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Assessment of McDonald's Growth in the French Restaurant Market

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## **Executive Summary**

This paper covers McDonald's and its growth and adaptation to the French marketplace. It starts with McDonald's corporate profile, which gives background information on the McDonald's Corporation. The paper covers McDonald's global presence, its financial earnings, and an analysis of the Human Resource issues faced by McDonald's and other organizations globally but especially in France. Theoretically, McDonald's should pursue a geocentric staffing policy but in practice, a polycentric approach would be more practical.

Business Risks, Opportunities, and Sustainable Business Issues are examined with a look at issues such as non-tariff barriers; product and service standards; licensing; franchising; social infrastructure and business and workforce culture.

In conclusion, we suggest that McDonald's continue with its local adaptation policy and employee training programs so that the assessment of McDonald's may continue to be that of a global brand that is local in every aspect of its business. We believe following this path will position the company to do well in the market while mitigating the cost of known and potential risks in France.

## Introduction

Few organizations better reflect the level of strategic flexibility necessary to be successful in today's global marketplace than does *Ad Age* magazine's 2004 "Marketer of the Year" McDonald's Corporation. With over 50 years of retailing expertise, McDonald's operates and franchises more than 31,000 restaurants in 119 countries on five continents. McDonald's unparalleled infrastructure and business acumen supports its global success as the number one foodservice retailer by sales with one of the world's most recognized brands. As such, Team McWorld considered McDonald's Corporation (NYSE: MCD) a logical choice for its case study of organizations and the external environment.

We chose Canada and France as the two markets of our study because of our belief that these two countries offered growth opportunities that would allow McDonald's to continue to expand its business footprint in the global marketplace. While our research to date confirms our initial assumption that both markets have potential for future growth, it is our opinion that the French market represents the better of the two opportunities for McDonald's to concentrate its globalization efforts.

This report is a prelude to our final report and recommendations to the Board of Directors and summarizes our assessment of McDonald's growth potential in the French restaurant market. It is presented in conjunction with our subgroup report on the company's Canadian segment, and incorporates the findings from our previous presentations and reports. It begins with an overview of McDonald's corporate profile, followed by a discussion of the human resources issues that will need to be addressed to facilitate expansion in the French market. We then discuss the important business opportunities, risks, and sustainable business issues associated with the proposed expansion efforts, and conclude with our preliminary recommendation to the Board.

### McDonald's Corporate Profile

(Source: McDonald's Corporation 2004 Annual Report; Hoover's Company Information, 2005)

McDonald's Corporation is recognized as the world's leading foodservice retailer owning one of the most recognizable brands with competencies in restaurant operations, real estate, retailing, marketing, and franchising. With over 50 years of retailing expertise, the company develops, operates, franchises, and services a worldwide system of restaurants that prepares, assembles, packages, and sells a limited menu of value-priced foods in more than 31,000 restaurants in 119 countries on five

continents. McDonald's also operates Boston Market and Chipotle Mexican Grill, and has a minority ownership in the United Kingdom-based Pret A Manager. The size of the organization in terms of outlets is greater than that of the world's top three retailers (Wal-Mart, Carrefour, and Royal Ahold) combined.

McDonald's manages its business as five distinct geographic segments: the US, Europe, Asia/Pacific, Middle East and Africa (APMEA), Latin America, and Canada. According to the company's 2004 sales statistics, approximately 66% of McDonald's sales are derived from its global operations (Europe 35%; APMEA 14%; Latin America 6%; Canada 5%; Other 6%). The US, Canada, France, Germany, the UK, Australia, China, Japan, and Brazil are McDonald's seven major markets and represent 70% of the company's total revenues.

