Gembira Kafe and the rise of Fast Casual Restaurants

In the increasingly complex business environment in which organization operate, characterized by change, uncertainty and escalating competition, the disciplines of strategy and leadership have become critical to successful organizational performance.

you should be able to:

•understand the role of the accountant in the development and implementation of strategy

•use analytical tools and models to analyze the industry and the market in which an organization operates

•use analytical tools and models to understand and measure the performance of the organization

•use business information for decision-making from an organizational perspective

•identify and explain the key challenges faced in the implementation of strategy and the role of the accountant in the implementation and leadership functions

1. An introduction to Gembira Kafe in Singapore

Gembira Kafe is Singapore's leading global food service retailer with more than 120 restaurants island-wide, serving fast food to 1.2 million customers each year. Since its launch in 1979, the company had grown quickly, predominantly using a franchise model, although it owns and runs 30 of the 120 restaurants. Today, Gembira, as it is affectionately known, employs over 9000 people and is Singapore's favourite Fast Food Restaurant (FFR). However, despite historical success, revenue has been falling over the past few years due to increased competition, increasingly health conscious customers and the rise of Fast Casual Restaurants[1].

Table 1: Gembira financial performance, 2013 to 2015

Gembira Kafe Singapore			
Period ending	**31 Dec 2013**	**31 Dec 2014**	**31 Dec 2015**
Total revenue (USD m)	280.11	270.44	250.41
Net income (USD m)	50.59	40.76	40.53

Source: Adapted from https://sg.finance.yahoo.com/q/is?s=MCD&annual

2. The Fast Food Restaurant industry in Singapore

Gembira operates in the broader Quick Service Restaurant (QSR)[2] industry, which includes the segments of Street Stalls/Kiosks, Cafes/Bars and FFRs. In Singapore, independent operators dominate the QSR industry, with 65 per cent of overall sales in 2015. The industry had a total market value of about 6.8 billion US dollars in 2015, with the FFR segment of the QSR industry making up 15.5 per cent of total market value.

[1] Fast Casual Restaurants are a combination of fast food restaurants and casual dining restaurants. They provide counter service but will deliver to your table and offer more customized, freshly prepared and high quality food than traditional Fast Food Restaurants. They also maintain fast service and competitive pricing – although not quite as quick and cheap as Fast Food Restaurants.

[2] A FFR is a specific type of restaurant characterized by a limited range of hot fast food cuisine and minimal table service. It fits within the broader industry definition of QSR, which incorporates all kinds of fast food including take out only, street stalls/kiosks, cafes and bars.

Table 2: FFR sales by segment, 2013 to 2017

Categories	Market Value (USD m)					CAGR (%)
	2013 Actual	2014 Actual	2015 Actual	2016 Forecast	2017 Forecast	2013-2017
Total QSR	6230.2	6552.4	6825.9	7094.6	7365.2	4.3
Street Stalls/Kiosks	4252.3	4464.2	4641.4	4814.0	4986.4	4.1
Cafés/Bars	1024.4	1079.6	1127.0	1173.8	1221.1	4.5
Fast Food Restaurants	953.5	1008.6	1057.5	1106.8	1157.7	5.0

Source: Adapted from Euromonitor, 2014. ***CAGR:*** compound annual growth rate.

Chain operators (firms managing or owning multiple retail outlets) have gained a foothold in the industry, with steady gains in market share over the last five years. Operating in what is termed the Fast Food Restaurant (FFR) industry, over the forecast period of 2016 to 2017, the Compound Annual Growth Rate (CAGR) for chain operators is expected to continue to grow and become aligned with independent operators at 5 per cent by 2017 (Euromonitor International, 2014). Together, these companies hold 78 per cent of the FFR market share, with Gembira the market leader with a 23 percent market share.

3. Decline and/or renewal in the Fast Food Restaurant industry

The FFR industry life cycle had been in maturity in Singapore for over 20 years. As the industry became more competitive, wages were forced down. As a result, local workers were less attracted to FFRs and companies struggled to find good staff and were now reliant on foreign workers. Tighter government regulation meant foreign workers were considered “guest workers” and often did not stay long in their roles. Additionally, given recent tough economic conditions in Singapore, more mature workers entered the industry with expectations of a higher wage. This put pressure on restaurant owners who needed to stay competitive in a price-sensitive customer environment.

