McDonald’s International Business Strategy in China

Posted on October 29, 2019

Introduction

China is one of the leading economies on the globe today. Their economic supremacy has been spurred by the introduction of a free market policy where competition is unrestricted, among other issues (Eriksson et al. 2015). This has led to some of the leading companies in the world opting to place their investments in China for various reasons. Today, more and more companies are sprouting in China, and other multinationals are finding a haven for business by discovering the opportunity that China offers and thus rushing their investment into the eastern country to grab the opportunity and be part of feeding the ever-growing population who are in dire need of products and services.

One of the leading international companies that have operations in China is the McDonald’s chain of restaurants. It is an American-based fast food restaurant with operations in well over one hundred and twenty countries across the globe today. The company first set foot in China in the year 1990, basing its first restaurant in Shenzhen. They have continuously increased their presence in the market and today have over two thousand branches and still counting. The urge to expand has never been this serious.

One of the main reasons that could have prompted the company to choose China as their destination for investment is the ever-growing population. Today, China boasts of being the most populated country on the globe. This means that there are more and more people walking around the streets of the 465 cities in the country and would need a fast food restaurant as they go about their daily routine. Working in the city gives one little time for lunch, and thus, grabbing a quick snack and a beverage over lunch hour could never be so relieving.

Secondly, China is today the second largest economy in the world. This potential was realized after they made economic reforms and became a free market economy where open competition was accepted. This was unlike before, when the country was strictly a communist country, and everything belonged to the state. This made more people interested in investing in the promising economy, including McDonald’s.

There have also been efforts by the government to ensure that the ease of doing business in the country has been promoted. This is done through tax incentives and the removal of the strict legal restriction that was previously imposed. There is no better place for any investor than in a country where the ease of doing business is a concern to the government, and they do everything to ensure that both local and international investors are not having a hectic time in their operations.

As of November 2015, the Chinese Yuan against the United States dollar was trading at 6.39. The rate has been steady, and as of today, it is exchanging at a rate of 6.62. This shows that the Chinese economy continues to remain steady. However, there have been uncertainties at times since the Chinese currency continues to remain volatile against other currencies. Companies choosing to invest in China have the advantage of getting credit at lower interest rates in China compared to the US. This could be the main reason why McDonald's has chosen to continue expanding its business across China due to the prevailing economic stability.

The continued economic expansion means that the country's population will have more people at the middle-income level in the next few years compared to now. This is a positive note as there will be more people having some disposable income; thus, their ability to purchase will be greater. Anyone in the industry, whether offering a tangible product or a service, relies on the ability of the people to purchase the same.

McDonald's has a business model that is mainly focused on the middle-income level population and those in the higher economic class. Such a business model is usually aimed at empowering the people in the target segment. China's economic declarations are meant to ensure that the people in the country have the ideology of both local production and consumption. This is a positive guide to international companies as the government's move will help them lean towards serving their customers with utmost proficiency.

There are other reforms introduced by the Chinese government aimed at stabilizing growth and making China self-sufficient in production and consumption. This is amidst slowed economic growth that has remained at a constant 7% for the past couple of years. The government is, however, advocating for a progressive economy driven by consumption other than fixed asset investments. This goes a long way in helping power the market and ensuring enough production to meet the needs of the ever-growing middle-income population in the country.

Also with the continued economic dominance in the globe, there are countries that are turning their reserve banks into the Chinese currency. This means that there are countries that see a bright future in the Chinese dominance in the global economy. The government has also been on the frontline to see the Yuan enter the special drawing rights list of the International Monetary Fund. This will be an added advantage for Chinese investors since the currency shall be trading in foreign exchange markets.

In the current world, there is a growing concern over the risks associated with the exchange risks that occur. The most common risks that arise include both translational and transactional risks. Changes in the exchange rates affect both multinationals and small and medium enterprises transacting business in any country (Long et al. 2013). Transactional exposure comes as a result of the effects of fluctuations in the currency exchange rates obligating the company to make or receive payments in foreign currency denominations. Translational exposure, on the other hand, occurs from the effect of currency fluctuations on the company's consolidated financial statements, especially when the same

company has foreign branches.

With the Chinese market, it is expected that the transactional and translational risks may not be too harsh on the companies that have directly or indirectly invested in the country. The country has been experiencing stable economic growth with some low inflation rates; thus, the cost of doing business remains steady as well. Companies may, however, be forced to experience a surge in the cost of transactions and translation due to the volatility of the Chinese currency.

China's balance of payments depends heavily on remittances, course capital flows, service exports, and both foreign direct investment and foreign indirect investments (Cardon et al., 2013). To be in a position to manage the risks, it is important for both McDonald's and other companies to understand the process of undertaking forex risk management in a specific way. Hedging of the underlying is the fundamental principle of accessing local foreign exchange markets.

Exchange risk is one unavoidable aspect that foreign investors should be aware of. The only way to avoid this issue is by totally not engaging in foreign investment. Companies, however, may not choose this as they need to expand their portfolio and increase profit margins for their organizations. To mitigate foreign exchange risks, there are methods that have been put forward, and that could be very fruitful in mitigating the same. Hedging and speculating are the two methods that McDonald's could use as a way of reducing the risks that come with foreign exchange.