McDonald's vision to be the world's best quick service restaurant experience is supported by the company's recognition of the importance of adjusting its operational strategies to meet the specific dynamics and needs of the countries in which it operates. This has played a major role in the company's global success. In many countries the company has modified its products to cater to local tastes. For example, in Muslim countries meats are used that are permissible under Islamic law; in Israel kosher dietary laws are adhered to; and, vegetarian burgers are offered wherever there is significant demand. In some countries the product names are changed as well such as in India where the Big Mac is a lamb burger called the Maharaja Mac. The physical restaurant set up may also be altered as it is in India which has separate areas for the preparation of vegetarian and meat dishes, or Rome where the restaurant features indoor fountains and marble floors installed in an effort to make the "McDonald's" concept more appealing to European nations who were not accustomed to the "fast food" restaurant layout when McDonald's first entered the market.

McDonald's has a great number of competitors with whom they vie for market share. In main rivals in the US are Burger King, Wendy's and YUM! Restaurants. Other U.S. restaurants that compete for McDonald's customers are AFC Enterprises, Chick-fil-A, CKE Restaurants, Subway, Domino's, Dairy Queen, Jack in the Box, Little Caesar's and Papa John's (Hoover Business Index, 2005). The company's international competitors include: Sodexho Alliance, YUM! Brands, Inc., Starbucks Corporation, Darden Restaurants, Inc., Brinker International, Inc., Wendy's International, Inc., Outback Steakhouse, Inc., CBRL Group, Inc., Jack in the Box, Inc., and CKE Restaurants, Inc. McDonald's has a

major competitor in the Canadian market in Tim Horton Restaurants which is ranked number 1 as a breakfast chain in Canada and is working hard to “bring down” McDonald's from the top lunchtime position. Surprisingly in 2003 the chain was able to surpass McDonald's in total sales in the whole of Canada (Brew, 2004.)

The company provides a global framework of common goals, policies, and guidelines rooted in the organization's core values. Within this framework, individual geographic units are at liberty to design programs and performance measures appropriate to their locale ([www.mcdonalds.com](http://www.mcdonalds.com), 2005). In addition to ordinary franchise fees, supplies, and a percentage of sales, McDonald's also collects rent as owner of the land on which most of its franchises are situated. This makes the company's business model slightly different than most other fast food chains ([www.answers.com](http://www.answers.com), 2005).

As the world's largest restaurant chain, McDonald's is a target for criticism. The company is often seen as a symbol of American domination of foreign economic resources even though its foreign franchises are locally owned and use locally produced foods. Other criticisms include allegations of exploitation of entry-level workers, ecological damage, selling unhealthy food, production of packaging waste, exploitative advertising, and adverse response to the company's approach to preserving its image and copyrights—all issues that we have addressed in our previous reports and presentations . Amidst the challenges and criticisms McDonald's continues its stride as the global industry leader.

With average annual sales of \$1.8 million per traditional restaurant, McDonald's maintains a strong financial position in the global market place. The company considers system-wide and comparable sales growth, operating margins, and returns as some of the measures to assess its success in achieving its objectives. McDonald's is not, however, immune to the effects of economic shifts and corporate blunders and has suffered losses due to ill-thought product changes, unsuccessful marketing campaigns, and the concerns of a growingly health conscience customer base with a preference for lighter food.

### **Human Resource Management in the French Market:**

Human resource management (“HRM”) refers to the activities an organization carries out to use its human resources effectively. The strategic role of HRM is extremely complex in an international business environment where staffing, management development, performance evaluation, and

compensation activities are complicated by profound differences between countries in labor markets, culture, legal systems, economic systems and the like (Hill, 2005). It is essential for a company's international HRM activities to be an appropriate fit to its international business strategy. McDonald's faces high pressures for local responsiveness and has significant opportunities for leveraging valuable skills within a multinational global network of operations. Consequently, HRM plays a critical role in implementing its transnational business strategy.

Staffing is the most fundamental and critical driver of organizational performance in overseas operations. It begins with workforce design and includes recruiting, assessment, development workforce planning and retention, and involves a combination of employees, contingent workers, contractors, consultants, and outsourced operations working around the world. Individuals hired should be talented in their fields, as well as in alliance with the company's espoused values and goals. A company must give special consideration when utilizing expatriate managers (those who are citizens of one country working abroad in one of the company's subsidiaries), as there are many nuances to be considered that would not always render a high performer in the home country suited for a management position in a host-country.

