Case 8

Beefing up the beefless Mac: McDonald's expansion strategies in India*

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Background

In March 2001, the McDonald's Corporation's Indian operation was at a critical juncture in its evolution. Over the previous few months, the company had expanded its retail base from Mumbai (10 outlets) and Delhi (14 outlets) to Bangalore (one outlet), Pune (one outlet), Jaipur (one outlet) and the Delhi-Agra highway (one outlet). During 2001, McDonald's had plans to open 15 more outlets with one each in Ludhiana and Ahmedabad (see Exhibit 1 for a brief profile of the different cities and Exhibit 2 for a map showing their locations in India) and the rest in cities where it already had a presence. By 2003, the company planned to increase the number of outlets to 80 and the cumulative investment in India to more than Rs 10 billion. (The approximate exchange rate in March 2001 was Rs 46.50 = US$1.) This would represent a threefold increase over the cumulative investment until June 2000 (Rs 3.5 billion). Three other cities (Agra, Baroda and Chandigarh) would also have at least one McDonald's outlet by 2003.

The Indian venture had been operational for more than four years and had recorded healthy growth but no profits. Commenting on the progress until that point in time, Vikram Bakshi (McDonald's partner in Delhi) said: 'Our growth and expansion in India over the last three years has definitely been very encouraging.' Only a few months previously, Amit Jatia (McDonald's other partner in charge of the Mumbai outlets) had said: 'We are still to recover our investment. You need a very large base and break-even is normally after seven to ten years.' Despite the venture's lack of profits, Jatia also showed his enthusiasm for expansion when he said, 'Having cracked the Indian market, McDonald's is ready to leverage its initial investments in infrastructure to rapidly expand.'

Observers were wondering about the appropriateness of McDonald's bold strategic move. Was the additional investment wise, especially in view of the lack of profitability of the existing operations? Since many of the new cities to be entered were less Westernised than Mumbai or Delhi, many observers doubted whether the demand potential would be sufficient to justify the economic operation of outlets. The cost and availability of prime real estate in major Indian cities was another issue. Opening a new outlet required an average investment of Rs 30 million. In Mumbai and Delhi, where prime real estate was expensive, the investments could be higher. Finally, some analysts doubted whether McDonald's could afford to spend big amounts on advertising to create a strong brand-name reputation if its outlet base and customer base remained relatively narrow.

McDonald's – the global fast-food powerhouse

McDonald's is, by far, the world's biggest marketer of fast food. In 2000, it operated nearly 30 000 restaurants and had 1.5 million people serving 45 million customers each day in 120 countries. The company had built an impressive set of financial figures, with US$40.2 billion in system-wide sales (out of which US$24.5 billion was accounted for by franchised

This case was written as a basis for class discussion rather than to illustrate effective of ineffective handling of an administrative or business situation.

Exhibit 1 | Profile of the Indian cities targeted by McDonald's

Place	Population (000s) 1991	2001	Remarks	State	Annual per capita income in Rs (1997–8)[1]	Annual per capita income in Rs (1997–8)[2]
Agra	892	1 076	Tourist attaraction; home to the Taj Mahal	Uttar Pradesh	7 263	5 890
Jaipur	1 459	1 893	Major tourist attraction	Rajasthan	9 356	7 694
Chandigarh	504	790	Capital city of two northern states, Punjab & Haryana	Punjab & Haryana	19 500	14 457
Ahmedabad	2 955	3 823	Major business centre in western India	Gujarat	16 251	13 709
Vadodara/Baroda	1 031	1 454	Business centre	Gujarat	16 251	13 709
Mumbai	9 926	12 903	Commercial capital of India	Maharashtra	18 365	16 217
Pune	1 567	2 004	Satellite town of Mumbai; manufacturing centre	Maharashtra	18 365	16 217
Ludhiana	1 043	1 482	Textile manufacturing centre in northern India	Punjab	19 500	1 457
Delhi	9 119	13 661	Capital city, seat of the central government	Delhi	22 687	19 091
Bangalore	2 660	3 637	India's Silicon Valley	Karnataka	11 693	11 153

Notes:
1 Income data from Per Capita Income (State-wise) – Maps of India. The figures refer to the whole state and not the particular cities. Income levels for cities are likely to be somewhat higher than the figures for the whole states.
2 Income data from the Associated Chambers of Commerce and Industry of India (http://203.122.1.245/assocham/prels/04181.asp\). The figures refer to the whole state and not the particular cities. Income levels for cities are likely to be somewhat higher than the figures for the whole states.

