Case 3-6: McDonald's and KFC: Recipes for Success in China

Quick Service Restaurant Giants in the Middle Kingdom

In 2008, McDonald's and KFC were the two largest quick-service restaurants (QSR) in the world, with 31,999 and 15,580 outlets, respectively.[1] Both chains were renowned for their broad spectrum of consumers on a global basis.

McDonald's appeared to be a clear winner in international expansion. It had over 17,500 international outlets and was the first corporation to set up a solid foundation for international franchising. It spearheaded global expansion with its first overseas outlet in Canada in 1967, and entered Japan in 1971.[2] McDonald's outlets had tremendous success in Japan—despite the difference in culture—with record-breaking daily sales and speed of expansion in the initial stage.[3]

KFC also started international expansion early, opening its first overseas outlet in England in 1964. However, it was given a bumpy ride when it began to penetrate the market in Asia. The Japanese outlets were far less successful than McDonald's and only started to make a profit in 1976, six years after KFC entered Japan. KFC outlets opened in Hong Kong in 1973 but were all closed down within two years. The company would eventually win the confidence of Hong Kong customers ten years after its first entry. In Taiwan it experienced relatively smoother development, although KFC headquarters was to spend a huge amount of money and effort in order to get the ownership back from its joint venture partners at a later stage.[4]

This case was written by Gabriel Szulanski, Professor of Strategy at INSEAD, Weiru Chen, Assistant Professor of Strategy, and Jennifer Lee, Research Associate. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The authors gratefully acknowledge funding from INSEAD R&D.

It was a totally different picture in China. In the 'Middle Kingdom,' KFC was not only recognised as the leader in foreign quick-service restaurants but was also a significant player in the Chinese restaurant industry as a whole, alone contributing 1% of the country's total food and beverage industry revenues in 2005.[5] In 2005, KFC's outlets in China recorded an average of US$1.2 million in annual sales per store, compared with just US$900,000 for similar stores in the US.[6] According to the 2008 figures, KFC had over 2,300 outlets in China, with an average profit margin of nearly 20.1%.[7]

In contrast, at 1,000 outlets, McDonald's presence in China was less than half of KFC's, with an estimated profit margin significantly below that of its leading competitor. Many people attributed KFC's success in China to its early entry—three years earlier than McDonald's—and its natural advantage in menu selection which corresponded to the typical consumer's preference for chicken over beef. However, were these reasons enough to explain KFC's continued growth and the extension of its lead over its rival? How could McDonald's as a latecomer and the second-largest QSR player in China, capitalize upon its global dominance and resources to catch up with KFC?

Replicate or Adapt?

The Inherent Challenge for International Franchisors

International franchising is frequently associated with service firms, such as hotels, retail outlets and quick service restaurants. These firms often have strongly identifiable trademarks and try to guarantee the customer a uniform and consistent level of service and product quality across different locations and over time. However, the high degree of standardised operations makes the replication of the format across diverse markets difficult. Differences in things such as ingredients, labour and physical space can mean significant modifications to the service formula. Consequently, the basic service may be similar to that of the home country, but details in the delivery of the service are often altered.[8]

Many foreign enterprises found China very different in culture and consumer behaviour. Franchise restaurants faced several major hurdles, including a different labour force structure, difficulty in recruiting technically competent and culturally sensitive managers, tough technological problems and a less than satisfactory legal environment and enforcement.[9] So the challenge for international franchisors like McDonald's and KFC was to decide whether to comply strictly with their original models, and if adaptation was required, when and how to make adaptations in order to deliver globally consistent standards while catering to local consumer needs.

Potential of China's Restaurant Industry

Chinese consumers' spending on eating out had increased tremendously along with the country's economic boom in the past decade. Retail revenues of the restaurant industry increased from 5.2% in 1991 to 14% in 2007 as a portion of total retail revenues from consumer goods.[10] According to annual statistics from the Ministry of Commerce of the People's Republic of China, the retail revenue of the hotel and restaurant industry reached 1,235.2 billion RMB in 2007, representing 19.4% growth over the previous year; foreign franchises were the main driver of food and beverage revenue growth as foreign direct investment in the hotel and restaurant industry totaled US$10.4 billion, an increase of 25.8% on the previous year.[11] China was the world's largest consumer of meat. The Economist Intelligence Unit forecast that annual meat consumption in China would jump from 59 kg per head in 2005 to 74 kg per head in 2009.[12] With US meat consumption at 128 kg a head, there seemed plenty of scope for the Western fast-food industry to expand in China.[13]

Foreign quick service restaurants played a significant role in China's restaurant industry. The share of fast food in the retail industry was expected to reach 9.3% by 2011 from 74% in 2007. China's fast-food industry was expected to grow at a CAGR of around 25% during 2008–2011.[14]

The first comprehensive franchising regulations, which came into effect in February 2005, made it easier for foreign fast-food operators to open branches and roll out the franchising model, which had proven to be such a sure path for fast-track growth in the US and Europe.[15] The new Law on Franchise Regulations, passed in February 2007, helped clear up the ambiguity surrounding franchisor's disclosure duty.[16] Thenceforth, the rights of both franchisors and franchisees were better protected.

Quick Service Restaurant Chains: A New Experience for China

Foreign quick service restaurants began to surface in China with the opening of KFC's first store in 1987, followed by McDonald's entry three years later. The timing was propitious for foreign enterprises as it had been nine years since China embarked upon a policy of opening up and reform in 1978 and Chinese curiosity about the West was at a peak.

Although GDP growth in China had averaged well over 9% per year since 1978, per capita GDP at the time of KFC's entry was a mere US$621.05.[17] Given the 120 to 130 yuan monthly salary of Beijing urban residents at that time, KFC prices were unaffordable to most, but many still flocked to the store to purchase the 12-yuan KFC hamburger or 8-yuan fried chicken. The most frequent customers were foreigners living in China. Despite the attractiveness of fast food chains, local consumers in those early days could seldom afford to eat at KFC, McDonald's or Pizza Hut. Dining at these establishments was considered such a luxury that some couples chose to hold their wedding banquets there.[18]

Behind the 'dream market' with a vast land area and 1.3 billion people, the complexity of China's population, geography and history presented major challenges for foreign players. Population density, economic development and wealth distribution varied greatly from east to west and from south to north. Foreign invested enterprises usually focused on the populous, more affluent eastern China. The western regions were beyond the reach of even domestic businesses without an effective national transportation system.

