 2017 there are 2,400 Chipotle restaurants in operation(Chipotle 2018). The company is now headquartered in Newport Beach, California after originally being in Denver, Colorado since its founding (Whitten, 2018).

Products

Chipotle's menu follows a typical Mexican restaurant theme, consisting of items such as burritos, tacos, burrito bowls, quesadillas, and salads. Along with food it offers soft drinks and a small selection of alcoholic beverages. Chipotle operates within the fast-casual segment of restaurants, meaning it places a focus on providing quality food in a timely manner at a reasonable price. Outside of the food it provides, Chipotle has a mobile app and website where customers can order food online. These services have allowed Chipotle to better identify customer patterns and reach out to new and former customers (Chipotle 2018).

Mission Statement and Current Goals

Chipotle's mission statement is to provide "Food with Integrity." This mission involves three main ideas:

- Serving the very best sustainably-raised food possible with an eye to great taste, nutrition, and value.
- Supporting and sustaining family farmers who respect the land and the animals in their care.
- Using meat from animals raised without the use of antibiotics or added hormones whenever possible (Irving, 2014).

Chipotle's goals keep its "Food with Integrity" mission in mind. Its main goal is to have a "focus on safe and delicious food made with better ingredients," (Chipotle, 2018). This goal involves having a small focused menu, providing nutritious and natural food, and having close relationships with suppliers. Another big goal is to provide an excellent guest experience. This goal involves having friendly well-trained staff members and constantly innovating ways to provide food to customers, including online ordering and delivery. Chipotle still plans on increasing the number of restaurants it operates. In 2018, it planned on opening around 150 restaurants which is slightly below average per year. This discrepancy is because the company is focusing more of its resources on finding ways to improve its customer experience (Chipotle, 2018).

Situation Analysis

External Analysis

PEST Analysis

There are a variety of external factors that affect how Chipotle operates.

Political

Chipotle's operations depend on a variety of regulations defined by federal and local food safety programs. There are a variety of changes to these regulations that could have effects on the company. Laws surrounding more extensive menu labeling or marketing of food products could affect customer perception. For example, sometimes Chipotle gets meat from providers whose animals eat genetically-modified organisms (GMO), but it still advertises that it is against the use of GMOs. Additionally, laws relating to climate change could affect how Chipotle's food suppliers create food and how the food is transported.

Economic

The biggest economic influence on Chipotle is the fluctuating prices of products. Since Chipotle prefers to use smaller family-based food providers, it is more difficult to acquire the necessary quantity of ingredients as compared to getting ingredients from large suppliers. If the economy is in a down period, suppliers may need to increase their prices which could have a negative effect on Chipotle's net profits. Likewise, people are less likely to go out to eat during an economic downswing.

Social

Chipotle's social factors have had the biggest impact on its net profits recently. In late 2015, there was an E. coli outbreak at 11 Chipotle restaurants that heavily damaged its public image. Chipotle's stock price and operating income dramatically decreased following the incident, but have since nearly returned to the numbers before the incident (Daszkowski, 2018). This fiasco has caused Chipotle to focus much more on food safety and quality assurance. If another outbreak like this were to happen, it could permanently damage Chipotle's image and stock and profit would most likely plummet.

Technological

Recently, a multitude of technological advancements have emerged recently that have affected how Chipotle restaurants operate. The prevalence of online ordering has forced Chipotle to adapt and create ways for customers to order online. Additionally, the emergence of online grocery delivery services, such as Hy-Vee Aisles Online and HelloFresh, has been a threat to Chipotle. However, new services that deliver restaurant meals, such as Doordash or Uber Eats, have helped to combat this threat. Lastly, new technological advances in food production that could either increase crop yields or lower prices of ingredients could have a positive impact on Chipotle.

Porter's 5 Forces

Bargaining Power of Suppliers

Chipotle gets its ingredients from a variety of smaller family farms. This gives Chipotle leverage over its suppliers, because if one of them was to ask for more money Chipotle could simply go to a different farm for ingredients. The drawback to this is if Chipotle begins to pay suppliers too low, it could damage its image among consumers. However, there is a limited number of farms that do not use GMOs and abide by Chipotle's "Food with Integrity" motto, so the suppliers that meet Chipotle's standards could attempt to raise prices collectively.

