Yum! China Case Analysis

Yum! Brands China, a division of the Yum Brands Company, is a fast food restaurant company that owns several restaurant chains such as KFC, Taco Bell, Pizza Hut and Long John Silvers overseas. Yum! China first opened its KFC in Beijing in 1987 and over the years has successfully expanded its operations and other chain restaurants throughout Mainland China, becoming one the largest fast food companies in that region. Seeing the success of Yum! overseas has spawned other western chains to open up in China. With growing competition from Subway, Dairy Queen, Starbucks, McDonalds and Burger King, Yum! China has been able to successfully manage the pressure and increase their presence in China.

1. What were the special challenges in business environment that Yum! had to overcome in the 1990’s to develop its business in China?

When Yum! started its operations in the early 1990’s the company has barriers to overcome in launching their operations in China. Yum! had to get through the government restrictions, handle their missteps in advertising, invest in a supply chain, expand company growth, organize a team, and contend with ownership.

Government - When Yum opened restaurants and wanted to expand faster, the company had to follow regulations imposed by the government. At that time, government was more interested in bringing in foreign companies that could bring technology into China. That changed when the Deng Xiaoping, a Chinese leader said “China was moving too slowly. We should open up the rest of the country”. As a result, the demand for foreign investment rose in every city and province and government allowed for foreign enterprises to enter and grow.

Advertising – One of Yum’s first misstep in China was their advertising slogan. Their slogan “finger lickin’ good” did not sit well with many of the Chinese people. In fact, it put many people off and did not fully understand or appreciate the meaning of the slogan. To many, the concept of licking fingers was a turn off and was considered to be very unsanitary.

Supply chains – In the 1990’s China had no existing third party restaurant supply providers. Because Yum relied on food service companies, Yum had to find another alternative to stock their restaurants. In 1997, Yum established their own distribution company to ensure their network of restaurants was fully stocked. Yum also made sure that materials were coming directly from China whenever possible. They worked with local raw material suppliers to improve quality, ensure food safety and increase capacity. Yum also developed a supplier rating system called Supplier Tracking Assessment and
Recognition and this helped Yum to identify and purchase from the best performing suppliers, which lead to improved quality and low costs of goods.

Growth/Expansion - Yum Brands first started out under the ownership of PepsiCo. Since PepsiCo was strongly associated with beverages and not as a fast food company, there was no direction for KFC, Pizza Hut and the other restaurant brands. After Tricon was created and later renamed Yum, the expansion in China was one of the company’s main strategies and Yum wanted to be the best restaurant company, not just in China but also in the world. Their strategy was to be part of the Chinese culture and to be seen as part of the local community.

Organizing a local team – To realize their goal of expanding, Yum! Brands China CEO and chairman Sam Su looked for employees with prior restaurant experience and for them to be based in China. He believed that having a team based in China would serve the company better as oppose to trying to run operations from abroad.

Ownership in China – Government restricted foreign companies from operating without local partnerships at the time Yum! first arrived in China. To overcome this obstacle, KFC and Pizza Hut were owned through joint ventures with local businesses and started to franchise their restaurants in order to make their presence in China. Operating through joint ventures and franchising helped Yum to understand the operation practices in China and secure permission from the government.

2. **Summarize the key elements of Yum! China strategies, policies, practices and management approaches. Identify Yum! China competitive advantages; are they sustainable?**

Strategies:

- Build a nationwide restaurant chain/expand their businesses to other regions
- Assemble a team that is local to the region
- Partner with local businesses
- Invest in a supply chain
- Market/evolve their brand to embody local culture and integrate western culture as well
- Constant new product development and customize menus to appeal to Chinese tastes

Building a nationwide restaurant chain of Yum Brands restaurants increases their presence overseas. Their objective of expanding their brands was to be “rooted in China, be part of China”. In their early stages, the vision was to expand on multiple fronts and have their restaurants all over the country. Yum’s continued vision and efforts to expand in China resulted in over 3,000 KFC’s in 650 cities and about 500 Pizza Huts in 120 cities, making them one of the largest food companies in China in 2010.
Assembling a local team to run the business was important to Sam Su. He believed that in order to expand Yum throughout China, the team should be based in China. Running operations close to home eliminated the need of traveling from abroad to fix problems and provided a hands-on approach. Su also looked for employees who had restaurant experience, and knew how to speak and write in Chinese and those who understand the Chinese customer.