Chinese-style fast food had existed prior to the entry of western quick service restaurants but represented a totally different concept and ambience compared with modern chains. Most of the catering units for Chinese fast food were small in scale, serving pre-made appetizers such as congee, buns and fritters of twisted dough (yiu-tiao). They lacked funding, trained employees and a well-maintained dining environment.[19] As restaurant staff required at least five years of experience, western food chains could not find a sufficient number of internal candidates to meet growth-driven demand and had to import skilled managers from neighbouring markets such as Taiwan and Hong Kong, and even from headquarters in the US.

KFC in China

The Very First Western Restaurant Chain

Yum!'s KFC brand was the first foreign quick-service restaurant chain to enter China.[20] On 12 November 1987, the first KFC in China was officially opened at Beijing Qianmen, within walking distance of Tiananmen. In 2002, KFC opened the first ever drive-through restaurant in the country. In 2004, the 1,000th KFC restaurant was opened in China (Beijing), only a few kilometres from the site of its first restaurant. From the beginning of 2005, the Yum! China Division (including Mainland China, Thailand and KFC Taiwan), based in Shanghai, reported directly to Yum! headquarter instead of to its international division, reflecting China's market size, unique strength and importance.[21] From 1987 to 2005, the number of KFC outlets in China grew by 50% annually, growth which was considered exponential outside its parent market in the US,[22] particularly in a country known for its culinary sophistication developed over thousands of years. Today, KFC is the number one quick-service restaurant brand in China. Yum! China has more than 2,300 KFC restaurants in nearly 500 cities in Mainland China (Q3 2008).[23]

Initial Stage—Replication with Localisation in Mind

In 1987, KFC set up a joint venture, B-KFC, with Beijing Animal Production Company and Beijing Tourism Board in order to gain access to better product supply and F&B management authority. Sim Kay Soon, a Singaporean who had held area manager and training officer positions within KFC system since the 1980s, was appointed to be its the first general manager, responsible for day-to-day operations.[24] Positions below (and including) assistant managers were all held by Chinese nationals. The company started using local food ingredients from day one. Chicken was purchased from Beijing Animal Production, and potatoes, cabbage and carrots were all purchased locally. However, cooking equipment was mostly imported, such as blenders, heating racks and even cash registers.

The first Beijing outlet represented KFC's largest restaurant worldwide with 1,400 square metres of space allowing for a capacity of 500 seats and considerable office space for B-KFC staff. Only four months after opening, the Beijing restaurant had become the highest-selling single KFC store in the world.

The response to B-KFC's recruitment was overwhelming as the base salary offered was set at 140 RMB per month, about 40% more than could be earned by associate professors at the country's universities at that time. So attractive was the compensation package that a ratio of 20 to 1 people applied for every opening. In the end, B-KFC hired those applicants who were high school graduates, could speak some English, did not have previous restaurant work experience, and had demonstrated a willingness to work hard.[25]

A Management Team Familiar with Local Culture

From the beginning, KFC hired elites from overseas—Hong Kong, Taiwan and other Asian countries—some with decades of experiences in the QSR industry, and most with a deep understanding of the language, culture, habits and customs of China. As many of the management team members were associated with Taiwan, they were nicknamed the "Taiwanese gang."[26]

Other than the top management team which was composed of almost all overseas Chinese, KFC was keen on developing local talent from day one. The company paid well to hire highly educated and motivated restaurant staff, and used its training system to develop those staff into future restaurant managers or even district general managers. 80% of China KFC's district general managers were university graduates, some from top schools. This strategy paid off when the company decided to expand aggressively after 10 years in China. Joseph Han, Operating Vice President of Yum! Brands in greater China from 1996 to 2003, described KFC China's people strategy:

> *...in China, KFC understands the importance of people's talent.... In the United States, in the fast-food chains, it is very difficult to hire very high-quality people, especially on the cook labour side. So in China, KFC built very aggressive talent recruitment projects. It went to universities to hire university students. KFC hired management trainees with very qualified university graduates.... There are a total of 22 branch offices for Yum! Brands in China and the general managers are now already 90% localised. Those people actually, 20 years ago, started at the restaurants as the cook person, or as a management trainee. This talent pool has become their great asset for the future development.*[27]

Takeoff during Time of Crisis

KFC chose to put down roots in big eastern cities along the coast in the 1980s and to go west in the 1990s. Like many foreign enterprises, KFC's expansion route was from east to west, from cities to towns, and blanketed China with wider coverage by linking outlet presence in cities and towns.

Within 10 years of its entry into China, KFC has basically covered the main cities in the populated areas, with only the sparsely populated and low purchasing-powered south-western and north-western districts yet to be penetrated.

During the Asia economic downturn in 1997, KFC faced the challenge of a thinning bottom line. It had two alternatives, either to cut costs or to increase sales. It chose to aggressively expand the number of outlets at a time when most competitors were holding back. The same strategy was applied in other times of crisis, for example, during the SARS epidemic in 2003—that year KFC added more than 300 new outlets, even more than in the previous year.[28]

Self-Developed Logistic and Distribution System

Along with the aggressive expansion plan, a well-connected supply chain was needed before any new KFC outlet could be opened in any city. KFC expected to establish a logistics system to supply neighbouring KFC outlets. If it took more than one day to reach any new KFC restaurant, the logistics team would start finding a new warehouse closer to the outlet.

