STRATEGIC ANALYSIS FOR:

Chipotle Mexican Grill

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SYNOPSIS

**Firm History**\(^1\)

Chipotle Mexican Grill (Chipotle) started as a fast casual Mexican restaurant in Denver, Colorado in 1993 by Steve Ells and was based on the principles of using locally sourced produce. In 1995, Chipotle opened their second restaurant with the profits from its first location, and later opened their third restaurant with a Small Business Administration loan. In 1998, McDonald’s saw Chipotle’s potential in the growing fast casual market and became a minority investor. In 1999, Chipotle expanded its business by launching its first restaurants outside of Colorado in Minneapolis and Columbus, Ohio. By 2001, McDonald’s had become Chipotle’s largest investor which allowed rapid growth. In 2006, McDonald’s spun off its non-core assets and divested Chipotle, which went public on the New York Stock Exchange. Today, Chipotle has over 1,500 stores and is a leader in the fast casual dining segment in the United States.

**Current Industry Environment**

The fast casual industry and Chipotle are currently facing large environmental changes. Consumer demand for sustainable food outstrips supply while technology is playing a larger role in consumers experience in restaurants. In addition, the Mexican fast casual markets outside the U.S. are relatively underdeveloped and represent a large opportunity for future growth.

Chipotle’s main target segment is millennials, 18 – 34 year olds that identify with Chipotle’s “Food with Integrity” philosophy. This largely contrasts quick service restaurants like McDonald’s that primarily serve families and teenagers\(^2\). Millennials represent a key segment for quick service and fast casual restaurants because 57% of young adults from 18 to 29 say they eat fast food at least weekly, the most often out of all consumer groups\(^3\). Since Chipotle resounds with consumers who are interested in socially sustainable foods, these consumers tend to be wealthier than typical fast food customers. For example, fast casual restaurants had an average purchase value of $7.40 compared to the $5.30 average

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\(^1\) Corporate website, 2014  
for quick service restaurants\textsuperscript{4}.

Chipotle operates the majority of its restaurants in the United States and has 11 locations in international markets such as the United Kingdom and France. In all markets, Chipotle is located in high foot traffic urban centers and neighborhoods with high household incomes and where schools, businesses, tourist attractions are located. This allows Chipotle to target wealthier consumers and trendy urban millennials who want fast food but also want a step up from traditional fast food restaurants. Chipotle does not offer drive-through service in contrast to quick service restaurants like McDonald’s and fast casual competitors like Qdoba Mexican Grill (Qdoba).

Chipotle targets two customer segments: consumers who purchase meals for themselves and consumers that order catering for others for an event or meeting. Chipotle restaurants are usually open from 11am to 10pm, which targets consumers who dine out for lunch, dinner or as a snack. Currently, Chipotle does not offer a breakfast menu compared to other competitors such as Panera Bread or Qdoba. Sales are evenly divided between eat-in and take away customers\textsuperscript{5}. In the U.S., Chipotle also operates a catering service similar to competitors Panera Bread and Qdoba that targets businesses and event planners that requiring catering for 6 – 200 people. Chipotle’s catering costs which include delivery range from $8.50 to $13.50 per person\textsuperscript{6} which represents a 10% to 20% premium above its in store prices. Expanding into catering allows Chipotle to increase its gross margin and sales volume while reaching new consumers through events ranging from business meetings to Super Bowl parties.

Chipotle needs to comply with country-specific political requirements, such as labeling, food quality, hygiene and labour regulations. These standards vary significantly between countries and can influence Chipotle’s quality of products since Chipotle sources its ingredients locally. For example, in 2012 California passed the “Transparency in Supply Chains Act of 2010” which requires certain companies to disclose their efforts on eradicating slavery and human trafficking from their supply

\textsuperscript{6} Company website, 2014.
chains\textsuperscript{7}. Chipotle would have to comply with these regulations.

Rising commodity prices could threaten Chipotle’s profit margin if it cannot pass on these increased costs to consumers. However, Chipotle’s positioning in the fast casual segment allows it to target wealthier consumers who tend to be less price sensitive. Chipotle expects prices of beef, dairy, and chicken to be high in 2014\textsuperscript{8}, increasing pressure on its margins. Chipotle’s sustainably raised food philosophy makes it difficult to deal with rising commodity prices as it already fails to source enough sustainably raised beef to meet demand. Because of this, Chipotle has sourced\textsuperscript{9} conventionally raised beef and chicken during supply shortages. If weather and market conditions make certain ingredients more expensive or harder to source, Chipotle may temporarily suspend items such as guacamole or certain salsas\textsuperscript{10}.

While quick service traffic has remained flat since the economic recession of 2009, the fast casual segment led by Chipotle has grown every year from 4\% - 8\%\textsuperscript{11}. Chipotle should continue to grow if consumers continue to trade down from full service restaurants and Chipotle can meet their expectations. Credit Suisse also estimates that flat employment growth still allows Chipotle to grow sales by double-digits\textsuperscript{12}.

