European Journal of Business and Social Sciences, Vol. 3, No. 6 , pp 81-102, **September 2014.** **P.P. 81 - 102**
URL: *http://www.ejbss.com/recent.aspx*
ISSN: 2235 -767X

h3 GOURMET: GREAT TO GO UPMARKET, BUT ARE PEOPLE WILLING TO PAY FOR THE DIFFERENCE?

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JEL Classification: M31

ABSTRACT

This case study addresses the pitfalls of internationalization and entrepreneurial decision-making in the creation of relevant differentiation for a gourmet fast-food concept, whose foundations lay in good old fashioned fast food rules dressed in a gourmet experience. In standardizing their market offer and having engaged in a frantic expansion program, h3, the organization under scrutiny here (and that illustrates business and management research methods in practice) has had to face serious strategic challenges and concerns. Initially limited to the confines of their home nation, Portugal, with subsequent expansion to Poland, Spain and Brazil, the chosen strategy of geographical diversification cannot be said to have been an indisputable success, as the organization is currently witnessing serious divestment decisions away from the Polish and Spanish markets. The Brazilian market on the other hand appears to be thriving.

Their concept is that of gourmet burgers with a fast food logistics and service culture underpinning it. Competition has been tough as several competitors have flocked into the market with pretty much the same idea. The company has sought to establish an emotional difference in what is increasingly a saturated market, although the h3 brand is quickly becoming synonymous with a novel association that has been emerging in the minds of consumers, gourmet and fast food coupled together in one food business concept. However, some service elements and customization characteristics (co-creation possibilities) may give the business a unique angle for relevant market differentiation.

Whilst there is no profound emotional difference that would otherwise have been present via the association with a well-recognized and established brand, h3 appears on the surface to have an even more worrying problem, in that they are apparently stuck in the middle in terms of their strategic outlook into the future, as on the one hand their cost structure is not fast food like and on the other, their ethos and potential basis for differentiation, gourmet meals is susceptible to imitation by any middle of the road competitor with serious intentions of coming into a profitable market. In addition to possibly not having enough-differentiation they are also not "branded" sufficiently…how best to tackle the future is then their plight.

Keywords: *strategy, branding, differentiation, stuck in the middle, fast-food and gourmet restaurants, geographic diversification, value creation and co-creation*

1. Introduction

1.1 The Origins of h3

This research is based on a case study about h3, a Portuguese company that encapsulates a certain gourmet perspective and some degree of differentiation (garnish combination and cooking point for each burger), allowing product customization (rare, medium and well done). The company is a venture that began with the development and association of two concepts: a chain of fast food burgers served in dishes and prepared at the moment of consumption and a gourmet approach in order to differentiate the proposal from other fast food chains.

The fast food venture has its origins in the conventional restaurant *Café 3* that served gourmet burgers, a very popular concept among New York's best known chefs but although a respected concept within a specific target segment. However, instead of the concept behind *Café 3* (established in Lisbon as a gourmet burger restaurant belonging to three entrepreneurs), *h3* can best be described as one whose principal focus is the supply of similar gourmet burgers but with large geographic coverage – following a chain of stores approach – and benefiting from economies of scale.

The burgers that were sold in *Café 3* were so successful that the three partners rejected the association between their burger and the plastic food sold in food courts and malls. Furthermore, they believed that the low prices of fast food should not necessarily mean that consumers were not entitled to a good quality meal. This most basic of ideas gave rise to the notion that it was indeed reasonable as a business proposition with economic substance and sense to convert a gourmet concept into a fast food chain of restaurants, also with a gourmet perspective.

The research based on the case study had a number of serious concerns, and the following are but a few (they served, for the purpose of an academic paper, as research questions):

- "Hasn't the fast food business reached maturity?"
- "Is there room left for just yet another burger chain?"
- "How can we possibly fight against the McDonald´s and Burger King´s of this world?"
- "How shall we best put together our business idea in order to challenge these corporate giants with a modicum of a chance of success in the process?"
- "What are the key management issues and principles at stake here?"
- "How can we assure quality and consistency in every store?",
- "How can we possibly motivate our personnel with the low salaries that are commonplace in the fast-food business?"
- "Is there room for creativity and innovation in this business?"

1.2 h3 Operation

The first *h3* opened in July 2007 at the *DV Monumental* (Lisbon) and was quickly followed in September by the *h3* in *Amoreiras Plaza*; both were immediate hits and under these circumstances, geographic expansion made all the sense. By March 2012, *h3* had 38 restaurants in Portugal; it had gone from being a simple yet ingenious concept, the work of creative individuals with a flair for risky ventures, to become a chain of restaurants with a clear brand identity and well-defined consumer targets in mind. The brand felt ready to tackle the extremely competitive international markets.

In this context, geographic expansion into the Spanish market was the logical thing to do. In the end it meant the opening of two restaurants in Spain in partnership with the *VIPS* group (Gino's, The Work, TGI Fridays and Starbucks Coffee, all in Spain and/or Portugal). The two restaurants were located in shopping centers in Madrid: *Kinépolis de Pozuelo de Alarcan* and *Diversia Shopping Centre*. In continuing with geographic expansion, January 2011 became a milestone for *h3* as they opened an outlet in a Warsaw shopping center: *Mokotow Galleries*. The Polish restaurant was operated through a local partner under a franchise agreement, but a hefty investment of over one million euros was required from *h3* to ensure the operation was to become a going concern well into the future. As it turned out, things weren´t to turn out just the way the *h3* top people thought they would, but this will be dealt with at a later stage. Just as your average punter orders a "*tuga*" in a Portuguese *h3* restaurant, the Poles ask for a "*proposz*". In addition to this the brand has nine restaurants in São Paulo, Brazil: the first two in *Vila Olimpia* and *Morumbi Shopping*, both in well-established shopping malls in this large metropolis.

