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MCDONALD'S: IS CHINA LOVIN' IT?

McDonald's, the world-famous brand that defined American fast food, first appeared on US television during the 1960s. The company entered mainland China in 1990, before China's franchise law was introduced. Regarded globally as a representation of US culture and values, McDonald's emergence in China soon attracted an avalanche of Chinese customers eager to try out its burgers and fries, which were vastly different from the staples offered by local Chinese quick-service restaurants. By 2008, McDonald's was the second-largest fast-food provider in China in terms of number of outlets and popularity, after its primary rival, Kentucky Fried Chicken ("KFC"). Not only was food culture in China vastly different from that in the West, but Chinese food culture and lifestyles were changing as a result of surging economic growth and massive urbanisation. The competitive environment was also intensifying as local and foreign restaurants sought to capitalise on China's increasing affluence. China's rapidly growing middle class was also demanding higher standards from both local and foreign companies. McDonald's local business practices in terms of food healthiness, employee welfare and other environmental issues were placed under close scrutiny. Would McDonald's be able to keep pace with the rapid transformation of China from a closed country to an open and dynamic society?

McDonald's Localisation Approach

In a traditional Chinese meal, dishes were served on communal plates, which were placed at the centre of a table for everyone to share. Diners would use their chopsticks to pick food out of the communal plates on a bite-by-bite basis. This was quite different from a typical Western meal, in which individual servings were doled out at the beginning of the meal and diners would have their own sets of food to themselves.

Fast food was not a completely new idea in China. Noodle and dumpling stalls and restaurants selling typical, light and simple Chinese food (eg, steamed bread, noodles, dumplings and wontons) were commonplace in the country, forming a part of the traditional culture. In the late 1980s and early 1990s, the emergence of Western fast-food chains had changed the restaurant landscape in China through the different experience they offered to Chinese consumers: efficient self-service, standardised servings, less reliance on eating

Dr. Claudia H.L. Woo prepared this case under the supervision of Dr. Stephen Ko for class discussion. This case is not intended to show effective or ineffective handling of decision or business processes.

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utensils, a clean environment and a comfortable atmosphere. The immense curiosity of Chinese about foreign brands and their in-store experience had enabled these companies to set relatively high prices for their food [see **Appendix 1**].

McDonald's China's Franchising

Of McDonald's overseas outlets, 70% were franchises.¹ However, due to legal restrictions, this was not the case with its outlets in China. In fact, it was not until 1997 that China enacted its first franchise regulations, which applied only to domestic franchisors.² Only in December 2004 was a preliminary legal structure created for foreign franchisors as part of China's commitments to the World Trade Organisation.³ Since McDonald's entry into China in 1990, it had operated under direct investment model. Instead of using franchise operation model to grant qualified individuals a license to operate a chain store, McDonald's restaurants in China were operated through joint ventures with local companies and its wholly foreign-owned enterprises ("WFOEs") established in the country.⁴ Despite a long-term vision of setting up a franchise model in China as the government refined the franchise law, McDonald's China focused more on ensuring brand quality and management control.⁵ It was also of concern to the company that there were cases in China of other franchisees signing on as partners just to learn trade secrets and recipes and then open their own stores under different names. By February 2007, only one of 879 McDonald's restaurants in China was franchised, while the rest were either wholly owned or joint ventures.⁶ Meanwhile, its major rival, KFC, had about 37 franchises among its 1,700 restaurants. Compared to KFC, which entered China in 1987, McDonald's was a late entrant. However, its name and trademark, which were symbols of America, and its ability to adapt quickly to local conditions were advantages over many competitors.

Use of Local Ingredients

With its vast capital and technological know-how, McDonald's had developed its own internal supply network, including farms in China since the early 1990s, to sell to both the domestic and export markets. By forging joint-venture ties with powerful Chinese partners (eg, the state-owned General Corporation of Beijing Agriculture, Industry and Commerce), McDonald's had established a network of local farmers, food-processing manufacturers and other suppliers. It also helped local industries develop specialised infrastructure where none had existed previously. By 2006, 95% of materials employed by McDonald's in its supply chain for the Chinese market (eg, beef, potatoes, milk and vegetables) were sourced from the country.⁷

¹ Wen, X. (2007) "McDonald's China Chief Bites into Expansion Plans", *Shanghai Daily*, <http://www.franchisetochina.com/h31.htm> (accessed 15 August 2008).

² For further reading on China's franchise law, see: Wageman, R. (31 July 2007) "China's New Franchise Rules", *Franchise Update*, <http://www.franchise-update.com/articles/316/> (accessed 6 August 2008).

³ According to the 2004 measures, foreign franchisors had to establish foreign-invested commercial enterprises in China instead of operating as offshore entities and collecting fees directly from franchisees in China. See: Vedder, T. (19 August 2007) "Fast Food Domination", *China International Business*, http://www.cibmagazine.com.cn/Features/Industry.asp?id=85&fast_food_domination.html (accessed 9 October 2008).

⁴ Vedder, T. (19 August 2007) "Fast Food Domination", *China International Business*, http://www.cibmagazine.com.cn/Features/Industry.asp?id=85&fast_food_domination.html (accessed 9 October 2008).

⁵ Wen, X. (2007) op. cit.

