

Doughnut Hole

Kenneth A. Sawka

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The rapid ascent and decline of Krispy Kreme -- as reported recently by *Yahoo! Finance*¹ -- exemplifies the tragedies that can befall a company that fails to take a disciplined and sustained examination of its external environment. According to *Yahoo! Finance*,

“Krispy Kreme had been a popular doughnut chain in the South since 1937, but remained unknown to the rest of us until about 1996. That’s when the first Krispy Kreme popped up in New York City, on West 23rd Street. Doughnuts are a major food group in New York, where people eat many of their meals while walking. These fabulous new doughnuts were favorably reviewed by local newspapers. Lines formed when the “Hot Doughnuts” sign was lit. Krispy Kreme went public in 2000, and it’s stock hit a high of about \$49 in 2003. Then, it started on a long downward spiral, losing about 90% of its value.”

Was Krispy Kreme so engrossed by its seemingly endless possibilities that it believed nothing could derail it? Was management so arrogant, or ignorant, that it missed -- or failed to look for -- indicators of the trouble that lie ahead? Or, was Krispy Kreme just unlucky? We may never know, but one thing is certain: Krispy Kreme was surrounded by ominous market signals that its fall from grace is almost inexcusable. According to the *Yahoo! Finance* article,

“This company had problems that had nothing to do with its doughnut recipe. It over-expanded and took on crushing debt. There were allegations of management misconduct. Some franchises went bankrupt. *Competition was fierce in the cheap eats category. More people started consuming healthy foods* (emphasis added). In short, Krispy Kreme managed to lose money selling something that is both cheap and delicious.”

Now, it may be easy to give Krispy Kreme a pass. Both fierce competition and strong consumer trends can be hard for any company to counter. And, its internal management problems have nothing to do with an inability to track external indicators. Surely, other firms

competing in the fast food segment were similarly challenged? What about McDonald’s?

“You hate McDonald’s, right? Everybody says they do. Nutritionists condemn it as a major cause of the American obesity crisis. Fat teens have tried to sue it for damages. French farmers demonstrated when it started expanding its presence there.”

McDonald’s announced its quarterly results on October 22 and reported earnings of \$1.15 per share on revenues of \$6.05 billion. The company’s sales grew 4.5 percent last year amid a horrific recession. What was that about fierce competition in the fast foods industry?

McDonald’s, perhaps unlike Krispy Kreme, seems to have an ability to spot, assess, and respond to competitive trends. Take its roll-out in 2001 of the McCafe concept in the US -- a brazen attempt to poach customers from Starbucks. McCafes are coffee bistros located inside or next to existing McDonald’s restaurants. They feature cappuccino, lattes, fruit smoothies, and premium teas, as well as muffins, scones, and more.

McDonald’s actions put Starbucks on the defensive. In response, the Seattle coffee giant introduced drive-throughs and breakfast sandwiches, moves that contributed to the dilution of the exclusive coffee experience that was the basis for its brand-building. Starbucks is just now emerging from a painful retrenchment, while McDonald’s continues to add to its billions and billions served.

McDonald’s and Krispy Kreme operate in largely the same segment. One has been wildly successful, the other less so. The difference? An external focus and ability to identify and set strategies for significant external trends and conditions.

Kenneth A. Sawka

Ken is the Managing Partner at Outward Insights, a Boston-area strategy and competitive intelligence consulting firm. He can be reached at ksawka@outwardinsights.com.

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¹ “The Tragedy of Krispy Kreme” by Carol Kopp, *Yahoo Finance*, October 13, 2009