The fast food concept is not a novel idea but fast food chains only really came into existence in the 20th century. Many of these chains are now well-known and have become globally popular and are often iconic in culturally heterogeneous places. Some of them have grown to become corporate giants and are now well established retail concepts all over the world. Some of the most recognizable names include such powerhouses as: Kentucky Fried Chicken (USA – 1930), McDonald´s (USA – 1940), Burger King (USA – 1954), Pizza Hut (USA – 1958), Domino´s Pizza (USA – 1960), Subway (USA – 1965) and Wendy´s (USA – 1969).

From the above discussion, the main objectives of this case study are:

- Reintroduce the debate cost-differentiation
- Complete the debate cost-differentiation with other theoretical perspectives that should be aligned with the mentioned debate
- Develop the *h3* case study and regarding theoretical and bibliographic revision the paper addresses a set of questions that can raise the possibility of introducing the company concept in different markets, for instance the Asian markets.

This paper is organised as follows. The first part provides a literature review of why there is a need to reintroduce the cost-differentiation dichotomy, where debate about cost-differentiation is provided along with some theoretical perspectives about reintroducing the correspondent discussion. The second part will describe the study's methodology, namely the case study of *h3*, where findings will be discussed in detail in relation to this specific case and its idiosyncrasies. The final part of this paper will highlight critical observations on the literature, research analysis and findings of *h3,* discussion and conclusion.

2. Literature Review

2.1 Reintroducing the Cost-Differentiation Debate

Porter (1980) distinguished three generic strategies: differentiation, cost leadership, and focus (Shahzad, Bajwa and Zia, 2013). A differentiation strategy aims to create a product or service that customers see as unique (Miller, 1988). In the policy literature there is an assumption that the generic business-level strategies of differentiation and overall cost leadership are generally inconsistent (Hill, 1988). However as most industries seem to offer opportunities to exploit economies of scale or economies independent of scale at some point in their value chain (Porter, 1985), it would seem that combining both the product differentiation and cost leadership strategies should be possible (Murray, 1988).

The literature on cost versus differentiation as either reconcilable or mutually exclusive strategic paths for organizations is vast and has been around for decades. Porter (1985) brought the debate into a wider forum and well beyond the realm of the academic community, but long before that, there had been ample discussion in the literature as to the viability of cost and differentiation as reconcilable strategic alternatives for organizations, with arguments being made both ways on the compatibility of both strategies and their simultaneous occurrence within an organization. There is extensive literature that pre-dates Porter on organizational strategic choice, but it is true that Porter´s generic strategies framework brought the topic to the forefront of organizational policy thought.

As far back as 1956 Smith was alluding to “a limit to which diversity can be carried without driving production costs beyond practical limits” concluding that “the employment of product differentiation as a strategy tends to be restricted by the achievement of levels of marketing costs that are untenable” (Smith, 1956). Porter (1979) called attention to raising buyers' switching costs and increasing product differentiation as possible strategic paths in certain industry segments, whilst acknowledging that the corporate strategist has to assess the forces affecting competition before deciding on pursuing a particular strategy in a clear acknowledgement of differentiation as a strategic possibility available to organizations.

Miller and Friesen (1986) furthered the debate when they employed the PIMS data base of consumer durable business units to assess the viability of Porter's generic strategies framework, and Hambrick (1983) when looking into strategic alternatives for organizations, concluded that the primary strategies pursued by high-performers in two industry settings closely resemble Porter's three strategic types of cost leadership, differentiation, and focus, arguing in the end for a typology that seeks for an appropriate combination of differentiation and cost in attaining competitive strength. Hall (1980) on the other hand suggests two possible strategies at the disposal of policy-makers in organizations: lowest cost with an acceptable level of quality and differentiation, with Karnani (1984) endorsing this thinking.

All this indicates that well before Porter, the debate on strategic alternatives available to organizations was already a lively one, with arguments for and against the merits of cost leadership, focus and differentiation strategies for organizations and vivid discussions as to the viability of the simultaneous usage of alternative organizational strategic approaches as well as the appropriateness of each in widely varying contexts and business situations.

In the light of this, Wright (1987) suggests that “while the cost leadership and differentiation strategies attempt to address a whole industry, the focus strategy addresses specific and smaller clusters of buyers within an industry”, while Phillips, Chang and Buzell (1983) refer to quality as a crucial differentiator of the value proposition, in that it insulates a business from competitive rivalry, by creating customer loyalty and lowering customer sensitivity to lower prices, acting in that way to protect the business from other competitive forces, whose presence and actions have a detrimental impact on corporate profit margins.

White (1986) and Dess and Davis (1982) before that conclude in their seminal work conducted on the assessment of the generic business strategies framework that they did not find distinct strategic orientations on the part of managers that could be indicative of a focus strategy. However they did find such indications for differentiation and cost strategies. Still on the ongoing generic strategies debate, Govindarajan (1988) found that the low-cost and differentiation generic strategies proposed by Porter (1980) are two competitive strategies that describe a means for attaining desired outcomes.

Miller (1986) adds to the debate by asserting the existence of conglomerates that are completely unfocused at the corporate level but have divisions that pursue well-defined strategies, often either marketing differentiation or cost leadership strategies. Miller and Friesen (1986) again found clusters that pursued combinations of Porter's differentiation and cost leadership strategies, and other clusters that did not. Further to that, their findings appear to support the proposition that greater autonomy is related negatively to the ROI performance of low cost defenders. On a possible link between strategic orientation and ROI, Hamermesh and White found that business units pursuing differentiation strategies showed slightly higher ROIs.

In the context of strategic implementation, differentiation strategies are thought to be more likely to require decision-making that resorts to intuitive judgment more than what is required to implement low-cost strategies (Gupta, 1987). There are however numerous "strategyless" examples of organizations that are stuck-in-the-middle in a strategic warp and there are also many examples of ventures that use cost leadership strategies (Chrisman et al 1988).

Focus strategies are understood to be more likely to be successful than either industry-wide differentiation or cost leadership as indicated by Kim and Lim (1988) when adopting a set of key decision variables suggested by Porter (1980). Focus or niche strategies are also risky strategies in that any niche market segment that consistently shows above average profitability will attract other players into the market who are only too willing to defy the incumbents.