Partnering with local businesses allowed Yum to gain a market share in China's restaurant industry. Because government did not allow foreign companies to enter without a local partnership, Yum's first KFC and Pizza Hut were owned through a joint venture. In addition to joint ventures, Yum also sought out franchisees. Through these two operations, Yum was able to understand the operations of a business in China and expand their coverage in the region.

In 1997, Yum started its own distribution company as a result of the lack of third party providers in China. The distribution company helped to keep up the demands of the growing number of restaurants and Yum was dedicated to sourcing materials from China. Yum’s supply chain consisted of materials from local suppliers and the company worked closely with the providers to improve quality, guarantee food safety and increase capacity.

Marketing is always essential to promote the brand particularly in a new region. When KFC first opened its doors in China, it was seen as a western brand but overtime, their image became part of the culture in China. To achieve this, KFC evolved the brand through product localization and differentiated marketing. They also targeted customers of all ages to bring in more business and promoted a friendly family oriented restaurant.

Knowing that Chinese customers expect variety in their menus, Yum China was assertive in their product development. They would introduce between 85-100 products a year and new products would be sold as special promotions. Executives also were conscious about different consumer tastes. Many KFC menus had local items such as wraps with fried chicken and local sauces, chicken, fish, shrimp “burgers”, egg tarts, fried dough sticks and soy milk drinks. Any new product development catered to what people liked to eat and Yum has created several menu options for the varying taste preferences.

Policies:

Yum! China’s policies are straightforward and simple. Because Yum got their products from 500-600 suppliers, their policy is to buy locally and work with vertically integrated suppliers. In addition to working with local suppliers, Yum made sure that there were trained staff available for new restaurant openings and that staff was trained in the most extensive manner.

Practices:

With over 3,600 restaurants throughout China in 2010, Yum’s practices have helped the company grow since the early 90s. In KFC restaurants, design was very modern and was decorated with the KFC colors. Employees were well groomed and dressed well. Restaurants had hostesses to greet customers and the restaurant had enough seating and
was always kept exceptionally clean. In many of the KFC’s in China, the menu was extensive with about 50 items to suit everyone’s different palettes. The company also, overtime adjusted recipes to appeal to the Chinese tastes. KFC also promoted more of a sit in leisure restaurant. In China, the Chinese look at restaurants as regular restaurants where one goes in to sit and have a good time, while in the US, fast food restaurants are a cheap and fast place to go in grab food. KFC also employed about 60 employees in one store whereas in the US there are 35 employees in one place.

Management Approaches:

Management at Yum! China stressed the importance of learning in their company. There is formal training, coach and cross-functional committees for management development. One senior member said, “We learn from each other, make decisions together, reflect on common goals.” In addition to improving upper management, all restaurant staff was “trained extensively in Western service standards and the way restaurants are functioned.” By doing so, this ensured that customers would receive the highest quality of service.

Yum! China’s competitive advantage include their management approach, the vast number of stores, product differentiation in their menus, their own distribution company, staff members who know the region well and their continual effort in making new products to appeal to more customers. They have been sustainable over the last 2 decades. These advantages put Yum! China ahead of their competitors and have helped them establish a large market share in the country. They have successfully realized their vision of expanding and being part of the local community.

3. Identify the major similarities and differences between the strategies implemented by Yum! China and Yum! in the US. What are the risks and benefits in allowing such differences among subsidiaries of the same company?

