

h3 Gourmet

Not so fast food

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THE ORIGINS OF H3

The whole story started when three old friends decided to start a business in which they would invest their savings and further their professional experience.

This resulted in Café 3, an unconventional restaurant based on the supply of gourmet meals; this is a very popular concept among New York's best known chefs. Although a respected concept within a specific market segment, the business never reached the necessary sales volume to render it sustainable and so did not fulfill the partners' ambitions.

Café 3's gourmet hamburgers were soon the restaurant's best buy as they were prepared with much more care than other burgers and were presented with a label of quality and distinction.

The product was so successful that the three partners rejected the association between a burger and the plastic food bought 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.

These assumptions gave rise to the idea of converting a gourmet concept into a fast food restaurant. They had a number of some serious concerns, such as "Hasn't the fast food business reached maturity?", "Is there any space left for another burger

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restaurant chain?”, “How will we fight against the McDonalds and Burger King giants?”, “How shall we organize our enterprise in order to challenge these giant chains?”, “What are the management principles?”, “How can we assure quality and consistency in all the stores?”, “How can we motivate human resources with the low salaries practiced in food restaurants?”, “Is there enough capacity to innovate?”; nevertheless, the three partners decided to take the risk and create an innovative restaurant concept under the name h3 – Gourmet Hamburger.

The three friends based their project on a perfectly ordinary product, namely burgers, but introduced gourmet ingredients together with fast food components; the pioneering offer presented to the public was quite distinct from anything else in the market. The first h3 opened in July 2007 at the DV Monumental (Lisbon) and was rapidly followed that September by the inauguration of h3 in Amoreiras Plaza. Its immediate success made them realize there was potential to expand outside of Lisbon. By March 2012, h3 had 38 restaurants in Portugal; it had gone well beyond a simple venture by the group of friends and become a restaurant chain aimed at international targets. For instance, two stores in the Spanish market are managed in partnership with the VIPS group (brand exploring the following chains: Gino’s, The Work, TGI Fridays and Starbucks Coffee in Spain and Portugal). Both these restaurants are located in shopping centers in Madrid: Kinópolis de Pozuelo de Alarcán and Diversia Shopping Centre. In January 2011 h3 opened a restaurant in a Warsaw shopping center: Mokotow Galleries. The Polish restaurant is operated through a local partner under a franchise agreement; however, an investment of over one million euros was required from h3. Just as people order a “tuga” in Portugal, the Poles ask for a “proposz”. The brand also has two restaurants in São Paulo, Brazil: in Vila Olimpia and Morumbi Shopping.

FAST FOOD CONCEPT

This concept goes back many years; however, new fast food chains were developed in the 20th century that soon became very popular are now well-known, such 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).

H3 ONCE MORE

In an interview for the *Food and Solutions Magazine* in April 2009, one of h3’s partners stated that five lessons had been absolutely vital for the development of the business concept and enabled them to invest in this project, namely:

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

“We understand 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 restriction for the decision

“Fast food consumer goods are not directly dependent on the economic crisis, so the attractive price 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 center has to offer a varied and complementary range.”

(The results of 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 we idealized the h3 concept, we decided to choose quality in everything: 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 of New York and London 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 seen: no longer merely a portion of beef but a truly gourmet meal which could include a wide range of original and sophisticated combinations.

The partners were keen to create a new product from a mix of lessons and ideas from the greatest “chefs” which would be simple to conceive at the operational level but could also offer clients a wide range of food. The table presents the traditional supply of the biggest international hamburgers chains in relation to that of h3 (see p. 140).

One of the main aspects that differentiates the h3 concept from other direct competitors is its ability to serve a fast food hamburger meal on a plate, with cutlery

TABLE
Traditional vs. h3 supply

	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/cooking 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 <i>foie gras</i>
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 <i>coulant</i> , ice-creams <i>everyday</i> or <i>holiday</i> , with chocolate, raspberry <i>coulis</i> , caramel or sweet eggs
Target	Juvenile and child	Demanding adult
Image/colour	Traditional fast food/red	Fashion and gourmet/blue and <i>bordeaux</i>
Concept	American	Portuguese

(knife and fork). In fact, this reflects Portuguese culture since there is a strong preference for knife and fork meals in Portugal. However, people have different eating habits in other countries and so this is not so important in other countries. Although this may be an obstacle to entry in other markets, h3 partners believe 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 is a simple hamburger.