Hedging

Hedging refers to the process of investing in a move to reduce the risk of adverse price fluctuations on an asset (Sampson et al. 2014). It is more of an insurance policy, but this time it is expected that the investor will be protected against losses in their international business as a result of the risks that come with foreign exchange-related transactions. Some of the hedging techniques include:

I) Currency Forwards Contract

Currency forwards are used to fix currency exchange rates today to avoid future uncertainties (Alan et al., 2013). The contract binds two parties to an agreement that a currency will be exchanged for another for a certain amount of money in the future. This is a good way of ensuring that the company is not affected by future transactions that may affect its financial status.

II) Currency Futures Contract

A currency futures contract is a legally binding agreement that specifies the rate of exchange between two currencies in the future. Once the contract has been signed, both parties should adhere to the terms of operation. If there are fluctuations in the currencies, the company with reserves

stands a chance of not being affected by the same; hence, the company stands no chance of losing its financial status.

Speculating

The foreign exchange market today transacts close to five trillion dollars daily, making it the largest financial market of all time. Speculating is the move by a company to sell its currency in a bid to avoid future uncertainties in market movements. Once the company realizes that the strength of the currency they are in possession of has an untold future, it can make an exchange at the forex market to ensure that the foreseen drop in its worth does not affect it.

Hedging has been used by many companies to help avoid financial uncertainties in their country of operation. There are different techniques that companies use in hedging to prolong their survival in the market. The best hedging technique that companies in China can use to avoid economic, translational, and transaction exposures is currency forward contracts. It could be used to solve the problems in the three aspects in the following ways:

Economic Exposure

Economic exposure refers to the risks that a company's currency flow may suffer due to fluctuations in the currency exchange. Once they have entered into a currency forward contract, they will not be affected by what will become of the currency in the future. This means that the financial status of the company shall remain the same at the time of the contract and in the future.

Translational Exposure

This refers to the problems associated with companies that deal with the occurring need to exchange currencies, especially those that have international branches. The currency forward contract is meant to protect their cash flow as they will be operating at the same rate; thus, at no time will their balance sheets be affected by the fluctuations in the currencies that they are using.

Transaction Exposure

Transaction exposure is almost the same as translation. In the financial market, the company must operate at the forex rates every time they make a transaction. As a result, the fluctuations in their common currency may affect their financial status. However, with a currency forward contract, they will be able to operate within the same financial statements of the company since the exchange rates shall remain fixed.

Entering the Chinese market comes with so many advantages. One of the reasons why the organization should enter the market is the ready market brought about by the ever-growing population in China. One of the basic human needs is food, and McDonald's is ready to provide the same to the huge market in China. However, there are cultural challenges that they might face, including:

Communication

The Chinese people are very conservative, and very few of them speak the English language. McDonald's, on the other hand, is a company originally from America, and thus English is the basic language that the management understands.

One of the major aspects of leading a successful business is communication. It shall, therefore, take time before the management and the employees they recruit can easily and fluently speak to each other. This may be a barrier to the success of the company in the Chinese market. The Chinese language learning has also witnessed an upsurge.

Competition

The Chinese people have feeding habits that are very different from those of Western people. The Chinese restaurants in the country are therefore expected to pose great competition. It is, therefore, important that the organization prepares an entry strategy that will allow them to acquaint themselves with the Chinese people easily.

Management Culture

The organizational culture of companies in China is very different from what Americans do. There will, therefore, be a need to train the employees to deal with organizational issues the Chinese way. Chinese people believe that the manager is the most powerful person in the organization and that their decisions are final and should not be questioned. This is unlike in America, where teamwork and consultation are what most organizations believe in.

Conclusion

The Chinese business environment is one of the best in the globe today. Many companies have found solace in their investment portfolios, where they are set to reap big by investing in China. Most of the leading companies around the globe have branches here and certainly have been able to get good returns on investment. Availability of labor and the low cost of doing business are what many people term as positive factors that make corporations run to China.

Recommendation

It is important for organizations to ensure that they have a good business plan that is backed up by positive financial management skills (Yang et al., 2015). This is to ensure that the company does not run into a financial crisis in case there is a fluctuation in the common currency that is being used in the host country in the forex market.

References

Eriksson, H., & Clarke, S. (2015). Chinese market responses to overexploitation of sharks and sea cucumbers. *Biological Conservation*, *184*, 163-173.

Alan, C. B., Sin, L. Y., Yau, O. H., Lee, J. S., & Chow, R. (2013). Market orientation and business performance in a Chinese business environment. *Journal of Business Research*, *56*(3), 227-239.

Yang, F. (2015). Lost in the market, saved at McDonald's: Conversion to Christianity in urban China. *Journal for the Scientific Study of Religion*, *44*(4), 423-441.

Long, B. (2013). *Spedging: The Difficulties Defining and Distinguishing Between Hedging and Speculating, how These Difficulties Complicate Regulation, and Some Proposals for More Effective Regulation* (Doctoral dissertation, Wayne State University).

Cardon, P. W., & Scott, J. C. (2013). Chinese business face: Communication behaviors and teaching approaches. *Business Communication Quarterly*, *66*(4), 9-22.

Sampson, T. W. (2014). Forecasting Short-Term Stock Returns Using Irregular Pricing Behavior in the Options Market.