Bargaining Power of Buyers

Chipotle is positioned as a restaurant that offers "reasonably priced" food (Chipotle, 2018). This limits the amount of bargaining power that buyers have when it comes to prices, as Chipotle is not concerned with having low prices compared to fast food restaurants like McDonald's or Taco Bell. Buyers have bargaining power over what is going into their meals though, since Chipotle aims to provide quality food. If Chipotle's ingredients declined in quality, the company would suffer monetarily and/or through negative public reactions.

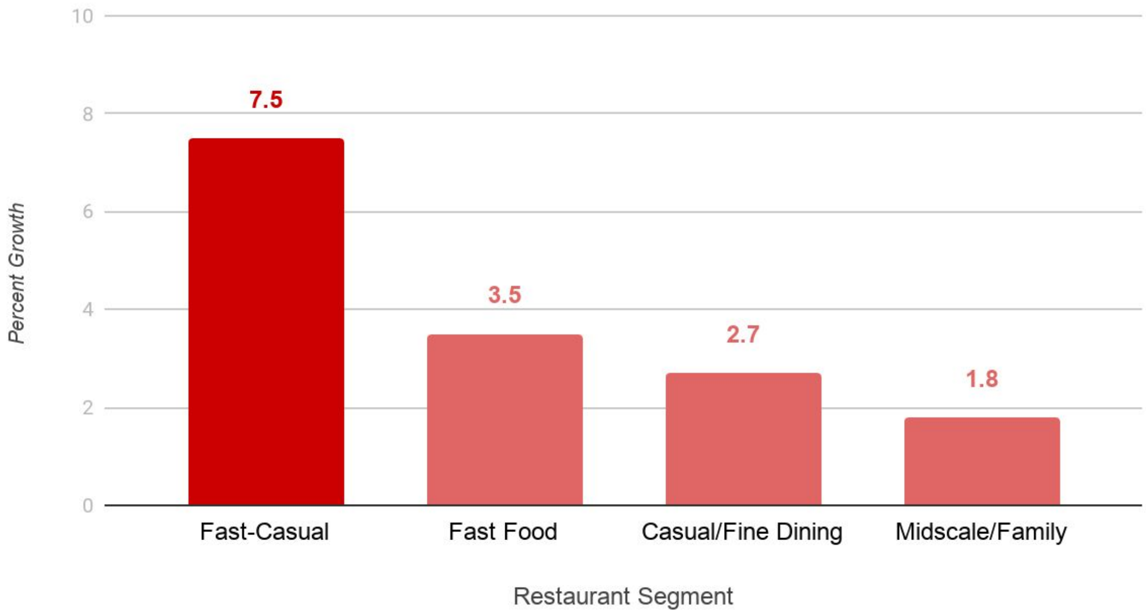
Threat of Substitutes

Chipotle faces competition from a variety of sources. At the highest level there are a multitude of places that provide food that can be seen as substitutes, including restaurants and grocery stores. Additionally, a variety of Mexican restaurants serve as substitutes and range from cheap fast food to fine dining. Lastly, there are a number of other fast-casual restaurants that serve as substitutes. Chipotle differentiates itself among many of its substitutes by providing Mexican food in a fast-casual setting. However, there are still some substitutes in this segment, including its main substitute, Qdoba.

Threat of New Entrants

Fast-casual dining is one of the fastest growing segments of restaurants with an expected growth of 7.5 percent in 2019, which is more than double the expected growth of any other segment (**Figure 1,** Maze, 2018). An increase in the number of fast-casual restaurants increases the threat of new entrants against Chipotle. New entrants, such as online grocery services, pose a threat for Chipotle outside of the fast-casual segment. These services are becoming more common and serve as an alternative to getting a meal at Chipotle.

