Service Business Development in an Emerging Market:

A Case Study of McDonald's Corporation

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新興国市場におけるサービス・ビジネスの展開

マクドナルド社の事例を中心に

長　島　芳　枝

1. Introduction

India ranks second among the 25 emerging economies labeled by the International Monetary Fund[1]. India's economic growth has accelerated significantly over the past two decades, and the average household disposable income has more than doubled since 1985[2]. With rising income, household consumption has increased and the new Indian middle class emerged. Along with the socio-demographic changes, during the 1990s, India introduced economic reforms, aiming at liberalizing the economy through various initiatives. Policies designed to create a market-friendly environment to attract foreign direct investment were also enacted[3]. With the extensive deregulations, fast food chains such as Kentucky Fried Chicken and Pizza Hut rushed into the market. McDonald's Corporation (hereafter, "McDonald's") was also one of the companies that made the decision to enter the Indian market.

McDonald's is a leading global foodservice retailer with more than 33,500 local restaurants, serving approximately 69 million people in 119 countries each day. More than 80% of McDonald's restaurants worldwide are owned and operated by independent local

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1 *World Economic Outlook Update,* International Monetary Fund, January 24, 2012.

2 Income growth in India has accelerated as the economy grew. In 1985–1995 incomes increased at 5.7% per year, and by 6% in 1995–2005.

3 *About India,* UNDP, 2012.

people. This is line with the company's policy to "think global, act local", ensuring that the franchises are not managed from the U.S., but rather by the local market itself. This is a strategy designed for McDonald's to look to expand to every country, while paying attention to local culture. By leveraging the market knowledge acquired through the entry process, McDonald's became capable of tapping the market[4].

In this paper, I examine how critical market knowledge is as the basis for value creation for firms that center their businesses on service. Investigation is conducted through a case study of McDonald's activities in India. In the manufacturing arena, product development management, customer relationship management, and supply chain management have been identified as key components of Marketing Dynamic Capabilities (Bruni and Verona, 2009). As such, the focus of the discussion will be on these three cross-functional business processes.

2. Marketing Dynamic Capability Framework

In recent years, strategy research has begun to emphasize an approach called dynamic capabilities, which builds on the notion of core competencies with the focus on building and adapting the competencies to address rapidly changing environments (Teece, 2007; Eisenhardt and Martin, 2000). This development was stimulated by the recognition that many successful or dominant firms fail to sustain their performance as markets and technologies shift. In spite of having the resources, these companies failed to adapt to changed circumstances. With dynamic capabilities, sustained competitive advantage comes from the firm's ability to leverage and reconfigure its existing competencies and assets in ways that are valuable to the customer but difficult for competitions to imitate. Both assets and capabilities have been argued as sources of advantage: assets are the resource endowments the business has accumulated, i.e., investments in the scale, scope, and efficiency of facilities and systems, brand equity, and the consequences of the location of activities for factor costs and government support. On the other hand, capabilities are complex bundles of skills and collective learning, exercised through organizational processes that ensure superior coordination of functional activities. They differ from assets in that they cannot be given a monetary value, as can tangible plant and equipment, and are so deeply embedded in the organizational routines and practices that they cannot be

[4] McDonald's Corporation Annual Report, 2011.

traded or imitated (Dierckx and Cool, 1989). Distinctions are frequently made between competencies, well-defined routines that are combined with firm-specific assets to enable distinctive functions to be carried out, and capabilities, the mechanisms and processes by which new competencies are developed (Teece, Pisano, and Shuen, 1997).

Dynamic capabilities help a firm sense opportunities and seize them by successfully reallocating resources, often by adjusting existing competencies or developing new ones. Unlike earlier strategic frameworks that were largely static, dynamic capabilities explicitly acknowledges that as markets and technologies evolve, firms need to adjust by reallocating assets and learning new skills. In an extension of this notion of dynamic capability, the construct of dynamic marketing capabilities has been proposed in recent years. Marketing Dynamic Capabilities are defined as the responsiveness and efficiency of cross-functional business processes for creating and delivering customer value in response to market changes. Marketing Dynamic Capabilities are about a firm's capabilities in specific functional areas of marketing to respond to market changes, and are reflected through the speed and efficiency of the firm's cross-functional business processes (Fang and Zou, 2009).

