Creating the McUniverse:
McDonald's Sources of Power in Foreign Markets

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Abstract This paper explores McDonald's transformation from a small town burger joint to the poster child for globalization and economic development abroad. To gain its position as one of the few truly global companies, McDonald's has exploited various sources of power and competitive advantage. Due to its massive size, McDonald's enjoys economies of scale in purchasing and expansion, both on a macro level and within individual regions. In addition to purchasing power, McDonald's has leveraged economies of scale in brand recognition to expand more easily into emerging marketplaces. Finally, McDonald's has established a unique source of process power thanks to its franchising practices, which allow the Golden Arches to adapt to local tastes while maintaining a strong brand identity. This paper examines these sources of power as well as the challenges McDonald's may face as it continues to create the McUniverse.

I. Introduction

McDonald's Corporation operates in 119 countries, serving 68 million customers a day. The brand has become a symbol to many of globalization, its prevalence throughout the world representing the convergence of social norms and the homogenizing impact of American culture. Whether or not McDonald's universal presence is viewed in a positive light, one thing is certain: McDonald's is one of the few truly global companies, and the only one of its kind among food chains. An example, or consequence, of this pervasiveness and international penetration is The Big Mac Index, developed by The Economist as an informal metric of Purchasing Power Parity. The Big Mac Index compares the price of McDonald's signature burger across nations as a proxy for purchasing power (the most expensive Big Mac is in Norway, selling for $7.51 USD; the cheapest in India for $1.50 USD.) [1]

It is no small irony that one of the most culturally pervasive, international corporations is so inherently All-American in origin and product. McDonald's Corporation traces its history to the first franchised McDonald's restaurant in Des Plaines, Illinois, opened in 1955 by Ray Kroc. Its core menu of burgers and fries was distinctly tied to the American tradition of cuisine, and its branding was simple, classic, and All-American. How did this Midwestern chain become the international presence it is today? How has such an American concept become a fixture in a diverse range of cultures?

McDonald's ability to develop and maintain such a successful international brand lies in several power sources. Due to its massive size, McDonald's enjoys economies of scale in purchasing and expansion. These economies of scale operate both on a macro level and within individual regions. McDonald's ability to negotiate with local retailers allows it to lower costs across the region that particular retailer serves. This is especially relevant in foreign marketplaces such as Asia Pacific where McDonald's competitors have been unable to achieve the critical mass needed to drive down cost. On a macro scale, McDonald's is able to keep costs low because of synergies between regional operations. These synergies include learning advantages associated with international expansion, which allow McDonald's to more easily overcome the difficulties of entering a foreign market, including franchising in less developed capital markets and integrating into dissimilar cultures.

McDonald's size on a global scale has become an increasingly relevant factor of its branding as well. The ubiquity of McDonald's around the globe has raised brand awareness to nearly 100 percent and gives the firm credibility and allure in foreign marketplaces. Because McDonald's is able to operate at a lower cost within these marketplaces, it is able to differentiate its product mix in order to assimilate more fully into foreign cultures. This product differentiation is crucial to McDonald's branding in foreign countries; it allows the firm to maintain its iconic and global brand image associated with value, quality, and reliability, while becoming locally relevant.

Finally, McDonald's complex franchising process in foreign nations represents a form of process power. McDonald's offers franchisees a great deal of freedom with regards to menu and store appearance because these franchisees are more in touch with local culture, and thus can better increase the store's local relevance. However, due to this freedom, selecting

[1] The Big Mac index. (2013, Jan. 31). The Economist. Retrieved from http://www.economist.com/content/big-mac-index

the correct franchisees is crucial. McDonald's is able to devote more time and resources to the franchisee selection process than its competitors because of its scale and the high profit margin of its company-owned stores. Since McDonald's company-owned stores operate on comparatively higher margins, the firm does not feel pressure to franchise aggressively when entering a new territory for the sake of adding to its bottom line. Instead, the rate of franchising is driven by the rate at which appropriate franchisees are found. McDonald's ability to franchise effectively in foreign countries, particularly those with less established franchising practices, has given the firm a huge advantage when expanding into lucrative overseas markets.