What was different about the global KFC system was that Yum! Brands established its own logistics system by working closely with local partners rather than simply outsourcing its supply to a third party. KFC established the "STAR System" for its China partners, and suppliers who passed the STAR test could also easily achieve national ISO9002 and HACCP[29] certification. Yum! Brands later consolidated a separate supply system in China—which saved the company nearly 100 million RMB in costs in 1998.[30] It set up Asia's largest logistics and distribution centre in Beijing in October 2004 for its groups of restaurants in China, a move that was the first and only for Yum! Brands Global companies, and which allowed another 10% cost reduction.[31] Warren K. Liu, Vice President of Yum! Brands Greater China from 1997 to 2000, later recalled that he was challenged again and again by headquarters on the decision to invest in its own warehouse, logistics and distribution system, which didn't exist in other parts of the world where Yum! Brands was present:

> *What we faced in China were an inefficient and fragmented distribution network, an inadequate highway system, local protectionism that lead to fragmentation in the supply chain, and inter-provincial trade barriers such as excessive tolls. In such an infrastructure-deficient market environment, direct control over supply storage and distribution complements KFC's rapid growth strategy; allowing KFC to penetrate new markets further, sooner, faster, at lower unit cost than its competitors.*[32]

Menu Selection—an American Brand with Chinese Characteristics

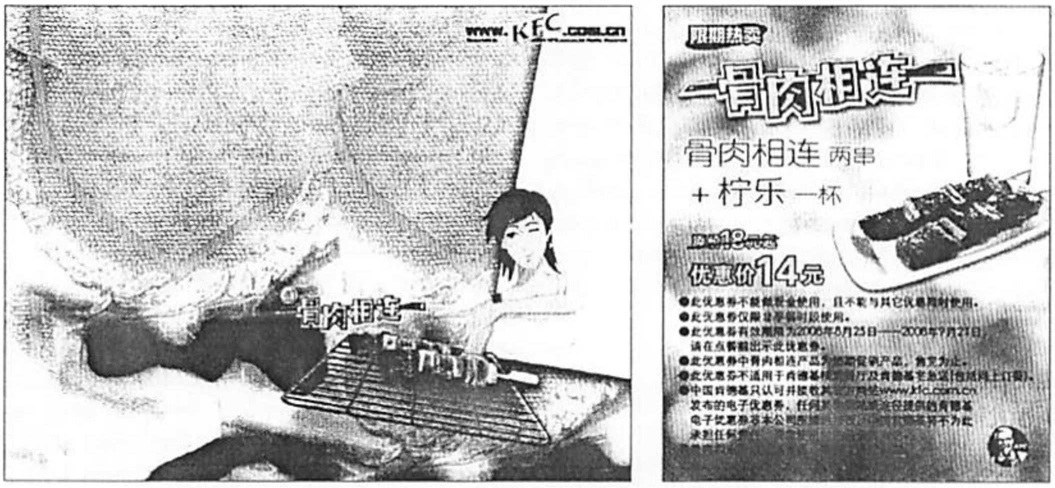
KFC has followed the principle of menu localization, striving to become an 'American brand with Chinese characteristics' since its entry.[33] Even in the earliest days, KFC China's most popular items were the spicy chicken wings and spicy chicken thigh burger, rather than its signature Colonel Sanders Original Recipe chicken.

Large-scale menu localisation started in 1998[34] when a local food R&D team and a test kitchen were set up in Shanghai. Since then, KFC has introduced many Chinese items onto their menus. Preserved Sichuan pickle and shredded pork soup was one of the first. The soup proved a success, and mushroom rice, tomato and egg soup, and Dragon Twister (traditional Peking chicken roll) were soon added to the menu. KFC also serves packets of Happy French Fry Shakes that contain beef, orange and Uygur barbecue spices.[35] Chinese consumers received those localised food items very well. While some global companies might have second thoughts about launching a food item containing bones for family consumers, as it might potentially create food safety concerns, KFC's chicken kebab is made of soft bones and meat (see Exhibit 1), and has become one of the most popular items among children and teenagers. Chinese consumers can find preserved egg with pork porridge, egg and pork floss roll, and Hong Kong milk tea for breakfast, egg and vegetable soup as a side dish, Dragon Twister for a main meal, and Portuguese egg tart for dessert on the menu.

In an interview, Joseph Han talked about why KFC China was determined to provide a localised menu, one of the keys to successfully penetrating into fourth and fifth tier cities in rural areas:

> *I think McDonald's and KFC do bring in the dining environment, and they bring in their working concept to change people's lifestyle. But product-wise, you can see Chinese are still Chinese. When Chinese students go to the United States to study, they still choose the kind of food they feel is close to their life. Even though they admire the Western lifestyle, I think they still need time to change their dietary habits. Especially breakfast. In the three meals, breakfast is usually cooked by your mother. Your mother always cooks traditional food. So that's why now even McDonald's in China created its own breakfast menu. Everywhere in the world you don't change, but when you came to China and India, I can guarantee you have to change, because maybe you can change younger people's lifestyle, but you cannot change some of their dietary habits.*[36]

China
KFC China Print Advertisement



Chicken Kebab—*"Bone and flesh Relations"*

KFC China TV Advertisement

Exhibit 1 KFC Advertisement

Franchised or Not?

KFC's aggressive expansion through franchising did not get off to a good start in China. In 1993, it signed its first regional franchise agreement for the Xian area in the northwest of China with a Taiwanese entrepreneur.[37] This served the purpose at that time for KFC China headquarters to focus on more strategically important coastal cities. However, due to a slower-than-expected development pace in Xian, KFC China had to go down the same path as in Taiwan during the 1990s, launch new outlets separately and independently from those operated by the franchisee, and finally bought back restaurant ownership in Xian.

The KFC team in China decided not to authorise any franchise agreements with entrepreneurs in any city or region to avoid making the same mistake as in Taiwan or Xian, no matter how small or remote that city or region might be. In August 2000, KFC authorised the first individual franchisee in Changzhou. By paying a one-time transfer fee of 8 million RMB, the franchisee could own an operating KFC outlet which was already in profit. The franchising strategy was limited to townships with a population of between 150,000 and 400,000, and which achieved more than 6,000 RMB in per capita annual consumption.[38] By the end of 2007, there were 228 franchised KFC outlets, 8.7% of its total number of outlets in China.[39]

McDonald's in China

Entry into China

On 8th October 1990, nearly three years after KFC set up its first outlet near Tiananmen Square, McDonald's opened its first outlet in China in Shenzhen[40] and it was warmly welcomed by the local consumers. It continued to extend in the southern cities of China, and in April 1992, the Golden Arches could finally be seen in McDonald's Wangfujing outlet in Beijing. This outlet was formed with an unlisted investment unit of the Beijing municipal government. Overtaking the Moscow outlet in size, it became the largest McDonald's restaurant in the world, attracting 13,000 customers on its very first day.[41]

By September 2003, McDonald's had 566 outlets in 94 cities across 19 provinces and China had become McDonald's third largest Asian market behind Japan and Australia. In 2004, China became one of its top ten markets—making the country McDonald's Corp's fastest-growing market worldwide.[42]

However, although the number of McDonald's outlets was on a par with that of KFC in the first six years after its entry, it had started to lag behind KFC since 1997. While KFC celebrated the opening of its 1,500th outlet in China (Shanghai) in 2005, McDonald's had around 600.[43] What had McDonald's done differently in China to explain this?

