

Case Study 1: KFC in China

Hsiao-Pei (Sophie) Yang

Introduction

In China, Yum! Brands, the parent company of Kentucky Fried Chicken (KFC), are opening a KFC store every day. Utilising a different strategy compared to other Western fast service counterparts, KFC has become the largest restaurant company in mainland China. KFC outpaced its nearest competitor, McDonald's, by more than 1,000 restaurants in China and is outpacing its development by a roughly three to one [1]. The US chicken giant adapts its Western business model in Chinese market through acknowledging the social and cultural differences. KFC realised that the US fast food model needs to be adapted because China's culture is not individualistic which is the characteristic of the US culture [2]. Therefore, it is necessary to combine the US fast food business model and adapted them to serve the needs of Chinese consumers.

China and Chinese Customers

In late 1978, China began implementing economic reforms to develop and modernise its economy. The economic reform opened China market to the outside world and improved the living of average Chinese people. A socialist market economy was adapted by the Chinese government to lessen the government's control of the economy, allowing some aspects of a market economy and encouraging foreign investment. Since then, income levels in China have been rising steadily as the country's citizens reap the benefits of its economic growth. A big challenge, however, for companies like KFC is that Chinese diets are changing quickly as incomes improve. Currently, there are more than 300 million middle class in China, creating significant long-term demand for restaurant brands and encouraging rapidly new unit development in the restaurant sector [1]. The rapidly rising income level increases Chinese consumers' spending power, and in turn drives market growth for companies operating in the country. Consequently, China is now KFC's fastest-growing and highest-margin market [3].

China has become the highest-growth market of KFC through its unique CHAMPS strategies that stands for "Cleanliness, Hospitality, Accuracy, Maintenance, Product Quality, and Speed" and by demonstrating its understandings of Chinese culture. Research of the behaviour of KFC consumers in China and USA found that the Chinese customers showed more positive brand impressions towards KFC than their American counterparts [4]. Interestingly, Chinese customers ranked the KFC higher than their American counterparts in areas like furniture, décor, cleanliness of restroom, healthiness and freshness of food. Furthermore, Chinese customers suggested that efficient, courteous, and nicely dressed service personnel and attractive and well-done advertising contributed to its positive brand impression of KFC [4]. Due to the positive brand identity, Chinese customers are more apt to eat within KFC restaurants and spend more time doing so than the American counterparts.

The Foreign Fast Food Market in China

A recent Mintel report (2012) suggested the total amount of foreign fast food [5]. Moreover, 44 % of Chinese consumers said that they plan to spend more on fast food in the coming year. Therefore, the potential for the foreign fast food sector in China is clear. Actually, the market for foreign fast food in China has seen steady growth over the past 5 years, as Chinese consumers have incorporated it ever more into their lives and culture. China's foreign fast food sector grew at a compound annual growth rate (CAGR) of 19 % from 2006 to 2011 to reach a market value of RMB 75.1 billion. And there is further good news for the market for foreign fast food in China, as Mintel forecasts the sector to increase to RMB 171 billion by 2017. China's fast food sector has recorded double-digit annual growth since 2003. The market was estimated at US\$303 billion in 2009 and forecasted to reach around US\$450 billion by 2014. Furthermore, the number

of outlets, chained and independent, is expected to increase to 71,964 outlets by 2017, up 39 % on the expected number for 2012 [5]. In terms of competition, KFC and Pizza Hut, both owned by Yum! Brands, are still ahead of McDonald's in China. KFC has the highest number of outlets in China, while Pizza Hut remains China's number one casual dining chain [6]. However, McDonald's, with more than 1,000 restaurants in China, is investing 18 H.-P. (Sophie) Yang heavily to catch up with Yum! Brands. Specifically, McDonald's plans to "re-image" about 80 % of its stores by 2013, which will involve European and Australian designs, comfortable seating, warmer colours and amenities such as WiFi.

KFC Adapts Its Strategy in China

KFC opened its first restaurant in Beijing in 1987. Owing to its successful localisation strategies in the China market, it has over 3,700 stores [7] in 700 cities in China and is becoming a good example of cross-cultural marketing of multinational enterprise. KFC's adaptation in China is discussed next to show how the US business model was altered in China.

Menu Adaptation

KFC China aims to be part of the local community and not be seen as a foreign company and it reflects on changing the original Western menu to suit Chinese tastes and preferences. Chicken is a familiar choice of food in China which is much cheaper and more widely available than other forms of meat, such as beef. However, in order to change the menu according to the Chinese preferences, KFC largely increased its menu items in China. Actually, KFC China's menus typically include 50 items, compared with about 29 in the US. The extended wide range of product offerings in China include items such as spicy chicken, fried dough sticks, porridge, sesame seed cakes, egg tarts, soya milk, and other items that tailor to the tastes of specific regions within the country, such as wraps with local sources or fish and Shrimp burgers on fresh buns. For example, KFC introduced rice dishes in Shanghai before selling them in other branches [8]. The company also introduces about 50 new products a year, compared with 1 or 2 in the US [9]. To counter concerns on fast food and obesity as it is now in the West, KFC China offers a healthier menu and has completely eliminated supersized items.