Figure 1: Projected 2019 Growth within Restaurant Segments



Source: Maze, 2018

Competitive Rivalry

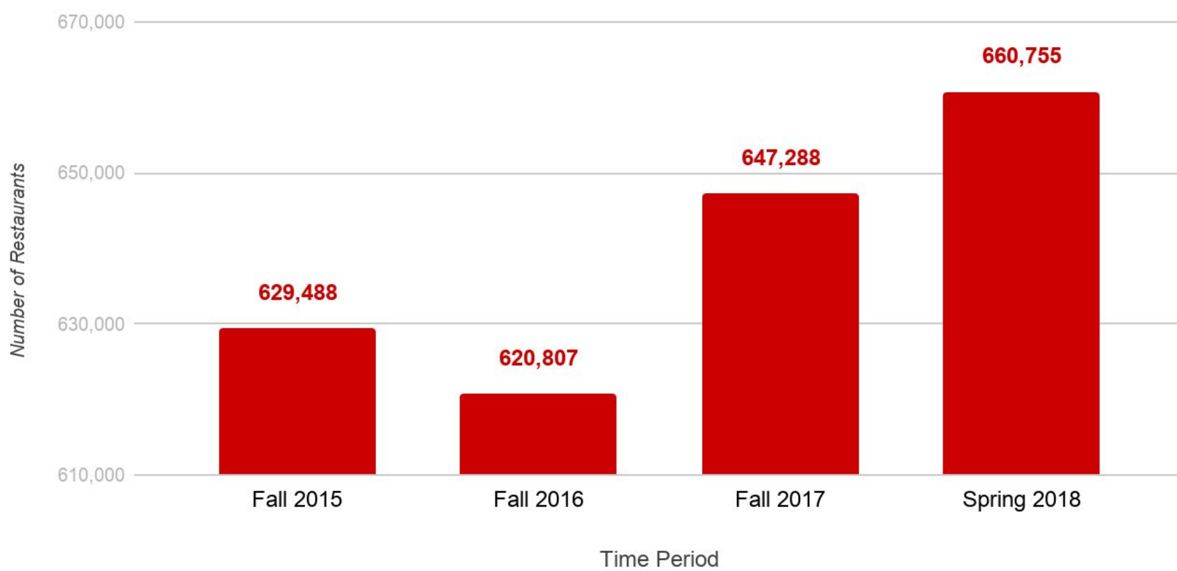
The restaurant industry is extremely competitive, with over 650,000 restaurants open in the United State as of Spring 2018 (Statista, 2019). Differentiation across multiple factors (price, taste, dining experience, speed of food delivery, brand name, public perception, etc.) is vital to success. Chipotle has focused on food quality, taste, and customer experience and has been successful thus far. Other restaurants may try to emulate Chipotle's success by following the same approach. This would be detrimental long-term as Chipotle would lose what differentiates themselves amongst its competitors.

SWOT Analysis: Opportunities and Threats

Opportunities

Chipotle has three main opportunities for growth. First, Chipotle can grow as a company by expanding into more international markets. As of 2017, only 13 of the 2,400 Chipotle restaurants operate outside of the United States and Canada (Chipotle, 2018). Expanding globally could increase its profits long-term even if expansion may be more expensive short-term. Another great opportunity for Chipotle is the booming restaurant industry. From Fall 2016 to Spring 2018 the number of restaurants in the United States grew by over 6 percent, as shown in **Figure 2** (Statista, 2019). This is likely in response to the United States' economy being stable which allows consumers to spend more money on luxuries, like eating out. Chipotle could capitalize on this by opening more restaurants while the demand is still present. Lastly, Chipotle has the opportunity to change the way that food is provided to customers. Chipotle not only has an app that allows customers to order food and pick it up without waiting in line at the store, but is also looking into other innovative ways for customers to get their food quickly. Chipotle has begun rolling out "Chipotlanes" at select restaurants, which are effectively drive-thrus where ordering takes place in the Chipotle app instead of at a drive-thru menu (Taylor, 2019). Coming up with more innovative ways to serve customers would benefit Chipotle since take-out orders comprise two-thirds of Chipotle's transactions (Lutz, 2014).