Similarities of strategy between Yum! China and Yum! in the US include:

- Expansion of their restaurants
- Offering a traditional menu to its customers and also making sure the tastes suit local preferences
- Creating a family atmosphere in their restaurants either through dining in or take out

With the success of their restaurants, both Yum! China and Yum! US knew that the next step was to expand and open more restaurants throughout the country. In China, by 2010 there were over 3,00 Yum restaurant brands. In the US Yum! was placed on the Fortune 500 List placing at #216. Revenue for Yum! in 2009 was nearly $11 billion and their restaurant brands were leaders in chicken, pizza, Mexican style foods and seafood. Yum! also started to multibrand their restaurants by selling two or more brands under one brand.

In both China and the US, Yum restaurants offered the basic traditional items on their menus. For KFC, their menu included “original recipe” or “extra crispy” and also introduced new products such as chicken strips, popcorn chicken and wings. Keeping close with the
products of what helped Yum restaurant brands thrive helped their restaurants to become successful and recognizable.

Though Yum! US restaurants are highly focused on making their restaurants a family oriented place as they are in China, Yum Brand values the importance of creating a family atmosphere. For example, Pizza Hut introduced family sized pasta dishes to keep in tune with the culture of family dinner and being a family oriented restaurant. In China, the importance of family is highly stressed inside their restaurants and many Chinese families value the time spent inside restaurants.

Differences of strategies:

· Supply chain and attaining materials/products
· Product development/innovation
· Team members
· Business ventures with other partners

In 1997, Yum! China started its own distribution company because of the lack of third party providers in China. They made it their policy to source from China whenever possible supporting local providers. In the US, Yum! used third party providers to acquire materials. In China, they work directly with vertically integrated suppliers to ensure safety and quality.

Unlike the US, product development in China is always on ongoing. In one year, Yum! China would have about 85 to 100 new products each year, where as in the US there would be 2 new products. In China, the continuous effort in product differentiation is motivated satisfying varying customer tastes and keeping in tune with what customers want. As part of their innovation and product development, executives at Yum! China always asked “what flavors do Chinese people like?”

When Sam Su looked for team members to bring into the company, he wanted a team where employees were local and can understood the Chinese consumer. Yum! China also provided extensive training for their staff in order to provide the highest quality of service to their customers. In the US, restaurants are staffed with people of different ethnicities. There is a sense of diversity but restaurants in the US are not as focused as the ones in China to understand customers.

In China, Yum Brands restaurants operate with a lot of local businesses mainly due to government laws. In the US though there are partnerships through charities and non-profit organizations, the joint ventures and franchises are not as extensive as the ones in China.

Risks and benefits of allowing such differences among the subsidiaries is that it allows individual growth for each subsidiary and help to identify and understand the strengths and weaknesses of the two companies. With these differences, there are more opportunities to explore to see what works well for Yum! More bases are covered with these differences and the company is not restricted to follow what others are doing.
However, with such different approaches to strategies, there are always risks when two subsidiaries operate differently. Risks involve unwanted results such as customer decline, and unsatisfied customers. When companies approach a different route, there are no certainties that it will work. Companies risk losing their reputation and consumer confidence if the differences in how they operate are not successful.

4. **Analyze the company’s annual financial statements. Compare the China and the US financial situations for the year 2007-2009 in terms of revenue, growth, cost structure, etc. How successful is Yum! China? Justify your response.**

Yum! Brands revenue growth has been positive up until 2009. In 2007 their revenue growth reached 8.38% and in 2008 they were close to match the growth in 2007 with a rate of 7.69%. This could be due to the growing success of the Yum! China division. China was becoming one of the upcoming countries to do business. Their economy was growing faster than any other country and in China, Yum! was rapidly expanding its restaurants and gaining a bigger market share in the country. In the US revenue and growth rate was declining a little between 2007 and 2008 but before this and the economic recession in the US, Yum! US was still profitable and successful. However when the economic recession hit the US it affected the restaurant industry. Fewer people ate out and many restaurants declined. In 2009, Yum! Brand’s revenue growth declined by 4.32%. Though the recession hit harder in the US, there was a global effect.