The aptness of Porter´s generic strategies framework of overall cost leadership, differentiation, and focus and its inter-contextual application has also been discussed in the light of its relatedness to profitability metrics. The dichotomy between differentiation and cost leadership strategies is based on the simple relationship between price, cost and profits, with the focus in both strategic alternatives being on profits, the difference between price and cost (Kotha and Orne, 1989). Focus strategies designate niches in an industry where firms seek a specific type of customer, product, or geographic concentration, through differentiation or cost leadership strategies (Porter, 1980).

Govindarajan and Fisher (1990) used Porter´s (1980) framework containing two opposite types of strategic orientation, low-cost and differentiation, but they admitted a pure low-cost strategy, a mixed strategy, and also a strategy of pure differentiation. Previous studies have identified activities associated with differentiation and low cost strategies (Dess and Davis 1984; Galbraith and Schendel, 1983) whilst Narver and Slater (1990) warned of the rigorous conditions concerning costs which were necessary for the sustainability of any business strategy.

Grant (1991) alludes to the resource position of the organization as important in the choice of strategy. Although the competitive strategy literature has tended to emphasize issues of strategic positioning in terms of the choice between cost and differentiation advantage, and between broad and narrow market scope, the key to these choices is the resource position of the organization (Grant, 1991). In this context Porter (1980) cited in Jennings and Lumpkin (1992) stated that differentiation and low cost strategies are aimed at achieving their objectives industry wide, whereas a focus strategy is built around serving only a particular segment of the industry (Jennings and Lumpkin, 1992). Other works followed Porter´s seminal typology that embodies the generic strategies framework of differentiation, cost leadership, and focus (Vickery, Droge and Markland, 1993).

Porter (1980), for instance, recommends generic competitive strategies that involve achieving extreme positions (lower costs or higher prices) and warns firms against getting stuck in the middle, a position corroborated by Ghemawat and Costa (1993). Other studies have employed the resource-based perspective to examine the timing of the costs and revenues associated with focus and differentiation strategies (Mosakowski, 1994), as well as the development of integrated models to assess the determinants of business profitability (Pelham and Wilson, 1995) which along with other strategic typologies that have emerged over the years constitute slight derivations of Porter's (1980) competitive strategy framework.

In this context, McGee and Dowling (1995) identify three basic types of competitive strategy: marketing differentiation, technical differentiation, and cost leadership. In addressing some of the criticisms directed at the simplicity of the generic strategies framework, Mintzberg (1988) cited in Kotha and Vadlamani (1995) proposed an alternative typology of generic strategies that mirrors the increased complexity of the corporate environment which begins by distinguishing focus strategies from those of differentiation and cost leadership.

The added complexity in the choice of a particular strategy comes from the systemic nature and the potential fit between activities and how it may substantially reduce costs or increase differentiation possibilities. Beyond that, the competitive value of individual activities or the associated skills, competencies, or resources cannot be decoupled from the system or the strategy (Porter, 1996). In this context a product/process redesign for example will defer the point of differentiation (i.e., defer the stage after which the products assume their unique identities). Lee and Tang (1997) develop a simple model that captures the costs and benefits associated with a redesign strategy.

The literature has evolved over the years and the contributions of Hart (1992) providing an integrative framework for strategy-making processes as well as the work of Dess and Lumpkin (1997) on differentiation versus low cost or differentiation and low cost have advanced the debate on the compatibility of strategic choices. Barney (1997) on gaining and sustaining competitive advantage and Borch, Huse and Senneseth (1999) work on the distinction between strategic approaches has to be emphasized.

In conclusion many argue that cost leadership and differentiation are not necessarily incompatible in the same organization at the same time. There are many situations in which establishing a sustained competitive advantage requires the firm to simultaneously pursue both low-cost and differentiation strategies (Aulakh, Kotabe and Teegen, 2000). Many authors have argued that under certain industry conditions it is possible for firms to simultaneously pursue both cost-leadership and differentiation strategic orientations (Hill, 1988; Jones and Butler, 1988; Kotha and Orne, 1989; Kotha and Swamidass, 2000, Desai, *et al.*, 2001 and Guiltinan and Paul, 1988).

Porter (1985) proposed three generic marketing strategies to reach potential customers: differentiation, cost leadership, and focus. The last of the three strategies, focus, has two variants, differentiation focus and cost focus (Aladwani, 2001). Other strategic typologies have been proposed over the years (Hortacsu and Syverson, 2004, Kaplan and Norton, 2004, Prajogo and Sohal, 2006, Rivard, Raymond and Verreault, 2006, Zott and Amit, 2008 and Grant, 2010), but in many cases they are derived from Porter´s seminal work.

A firm's competitive strategy will necessarily be related to organizational performance, with the crucial point here being that a choice of a particular strategy has to be made at all times, the inference being that should the organization fail to choose a strategic orientation, it will remain stuck in the middle, in a kind of strategic limbo. More specifically, firms that emphasize, either a focus, low-cost, or differentiation strategy are found to achieve the highest growth levels (Smith, Baum and Locke, 2001). Whilst this is widely acknowledged to be true, there is also evidence that many firms achieve low costs, yet also have differentiation strategies (Miller and Freisen, 1986).

Differentiation has been very much associated with obtaining a price premium (Sharp and Dawes, 2001) and organizations have also invested for a long time in drivers of differentiation, but the two generic strategies are differentiation and low-cost, although Porter's later work with the development of the value-chain model, which focuses on the activities and functions of the firm and the underlying factors that drive cost and differentiation advantages provided not only strategic options to organizations but a more thorough path on the underlying drivers of a particular strategic choice, thus adding complexity to the generic strategies basic framework (Hedman and Kalling, 2003).