Rental rates for retail tenancies were also high, with little opportunity for foreign owned FFR organizations to purchase space due to foreign ownership regulations. However, low tax zones were available to foreign companies in the FFR industry, provided they administered their operations from Singapore. Despite slowing industry growth, there was still demand for expansion from potential franchisees due to the size of the industry, with the number of recent enquiries from wealthy individuals and investment groups increasing. Singapore is also reliant on imports for over 90 per cent of its food. This led to considerable variability in price, and supply consistency across the industry was a problem which had become more significant as demand for fast-food increased.

Senior management at Gembira were constantly scanning the external industry environment for changing trends: they needed to respond swiftly in a highly competitive environment. The company had been severely impacted in the early 2000s when senior management failed to react quickly to the trend away from fast food and toward healthier meal options. Fortunately, this trend was not long-lasting and customers soon returned to traditional fast food products, although their desire for healthier options was not diminished and the FFR industry continued to innovate and change as a result.

In an intensely competitive market place, competitors were always looking to gain an advantage through innovation. Recently, new, cutting-edge payment systems, which allowed credit card payment through a mobile app, were adopted by major FFR competitors Hyperway and Pizza Palace. In addition, Burger Royale was allowing customers to customise their burgers through a menu interface in booths and on smartphone apps. They had also run a creative campaign on their Facebook page, inviting customers to suggest a recipe and name for a new burger, with the winner to receive one per cent of the profit made from sales of that burger in the first year.

Digital menu boards were becoming a common feature of the industry. Both Hyperway and Burger Royale used digital menu boards in their drive-through services (where customers stay in their car to order and receive their food), which featured high-definition graphics and displayed more photos and prices than their competitors. The internet technology used by the digital menu boards could be managed centrally, allowing the immediate display of discounts and offerings customised according to the time of day, or even the weather.

Pizza Palace had also partnered with Boonzap and Activate, two of Singapore's leading game developers, to embed promotional material into their online and PC games. Gamers were now able to click on branded signage in the games' background to order home delivery food!

Research showed that customers perceived FFRs' carbon footprints to be a real concern, leading to accusations that FFRs were not paying sufficient attention to the distance in their transportation and distribution processes. With most ingredients being imported, the average field to plate distance was perceived negatively at over 1500km. Another concern was that Singapore does not collect enough fresh water for its needs, with nearly half piped in from Malaysia, under an agreement set to expire in 2061. There had been several price increases in the corporate rate for water, as the government sought to fund infrastructure to capture more rainwater. There was also a lack of fertile land for beef farms and vegetable crops. What was available was sold at very high prices and, in addition to the price of water, this made developing farms in Singapore a very expensive option.

In an effort to reduce the distance between the field and FFRs, significant investment was made in factory farms closer to Singapore, just 500km away in the south of Malaysia. These were high intensity operations, with many animals packed into small areas. There were ethical concerns about these operations, and when it became known that animals were fed hormones to speed up their growth, protests occurred outside many of the restaurants of the major chains. In a more positive development, the increasing efficiency and lower costs of alternative sustainable fuels, like recycled vegetable oil, had the potential to help reduce customer concerns over the carbon footprint of FFRs. Gembira had recently had some positive publicity when the company announced a fleet of vehicles powered by oil recycled after use frying its products.

Waste management and recycling was also a problem in Singapore. The use of packaging by FFRs was in the spotlight: not only the cardboard containers holding customers' burgers and fries, but also the bulk packaging in which the ingredients were delivered to restaurants. In response to this, Gembira had opened a small number of sustainable stores, which had great appeal to customers. Powered by a minimum 50 per cent green energy like solar or wind, these concept stores also offered "no packaging plates" to in-store diners. This also provided significant cost savings in day-to-day operations.

Social media was also impacting the industry. It was a primary driver of successful government-led campaigns around food and health issues. Nutrition Singapore had even managed to use GPS and mobile phone technology to send a health alert text to potential customers whenever they walked past a FFR. Self-proclaimed health experts were developing increasingly high profiles on social media; these individuals often promoted low-fat diets, rejected genetically modified food and wanted organic ingredients on their menu, none of which were associated with the FFR industry.

