

KENTUCKY FRIED CHICKEN IN CHINA (C)

Professors Allen J. Morrison and Paul W. Beamish prepared this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In early March 1988, Tony Wang stared out the third storey window of Kentucky Fried Chicken's (KFC) Beijing restaurant at the crowds gathering on the street below. It was barely 10:00 on a Sunday morning and already people were lining up to purchase a meal that for most would cost over one-quarter of their weekly salary. To Wang, vice president of KFC for southeast Asia and China, the crowds came as no surprise. In fact, in only four short months since opening, the Beijing restaurant had become the highest selling single KFC store in the world. What was surprising to Tony Wang were his growing reservations about proceeding further in the Chinese market.

Wang was particularly worried about the mounting uncertainty of the entire venture. Although the restaurant had been successful in capturing the interests of Chinese consumers, conflicts with the company's two local partners were frequent and showed no signs of immediate resolution. Most of these disputes revolved around the imposition on KFC's management practices, which Wang regarded as essential in determining the operation's profitability. KFC's control mechanisms were designed to ensure standard levels of quality, service and cleanliness at all of the restaurant chain's stores around the world. Yet, the strictness with which these standards were enforced angered the local partners who felt left out of the decision making while wondering whether lower requirements would be equally acceptable to customers.

In spite of these concerns, sales continued to climb to the point where chicken supplies were running out. Adding to the confusion were the requests of both local partners for more rapid expansion into other Beijing locations. Should KFC feel compelled to spearhead further expansion at this point in time? Tony Wang wondered how and when to respond to his partners, his employees, and the burgeoning Chinese market.

TIANANMEN SQUARE LOCATION

With the partners in place, B-KFC proceeded to investigate possible store locations in and around Beijing. Visibility, store-size and availability, and traffic flow were the primary criteria used in selecting the site. After weighing several alternatives, a decision was made to pursue a location just off Tiananmen Square. The site featured a vacant three-storey facility in excellent condition. The location in the heart of the city would provide unsurpassed visibility.

However, with the benefits of visibility came the possibility that the location would be difficult to obtain. Much time could be wasted in negotiations which could be publicly encouraged by government officials eager to seek political gain from the West. The fear was that in the end the site would be silently vetoed by Communist party leaders troubled by the cultural imagery of Colonel Sanders in the shadow of Mao's tomb.

In winning the site, it was becoming ever more apparent that the imagery battle would be critical. According to Wang, their key strategy was:

To convince the government that the restaurant would represent a symbol and statement of the Peoples' Republic of China's commitment to an open policy with the West. Just as our image was important, we tried to play on the Chinese concern that they present a positive image with the outside world.

While this strategy was supported in principal by the two local partners, Animal Production and the Tourist Bureau knew they had far more to lose than their American partner by pushing the government too hard. According to Mr. Xia:

We had several disagreements. Our position was that we shouldn't push too much. Government backlash was always possible.

Through sensitive negotiations, a government backlash seemed to be avoided and a lease was finally approved in April 1987 for the Tiananmen Square location. The lease represented a 10-year commitment from B-KFC. The store's facilities would represent KFC's largest restaurant in the world with 1,400 square metres of space allowing for a capacity of 500 seats and considerable office space for B-KFC staff.

Still lacking was a building permit (to make renovations to the site), and hookups for water, gas, and heating. Many times in Beijing applications for service would go missing or service would be “unavailable” for no apparent reason. Heating was a particular problem — all facilities in the city were heated by common pipes from central Beijing heating plants. In these matters, KFC relied on the local partners for assistance, but felt a certain resistance to press for timely and adequate service.

KFC'S ORGANIZATION IN CHINA

By contractual arrangement, KFC was to provide a general manager responsible for the day-to-day operations of B-KFC. The man who held this position was Sim Kay Soon, a 30-year-old Singaporean. Sim joined the KFC system in 1980, and was selected for this position by Wang in the spring of 1987. In the interim period, he held area manager and more recently training officer positions. As general manager, Sim reported to Daniel Lam, KFC's newly appointed Area Director for China. Lam was based in Hong Kong and spoke fluent English, Mandarin and Cantonese.

As events in China progressed, Wang began relying more and more on Lam for management support. Wang's attention was increasingly being split with his other duties in southeast Asia. Estimates were that by the end of 1988, KFC would have 153 units established in the region, an increase of 45 units in the last two years alone. Table A presents a breakdown of country sales for southeast Asia.