Porter (1980, 1985) suggested that above-average performance can only be achieved by adopting pure generic strategies based on either differentiation or cost advantage; in contrast, firms pursuing stuck-in-the-middle strategies were left stranded with no competitive definition (Spanos, Zaralis and Lioukas, 2004). The ramifications of this thinking are manifold, but as a way of example and invoking Porter´s (1980) framework, differentiation and low cost strategies are thought to elicit different HR policies and practices requiring particular sets of employee attitudes and behaviors to foster success (Guthrie, Spell and Nyamori, 2002).

Strategy is thus and in a certain sense seen as making a choice between differentiation and low cost, but in contrast there are those that seek to create blue oceans and pursue differentiation and low cost simultaneously (Kim and Mauborgne, 2004, Chenhall, 2005). An example of this is the emergence of the low cost airline business and the challenge it posed to all airlines to find ways of attracting passengers, through a mix of fare discounting, greater frequency, improved flight times and no-frills levels of on-board service. Thus, there is evidence that firms sort themselves into either differentiation or low-cost strategies as the competitive realities of a deregulated world unfold (Delmas, Russo and Montes-Sancho, 2007), but there are also those who argue that it is indeed possible that organizations may pursue more than one strategy simultaneously. Bearing in mind that possible combinations are many in kind and degree it is important to stress that both approach and process matter (Pretorius and Maritz, 2011) and that strategic choice is far from being black and white: in practice it is not as dichotomous as it seems because the process matters and the strategy is probably grey, dark grey to light grey (Campbell, Renshaw and Engstrom, 2011).

2.2 Parallel developments and enriching Cost-Differentiation dichotomy

In parallel with this theoretical and practical effervescence on matters of strategy and in particular, competitive strategy, that has arisen since the mid-nineties, there have been currents of thought that have advocated that strategy should be merged with competitive strategy in developing theoretical frameworks that will enable for an enrichment of the strategy debate: these rows began within the marketing (mainly with the seminal works of Vargo and Lush, 2004a, 2004b) and within the field of logistics, mainly through a remarkable book, Supply Network Strategies (Gadde, Håkansson and Person, 2010).

From the marketing side, it may be argued that marketing is developing in the direction of a service-based logic of exchange. This new approach has spread all over the literature under the designation of service dominant logic (S-D logic). S-D logic paved the way not only for the creation but also the co-creation of value, bringing with it two other fundamental aspects: the need for a real process orientation of the firm and the criticality of relationships. In fact, customers are active players in the process and, for that reason, they are endogenous to the creation of value.

From the logistics side one may say that the broader concept associated with it, supply chain management, is developing and extending its scope to more than that of euphemistic integration, meaning that there is a real necessity to assume an all-encompassing character between differentiated legitimacies and companies logics: marketing, production and financial logics, to name the market/client, internal/organizational an capital/shareholder paradigms. With this evolution logistics, and particularly supply chain management, have recognized the need to cut and cross company frontiers, going up and downstream and embodying clients, suppliers, and, eventually, competitors, suggesting a definitive and strong route to collaboration.

Literature offers us the chance to find some previously developed theories that have already started to reveal signs of a shift towards an alternative logic (more complex, broader, more all-inclusive). Not necessarily stretching the shift from goods to services neither from transactions to relations. Browsing other alternatives beyond what is already taken for granted, namely the well-known and deeply explored dichotomy between low cost or differentiation leads to the enrichment of the concept and the basics of competitive strategy. Resource-advantage theory thus notes the association between organizational resources (or competencies) and sustained competitive advantages (Prahalad and Hamel, 1990), independently from the cost-differentiation perspective. This is one of multiple examples available in the literature.

Those two previously described developments have in common the necessity for genuinely serving a client/market: by giving attention to the possibilities brought about by the co-creation of value (the client being a participant in the process of value creation) and, thus, stressing the necessity for designing and managing processes and relationships (marketing perspective), by paying attention to real integration/collaboration, the root that claims for relationship intensification (supply chain perspective) is a shared one.

In both cases, the interesting liaison with competitive strategy is very important because they both end by recognizing, more directly or indirectly, with different approaches and evolving from different areas, that more important than strategic competitive choice and the apparent irreconcilable difference between cost and differentiation is, nowadays, the competitive/collaborative (co-opetitive) arena. And this arena is made not only by competitive stances but also by processes, relationships, competencies and integration that lead to the creation and co-creation of value (Christopher, 2011; Vargo and Lush, 2013; Gadde, Håkansson and Person, 2010; Engelseth and Törnroos, 2013).

3. Methodology

3.1 General Approach

This research aims to reintroduce the debate cost-differentiation by using a single case – *h3*. In order to achieve this aim, two main methods were sought namely literature review where theoretical insights were presented to provide justification why we need to reintroduce the cost-differentiation and empirical study by conducting in-depth interviews using case study approach – *h3*. Table 1 below provides the interviewee details and Table 2 provides the interview guide questions. An exploratory research approach typically occurs when a researcher examines a new interest or when the subject of study is relatively new. Yin (2013) points out that a single case approach is justifiable if the research objective is exploring the path and foreseeing the future of a specific company towards particular and idiosyncratic goals. Thus, the present research follows a non-positivistic approach, i.e., a subjective interpretative approach with a single case approach to *h3*. Data collection were conducted in three different ways (1) In-depth interviews (semi-structured) with the tree *h3* entrepreneurs; (2) In-depth interviews with the store's (h3) clients (one hundred clients) and (3) direct observation of the daily routines in peak hours in several different h3 stores (more than 150 hours distributed by 6 months observations). Deep observation of the model and direct contact with the entrepreneurs and clients in parallel with revisiting the literature and several exchange of ideas between the authors served as the basis to build the paper around the h3 company and to create the idea that there was an immense potential in terms of discussion and contribution at the academic level.