Consistent Global Supply Chain Partners

McDonald's developed its supply chain partners along with its global business growth. HAVI Food, its global logistics partner, would enter any new market to invest and set up the logistics system even before the first McDonald's outlet opened in that market. In China, HAVI Food also established a logistics centre exclusively for McDonald's, and there were three major distribution centres in Beijing, Shanghai, Guangzhou, and satellite dispatch centres in other smaller cities.

McDonald's also tried to work with its global food suppliers as much as possible. There were 43 suppliers for McDonald's in China, 70% of which were its global partners. For example, J.R. Simplot Co., which supplied frozen French fries to McDonald's, had founded a joint venture company in Beijing in 1993, surveying the varieties of potatoes before McDonald's entry; McDonald's vegetable supplier set up a branch in Guangzhou in 1997 in order to satisfy McDonald's intention to source locally, and 100% of its facility and equipment were imported from overseas. Likewise, the global suppliers of McDonald's buns and seasonings had all set up branches in China to strengthen the supply chain network for McDonald's in China.[44]

Why did McDonald's insist on bringing their global partners to China? Peter Tan, former Senior Vice President and President of McDonald's Greater China, summed it up:

> *McDonald's in China today reflects the attitude that they are a global brand, hence the need to set standards that are globally consistent, be it in Oakbrook, USA, or Xian, China... McDonald's is saying that 'we are in this emerging country, but because we are a global brand, we need to give them first world standards...' McDonald's had fewer than five chicken suppliers up in the northeast, and the reason for this is that McDonald's is very concerned about quality consistency.*[45]

Catching Up with Cautiously Aggressive Expansion

Although McDonald's came in late, its expansion in China was still aggressive, especially in the earlier years. Its strategy was to start in the foreign influenced and economically affluent southern cities and then expand to cities in north and central China.

However, compared with KFC, McDonald's did not successfully penetrate as many third and fourth tier cities as its rival (see Exhibits 2 and 3). By September 2003, McDonald's had 566 outlets in 94 cities across 19 provinces. The bulk of the restaurants were concentrated in over 40 cities on China's east coast where incomes were higher. The bulk of

Exhibit 2 KFC's penetration in China in the first ten years

Year of Entry	Coverage
1987	Beijing
1989	Shanghai
1992	Nanjing
1993	Suzhou, Hangzhou, Wuxi, Guangzhou, Qingdao, Xian (franchised)
1994	Fuzhou, Tianjin, Shenyang
1995	Chendu, Dalian, Wuhan
1996	Shenzhen, Xiamen
1997	Changsha, Chongqing

Source: Warren K. Liu, *KFC in China—Secret Recipe for Success*, John Wiley & Sons (Asia) Pte Ltd., 2008.

Exhibit 3 McDonald's penetration in China in the first 10 years

Year of Entry	Coverage
1990	Shenzhen
1992	Beijing
1993	Guangzhou
1994	Tianjin, Shanghai, Nangjing, Wuhan, Chendu, Chongqing
2001	Xian

Source: McDonald's and KFC edited by B.Q. Chen, China Economy Publishing, 2005.

McDonald's sales in China came through its restaurants in Beijing, Shanghai, Shenzhen and Guangzhou. In September 2003, it was reported that McDonald's planned to open 100 new stores per year in China over the next couple of years. A majority of the proposed outlets would be opened in developed markets such as Beijing, Shanghai and Guangzhou. The remainder would be located in Inner Mongolia and other less developed regions of China. The company also planned to expand in Western China.[46] By January 2007, McDonald's had penetrated into more than 120 cities across China,[47] and in November 2008, it finally crossed the 1,000 outlets threshold, with plans to add another 175 in 2009.[48]

However, unlike KFC, McDonald's did not take bold steps in expanding its territory in China. The number of outlets in China began to dwindle from 2002 onwards. In order to strengthen its foothold in China, McDonald's moved its Asia headquarters from Hong Kong to Shanghai in January 2005, signaling its determination to intensify its aggressive expansion in China.

Standardised Global Menu with Local Selections

McDonald's was known for its quality of food and consistency in food preparation processes. In order to maintain quality and consistency, McDonald's imposed standardisation in three domains—ingredient procurement, food preparation and food quality. The same consistency could be seen in their food menu; Big Mac remained their signature product, although chicken varieties were added to suit local consumers' tastes and accounted for an estimated 60% of food sales in McDonald's China.[49]

The McDonald's menu in China was essentially the same as in the US. Its use of local food selection was apparently not as varied as KFC's. However, not content to lag behind KFC, McDonald's introduced Vegetable and Seafood Soup and Corn Soup in 2004,[50] and other Chinese-style menu items such as red bean sundaes and taro pies, which also became popular. McDonald's gradually recognised the importance of catering to local consumers' tastes. Jeffrey Schwartz, newly-appointed President of McDonald's China in 2005, said that 80% of the menu in China would be the same and the other 20% would be allowed to be different in order to reflect regional tastes. He also said that McDonald's would open outlets in more areas in the future to make McDonald's food accessible to more customers.[51]

McDonald's detail-oriented approach was also extended to their China operations. Every aspect of food preparation was done according to the operating manual. Packaging such as Happy Meal boxes and apple pie wrappers were produced to exactly the same global standards. In an interview, Peter Tan commented on the balance between production innovation and global consistency:

> *For a global brand to maintain brand consistency, it is important to ensure that the icon products remain an integral part of the menu offering. But then the question arises as to how you penetrate into emerging countries where you need to balance between what the brand stands for versus local tastes. That's where I think product innovation done strategically plays a vital role.*[52]

Today, McDonald's menu in China has grown to include foods tweaked for local tastes to satisfy consumers, such as spicy chicken fillet and pineapple sundae. Some of the menu ideas, such as the corn cup developed in China, have been exported to other markets around the world. However, according to CEO Jeffrey Schwartz, the hamburger and fries Western-style are still at the heart of the Chinese menus.[53]

Franchised or Not?