⁶ Shen, S. (7 February 2007) "McDonald's Goes Slow in China Franchising", *International Herald Tribune*.

⁷ Cheung, A. (11 December 2006) "An Exclusive Interview with Gary Rosen, McDonald's Chief Marketing Officer in China", *The China Perspective: Consumer and Retail*, <http://thechinaperspective.com/articles/anexclusiveinterviewwithgaryrosenMcDonald'schiefmarketingofficerinchina1751/index.html> (accessed 29 August 2008).

Unique Store Design and Innovative Chinese Menu

To blend into the local culture, McDonald's decorated its restaurants with designs symbolising traditional Chinese culture. For example, during major Chinese festivals such as the Chinese Lunar New Year and mid-autumn celebration, it decorated store interiors with traditional Chinese paper art—red paper cut-outs of Chinese characters and pictures of auspicious symbols—like many local Chinese restaurants did. It also offered special festive items, such as the Prosperity Burger during the Lunar New Year. Just as KFC had capitalised on Chinese's preference for chicken over beef,⁸ McDonald's adapted its menu in China to focus on chicken burgers and spicy chicken wings. From time to time, other side-dishes inspired by the Chinese diet, such as red bean pie and seafood soup, were added to the menu. However, prior market test results showed that McDonald's Fantastic Rice Burger (a burger in between two patties of rice) launched in Hong Kong in 2006 was not that appealing to mainland Chinese consumers, despite rice being the staple food. Thus, the company only launched the rice burger as a promotional item in mainland China.⁹

Drive-Through and 24-Hour Services

In 2005, to compete with KFC,¹⁰ which had announced the debut of China's first drive-through restaurant in late 2002, McDonald's partnered with Sinopec, China's largest petrol retailer, to build McDonald's drive-through restaurants at some of Sinopec's 30,000 petrol stations in China.¹¹ With increased car ownership and a rapidly expanding middle class, McDonald's saw a demand for food on the go. Additionally, with teens' and young adults' growing appetite for Western food and nightlife, McDonald's had begun extending its business hours to 24 hours per day since the beginning of 2006. By mid-2007, nearly half of McDonald's 800 restaurants in China operated 24 hours per day; 60% of its restaurants in southern China were open 24 hours, compared with 45% in the north.¹²

Alliance with Internet Shopping Site and Delivery Service

The changing Chinese lifestyle was evident in the growing popularity of internet shopping among China's younger generation. To increase its exposure and attract these internet users, McDonald's China partnered with a popular Chinese online shopping site, Taobao.com,¹³ in September 2007 to give online shoppers coupons for McDonald's food and other promotional items. Additionally, diners in McDonald's restaurants were given a Rmb 20¹⁴ cash coupon for Taobao.com for every Super Value Meal they purchased.¹⁵ Although consumers were unable to place food orders online, the partnership gave McDonald's a greater online presence than its direct competitors. To further accommodate the fast-paced lifestyle of young Chinese and to catch up with rival KFC, it launched home delivery service from its 42 outlets in Shanghai in early 2008, covering half the city's population of 14 million.¹⁶

⁸ Eating beef was a taboo for Chinese who practiced Buddhism and regarded cows as sacred. However, while some Buddhists avoided meat entirely, there were others who only shunned beef.

⁹ Cheung, A. (11 December 2006) op. cit.

¹⁰ In 2006, McDonald's market share in China was 17.9%, up from 8.4% in 2004, whereas KFC's was 34.6%, compared with 15.8% in 2004. See: China Economic Review (30 January 2008) "McDonald's to Add 125 Outlets in China", http://www.chinaeconomicreview.com/dailybriefing/2008_01_30/McDonald's_to_add_125_new_outlets_in_China.html (accessed 9 September 2008).

¹¹ China Daily (21 June 2006) "McDonald's, Sinopec Serve Up Drive-Thru Deal", <http://www.china.org.cn/english/2006/Jun/172243.htm> (accessed 22 August 2008)

¹² MadisonBoom (7 July 2007) "McDonald's China Boosts its 24-Hour Services", <http://www.madisonboom.com/?id=1944> (accessed 20 August 2008)

¹³ Taobao.com was a subsidiary of Chinese e-commerce firm Alibaba, which was partly owned by Yahoo.

¹⁴ Rmb 1 = US\$0.146 in July 2008.

¹⁵ ChinaTechNews (11 September 2007) "McDonald's Goes Online at Taobao.com", <http://www.chinatechnews.com/2007/09/11/5869-McDonald's-goes-online-at-taobao.com/> (accessed 10 September 2008).