THE H3 PRODUCT

The products offered by h3 are the basis for the enterprise's success.

The h3 menu includes a hamburger with Thai rice and/or fresh fries. They have 10 different menus with a variety of ingredients, namely: Grilled, with Sauce, Champignon, Tuga, Benedict, Cheese, French, Mediterranean, Milano and Super

bread. Fresh spinach and salad with vinagreta are available as extra accompaniments (or side dishes). As for drinks, lemonade and iced tea are available as well as the usual industrial drinks (Coca-Cola, Sprite, Fanta, a glass of beer or wine). Profiteroles were initially on the menu for desert, but have since been replaced with ice cream: – everyday and holiday – and chocolate coulant.

Mention should also be made of the fact that originally coffee was not served in the h3 restaurants in shopping centers as it was not part of their core business and there are always many quality coffee shops in these centers. However, coffee has become an acceptable complement and is available as an option, because of its unitary contribution to the overall profit margin on each meal.

H3 COMMUNICATION

h3 opted in favor of directing most of its marketing budget to internal rather than external communication. They also strongly believe in the word-of-mouth as a communication weapon.

Most external communication with the consumer is made on-line through their site (www.h3.com) and a strong presence in social networks like Facebook so as to present all the products and keep the target public up to date with the latest news.

Periodically, the company also does publicity focused on a specific region so as to announce the opening of an h3 restaurant in a new city (not only in Lisbon and Oporto but also all over the mainland, Madeira and the Azores) and/or shopping centers. The company opted not to invest in publicity in other media such as newspapers or TV.

h3 partners acknowledge that their employees are keys to their success and therefore “It is very important that they may feel they are part of a valuable community, that they contribute to the image of the brand and that they wish to be our face, since they are effectively h3 ambassadors” according to one of the partners. “Our employees are part of the organization and take great responsibility for the marketing”. As a result, the investment in internal communication and professional training has become a central issue and aims to ensure that employees are both happy and proud to work at h3. This should impact the clients as soon as they order the meal. But, and there is always a “but”, “how do these employees exercise their creativity? And how can these people on very low salaries feel ‘richer’?”

A communication 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 from 13% to 23% at the beginning of 2012. This involved a “Tuga Resists” document explaining to clients that the price of the burgers would rise due to the increase in tax. Simultaneously, the “Tuga Resists” card was also launched that said “I am going to eat the VAT”; after each h3 burger, the client’s card would be stamped and after accumulating a total of 9 stamps i.e. 9 hamburger meals, the client was given the 10th meal, thus compensating for the VAT previously charged. This means that h3 took advantage of the VAT increase to create a fidelity campaign.

At the same time, the brand took advantage of this publicity campaign to reinforce itself as an international brand, stressing that its Portuguese suppliers have been growing by accompanying the company’s internationalization.

H3 PRICING

The h3 pricing strategy is to offer a high quality fast food meal, thus creating a value for money proposal that optimizes the price-quality ratio. As a consequence, its products are slightly more expensive than those of their direct competitors. The prices on the menu range from €6.75 to €10.5. Deserts vary from €2.10 to €3 and therefore increase the final price of the meal significantly.

The pricing of products at higher levels than competitors is due to the brand strategy of potential differentiation. The purpose of this policy is to justify not only the type of products on the menus e.g. foie gras, fresh mushrooms or Port wine, but also the image they wish to convey i.e. a higher value offer than that of the competition.

H3 DISTRIBUTION

The ingredients for h3 products are distributed directly to the stores all over Portugal (and also in Poland, Spain and Brazil) and the hamburger meals are offered as a finished product in the h3 restaurants. In addition, the products are distributed indirectly through home deliveries outsourced to another company.

The layout of the restaurants is adjusted to three formats in accordance with the space available for cash registers and the frontal length of the unit: Perpendicular queue (Amoreiras Plaza store), Parallel queue (single queue, as in Saldanha Residence) and Double queue (case of Dolce Vita Tejo and Monumental).