Table A

KFC REGIONAL SALES ESTIMATES FOR 1988

	Number of Units	Sales (US\$ millions)
Malaysia	66	33.9
Indonesia	34	11.3
Hong Kong	13	12.3
Thailand	7	2.8
Singapore	33	27.0
Total	153	87.3

For Sim, the move to Beijing represented a one and a half year appointment out of the booming regional office. It also represented a significant promotion. Nevertheless, the position was somewhat of a hardship posting as few of the conveniences found in Singapore would be available in Beijing. Sim expected that

a combination of stress and monotony would characterize his stay. His intended residence for 18 months was a Chinese hotel room negotiated by the Tourist Bureau.

HIRING LOCAL WORKERS

When initial announcements were made in the local papers that B-KFC would soon begin hiring, the joint venture was flooded with applicants. The decision to hire any particular applicant was made by Sim as the General Manager of B-KFC. From the outset, KFC insisted on a policy that treated all applicants equally. No referrals would be accepted under any circumstance. This was a unique move in China where family contacts were often used to land highly sought after jobs. This was also a move that was initially opposed by the two local partners.

Working for a foreign joint venture was an attractive opportunity for many Chinese because foreign partners often paid considerably above local wage levels. In Beijing, for example, it had been reported that English-speaking doormen at the joint venture Sheraton Great Wall Hotel could earn up to three times as much as the top brain surgeon in the country. At KFC, the base salary promised applicants was set at RMB 140 per month. This level was about 40 per cent more than could be received at typical industrial facilities and up to 10 per cent more than the remuneration received by associate professors at the country's universities. As was common among foreign joint ventures, B-KFC also devised an additional incentive scheme to encourage worker productivity. Incentive pay for conscientious employees could amount to another RMB 150 per month. For the Chinese worker, it was a bonanza. So attractive was the compensation package that 20 people applied for every opening available.

The example of Mrs. Liu is indicative of the type of employees hired by B-KFC. Before coming to work for B-KFC, Liu was employed as an English teacher at a local Beijing public school. According to Liu:

As an English teacher I was not well paid. The job was very dull, although most of my students enjoyed learning English. Still I wasn't getting ahead. I was teaching English, but I wasn't learning English — I had no one to speak to. At KFC you have more chances to use and learn English. We are paid more here but we also work harder.

CONCERNS ABOUT EMPLOYEES

While employees were attracted to B-KFC because of the opportunities for high pay and training, KFC was concerned about the abilities of employees to provide

the levels of quality, service and cleanliness demanded by corporate standards. Employees seemed to have little understanding of these principles. The Chinese had limited exposure to quality products, long (and reluctantly) accepting as normal, goods of substandard workmanship. The attitude was one of making do, of lowering expectations. Because employment was guaranteed in Chinese society, hard work was also viewed by some as something to be avoided. Some workers were apathetic towards their jobs and found little incentive to overcoming the challenges inherent in most work. This could potentially impact on the Western norms for cleanliness and service.

Control over workers was exercised through three primary mechanisms: hiring, training, and incentive pay. Under Chinese joint venture law, B-KFC was given the power to hire and fire workers according to its own criteria. Hiring at B-KFC was based on five key qualifications: acceptable applicants must be high school graduates, must speak some English, must be presentable in grooming and dress, must demonstrate a willingness to work hard, and cannot have had previous restaurant work experience. The typical applicant was in his or her early 20s, and had taken some English in school.

With almost 120 of the most promising applicants hired by early August, B-KFC set out on the arduous task of acculturating employees and training them in the fine art of American fast food. Under previous arrangements, all training expenses were born by the franchiser — KFC. Training began with the extensive use of videotape of KFC's operations in both Hong Kong and Singapore. According to Tony Wang:

We customized the training videotape that we had used elsewhere in Southeast Asia to meet particular Chinese needs. Our main objective was to show the employees what fast food was like.

Beyond this, the company imported cooking equipment, blending machinery, heating racks, cash registers, etc., to begin hands-on training of the employees. Concurrent with these efforts, four new assistant managers — all Chinese nationals — were sent to Singapore for intensive training at local restaurants. According to Anthony Leung, a senior manager in KFC's Singapore office who helped supervise the training and who was later transferred to Beijing as B-KFC's General Manager:

These new employees were bright, hard working, and eager to take in all that there was to learn. It was a very positive experience.

Incentive pay played a major role in improving employee attitudes toward QSC. Every job was assigned an index of 100 points. Unsatisfactory work meant a reduction of points with a corresponding cut in bonus pay. According to Mrs. Liu:

All employees get bonuses, unless they miss work, then they only get a percentage of their bonuses. Each job has standards set; if the standards are not met, we get points taken off. This also means a smaller bonus. The average bonus each month is from RMB 50 to RMB 150. The best I could ever expect in a factory would be about 120 renminbi per month So we work harder, but we get paid more. I like this.

