CASE

McDonald's Corporation in Emerging Markets[1]

Nearly everyone has an opinion about McDonald's, including Jerry Seinfeld. In one of his live standup acts, he relayed the following observations.

> Why is McDonald's still counting? How insecure is this company? 40 million, 80 jillion, billion, zillion, killion, tillion. . . . Is anyone really impressed anymore? "Oh, 89 billion sold. . . . alright, I'll have one. I'm satisfied." . . . Who cares?
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> I would love to meet the chairman of the board of McDonald's and just say to him, "Look, We all get it. OK, you've sold a lot of hamburgers, whatever the number is. Just put on the sign, 'McDonald's—We're doing very well.' We are tired of hearing about every dang one of them."
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> What is their ultimate goal, to have cows just surrendering voluntarily or something? Showing up at the door: "We'd like to turn ourselves in. We see the sign. We realize we have very little chance out there. We'd like to be a Happy Meal® if that's at all possible."

With 30,000 outlets in 121 countries, McDonald's Corporation is "doing very well" by many measures. It has taken an aggressive growth stance by entering into risky emerging markets and riding on the economic growth spurt of the 1990s. But as the world slipped into an economic recession in 2001, McDonald's has felt the blow, showing six consecutive quarters of declining results. Although prosperous in some emerging markets, like Russia and China, it has done poorly in others, like Turkey, Malaysia, and the Philippines, where it closed 163 unproductive stores at a cost of $91 million in 2001. As the world economy has taken a downward turn, McDonald's is facing risks and challenges that raise questions and doubts about the future of its worldwide operations.

McDonald's entry into Russia in 1990 exemplifies the process and difficulties it has encountered in most developing countries where it has begun operations. During the 1976 Olympics in Montreal, George A. Cohon, president of McDonald's Canadian subsidiary, made the first contact with Soviet officials. They began lengthy negotiations, which lasted until 1988 when a formal agreement was signed. In the meantime, McDonald's had opened restaurants in Hungary and Yugoslavia, thus providing the company with valuable experience in operating in communist countries. By the mid-1980s, the company was expanding more rapidly outside the United States than inside, and company executives reasoned that if they were to meet the company's rapid growth objectives, that trend must continue.

Although the Moscow City Council was a partner of McDonald's in the Russian joint venture, the company repeatedly ran into negative responses, such as "Sorry, you're not in my five-year plan," when it attempted to obtain such materials as sand or gravel to build the restaurant. The company had to negotiate to ensure it would be allocated, in the then-Soviet Union central plan, sufficient sugar and flour, which were in chronically short supply. Even for some products in sufficient supply, such as mustard, government regulations prevented Soviet manufacturers from deviating from standard recipes in order to comply with McDonald's needs. In other cases, strict allocation regulations dictated that Soviet plants sell all output to existing Soviet companies, thus leaving them no opportunity to produce products for McDonald's. Yet another problem was that some supplies simply were not produced or consumed in the Soviet Union, including iceberg lettuce, pickling cucumbers, and the Russet Burbank potatoes that are the secret behind McDonald's French fries.

To handle these problems, McDonald's scoured the country for supplies, contracting for such items as milk, cheddar cheese, and beef. To help ensure ample supplies of the quality products it needed, it undertook to educate Soviet farmers and cattle ranchers on how to grow and raise those products. In addition, it built a $40 million food-processing center about 45 minutes from its first Moscow restaurant.

One problem McDonald's did not encounter was attracting employees and customers. The company placed one small help-wanted ad and received about 27,000 Russian applicants for its 605 positions. McDonald's did no advertising prior to its Moscow opening. However, Russian television covered the upcoming event extensively. When the restaurant's doors opened for the first time in January 1990, it was almost impossible to accommodate the crowd, even though it was the largest McDonald's in the world. An estimated 30,000 people were served the first day, eclipsing the previous daily record of 9,100 set in Budapest. The crowds continued to arrive, even though the price of a Big Mac, French fries, and soft drink equaled a Russian worker's average pay for four hours of work. In contrast, lunch at a state-run or private sector cafe cost 15 to 25 percent as much as a meal at McDonald's.

The entry of McDonald's into China in 1990 resembled its experience in Russia. However, the Chinese government moved faster and was more accommodating than the Russian government had been. China's government wanted to establish its fast-food market and felt that Western companies like McDonald's could take the risks in proving its success. McDonald's encountered similar roadblocks in China, such as lack of quality supplies and distribution difficulties, and it has found analogous benefits, like high volumes of customers and employees.

In 1997, the Asian financial crisis hit, devastating most of the economies in Asia. However, China's economy, including its catering industry, kept growing. In fact, the Chinese government in 1998 designated the catering industry as a new economic growth sector, growing at an annual rate of 20 percent in the 1990s. Because China avoided most of the economic turmoil its neighboring countries experienced, McDonald's prospered. Much of this growth is attributed to increases in individual's income, changing consumer patterns, development of the tourism sector, and overall growth in the fast-food industry—all signs of a growing economy.