Daneels (2002) found that a specific type of marketing capability that he calls customer competence allows firms to serve certain customers. Dynamic marketing capabilities, instead, support firms in the process of changing from their stationary process. In fact, dynamic marketing capabilities are specifically focused on releasing and integrating market knowledge that helps firms evolve. Under dynamic marketing capabilities, market sensing and customer-linking capabilities (Day, 1994), customer-oriented capabilities (Slater and Narver, 1998) and second-order customer competences (Danneels, 2002) are included.

Eisenhardt and Brown (1999) and Eisenhardt and Martin (2000) suggested that for a specific business process to become a dynamic capability, it must be able to span and support a firm's multiple lines of business, and combine and deploy functional resources. Product development management consists of and interconnects with functions such as those for ascertaining customer needs, identifying new product ideas, designing new product protocols, and manufacturing and launching new products (Day, 1994). Customer relationship management interconnects the functions of acquiring and leveraging customer information, establishing and maintaining relationships with customers and channel members, and providing after-sales services and support. Finally, supply chain management connects such functions as selecting and qualifying desired suppliers, establishing and managing inbound and outbound logistics, and designing work flow in product/solution assembly (Mentzer et al., 2001).

These cross-functional processes are critical to creating and delivering customer value, directly or indirectly. Specifically, an efficient and fast-responding product development management process can enhance customer value through innovativeness of a product, improved product quality, fast cycle time for product development, and control of the development budget (Griffin and Hauser, 1993). Likewise, an efficient and responsive customer relationship management process can identify, target, deliver to, and serve customers in ways that are tailored to their individual needs and preferences (Woodruff, 1997), whereas an efficient and fast-responding process of supply chain management works indirectly through procuring, jointly designing moving, and using raw materials and components, as well as transforming inputs into cost-efficient and/or differentiated customer solutions against competitors (Mentzer et al., 2001).

3. McDonald's Case

3.1. Global Business Network

McDonald's business is managed by geographic segments, and reportable segments include the United States (U.S.), Europe, Asia/Pacific, Middle East and Africa (APMEA). Canada and Latin America are classified as "other countries". The U.S., Europe and APMEA segments account for 32%, 40% and 22% of total revenues, respectively. The United Kingdom (U.K.), France and Germany, collectively, account for over 50% of Europe's revenues; and China, Australia and Japan, a 50%-owned affiliate, collectively, account for over 55% of APMEA's revenues. These six markets along with the U.S. and Canada are referred to as "major markets" in McDonald's and comprise approximately 70% of total revenues[5].

McDonald's franchises and operates McDonald's restaurants. Of the 33,510 restaurants in 119 countries at year-end 2011, 27,075 were franchised or licensed. The network includes 19,527 franchised to conventional franchisees, 3,929 licensed to developmental licensees and 3,619 licensed to foreign affiliates, primarily Japan, and 6,435 operated by McDonald's[6].

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5 McDonald's revenues consist of sales by directly-operated restaurants and fees from restaurants operated by franchisees.

6 Franchisees provide a portion of the capital required by initially investing in the equipment, signs, seating and décor of their restaurant business.

Figure 1: Revenues by Geographic Segment

USD in Million

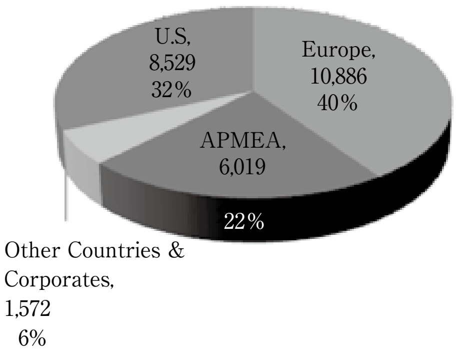
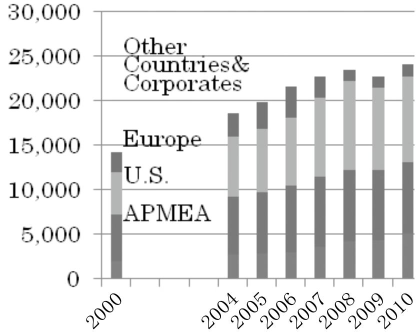