Figure 2: Number of restaurants in the United States Fall 2015 - Spring 2018



Source: Statista, 2019

Threats

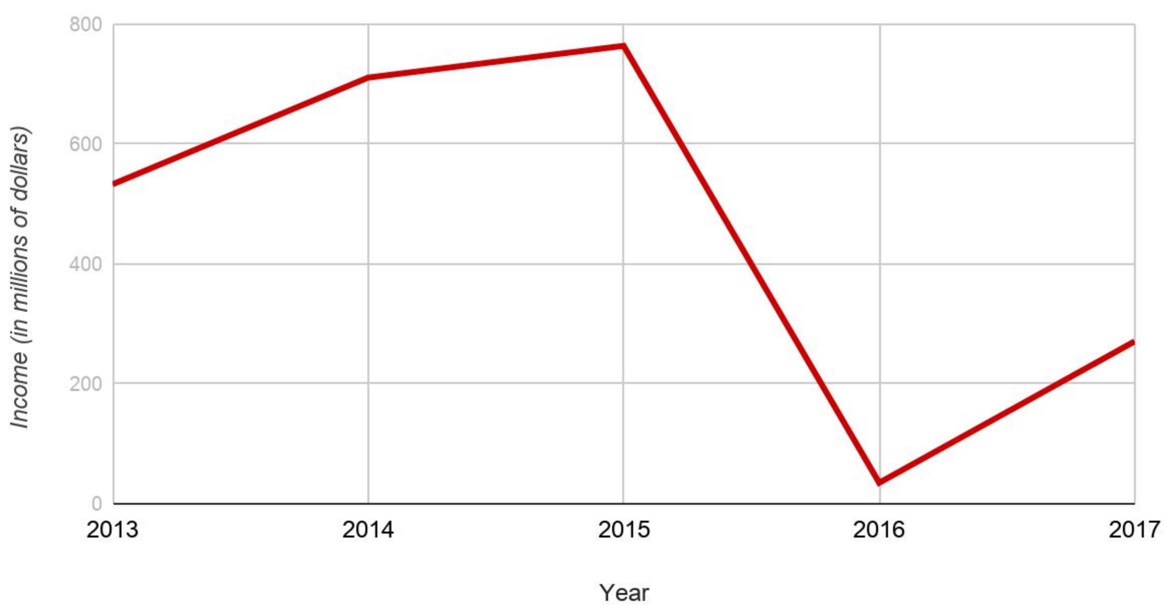
There are three main threats that inhibit Chipotle's ability to grow as a company. The first is the intense competition within the restaurant industry. Not only do companies have to constantly come up with new ideas to differentiate themselves, but they also depend on how effective competitors are at attracting customers. This dynamic can lead to volatility in popularity amongst restaurants since they are constantly trying to attract customers with deals or new menu items. Another threat is food safety regulations. Chipotle has had issues with food safety in the past. Stricter food safety regulations in the United States or countries Chipotle tries to expand into would lead to higher costs for testing ingredients and training farmers. Lastly, increased labor costs are a huge threat to Chipotle. Minimum wage in many parts of the United States has been on the rise recently and many countries in Europe have high minimum wage requirements. However, minimum wage requirements are not the only increasing costs. Chipotle has had to begin offering more benefits to managers, such as additional paid time off and signing bonuses, to compete with similar trends in the market (Chipotle, 2018).

Internal Analysis

Financials

After a rough 2016, Chipotle has rebounded financially. Following the E. coli outbreak, stock prices and operating profits plummeted. However, both have been recovering rapidly (See **Figure 3**). Chipotle's total debt sits at $681 million while its total equity is just over $1.63 billion. This gives Chipotle a debt-to-equity ratio near 0.42, meaning Chipotle pays more with equity than with debt. This implies that Chipotle has a more conservative capital structure which typically means lower growth rates. However, for the past three years Chipotle's total debt has increased while total equity has decreased, showing that changes are being made to the capital structure. Chipotle's operating expenses have increased annually from $2.68 billion in 2013 to $4.21 billion in 2017. This increase can be attributed to the rising costs of labor, food, beverages, and packaging, all of which account for nearly two-thirds of Chipotle's operating expenses (Chipotle, 2018).