Though the revenue of Yum! Brand fluctuated, the company did fairly well in profitability from 2007-2009. In 2009 was when the company saw its highest profitability at 9.88%. Yum! Brand was also able to continue to expand and open more stores from 2007-2009. Each year yielded around 2% growth and in 2008 the store growth rate was at its highest at 2.61%

When compared to Yum! US's financial performance, Yum! China has done exceptionally well. In China, the growth rate of revenue was always positive. Though there was a decline from 2008 to 2009, Yum China still managed to operate successfully and generate a higher income than Yum! US. In 2008 and 2009, the revenue for Yum! US was -1.36% and -14.73% respectively. The decline was due to the fact that consumers in the US stopped eating out to save money during the economic downturn. In terms of profitability for Yum! US, the profitability of Yum! China was greater than those of the US restaurants. In 2009 profitability for China was 17.78% and only 14.46% in the US. 2008’s profitability was 16.96% (China) and 12.49% (US). In 2007 profitability was 20.35% and 13.17%, respectively.

Yum! US was operating and expanding much slower than Yum! China. In the US, the comparable growth store rate declined by 36% in 2009 and in 2008, store growth only rose by 3.86%. In China, their goal was to expand vastly and quickly and in both 2008, and 2009 their growth rate was positive. In 2008, store growth rose by 6.55% and in 2009 by 0.98%

Yum! China yielded better results than Yum! US. Yum’s China division is very successful since their revenue growth, profitability and store growth rates were all possible. Though
there are some declines in between years, Yum! China did not suffer as big of a loss like Yum! US. Because China’s market is growing faster than the US and any other country, it makes sense for business to be up and generating revenue.

For a more detailed financial analysis, refer to Appendix I.

5. Evaluate the “New Fast Food” proposal: Discuss the pros and cons, risk and potential benefits of such a new approach.

Pros:

· Added variety/more menu options
· Improved quality and taste
· No more super sized items/cutting down portions and prices
· Meals are served with vegetables and juice
· Nutrition labels and information
· Nutritious and balanced
· Promotes healthy living

With the “new fast food” proposal the menu is expanded and offers healthier options for customers. Not only are customers allowed healthier choices, but they are also informed about the nutrition value of the foods. With this new proposal super sized items are also gone. By eliminating items that use more materials, costs to make those go down. Items on the menus also go under changes when trying to make a product healthier and by initiating these changes, quality and taste can be improved.

Cons:

· Expensive
· Time consuming

The cons of this new proposal include the time and money it takes to research and develop new items on the menu and that people may not fully adapt or accept the new changes in the new menu. As part of the proposal, new healthier items would be added on the menu. To find out what people would like to see or eat, research has to be conducted to find out particular likes and dislikes. This process can be time consuming and the longer the research process the more costly it would be.

Risks:

· Customers may not welcome the changes; dislike the new items
· Chance of failure and losing customers and revenue because of proposal
Backlash from government and the fast food industry

The new proposal suggests to introduce healthier menu options and cutting down on portions. There is always a chance of customers who do not agree with the practices and with this proposal the risks are customers disliking the new menu and if they dislike the changes, the company risks alienating customers. Since government in China is very controlled, there is a risk of facing backlash from government. Yum wanted to government to take obesity seriously and lobbied officials to be more aggressive in teaching kids a healthier lifestyle. In addition to pushing government to embrace this new change, Yum also called for their competitors in the industry to work together to promote healthy living.

Benefits:

- People eating healthier and living a better lifestyle
- Kids are more informed about nutritious choices
- Reduces the rate of obesity among children and adults
- Good PR and improve company image

The benefits of this program is that it promotes a healthier lifestyle by informing people to make healthier choices. Kids learn at an early age to be active and learn about nutrition. Having started early and being informed about making good eating choices help mold them in the future to stay healthy and fit. By proposing this new campaign, Yum! is giving back to the community by providing health education and funding programs for kids. This effort paints a positive image for the company and promotes their CSR.

6. Is it the responsibility of Yum! China to undertake single-handed such a significant shift in nutritional content and to further depart from the overall corporate strategy, or should it be left to the Chinese government to educate its citizens and influence their diet? Why?