II. McDonald's and the World: Significance on a Global Scale

Before determining how McDonald's exerts power over the international marketplace, it is important to establish the significance of a large international presence to the firm. While McDonald's has worked hard to develop a large global footprint, these efforts would be misguided if its international operations were unprofitable or diluted its domestic sources of power. McDonald's first expanded abroad in 1967, when store locations opened in Puerto Rico and Canada. Since then, expansion abroad has been a crucial driver of McDonald's revenue. Today, almost 70% of its sales are generated outside of the U.S., as shown in Figure 1.

McDonald's success abroad is crucial to the company and has become even more important in recent years. In 2003, prodded by slumping domestic sales and negative media attention, McDonald's instituted a two-pronged strategy reform. In the United States, the company sought to rebuild its brand image by renovating stores, expanding menu offerings, and extending store hours. The second strategy focused on growth driven by international franchising, which offered immediate returns with little overhead cost. In particular, this strategy targeted the emerging markets of China and India where a growing middle class offered a lucrative customer base for the fast food chain.[3] In 2008, McDonald's opened its 1,000th store in China, and the firm has continued to expand rapidly, opening 250 new Chinese restaurants in 2012.

The significance of foreign markets to McDonald's core strategy cannot be overstated. Figure 2 shows the system-wide sales increases for McDonald's stores in 2010-

McDonald's 2012 Revenues by Segment

Geographic Segment	$ Millions	Percent
U.S.	8,814	32%
Europe	10,827	39%
APMEA	6,391	23%
Other Countries & Corporate	1,535	6%
Total	27,567	100%

Figure 1[2]

[2]McDonald's. 2012 Annual Report. (2012). Retrieved from http://www.aboutmcdonalds.com/mcd/investors/annual_reports.html

[3]Adamy, Janet. (2009, March 10). McDonald's Seeks Way to Keep Sizzling. The Wall Street Journal. Retrieved from http://online.wsj.com/news/articles/SB123664077802177333

-2012. While same-store sales in the United States grew by 5% in 2011, sales in Europe increased by an astounding 14% and sales in Asia Pacific/Middle East/ Africa (APMEA) increased 16%, driven largely by growth in the Chinese marketplace.

2012, however, was a different story. In October, McDonald's experienced its first global monthly sales decline in 9 years, sending some investors into panic. While most analysts affirmed the dip was structural rather than permanent, 2012's slagging sales highlight the risk of McDonald's reliance on global expansion in a year where Europe floundered in the throes of recession and growth stagnated in China.

While McDonald's has become an international brand, its competitors have not reached the same level of global penetration. The second-largest burger chain in the world, Burger King, operates in 79 countries to McDonald's 119, 66% of which are in the U.S. In contrast to McDonald's, Burger King derives about 36% of revenue from overseas sales.[4] Its expansion has been marked by several failures; Burger King experienced quality control issues in the early stages of its international expansion, and its most notable failure abroad came in 1998 when Burger King shut down all of its French outlets.[5] McDonald's significance abroad is unique among its competition, and it is this sizable market presence within foreign countries and on a global scale that forms the basis of McDonald's economies of scale.

III. Economies of Scale: Purchasing and Expansion

Economies of scale have played a significant role in McDonald's ability to enter and establish market share in new countries. McDonald's operates restaurants at a lower cost than competitors due to relationships with distributors, efficient and well-managed supply chains, and scale economies in purchasing. Because of its superior ability to negotiate contracts with distributors, McDonald's is able to drive down commodity prices. In 2012, worldwide company restaurant expenses for McDonald's totaled 82% of revenue, meaning company-owned stores operated on an 18% margin. Burger King's restaurant expenditures, including product costs, labor costs, and occupancy costs, totaled 89% of revenue, leaving a 11% profit margin on average worldwide. In Burger King's APMEA locations, this margin was only 10%. While pricing is almost identical for these two

System-wide Sales Increases

Geographic Segment	2012	2011	2010
U.S.	4%	5%	4%
Europe	(2)%	14%	3%
APMEA	5%	16%	15%
Other Countries & Corporate	4%	17%	13%
Total	3%	11%	7%

Figure 2[6]

[4]Burger King. 2012 Annual Report. (2012). Retrieved from http://investor.bk.com/conteudo_en.asp?idioma=1&conta=44&tipo=43575

[5]Burger King, Citing Poor Profits, Will Bid France Adieu. (1997, July 30). The New York Times.