Chipotle consumers are likely to have graduated from high school and gone on to graduate college as well\textsuperscript{13}. Chipotle targets millennials with busy lifestyles but still try to eat healthy. Chipotle’s brand personality across social media and conventional marketing channels resound with its demographic\textsuperscript{14}. The design of its store comprised of wood, glass and steel is modern and sleek compared to traditional interiors of its competitors.

\textsuperscript{8} Annual report, 2012
\textsuperscript{9} Annual report, 2012
\textsuperscript{10} Annual report, 2012
\textsuperscript{13} Simmons OneView Study, 2009
\textsuperscript{14} Mike Schultz, “A story about Chipotle’s non traditional marketing strategy”, Digital Spark Marketing. 2012.
Customers of quick service and fast casual restaurants have increasingly demanded fresher and healthier offerings\(^{15}\) in addition to value and convenience. Chipotle, which was founded on principles of sustainable-farming, is well positioned to meet these consumer demands. Chipotle also sponsors festivals that are aligned with the brand, such as those focused on local, organic and sustainable foods.

Chipotle is strongly positioned in the U.S. where Mexican cuisine is popular and familiar with consumers\(^{16}\). In countries that are not familiar with Mexican cuisine, such as the United Kingdom\(^{17}\), Chipotle will need to both educate customers about its brand and Mexican cuisine in general.

Restaurants in the quick service and fast casual segments are using technology to enhance the consumer experience by allowing consumers to order and pay for their meals from the web or mobile devices which lets consumers “beat the rush”. McDonalds, with its GoMcDo app in France, has stated that orders through the mobile application could represent up to 15% of all orders\(^{18}\). While Chipotle’s mobile application allows customers to order and pay has been downloaded more than 3 million times since 2009\(^{19}\), its functionality is limited. Chipotle could include additional functionality into its mobile applications by including push offers and loyalty programs which can target the entire consumer lifecycle.

Connected devices from smart watches to smart cars are beginning to enter the market which could be an opportunity to differentiate itself. For example, Domino’s Pizza announced\(^{20}\) it was developing an application with the Ford Sync navigation console to lets users order pizza directly from their cars. In addition, PayPal\(^{21}\) and Samsung have created the ability for users of the Samsung Gear 2 smartwatch to check-in to pay at local stores that accept PayPal. Chipotle could differentiate itself from the competition by building unique consumer experiences around these connected devices.

Chipotle may need to adapt its menu to local market taste preferences. For example, McDonald’s

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\(^{17}\) Justin Brachman, “The Genetically Modified Burrito: Chipotle Tells All”, Businessweek, June 18, 2013.

\(^{18}\) Airtag, “McDonald’s Case Study”, Airtag, 2009.

\(^{19}\) Annual report, 2012


and KFC (Yum! Brands) tailor its international menu to regional customs by adapting local flavours and ingredients in the country. This has contributed to 70% of Yum! Brands profits coming outside the U.S. in 2013. Chipotle’s standardized menu focused on Mexican cuisine could be a problem in meeting international taste preferences and developing local supply chains.

**STRATEGY**

**Business Level Strategy**

Chipotle follows a differentiation strategy. Its products are premium priced and compete with other fast casual competitors such as Qdoba and Panera Bread as opposed to cost leaders such as McDonald’s and Taco Bell. Chipotle believes that even though the cost of using organic ingredients is higher, customers are willing to pay extra for healthier food. Chipotle’s “Food with integrity” mission positions itself as a provider of higher quality food by using fresh, gourmet and increasing organic ingredients successfully differentiates their products from competitors and meets the consumer demand for healthier food.

**Corporate Level Strategy**

Chipotle is a single business following a market penetration and market development strategy. The degree of Chipotle’s diversification is low because more than 95% of its revenues are generated from Chipotle Mexican Grill. Chipotle’s diversification is low despite launching ShopHouse Asian Kitchen and investing in Pizzeria Locale because these businesses are still young and do not contribute significantly to Chipotle’s revenues. While Chipotle is currently focused on growing Chipotle Mexican Grill domestically and internationally, it could increase its diversification by investing in its other businesses or expanding the “Chipotle” concept to other cuisines.

**International Strategy**

Chipotle uses a global strategy. Chipotle’s strategic decisions are centralized in the United States for its locations in the U.S., Canada, United Kingdom and France. The products that Chipotle sells are standardized across markets with slight differences in the variety of food for different markets. Chipotle also shares their resources across the state borders. Although majority of the food is prepared in each
restaurant, some ingredients such as beans and meats are prepared in their central kitchen located in Chicago. Chipotle enters international markets by establishing new wholly owned subsidiaries. While this is costly, it allows Chipotle to ensure the high quality of its products that differentiates the brand.

**Cooperative Strategy**

Chipotle engages in a vertical complementary alliance with its suppliers. The company relies on close relationships with suppliers to continually supply all of its restaurants with fresh ingredients. Chipotle also has an equity strategic alliance with Pizzeria Locale, a fast casual pizza restaurant in Denver. Pizzeria Locale currently has one restaurant and is looking to expand with Chipotle’s backing.