According to Hill (2005) the staffing policy of an international business can be classified into three main types: ethnocentric, polycentric and geocentric. The ethnocentric approach utilizes a model that in which all key management positions are filled by parent-country nationals. This type of policy is practiced when the firm believes that the host country lacks qualified individuals to perform the job duties and resolves to relocate the bulk of their HRM competencies to the foreign business as opposed to recruit from the host country. A polycentric approach requires host-country nationals to be recruited to manage subsidiaries in their own country, while parent-country nationals occupy the key positions located at the corporate headquarters. This pathway is primarily taken by firms that are trying to reduce costs and cultural gaps that result in misunderstanding. The geocentric approach focuses on staffing with the best people for key jobs regardless of nationality. While this policy is the most attractive of the three because it is consistent with creating a strong unifying cultural and informal management network, and is well suited to firms pursuing either a global or a transnational strategy, the fact that many countries use immigration laws that require the employment of host-country nationals to ensure that foreign subsidiaries employ their citizens, often limits a company's ability to employ a pure geocentric approach.

McDonald's believes that in order to achieve its goal of being the world's best quick service restaurant experience, it must have the best experience for its employees worldwide. The company strives to ensure that its five "People Principles", which consist of: 1) respect and recognition; 2) values and leadership behaviors; 3) competitive pay and benefits; 4) learning, development, and personal growth; and 5) resources to get the job done, are upheld throughout its worldwide operations.

Although the company generally utilizes a geocentric staffing approach as it seeks to provide opportunities for recruitment, employment, training, development, performance reviews, pay, advancement, and any other aspect of employment on the sole basis of individual abilities and job performance, McDonald's international HR management reflects the company's recognition of the importance of being strategically flexible in its use of a polycentric staffing approach that utilizes host country nationals to staff, manage, and own its franchises. This is especially important in France due to the high levels of unemployment among the youngest age group (people aged 25 years or under) who also tend to constitute a large segment of the companies workforce. This is one of the key problems of the labor market as the group has an unemployment rate of 23.1%. Among the members of the EU, France's harmonized rate of unemployment of 9.8% in February 2005 was the second highest after Spain (EIU Viewswire, 2005).

McDonald's understands that attracting and retaining employees is one key to achieving business sustainability, which is why the company expends considerable effort and resources training and teaching their employees not only the skills they need to do their current jobs, but also other critical skills such as teamwork, communication and discipline that will help them in other jobs (McDonald's EU Corporate Responsibility Report, 2004). Through its Hamburger Universities in the USA, England, Japan, Germany, and Australia, the company attempts to transfer the knowledge gained from its years of experience by instructing its personnel in McDonald's core competencies and various other aspects of the business through the use of resident professors, translators, and electronic equipment that enables professors to teach and communicate in 22 languages at one time.

Nonetheless, like most foreign investors, McDonald's does benefit from France's skilled labor force and strong social infrastructure. France's growing population is supported by one of the higher birth rates of the western European nations and an impressive life expectancy rate. Education is free,

beginning at age 2, and mandatory between the ages of 6 and 16. The country has 69 universities, special schools, technical colleges, and vocational training institutions (U.S. Department of State, 1999). Both of these factors support France's ability to build up its human capital to be as attractive as it is to foreign investors. While this is a definite positive for McDonald's expansion efforts, there are several other HRM issues relevant to the French market that must be considered. In addition to extremely high payroll and income taxes that offset some of the positives represented by the country's skilled labor force, France also has some extremely pervasive labor regulation that must be factored into McDonald's further expansion efforts.