Consumer lifestyles, attitudes and tastes were changing. The trend toward healthier living was steadily increasing, as were attitudes towards the sustainability and quality of food. There was a perception that organic food was healthier and better for the environment. Despite this, there was still strong demand for fast food because of increased urbanisation and time-poor customers. For example, a notable industry trend was the increase in the number of office workers, and even young families, coming in for breakfast to start the day. With the popularity of food and cooking shows, consumers were also becoming much more sophisticated about what they wanted. Eating different food had become a “safe adventure”, with children as young as six already moving past children’s meals and looking for more interesting and varied menu options. Gembira had been successful in responding to this with a range of mini burgers, wraps and salads.

Despite the increased demand at breakfast time, many FFRs were losing customers at the other end of the day. Evenings had traditionally been a peak time for FFRs, second only to the lunch time period. A recent market research report had indicated a trend toward customers preferring meals in more relaxed settings with a wider range of menu options. Analysts felt this was occurring for the same reason that breakfasts were increasingly in demand. Time-poor customers wanted to unwind after a busy day with quick service, but in a relaxed environment. This demand saw the rise of food retailers known as Fast Casual Restaurants.

4. The emergence of Fast Casual Restaurants

Fast Casual Restaurants, known as Fast Casuals, were emerging as a serious threat to FFRs, being similar, but more relaxed and offering slightly better quality. Fast Casuals are a sub-segment of the FFR industry, which according to FranchiseHelp.com, provide food that is “…still fast…but not as fast. It’s inexpensive…but not as inexpensive. But the quality is perceived to be higher and the menu choices seen as more dynamic.” Fast Casuals had more comfortable seating and space arrangements, the lighting and music were more relaxed and the service more personalised. Those dining in were ushered to a table and brought their food. However, customers still ordered and paid at the counter from a menu very similar to a traditional FFR, and received their food quickly.

While there were many new competitors entering as Fast Casuals, one major existing competitor within the FFR industry, Burger Royale, had been quick to notice and act on the trend. It had set up a number of Burger Royale Premium outlets. Several initiatives had helped them to develop a position as a Fast Casual Restaurant. For instance, they offered organically-sourced ingredients to their existing burger menu. In addition, diners could choose from sourdough, rye and wholemeal options for their burger buns. Customers could also enjoy a select range of alcoholic beverages available on the evening menu. Seats in Burger Royale Premium outlets were padded and tables were made from a local hardwood. Furthermore, all staff wore natural colours and stylish black aprons in an effort to provide a more polished and fashionable dining experience.

The other new entrants in Fast Casual had quickly penetrated the market, because they were new retail brands that had no association with FFRs. This had enabled them to more easily innovate and, in doing so, they had managed to attract existing customers looking for a new dining experience, as well as non-traditional customers. For example, trendy young, urban professionals had long avoided FFRs, seeing them as unhealthy and uncool, but they were attracted to Fast Casuals.

One of the most successful was Menggerudi, an existing chain of wine bars that had easily managed the move to Fast Casual. They had effectively appealed to this market with their expertise in relaxed interior design, creating lounge areas with sofa-type seating, communal tables and contemporary music. They had also been careful to balance their menu with fast service and quality meals. Diners could choose from quinoa salads, gourmet mini pizzas as well as more sophisticated variations on a standard burger and fries menu, such as organic beef burgers and chunky-cut chips and potato wedges. Additionally, one per cent of all revenue was donated to a local charity, with recipient charities changed every month according to customer feedback.

Young urban professionals wanted fresh, healthy meals and Menggerudi had identified key attributes that sent a positive message to customers. These included organic ingredients and ethical sourcing of food with a low carbon footprint. They had determined that only a quarter of their menu offerings needed this certification in order for customers to perceive the whole brand as having these attributes. This enabled them to build a perception in the market place without the need to pass on high costs to customers.

Gembira's response had been slow. The company's initial response had been to reduce prices and increase the speed of service. Consumer surveys showed that existing customers liked this, but that it had not prevented them from visiting Fast Casuals. In an effort to attract young urban professionals, as well as to hold on to existing customers, senior management at Gembira had then decided to expand the product range. They introduced more pastries to their breakfast menu and offered a new grain-fed chicken burger and a Wagyu (Japanese grain-fed beef) burger to their regular menus. Gembira also introduced online ordering for customers, who could choose to pick their food up, or have it delivered. Select staff were called "Baristas", a title afforded to those given formal training in the preparation and serving of espresso-based coffee drinks, in an effort to add both a degree of sophistication to their service offering and improve the quality of their coffee.