Figure 3: Chipotle Annual Operating Income



Source: Chipotle, 2018

Chipotle owns 2,408 restaurants, 8 of which are new, experimental subsidiary restaurants. These properties, along with the equipment inside of them, make up $1.34 billion (65 percent) of Chipotle's total assets, and the property and equipment value is more than double the value of Chipotle's current assets. Another interesting point comes from Chipotle's cash flows. In 2015 and 2017 (the years surrounding the majority of the E. coli backlash) Chipotle spent hundreds of millions of dollars on investments. However, directly following the incident in 2016 Chipotle sold investments and made over $500 million. This shows a change in strategy based off the lower operating income. Chipotle sold some of its investments to make up for its failures. This strategy also shows smart long-term planning from Chipotle by having backup cash flows in case something goes wrong (Chipotle, 2018).

SWOT Analysis: Strengths and Weaknesses

Strengths

Chipotle has an abundance of strengths that have allowed itself to grow as a company. One of Chipotle's greatest strengths is its marketing. Chipotle has three forms of marketing: top-of-mind, brand, and local (Chipotle, 2018). Top-of-mind advertising is marketing that gets people to come into the store. Brand advertising is focused on getting customers to build greater associations with the Chipotle Brand, a reference to its mission statement "Food with Integrity." Lastly, local advertising involves promotions at individual locations that are intended to bring in new customers. Chipotle advertises through a variety of mediums including billboards, social media, television commercials, and flyers. Another strong point is Chipotle's ability to handle negative public reactions. Following the E. coli outbreak in 2015, Chipotle's stock price dropped by over $400 over the course of two years. However, through its commitment to food safety and its ability to cultivate positive customer experiences, Chipotle's stock price is currently within $50 of its all time high of $749 in 2015 before the incident (Yahoo!, 2019). Its ability to rebound from failures shows versatility and a strong sense of customer loyalty towards the company. Lastly, Chipotle's mobile app usage is a positive sign for the future. In Q4 of 2018, Chipotle's digital sales increased by 65.5 percent, which amounted to 12.9 percent of the company's sales. This increased usage of the app shows that customers are committed to the company, and it gives Chipotle more ways to reach out to customers.

Weaknesses

Although Chipotle has been successful, it still suffers from a few weaknesses. Food safety concerns is one issue that will likely affect Chipotle for a long time. The drawback of using small farmers is the farmers' lack of money to do as much testing on their crops and animals as big farmers. Not using antibiotics and pesticides also leaves ingredients with a higher risk of passing on foodborne illnesses. This forces Chipotle to spend more money on its end for food safety procedures. While Chipotle's small menu can be advantageous for how fast food can be served, it can also be a weakness. A lack of variety may prevent people from going to or even trying Chipotle. Also, if there was a shortage of one ingredient, it would have a bigger impact on Chipotle compared to other restaurants. Similarly, the lack of cheap options can limit the number of customers that go to Chipotle. Price point is a major contributing factor for where people choose to eat, and competitors have an edge on Chipotle in this area.

Competitive Advantage

One of the main advantages that Chipotle holds over its competitors is the dining experience. Chipotle prides itself on having great ingredients, a positive atmosphere, and quick delivery of meals. One of the main ways Chipotle maintains this is by making customers' meals in front of them. This experience allows customers to see what is going into their meals while having a positive interaction with the workers. Customers also get their meals in a timely fashion, which in turn, creates a positive customer experience. If customers do not want to do this, they can also order online and pick up their meals in the store with no line. This option adds another positive aspect to the Chipotle dining experience. Chipotle's commitment to quality food adds to its competitive advantage. The commitment to supporting smaller farmers who follow ethical practices is a positive in many people's eyes and can persuade them to choose Chipotle over its competitors. Lastly, brand name recognition is a valuable advantage, especially over local establishments. If people travel to new areas or move to a new location, they know what they are getting from Chipotle, as opposed to local restaurants.