The 35-hour workweek has been mandatory since 2002 and is one of many regulations that prevent companies from having flexibility in their workforce. Although unemployment is high, the prospect of easily hiring additional workers as a business grows is not as positive as one would expect due to regulations surrounding the hiring and recruitment processes. Most employees are under employment contracts or collective bargaining agreements with the later (90%-95%), being the majority (EIU, 2005). Although union membership is low compared to other EU countries, it is offset by the country's mandatory requirement to have work committees and councils. These committees and councils wield an enormous amount of de jure and de facto power because by law, "the committee is consulted on all matters affecting the company and must be informed in advance of any decisions affecting working conditions (EIU, 2005). If the nature of a decision is such that an announcement must be made to the stock exchange, the labor-management committee must be informed first" (EIU, 2005). As such labor unrest is major potential concern for McDonald's in France.

We will need to remember that even though unemployment rate is high and there is a plentiful labor supply, McDonald's will need to be must be mindful not to rely on market forces, such as supply and demand, to extract labor cost savings from its employees. Additionally, because the labor market is relatively inflexible we may be unable to adjust our workforce to meet changing business needs.

While these situations do pose several challenges to the company, they are the same challenges faced by all of our competitors that we have thus far been successful against in significantly growing our market share. Although the costs of complying with these regulations have been passed onto the consumer in the form of higher menu prices, our sales have continued to increase. We therefore, do not

believe that these non-tariff barriers will present a problem to the continued success of our HRM strategies.

### **Business Opportunities and Risks in the French Market**

As previously stated, approximately 66% of McDonald's sales are derived from its global operations. More than half (35%) of those sales are from the company's European segment of which France, Germany, and the UK account for approximately 65% of the revenues (McDonald's Corporation, 2004). While it seems unlikely in a country where people take to the streets to protest against American culture and globalization, France is the only country in Europe in which McDonald's has consistently done well since the first outlet opened in 1979. The company largely dominates the French restaurant market sector, dwarfing rivals such as the French fast-food group Elicor, and Quick, a Belgian chain. With more than 1,040 restaurants in over 750 cities in France, McDonald's France is the company's most profitable European subsidiary (The Economist Intelligence Unit Limited, 2005).

Among the reasons that McDonald's has done so well in France is the company's "upgrading and transparency" strategies. McDonald's French management team has spruced up drab restaurants, improved its menus and introduced a host of innovative concepts. Despite a long conflict at one Paris branch over low pay, management has maintained good terms with the country's combative labor unions discussed in the previous section of our report. The French segments management additionally took a wise low-profile in the court case against the anti-globalization campaigner who trashed the McDonald's in the southern French town of Millau in 1999 which went over well with the French public. McDonald's France management has also been clever in adapting food and décor to local tastes as well as publicly advertising how many French cows, chickens, lettuce and tomatoes it uses annually in local newspapers. As France continues to hold its position as the most profitable segment in the European market, with a record new McDonald's opening every six days in 2003, we are confident that these practices will continue to provide the company opportunities for expansion in the French market.

While it is true that the French government welcomes foreign investment in most industries, especially when it creates jobs, contributes to new technology or increases exports, and works diligently to make France more attractive to foreign investors through tax incentives and infrastructure investment, there are definite risks to be considered in expanding our operations in the country.

### **The French Political System**

France is independent of the USA when it comes to public foreign policies and the two country's governments disagree on many areas of global relations. France also has a population prone to protest certain US policies around the world. It is important that management consider these dynamics in its expansion efforts as it could present a significant challenges.

### **Non-Tariff Barriers in France**

In addition to the non-tariff barriers related to employment law discussed earlier, McDonald's France must be cognizant of the fact that all goods entering France must conform to both French and EU standards. It is important for the company to stay current with EU and French laws as the regulations and standards often differ substantially from those in the US. While not traditionally considered a closed market, certain regulations exist in France that limit access for specific U.S. agricultural exports. Of special interest to McDonald's operations in France are the restrictions on hormone-fed beef and poultry, enriched flour, and genetically engineered foods and crops. Additionally, there are certain fruits and vegetables subject to seasonal price restrictions (Trade Information Center, 2005). The company will also need to keep the country's local content purchases requirement in the forefront of its planning moving forward with its expansion efforts. This barrier adds another layer of hidden costs to the price of the product because lower priced and even better quality products that are available outside of those made by French companies cannot be used.