Sources: Population data from www.world-gazetteer.com/fr/fr_in.htm.

restaurants), US$21.7 billion in assets, US$3.3 billion in operating profits and US$2 billion in net profits. (See Exhibit 3 for a geographic analysis of McDonald's operations.) It was also routinely cited by the business press as being a savvy marketer. In June 1999, with a value of US$26.231 billion, the McDonald's brand was rated as being the eighth most valuable brand in the world, ahead of well-known brands such as Sony, Nokia and Toyota.

McDonald's has had a long history in Asia. It entered the Japanese market in 1971, which was followed by entry into other newly industrialising economies (such as Singapore and Hong Kong, among others) in Asia. Entry into China occurred only in 1990. McDonald's entered India in 1996. (See Exhibit 4 for McDonald's start-up dates in East Asian and South Asian countries.) The late entry could be attributed to several factors, such as the fact that a significant percentage of India's population is vegetarian, the limited purchasing power of the population and the closed nature of the economy.

The Indian market

India is a vast subcontinent with an area one-quarter of that of the United States, and a population almost four times that of the US, at about 950 million. The per capita GDP is quite low, at US$390 in 1999. However, after adjusting for purchasing power parity, India was ranked the fifth-largest economy in the world (ranking above France, Italy, the UK and Russia) with the third-largest GDP in Asia in 1999. (See Exhibit 5 for income distribution in India.) Among emerging economies, India is often considered second only to China.

India's economic diversity is matched by its social diversity. There are more than 20 major spoken languages and over 200 dialects. The Indian currency (Rupee) has its denomination spelt out not only in English and Hindi, but also in 13 other languages. About 50 per cent of the population is considered to be illiterate, and advertising reaches them via billboards and audiovisual means. For national launches, at least eight languages are used. In addition, the country faces

Exhibit 2 | McDonald's outlets in India (existing and planned)

a poor infrastructure with frequent power outages, even in New Delhi (the capital city) and Bangalore (India's Silicon Valley).

In terms of political system, India is a democracy. Since independence from the British in 1947, the economic system has historically been modelled on the socialist style. Under this system, the government strictly controls the entry and exit of domestic as well as multinational corporations (MNCs) into different sectors. MNCs also face a variety of other restrictions. Since 1991, India has started deregulating the economy. However, the socialist mind-set cannot be erased overnight. A Member of Parliament said of fast-food chains such as McDonald's and KFC, 'We want computer chips and not potato chips.'

The country has a few anti-Western factions, which have opposed the entry of MNCs in general. The mistrust of MNCs could be at least partially attributed to the fact that the British rule of India was rooted in the entry of the British East India Company (for trading purposes) into the country. There are also several small but vocal groups of health activists and environmentalists that are opposed specifically to the entry of fast-food giants such as McDonald's and KFC. When KFC opened its restaurant in Bangalore in 1995, local officials found that KFC had excessive levels of monosodium glutamate (MSG) in its food and closed the outlet. The outlet soon reopened, however. Said Vandana Shiva, a vocal exponent of environmental and animal welfare issues, in an audio interview with McSpotlight,

> *The McDonald's experience, which is really the experience of eating junk while thinking you are in heaven, because of the golden arches, which is supposed I guess to suggest that you enter heaven, and the clown Ronald McDonald, are experiences that the majority of the Indian population would reject. I think our people are too earthy. First of all, it would be too expensive for the ordinary Indian – for the peasant, or the person in the slums. It's an experience that a very tiny elite would engage in, and most of that elite – which knows what good food is all about – would not fall for it. McDonald's is doing no good to people's health, and in a country like India where first of*

Exhibit 3 | Geographic analysis of McDonald's operations and performance (financial year 2000)

		Geographic breakdown				
	Total	**USA**	**Europe**	**Asia-Pacific**	**Latin America**	**Others**
Revenues	14 243	5 259	4 754	1 987	949	1 294
Operating income	3 330	1 773	1 180	442	102	94
Total assets	21 684	7 877	7 084	2 790	1 856	1 069
Capital expenditures	1 945	469	798	224	246	161
Depreciation & amortisation	1 011	418	297	121	69	61

Notes:

- All figures in US$ millions.
- Corporate accounted for US$262 million (loss) to operating income, US$1 009 million of assets, US$48 million of capital expenditures, and US$46 million of depreciation and amortisation.
- Figures may not add up, due to rounding.

Source: www.mcdonalds.com.