¹⁶ Shen, S. and Klamann E. (25 February 2008) "McDonald's Tries Home Delivery to Push China Sales", *Reuters*, <http://www.reuters.com/article/hotStocksNews/idUSPEK34256620080225> (accessed 10 September 2008)

Tier Pricing

Customers in the US ate at McDonald's because of its speed, convenience and relatively cheap food. Young Chinese customers had a different view; they visited McDonald's and other Western restaurants or café chains because they were trendy places to socialise with friends and relax, even though the food was more expensive than at local restaurants. Because the average per-capita annual income in urban Beijing, the capital of China, was just over US\$3,200 in 2006,¹⁷ many lower-income consumers could not afford to eat at Western fast-food chains, which charged over US\$3 for a basic meal.¹⁸ Although there was growing affluence in China as a whole [see **Exhibit 1**], the average income varied greatly between regions and between rural and urban areas [see **Exhibits 2 and 3**]. To respond to uneven wealth distribution in such a big country and to counter the impact of food price inflation since 2007, McDonald's explored the use of a tier pricing model in China, as it had in the US and European markets and some places in Asia such as Taiwan and Japan, to sell products at a range of prices for consumers with different purchasing power.¹⁹ By partitioning the country into a few districts, prices were adjusted according to income levels, the consumer price index and other cost factors for each district [see **Exhibit 4** for China's gross domestic product ("GDP")²⁰ distribution by province].

Appeal to Nationalism in Advertising

In 2008, Beijing hosted the Olympic Games. McDonald's had built most of its global marketing campaign around the theme of advocating Olympics spirit among people from all over the world and promoting an "active balanced lifestyle". However, this universal message gave way to a nationalistic appeal in China, where McDonald's used the Chinese slogan "*wo jiu xihuan zhongguo ying*" ("I'm lovin' it when China wins") as part of its localisation strategy. Jeff Schwartz, McDonald's China's chief executive officer, believed the campaign demonstrated the company's "deep-seated commitment to the people of China, the Chinese government" and was of the opinion that its slogan resonated "very, very strongly with all the Chinese consumers".²¹

Infusion of Western Tradition

Despite traditionally making beef burgers, McDonald's had, upon entering China, localised its menu for the Chinese market by offering a selection of chicken products besides the traditional beef burger. In 2006, the advertising campaign of McDonald's China was a milestone for the company, which re-established its American roots and reconsidered its strategy by pushing its beef products with sexually suggestive ads [see **Exhibit 5**]. Gary Rosen, the chief marketing officer of McDonald's China said, "People want McDonald's to be a Western brand. When people come to us, they want an alternative to what they can get everywhere else."²² Furthermore, instead of introducing breakfast items that were more

¹⁷ National Bureau of Statistics (2007) "China Statistical Yearbook", <http://www.stats.gov.cn/tjsj/ndsj/2007/indexeh.htm> (accessed 10 September 2008).

¹⁸ A McDonald's Big Mac set meal cost about US\$3.60 in China, which was far more expensive than meals in regular Chinese restaurants. See: Tian, K. (9 March 2008) "McDonald's in China", *The Buffalo News*, <http://www.buffalonews.com/lifearts/next/story/429644.html> (accessed 10 September 2008).

¹⁹ Smith, G. (20 August 2008) "McDonald's Taiwan Drops 'One Price Fits All' Strategy", *BrandPublic.asia*, http://www.brandpublic.asia/Media/Marketingarticle/2008_08/McDonalds-Taiwan-drops-one-price-fits-all-strategy/32284 (accessed 10 September 2008)

²⁰ GDP is the total market value of all final goods and services produced in a country in a given year.

²¹ Tschang, C. (28 May 2008) "Olympic Sponsors Cheer the Home Team", *Business Week*, http://www.businessweek.com/globalbiz/content/may2008/gb20080527_190692.htm (accessed 10 August 2008).

²² Fairclough, G. and Adamy, J. (21 September 2006) "Sex, Skin, Fireworks, Licked Fingers—It's a Quarter Pounder Ad in China", *The Wall Street Journal*, <http://online.wsj.com/article/SB115878077581269173.html?mod=seekingalpha&CFID=10378831&CFTOKEN=24862953> (accessed 19 August 2008)

traditionally Chinese in taste, McDonald's China promoted its American-style breakfast (eg, Sausage McMuffins, McEggs, and Hashbrowns) to all its branches in China in late 2006. Not only were the margins on breakfast items higher than on burgers, but the growth potential of the breakfast market was enormous in China, with 80% of Chinese consumers eating breakfast, among which 68% ate breakfast away from home.²³ Another major new element of its US breakfast menu, premium coffee, was tested in China, although Chinese consumers generally drank more tea than coffee. There were also plans to build in-store coffee shops, McCafes, in China, consistent with its strategy in America. While staying true to its heritage, Rosen considered the company to be "a Chinese company operating in China with a well-established Western brand" acting as "a window to the West".²⁴

Controversial Issues

Amid rising inflation in China, a Chinese state-owned newspaper revealed in April 2007 that McDonald's and Yum Brands Inc (which owned KFC and Pizza Hut) had underpaid their part-time employees in Guangzhou, a first-tier²⁵ city in southern China [see **Exhibit 4**]. Four months later, the state-backed All-China Federation of Trade Unions called on McDonald's to let its workers unionise and to adjust its pay. Consequently, the company publicly announced an increase in its employees' pay to between 12% and 56% above local minimum wages.²⁶ In February 2008, when China's inflation hit an 11-year high of 8.7%, many restaurants across the country raised prices to make up for the surging costs of various materials.²⁷ Following three separate price increases in 2007, McDonald's China quietly raised prices for almost all its products by 5–10% on 23 February 2008.²⁸ Therefore, some consumers expressed dismay, as no proper formal announcement had been made. Some also expected that the appetite for McDonald's might decline, particularly among those who had travelled abroad and realised that they were paying a luxurious price at home for food that was valued lower overseas.