**CURRENT SITUATION**

Chipotle’s stated mission is:

“*Food with integrity*”

Chipotle emphasizes using organic produce and naturally raised meats. Chipotle believes that higher quality ingredients creates a better tasting meal and differentiates their products from competitors.

In 2010, Chipotle expanded internationally and now has 11 international locations in the United Kingdom, France and Canada. Chipotle also created ShopHouse Asian Kitchen in 2011, an Asian noodle house similar to Chipotle, and invested in Pizzeria Locale in 2013, a fast casual pizza chain. In 2013 Chipotle added organic tofu to its menus to attract vegetarians and vegans.

Chipotle competes in the fast casual dining segment in the U.S. and its top competitors include Taco Bell, Qdoba Mexican Grill and Panera Bread. In 2012, Chipotle increased their annual revenues by 20.34% to $2.37 billion USD compared to competitors Panera breads and Yum! Brands (Taco Bell) with 15% and 0.08% respectively. Chipotle currently has over 1,500 locations and 37,310 employees.

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22 Corporate website, 2014  
24 Company Q4 2013 report, 2013  
25 Panera Bread annual report, 2012  
26 Yum! Brands annual report, 2012  
27 Company website, 2014
In September 2013, Chipotle launched a controversial “Scarecrow” campaign to provoke an emotional response to the unethical food practices of industry competitors. The campaign contrasted the health and ethical issues present in other restaurants and Chipotle’s healthy and ethical positioning. While controversial, this video was the 55th most shared video in 2013, with some critics drawing parallels to Dove’s “Real Beauty” campaign that helped revitalize the brand. In 2014, Chipotle continued its viral marketing approach to promoting ethical food sourcing and indirectly attacking competitors by creating an original series “Farmed and Dangerous” that launched on video streaming site Hulu.

**STRATEGIC CHALLENGES**

**Consumer Awareness and Profitability in International Expansion**

Chipotle faces two large challenges in growing through international expansion. One challenge is that customers in those markets may not be familiar with either Mexican cuisine and/or Chipotle’s brand. This is challenging because Chipotle faces competition from fast casual restaurants outside the Mexican food category, must develop the general Mexican food category, and must establish Chipotle’s unique positioning. The second challenge is developing relationships with local produce suppliers and establishing a new supply network to provide ingredients to its international locations. While Chipotle has the financial and managerial resources to make these investments, the international operations need to be operating at full capacity in order to be as profitable as the U.S. operations. If Chipotle cannot establish economies of scale from its international suppliers, the profitability of its international operations are threatened. While international expansion is a logical move to continue Chipotle’s growth, it faces strong obstacles in consumer awareness and developing an efficient supply chain, in addition to currency risk, local regulations and adapting its product to local cultures.

**Increased Competition from Quick Service Restaurants**

Chipotle faces increased competition from quick service restaurants that are looking to counter

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29 Press release “Chipotle Debuts Original Series “Farmed and Dangerous” on Hulu and Hulu Plus, Chipotle, February 27, 2014
stagnant growth\textsuperscript{30}. In the U.S., Taco Bell launched its Cantina Bell menu\textsuperscript{31} with a celebrity chef to better compete with the Chipotle. Taco Bell and other quick service restaurants have also begun modernizing its restaurant interiors to simulate the dining experience of Chipotle\textsuperscript{32}. In addition, quick service restaurants are adopting fast casual restaurant traits such as Pizza Hut’s updating dining rooms that encourage diners to eat in and KFC testing a fast casual “KFC Select” restaurant\textsuperscript{33}. Enhancements from quick service restaurants to attract fast casual customers by providing a comparable product at a lower price point could become a threat to Chipotle.

\textbf{Growth and Profitability Constrained by Supply Chain}

While Chipotle promotes ethical sourcing of products without genetically modified organisms (GMOs), these requirements mean that it sometimes cannot fulfill all of its demand through organic suppliers. This forces Chipotle to sometimes source produce with GMOs when preferred suppliers cannot meet demand. If Chipotle wants to follow a market penetration or product development strategy in the U.S., it may be unable to source additional products from organic suppliers. This could lead to increased amounts of non organic produce and threaten Chipotle’s ethical brand. In addition, rising commodity costs are expected to increase Chipotle’s overall costs. However, because only a limited number of suppliers can provide the products in quantities that Chipotle requires, it cannot deflect these increased costs.

\textsuperscript{31} Kim Bhasin, “Taco Bell Has Big Plans For Its New Upscale Menu”, Business Insider, September 29, 2012
\textsuperscript{32} Joe Satran, “Chipotle Design Influence Palpable in Revamped Taco Bell, Wendy’s”, Huffington Post, November 17, 2012
\textsuperscript{33} Mark Brandau, “QSRs adopt fast-casual traits to compete”, Nation’s Restaurant News, January 28, 2014
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Airtag, “McDonald’s Case Study”, Airtag, 2009.


Chipotle Mexican Grill company website, 2014.