Exhibit 4 | Dates of McDonald's entry into East and South Asian markets

Year	Country
1971	Japan
1975	Hong Kong
1979	Singapore
1980	Philippines
1981	Malaysia
1984	Taiwan
1985	Thailand
1988	South Korea
1990	China (Shenzhen Special Economic Zone)
1991	Indonesia
1992	China (Beijing)
1996	India
1998	Pakistan
1998	Sri Lanka

Sources: J. L. Watson (ed), 1997, *Golden Arches East* (Stanford, CA: Stanford University Press), Table 2; *Food and Drink Weekly*, 26 October 1998.

all, we are not a meat culture, and therefore our systems are ill-adapted to meat in the first place, and where people are poorer – shifting to a diet like this will have an enormous impact.

Since 1991, when the Indian economy began opening up to foreign investments, many multinationals have rushed in – lured by the attraction of serving a large middle class, estimated at 300 million. However, even some of the well-known global brands failed with their initial strategies and were forced to reposition, including, in some cases, drastic reduction of prices. Some multinationals (for example, Peugeot) even had to close shop. Kellogg's, which entered with high-priced cereals (several orders of magnitude more expensive than a traditional Indian breakfast), faced a lack of demand. KFC initially failed to realise that Indians were repulsed by chicken skin, which was vital for the Colonel's secret batter to stick. Thus, apart from a lack of understanding of the local tastes, a combination of circumstances – including overestimation of the demand potential, rosy assumptions about the dismantling of bureaucratic hurdles to doing business, infrastructural inadequacies and, finally, inappropriate firm strategies (for example, pricing) – led to many failures and disappointments.

McDonald's entry strategy in India

McDonald's India was incorporated as a wholly owned subsidiary in 1993. In April 1995, the wholly owned subsidiary entered into two 50:50 joint ventures: with Connaught Plaza Restaurants (Vikram Bakshi) to own and operate the Delhi Restaurants; and Hardcastle Restaurants (Amit Jatia) to own and operate the Mumbai outlets.

Although McDonald's had done product adaptation to suit local tastes and cultures in several previous ventures, such as the Teriyaki Burger in Japan, rice dishes in Indonesia, noodles in Manila and McLox Salmon sandwiches in Norway, the degree of adaptation required in India was significantly greater. McDonald's replaced its core product, the Big Mac, with the Maharaja Mac. The latter had a mutton patty (instead of the beef patty in the Big Mac), to avoid offending the sensibilities of Hindus (80 per cent of the population), who consider killing cows as sacrilegious, and Muslims (12 per cent of the population), for whom pork is taboo. In addition, since 40 per cent of the market is estimated to be vegetarian, the menu included the McAloo Burger (based on potato), a special salad sandwich for vegetarians, and the McChicken kebab sandwich. It also

Exhibit 5 | Income distribution in India

Classification	Number of people (millions)	Households (millions)	Income in US$
The Deprived	763	131	<600
The Aspirants	120	20	1 000–3 000
The Climbers	45	8	3 000–6 000
The Strivers	25	5	6 000–12 500
The Rich (total)	2.18	0.3545	>12 500
The Near Rich	1.55	0.25	12 500–25 000
The Clear Rich	0.444	0.074	25 000–50 000
The Sheer Rich	0.144	0.024	50 000–125 000
The Super Rich	0.039	0.0065	>125 000

Sources: Income figures are approximate and based on A. Chatterjee, 1998, 'Marketing to the superrich', *Business Today* (Living Media India Ltd), 22 April; W. Berryman and J. McManus, 1998, 'India: Turning the elephant economy', *Independent Business Weekly*, 24 June.

offered spicier sauces, such as McMasala and McImli (made from tamarind). Other elements of the menu, such as chicken nuggets, fillet fish sandwiches, fries, sodas and milkshakes, were in common with the rest of the McDonald's system.

In 1998, McDonald's India set up a menu development team to collect consumer feedback. Subsequently, the team came up with its menu vision, and new products since then have been based on this vision.

The adaptation of the strategy went well beyond the menu, encompassing many aspects of the restaurant management system. Two different menu boards were displayed in each restaurant – green for vegetarian products and purple for non-vegetarian products. Behind the counter, restaurant kitchens had separate, dedicated preparation areas for the meat and non-meat products. The kitchen crew (in charge of cooking) had different uniforms to distinguish their roles and did not work at the vegetarian and non-vegetarian stations on the same day, thus ensuring clear segregation. The wrapping of vegetarian and non-vegetarian food took place separately. These extra steps were taken to assure Indian customers of the wholesomeness of both products and their preparation. To convince Indian customers that the company would not serve beef and would respect the culinary habits of its clientele, McDonald's printed brochures explaining all these steps and took customers on kitchen tours.