Sample	Job Title	Number of Interviewees/hours
Entrepreneurs	Owners of the company	3 Interviews/10 hours
Author's direct observation in peak hours	---	+100 hours
Clients	100 clients (in peak hours)	100

Table 1 – Interviews: persons involved, number and/or hours spent in the process

Issues	List of Questions
Adopting trend	1) Why do consumers consume these types of hamburgers and why they don't want to consume the product (if any)? 2) Is there a movement of acceptance and spreading the gourmet consumption habit? 3) What are the reasons for the increasing pattern of consumption?
Following the phenomena	1) Consumers are very different in age, habits, social life, earnings,…/… so why this is really a transversal phenomenon? 2) What are the perceived elements of the h3 strategy? 3) What type of approach is it used to spread the trend of *hamburgology* by h3?

Table 2 – Interviews guideline (semi-structured interviews)

3.2 Findings: Some Lessons Learned

In an interview given to Food and Solutions in April 2009, one of the partners stated that five lessons had been absolutely vital for the development of the business concept and had made the whole project viable as a going concern that stood to thrive well into the future, namely:

1st Lesson: Pay strong attention to clients and understand their wishes

"We understood that the most popular dish at *Café 3* was hamburgers, so we began thinking of changing it into a fast food business."

2nd Lesson: The economic situation was not a constraint for the decision to go ahead

"Fast food consumer goods are not directly dependent on the economic crisis in that low prices and various promotions still make them attractive."

3rd Lesson: Specialization – *h3* restaurants only sell hamburgers

"In recent years the fast food sector has stagnated; no new concepts have emerged but only copies of already existing ones. The food court of a shopping centre has to offer a varied and complementary range."

(The results from this lesson have already been seen with the introduction of *Alheira* croquettes – as a starter or a main course – and two salads: *Café 3* and *Caesar* (meanwhile discontinued).

4th Lesson: Maximum Quality

"From the moment that we came up with the *h3* concept, we decided to put quality above all and in everything we do: image, service; suppliers, location, amongst others."

5th Lesson: Do Not Be Afraid

"From the outset, the key to success was to act as if we were operating a big brand, because that was what we wanted to be at the time, and what we still strive for."

In addition, it should be noted that the trends set by the great chefs in London and New York were a great inspiration for *h3* hamburgers, as they had started to include burgers cooked with high quality gourmet ingredients on their menus.

These practices changed the way burgers were perceived by the public at large: no longer was a burger merely a portion of beef but instead a truly sophisticated gourmet meal that could entail a wide range of original and sophisticated combinations in its making and presentation.

The partners were keen to create a new product that would emanate from a set of suggestions and ideas originating from trendy chefs, ideas that would be simple to operationalize and bring into fruition, but that could in addition also provide clients with a wide range of food at reasonable prices. Table 3 presents the traditional offering of the largest international burger chains and compares it to that of *h3*.

	Traditional Offer (McDonalds, Burger King, amongst others)	***h3* Offer - Hamburger Gourmet**
Ways of serving	In bread with disposable boxes	In a porcelain heated plate with knife and fork (although they already introduced burgers in bread)
Type of meat/weight/coking mode	Frozen/100 grs./Standard mode	Fresh meat/200 grs./undercooked, medium or toasted
Extra accompaniments or side dishes	Frozen potato crisps	Thai rice, sliced and fresh French fries, salad and spinach
Sauces	Industrial sauces (ketchup, mayonnaise, mustard)	In house made sauces with fresh ingredients
Hamburger accompaniments	Onion, pickles, bacon, lettuce	Poached egg, fried egg, cheese, tomato, vegetables and/or fresh spinach or fresh *foie gras*
Drinks	Industrial (Coke, Iced tea and others) and Coffee	Industrial or natural drinks such as lemonade, iced tea and lemon tea, draft beer or glass of wine
Desserts	Ice creams, pies	Chocolate *coulant* , ice-creams *everydae* or *holidae* , with chocolate, raspberry *coulis* , caramel or sweet eggs
Target	Juvenile and child	Demanding adult
Image/colour	Traditional fast food/red	Fashion and gourmet/blue and *bordeaux*
Concept	American	Portuguese

Table 3 – Traditional Offer versus h3 Offer

4. h3 further analysis and discussion

4.1 Context

The *h3* concept is set apart from that of other direct competitors in a variety of ways, but one key aspect is its ability to serve a fast food burger meal on a plate, with cutlery (knife and fork) included. In effect, this is reflective of Portuguese cultural idiosyncrasy, in that there is a clear preference for knife and fork meals in gastronomic choices and traditions in Portuguese cuisine. However, people have different eating ways and habits elsewhere and so knife and fork may in fact turn out not to be key with other consumer constituencies in other cultural contexts.

Although this may conceivably be an obstacle to market entry in other countries, *h3* partners believe that people are always willing to raise their standards. One of the directors notes that whereas a person that is used to eating from a porcelain plate with a knife and a fork is unwilling to use a plastic or paper plate, the contrary is not necessarily true. It is thought that consumers nowadays are more receptive to experiencing new concepts and changing standards, with preference going to higher quality meals, even if the product in question turns out to be your average, middle of the road burger.

4.2 h3 Product

The plethora of gourmet products that h3 has in its menus is believed to be the basis for the success of the business concept at least thus far. The h3 menu includes a burger with Thai rice and/or fresh fries. The menus vary in accordance with an endless variety of high quality ingredients which combine to create 10 appetizing and much sought after specialties: Grilled, with Sauce, Champignon, Tuga, Benedict, Cheese, French, Mediterranean, Milano and Super bread. Fresh spinach and salad with vinagreta are available as extra portions (or side dishes). As for drinks, lemonade and iced tea are available as well as the usual supply of cold drink varieties (Coca-Cola, Sprite and Fanta) as well as beer and wine. A dessert of profiteroles was initially on the menu, but has since been replaced with ice cream: – everydae and holidae – and chocolate *coulant.*

Mention should also be made to the fact that originally coffee was not served in the h3 restaurants in shopping centres as it was not part of their core business and as there have always been many quality coffee shops in these centres to cater to those who require their caffeine boost, a cultural trait of the average Portuguese punter. In the light of this coffee has been added to the menu, but also because of its significant marginal contribution to the unit profitability of meals.