One of the company’s main concerns when defining the layout of each store is to keep the clients’ waiting to a minimum as the clients must hold their tray until they are given the meal. The average waiting time per client is around 30 seconds but the record time

of 17 seconds has already been reached! However, the time varies greatly from one restaurant to another and this process is not yet adequately controlled. At the end of 2011, the company announced that it had gone from 170 to 200 meals per hour per shop in the Colombo, which no longer has a single queue, and Chiado restaurants in Lisbon. On the other hand, this meant that 3 extra people had to be hired for each crew.

Response time can be considered a critical variable since h3 goes from periods of peak demand to very quiet periods when it is difficult to make best use of the available human resources: lunch and dinner time must be optimized. Although restaurants like McDonalds, for instance, also have peak times, they have customers every hour of the day and night (in the stores opened 24 hours per day) so are quite different from h3.

It is therefore easy to understand why quick service is fundamental.

However, the group strategy may be conditioned by the possibility of customization. Some are peremptory when stating that this possibility of customization is a determinant influence in the development of the process and will mean the group must make some adjustments to its previous outlined strategy.

Initially, the lack of space in the large shopping centers together with a still unknown brand were obstacles to placing h3 restaurants the best centers as it was hard to convince them that h3's presence would be advantageous to both parties. Indeed, although they have managed to open a street restaurant in Parque das Nações, it has still not been possible to place a restaurant in the Vasco da Gama center which is (one of the best locations in Lisbon with the largest turnover of people per square meter. However, things are improving thanks to h3's success and they now are placed in Portugal's most important shopping centers e.g. Colombo Shopping Center, Cascais Shopping, Oeiras Parque, El Corte Inglés in Lisbon and Gaia, and Arrábida Shopping.

h3 is now also exploring the possibility of opening street restaurants in town centers. This is in a development phase and two have already opened in Lisbon: in Parque das Nações and in Chiado, the historical part of Lisbon. This new model has been accompanied by some new products on the menu (more deserts and extras) due to the special characteristics of a street shop and from the need for more diversity.

Despite all the success, there are also some constraints at both the logistic and the strategic level. Additionally, some clear constraints can also be seen at the organizational and human resources levels.

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.

H3: THE FUTURE

h3 currently has around 600 employees, 38 stores in Portugal (10 of which under franchise agreements with João Ventura in the North of Portugal), partnerships with local companies for their international operation in Brazil, Spain and Poland and a turnover of over 22 million euros (data from 2010) after just 4 years. Its future depends on developing economies of scale and expanding the shops both internally and externally and/or consolidating growth and improving the process despite slowing down.

So far margins have been positive and this has allowed the h3 chain to launch itself quite quickly using little capital from outside the group. However, it is important to remember that Portugal is going through an economic crisis and recently received a bailout package from the troika. Available income has decreased and this will continue over the coming years. Assuming that h3 continues to invest in quality, it must be recognized that current prices may make it impossible to attract the necessary demand to maintain profitability.

Experience has demonstrated, for example, 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, but also to different eating habits. It is also known that 33 of the current 38 restaurants were launched before the end of 2010 and that the growth in Portugal in 2011 and 2012 is down. Only two stores have been opened in 2012: one in Spain and another in Brazil. Can the national market sustain further expansion and more prospective investments abroad?

At least four main issues are raised: a) can a food restaurant chain expand in such a short time and remain consistent in terms of its food products, operations within stores and supply, professional training and work specifically in terms of the “hamburger grill” (the most important rule at h3 professional training school is: “you shall not crush the hamburger!”); b) what strategic path can a food restaurant chain based on a fast food logic follow and why?; c) will the “hamburgology” science developed by h3 be able to survive the latest trend – creating conditions to survive, grow and win in various markets and go global? How?; d) What competitive advantages have they already obtained or will they be able to obtain in the future? Should these be

based on resources and/or competences? Or both? And what about critical success factors?

One thing is certain: the Bloomberg TV channel presented a story about h3 in early March 2012 which gave it great praise. 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 without the need of bank loans and, in particular in the current economic context which includes the financial aid program of IMF, ECB and European Commission.

Andrea Smith wrote on 14th April 2009 in "Catavino" (an on-line newspaper about 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, I admit!), I would never imagine h3 being the best burger experience I've ever had to date! So, watch out America, you've got some serious competition coming your way!».