Strategy Alternatives

Based on the analysis above, Chipotle could choose from three strategy alternatives. The first alternative is to expand internationally. Chipotle already has 24 restaurants open in Canada and 13 restaurants open in Europe as of 2017 (Chipotle, 2018). Expanding to more markets provides more revenue sources, but at the same time offers a lot of risk. Finding suppliers in foreign countries can be a problem for any restaurant. Chipotle's dedication to having the highest quality and most ethical ingredients makes this problem even harder to solve. Chipotle has also noted that it has limited brand awareness in international markets, which is another limiting factor. International expansion may initially be risky, but the long-term reward would be beneficial for expanding income sources.

Another alternative is to branch out into other styles of food, either within Chipotle restaurants or new subsidiary restaurants. Chipotle has already tried this previously with Tasty Made (a burger joint) and Pizzeria Locale. Tasty Made was a failure, lasting only two years in one location before shutting down. Pizzeria Locale operated in multiple locations but recently all were shut down outside of the Denver area. Although Chipotle has had a difficult time branching out into other food genres, expansion into new areas is not a lost cause. Chipotle used these ventures as a learning experience and stated that its “immediate focus [has remained] on thoughtfully growing the Chipotle brand” (Chipotle, 2018). However, Chipotle has also recognized that the inability to find new revenue sources limits its growth potential long-term.

The last alternative provides a more basic approach. It would revolve around Chipotle operating similarly to how it does today, but with an enhanced focus on food safety, menu variety, and innovative service. Chipotle must show its customers that it is committed to providing quality food to patrons, and that it is committed to preventing issues like the 2015 E. coli outbreak. This will help mend its public image over time. Chipotle has already begun experimenting with new ways for customers to order food through the use of the Chipotle mobile app. Finding additional ways to get customers their food easily and quickly, like the new Chipotlanes, will be advantageous and make customers more likely to come back. Lastly, Chipotle’s simple menu can be seen in many ways as an advantage. However, the small menu can be detrimental for other reasons, such as attracting new customers or handling food shortages. Increasing menu variety is not a new plan, as Chipotle has experimented with new menu items recently by adding queso and chorizo. There are a variety of ways that Chipotle could expand its menu to attract new customers. Currently, there are no seafood options at Chipotle restaurants although seafood is commonly seen as a necessity at other Mexican restaurants. Chipotle could also expand the number of plant-based ingredients it offers. Adding these options would be beneficial to most consumers, but even more so to pescatarians, vegetarians, and vegans, who all commonly have limited options at most restaurants. There are some downsides to this aspect of the plan however, as adding new foods to the menu requires research and development and may require finding new suppliers. These problems may be difficult to solve, but finding new ways to get customers inside the restaurant is vital to Chipotle’s long-term growth.

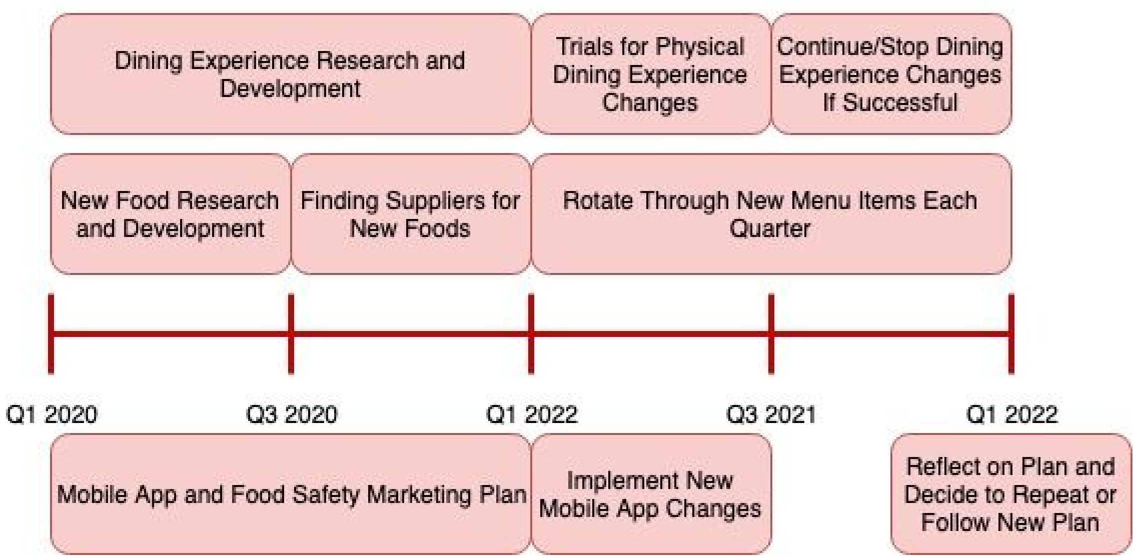
Strategy Recommendation and Justification

