McDonald’s Market entry in Russia & Vietnam

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**Executive Summary**

Fast food restaurants can be characterized as one of the largest sectors of the food industry with over 200,000 restaurants and $120 billion in sales in the U.S. alone. A significant decline in sales over the past couple of years, reflect the maturity of the industry in the US (market saturation, economic down turn and health conscious eating). However, analysts are still optimistic about the outlook of the fast food industry globally and envisage growth in emerging and international markets. McDonalds’ strategic expansion abroad is a result of home market saturation. They selected to enter emerging markets like the Russian and Vietnamese one.

McDonald’s entry in Russia took several years. The entry project was led by an experienced senior manager and became a success. A sound partnership with good political ties, a well-organized supply chain, a smart currency decision, an adaption to the local habits, an appropriate training of employees and a proven marketing strategy were the key success factors.

Using the Russian experience, it makes sense for McDonald’s to enter the Vietnamese market as part of their “glocal” strategy expansion. Despite being a latecomer in this country, there is still a tremendous opportunity for growth. There is a young population (turned into the western culture), a fast income growth and government reductions in trade barriers to attract investors. Building the right and influential relationships is important particularly in McDonald’s franchise business model (more than ~80% of the stores) and adaptation to local taste and culture while keeping the famous McDonald’s core menus.

For the development of new markets, McDonald’s preferred strategy is to transfer risks and ownership to local franchisees (developmental licensees). In both examples, McDonald’s has used a strategy of aggregation using some economies of scale, food supply, stores design and adaptation by developing local products to match local tastes. They managed to keep a good balance between flexibility and responsiveness at local level while implementing coordination and control upstream.

1. **Evaluation of the market entry strategy of McDonald’s in Russia**

In this section we evaluate McDonald’s entry strategy in Russia based on several dimensions as seen during the course.

1.1. **Market and competition environment**

**Political context:** In 1990, at the time of the market entry, Russia and the United States were still in Cold War and represented the opposition of two socio-economic models: Capitalism and Communism.

**Economic situation:** The business environment was uncertain and volatile. There was a foreign exchange risk exposure as the rubles were non-convertible and illegal currency vs USD and German Mark (hard currencies). McDonald’s choose to operate in rubles only with a long term investment perspective.
assumption that the ruble would one day be convertible and targeting the Russian customer. This policy paid off and was highly appreciated.

**Market Environment:** The concept of fast food did not exist in Russia. Choices of fast food restaurant included Rostinter or KFC replica and other western based companies like Pizza Hut, Subway and Domino. It was an emerging market. Competition was low. McDonald’s established a standard for quality and cleanliness in the profession which represented entry barriers for rivals. The threat of new entrants was low and there were not many substitute products. Russians represented a market of 148 million habitants of which 75% lived in urban areas.

1.2. Customers assessment

**Consumers target and segments:** The target was the population living in urban areas.

**Culture and food habits:** Russians are used to long business lunches in formal dining rooms with table and cutlery. They eat meat, bread, potatoes and milk. Those take place in small informal cafes without seats. They have no idea how to eat with hands. McDonalds launched a television campaign which was viewed by one fifth of the population. Only 15% of the population dines out regularly. To enhance the local food preferences, McDonald’s Russia introduced potato wedges, cabbage pie and cherry pie in their menu. McDonald’s managed to influence the way they were perceived addressing people’s needs in eating cheap and fast rather than being a capitalism “intruder”.

1.3. Legal and regulatory context

**Government:** The government’s austerity program, eight years after introduction resulted in a reduction in traffic. Doing business in Russia implies to deal with a maze of bureaucracy and protectionism.

1.4. Entry mode structure

In 1987, a law eased restrictions on importation of foreign capitals, technology and expertise. A deal was concluded after 12 years of “hamburger diplomacy” through a joint venture with 51% of ownership by the city of Moscow and 49% for McDonald’s. A joint venture was the only mean of entry. It has the advantage to share the risk, join financial strength and reduce political uncertainty. The disadvantages are the shared management control, the impossibility to recover capital and the divergent views on expected benefits. Later, new restaurants opened in Russia owned 100% by McDonald’s.

