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## Kentucky Fried Chicken (Japan) Limited

In January 1983, Dick Mayer leaned back in his chair and gazed absent-mindedly at the Norman Rockwell portrait of Colonel Sanders on his office wall. Mayer, a veteran Kentucky Fried Chicken (KFC) executive, had recently been promoted from vice chairman and head of the company's U.S. operations to chairman and chief executive officer, and for the past few weeks had been focusing his attention on the challenges facing him in Kentucky Fried Chicken-International (KFC-I). As he talked to KFC-I managers about their problems, opportunities, and challenges, he was exposed to a wide range of opinion on what was needed to continue KFC's growth and profitability overseas.

At one end of the spectrum was Loy Weston, president of KFC's highly successful joint venture in Japan. Weston's view was that in recent years headquarters staff interference in local national operations was increasingly compromising the spirit of entrepreneurship that had built the overseas business. In Louisville, however, Mayer heard a different story. For example, Gary Burhow, vice president of strategic planning, felt that the lack of effective planning and control in the early years of KFC-I had led to suboptimal financial performance, inconsistent strategies, and stalled expansion into new markets. He emphasized that, the recent efforts by headquarters staff was aimed at supporting the overseas subsidiaries and bringing to them the very considerable resources and experience of the parent company.

### The Beginnings

Harland Sanders was born in Henryville, Indiana, in 1890, the son of a farmhand. A sixth-grade dropout, he occasionally worked as a cook. In his late forties, he developed a recipe for chicken based on a pressure cooking method and a secret seasoning mix of eleven herbs and spices. When Sanders' gas station, restaurant, and motel were bypassed by the new interstate highway system in 1956, he decided to try to franchise his chicken recipe. With his white suit, goatee, string tie, and benign charm, he sold some 700 franchises in less than nine years. In allocating franchising rights for KFC, Sanders was generous to his friends and relatives. His management style was to rely on the basic goodness of the people around him and trusted his franchisees to play fair. There were no management systems or strategic controls.

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### *Industry Growth and Development*

Colonel Sanders became a pioneer in one of the fastest-growing industries of the postwar era. Many of the practices he initiated were quickly imitated by others and within a few years, several "rules of the game" came to be accepted in the U.S. fast food industry.

One of the first norms to be established was expansion through franchising. The high capital cost of opening new stores, together with the need to expand rapidly to stake out the territory, quickly forced companies toward this option. Franchising also allowed companies to capture operating economies, particularly in advertising and raw materials purchasing. As franchises matured, chain managements often became interested in buying them back or opening their own stores. This not only gave them better understanding and control of operations, it also allowed franchising fees to be supplemented by profits.

At the store level, the importance of scale economies was also quickly recognized. Because each restaurant outlet had high fixed costs and small returns on unit sales, traffic volume was crucial. This made location a key success factor, and decisions on which region, town, neighborhood or even side of the street could mean the difference between success and failure.

Within the industry, companies soon learned that effective store management was also a key factor in profitability. Because margins were small, the opportunities for waste, shrinkage and inefficiency were many; it took a special kind of individual to keep a fast food outlet operating smoothly and profitably. In addition to ensuring short-term profits, store managers were also responsible for building local public relations, maintaining employee morale, developing customer goodwill, keeping tab on competing chains, and so on. And yet the salaries paid to these entrepreneurial individuals were relatively low for the 60-80 hours a week they devoted to their work. Most were attracted to the company-owned outlets by the prospects for promotion into regional and divisional positions.

As the industry developed, the importance of the chain's overall market image also became increasingly clear. The need for a focused theme or product line was acknowledged to be critical, as was the importance of the consistency and reliability of the product throughout the chain. Successful new product innovations were difficult, and management was always conscious of the risk of confusing the chain's image if it deviated too far from its basic menu and core theme.

### *Acquisition and Growth: The Late 1960s*

By 1964 the 700 KFC outlets were grossing over \$37 million a year and the Colonel, now in his mid-70s, had begun to mutter that the "damned business is beginning to run right over me." The time seemed ripe for a change of ownership. When a 29-year-old Kentucky lawyer, John Y. Brown, and a 60-year-old financier, Jack Massey, offered Sanders \$2 million, a lifetime salary, and a position in charge of quality control in the business, the Colonel accepted.

Under Brown and Massey, growth exploded. During the next five years, KFC's revenue grew 96% a year (from \$7 million to \$200 million). In 1970, the company was building 1,000 stores a year in the United States. Brown recognized that the key to continued growth was to find, motivate, and retain hard-working and entrepreneurial managers and franchisees. His philosophy was that everyone involved with a KFC operation had a right to expect to become wealthy.

But with the rapid growth, problems soon cropped up. KFC headquarters experienced high turnover in its management ranks, with a number of senior executives leaving in quick succession to

become franchisees for KFC's new ventures. If he was to keep these key people, Brown had to find new challenges and promotion opportunities within the company.