McDonald's has always been a franchising company and franchisees have played a significant role in its success. About three-quarters of McDonald's outlets worldwide have been franchised.[54] However, due to ambiguity in China's legal environment, up until 2003 McDonald's China had established all of its 566 outlets by joint venture or sole proprietor, rather than using its global franchising model. It announced in 2003 that it would open ten franchised outlets in China by June 2006, with a loyalty fee of 2.5 to 3.2 million RMB. The requirements that individuals must meet before being granted a franchise were the same in China as they are worldwide. The first pilot franchise was launched in Tianjin in September 2003. The licence was awarded to Meng Sun on the basis of her business acumen and understanding of the Tianjin market.[55] In 2007, McDonald's had fewer than 0.5% outlets in China that were franchised[56] while the percentage was 78% worldwide.[57]

The Challenges Ahead

McDonald's

2004 was a year of tragedy and loss for the company. The CEO who had put McDonald's on the road to revitalization, Jim Cantalupo, died on the eve of the company's global convention. His successor, Charlie Bell, was diagnosed with cancer soon after taking the helm. He resigned in November of that same year, and passed away in January 2005.[58] The China management team saw a high level of turnover: McDonald's Greater China President, Peter Tan, left in June 2005. His post was filled by Guy Russo, who was originally President of McDonald's Australia. In October the same year, the Managing Director of McDonald's North region and the General Manager of McDonald's Beijing both left the company.[59]

Despite the general perception that McDonald's would try to catch up with KFC in China using franchising, a report in 2007 revealed that they were cautious about franchises. China Vice President, Gary Rosen, commented: "The franchise business requires a lot of effort and right now we have other priorities in China." The company would open at least 100 new stores in the country annually and half of them would be wholly owned drive-through outlets.[60] McDonald's took a strategic move to link with China's SinoPec in 2006, giving McDonald's the rights to build drive-through outlets at the oil company's 30,000 gas stations.[61] Up until November 2008, it owned 81 drive-through restaurants in China. Another expansion direction for McDonald's China was to convert its restaurants into 24-hour operations. By the end of 2008, 80% of its 1,000 outlets in China already provided service round the clock.[62] All these efforts were consistent with its global strategy of making McDonald's a convenient choice for customers.[63]

> *We have a business model of getting better versus getting bigger. It's not about how many restaurants you have, it's about how many restaurants that serve your customers well. It's not about how big, it's about how good and how you run your business.*[64]
>
> —Jeffrey Schwartz, CEO, McDonald's China, 2008

KFC

Despite its success in China, KFC Global was struggling to overcome weak performance in the homeland. Data showed that in 2008 Yum's overall second-quarter profit rose 4%; it achieved 38% growth in operating profit in its China division and 18% growth in its international division. These figures offset a 12% drop in US operating profit for that quarter. Yum! CEO, David C. Novak, singled out KFC in the US as "our only major soft spot."[65]

On the road of aggressive expansion, KFC China ran up against the issue of consumer confidence in its food safety standards. Sudan I, a red chemical dye thought to cause cancer, was discovered in two products sold in China: KFC's New Orleans Roast Chicken Wings and New Orleans Roast Chicken Legs.[66] KFC took the dishes off the menu, but Chinese consumers were still angry because a large amount of the consumption was made by children.[67]

Other Competition

Burger King, the second-largest United States hamburger chain, entered China in 2005, planning to open ten stores in China in 12 months with a view to participating in the large and fast-growing eating out market.[68] It signed a regional franchisee agreement with a company in Fujian, a populous province in southern China, in order to expand its territory.

Faced with increasing competition, how could McDonald's strengthen its position in China? Should it aggressively increase its number of outlets by taking bold steps like KFC, or gradually expand its presence by strictly following its global strategy and procedures? Could KFC sustain its leading edge while ensuring expansion and quality at the same time? Would the success of China KFC be carried over to its US base and bring changes to the business model in order to compete with McDonald's Global?

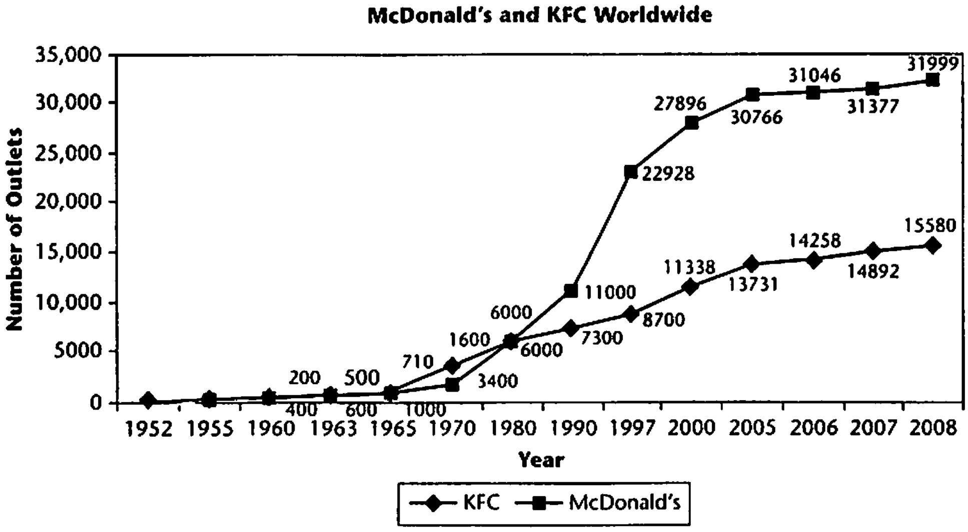


Exhibit 4 Historical Store Count

Source: McDonald's and Yum website. Various press releases and web articles.