Responsibility should not lie all on Yum! China. The food industry does have some responsibility to their customers regarding health and food safety. But at the end of the day, Yum! and its competitors are just regular restaurant companies.

When Yum! proposed the “New Fast Food” idea, executives wanted to eliminate the stigma and association with fast food and obesity. However, because of alarming statistics that showed the link between the two, Yum! decided to take a proactive approach to improve the lives of their customers through healthier meals and health education and programs. By doing so, Yum is raising awareness of the benefits of making healthier choices and living a more active lifestyle. With that, Yum! has given back and changed the way they operate but their ultimate goal is making profits and expanding their business.

In end government should take more of an active approach and campaign more aggressively to raise awareness and educate their citizens. Yum! has already lobbied the government to take obesity seriously and urged more health education. If the Chinese government takes over, they can mandate health education in their school systems and also
regulate restaurants on how they prepare and sell their food. It is government’s responsibility to make sure that their citizens are safe and have their people’s best interests in mind. Government involvement would bring to light the growing problem and may change the way people live and eat.

7. If it was decided to expand further the implementation of the “New Fast Food” strategy, what steps would you recommend to build internal and external support and insure its successful implementation while satisfying the expected growth of Yum!?

Internal support:

· Have management practice what they are preaching
· Implement a reward system
· Informational seminar/lecture
· Sponsor a “health day” even for employees

To gain internal support, it is important for management to set examples to all lower level employees. This sends a message that executives at Yum! China are genuine about changing the way fast food works and are committed to improving life styles. Another strategy to gain internal support is through a reward system. Yum can start rewarding their employees with benefits, or recognition and through these rewards, employees are more motivated to embrace the values and objective of the proposal. The company can also hold a seminar/lecture for their employees to fully inform them of the benefits of the new proposal. When employees have a better understanding, they are more likely to endorse something they believe in. Coinciding with the lecture, holding a “health day” for company employees can shed new light of the benefits of living healthier and making conscious healthy choices.

External support:

· Celebrity endorsement
· Partner up with government
· Partnership with athletic companies
· Promote strategy through nation wide sports events

To gain external support, having a celebrity or public figure that people look up to can greatly influence the choices of people. Endorsements by well-known figures can send messages to thousands and have the general public embrace the new changes. Partnering up with the government to aggressively promote the new proposal can also get people to listen. Government officials in the health department can easily endorse the new plan and point out the benefits. In addition, working with sports companies and sporting events help to send the message because both share the same values of living a healthy lifestyle.
8. What changes, opportunities and threats do you foresee for the next few years that you must take into consideration before making your final recommendations?

Changes:

· Consumer tastes
· More health conscious eaters/habits
· Eating trends

Opportunities:

· Geographical expansions
· New product development
· Online orders/sales
· Store growth because of the growing population in China
· Beverage industry is growing-capitalize on affiliation with PepsiCo.

Threats:

· Increase in prices for materials and from suppliers
· Competitive industry (anyone can enter)
· Government regulations
· Product substitution
· Economic turbulence

Changes that Yum! China should take into consideration include consumer tastes, eating habits and eating trends. In this industry, change is always happening and restaurants can easily adapt to the new changes. Eating habits are constantly changing through new products and eating habits. Such changes may include customer preference for organic foods and people wanting to eat healthier essentially cutting out fatty foods. Because these changes are easily adaptable, Yum! can still continue to grow and be successful.

Opportunities for Yum! China is to expand geographically. This coincides with their strategy of having 15,000 stores in China. Expanding geographically to rural areas can boost up sales and stimulate the local economy. One of Yum! China’s strong points is that they constantly come up with new products to sell. Each year they produce 85-100 new items to differentiate their products. Yum! China should continue this practice as they are very good at product development. Capitalizing on their strength allows Yum to grow and expand their market share. In the past decade, the Internet has grown and surged in popularity. Yum can take advantage of the use of the Internet by starting to sell online.
Accepting online orders can increase sales for the company and decrease costs. Time spent on taking a customer’s order is decreased with every online purchase because a worker does not have to wait for the customer to order and then input the order. Not only does this same labor time for the company, this saves time for the customer. The customer does not have to spend extra time by going out to purchase a meal. Instead they can do it in the comfort of their own home and possibly have it delivered to them or ready for them to pick up. Another opportunity for Yum is using China’s growing population to their advantage. With a growing population, there could be more demand and with high demands, business can grow. By using this to their advantage, Yum is one step closer to achieving their objective of growing in China. In addition, other opportunities for Yum is the growing beverage company. Today, there are many drinks that target several groups. There are sports drinks, water, energy drinks, etc. In its early days, PepsiCo operated Yum and because PepsiCo is in the beverage industry, Yum can use the affiliation to attract more beverage buyers toward the fast food industry.