McDonald's positioned itself as a family restaurant. The average price of a 'Combo' meal, which included burger, fries and Coke, varied from Rs 76 for a vegetarian meal to Rs 88 for a Maharaja Mac meal. This could be compared with KFC meal prices at Rs 59 (Crispy Burger, regular fries and large Pepsi) and Rs 79 (KFC Chicken, Colonel Burger and regular Pepsi). McDonald's Happy Meal, which included a complimentary toy, was priced at Rs 46. The prices in India were lower than in Sri Lanka or Pakistan, and even the price of the Maharaja Mac was 50 per cent less than an equivalent product in the United States.

To fight its premium image among the public, the company undertook selective price cutting and ran some periodic promotions. In February 1999, the company was offering 'economeals' for as low as Rs 29. The company reduced the price of vegetable nuggets from Rs 29 to Rs 19 and that of its soft-serve ice-cream cone from Rs 16 to Rs 7. Apparently, this still afforded McDonald's a healthy margin (40 per cent for cones). As Vikram Bakshi, explained, 'I will never become unaffordable, as I will not then be able to build up volumes.' The lower price could be attributed to two factors: the pricing strategies of MNC rivals as well as mid-range local restaurants, and the development of a local (low-cost) supply chain.

McDonald's pricing strategies, as well as special promotions, were influenced by rivals. In February 1999, several competitors were running special promotions, with KFC offering a meal inclusive of chicken, rice and gravy for Rs 39. For Rs 350, Pizza Hut was offering a whole family meal, including two medium pizzas, bread and Pepsi. Wimpy's was offering mega meals at Rs 35. A typical vegetarian 'set meal', or 'thali' (which included Indian breads, rice, vegetables and yogurt) at a mid-range restaurant cost around Rs 50, which was considerably lower than a McDonald's meal.

Some analysts believed that that by introducing loss leaders (for example, cones), McDonald's wanted to highlight good value for all its products. Whether customers attracted by special promotions pay repeat visits to McDonald's remains to be seen.

In October 2000, the company introduced two new Indianised products to its menu – the Chicken McGrill and the Veg Pizza McPuff. At that point in time, 75 per cent of the menu in India was unique – that is, different from the rest of the McDonald's system. The Chicken McGrill had a grilled chicken patty topped with onions and mint sauce, to give it an Indian flavour. The Veg Pizza was a takeoff on the popular Indian samosa (potato-based curry puff) with differences in shape (rectangular) and stuffing (capsicum, onions and Mozarella cheese with tomato sauce). In keeping with the low pricing strategy in India, these items were priced at Rs 25 and Rs 16, respectively.

With its value pricing and localised menu, McDonald's had attracted some loyal customers. One such customer said, 'A normal kebab, with all the trimmings, at a regular restaurant would cost more than Rs 25 and if the new McGrill is giving us a similar satisfaction with its mint chutney (sauce), then we'd rather eat in a lively McDonald's outlet than sitting in a cramped car on the road.'

Some elements of the promotional strategy remained the same as in other parts of the world. One instance of this included the emphasis on attracting children. A Happy Meal film was consistently shown on the Cartoon Network and the Zee (a local channel) Disney Hour. McDonald's also teamed up with Delhi Traffic Police and the Delhi Fire Service to highlight safety issues, again trying to create goodwill among schoolchildren. In October 1999, in conjunction with The Walt Disney Company and UNESCO, McDonald's launched a search for Millennium Dreamers. The program would bring together 2 000 young people from around the globe who had made a positive and significant impact on their communities. Based on the number of its outlets, India was allocated two representatives.