1.5. Trade risks and supply chain

In Russia, McDonald’s needed a reliable supply chain. The agriculture was outdated and highly inefficient. The context was difficult as Russian farmers were reluctant to change. McDonald’s wanted to introduce the pickle an essential element of their product but unknown in Russia. Their key suppliers trained soviet farmers. They secure the infrastructure by granting loans to Russian suppliers. It resulted in an increase of productivity, successful businesses for suppliers who became trusted partners. There was no tradeoff on quality control, nor flexibility on taste of the core products. The suppliers had no bargaining power. McDonald’s took a major risk by investing 45mio dollars in this project. 400 jobs were created.
McDonald’s changed the way Russian ate and influenced the agricultural market by deciding what should be grown in the country.

1.6. Marketing strategy

**Timing of the market entry and location:** The opening took place in January 1990, after two years of marketing campaigns and 14 years of intense negotiations.

**Product range, price and store design:** The core menu was exactly as in New York. Some additional offers to meet the Russian taste were added to the menu (Adapation/Aggregate strategy). A lower price was applied compared to other countries. The Moscow store was the largest McDonald’s in the world. Russians loved the travel concept: as you walked through the restaurant, you enter a new world with a different country atmosphere. No smoking, no alcohol and no privilege in the restaurant created the differentiation. The look and feel was clean, sparkling and cheerful. McDonald’s should be cost leadership focus to be price competitive (low cost integrated and differentiation strategy).

**Labor force, recruitment and training:** Russian workforce was unmotivated in contradiction with McDonald’s value proposition of cheerful customer service. The challenge was to select and train staff. McDonald’s posted a successful recruitment campaign as Russian considered a positive step in their career to work for a western company. Top managers were trained in the hamburger university in Toronto and training programs were translated in Russian. The management teams were expats in the beginning and after a few years Russian. The strategy was decentralization of the management.

**Public relations:** To gain good coverage McDonald’s developed press acquaintance with the state agency for TV and radio long before the first opening. They invited journalists to taste French fries. The communication was in Russian as common language.

1.7. Post entry analysis

Despite difficulties at the beginning, in several areas such as HR, supply chain, procurement, the expansion was satisfactory. McDonald’s captured more than 70% of the Russian fast food market. Business analysts said that McDonald’s Russia reported profit margins of 20%, which was much higher than the company average.

McDonald’s acquired the land in central Moscow for its store and became one of the main land owners in the city which attracted some criticism.

McDonald’s in central Moscow was always busy even in periods of political instability being considered as a Russian restaurant. During the ruble crisis in 1998, McDonald’s decided not to raise prices and instead guaranteed prices, maintained media presence and modified product offers. Those adaptations paid off.

According to the triple A framework, we conclude that McDonald’s decided to go for a high level of adaptation by meeting local needs and medium level of aggregation by keeping same core products, store design and brand image worldwide.
In 2014, all locations are under McDonald’s own management but since the goal is to use franchisee, McDonald’s is looking for the right partners.

Today, more than 200 McDonald’s restaurants in Russia—or roughly half the country’s total 440 locations—are now under government investigation. This is widely seen as retaliation for sanctions imposed by the U.S. and Europe over Moscow’s role in the Ukraine crisis. Health and safety regulation “is an instrument that’s often used” by the Kremlin to gain leverage in political disputes. McDonald’s Russia sales were $2.2 billion—or about 8 percent of its worldwide sales of $28 billion. Russia’s consumer-safety regulator closed the flagship Pushkin Square restaurant, along with several others, for alleged violations of sanitary rules. A mass shutdown could jeopardize the jobs of some 37,000 people who work for the company in Russia, as well as Russian farmers and others who supply food to local outlets.

2. A market entry strategy for McDonald’s in Vietnam

2.1. Market and competition environment

**Political context:** Vietnam has a surging middle class. Most of its 90 million citizens were born after the Vietnam War with the US that ended in 1975. Resistance is now over and the young population is keen to adopt the “American way of life” (westernization).

Vietnam has normalized its relations with the United States in 1995, allowing American firms particularly in the food industry to enter the Vietnamese market. Government of Vietnam allows fast food operators to operate more efficiently with franchising regulations and KFC successfully opened its operations in 1997.

**Economic situation:** The fast food industry sector has shown steady increase in Vietnam. The value of the QSR (Quick Service Restaurants) industry in Vietnam is up to VND870 billion (USD 41.4 million) in 2011. This demand increase for the fast food in Vietnam is explained by the improving lifestyle standard and spending power of the Vietnamese population. The market is therefore stable for foreign investors and offers opportunities.

The advertising costs will be lower in Vietnam than in Russia as McDonald’s is known in this market through its internationally well-known brand.