Exhibit 5 KFC Top 25 Markets by Unit Count

For Full Year 2007	
2007 Top 25 Markets	**KFC**
United States	5,273
China Mainland	2,140
Japan	1,152
Canada	720
Great Britain	664
Australia	559
South Africa	479
Malaysia	402
Mexico	323
Thailand	314
Indonesia	300
Philippines	165
Korea	158
Taiwan	138
Saudi Arabia	97
New Zealand	95
Puerto Rico	86
Poland	83
Egypt	81
Singapore	70
Hong Kong	69
France	57
Germany	51
Spain	47
India	31

Source: www.yum.com

Exhibit 6 Yum Worldwide System Units

Year end	2008	2007	2006	2005	2004	2003
Company Owned	7,568	7,625	7,736	7,587	7,743	7,854
Franchisees	25,911	24,297	23,516	22,666	21,858	21,471
Licensees	2,168	2,109	2,137	2,376	2,345	2,362
Total[a]	36,292	35,345	34,595	34,277	33,608	33,199

Year end	2008	2007	2006	2005	2004	2003
United States						
KFC	5,253	5,358	5,394	5,443	5,525	5,524
Pizza Hut	7,564	7,515	7,532	7,566	7,500	7,523
Taco Bell	5,588	5,580	5,608	5,845	5,900	5,989
Long John Silver's	1,022	1,081	1,121	1,169	1,200	1,204
A & W	363	371	406	449	485	576
Total Us	19,790	19,905	20,061	20,472	20,610	20,822

International	2008	2007	2006	2005	2004	2003
KFC	7,347	6,942	6,606	6,307	6,084	5,944
Pizza Hut	5,026	4,882	4,788	4,701	4,528	4,357
Taco Bell	245	238	236	243	237	247
Long John Silver's	38	38	35	34	34	31
A & W	264	254	238	229	210	183
Total International	12,920	12,354	11,903	11,514	11,093	10,762

China	2008	2007	2006	2005	2004	2003
KFC	2,980	2,592	2,258	1,981	1,657	1,410
Pizza Hut	585	480	365	305	246	204
Taco Bell	0	2	2	2	1	1
A & W	0	0	0	0	0	0
Total China[b]	3,582	3,086	2,631	2,291	1,905	1,615

[a] Includes unconsolidated affiliates.
[b] Includes East Dawning units for China.

Source: www.yum.com

Exhibit 7 Yum China Division Operating Results (in millions)

	2001	2002	2003	2004	2005	2006	2007
Company sales	$569	$722	$871	$1,082	$1,255	$1,587	$2,075
Franchise and licence fees	18	22	30	38	41	51	69
Revenues	587	744	901	1,120	1,296	1,638	2,144
Food and paper	244	289	331	401	454	562	756
Payroll and employee benefits	61	77	93	125	167	205	273
Occupancy and other operating expenses	179	217	275	337	415	497	629
Company restaurant expenses	484	583	699	863	1,036	1,264	1,658
General and administrative expenses	46	51	62	80	92	119	151
Franchise and licence expenses	-	-	-	-	-	-	-
Closures and impairment expenses	6	6	6	4	7	6	7
Other (income) expenses	(12)	(16)	(27)	(32)	(50)	(41)	(47)
	524	624	740	915	1,085	1,348	1,769
Operating profit	$63	$120	$161	$205	$211	$290	$375
Company sales	100%	100%	100%	100%	100%	100%	100%
Food and paper	42.9	40.0	38.0	37.1	36.2	35.4	36.4
Payroll and employee benefits	10.7	10.6	10.7	11.5	13.3	12.9	13.2
Occupancy and other operating expenses	31.5	30.1	31.5	31.1	33.1	31.3	30.3
Restaurant margin	14.9%	19.3%	19.8%	20.3%	17.4%	20.4%	20.1%
	$	$	$	$	$	$	$
Company sales	569	722	871	1,082	1,255	1,587	2,075
Franchisee sales	328	397	510	619	665	840	1,098
System sales growth							
Local currency	17%	25%	23%	23%	11%	23%	24%
U.S. dollars	14%	25%	23%	23%	13%	26%	31%

Source: www.yum.com

Exhibit 8 Yum U.S. Division Operating Results (in millions)

	2001	2002	2003	2004	2005	2006	2007
Company sales	$4,287	$4,778	$5,081	$5,163	$5,294	$4,952	$4,518
Franchise and licence fees	540	569	574	600	635	651	679
Revenues	4,827	5,347	5,655	5,763	5,929	5,603	5,197
Food and paper	1,225	1,346	1,463	1,546	1,576	1,399	1,317
Payroll and employee benefits	1,313	1,479	1,576	1,573	1,600	1,489	1,377
Occupancy and other operating expenses	1,100	1,189	1,303	1,333	1,385	1,340	1,221
Company restaurant expenses	3,638	4,014	4,342	4,452	4,561	4,228	3,915
General and administrative expenses	418	469	469	501	536	546	510
Franchise and licence expenses	49	39	16	19	26	23	29
Closures and impairment expenses	27	23	16	14	46	37	14
Other income	-	-	-	-	-	6	(10)
	4,132	4,545	4,843	4,986	5,169	4,840	4,458
Operating profit	$695	$802	$812	$777	$760	$763	$739
Company sales	100%	100%	100%	100%	100%	100%	100%
Food and paper	28.6	28.2	28.8	29.9	29.8	28.2	29.2
Payroll and employee benefits	30.6	30.9	31.0	30.5	30.2	30.1	30.5
Occupancy and other operating expenses	25.6	24.9	25.6	25.8	26.2	27.1	27.0
Restaurant margin	15.2%	16.0%	14.6%	13.8%	13.8%	14.6%	13.3%
Company same store sales growth	1%	2%	0%	3%	4%	0%	(3)%
Company sales	$4,287	$4,778	$5,081	$5,163	$5,294	$4,952	$4,518
Franchise sales	10,309	11,061	11,257	11,724	12,428	12,804	13,304

Source: www.yum.com

Exhibit 9 Yum Division Historical Sales Growth (in %)

CHINA DIVISION (Mainland China, Thailand, KFC Taiwan)	2008	2007	2006	2005	2004
1st Quarter	28%	19%	14%	26%	17%
2nd Quarter	28%	19%	29%	2%	34%
3rd Quarter		23%	25%	11%	20%
4th Quarter		30%	23%	6%	21%
Full Year		24%	23%	10%	23%

INTERNATIONAL DIVISION (Excludes China Division)	2008	2007	2006	2005	2004
1st Quarter	9%	10%	6%	7%	5%
2nd Quarter	8%	11%	8%	6%	6%
3rd Quarter		11%	9%	4%	9%
4th Quarter		9%	11%	4%	6%
Full Year		10%	9%	5%	6%

U.S. COMPANY SAME-STORE	2008	2007	2006	2005	2004
1st Quarter	3%	−6%	4%	4%	3%
2nd Quarter	4%	−3%	0	5%	2%
3rd Quarter		−1%	−2%	4%	4%
4th Quarter		−1%	−2%	4%	2%
Full Year		−3%	0	4%	3%