Social critics also pointed out that McDonald's had not applied the same health-improvement and environmental standards in China as it did in other places.²⁹ For example, its Happy Meals targeted at children offered "better-for-you" substitutes (eg, milk and Apple Dippers) in the US, but not in China. Also, McDonald's in Hong Kong observed two "no-straw days" every month, but this programme was not implemented in mainland China. Over growing Chinese government concern that a Western fast-food diet might cause China the same health problems (eg, obesity) considered epidemic in the West, McDonald's China claimed to be making considerable efforts to assure consumers the healthiness of its ingredients used (eg, exclusive use of free-range eggs, meat from reliable farms, refusal to use genetically modified ingredients, and no trans-fats french fries³⁰).

²³ Reuters (23 May 2007) "McDonald's Pushing McMuffins and Coffee in China", <http://www.flex-news-food.com/console/PageViewer.aspx?page=8868&print=yes> (accessed 8 August 2008)

²⁴ Cheung, A. (11 December 2006) op. cit.

²⁵ First-tier cities included eastern coastal cities and southern cities, such as Beijing, Shanghai, Shenzhen and Guangzhou. Second-tier cities were generally located in industrialised areas of north-eastern and western China, such as Tianjin, Shenyang and Wuhan.

²⁶ Asia Times (8 August 2007) "McDonald's Raises Wages in China", http://www.atimes.com/atimes/China_Business/IH08Cb02.html (accessed 8 August 2008)

²⁷ Chen, S. (25 February 2008) "McDonald's Quietly Raises Prices in China", *Forbes*, www.forbes.com/2008/02/25/mcdonalds-china-pricehikes-markets-equity-cx_jc_0225markets04.html (accessed 8 August 2008)

²⁸ Ibid.

²⁹ French, P. (28 May 2008) "Why is China Different from Western Brand", *ChinaDialogue*, <http://www.chinadialogue.net/article/show/single/en/2046-Why-is-China-different-for-western-brands-> (accessed 8 August 2008).

³⁰ Xinhua (14 February 2006) "McDonald's Says its China Restaurants Do Not Use Trans-Fats in French Fries", http://english.peopledaily.com.cn/200602/14/eng20060214_242478.html (accessed 9 August 2008)

At times, McDonald's in developing nations had been targeted by anti-American activists;³¹ however, in 2008, the company risked a backlash in the rest of the world for "selling out" to the Chinese as a result of the "I'm lovin' it when China wins" slogan for its Olympics marketing campaigns in China. Like many other multinational companies who had played the nationalism card in China, McDonald's had hoped there was little risk in doing so because the campaigns were in Chinese and ran only in China.³² Nevertheless, the slogan triggered criticism back in the US; Brian Sullivan, the American news anchor for the Fox Business Channel, openly commented, "Supporting the host nation is one thing ... and you're [McDonald's] spending a lot of money on the Games and it's appreciated. But show your appreciation to the American athletes and don't openly pander to China's Olympic fervour. Remember: you are an American company. You were built here."³³

While the booming economy of China offered the environmental conditions corresponding to fast-food culture, the environment also posed challenges to McDonald's. The prevalence of McDonald's restaurants in China seemed to suggest the Chinese were "lovin' it". However, would McDonald's be able to sustain its momentum as China transformed itself into a developed nation? What would be the opportunities and threats presented to McDonald's by the transforming environment in China?

³¹ Bomb attacks on McDonald's restaurants had happened in various developing countries, including Turkey, China and Saudi Arabia.

³² Tschang, C. (28 May 2008) op. cit.

³³ SportsBusiness Daily (8 July 2008) "Olympic Notes", <http://www.sportsbusinessdaily.com/article/122165> (accessed 10 August 2008).

APPENDIX 1: CHINA'S FAST-FOOD INDUSTRY

Western Fast-Food Chains

McDonald's rival, KFC, was the first foreign company to bring the concept of fast food to the country in 1987—a full five years ahead of McDonald's entry into China. Its first outlet in Beijing was in a three-storey building of 1,100 square metres, making it the world's largest KFC by floor space. Although the standard KFC meal cost almost one-tenth the monthly income of urban residents of Beijing then, more than 2,000 buckets of fried chicken were sold on the opening day, when the line of customers stretched 50 metres out the door.³⁴ KFC's success had lured McDonald's to the Chinese market in October 1990; the company opened its first 500-seat restaurant in Shenzhen, where there was no KFC at the time. Again, despite the high price it charged, the Ronald McDonald clown, Golden Arches and Big Mac attracted many local consumers to the restaurant. That same year, Pizza Hut also opened its first store in Beijing and introduced another new concept—that of “casual dining”, where soft music was broadcasted and customers were greeted at the door, were led to their tables, and dined in a relaxed and less-frenzied atmosphere than that of other fast-food outlets.³⁵ At the time, such service was comparable to that of high-class Chinese restaurants. Many Chinese in those early days considered dining at KFC, McDonald's or Pizza Hut a luxury.