McDonald's success in China has continued into the twenty-first century. In the first six months of 2001, McDonald's opened 96 restaurants in China, totaling 430 restaurants altogether. It plans to open 100 stores each year from 2003 to 2013. McDonald's record of success in Russia did a turnaround in 1998 when the Russian economy collapsed because of the devaluation of the ruble. However, with sales and growth on the rebound in Russia, McDonald's had 73 stores by the end of 2001. In fact, it is McDonald's success in China, Russia, and a couple of European countries that is one of the few positive notes in McDonald's 2001 annual report. The 2001 letter to shareholders written by the chairman and CEO of McDonald's opens by saying, "From many different perspectives, 2001 was one tough year." He goes on to say, "Our 2001 performance was hampered by the strong U.S. dollar and weak economies in many countries in which we operate." The continued economic crisis in Asia and Latin America and the economic recession in the United States led to reduced profits. In 2001, McDonald's was forced to close down 163 unproductive stores in countries whose economies are struggling.

When questioned about how world economic situations affect the company's expansion plans, Matt Paull, the chief financial officer (CFO) of McDonald's replied,

> When planning openings, we consider each market's current economic conditions, long-term demographic and lifestyle trends, competitive environment and stage of development, as well as the potential effect on existing McDonald's restaurants and returns.
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> Based on these criteria, we reduced the number of restaurant additions over the past few years and expect to add 1,300 to 1,400 McDonald's restaurants in 2002. About 60 percent of these openings will be in the U.S., Europe, and Canada, where economies are relatively stable and returns are strong. We also are adding restaurants in China, where the near- and long-term growth potential is enormous.
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> At the same time, we are reducing openings in markets with weak economic environments until we see signs of improvement. Since we already have a clear competitive lead in these countries, this temporary slowdown makes good business sense.

What will be the future of McDonald's worldwide operations? Will it continue to focus more on the United States, Canada, and Europe as stated earlier, or will it return to the emerging markets where growth is higher, although more unstable? Will McDonald's management be able to choose the right countries, commit the right amount of resources, and provide a strategy for sound economic growth for the future?

INTRODUCTION

Company managers need to understand economic environments to predict trends that might affect their performance.

Understanding the economic environments of foreign countries and markets can help managers predict how trends and events in those environments might affect their companies' future performance there. In this chapter, we discuss the economic environments of the countries in which an MNE may want to operate. An MNE such as McDonald's knows how to operate in its home-country economic system. However, when such a company wants to do business in another country for the first time, it needs answers to questions such as these:

1. Under what type of economic system does the country operate?
2. What are the size, growth potential, and stability of the market?
3. Is the company's industry in that country's public or private sector?
4. If it is in the public sector, does the government also allow private competition in that sector?
5. If the company's industry is in the private sector, is it moving toward public ownership?
6. Does the government view foreign capital as being in competition with or in partnership with public or local private enterprises?
7. In what ways does the government control the nature and extent of private enterprise?
8. How much of a contribution is the private sector expected to make in helping the government formulate overall economic objectives?

These questions appear simple to answer. However, because of the dynamic nature of political and economic events, the answers are complex—or yet to be seen. For example, foreign companies have continued to invest in Hong Kong since the United Kingdom returned Hong

A global concern is the growing gap between rich and poor, especially in many developing countries. The photo shows the stark contrast between urban slums and upper-income housing in Caracas, Venezuela.

Kong to China in 1997, even though the business world is wondering whether China will stifle some of Hong Kong's economic freedoms. Companies like McDonald's, which invest in emerging markets, are experiencing enormous difficulties because the changes taking place in those countries are so rapid and unpredictable. The question is whether today's global companies can keep up with the world's changing economic landscape.

Key economic forces include

- The general economic framework of a country
- Economic stability
- The existence and influence of capital markets
- Factor endowments
- Market size
- Availability of economic infrastructure

As Figure 4.1 notes, economic forces are an important part of the physical and societal factors that help comprise the external influences on company strategy. Economic forces include such issues as the general economic framework of a country, economic stability, the existence and influence of capital markets, factor endowments, the size of the market, and the availability of a good economic infrastructure, such as transportation and communications. Managers need to understand the nature of the world's economies if they are going to make wise investment decisions. To provide them with a frame of reference, we will first describe countries by income level, location, and economic system. Then we will look at key economic indicators, such as economic growth, inflation, and surpluses and deficits that affect the decision of management on where to commit MNE resources and efforts. Finally, we will examine the potential of the major geographic regions in the world, with special emphasis on countries in economic transition.

AN ECONOMIC DESCRIPTION OF COUNTRIES

Factor conditions—inputs to the production process, such as human, physical, knowledge, and capital resources and infrastructure.

There are 207 countries in the world with populations of more than 30,000.[2] Which of those countries are the ones where managers should commit resources? Although the answers vary by company, it is true that companies do business abroad for a variety of reasons, such as access to factors of production or demand conditions. **Factor conditions**, or production factors, include essential inputs to the production process, such as human resources, physical resources, knowledge resources, capital resources, and infrastructure.[3] Physical resources include weather, the existence of waterways to get goods to and from market, and the availability of crucial minerals and agricultural products. Knowledge resources are best represented by research and development conducted by companies and governments. For example, the Silicon Valley in the United States is a hotbed of high-tech research. The U.S. government has also poured significant resources into the U.S. aviation industry for the development of military aircraft, and this technology has been helpful in developing the civilian aircraft industry as well. Capital resources include the availability of debt and equity capital that firms can use to expand. Infrastructure includes roads, port facilities, energy, and communications.

FIGURE 4.1 Physical and Societal Influences on International Business