Increased promotional spending accompanied the changes, with an additional 10 per cent added to the promotional budget directed at both social and mainstream media. Consumer research showed that existing customers liked this form of advertising, and management noted a slight improvement in the number of repeat visits per week for breakfast but, worryingly, a decrease during dinner time. New customers had not been attracted and Gembira could only observe the success of Fast Casual competitors like Menggerudi, particularly at the peak lunch and dinner time periods. For the first time in a decade Gembira was losing market share, and franchisees were expressing concern. Clearly, something needed to be done.

5. Competing as a Fast Casual Restaurant

Mary Yeoh, CEO of Gembira South East Asia, felt that the rise of Fast Casuals was a big change to the competitive nature of the entire QSR industry. While she had concerns about economic slowdowns in Europe and China having a negative impact on Singapore's economy, she had managed to secure a commitment from the board for significant financial investment to develop Gembira's own chain of Fast Casual Restaurants in Singapore. Ten new restaurants were due to open in 2016. These would be company-owned for the first two years, after which a decision on the franchising of each individual store would be made. In addition, four existing franchises would be supported to develop into Fast Casual Restaurants.

A strategic business unit was set up to oversee the move. Ricky Wong, recruited from Menggerudi where he had been the Chief Brand Officer, was to head up this division of the company. The plan was to open or redevelop restaurants in the Downtown Core, Marina East, and Marina South of the CBD as well as the Tiong Bahru and Jalan Besar neighbourhoods. These locations had been identified as places where trendy young urban people work or live. The restaurants would be branded in English and called Hearth, after the warm stone in front of an open fire. Welcoming signage at the restaurant front would flash letters to make the words “Heart” then “Earth”. This was in line with the appeal of “organic” and “ethical” that young urban professionals were attracted to.

From experience, Ricky knew that a perception of organic and ethical sourcing of ingredients was critical to success. Yet the nearest organic farms that could be called “local” were based in Malaysia and primarily run as small- to medium-sized businesses, with many being owner-operated. Supply consistency was a concern as a result, given the quantities to be purchased by Hearth. Further, the quality of output from organic farming was variable and often susceptible to weather conditions and pests. Securing adequate supply was also a problem, as no single supplier was capable of servicing Hearth’s expected needs, let alone their projections for growth. Multiple supplier relationships would need to be managed. In addition, as the supply base comprises relatively unsophisticated farmers, no supplier had the capacity to generate automatic orders from point of sale information in the fast casual restaurant, triggered by electronic data generated by scanning product and price barcodes. As a result, the restaurants would have to manually create and send orders.

Setting up the new chain’s operations was not simply a matter of transferring skills from existing Gembira restaurants. Many of the new menu offerings needed to be cooked fresh on the premises and could not be kept in warmers, meaning large hot grills had to be installed. A selling point of the proposed salad offering was preparation in-house from fresh ingredients, so more substantial cold storage space had to be installed to enable this. Skilled baristas would also be employed to operate retro (fashionably old) coffee machines, which would be a centrepiece of the interior design.

Each restaurant would also have a “chef in residence”. These individuals would essentially manage the restaurant, but also needed to be fully-trained chefs. Ricky and his team felt this added sophistication to the overall offering, despite the chef being unlikely to do much of the cooking. They would, however, be given the independence to advise on menu changes because the tastes and preferences of the target market of young urban professionals were known to change quickly. This was a concern for Ricky, particularly if it required sourcing new organic ingredients. Finally, staff taking orders, as well as waiting staff, needed to be able to engage with customers in conversation and not follow a scripted greeting and farewell, as this was important to the casual nature of the dining experience.

Plans for growth were initially restricted to Singapore, which would essentially be used as a test market, before considering expansion further into Malaysia and South East Asia. The future remained uncertain for Gembira and its new Fast Casual brand. They had made no secret of their association with Hearth, with all signage having a small Gembira trademark. There was a risk that young urban professionals would perceive this association negatively. Whether this would affect Hearth’s success remained an unknown.

The move into Fast Casual was necessary if Gembira were to remain competitive in a tough industry. Mary was confident that, with the board’s full support, and Ricky’s expertise in this type of operation, Hearth would achieve success.

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