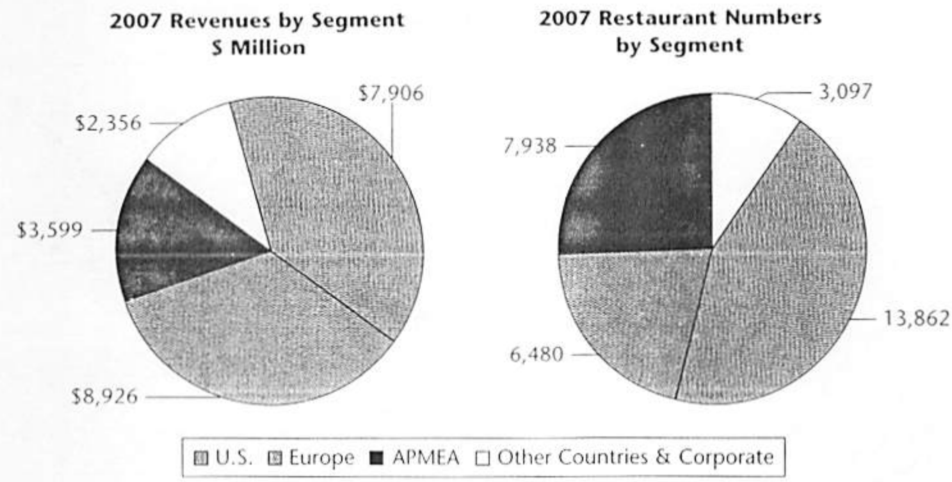
Source: www.yum.com

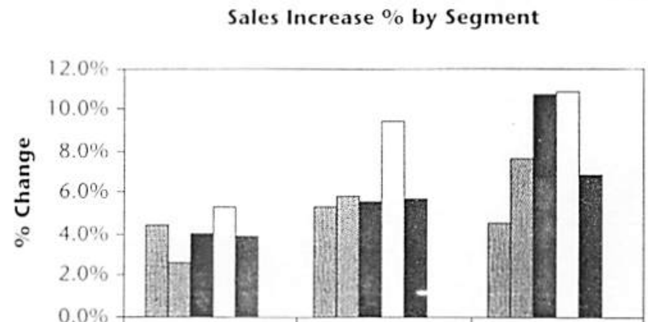
Exhibit 10 McDonald's Number of Restaurants Top 25 Market by unit count

(at year-end 2007 and 2002)	2007	2002
Total	31,377	31,108
United States	13,862	13,491
Japan	3,746	3,891
Canada	1,401	1,304
Germany	1,302	1,211
United Kingdom	1,191	1,231
France	1,108	973
England	1,019	1,055
China Mainland	876	546
Australia	761	726
Brazil*	551	584
Spain	378	333
Mexico*	364	261
Italy	361	329
Taiwan	348	350
Philippines*	273	236
South Korea	233	357
Sweden	230	245
Netherlands	220	220
Poland	213	200
Hong Kong	207	216
Russia	189	94
Argentina*	183	203
Malaysia	176	149
Austria	163	157

*Developmental Licensee market as of December 31, 2007.

Source: www.mcdonalds.com.





	2005	2006	2007
U.S.	4.4%	5.2%	4.5%
Europe	2.6%	5.8%	7.6%
APMEA	4.0%	5.5%	10.6%
Other Countries & Corporate	5.3%	9.4%	10.8%
Total	3.9%	5.7%	6.8%

U.S. Europe APMEA Other Countries & Corporate Total

Exhibit 1 McDonald's Financial Results by Segment

APMEA: Asia/Pacific, Middle East and Africa.

Source: www.mcdonalds.com

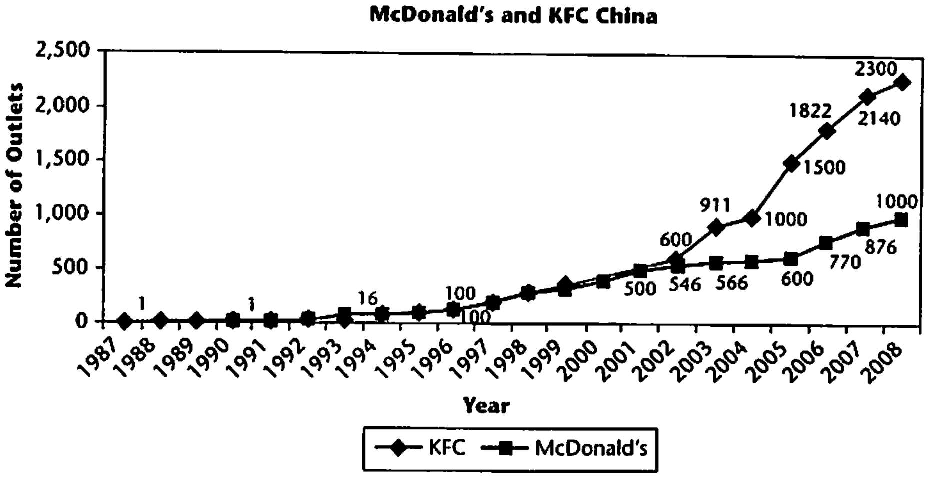


Exhibit 12 Historical Store Count

Source: McDonald's and Yum website. Various press releases and web articles.