Of the three strategies the third option is the best. Chipotle has been successful since the E. coli scandal by sticking to its “Food with Integrity” motto while affirming its commitment to food safety. Continuing to affirm this commitment while also shaking up the menu and innovating the ways customers are served limits risk while adding ways to increase profits. Expanding internationally has been an issue for Chipotle thus far and there is no way of knowing if these efforts will improve. Likewise, Chipotle has had issues branching out into other food styles, so investing more time and money into that strategy poses a lot of risk. Increasing menu items is an important part of the third alternative. Expanding the menu is something Chipotle has done in the past and if foods aren’t successful it can simply take them off the menu (as it has done with chorizo). Even if a new menu item fails, advertising that something new is coming to the menu can boost sales, and providing more options appeals to a larger customer base. Chipotle’s increased mobile ordering rates is also a good sign for the future. Customers downloading an app is essentially free advertising as the app shows up on people’s phones while looking through their apps. It also allows Chipotle to easily send customers new deals if the company wants to. Coming up with additional ways for customers to order food will increase Chipotle’s profits. For example, having an option to schedule a weekly order is a great way to guarantee sales for Chipotle and a great way to guarantee a quick, easy meal for patrons. Continually improving how customers order food will provide Chipotle with a unique competitive advantage that will keep customers coming back.

Implementation Timeline

A rough timeline for the implementation plan can be seen in **Figure 4**. The plan will begin in Q1 of 2020. The first step in carrying out the strategy recommendation is research and development. This involves both researching and testing what new foods to provide and what ways the dining experience can be improved. This period will last for 6 months for new food research and a year for dining experience research. The six months following food research will be spent finding suppliers who share Chipotle’s values. During this one year period a massive marketing campaign for the mobile app and food safety commitment will happen. This will help improve Chipotle’s public image and get more app users before new changes are rolled out. Following this, Chipotle will spend three months at a time rotating a limited number of menu items to see how customers respond. However, if a menu item is extremely popular, changes can be made to make it a permanent option. New changes to the mobile app will also be implemented at this time. Any new physical changes to the dining experiences, like Chipotlanes, will go through trials in a limited number of locations for six months. Following this period, the decision to discontinue or further implement these ideas will be made on customer feedback, percentage of sales within the stores, and change in sales compared to similar locations without the new changes. This cycle can then repeat if deemed successful and reevaluated otherwise.

Figure 4: Implementation Timeline



Contingency Plan

The second best alternative is to expand internationally. Chipotle has limited experience with both international expansion and venturing into different food styles. International expansion has been the more successful venture of the two, and can lead to a larger customer base. Expanding into other food varieties would force Chipotle's subsidiaries to compete with Chipotle restaurants as well. Expanding globally still has a major amount of risk associated with it. Chipotle will need to find international suppliers that have similar values and will need to strengthen its brand name to succeed. This is a difficult process which is why it is not the best solution. However, since both of the alternatives are risky, the international expansion alternative serves better as a contingency plan since it offers more reward and Chipotle has shown it can have international success.

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