While there are certainly other risks to be considered we feel that they are manageable and do not impede on the decision of management to consider focusing on the market segment in an effort to utilize its success as leverage to improve results in other markets. This position is enhanced by the opportunities presented by franchising and licensing in the French market.

### **Franchising in the French Market**

In France, franchises do quite well, and McDonald's is obviously no exception. It is imperative for entrants into the market to become familiar with the extensive regulations concerning franchise operations in France and be prepared to offer a business model that offers local owners more flexibility and control over and input into the business process because the "traditional master franchise" model is ineffective. While the regulations and general business environment of France present challenges to

companies interested in investment in the country's fast food industry, McDonald's flexibility and adaptability positions the company to be able to continue to mitigate these risks and evade the barriers that would otherwise impede its ability to become the number one fast food operator in the country as it has.

### **Licensing in France**

France has the potential to offer McDonald's the recipe for boosting foreign sales which is a key to future growth given the US market has become saturated (BusinessWeek, 2003). The French market offers McDonald's similar benefits to those gained from its strategic alliances with toy makers, clothing retailers, and movie retailers in the US. McDonald's France is already successfully teaming with French companies such as Danone to put its name on their fruit yogurts, Carte Noire for coffee products, and the French soft drink company Orangina ( ViewsWire, 2005). Licensing has the potential to offer the company an excellent opportunity to gain further market share against its French competitors and is therefore a highly recommended strategy for the French market.

### **Sustainable Business Issues in the French Market**

Business sustainability necessitates that organizations be responsible, accountable, and transparent in their business dealings. Key stakeholders demand that performance be measured and achieved in terms of environmental and social policies in addition to economic ones (Dow Jones, 2005). Similar to the suggestions that Hall & Vredenburg (2003) offered in their article, McDonald's recently launched sustainable developmental innovations to the company in efforts for future success. In 2003, McDonald's Corporation introduced a comprehensive revitalization plan aimed at satisfying its consumers as well as improving its financial discipline by reducing its debt, paying down capital expenditures, and reducing selling general and administrative expenses as a percent of revenues. In addition, McDonald's returned a vast majority of excess cash to their shareholders in the form of dividends and share repurchases.

When reviewing McDonald's operations in France, it is apparent that in order to secure the company's competitive position, McDonald's must address its global and industry challenges. According to the Dow Jones Sustainability Index, companies with leading sustainability display high levels of

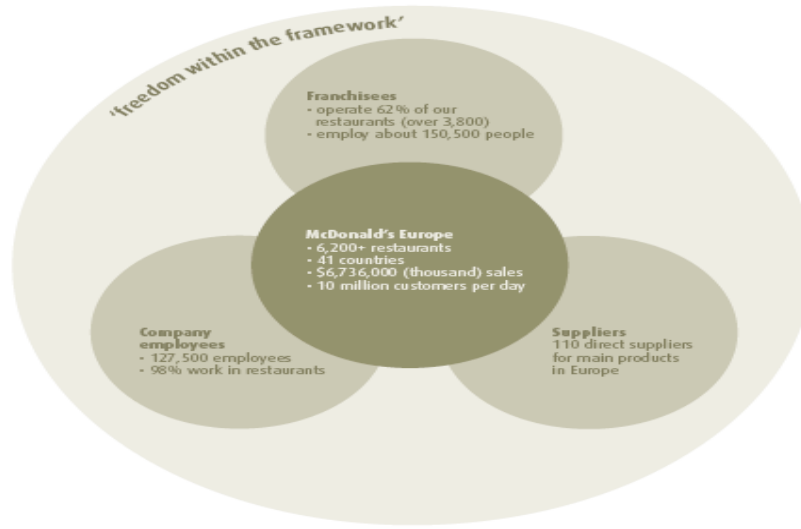
competence in the areas of strategic management, financial acumen, customer awareness and product knowledge, corporate governance and stakeholder engagement, and human resource management.