About this time, Brown became fascinated with the apparently boundless opportunities for KFC to expand overseas. The rapid economic growth and trend toward two-income families that had fueled the growth of the fast food industry in the 1950s and 1960s were appearing in the late 1960s in other countries. Despite warnings from some who felt that food tastes differed widely from one country to the next, and that the whole concept of fast food was a cultural phenomenon that could not be transported outside the United States, Brown was convinced there was an opportunity. Besides, he felt he would be able to keep some of his entrepreneurial executives challenged by sending them to start new KFC ventures abroad. One executive later described Brown's international expansion strategy in these terms: "He just threw some mud against the wall and hoped some of it would stick."

The country managers were like Roman governors sent to govern distant provinces with nothing more than an exhortation to maintain Rome's imperial power and reputation. Few had any operating expertise, they were offered little staff support and the only attention paid to operations was Colonel Sanders' personal efforts to maintain the quality of his original product. Each country manager was on his own to make a success of his venture, and most had to learn the business from scratch.

## Changes in the Early 1970s

### *KFC (Japan): Getting Started*

It was against this background that Mitsubishi approached KFC with a proposal to start a joint venture in Japan. The giant Japanese trading company had a large poultry operation and wanted to develop the demand for chicken in its home country. Finding a perfect fit with his priorities, Brown was quick to seize the opportunity. The only problem was, he had nobody in the company equal to such a challenging assignment. But he thought he knew a good candidate—an IBM salesman named Loy Weston.

During the Korean War, Weston had been stationed in Japan and became intrigued with Japanese culture. After the war, he joined IBM's sales department and studied law at night. While at IBM, he started a dozen entrepreneurial ventures in his spare time, including airplane leasing, coffee machine sales, and sandpaper wholesaling. In the sixties he was based in Lexington, Kentucky, as a member of IBM's new-product sales group. It was then he met John Y. Brown.

After the Mitsubishi contact in 1969, Brown called Weston and asked if he would go to Japan and start a new company. Weston agreed, and soon the two men were discussing how to make the venture work. Brown's directions to Weston were simple. He asked him not to franchise until he had proven the fast food concept with company-owned stores. Brown's dictum was: "Build a store and make it work; then build another and another." Weston was to receive \$200,000 as start-up capital and an annual salary of \$40,000. He was promised an expense account after the company had been successfully established. His training consisted of two weeks cooking chicken at a KFC restaurant in Detroit.

Heading east to Japan, Weston decided to stop over in Greece. In Athens, he met the president of Dai Nippon, an Osaka-based printing firm. When the Japanese manager learned that Weston was going to start a new company that would require a lot of printing, he offered to telex to his office and have someone meet Loy. That individual was Shin Ohkawara, a Dai Nippon sales representative.

Weston thought he recognized some real potential in this young salesman and decided to cultivate a friendship with a view to persuading him to join KFC. He asked Ohkawara to take him to different restaurants so he could learn more about the Japanese food industry. This gave Loy an opportunity to scout the market and at the same time to get to know the young Japanese better. Weston used these occasions to impress Ohkawara with the grand plans he had for the new company, playing up the Mitsubishi connection to emphasize KFC's strength and commitment. After about six months, Shin Ohkawara agreed to join KFC.

Despite the fact that no formal joint venture agreement had been signed between Mitsubishi and KFC in the six months following his arrival in Japan, Weston had gone ahead with the test marketing of KFC products in a local department store, although without a Japanese partner such an operation was strictly illegal. He found that Japanese disliked the mashed potatoes in the KFC standard menu and that the cole slaw was too sweet for local palates. On the spot Weston decided to substitute french fries for the prescribed mashed potatoes, and reduced the coleslaw sugar content from the company-set standard. "These were no-brainers. The idea of getting clearance from the United States didn't even occur to me." The first real KFC store was in the American Park in the EXPO-70 in Osaka. KFC Corp. sent the equipment from Louisville and the store was erected in just two weeks.

The joint venture agreement was finally signed on July 4, 1970. To build on the exposure gained at EXPO-70, two more stores were opened in Osaka. Sites were chosen where land was relatively cheap and where new shopping centers were opening up. In keeping with U.S. practice, stores were large, free-standing structures with 4,400 square feet of floor space. Shin Ohkawara, who managed one of the stores, recalled the early days: "The stores were exact replicas of the U.S. take-out stores. Although the distinctive architecture was a big plus in the United States, nobody in Japan recognized what we were selling, and sales were very poor. The U.S. manual said that we could not keep the food more than two hours after cooking. So we threw out more chicken than we sold."

The new venture was soon in trouble. Losses mounted and the company had exhausted the \$400,000 put up by the joint venture partners. Weston needed to borrow more. Meanwhile he also had to recruit people to run the existing stores. Both he and Ohkawara were putting in 15-hour days and they knew they could not do that indefinitely. The latest threat was the appearance of McDonald's in Tokyo. With all its problems, it appeared KFC-J was heading for an early demise, and Weston wondered how he could turn the operation around.