Figure 2: Changes in Revenues

USD in Million



McDonald's views itself primarily as a franchisor and believes franchising is important to delivering great, locally-suited customer experiences and driving profitability. However, directly operating restaurants is regarded as the key to being a credible franchisor and is essential to providing McDonald's personnel with restaurant operations experience. In its directly-operated restaurants, and in collaboration with franchisees, it further develops and refines operating standards, marketing concepts and product and pricing strategies, so that only those that it believes are most beneficial are introduced in the restaurants. It continually reviews and adjusts as appropriate, its mix of directly-operated and franchised restaurants to help optimize overall performance[7]. McDonald's claims this business model enables it to deliver consistent, locally-suited restaurant experiences to customers. In addition, the model facilitates its ability to identify, implement, and extend innovative ideas that meet customers' changing needs and preferences.

3.2. Entry to the Indian Market

Until the early 1990s Western fast food chains had largely ignored Indian markets. This was partly because of the high poverty rate of the country. In 1985, 93 percent of the population had an annual household income of less than 90,000 Indian rupees, or less than USD1,970 per year. By 2005, however, the size of this income bracket had dropped by about two-fifths to 54 percent of the population: India's growth has had a significant impact on the poor income bracket over the past 20 years[8].

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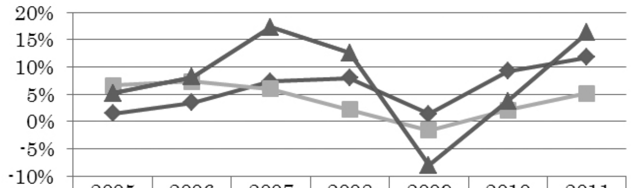
[7] Franchised restaurants include conventional franchised, developmental licensed, and foreign affiliated.

[8] *National Accounts Statistics,* Central Statistical Organization, Government of India, 2011.

Figure 3: Rate of Increase in McDonald's Revenues



	2005	2006	2007	2008	2009	2010	2011
APMEA	1.4%	3.4%	7.3%	8.0%	1.3%	9.2%	11.7%
U.S.	6.6%	7.3%	5.9%	2.2%	-1.7%	2.1%	5.1%
Europe	5.1%	8.1%	17.3%	12.6%	-8.0%	3.7%	16.2%

In order to capture its own share of the pie, in 1991, McDonald's took a step and obtained an approval from the Foreign Investment Promotion Board (FIPB) of India to set up operations. However, it was not until October 1996 that McDonald's opened its first Indian outlet. The company chose to fully understand the market first, and spared 6 years researching the market environment.

In October 1996, McDonald's opened its first Indian outlet in Vasant Vihar, an affluent residential colony in India's capital, New Delhi. It has been a 50-50 joint venture partnership between McDonald's and two Indian entrepreneurs: Amit Jatia and Vikram Bakshi. They signed the joint-venture agreements with MacDonald's in April 1995, and before opening any outlet, they trained their staff extensively in McDonald's franchised restaurants in Indonesia and U.S[9]. Under this joint venture agreement, McDonald's has succeeded in building a wide network of outlets throughout the country.

Figure 4: Market Entry - Timeline of Major Events

1991	1993	1996
● Obtained a license to enter the Indian market.	● Signed a JV agreement with Radhakrishna Foodland for food distribution.	● Signed a JV agreement with Hardcastle Restaurants and Connaught Plaza Restaurants. ● Entered into partnership with Cremica and Vista Processed Foods. ● Opened the first restaurant in India in October.

India has a very diverse population with more than 5,000 ethnic communities represented. Each region and sub-region in India has distinct food traditions and preferences. Indian consumers typically maintain their distinct food habits even after moving to different parts of the country. In large cities and metropolitan areas, there are restaurants that serve only specialty regional foods[10].