Exhibit 13 Comparsion of McDonald's and KFC in-store Menu

	China	
	McDonald's	**KFC**
Main Meal	Big Mac Double Cheese Burger Hamburger Cheese Burger Beef 'N' Egg Burger McSpicy Chicken Burger McChicken Burger Fillet-O-Fish Vegetable Beef Burger McSpicy Chicken Twister Curry Chicken Burger Teriyaki Chicken Burger Double Mala Chicken Burger Spicy Teriyaki Chicken Burger	Buckets of Chicken New Orleans BBQ Chicken Burger Spicy Chicken Burger Crispy Chicken Burger Garden Crispy Chicken Burger Cod Fish Burger Mexican Chicken Twister Dragon Twister Spicy 'Saliva' Chicken Burger
Side Dishes/ Light Snacks	McNugget McSpicy Chicken Wings Sweet Corn in a Cup French Fries	Corn on a cob Mashed Potato Egg 'N' Vegetable Soup Vegetable Salad Corn Salad Carrot Bread Roll Chicken Kebab French Fries Chicken Nuggets Popcorn Chicken New Orleans BBQ Chicken Wings Original Recipe Chicken Spicy Chicken Wings Cod Fish Sticks
Breakfast	Big Breakfast Pancake Cheese'N'Egg Burger Pork McMuffin Orange Juice Fresh Milk	Crispy Chicken Burger (with egg) Cheese'N' Egg Burger Pork'N' Egg Burger Beef'N' Egg Porridge Chicken'N' Mushroom Porridge Preserved Egg'N' Lean Pork Porridge Egg'N' Pork Floss Twister Egg'N' Pork Twister Shrimp'N' Egg Twister Hong Kong Milk Tea Shrimp Spring Roll Orange Juice
Dessert	Sundae (Chocolate/Pineapple/Strawberry) Ice Cream Cone (Vanilla/Chocolate/Mixed/Crunchy) Milkshake (Chocolate/Strawberry)	Portuguese Egg Tart Sundae Ice Cream Cone Coffee/Irish Coffee Lemon Cola Pomelo Honey Tea

Shaded areas: local specialities.

Source: McDonald's and KFC China websites.

China
McDonald's China Print Advertisement

I just love not having a backbone

I just love being sissy

I just love fighting my teacher

McDonald's China TV Advertisement

Exhibit 14 McDonald's Advertisement

Appendix: KFC and McDonald's Global Milestones

KFC

At the start of the Great Depression in 1930, Harland Sanders opened his first restaurant in the small front room of a gas station in Corbin, Kentucky. He was made an honorary Kentucky colonel six years later in recognition of his contribution to the state's cuisine. The Original Recipe chicken, which was deep fried in a pressure cooker with 11 herbs and spices, was created in 1940. In 1969, the Kentucky Fried Chicken Corporation was listed on the New York Stock Exchange. In 1986, PepsiCo, Inc. acquired KFC from RJR Nabisco, Inc., and 11 years later, in 1997, PepsiCo, Inc. announced the spin-off of its quick service restaurants—KFC, Taco Bell and Pizza Hut. In 2002, the world's largest restaurant company changed its corporate name to Yum! Brands, Inc. In addition to KFC, the company owns A&W® All-American Food® Restaurants, Long John Silver's®, Pizza Hut® and Taco Bell® restaurants.

Management Philosophy

KFC's parent company, Yum! Brands, runs a multi-brand strategy and is proud of its customer focus approach. Its restaurant management philosophy is summarized by the acronym "CHAMPS"—cleanness, hospitality, accuracy, maintenance, product quality, and speed. After the first successful ten years, Yum! began looking to sustain long-term growth, especially on an international level. According to the Yum! 2008 management presentation, its four key growth strategies are to build leading brands in China in every significant category; drive aggressive international expansion and build strong brands everywhere; dramatically improve US brand positions, consistency and returns, and drive industry-leading, long-term shareholder and franchisee value.[69]

International Expansion

KFC's penetration of Asia started with Japan in 1970. In 1984, it entered Taiwan, awarding the franchise to a joint venture company formed by two Japanese companies and a local entity. A year later, it re-entered Hong Kong after a 10-year gap, by giving franchise rights to Birdland, which later acquired the franchisee in Taiwan. From 1996 to 2001, Yum! Brands tried to win back ownership in the Greater China area by launching new KFC outlets in Taiwan in tandem with Birdland's operations, until finally in 2001, Birdland agreed to sell its KFC outlets in Taiwan to Yum! Brands. These experiences in Asian markets prepared Yum! Brands for its entry in 1987 into the largest and most exciting market in the world—China.[70]

McDonald's

The McDonald's concept was introduced in Southern California by Dick and Mac McDonald in 1937. In 1953, the McDonald brothers franchised their restaurant to Neil Fox, the first franchisee. The second McDonald's opened in Fresno, California—the first to feature the Golden Arches design. The fast-food idea was modified and expanded by their business partner Ray Kroc, of Oak Park, Illinois, who later bought out business interest of the McDonald brothers in the concept and went on to found McDonald's Corporation in 1955. In 1965, McDonald's went public with the company's first offering on the stock exchange. Twenty years later, in 1985, McDonald's was added to the 30-company Dow Jones Industrial Average.

The signature product, the Big Mac, was added to the product line in 1968 and was the brainchild of Jim Delligatti, one of Ray Kroc's earliest franchisees. Another popular product—the Happy Meal—has been making children's visits special since 1979.[71] McDonald's has become a global phenomenon, with more than 31,000 outlets operating in over 100 countries today.

Management Philosophy

Like KFC, McDonald's values were consumer driven. Its principles were summarized by QSCV. Quality, Service, Cleanness and Value. McDonald's was also known for the consistency of its procedures and quality, and its powerful global marketing campaigns. Its recent advertising campaign "i'm lovin' it",™ launched in every country in the world by September 2005, featured sports, entertainment, music, and fashion. Pop icons such as Justin Timberlake, Destiny's Child, and Wang Lee Hom for Asia were central to the campaign.

McDonald's was also known for its detail-oriented insistence on food preparation. Fred Turner, Senior

Chairman of McDonald's, developed the first operations manual in 1957. By 1991, it counted 750 detailed pages, setting out exact cooking times, proper temperature settings, and precise portions for all food items. For example, French fries were to be 9/32 of an inch; to ensure quality and taste, no products were to be held more than 10 minutes in the transfer bin.[72]

Peter Tan, former Senior Vice President and President of McDonald's Corporation Greater China, attributed McDonald's success to the fact that it provided consistency, convenience in terms of location, and good pricing. Great advertising, great taste in signature products such as Big Mac and French fries, and retail excitement such as Happy Meal promotions also played important roles.[73]

International Expansion

In 1967, the first McDonald's restaurant outside the United States opened in Richmond, British Columbia. In 1971, the first Asian McDonald's opened in Japan, in Tokyo's Ginza district. Although McDonald's opened its first outlet in greater China in Hong Kong as early as 1975, and Taiwan opened its first McDonald's in 1984, the first Mainland China McDonald's outlet was only introduced in October 1990 in Shenzhen. On 23 April 1992, the world's largest McDonald's opened in Beijing, China with over 700 seats.[74] In 1994, McDonald's made an historical debut in Kuwait City, and in 1996 the fast-food giant entered India.

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