Booming Fast-Food Sector

Companies that originated in Asia and which were familiar with both Chinese tastes and Western management styles also emerged in China during the economic reform. For example, Hong Kong's Café de Coral,³⁶ the market leader of the fast food sector in Hong Kong, expanded its market to the mainland China in 1992 by offering both Chinese and Western food. Taiwan's Ting Hsin International Group entered China in 1994 and introduced its Dicos³⁷-brand fried chicken. Another popular Asian fast-food brand was Japan's noodle chain, Ajisen Ramen,³⁸ which entered China in 1995. As foreign fast-food companies sprang up quickly during the 1990s, the Chinese government expected the fast-food sector to grow rapidly in the country and contributed significantly to restaurant industry revenues. Such governmental estimation had stimulated the establishment of many home-grown fast-food chains, which offered more-Chinese menus and lower prices than their foreign counterparts. However, many of them were short-lived because they failed to develop systems like those of foreign chains, which oversaw every detail of the business, including site selection, purchasing of ingredients, food preparation, service delivery, restaurant hygiene, and staff training and management. To assure staff quality, McDonald's trained its staff at its corporate schools, Hamburger University, which had a branch campus in Hong Kong; whereas KFC tailored its education development centre especially for China and required each employee to go through a 200-hour training programme.³⁹

³⁴ Ding, Q. (30 June 2008) “Fast Food Nation”, *China Daily*, http://www.chinadaily.com.cn/bw/2008-06/30/content_6804213.htm (accessed 5 September 2008)

³⁵ Ibid.

³⁶ Café de Coral Group (大家乐) was established in Hong Kong in 1968. It was listed in Hong Kong Stock Exchange and had restaurants and food processing businesses in Hong Kong, Macau, Mainland China and North America. It expanded its business to mainland China in 1992 and offered a combination of Western and Asian meals, for breakfast, lunch, tea-break, dinner, and late supper. See Café de Coral China's website: <http://www.cafedecoralcn.com/>

³⁷ Dicos (德克士) was the first fast-food service venture of Taiwan's Ting Hsin International Group. In 1994, Dicos Fried Chicken entered the China market. It had three regional offices in the Eastern, Western and Northern areas of China, and estimated to reach over 600 franchise stores by the end of 2006. However, in July 2007, Dicos was reported completely retreated from Beijing, as a result of the fierce competition with KFC and McDonald's. See Dicos China's website: <http://www.dicos.com.cn/index.asp>

³⁸ Japan's Ajisen Ramen (味千拉面) entered the mainland Chinese market in 1995, when its first store was set up in Beijing through a joint venture. It focused on selling Japanese ramen noodle soup dishes. Ajisen Ramen China Holding Company was listed on the Hong Kong Stock Exchange in 2007. See Ajisen Ramen's website: <http://www.aji1000.co.jp/companyinfo/history.html>

³⁹ Ding, Q. (30 June 2008) op. cit.

Chinese Fast-Food Chains

In 2001, some local Chinese fast-food chains began to update and standardise their systems. Malan Noodles⁴⁰, established in 1993, was one of the successful Chinese fast-food chains. It designed crafts and procedures for noodle-making and instituted technical standards for stewing and modulating gravy to ensure consistent taste of the noodles and minimise human error. In 1999, Malan Noodles was China's most popular fast-food chain after KFC and McDonald's, and it set up its first overseas outlet in Los Angeles in the same year. However, Malan Noodles had been through hard times; several of its stores closed down between 2003 and 2005 due to fierce competition from both local and foreign chains.⁴¹ In 2007, Euromonitor International, the global market research agency, ranked Malan Noodles the sixth position – after KFC, McDonald's, Dicos, Café de Coral, and Ajisen Ramen – in “Top 20 Chained Fast Food Brands in China” for the year 2006.⁴² Besides emphasising the nutritional value of its noodles and the ingredients that it used, it also promoted a wide selection of Chinese dishes to customers, unlike Western fast food, which lacked variety. By 2008, it owned more than 400 stores in the China. Daniang Dumpling⁴³ was another successful Chinese chain. It began operations in April 1996, selling dumplings of different flavours and cooking methods. It also offered a variety of traditional Chinese dishes and, until 2008, owned more than 300 stores in China. Other popular Chinese chains included Eastern Dumpling King,⁴⁴ YongHe King⁴⁵ and Kungfu Catering.⁴⁶ These local Chinese chains mostly concentrated their business in urban cities in specific regions and offered food-delivery service. Lihua Fast Food was a special fast-food delivery company established in 1993 that operated without storefronts but owned a well-equipped kitchen with a skilful kitchen crew. It made use of computers to facilitate an efficient food-ordering and tracking system, and utilised the Global Positioning System (“GPS”) to aid food delivery. It was also the first fast-food company in China to use environmentally friendly packaging and implement the ISO 4001 environmental management system.

Generally, foreign brands competed for national market share, whereas many local brands concentrated on specific regions.⁴⁷ Inadequate funding was a big stumbling block for Chinese fast-food chains, some of which resorted to local or international venture capital or capital markets to raise business development funds.

New Competition

After the peak time in 1990s when the presence of foreign restaurants mushroomed in China, there were still many large, foreign fast-food chains eyeing the growing market in mainland China. One of them was the Burger King, which launched its brand in China in 2005 but

⁴⁰ See Malan Noodles's (马兰拉面) website: <http://www.malan.com.cn/>.