The exchange rate between the U.S. dollar and the Vietnamese dong is important because the dong, although not freely convertible, is loosely pegged to the dollar through an arrangement known as a "crawling peg". This set-up means that McDonald’s will have to hedge its Dong to be able to repatriate USD in the States (at an early stage in their development McDonald’s or their franchisee might use the cash to reinvest in the growth of their operations). Vietnam's economy experienced a hyperinflation period, at the end of 2012, inflation stood at 7.5%. Therefore, the McDonald's low cost strategy (coupled with the price sensitiveness of customers towards price changes) will be a point of attention.

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1 To analyze McDonald’s strategy and options to enter the Vietnamese market, we have assumed to be in 2014, one year prior the effective market entry.
**Market environment:** In 2014, the Vietnamese food retail sector is growing rapidly between 3.7 – 4.3 percent per annum. The sector attracted significant foreign investments. The wealthy urban centers of Hanoi and Ho Chi Minh City provide highly receptive consumer audiences. Western brands as Starbucks, Subway, Burger King and KFC have already penetrated the country.

The main competitor that McDonald’s will face is KFC, which represents 39% of the Vietnamese market with 130 outlets. Vietnamese customers are familiar with the KFC brand that has a growth rate of 20 to 30 new restaurants per year. KFC is planning to implement drive thru restaurant to suit Vietnamese needs and increase their satisfaction level. Besides that, Lotteria, which represents 36% of the market, is the second rival fast food company with 50 outlets. Also, Lotteria is aggressive offering discounts to increase awareness among the Vietnamese. When rival company offer fast food menu, the consequences is there are only fewer customers in each location. Competition is high.

### 2.2. Customers assessment

**Consumers target and segments:** McDonald’s can target a large (approximately 92million as of July 2013) and young population (43% are under 25 years old) in a country where the GDP per capita of around US$ 1,800 is rising. The middle-class is made of urban professionals who accepted fast-food products as potential alternatives to traditional choices. This creates room for future growth. A survey from Nielsen Company completed in 2010 indicated that 42% of the Vietnamese population had the intention to try fast-food. The most frequent group enjoying fast food products are the 20 to 30 years generation. It generates 76% of the fast-food business profits.

McDonald’s can segment its offer to address the children market (26 million people) and the young adults (15-25 years old). By concentrating on these markets it can build a growing stable business and establish customers’ loyalty.

In each country they have entered, no matter the taste or the local variety, McDonald’s has paid considerable attention to children. McDonald’s has built “happy land” (playground) and provides a fantastic “happy meals” proposal with novelty toys.

**Culture and food habits:** The basic food in Vietnam is dry, flaky rice supplemented with vegetables, eggs, and small amounts of meat and fish. Vietnamese are fond of fruits such as bananas, mangos, papayas, oranges, coconuts and pineapple. They are accustomed to little milk with cheese, and many cannot produce the enzymes needed to properly digest dairy foods (lactose intolerance). They drink a large amount of hot green tea and coffee without adding sugar, milk, or lemon.

In an urbanization context, dietary practices and food consumption patterns are changing. The young generation is open to fast food culture but health is a growing concern in a society where diabetes and child obesity are rising.

### 2.3. Legal and regulatory context

**Government:** Since Vietnam relaxed its investment restrictions, big brands came into Vietnam. The government eased the entry with more transparent regulations and less burdensome paperwork. Vietnam has ease restrictions on food service operators and allows them to open their shop without a
local partner. Therefore there are not many laws and regulation barriers to trade and McDonald’s can easily open new outlets in Vietnam.

2.4. Entry mode structure

Given the culture, language and the specificities of the local market, it is recommended that McDonald’s starts with a joint venture with a local entrepreneur (as it was the case in Russia to the difference that is was compulsory) or operates under the developmental licensees agreements.

There is still an historic context following the Vietnam War and Vietnamese are to date proud to have defeated the United States. To avoid that the entry of McDonald’s would be looked at as a kind of revenge, it is even more recommendable to look for a partner with a local influential stakeholder or have government support.

2.5. Trade risks and supply chain

There will be challenges to establish an efficient food distribution chain and refrigeration network. The Vietnamese cold chain has weak points. To establish good contacts with an importer who understands the challenges of perishable goods is key to ensure quality assurance.