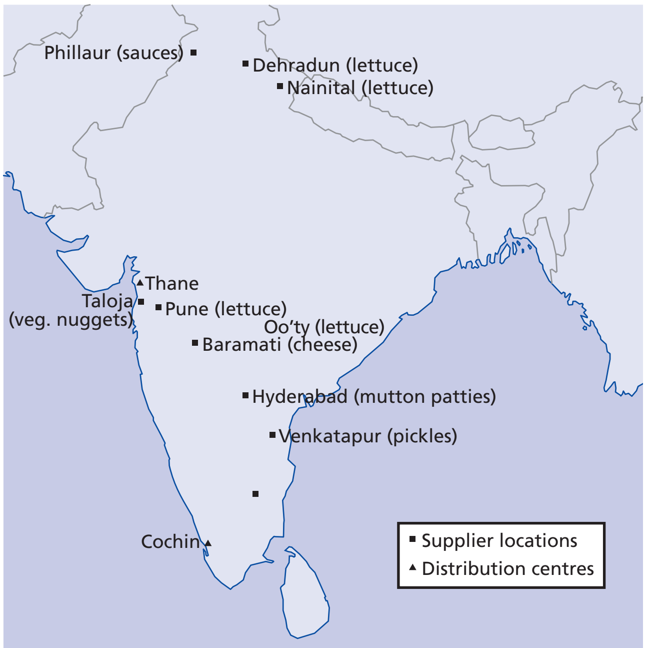
By June 2000, the company had started rolling out its first national campaign, as it was expanding beyond Mumbai and New Delhi. The campaign, budgeted at Rs 100 million, was expected to highlight (in phased order) the brand (the experience that there is something special about McDonald's), food quality and variety. The company also ran special promotions during festivals, and 'vegetarian' days, and was even developing garlic-free sauces to bring in 'hard-core' vegetarian traffic.

In terms of the selection of cities, McDonald's followed the same strategy in India as in the rest of the world. Its initial focus on Mumbai and Delhi was driven by the following factors: they were the two largest cities in India; their citizens enjoyed relatively high income levels compared to the rest of the country; and they were exposed to foreign food and culture. After establishing a presence in the leading cities, McDonald's then moved to smaller satellite towns near the metropolitan cities (for example, from Delhi to Gurgaon and Noida, both suburbs of Delhi, and from Mumbai to Pune). McDonald's often found that there were positive spillover effects, in terms of its reputation, from the metropolitan cities to the satellite towns. In Jaipur, the company was hoping to attract foreign tourists.

Developing the supply chain

McDonald's search for Indian suppliers started as early as 1991. Its initial challenge was to develop local suppliers who could deliver quality raw materials, regularly and on schedule. In the five-and-a-half years until start-up, McDonald's spent as much as Rs 500 million (US$12.8 million) to set up a supply network, distribution centres and logistics support. By mid-2000, some estimates placed the total investment in the supply chain at almost Rs 3 billion. Local suppliers,

Exhibit 6 | McDonald's supply chain in India



distributors and joint venture partners and employees had to match the restaurant chain's quality and hygiene standards before they became part of its system.

McDonald's experience in identifying and cultivating the supplier of lettuce provided an excellent illustration of the difficulties involved. In 1991, hardly any iceberg lettuce was grown in India, except for a small quantity grown around Delhi during the winter months. McDonald's identified a lettuce supplier (Mangesh Kumar from Ootacamund in Tamilnadu, a southern state) and helped him in a broad range of activities, from seed selection to advice on farming practices. In the case of several other suppliers, such as Cremica Industries which supplied the sesame seed buns, McDonald's helped them to gain access to foreign technology. In another instance, it encouraged Dynamix, the supplier of cheese, to establish a program for milk procurement by investing in bulk milk collection and chilling centres. This, in turn, led to higher milk yields and overall collections, as well as to an improvement in milk quality. McDonald's ended up with a geographically diverse sourcing network, with buns coming from northern India, chicken and cheese from western India, and lettuce and pickles from southern India. There were as many as 40 suppliers in the company's supply chain. (See Exhibit 6 for McDonald's supply chain.)

A dedicated distribution system was established to match the suppliers' production and delivery schedules with the restaurant's needs. The first two centralised distribution centres were set up near Mumbai and at Cochin (in the southernmost part of India) in joint ventures with two local retailers, both of whom had to learn from international distributors of McDonald's products how the restaurant chain handled distribution worldwide and, especially, how to enhance the quality of storage operations. The company estimated that each distribution centre could service about 25 outlets. McDonald's strove to keep the storage volumes of products high in order to exploit all possible economies of scale. The distribution centres were also expected to maintain inventory records and to interact with suppliers and the logistics firm to ensure that their freezers were well stocked. Said Amit Jatia, 'The most important part of our operations was the development of a cold chain [the process of procurement, warehousing, transportation and retailing of food products under controlled temperatures]. There is practically no need for a knife in any restaurant. All the chopping and food processing is done in the plants. Only the actual cooking takes place in the restaurants.'