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9 "McIndia," *Business Today*, November 25, 2001.

10 "Changes in the Indian Menu over the Ages," *The Hindu*, October 21, 2004.

3.3. McDonald's Marketing Dynamic Capability

3.3.1. Product Development Management in India

Approximately 80% of India's population is Hindus and cows are sacred among the Hindus. Also, 150 million Indian Muslims do not eat pork and 25 to 30% of the population is vegetarian[11]. Under the conditions, it was necessary for McDonald's to have a vegetarian option. Accordingly, the company developed several new products specifically for Indian consumers. In fact, introducing special local products for the local palate was not a new venture for McDonald's. Teriyaki Burger in Japan, Croque McDo in France, Maharani Burger in Malaysia, a green pepper burger in Singapore, Thai burger with Thai curry paste, spaghetti in the Philippines, spicy chicken with rice in Indonesia, and spicy seafood noodle in China are the examples of its localization in each of these markets. In India, however, a huge step was taken by the company. For the first time in its history, McDonald's offers no beef or pork items in the country. In India, it decided not to offer its core burger products, Big Macs, and Quarter pounders[12].

Veggie burgers, which are very popular among the vegetarians in India, went through rigorous testing procedures. McDonald's test-marketed the veggie burger in 1994 in its outlets located in three Asian population-dominated towns of London, Southhall, Ilford, and Hounslow, before launching the product in India in 1996[13]. McDonald's rose to the challenge and worked together with consumers to identify what it was that they wanted from their food.

McDonald's conducted research on the tastes, likes and dislikes of Indian consumers, and utilized that research in their product development extensively. McDonald's developed products uniquely designed for the Indian consumers' palate. Their first vegetarian burger was the Aloo-Tikki burger, known as the McAloo Tikki, with a patty of potatoes and peas flavored with Indian spices. To develop the burger, McDonald's had to test 130 different ingredients and use 50 suppliers. For the non-vegetarians, the company introduced its standard fish and chicken burgers, in addition to mutton-based Maharaja Mac burgers[14].

The Indian market has been a place in which McDonald's exhibited its efficient and ac-

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[11] *The World Factbook,* Central Intelligence Agency, 2012.
[12] *McDonald' India Profile,* McDonald's Corporation, 2012.
[13] "McDonald's Set to Enter Veg Territory," *Business Line,* February 18, 2002.
[14] Hannon, Ellliot,"*McDonald's In India: Would You Like Paneer On That?",* September 23, 2012.

curately-responding product development management process. To date, in a number of occasions, the company has successfully enhanced customer value through innovativeness of products and attentiveness in development of new products and services.

3.3.2. Supply Chain Management and Local Procurement

In developing locally-suited products in India, one challenge McDonald's faced was to ensure integrity of its food products. Approximately 50,000 rupees in crores, about USD12.5 billion worth of food produce was wasted in India because of lack of proper storage and transportation infrastructure. McDonald's spent six years developing the supply chain, with the focus on implementing successful supply chain strategies to materialize its QSCV principle; Quality, Service, Cleanliness and Value. Pricing flexibility and new product launches have been the key components of this principle.

To ensure that the quality of their products was up to the company standards, McDonald's needed to introduce Cold Chain technology into India. Cold Chain stands for a network for procurement, warehousing, transportation and retailing of food products under controlled temperatures. McDonald's restaurants stored products to be used on a daily basis, within a temperature range of -18 to 4 degree Celsius[15].

In making the efforts to minimize costs and preserve integrity of products, McDonald's made the decision to partner with Radhakrishna Foodland Private Ltd. (hereafter, "Radhakrishna"). McDonald's selected Radhakrishna as the partner based on the concerted efforts made to meet its operational standards. Radhakrishna also used its resources to develop better facilities and infrastructure as required by McDonald's eateries. With McDonald's support, the company was able to setup a trucking fleet to move supplies to restaurants promptly at short notice. With the Cold Chain technology transferred from McDonald's, each of the trucks had separate rooms with three different temperatures of refrigeration; a freezer section for meat, a chilled section for vegetables and a non-refrigerated section for paper cups, napkins and plastic cutlery. This way each truck was able to deliver multiple items at once, saving a huge amount of transportation costs[16].