STARTUP OPERATIONS

To add real life experiences to the training, B-KFC began experimenting with sales to the public in September. Chicken was purchased from Beijing Animal Production, while potatoes, cabbage, and carrots were all purchased locally. Cases of Pepsi and 7-Up were shipped in from southern China. A small dry goods warehouse was leased in the city and uniforms were ordered. According to Anthony Leung:

We opened on a trial basis in the fall of 1987. We were only open seven hours a day — from 10:00 a.m. to 2:00 p.m. and from 5:00 p.m. to 8:00 p.m. The times we were closed in the morning and afternoon we spent reviewing and training.

By this time, the store had been connected to electricity and gas, but was lacking heat. As the fall weather approached, the lack of heat was becoming increasingly problematic. With the startup of operations, the restaurant was drawing between 2,000 and 3,000 customers per day and the fear was that with the onset of colder weather, many of these customers would be scared off if there was no heat. To make matters worse, a visit by corporate QSC inspectors resulted in the fledgling startup receiving failing grades. Much more work was clearly needed.

After testing various menu options, a decision was made to limit the number of items offered to the bare requirements of KFC. Attempts at producing quality french fries had ended in failure — adequate frying potatoes could not be found in China. Mashed potatoes and gravy would be offered instead. Chicken would be regular flavour only. The restaurant would be decorated with two life-size statues of Colonel Sanders and posters of American cities.

Setting prices for the store was a unique challenge. With no other fast food available in the city, prices were set to meet expectations of operating efficiencies, raw material costs, and “market pressures” for restaurant meals in the city. Prices for a three-piece dinner including potatoes, gravy and a bun were set at RMB 9.40. FEC prices were set at the same rates. While this seemed high compared to street food in Beijing, it was comparable with prices charged at many city restaurants. When asked about price, one teenage customer observed:

The prices are really very good. When you consider the food as a treat, it is very affordable. Besides, where in Beijing can you find such a nice atmosphere? This is a perfect place to take a girl on a date.

Finally, after months of effort, operations had reached a point when corporate inspectors could recommend an official opening. A gala affair was planned for November 12, 1987 and included speeches by the U.S. ambassador, the mayor, the chairman of KFC, and other dignitaries. The international and domestic news media were also invited. The opening was covered by local newspapers and the national press and was watched with great interest by tens if not hundreds of millions of Chinese.

From the outset, sales were brisk. The restaurant opened with eight cashiers on duty — one for local RMB sales, one for FEC sales. The crowds were so large that it was not unusual for local customers to wait up to 45 minutes in line to be served during peak times. Rarely were there more than a few people in line at the FEC counter. A separate window was also opened for take-out orders. Average daily sales during the winter of 1988 were about RMB 25,000 per day, or about 750 chickens. However, the trend was upwards, with demand rising on many days in March to well over 1,000 chickens per day.

With sales booming, discussion among the partners centred around the feasibility of adding an additional restaurant in Beijing. Clearly existing capacity was being overstretched. B-KFC was overwhelmed by customer interest. The operation was also generating huge cash flows. There were early predictions that the initial investment of the three partners would be repaid within the first year of operation. Also, it seemed that the city was pleased with the way the venture was being run. Even the heat had finally been turned on, indicating that patience and tenacity were qualities that eventually would pay off in China.

UNRESOLVED PROBLEMS

Still, many doubts were lingering in Tony Wang's mind and he wondered if the venture should adopt more of a "go slow" approach. His first concern lay with challenges in imposing Western management practices on the employees. Even though incentive pay had played an important part in improving employee productivity, the employees still required constant supervision. According to Anthony Leung:

There are major differences which separate American management practices from the Chinese perspective. In America, managers try to be objective — they assess peoples' performance. In China, they judge employees by other criteria. What is their personality like?

Are they friendly? How well can they talk? Let me give you an example. I recently asked one of our employees to mop the floor. He told me that it had just been mopped. When I pushed him on this he admitted that he really didn't know when it had been mopped. Finally, after some arguing he agreed to mop it 'again.' However, when I returned later I saw that the job had still not been done. Again, he used the same argument that 'it was mopped earlier.' What can you do?

In fact, we have a very mixed group of employees here. It is a constant challenge to get employees to follow QSC procedures. Probably the biggest problem is that they feel very insulted when you try to tell them how to do a particular job. They may agree in principle, but this is seldom enough.

The need to supervise employees placed a particular strain on local management. Most of this team had been imported on term assignment from Singapore or Hong Kong. For these managers, Beijing was regarded as somewhat of a hardship post; most were eager to leave at the earliest possible time. A serious challenge facing Tony Wang was in replacing these managers with competent and motivated KFC managers who spoke Mandarin Chinese and preferably some English. Even in Singapore and Hong Kong, these people were hard to find.