⁴¹ LanZhou Morning Post (26 July 2005) “Malan Noodles Undertakes Market-Repositioning Measures”, <http://finance.sina.com.cn/chanjing/b/20050726/13321835751.shtml> (accessed 2 September 2008)

⁴² Cited in Han, M., Xu, M., Xian, V. and Hu, J. (29 February 2008) “China, Peoples Republic of HRI Food Service Sector: 2008”, GAIN Report no. CH8401, USDA Foreign Agricultural Service, <http://www.fas.usda.gov/gainfiles/200802/146293804.doc> (accessed 20 November 2008)

⁴³ See Daniang Dumpling's (大娘水饺) website: <http://www.cnDDR.com/index.htm>.

⁴⁴ Eastern Dumpling King (东方饺子王) was established in 1993 and served dumplings of various flavours and other traditional Chinese dishes. It aimed to promote traditional Chinese eating culture, and its website provided a history of some of the traditional Chinese festive occasions and the meaning behind some traditional Chinese foods. See Eastern Dumpling King's website: <http://www.ccdjzw.com/>.

⁴⁵ YongHe King (永和大王) was established in December 1995 and specialised in noodles and Chinese dishes. It merged with the Philippines' giant fast-food conglomerate, Jollibee, in 2004. Jollibee was a listed company in Philippines founded by a Chinese immigrant. Jollibee owned restaurant chains around the world, such as Delifrance and Chowking. See Yonghe King's website: <http://www.yonghe.com.cn/>.

⁴⁶ Kungfu Catering (真功夫快餐) was established in 1994 and was famous for the use of steaming in preparing its Chinese dishes, which it claimed to be healthy. The company used the image of Bruce Lee, the famous Chinese martial artist, in its logo.

⁴⁷ Vedder, T. (19 August 2007) “Fast Food Domination”, *China International Business*, http://www.cibmagazine.com.cn/Features/Industry.asp?id=85&fast_food_domination.html (12 September 2008).

lagged way behind McDonald's in terms of brand awareness and outlet numbers. Both McDonald's and Burger King had a disadvantage compared to KFC because their core products were based on beef rather than chicken, which was suited to local tastes. Another burger restaurant was Japan's Mos Burger,⁴⁸ the largest fast-food franchise in Japan after McDonald's, which targeted mainland China in 2008.

Growing disposable income in urban China had pushed customers, especially those in the prosperous southern and eastern coastal regions, to place higher expectations on restaurants in general regarding such aspects as the design of their outlets, the innovativeness of their menus and the nutritional quality of their food. Thus, theme restaurants such as Rainforest Cafe⁴⁹ entered the Western fast-food market in China and won the favour of many Chinese adults and children. Other fast-food restaurants such as the US's Subway, which primarily sold sandwiches and salads, also stepped in to fill the healthy-fast-food niche. The success of coffee chains such as Starbucks, which appealed to youngsters and workers on the move, also forced fast-food operators to create more sophisticated eating environments.

⁴⁸ Japan's Mos Burger (摩斯漢堡) owned many overseas outlets in Singapore, Thailand, Hong Kong and Taiwan. It was famous for its rice burger, in which rice was used as a bun. It also offered teriyaki chicken, chicken breasts, fish and standard hamburgers. See Mos Burger's website: <http://www.mos.co.jp/english/>.

⁴⁹ Rainforest Cafe was a theme-restaurant chain owned by Landry's Restaurants, Inc of Houston, Texas. The restaurant was decorated to depict some features of a generic rainforest. See Rainforest Cafe's website: <http://www.rainforestcafe.com/>.

EXHIBIT 1: PER-CAPITA ANNUAL INCOME AND ENGLE COEFFICIENT⁵⁰ OF URBAN AND RURAL HOUSEHOLDS, 1978–2006 (IN US\$)⁵¹

Year	Per-Capita Annual Disposable Income of Urban Households		Per-Capita Annual Net Income of Rural Households		Engle Coefficient of Urban Households	Engle Coefficient of Rural Households
	Value (US\$)	Index	Value (US\$)	Index	(%)	(%)
1978	50.14	100.0	19.51	100.0	57.5	67.7
1980	69.73	127.0	27.93	139.0	56.9	61.8
1985	107.91	160.4	58.05	268.9	53.3	57.8
1990	220.49	198.1	100.20	311.2	54.2	58.8
1991	248.29	212.4	103.46	317.4	53.8	57.6
1992	295.88	232.9	114.46	336.2	53.0	57.6
1993	376.30	255.1	134.55	346.9	50.3	58.1
1994	510.45	276.8	178.27	364.3	50.0	58.9
1995	625.32	290.3	230.34	383.6	50.1	58.6
1996	706.48	301.6	281.21	418.1	48.8	56.3
1997	753.40	311.9	305.15	437.3	46.6	55.1
1998	792.06	329.9	315.65	456.1	44.7	53.4
1999	854.68	360.6	322.70	473.5	42.1	52.6
2000	916.88	383.7	329.00	483.4	39.4	49.1
2001	1,001.50	416.3	345.49	503.7	38.2	47.7
2002	1,124.61	472.1	361.44	527.9	37.7	46.2
2003	1,236.94	514.6	382.84	550.6	37.1	45.6
2004	1,375.55	554.2	428.71	588.0	37.7	47.2
2005	1,531.98	607.4	475.22	624.5	36.7	45.5
2006	1,716.89	670.7	523.70	670.7	35.8	43.0

Source: National Bureau of Statistics of China (2006) “China Statistical Yearbook”.