4.3 h3 Communication

h3 has made a conscious decision to direct most of its marketing budget to internal rather than external communication. They also strongly believe in *word-of-mouth* as a powerful communications weapon. Most external communication with the consumer is made on-line through their website (www.h3.com) and a strong presence in social networks, including Facebook has meant that they are more than capable of showcasing their offer to a target group of consumers and keep their constituencies up to date with the very latest news with regards to the organization and/or its products and initiatives.

Periodically, the company will also engage in publicity stunts mostly related to the announcement of the opening of an *h3* outlet somewhere in Portugal (not necessarily in Lisbon or Oporto), but virtually anywhere in mainland Portugal, including the Madeira and Azores isles, and most typically in shopping centres. The company has made a decision not to invest in advertising in other media, including newspapers or TV.

h3 partners acknowledge that their employees are a key ingredient of their organizational success and express their commitment to staff by stating that "it is very important that employees feel that they are a key part of a valuable stakeholder community, that they contribute to the image of the brand and that they are the window of the organization to the outside, *h3* ambassadors, without whom the company would be faceless" as one of the partners eloquently put it.

"Our employees are part of the organization and take great responsibility for its marketing". As a result, investment in internal communication and professional training has become a central thrust of the organization with the ultimate aim of ensuring that employees are both happy and proud to be associated with *h3*. This should be very clear and immediately intuitive to clients as they are about to order a meal at any *h3* restaurant. That being said, how do employees manifest their creative juices in service situations? And what can we do to make people on very low wages feel wealthier?"

A communications campaign called "*Tuga* Resists" (Portuguese resist) has recently been launched in every store located in Portugal as a result of the increase in VAT in the food restaurant sector, a hefty hike from 13% to 23% at the beginning of 2012. *h3* responded with a document explaining to clients that burger prices would be jacked up solely in line with the corresponding increase in taxes and not a cent more. Round about the same time the "*Tuga* Resists" card was also launched and it said something along the lines of "I am going to eat the VAT"; for each *h3* burger eaten, the client's card would be stamped and after 9 stamps had been gathered, which meant that 9 burger meals had been consumed, the client was given the 10th meal free of charge, thus compensating for the VAT that had he had been previously billed for. This in the final analyses only meant that *h3* was able to take advantage of the VAT increase to create a loyalty campaign. The brand has also profited from this communications coup, and has in the process been able to establish itself as an international brand, although not by any stretch of the imagination a household name next to its key foreign constituencies yet. The organization has also contributed significantly, and in scale to the Portuguese economy, as its suppliers have accompanied the internationalization of the organization.

4.4 h3 Pricing

The *h3* pricing strategy has been designed to offer a high quality *fast food* meal for a reasonable price, thus creating a *value for money* proposition that optimizes the price-quality ratio. As a consequence of that, its products are slightly more expensive than those of their direct competitors. The prices on the menu range from €6.75 to €10.50. Deserts vary from €2.10 to €3 and therefore put a hefty and significant burden on the final price of the meal.

Trading its menus at higher price points than its competitors was for *h3* a pillar and key ingredient of their overall strategic brand building idea, which consisted of an alignment with the ethos of the brand and its desire to tell itself apart from the rest of the crowd by way of relevant and tangible differentiation anchored on the higher quality of its products and the higher prices it was capable of charging for them as a result. In so doing they were able to justify not only the type of products on their menus e.g. *foie gras*, fresh mushrooms or Port wine, but also to project the image that they had been hoping to convey from the word go, that of a higher value proposition than anything that the competition was capable of throwing at them.

4.5 h3 Distribution

The ingredients that are used in making every product sold at *h3* are distributed directly to the individual restaurants in Portugal and the same goes for the outlets in Poland (where they went in, failed and got out)**,** Spain and Brazil. The meals, mostly burgers are available both on site and also delivered directly to customers in the comfort of their own homes. The layout of the restaurants is in accordance with one of three formats depending on available space for cash registers and the width of the space in question.

One of the organization´s key concerns when agreeing on a particular type of layout for an individual store has from the very beginning been to keep the client waiting time to a bare minimum, as clients are required to hold their trays whilst waiting for their meal to be served. The average waiting time per client is around 30 seconds but a record time of 17 seconds has been achieved. However, waiting times varies greatly from one restaurant to another and this process is not yet adequately monitored and properly controlled for. At the end of 2011, the company announced that it had gone from serving 170 to 200 meals per hour per shop in the *Colombo* and Chiado restaurants in Lisbon. This meant that 3 extra people had to be hired for each crew.

Response times are critical in the attainment of logistical efficiencies in this type of operation as *h3* easily goes from periods of peak demand to very quiet periods when it is difficult to make best use of the human resources available: lunch and dinner time must therefore be optimized. Although restaurants, including McDonalds for example, also have peak times, they have customers every hour of the day and night (in stores that are open 24 hours) and so their customer visitation patterns are quite different from those of *h3*. In the light of this, it is easy to understand why quick service is critical.

There are within the *h3* group, strong proponents of process standardization and service customization, both understood to be key to operational efficiency, but in acting on these, significant adjustments to previously outlined strategy will necessarily have to be made. Initially, lack of space in large shopping centres, together with an *h3* brand which was still largely unknown to the public meant that the organization found it extremely difficult to get hold of top notch locations for their restaurants in the best shopping centres. This was the case as *h3* found it hard to convince shopping centres and their management structures of the virtues of their presence and how advantageous to both parties, that would be.

Indeed, although they have managed to open a street restaurant in *Parque das Nações*, it has still not been possible to open a restaurant in the *Vasco da Gama* shopping centre, widely acknowledged to be one of the best locations in Lisbon, with the largest concentration of people per retail square foot in Portugal. However, things have been improving, and this is largely thanks to *h3*'s commercial success. They now have a presence in Portugal's most important shopping centres, including the *Colombo Shopping Centre*, *Cascais Shopping*, *Oeiras Parque*, *El Corte Inglês* in Lisbon and *Gaia*, *and Arrábida Shopping* in the Oporto area.

h3 is now toying around with the idea of delving into street restaurants in city centres. This is already well beyond the planning stage and in effect two have already opened in Lisbon: in *Parque das Nações* and *Chiado* in the old town of the capital city of Lisbon. This new retail format has been accompanied by the inclusion of trendy new products on the menu (more deserts and extras) due to the special features of a street shop model and the implied requirements for more diversity that it entails.