Personnel problems were also having an effect on the relationship between the partners. These problems often stemmed from Chinese partner resentment of the imposition of Western management practices. With offices located within B-KFC's Tiananmen Square store, Chun Fang Gao and Jue Xia both received salaries from the company and selected and employed their own small personal staffs. The restaurant's operations were clearly observable as were conflicts between the KFC-appointed managers and employees. Not infrequently, disagreements erupted over the handling of employee disputes. Furthermore, employees had a tendency to turn to the local partners for support in dealing with the KFC-appointed managers. The frequency of disputes increased the concern among both local partners that perhaps KFC's rigid QSC expectations were unnecessary for Chinese employees or customers. In fact, the belief among employees was that sales would not suffer and morale would improve with a slackening of company standards.

From KFC's perspective, the local partners were overstepping their authority. Tony Wang viewed the primary role of the Tourist Bureau as one of facilitating a smooth relationship with the government. Yet, with operations booming, good public relations were coming more naturally, thus diminishing the importance of the partner. As for Animal Production, its responsibility was to provide a constant supply of quality chickens. However, with skyrocketing sales, Animal Production had reached its capacity and it appeared that a second supplier would be necessary.

From KFC's perspective, the partners were becoming more of a bother than a necessity. This was particularly true the more they delved into the day-to-day operations of the company. This perspective was echoed by Anthony Leung:

It seemed that the partners were overly enthusiastic. They wanted to get involved in everything. The KFC people were pushing very hard for them to back off.

Not surprisingly, the partners had different perspectives of their roles. Their belief was that they understood Chinese customers much better than KFC and they could and should participate in improving operations. From the Tourist Bureau's perspective, Gao maintained that just as their active involvement had been essential for the project to get off the ground, it would be required to assure its smooth operation in the future. The only obstacle to expansion was KFC. The position of Animal Production was in many ways similar. According to Xia:

I think that we all would agree that our biggest problem is interpersonal. Each partner controls who it will send as its representative. Just as I cannot control who KFC brings in as General Manager, KFC cannot control who Animal Production brings in. With Chinese and American partners, we are bound to have conflicts. My personal belief is that profits are helping to diminish the inherent conflict between partners.

Our major concern with KFC doesn't revolve around operating matters, but around their quality standards. They only accept chickens from us that have been raised for seven weeks. Yet, far more money can be made by keeping the chickens for another week when weight gain is most rapid. But KFC refuses to go along with this. We have other places that can provide more money for our chickens than B-KFC. So we thought 'this is not a really good deal for us.' Yet, we are strong supporters of more rapid growth. Problems with chicken supply can be overcome. We have no problem with using outside suppliers.

Problems with employees and partners, and the difficulty finding an adequate supply of chicken, raised important questions in Tony Wang's mind about the long-term desirability of operating in China through B-KFC. Clearly, customer demand had been great, suggesting many opportunities outside Beijing. Indeed, letters had begun pouring in from enterprises throughout China eager to explore joint venture opportunities. Yet, what had been learned from the B-KFC experience? Other than a greater appreciation of the difficulties of working in China, Tony Wang wasn't sure what he would do differently the next time around — if there was to be a next time.

Even though the Tiananmen Square store was generating attractive profits, it remained uncertain what the money could be used for. It appeared that hard currency generated from the operation would amount to about \$50,000 per year. This was a respectable sum, but hardly seemed commensurate with the efforts put into setting up and running the venture. Hard currency profits would likely represent an even lower percentage of sales at alternate locations in the country. Expansion costs for a new store would also be high. It was estimated that KFC spent about US\$250,000 in training and materials costs for the Tiananmen Square location alone. Tony Wang wondered if this one store would ever be worth it from a hard currency profit perspective. What good was soft currency to KFC, when there were ultimately few things to buy in China?

The challenge of setting up an American-style fast food restaurant in China had been met with phenomenal success. Tony Wang felt that he had made a significant positive impact on Chinese perceptions of Americans in general and American food more specifically. He had appeared on national television and had been quoted in newspapers around China. Yet, the future remained uncertain. Clearly, much more needed to be done to improve existing operations. However, cleaning up disputes was not something that Tony Wang found personally compelling. He was beginning to wonder whether the personal challenge of China was beginning to wane. He had made perhaps too many trips to Beijing as it was. In fact, he suffered regular flare-ups of gout brought on by his constant travels. Could he assign others to do the job, he wondered? Furthermore, it was uncertain what sort of timetable the expansion plans should follow. To delay would result in more friction between the partners and might foreclose on future expansion possibilities. What was not clear at all was whether the time was right for expansion. Perhaps instead of placating the partners, expansion would exacerbate existing problems. Furthermore, why these partners; why not others, in other cities? Why China at all? Indeed, corporate resources would likely be better directed at other emerging markets throughout Southeast Asia — Thailand, Malaysia, Indonesia, and the Philippines. Time was running out for some sort of response.