Urban/Rural Division of Population

	2000	2001	2002	2003	2004	2005	2006
Urban (% of Population)	35.36	35.93	36.33	36.80	37.33	37.74	38.30
Rural (% of Population)	64.64	64.07	63.67	63.20	62.67	62.26	61.70
Total (%)	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Population (Million persons)	1,248.12	1,261.25	1,274.52	1,287.88	1,301.23	1,314.59	1,327.96

Source: Adapted from Access Asia (2007) “Fast-Food and Consumer Catering in China 2007: A Market Analysis”.

⁵⁰ The Engle Coefficient was a measure of the proportion of expenditures spent on food.

⁵¹ The original currency figures in Exhibits 1, 2, 3 and 4 were in Rmb. Rmb 1 = US\$0.146 in July 2008.

**EXHIBIT 2: PER-CAPITA ANNUAL INCOME OF URBAN HOUSEHOLDS BY SOURCE
AND REGION IN CHINA, 2006 (IN US\$)**

Region	Disposable Income	Total Income	Income from Wages and Salaries	Net Business Income	Income from Properties	Income from Transfers
National Average	1,716.88	1,857.00	1,279.98	118.20	35.63	423.20
Beijing#	2,916.72	3,272.90	2,377.49	34.51	39.50	821.41
Tianjin#	2,085.33	2,259.50	1,351.92	108.47	24.10	775.01
Hebei	1,504.47	1,589.53	1,031.53	113.77	16.57	427.65
Shanxi	1,464.04	1,575.91	1,150.09	55.05	23.28	347.50
Inner Mongolia	1,512.27	1,578.53	1,102.69	139.52	30.63	305.70
Liaoning	1,513.96	1,639.58	965.27	100.47	21.39	552.46
Jilin	1,427.16	1,495.81	960.17	114.79	17.12	403.73
Heilongjiang	1,340.62	1,419.40	880.10	150.69	14.50	374.11
Shanghai#	3,017.51	3,330.05	2,338.39	139.94	43.84	807.88
Jiangsu	2,056.30	2,226.30	1,387.20	183.94	37.90	617.27
Zhejiang	2,666.70	2,913.29	1,900.30	317.13	129.76	566.09
Anhui	1,426.57	1,543.88	1,084.91	99.32	21.65	338.01
Fujian	2,007.98	2,204.95	1,484.02	139.64	74.28	507.01
Jiangxi	1,394.46	1,462.13	1,007.10	95.39	15.61	344.03
Shandong	1,780.07	1,930.54	1,524.54	81.49	32.22	292.29
Henan	1,432.30	1,509.52	1,001.78	112.48	18.94	376.33
Hubei	1,431.19	1,537.87	1,105.74	71.09	17.93	343.11
Hunan	1,533.68	1,627.33	1,080.65	135.76	41.93	368.99
Guangdong	2,338.27	2,587.93	1,902.57	195.55	82.56	407.25
Guangxi	1,445.22	1,551.15	1,083.23	130.06	27.71	310.14
Hainan	1,371.69	1,471.93	1,015.35	106.16	33.76	316.66
Chongqing	1,689.18	1,832.14	1,352.90	76.68	28.16	374.40
Sichuan	1,365.12	1,477.08	974.69	94.02	37.99	370.37
Guizhou	1,331.03	1,378.14	950.04	129.40	17.65	281.04
Yunnan	1,470.20	1,583.82	1,004.68	78.36	68.22	432.56
Tibet	1,305.40	1,392.97	1,096.79	56.92	31.82	207.43
Shaanxi	1,353.08	1,450.98	1,015.90	45.12	25.61	364.35
Gansu	1,302.41	1,399.62	1,023.23	58.92	4.69	312.78
Qinghai	1,314.05	1,431.26	922.23	82.36	9.19	417.48
Ningxia	1,339.88	1,460.30	941.82	142.93	13.02	362.53
Xinjiang	1,295.21	1,414.60	1,093.64	86.84	8.52	225.60

Beijing, Tianjin and Shanghai are cities administered by the central government. The others are provinces.