Despite all the success that has been attained thus far in a relatively short time span and under exceptionally difficult macroeconomic circumstances, there have also been constraints at both the logistic and the strategic levels, as well as organizational and human resource issues that need to be considered and dealt with effectively. Finally *h3* works with a partner called No Menu for indirect distribution; the company specializes in home delivery and operates in 16 cities in Continental Portugal. Their core business is home deliveries for a pre-selected range of restaurants (www.no.menu.com), one of which is *h3*.

4.6 The future of h3

h3 currently employs around 650 people in 40 stores in Portugal (10 of which under franchise agreements with *João Ventura* in the North of Portugal). It has developed partnership agreements with local companies for their international operations in Brazil, Spain (where, due to bad results, they have closed the operation in 2013) and Poland (shut down also in 2013). In Portugal and Brazil where in 2014 h3 has operations, the chain is able to show a healthy commercial picture for its 4 year effort, a combined turnover of around 30 million euro (2012 data), around 35 million in 2013 and a forecasted turnover of around 40 million euro by the end of 2014. Its future depends very much on how it manages to take advantage of economies of scale and the outcome of its expansion strategy, both internally and externally, as it does on growth and process improvement strategies.

So far financial results in general and operating margins in particular have been positive and this has allowed the *h3* chain to launch itself quite quickly, using very little capital from outside the group. However, it is important to remember that Portugal is undergoing a severe economic crisis and was recently the recipient of an international institutional bailout package that has brought with it clear constraints that have altered the consumption patterns of the average punter. Disposable income has significantly decreased and this will continue for the foreseeable future. Assuming that *h3* continues to emphasize quality as the cornerstone of its value proposition, it must be acknowledged that its current pricing strategy may not be sustainable in the light of the implied difficulty in attracting the necessary demand that is needed to maintain current profitability levels under the present economic climate.

There is evidence that it is more difficult to implement the *h3* concept in the North of Portugal than in the South; this is due in part to lower family income and the above average prices practiced by *h3*, but also attributable to different eating habits up North. It is also acknowledged that 33 of the current 40 restaurants were launched before the end of 2010 and that growth of the chain in Portugal in 2011 and 2012 has slowed down dramatically. Only two stores were opened in Portugal in 2012. The others were opened outside Portugal, one in Spain (with bad results, conducting to the operation shut down) and nine in Brazil, continuing its expansion. The million dollar question is then whether the domestic market is capable of sustaining further expansion. A second question relates to whether they should continue to invest abroad and in several other markets (what markets?), since their endeavours in both Spain and Poland cannot be described as successes. Only market experiences. In Brazil h3 have benefited from the effect World Football Championship but from now on is it possible to continue the expansionist movement?

In the case of Poland it is safe to say at this juncture that the business concept did not work, that is they went into the Polish market, were unsuccessful in their attempts to build up a business in that country and then decided to pull out of that market altogether. All of this took place in the space of about a year. In Spain the partnership has undergone severe strains and divestment from this market occurred in 2013.

In Brazil, and because this is a huge market that offers much promise, after some adaptation and the initial resistance of local punters, there have been renewed investments, and it is the belief of the group that this is a market of enormous potential, an expanding market. Of course, has have been said, the World Cup added some buzz and business to h3. The group has already shown its ambition and now believes that it is perhaps best to opt for a single market in particular, in terms of expansion, and one that shows potential from the word go, rather than pursuing a strategy of experimentation and simultaneous attack of various markets. In all, if the unsuccessful ventures in Poland and Spain have been of any use to top management at *h3* is that they have shown that one cannot be too careful when expanding abroad and that each market has its own particularities and idiosyncrasies.

Brazil is a logical step forward when it comes to geographic diversification due to the cultural proximity that it entails and the undisputable fact that the Brazilian market is a growth market, a slice of which top management at *h3* are only too keen to lay their hands on. This justifies the sole focus of international expansion in Brazil. Domestic expansion on the other hand is expected to continue albeit at a more moderate rate. Other expansion plans are currently on hold due to the dark macroeconomic scenarios that are expected both in Portugal and elsewhere, and in any event, any decision to expand internationally will need to be much more carefully scrutinized and monitored for risk. More realism and less impetuosity would be sound pieces of advice with respect to that.

In this context, and in the case of Brazil, the company expects a turnover of about thirteen million euros by the end of 2014. Add to that the 27 million euros that are expected to be made in the domestic market and the total turnover is estimated at around 40 million euros. The h3 restaurants in Brazil have been developed through partnerships mainly in São Paulo. In addition to this there are plans for regional expansion within Brazil itself and this in effect has already materialized in a couple of cases. There are currently more stores over and beyond the actual number that already exist in Brazil, operating a system of regional franchising, namely in Recife and in Bahia.

At least five critical issues need to be raised at this juncture:

- Can a food chain expand so much in such a short period of time whilst remaining consistent in terms of the high quality provision of its food products, store operations, the level of professional training provided to its staff, ensuring that again product quality does not suffer? This is important in that at *h3* the most important commandment is the following: "You shall not crush the burger?"
- Which strategic path can a food restaurant chain with a fast food ethos and business logic follow and why?
- Is *h3* a simple case of competitive strategy, meaning with this a basic low cost or differentiation approach or, more than that, a mixture between different competitive strategies, or revealing an hybrid conjugation between them that, on the one hand is looking for economies of scale and growing paths and opportunities and, on the other hand, allows its clients to customize the burger asking for well done, medium or rare, within other co-creation possibilities, including a service logic and a differentiation perspective even if developed under the auspices of fast food ("not so fast food" or "fast food gourmet")?
- Will the "hamburgerology" science developed by *h3* be able to survive the latest trends in the business? how can *h3* create the necessary conditions to survive, grow, and be successful in every market they decide to go into, if indeed the global path is their aim as seems to be the case? How can they do it?
- What competitive advantages have they already been able to attain and which ones will they be able to attain in the future? Should these be based on resources and/or competencies? Or both? What are the critical success factors here?