From 2005, the company developed "new fast food" concept, focusing on nutritious, balanced and healthy living diet. The product items added to its menus include roast chicken, sandwiches, fish, shrimp, and more fruit and vegetable dishes. Furthermore, KFC's children meals are served with vegetable and juice, while fries and soda can be substituted on request. Due to the extensive menus offered, it requires more staff in the kitchen area. Therefore, KFC China cannot position itself as the cheapest dining option. Also, China's inflation rate has hovered above 5 % in 2011, driven by the country's speculative real estate market and soaring demand for commodities [10]. Due to the pressure from food and labor inflation, the company raised prices in China in 2011 and 2012 to help offset higher costs for food and labor and to bring margins up to around 20 % [11]. KFC China increased prices on a number of its popular menu items, including prices on chicken dishes, drinks, and burgers in order to battle soaring business costs. In average, customers spend the equivalent of \$2.50– \$3.50 per visit to a KFC in China [9].

Distribution Adaptation

In China, multinationals normally focused on first tier cities, where their global brands attracted mid- and high-income consumers with an interest in western lifestyles. However, growing competition in first tier cities resulted in a growing focus on lower tier cities, particularly from KFC China. In 2007, KFC notably introduced lower franchising fees for second and third tier cities, with the chain subsequently expanding more rapidly in these cities [12]. Following that, KFC embraced smaller cities and build a national business with outlets all over the country. As Chinese government restricts direct foreign investment in early days, KFC China utilised a franchise model. However, when the country becomes more receptive to wholly owned foreign

enterprise, the company switched to a strategy of company-owned outlets, which allows greater control compared to the franchising model [9]. KFC China sources food from within the country whenever possible. This is not an easy task in the early stage, when the supply chain system for chicken isn't well-developed and multiple vendors provided only a handful of birds each. Despite of the highest population in the world, compared to the West, the supply chain in China is still unsophisticated, aboriginal, and relying on small food processors which are inefficient and lack of technology for mass production [13]. As food safety is a big concern for Chinese consumers, KFC China made a big decision to build the supply chain from the ground to help ensure quality. Despite of the huge investment involved, such decision is necessary if the company was to expand rapidly, carry a lengthy and complex menu, and introduce new products quickly [9]. Furthermore, in order to broaden the reach of its brand, KFC China offers delivery services in more than half of its restaurants. In average, KFC is opening about 450 new restaurants in China per year, and half of them among those offer delivery services [14]. According to Yum! Brand Chief Financial Officer, Rick Carucci, KFC aims to have more than 2,000 new KFC restaurants in China that will offer delivery over the next decade. KFC also adapts the delivery format in China. Unlike the drive-through format operated in the West, KFC delivery drivers ride red motorbikes on streets in China, equipping with similar heated boxes, who charges a flat fee for delivery. Thanks to the technology, online orders now account for about 40 % of the delivery orders for KFC China. As a result, KFC China plan to stop building call centres in the future as the numbers of customers buying online are increasing. Furthermore, Chinese customers tend to order more food online because they don't feel as rushed as they order by phone [14].

Training Adaptation

The extended menu means that food preparation is more complex and requires more staff in KFC China than in US. KFC China typically employs 60 people in a restaurant, which is nearly twice as many as in the US [8]. To maintain its current restaurant-opening rate, KFC needs at least 1,000 new managers and 30,000 new crew members a year. In terms of personnel recruitment, the strategy of KFC China is to hire local management. They hire Chinese managers who read and speak the language, which understood the restaurant business and Chinese consumers but also have had Western business experience [2]. Still, teaching employees how to interact with customers is a challenge, as one-child policy and the wide usage of home PCs mean that the younger generation in China interacts less with others than their parents' generation [2]. KFC adapts to the working needs of those young employees, as many are college students working their first job. For example, young employees are encouraged to socialise over company provided video games on their breaks. This practice serves several purposes: it eases the minds of parents anxious about sending their children out into the world, provides crucial social skills for young adults who grew up in single-child households, creates lifelong Yum! Brands customers, and develops a culture of customer service in a country where there was none [2].

The Road Ahead

Despite its huge success in China, KFC China is facing a typical corporate dilemma. They are more capable to improve and make changes within current setting than to take entrepreneurial approach to start new type of business. For example, Yum! Brands, the KFC parent company, started a Chinese food brand named "East Dawning" from 2006, but it was not as successful as expected. Compared to its rivals, KFC China is taking a radical approach, which is also a more interesting road. When the competition is timid, it will continue to enjoy success. However, with an extended and complex food menu in China, the long term evolvement of KFC China is obviously challenging. It risks brand identity, operation simplicity and long term development in exchange for hypothetical larger consumer base and more revenues in order to meet its fast expansion [15]

Questions

1. Discuss Chinese customers' consumer behaviour in selecting fast-food services and evaluate the potential of the China market for the foreign fast food chains.
2. Evaluate the suitability of KFC's approach to amend its menus largely in China.
3. Examine the distribution strategies of KFC China. What are the pros and cons of its approach in opening stores in second and third tier cities in China?
4. Discuss the training adaptation of KFC China. What challenges does KFC face in China?