Threats for Yum! China include increases in raw materials and suppliers, competition, government regulations, product substitution and an unstable economy. Prices on raw materials can fluctuate and suppliers have control on what price to sell their goods at. If prices increase for meat, produce, and bread rise, the cost to produce one meal can cost more and to balance out the cost, Yum may have to increase prices on their goods. If price increases, customers may stop eating out less and that would mean a drop in business for the company. In the fast food industry, there are not many barriers to keep new entrants from joining the fast food industry. Smaller local burger joints, sandwich shops are also rivals to the big chain restaurants, so there will always be a constant threat of competitors. Government can also be a threat that stands in the way of Yum’s strategic plans. Government has the power to regulate what foods are being sold, control over health and safety and regulate business practices. There is also the high threat of product substitution in this industry. Customers can easily switch without incurring any high costs and can also switch to healthier options. In the past few years during the economic recession, restaurants saw declining numbers in revenue and profit as in the case for Yum! US. Any economic disturbances can affect productivity and alter strategic plans.

9. Looking at the future, what recommendations would you make to Chairman Sam Su to insure the long-term success of Yum! and meet his objective to have 15,000 stores in China? Be comprehensive and justify your recommendations.

Product development/differentiation: New product development is one of Yum! China’s strength. Following through and continue to research into what new products can be made will help Yum! China in the long run. Constant innovation will draw more customers in because of new food items that have never been offered before. It also varies the items on the menu since customers like variety and it also differentiates Yum! from competitors’ menus.

Marketing: Marketing is also key to Yum! China’s success. When KFC first entered China, the primary focus was to market to families. Now with over 3,000 Yum! Brands restaurants, Yum! can start to be more aggressive in marketing. For example, marketing new foods through special promotions can pique the interest of a new customer. Marketing
through ads, radio, television, newspaper and sponsorships with other companies can also raise awareness and promote new on going deals Yum! restaurants have to offer.

*Taking orders online/internet sales:* Taking orders online can greatly increase sales and revenue. The Internet is now an integral part of everyone’s lives. Accepting orders online can reduce labor time and costs because workers no longer have to wait for customers to order. Since technology and Internet use is now mainstream, selling online can help Yum! grow.

*Take advantage of the growing population:* China is the most populous country in the world and continues to grow everyday. Taking advantage of the growth in population can be very beneficial. With more consumers, there is a larger target audience and the chance of gaining a bigger market share. Yum! can expand into local and rural areas as each province becomes more populated. With more people, demand rises and when demand rises, businesses grow.

*Work with beverage companies:* As noted before, the beverage industry is on the rise with the popularity of sports drinks and energy drinks. Since Yum! was once affiliated with PepsiCo, Yum! can use this to their advantage by attracting customers from the beverage industry to the fast food industry.

*Expansion:* Expansion of Yum! brand restaurants will solidify the company’s position in China. Opening stores in populated and busy areas will boost up sales and lead to opening of more stores. Expansion can happen either through opening more company owned stores, or joint ventures and franchises. Then gradually expand beyond China and into rest of Asia.

*Lower costs/more value meal plans:* Yum! can start to implement a change in pricing by reducing the price for a meal or create a value meal plan, for example create a dollar menu. Also Yum! can look into reducing the cost of goods sold. If cost of goods sold is lower, meal prices would also be lower and that can attract more customers because of the low prices.