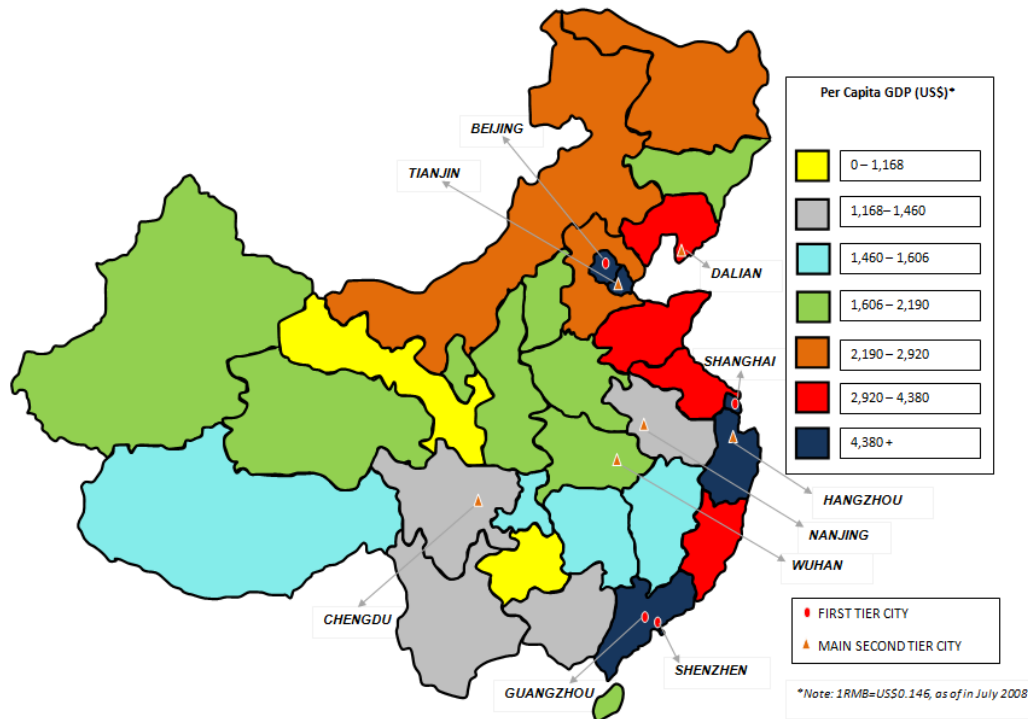
Source: National Bureau of Statistics of China (2006) "China Statistical Yearbook".

**EXHIBIT 3: PER-CAPITA ANNUAL INCOME OF RURAL HOUSEHOLDS BY SOURCE
AND REGION IN CHINA, 2006 (IN US\$)**

Region	Net Income	Income from Wages and Salaries	Income from Household Operations	Income from Properties	Income from Transfers
National Average	523.71	200.72	281.92	14.67	26.39
Beijing#	1,208.22	736.92	285.74	99.11	86.46
Tianjin#	909.28	474.20	395.27	18.45	21.36
Hebei	555.07	221.14	297.79	15.73	20.41
Shanxi	464.41	200.65	236.94	10.88	15.94
Inner Mongolia	487.91	86.24	351.31	12.38	37.98
Liaoning	597.20	218.92	322.78	20.70	34.79
Jilin	531.60	88.35	373.28	27.41	42.57
Heilongjiang	518.66	95.61	368.14	21.27	33.64
Shanghai#	1,334.24	976.15	112.09	81.49	164.51
Jiangsu	848.73	453.30	331.62	26.06	37.75
Zhejiang	1,070.88	521.97	450.30	45.49	53.11
Anhui	433.49	172.88	236.19	7.71	16.71
Fujian	705.87	270.91	362.32	16.57	56.08
Jiangxi	505.09	210.44	272.07	5.13	17.46
Shandong	637.77	244.04	351.83	18.63	23.27
Henan	476.11	149.32	307.81	5.89	13.09
Hubei	499.23	175.08	305.89	3.78	14.47
Hunan	494.88	211.65	254.53	6.20	22.50
Guangdong	741.65	424.30	247.27	32.25	37.83
Guangxi	404.78	142.25	249.04	3.28	10.21
Hainan	475.31	81.14	363.09	7.22	23.86
Chongqing	419.58	191.25	197.04	3.98	27.31
Sichuan	438.35	178.05	231.63	7.71	20.95
Guizhou	289.75	104.46	162.47	5.39	17.43
Yunnan	328.57	64.50	238.21	12.00	13.85
Tibet	355.50	82.98	205.93	22.78	43.81
Shaanxi	329.99	123.85	178.02	7.67	20.45
Gansu	311.57	93.06	188.61	7.67	22.23
Qinghai	344.32	95.38	200.66	14.70	33.59
Ningxia	402.98	120.17	242.66	7.79	32.36
Xinjiang	399.64	37.09	339.16	8.57	14.82

Beijing, Tianjin and Shanghai are cities administered by the central government. The others are provinces.

Source: National Bureau of Statistics of China (2007) "China Statistical Yearbook".

EXHIBIT 4: VALUE OF GDP PER CAPITA BY PROVINCE, 2006

Source: Adapted from Access Asia. (2007) “Fast-Food and Consumer Catering in China 2007: A Market Analysis”.

EXHIBIT 5: MCDONALD'S BILLBOARD ADS USING SEXUAL APPEAL, 2006

The Chinese tagline read: "stimulate your senses, feel the perfect beef taste".

Source: Fairclough, G. and Adamy, J. (21 September 2006) "Sex, Skin, Fireworks, Licked Fingers—It's a Quarter Pounder Ad in China", *The Wall Street Journal*, <http://online.wsj.com/article/SB115878077581269173.html?mod=seekingalpha&CFID=10378831&CFTOKEN=24862953> (accessed 19 August 2008)

To view the related TV ad, "Feel the Beef", click the "Watch the Ad" link as appeared in the above website.