One thing is undeniable: the Bloomberg TV channel showcased a story on *h3* in early March 2012, and they were not short on the accolades and generous applause of the organization and its achievements. David Tweed's report described *h3* as a fast food restaurant chain with a gourmet touch and accessible prices. Additionally, the reporter praised the quick internationalization approach without the need for bank loans particularly in the context of the current economic situation into which Portugal has been submerged for some time and in which it will remain until it can do something about its real economy of production of goods and services, and that included (and already includes, to be practical) the institutional intervention of the IMF, ECB and European Commission.

Andrea Smith wrote on the 14th April 2009 in "*Catavino*" (an online newspaper specializing in Iberian wines since 2005): «To be honest, it was a surreal experience to dine at *h3*. After 24 years living in the USA and countless experiences eating burgers of all types (including McDonalds of course, guilty as charged), I would never imagine *h3* to be the best burger experience I´ve ever had to date! So, watch out America, you´ve got some serious competition coming your way!)

5. Conclusions

To have started a new business in the latter half of the last decade was by all accounts a bold move even for the most tried entrepreneur and few would even dare to consider such a mammoth undertaking in those circumstances. With the crises of the financial system looming in the horizon and the more than likely ramifications and spreading of the financial crises onto the real economy of goods and services, the *h3* concept had to be sufficiently different, and more to the point, consumers had to see it that way.

In order for the business concept to achieve a modicum of success, and if the intention was for it to remain a going concern into the future, h3 had to find a unique angle, a worthwhile singularity in its value proposition, and more important, it had to ensure that the consumer would perceive it that way. In achieving success they would have to create a valuable distinctiveness in their overall offer and that meant a well thought, designed and implemented differentiation strategy, concurrent with a cost structure kept under extremely tight control. Is *h3* the fast food example of a value co-creation business experience? Is it possible to sum the necessary growth of the business model with the customization and value co-creation opportunity that h3 allows to its clients?

It can be argued that there are mixed feelings as to the outcome of this remarkable entrepreneurial endeavour. They did successfully manage to differentiate their overall offer not only in terms of product but also in the better service that they were able to provide. They opened a number of outlets in Portugal and they were successful in achieving economies of scale in their operations. However the present macroeconomic context and the particular sector of activity in which *h3* operate is characterized by an intensely competitive business environment.

Emerging competitors make them pay very careful attention to their cost structure and margins are squeezed under these circumstances. In fact should they wish to make any money at all, the hard-nosed focus needs to be put on their cost structure and how to permanently drive it down. In the light of this, it is very difficult indeed to free much needed financial resources that would be key in establishing the kind of differentiation they require to stand apart from others in this most crowded of environments. An additional concern is that gourmet foods have become a bit of a fad with other players coming into the market, thus increasing the complexity of the situation.

h3 went upmarket. Upon first scrutiny this was a good idea, and they did it fully convinced that they had tapped into an untapped niche of the fast food business. In so doing they understood the need for relevant differentiation and they inscribed this into their value proposition by providing high quality products at reasonable prices and allowing customization. However what started out as a niche segment soon became a very crowded and much sought after slice of the restaurant business.

On the other hand, the basis for their competitive advantage, that which sustained their overall differentiation strategy, although product based and thus susceptible to imitation contains a certain number of elements of service that are inexistent in fast foods: customization possibilities and mixing ingredients to make a unique and proper meal. They have tried geographic diversification, and went over to Poland and Spain, from where they exited soon after. Brazil was another delving into the international markets. Here they were found not to quite cater to local tastes and aesthetics. In Brazil the momentum is appropriate to quick expansion and the first battles are over. Brazilian people have already accepted the different fast food approach: the gourmet approach to burgers.

It is still early days and way too soon to call it curtains. It is conceivable that judging by past record, top management at *h3* is only more than capable of turning the tables on what are difficult odds. If they do, they will be pulling a remarkable coup, a gutsy move, and one of unprecedented worth in the history of Portuguese retail.

The future for *h3* is a very difficult call. One of the expansion possibilities is the Asian market. Also because Yum! Brands (KFC, Taco Bell, Pizza Hut, LJS and A&W) are facing huge challenges, as they are question marks everywhere across Asian markets (Business Monitor International, 2013, Asia Pacific Food and Drink Insight, 2013) and *h3* has some characteristics that, despite of intense rivalry amongst competitors, fit well in with the entrants analysis (MarketLine Industry Profile, 2012), namely in terms of supplier potential base and a value proposition that may clearly avoid a price war, namely when presenting service elements that are powerful weapons.

Given the Portuguese connection there are certain obvious ports of call for the organization, including Macao and its wealthy upper middle class. Macao could easily lend as an expansion platform to the very appealing markets of Hong Kong and even perhaps mainland China where Shanghai given its recent mammoth development presents wonderful opportunities as a market that upon first inspection looks to be in tune with the *h3* ideology and value system. China has all around huge potential and if only 15% of the Chinese population will in 10 years have a disposable income somewhere in the region of the European average, this means a market of circa 200 million people with serious money, and willing to try foreign customs and tastes dressed in a form of cosmopolitan gastronomy that the Chinese are only too willing to get a taste of.

The Chinese market is by all accounts therefore an appealing proposition. Malaysia is another serious possibility not only because of the growth potential of this country, but once again due to the cultural connection between Portugal and in particular the city of Malacca, where the Portuguese arrived in 1511, and where to this day there remains a Portuguese settlement, a kind of cultural enclave bearing testimony to the possibility of adaptation and respect for local customs and idiosyncrasies, a living witness to people cohabitating in peace and harmony. What better metaphor for celebrating harmony between the peoples of this world than gastronomy?

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