According to its Sustainability Report for the past 9 months of 2005, McDonald's reported significant revenue and operating income growth, on top of last years results. The results are a reflection of positive global comparable sales along with the strength of the US market. In the first three quarters of 2005, consolidated revenues increased by 8%. The increase was the result of multiple initiatives launched by the company, as well as higher sales in Germany, the United Kingdom, and our market of choice, France.

**MCDONALD'S REVENUES**  
Dollars in millions

Excluding Currency Quarters Ended September 30, Company-operated sales	2005	2004
U.S.	\$ 1,066.5	\$ 995.0
Europe	1,412.6	1,315.9
APMEA	645.3	625.3
Latin America	329.9	240.5
Canada	205.1	196.6
Other	341.3	291.5
Total	\$ 4,000.7	\$ 3,664.8
Franchised and affiliated revenues		
U.S.	\$ 738.2	\$ 707.9
Europe	419.8	401.7
APMEA	92.9	82.9
Latin America	22.8	20.3
Canada	50.4	46.1
Other	2.3	2.0
Total	\$ 1,326.4	\$ 1,260.9
Total revenues		
U.S.	\$ 1,804.7	\$ 1,702.9
Europe	1,832.4	1,717.6
APMEA	738.2	708.2
Latin America	352.7	260.8
Canada	255.5	242.7
Other	343.6	293.5
Total	\$ 5,327.1	\$ 4,925.7

McDonald's has developed a business policy that relies on a strong relationship among its franchisees, its suppliers, and its employees. This relationship, coined in the companies Freedom within the Framework policy, allows McDonald's to provide greater freedom to its franchisee's ([www.mcdonalds.com](http://www.mcdonalds.com), 2005).



As a result this policy McDonald's has developed a deep understanding of its local markets, particularly in France where the market is generous when brands are flexible and adapt to local conditions (Brand Strategy, 2005). McDonald's has learned to adapt to the way the French approach food, not just the food itself. The company gets more than 55% of its total transactions during lunch and dinner times; an important learning since the French are not in the habit of snacking (Brand Strategy, 2005).

McDonald's Freedom within a Framework approach has allowed it to undertake a policy of transparency in its dialogue with farmers, suppliers, employees, and other stakeholders. Although it seems unlikely, the policy seems to be working as France is now McDonald's most profitable European subsidiary. As stated in our introduction, we attribute this to the company's strategic flexibility which is nowhere better reflected than in the France. Consequently, we agree with Brand Strategy's (2004) assessment that McDonald's may be a global brand, but in France, it is local in every aspect of its business, and that is what we believe will position the company to do well in the market.

### **Conclusion/Recommendation**

There are many challenges facing organizations when they attempt to expand globally and most of them can be overcome. However, the effort to do this must be measured in terms of the benefit or

potential benefit to be obtained. Unger's piece on "An immigration experiment worth watching in Spain" did not fit our case on France. His analysis of Spain's guest worker program does not fit a service industry such as McDonald's as much as it does a manufacturing industry. Although Unger's piece does not fit this situation, it is important to note that the Globalization101.org report on migration tells us that economies and societies need input from outside their borders in order to continue their economic growth. As France has learned, countries that are less open to immigration tend to foster significant social conflict between native citizens and new arrivals, particularly when those new arrivals are from Africa and the Middle East (Globalization101.org, 2005). The findings point to a few issues that bear watching. The issue of migration and immigration in France is an important one because the unemployment rate in France is stubbornly high, especially among the young (Under 25) and among the immigrant population. The high unemployment rate was one of the reasons cited for the recent riots and upheaval in France.

Many believe that the current social unrest in France will lead to laws and other regulations that will directly impact McDonald's and other employers. McDonald's has the ability to hire and train many low skilled employees when the French government decides to liberalize its employment law regulations. Once that liberalization happens, France will move from the category that we recognize as a "good place to do business" into the category of a "great place to do business".

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