[6] 2012 Annual Report

brands, McDonald's has enjoyed significantly higher profit margins due to its ability to reduce costs with distributors, largely through aggressive negotiation tactics. In particular, McDonald's APMEA operations have developed a significant cost advantage due to its scale within the region.

This cost advantage in purchasing has also given McDonald's greater flexibility in the choice between franchised and company-owned stores. While well over 90% of Burger King stores are franchised, McDonald's owns about 30% of its locations worldwide. This is particularly relevant when it comes to international expansion. While Burger King and other competitors have incentive to franchise rapidly, holding as few stores as possible in order to gain franchise revenue, McDonald's is able to support more company-owned stores. Because McDonald's enjoys a higher margin on company-owned stores, it is able to expand further within a developing marketplace without giving up control over its operations, leading to higher quality and more successful entries in foreign countries. In recent years, particularly as McDonald's has established an entrenched presence in foreign marketplaces, the firm has focused on franchising more rapidly to reduce overhead costs. While this push towards franchising is set to gain steam in the future, the firm's continued optimization of company-owned locations gives it an advantage abroad.

McDonald's is also able to leverage its nearly unlimited resources to facilitate entry into new markets. One interesting example of this came with McDonald's expansion into India in 1996. Prior to opening in India, McDonald's devoted seven years to developing the supply chain. In 1989, McDonald's sent a team to study agriculture and food production in India in order to optimize its cold chain delivery system. Farmers were trained to produce specifically in accordance with McDonald's standards; the iceberg lettuce was developed using a new culture farming technique such that it was consistent with McDonald's lettuce worldwide. In order to meet annual demand, the team helped teach Trikaya Agriculture, the lettuce supplier, how to grow lettuce crops all year long. McDonald's had the scale and resources to involve itself in every part of the production process, offering guidance on such minute details as the maximum size of pea that could be used in India's lamb burgers.[7] The firm's power abroad and the expectation of rapid Indian expansion once entry was established gave McDonald's superior negotiating power with distributors and with Connaught Plaza Restaurants, with whom McDonald's entered into a joint venture. Today, McDonald's has 300 locations in India. Burger King, on the other hand, only announced plans to enter the Indian marketplace via a joint venture in November 2013. Previously, supply chain barriers blocked 'the Crown' from entering this attractive market.

IV. Branding and Economies of Scale in Brand Recognition

McDonald's also enjoys a significant competitive advantage due to its branding and worldwide brand recognition. This advantage is a type of position power, meaning that it is a sustainable and inimitable source of competitive advantage. From its nascent stages, McDonald's has always been acutely aware of the importance of branding and brand image in the fast food industry. Since the industry is driven by the perception of value, it is difficult to compete in price; competitors almost immediately match price

[7]Bisht, Amit. (2009, Jan. 20). McDonalds India Supply Chain. Articlesbase. Retrieved from http://www.articlesbase.com/marketing-articles/mcdonalds-india-supply-chain-729402.html

changes, and gains in market share are arbitraged away. For example, when McDonald's introduced the Dollar Value Meal in 1992, Burger King answered less than a year later with an almost identical menu combination. Similarly, with core menu items at McDonald's so similar to those of its competitors, competition based on superior products is equally challenging. While quality, taste, and service are fundamental to the McDonald's experience, it is difficult to determine what makes a decidedly better hamburger, particularly at such a low price. Thus, much of McDonald's success both domestically and abroad can be attributed to the perception of superiority, or brand image, that the corporation has manufactured.

McDonald's brand is indeed pervasive in modern society: in a study done in six nations, more of the 7,000 participants could recognize the Golden Arches than the Christian cross.[8] This high level of brand recognition makes entering new markets less challenging as it decreases the uncertainty surrounding demand for the product. In India, for example, the McDonald's team was able to study the demand not just for low-priced American food, but also for McDonald's in particular. The connotations of affluence and Americanism attributed to McDonald's abroad allow the corporation to receive differential returns on an easily replicable concept. In most nations, people will choose McDonald's not only for the consistency of product and service, but also for the brand image. McDonald's is an iconic symbol of all things Western, and as such, many customers perceive the brand as superior to alternatives.