Vietnam’s infrastructure is still weak. Roads, railways and ports are inadequate to cope with the country’s economic growth. The domestic agricultural landscape is large and diverse. The food-processing industry is fragmented. The country’s agricultural sector has been too slow to adapt to new technologies to be globally competitive in the long term and needs significant investment. This means that McDonald’s should preferably implement its own manufacturing company such as in Russia if the local offer is not up to expected standard of quality. Another approach could be to import products from abroad until they reach a critical mass to use local suppliers.

In this context, to maintain quality and taste McDonald’s should rely on its global system of suppliers. The set up cost is high. A critical number of stores in the country should be supplied to allow proper economies of scale. In the setup phase, McDonald’s could import products from its existing suppliers in Asia.

2.6. Marketing strategy

Timing of the market entry and location: McDonald’s restaurants are located in highly populated urban cities such as Hanoi and Ho Chi Minh City. In addition, since the number of cars is increasing significantly the best location for stores including drive thru service should be at the crossroad of the main North to South routes.

In terms of timing, the market entry is late. McDonald’s will face intense competition from both local and foreign competitors in Vietnam.

Product range, price and store design: McDonald’s has a set of standardized items that taste the same but adapt to the environment to ensure success. Their devise is ‘think global, act local’. In order to gain a competitive advantage, adaptation is required. McDonald’s should apply the localization or product differentiation strategy. As an example, McDonalds’ can introduce the dishes like “McThai” that
combine a variety of herbs, vegetables and meats. Vietnam also has a big potential for the vegetarian market.

The average wage in Vietnam is about US$150 a month. McDonald’s has to come with the right price for the right market. It has to take into account price perception in its pricing method.

The first shop should cover a very large area and be designed in accordance with McDonald’s standards, including a playing ground for children. The translations problems could be overcome by using pictographs.

**Labor force, recruitment and training:** Vietnam’s minimum labor cost was the second lowest in Asia and most of the young people were willing to work for low wages. Vietnamese employees are hardworking and ambitious. Therefore, McDonald’s can operate with low production cost and more productivity.

Courtesy is a big thing in Far East and having staff in each outlet paying attention to answer customer’s questions and talk with parents is important. Managers will have to understand both the corporate and the local culture and train them as they did in Russia.

McDonald’s should use a scheme which will satisfy the Vietnamese employees through an efficient reward program that addresses compensation, benefits, recognition and appreciation. McDonald’s will motivate and attract talented staff to generate greater sales performance.

**Public relations:** There is already a large knowledge about the brand and the fast food industry. This will ease the market penetration. McDonald’s will have to invest in positioning its products towards its customer segments, the children and teenagers and meet local requirements. Channels are television advertising and social media campaigns.

### 3. Discuss which cultural conflicts might emerge with the entry in Vietnam and propose solutions

In this section we evaluate the cultural differences that could impact McDonald’s entry in Vietnam and the way they are doing business. We will first discuss Hofstede Model and then the Lewis Model\(^2\) to grasp cultural differences between the United States and Vietnam. We will then make recommendations to overcome these differences.

#### 3.1. Hofstede Model

Comparing the data available on cultural dimensions described in the Hofstede Model (see Schedule 1), it appears that the three dimensions that are the most apart are power distance (PDI), individualism (IDV) and long-term orientation (LTO). The other dimensions (i.e. masculinity (MAS) and uncertainty of avoidance (UAI)) are not aligned between the two cultures.

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\(^2\) We have decided not to use the GLOBE model since Vietnam was not included in the data used to build the model (X. Shi and J. Wang, *Interpreting Hofstede Model and GLOBE Model: Which way to Go for Cross-Cultural Research?*, International Journal of Business and Management, Vol. 6, N. 5, May 2011.)
**PDI:** PDI highlights how less powerful members of an organization accept unequal distribution of power. Since in Vietnam PDI is high and UAI is low (i.e. Vietnamese try to maintain harmony and avoid conflict and confrontation), employees view their organizations as families, and expect that their supervisors take care of them.

**IDV:** Whilst US is regarded as a high individualistic culture, Vietnamese approach is more collective (i.e. the group’s needs determine behavior).

**MAS:** As Vietnam is a very hierarchical society, Vietnamese in general feel uncomfortable if they do not know the status of the people with whom they interact.

**LTO:** Vietnam scores really high compared to US on LTO that covers six features as being group orientation, respect for hierarchy, the concept of face, avoidance of conflict and confrontation, the importance of relationships and the need for harmony. In business, where US business culture views negotiations as a competitive process of offers and counteroffers, in Vietnamese culture, it is more seen as a creation of long-term relationships between two parties which is more important than the actual deal.