Due to this well-coordinated supply chain system, McDonald's was able to minimize

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[15] Over 50% of McDonald's food products needed to be stored under controlled conditions before being used.

[16] Radhakrishna Foodland Private Ltd. became responsible for getting products from various suppliers and delivering products to McDonald's outlets.

costs, optimize quality control, and ensure higher consumer satisfaction. On the other hand, the improved transportation and food processing technology stimulated India's agricultural productivity while raising farmers' incomes. This was received well with the Indian government and the company won the goodwill of the government.

McDonald's was in agreement with the Government of India to source all of its materials required from the local suppliers and farmers. It worked with the local communities to use local labor which included contractors and architects. The relationships with the suppliers were proven to be the key for success: not only has it been able to lower its costs, but it also was successful in building networks with these communities[17]. This contributed toward expanding the local business and accessing the latest food technology as well as advanced agricultural practice locally available.

An example of how McDonald's worked in partnership with the Indian suppliers can be found in its procurement of lettuce. Traditionally, in India, lettuce was grown only during the winter season. With McDonald's assistance, Trikaya Farms (hereafter, "Trikaya") in Talegaon, Maharashtra became capable of growing crops all year round. McDonald's rendered assistance to Trikaya in the form of sharing advanced agricultural technology with them together with its expertise in utilizing a drip irrigation system. In forming a part of quality control, McDonald's helped Trikaya to install a large cold storage facility, Cold Chain consisting of a pre-cooling room to remove the field heat, and large refrigerated vans with humidity controls[18]. Trikaya now is in a position to export their lettuce to the overseas market; McDonald's international operations in the Middle East and Asia Pacific.

McDonald's places a high priority on integrity of its products; not only did the company assist with development of lettuce, but it also spent nine years searching for the suitable type of potatoes for its French fries. Internal surveys showed that 30% of its customers came to McDonald's to eat the fries, so it was important to get it right. Unfortunately, Indian potatoes were too moist to be used for McDonalds French fries. McDonald's needed potatoes with 22 to 24% solidity, whilst local potatoes had moisture content of 85 to 88%. In order to combat this problem, McDonald's asked its global partner, McCain Foods, to help grow the right kinds of potatoes in India.

McCain Foods came to India with two agronomists and began searching for the right

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[17] McDonald's purchased more than 96% of its products and supplies from the Indian suppliers.

[18] In addition, transfer of McDonald's expertise enabled Trikaya to supply crops to a number of hotels, clubs, flight kitchens and offshore catering companies nationwide in India.

location to grow potatoes. Initially, they planted samples and collected seeds in Lahaul, Himachal Pradesh, but after testing locations for several years, McCain Foods settled in Gujarat. This was a state in which they did not get any winter rain. Nights and mornings were without fog, the conditions required for the potatoes to sprout. McDonald's helped the Gujarati farmers with drip irrigation, which saved 30 to 50% of water they used, and their yields per hectare increased by 30 to 40%[19].

Joint efforts of McDonald's and its partners made it possible to build a reliable and efficient process of supply chain in the Indian market. Today, we can observe that the company's supply chain management works through procuring and using of raw materials and components, as well as transforming inputs into differentiated customer solutions against other players in the market.

3.3.3. Indian Customer Relationship Management

In order to differentiate itself from the local food retailers, McDonald's needed to develop its brand in a different way from other parts of the world. Initially, McDonald's wished to induce trials and get customers into its outlets. Word of mouth promotion and advertising were expected to encourage eating experiences at McDonald's. However, this approach turned out to be unsuccessful. McDonald's needed to find ways and methods to motivate the customers willing fo try and accept new products and services[20].