However, McDonald's has also been able to manipulate its brand to represent more than just American culture transplanted abroad. In 2008, McDonald's was the official restaurant of the Beijing Olympics, showing a global awareness that resonates across different cultures. By marketing in conjunction with such a famed international event, McDonald's furthered its image as a worldwide firm, not merely an American corporation exported overseas. This ethos of cultural assimilation is a crucial aspect of McDonald's success abroad. Rather than maintain a single brand image, McDonald's has tailored its branding to fit more with local culture and traditions. For example, in Europe, McDonald's caters to a far more upscale consumer base than in the United States. The branding is representative of the culture there, and is used to differentiate McDonald's from other American fast food chains. This sort of position power is crucial to McDonald's success overseas; while other chains can advertise and change their branding, it is difficult to change the fundamental brand perception within a country. McDonald's regional scale also strengthens its branding within foreign nations. While the overarching image of the company remains linked to the West, McDonald's is able to pervade local cultures by opening more locations and assimilating into the lifestyle. In this way, branding and scaling are symbiotic processes: McDonald's furthers its brand by opening more locations, while branding helps create the residual demand necessary to scale effectively. This regional scale economy in branding strengthens the connection between the local clientele and the brand. In a 2009 interview, in fact, former Chief Marketing Officer Larry Light noted that most children in Japan believe that McDonald's is a Japanese brand that has been exported to America.[9] It is this sort of cultural immersion and local relevance that sets

[8]Schlosser, Eric. (2001). Supersize Me. New York: Houghton Mifflin Company.

[9]Light, Larry. (2009, April 29). McDonald's Former Chief Marketing Officer Larry Light Talks About Brand Revitalization. Customer Management.

McDonald's apart from other brands in foreign markets.

Another benefit of maintaining differentiated brands is that McDonald's is able to experiment with product innovation in a way that firms based primarily in one country cannot. Innovations and potential extensions of the brand are often tested in foreign marketplaces where such experiments will not hurt the centralized brand image as they might in America. Take, for example, the firm's foray into the premium coffee industry. McCafé was launched in Melbourne, Australia in 1993 as a chain of stand-alone coffee shops similar to Starbucks. Because the McDonald's brand has a more upscale connotation in Australia, McCafé was able to charge a premium on espresso beverages and leverage the already well-regarded McDonald's brand to create differential returns. Taking note of the success in this smaller marketplace, McDonald's looked to expand the McCafé stores throughout Australia and into Europe. By 2003, McCafé was the largest coffee shop brand in Australia and New Zealand, and in 2007, McDonald's brought McCafé to the domestic marketplace. However, due to the different brand perception in the United States, the business model was altered; instead of stand-alone stores, McCafé products were integrated into the current menu offerings at McDonald's stores and sold alongside popular breakfast foods. The premium coffee is sold at a lower price than a comparable Starbucks drink, and the branding is centered more on convenience, value, and accessible indulgence. McCafé is considered to be one of McDonald's most successful initiatives in recent years, and has expanded internationally to Canada, the UK, and India. In 2013, McDonald's announced a joint venture with Kraft to sell McCafé coffee in U.S. stores, further extending the brand.

While there are indeed limits to differential branding overseas (McDonald's attempt to expand its brand into luxury hotels in Switzerland was met with quick failure), McDonald's Corporation has had great success in its ability to assimilate into foreign cultures. This ability, along with its universally recognized core brand image, has given McDonald's a significant competitive advantage overseas.

V. Branding and Product Differentiation Abroad

An important facet of McDonald's branding abroad is the differentiation of its products to appeal to local tastes. Larry Light has said of McDonald's integration into foreign markets: "We established a global brand framework. But, our purpose was not to limit creativity but to focus it. Local brand relevance is a superior approach to lowest common denominator standardized marketing worldwide."[10] The freedom of franchisors to adapt to local customs allows a higher degree of flexibility within the menu and appearance of the store. This means that the McDonald's fare from one country to another may vary greatly from shrimp burgers in Japan (called the "EBI Filet-O") to Chicken SingaPorridge in Singapore.