### 3.2. Lewis Model

The Lewis model (see Schedule 2) shows clearly that Vietnam is a reactive culture while US is a linear/active culture on the other side of the triangle.

In a nutshell, linear active cultures schedule, organize and follow processes. They can discomfort the other cultures by their focus on the task and the lack of consideration for relationships. This could be highly problematic *in casu* as it is in opposition with the reactive culture of Vietnam which implies a strong focus on relationships. Reactive cultures tend to listen and react carefully, prioritize courtesy and respect and not act confrontational.

### 3.3. Recommendations

Based on the results of the models described above, we can first draw the attention to the fact that it is crucial for US corporations to build strong relations and trust before entering Vietnam. A major challenge for US corporations is that they will have to develop relationships and a network before getting anywhere. Knowing and partnering with the right people will allow to enter the rights places where to discuss business and build trusted relationships. On the structure entry mode, McDonald’s operating by means of franchising, has to find the right partners in Vietnam.

Differences in national culture influence the conduct of business internationally. Effective international managers must understand how their own culture differentiates from others cultures. In Vietnam, US managers should ensure to “keep frequent communications to discover problems or changes in the thinking of their Vietnamese partners”.

To gain employees loyalty, McDonald’s will have to focus on building relationships. Personal relations will play a large role to maintain harmony. For the Vietnamese, the contract has less importance than the type of management.
We observe that the western culture and American lifestyle expands globally, including the fast food restaurants concept. In Vietnam, half of the population represents young individuals who are eager to try new foods and associate with brands. The Confucius approach will also influence the marketing. Due to their aversion of aggressive behaviors, they do not criticize competitors or compare products.

In conclusion, McDonald’s should focus on building long-term relationship rather than tasks and processes. The key principle is maintaining harmony in business.

4. Make a suggestion whether McDonald’s should enter the Vietnamese market

We recommend McDonald’s enters in the growing fast food market of Vietnam to gain profit and increase their sales. Despite being a latecomer, McDonald’s has a tremendous opportunity for growth for the following reasons: a young population, a fast income growth, attraction of western lifestyle and lower governmental entry barriers.

To do this they have to use the adaptation and aggregation principles i.e. use their main brand and products known worldwide but adapt also to the local needs through specific offers.

They should focus on children and young adults to build stable business by generating long term customers’ loyalty. They also should address the local/regional supply chain to ensure quality and consistency. Also as a late entry, competition will be stronger and therefore marketing and advertising efforts more important.

In order to reduce risks, they should look for franchisees as implied in their developmental licensees model (territorial exclusivity, obligation for growth by opening new locations). McDonald’s will have royalties for the brand and a share of income without having the risk of a market decline.

Compared to Russia, Vietnam presents similarities and differences.

Similar issues are first, the need for a “glocal” approach which has been successful in Russia. McDonald’s must continue to think global but act local and preserve a certain degree of flexibility in its expansion. Second, select the right local partner. In Russia, partnering with the right and influential people has proven to be a key success factor. This should be considered in Vietnam where cultural challenges exist and governmental support is needed.

With respect to differences, first we feel that the supply chain aspects developed in Russia should not be implemented directly in Vietnam. McDonald’s should get critical mass before sourcing everything locally. They should first try to leverage from their existing supplier capacity in South-East Asia. Second, as already stated, the target in Vietnam should be the children and not everyone as in Russia.

Retrospectively, on 8th February 2014, McDonald’s opened its first outlet. The outcome was successful and in 24 hours it served almost 22,500 customers. The managing director, who is married to the daughter of the Prime Minister Nguyen Tan Dung, told investors that 61,980 Big Macs were sold in its first 30 days of business. This is an example of a successful business story.
Schedules

Schedule 1

![The 5D Model of professor Geert Hofstede](image1.png)

*Figure 1. Comparison of value orientations: United States versus Vietnam (ITIM International, 2001).*

Schedule 2

![Cultural Types: The Lewis Model](image2.png)

*Key:
- blue = linear-active - cool, factual, decisive planners
- red = multi-active - warm, emotional, loquacious, impulsive
- yellow = reactive - courteous, amiable, accommodating, compromiser, good listener
- green = reactive - direct, aggressive, competitive
- black = face-saving, devious, non-direct
*
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