Through its extensive research, what McDonald's found was in India, eating out was a special occasion to many Indian families. Meals had been an essential medium for social sharing and relationship. Having realized the local practice, McDonald's re-positioned itself and started to take a family-oriented strategy. In the end, families have become the company's cornerstone as the customer base. In the metropolitan cities, however, the demand for fast and readymade food was increasing with a growing number of dual income households. With the changes in India's family structures extended families are no longer the standard. McDonald's restaurants have become the favorite places for busy working young parents[21]. On weekends in metropolitan cities such as Delhi and Munbai, parents bring their children to McDonald's widely popular playgrounds to enjoy and relax. Fun

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[19] Seven years later in 2007, McCain Foods was finally comfortable enough to invest USD40 million to build a plant in Mehsana, Gujarat.

[20] This was partly due to the Indian culture which was not familiar with the concept of food technology and the streamlined process in food service.

[21] These were the ambitious middle, upper meddle, and affluent classes who were keen to combine eating with fun.

and entertainment assumed importance in the financially stable families.

McDonald's has also targeted children as its main clientele in India: children were the major influencers. McDonald's advertisement put forth an attractive proposition to the children's segment that played a major role in the decision making process with regard to the choice of a restaurant. The company was perceived to be a fun place with special areas marked for kids and toy gifts[22]. India's upwardly and mobile middle-class families have shown considerable interest in enjoying what is often described as "McDonald's experience"; eating McDonald's food in clean, friendly, and fun-filled environment with quick and accurate services.

In addition to young families and children, McDonald's has also tried to attract senior citizens' segment. It has been providing lounges for senior citizens to relax and enjoy its food. Special arrangements were made for those who are used to the atmosphere of traditional restaurants: they are guided to available sitting places as is done by waiters in other restaurants. For people who prefer to eat at home, home-delivery service called McDelivery has become available. This innovative service became especially popular among the middle-class people who enjoy watching movies and cricket matches at home. After launching this service, some of the outlets observed sales increase of 15%.

In an effort not to disconcert cultural sensitivities of the consumers of the Indian society, McDonald's has enforced strict standards in cooking. It has mandated that all vegetarian and non-vegetarian stations be separate. All foods have been strictly segregated into vegetarian and non-vegetarian lines. Cooks wear different colored aprons, green for vegetarian and red for non-vegetarian, and were not allowed to cross over to the other workstations without showering. Separate utensils are used in preparing vegetarian and non-vegetarian foods[23].

In the examples exhibited, it can be observed as to how sensitive McDonald's has been in serving specific segments of its customers. Here, efficient and responsive customer relationship management processes are carried out in order to identify, target, deliver to, and serve customers; Hindus, Muslims, young parents and children, senior citizens, and strict vegetarians. These have been practiced in ways that are tailored to the specific customers' individual needs and preferences.

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[22] McDonald's welcomed children with its low-height order counters and playgrounds called "Fun Zones" which are considered safe, hygienic, and child-friendly.

[23] The efforts were made to convince customers of the 'Shudh Shakahari Experience,' which stand for pure vegetarian experience.

4. Conclusion

According to Day (1994), every business acquires capabilities that enable it to carry out the activities necessary to sustain itself through offering of its products or services. One must be superior if the business is to outperform the competition. These are the distinctive capabilities that support a market position that is valuable and difficult to match. They must be managed with special care through the focused commitment of resources, assignment of dedicated people, and continued efforts to learn, supported by dramatic goals for improvement.

In this paper, I have argued the concept of dynamic marketing capabilities and demonstrated how it may work in a global food service company. The findings have highlighted why market knowledge helps initiate the innovation process. How market knowledge is combined with technical knowledge in the different stages of the market entry and product development was also presented. It has also been described why market knowledge can be an important source of capability reconfiguration in the product development process. The description has been largely based on the observation of key variables involved in market knowledge release and integration by McDonald's in the case of its market entry to India.

The culturally unique Indian market has been a place in which McDonald's, a global food retailer, has exhibited its efficient and accurately-responding product development management process. To date, in a number of occasions, the company has successfully enhanced customer value through innovativeness of products and attentiveness in development of new products and services.

Joint efforts of McDonald's and its partners made it possible to build a reliable and efficient process of supply chain. The company's supply chain management has worked through procuring and using of raw materials and components, as well as transforming inputs into differentiated customer solutions against other players in the market.

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