McDonald's has established position power abroad by understanding the palates of customers and catering to their needs. This demand-driven approach to menu formatting sets McDonald's apart from its competitors. While most international fast food chains vary product mix and menu items by region, no other brand has been able to successfully integrate local culture and cuisine into the core menu as fully. One reason for this is cost.

[10]Customer Management

Three quarters of McDonald's grocery bill is comprised of ten different items, and while this purchasing bundle is relatively condensed, most other hamburger chains purchase fewer items, concentrating instead on driving down price by limiting menu offerings and purchasing critical ingredients in bulk.[11] Because McDonald's has economies of scale within many of the regions it operates, it can buy enough to drive down prices on different ingredients even if these menu items would not be profitable on a global scale.

One example of McDonald's superiority in assimilation comes in the French marketplace. Even in a nation known for food snobbery and distinguished diners, McDonald's has managed to maintain an extremely lucrative business; the French operation of McDonald's is second only to the U.S. market in profitability. McDonald's has been able to overcome anti-American sentiment in France by catering the menu, atmosphere, and experience to French tastes. In a New York Times interview, a spokeswoman for McDonald's France says, "The French eat McDonald's in a French way. They come less often but spend more because they want a proper meal." This is defined as a sit-down experience with two courses.[12] The food consumed at French outlets also varies substantially from the U.S. operation: the largest sellers are the jambon beurre, a sandwich of butter and ham on baguette, and the McCroque sandwich, neither of which are available outside of France. In contrast, Burger King entered France in 1981, but closed its French operation in 1997 due to lagging profits. This failure was largely due to its inability to capture the loyalty of the French people; to them, Burger King was simply an American transplant. McDonald's sustained advantage in foreign marketplaces can be attributed in part to its ability to adapt to local dietary needs and format its menu in a way that is both globally appealing and locally applicable.

VI. Process Power in Franchising and Foreign Expansion

McDonald's undoubtedly has position power in foreign markets: its size and scope of operations, as well as its branding and local relevance give the firm sustained and significant advantages over its competition. The final element that makes McDonald's so superior in its foreign strategy is process power, defined as "the development over time of a complex company process that is central to the business proposition of that business."[13] The fundamental characterization of process power is that the process must be so complex or opaque that other firms cannot imitate it in order to achieve the same results. McDonald's ability to enter foreign markets and scale within these markets is in part due to its process, not just its size.

In the case of India, McDonald's rigorous supply chain studies allowed the firm to enter the market and immediately begin scaling without risking a drop in quality or a shortage of raw materials. The complexities of setting up these distribution channels ex ante are significant, as they include both negotiating with and training the distributors.While scale and learning economies contribute to McDonald's superiority in planning and entering markets, the process used by McDonald's also gives the firm a significant advantage.

[11] 2012 Annual Report

[12] Audi, Nadim. (2009, Oct. 25). France, Land of Epicures, Gets Taste for McDonald's. The New York Times. Retrieved from http://www.nytimes.com/2009/10/26/world/europe/26mcdonalds.html

[13] Helmer, Hamilton. "Sources of Power."

Once McDonald's enters, its ability to optimize the franchising process, particularly in less developed markets, is crucial. In several of the countries McDonald's has entered, it was the first firm to establish a franchised business. While other firms are inclined to expand faster by aggressively franchising, McDonald's has extremely stringent vetting policies for potential franchisees; in addition to requiring a high level of independent capital backing, franchisees are required to undergo extensive training at their own cost.[14] Because quality and consistency are so important in the fast food industry, the ability to successfully vet and train franchisees is a large facet of McDonald's success. While other firms can train franchisees as well, no other competitor has the capabilities yet to put in place such effective training processes in foreign countries. Because cultural assimilation is so important to McDonald's success abroad, the ideal attributes of a franchisee change from region to region. McDonald's superior ability to pick not only the most experienced, but also the most culturally aware franchisees makes McDonald's superior to other firms in the area of franchising. The complex optimization process of selecting which locations should be franchised, and to whom, has given McDonald's an advantage in foreign markets, and its ability to scale without losing control over the brand is unmatched by competitors.