Even with the suppliers and distribution system in place, McDonald's needed a distribution link to move raw materials to its restaurants. Logistics management was contracted out to AFL Logistics – itself a 50:50 joint venture between Air Freight (a Mumbai-based firm) and FX Coughlin of the United States, McDonald's international logistics provider. AFL logistics was responsible for the temperature-controlled movement of all products (by rail, road or air, as appropriate) from individual suppliers to the regional distribution centres.

McDonald's had to work extremely hard at inculcating a service orientation in its employees, especially those involved in physical logistics, since the freshness of the food was at stake. The truck operators had to be explicitly and clearly instructed not to switch off the truck's refrigeration system to save on fuel or electricity. The corporation went to the extent of installing trapping devices, which would show the temperature chart through the entire journey.

Since 1999, McDonald's had started using India as an export base for cheese, lettuce and other products that went into its burgers. Exports had already begun to Sri Lanka, where it had opened in October 1998, and trial shipments had commenced to Hong Kong and the Middle East. Said Amit Jatia, 'Things are becoming global in nature. Once you set up a supply chain in a strategic location, it can service other countries as well.'

Past performance and planned strategies

During its first 12 months of operations, McDonald's opened seven outlets (four in Delhi and three in Mumbai), had 6 million customer visits and served 350 000 Maharaja Macs. By the end of 1998, the number of outlets had gone up to 14, and, by mid-2000, it had expanded to 25 outlets with an outlet in Pune and Jaipur. The estimates for average daily customer visits to a McDonald's outlet differed widely. According to a mid-range estimate (conservative estimates were half as much, whereas generous estimates could be about 40 per cent higher), in June 2000, McDonald's outlets were doing (on average) about 1 500 transactions (or bills raised) a day, serving over 3 500 visitors. This was a significant improvement over 1998 when a typical McDonald's restaurant was doing only 900 transactions per day (according to the same source). Industry sources, however, were in agreement that the spending per customer visit at McDonald's was around Rs 45.

The growth rate in McDonald's sales had been 70 per cent over the previous two years (1998–2000) and was expected to be sustained until 2002. This growth rate included the effect of starting up new outlets. Even with this growth, analysts were expecting that the

Indian operation would take three to four more years to break even overall. This was attributable to the heavy investments made in vendor development, infrastructure and brand building.

One gratifying aspect of McDonald's success was the fact that, by mid-2000, it derived as much as 50 per cent of its revenues from vegetable food items, thus disproving its critics – especially those who were sceptical of its ability to serve food that suited Indian palates. In 1997, customers rated McDonald's food as bland. By September 2000, the perception had changed, however. Customers thought that McDonald's food had a unique taste.

To exploit the opportunities created due to its better brand awareness and customer acceptance, McDonald's was following a three-pronged strategy: increase the seating capacity in existing outlets to cater to additional traffic; open new outlets in Mumbai and Delhi; and, finally, penetrate new cities.

McDonald's was also in talks with Delhi Metro Rail Corporation, Airports Authority of India, Indian Railways and Delhi Development Authority to open smaller McDonald's outlets in airports and railway stations, among others. The investments required to open these smaller outlets were only half that of the regular outlets.

High real estate prices were a thorny issue in nationwide expansion. In metropolitan cities such as Mumbai, prime real estate was extremely expensive and sometimes not available at all. The costs were also high in other cities such as Bangalore. 'Our expansion plans are always relative to the availability of real estate, Bakshi said.

McDonald's also had plans to set up several outlets along the Delhi-Agra national highway in a tie-up with a major petroleum refining and marketing organisation, Bharat Petroleum Corporation Limited. Jatia said, 'We feel both local tourists and foreigners travelling by road don't have many reliable eating options right now.' The first such outlet, a project estimated at Rs 35 million, was already in operation. The company proposed to offer highway travellers parking space and a play area for children. The emphasis on quality, service, cleanliness and value (QSCV) had been quite successful in drawing highway travellers in its home market (the United States). Some analysts, however, believed that highway travellers in India, who were typically truck and bus drivers, would not be willing to go in for the type of food or prices that McDonald's currently offered. In addition, McDonald's was looking at tie-ups with other oil companies, as well as retail vehicles such as malls, multiplexes or cinema halls.

Endnote

* This case was first published, in an earlier form, in Kulwant Singh, Nitin Pangarkar and Gaik Eng Lim (eds), 2001, *Business Strategy in Asia: A Casebook* (Singapore: Thomson Learning).

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