VII. Future Challenges

While McDonald's has achieved significant differential returns due to its foreign strategy, there are still concerns the firm must address in the future in order to maintain its success. The flat sales of 2012 disrupted a nearly decade-long streak of growth for the chain. While CEO Don Thompson blamed the issue on "the pervasive challenges of today's global marketplace," some worry that McDonald's had grown complacent in its leadership position both domestically and abroad, allowing old competitors like Burger King and newer competitors like Chipotle to gain mind share, particularly in the U.S. as eating habits change post-recession.

In addition to concerns over the sustained viability of the U.S. marketplace, there are threats to the McDonald's business plan abroad. As McDonald's business plan relies increasingly on foreign sales and expansion, these threats become more and more relevant. Currently, about 70% of McDonald's revenue is generated abroad and 35% of its total debt is denominated in foreign currencies; accordingly, McDonald's earnings are affected by fluctuations in foreign currencies, particularly the Euro, British Pound, Australian Dollar and Canadian Dollar. As foreign currencies strengthen relative to the dollar, goods sold in foreign markets are suddenly worth more dollars back in the U.S., boosting earnings.[15] On the other hand, a stronger dollar reduces the value of sales from abroad. In prior years, McDonald's benefited abroad from the weakening dollar and fared much better than competitors whose business was more firmly entrenched in the domestic marketplace. However, as the dollar continued to strengthen and economic turmoil persisted in Europe, profits from McDonald's prized foreign markets were adversely affected. If the dollar continues to strengthen, McDonald's will be forced to reassess the profitability of a business model that

[14]"McDonald's Franchising." http://aboutmcdonalds.com/mcd/franchising.html
[15]2012 Annual Report

focuses on foreign expansion.

McDonald's earnings are sensitive to fluctuations in commodity prices as well, particularly beef, corn, poultry, and cheese. Since 2005, commodity prices have been increasing, and in 2013, commodity prices are expected to rise 1.5 to 2.5% domestically and 3 to 4% in the European marketplace.[16] Because the firm's branding relies so heavily on value, it will be difficult to pass these cost increases onto consumers. For example, the success of the Dollar Value Meal is largely attributed to marketing surrounding the price: all products on the menu are less than a dollar. While McDonald's previously has expressed that raising prices on these items is out of the question, they have introduced the 'Dollar Menu & More,' which has items ranging from $1 to $5. To absorb these increasing costs, McDonald's may have to renege on its 10-year-old 'Dollar Menu' value proposition entirely.

A final challenge that McDonald's must face is the effect of changing consumer preferences on brand perception. McDonald's has struggled in recent years to maintain a positive public image amongst accusations that the firm has had negative environmental and health externalities. While McDonald's has attempted to address these issues by creating more environmentally friendly packaging and integrating healthier options onto the menu, the firm's image has remained tarnished. Furthermore, a recent report from the Boston Consulting Group and Service Management Group reveals that the coveted millennial customer-base is increasingly eschewing McDonald's and other fast food chains for fast-casual, seemingly healthier options such as Panera Bread and Chipotle. As international markets join the health-conscious movement, McDonald's will have to work harder to change its image as a purveyor of artery-clogging junk food.

VIII. Conclusion

The McDonald's of today poses little resemblance to the firm of 50 years ago. Not only is it bigger, it has transformed from a uniquely American brand to a global presence. To developing nations, the arrival of the famed Golden Arches is an indicator that the country has achieved a certain level of development, a sign it has established capital markets and levels of disposable income sizable enough to support a Western firm. To established nations, McDonald's is a ubiquitous presence, a homogeneous experience, and a common denominator: nearly everyone, at one point, has visited one. The impact of McDonald's around the globe is unmatched by any other food chain, and arguably, by any other brand. It is little wonder that the core concept of the firm, low-priced, efficient, good-quality food, has played well in many different cultural settings. However, the success of McDonald's cannot simply be attributed to a good idea. McDonald's power lies in its ability to leverage its scale and global presence to enter new markets, innovate, and keep costs low. Its differentiation in branding and menu make McDonald's locally relevant, while its overarching company ethos reassures customers of what they will receive when they enter. While the firm faces challenges in the future, there is little doubt that McDonald's will continue to thrive and grow, and with it, the promise that wherever you travel, the Golden Arches will be there, waiting.

[16] 2012 Annual Report Proxy

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