### *U.S. Operations: Emerging Problems*

By late 1970, KFC faced a changed environment in the United States. The economy went into a recession and the company's revenues and profits began to plateau. Meanwhile, its new diversification ventures, like fish and chips and roast beef, were failing to meet expectations. KFC's stock price fell from a peak of \$58 to \$18, leading many of those who had hoped to get rich to quit the company. As the management exodus continued, Brown saw an opportunity to install a more professional team to build the systems necessary to gain control.

Competition in fast food in the United States was becoming more intense, and an industry shakeout began. KFC managers started hearing field reports about poor product quality and customer service in their stores. So concerned were they about the emerging economic, competitive, and operating problems in the United States, that they tended to leave the foreign operations to fend for themselves. Amid all this came a rift in the echelons of top management, and in mid-1971, Brown and Massey sold KFC in an exchange of stock valued at more than \$275 million to Heublein, Inc., a packaged goods company that had developed strong brand franchises such as Smirnoff Vodka in the United States and many other countries.

To fit into the Heublein organization, which was structured along domestic and international lines, KFC's small international staff was merged with Heublein's international group in Farmington, Connecticut, and a manager from Heublein's international operations was brought in to serve as the vice president of KFC-International. A small staff was assigned exclusively to KFC-I to serve as a link between the overseas subsidiaries and Heublein headquarters. (See **Exhibit 1A**.)

Despite efforts to establish more control over the subsidiaries, headquarters management found KFC-I's independent-minded subsidiary managers uncooperative. Reports often came too late or with too little information. Sometimes they were not sent at all. Although visits from corporate headquarters to the subsidiaries became more frequent, they were usually limited to general exchanges of views about the way the subsidiaries were functioning. In the end, each country manager was left with responsibility for expanding within his territory, using funds generated from his existing operations.

## Lurching Toward the Mid-1970s

### *KFC (Japan): Shaky Beginnings*

In the early 1970s, KFC-J was struggling to get on its feet. After heavy losses in Osaka and a not-so-propitious start in Kobe, the company was operating on a shoestring. In early 1972 Weston went to the United States to make a pitch to the new parent company for additional financing. To his surprise, Heublein agreed to increase their share of KFC-J's equity by \$400,000. With matching funds from Mitsubishi, and bank guarantees from both parents, he now received a warmer welcome when he applied for additional debt. Now all he had to do was to make the stores work.

As he continued to wrestle with the start-up challenges, Weston was struck by what he described as a "simple but profound insight." He began thinking of KFC-Japan not as a fast food company but as a firm in the fashion industry.

Recognizing that we were selling to young, trendy Japanese who wanted to emulate American habits helped us develop a totally new strategic vision. It also led to lots of changes. First, it meant we had to focus on Tokyo since this was the center of fashion and the source of new trends in Japan. Then we began to focus all marketing efforts on our target group—upscale young couples and children.

These decisions resulted in further changes in product and market strategy. To build volume, stores were located not in suburban shopping centers but near key stations on the commuter lines. High rents and limited space forced them to reduce the standard store size to less than half the area specified in the KFC operations manual. This meant kitchens and equipment had to be totally redesigned. To build volume, Loy and his team also decided to add fried fish and smoked chicken products—two favorite foods of the Japanese—to the menu. They also adjusted prices to compete with a typical take-out Japanese pork dish called *katsudon*. Advertising increasingly deviated from KFC themes, and to accommodate smaller Japanese appetites, "mini-barrels" with 12 rather than the U.S. standard of 21 chicken pieces were introduced. All these decisions, Loy Weston proudly acclaimed, were made locally, without consulting corporate headquarters.

By the end of 1972, the company had opened 14 new stores, most of them in Tokyo. In 1973, 50 more were added. Weston was optimistic that 1974 would be the year KFC-J would turn its first

profit. Then the oil crisis hit the Japanese economy, and continuing losses forced a refinancing and a slowdown in store expansion. Loy felt he was starting all over again.

### *U.S. Operations: Facing Difficulties*

Meanwhile KFC's domestic operations were in turmoil. Many former franchisees who had become corporate executives under Brown either left on their own or were fired. KFC's sales stagnated. There was widespread discontent among the franchisees, some of whom felt the new owners did not understand the chicken business and were not providing the leadership expected from a franchisor. There was even talk of a class action suit against Heublein among the more disgruntled franchisees. Company stores floundered and began underperforming the franchised operations, further convincing franchisees that the company did not know its own business. Even founder Colonel Sanders was reported to be unhappy, telling a group of journalists that the "chain's gravy was beginning to acquire the look and taste of wallpaper paste." Such disarray was a boon for competitors. The emerging Churches franchise and a number of regional chains began to cut deeply into KFC's dominance of the market.

Not only had growth stopped but by 1976, KFC's sales actually showed a four-year decline of 8%. Store-level profits were declining 26% annually. As Dick Mayer was to recount later: "Quality, service and cleanliness [in the company-owned stores] were just terrible. . . . Product ratings were inconsistent, standards were almost nonexistent, service time was highly variable, employees were often surly, and the buildings were dirty and run down." In this period, Heublein was not keen on committing funds to what appeared to be a lost cause. Except for sending a few cost-cutting experts to help ease the cash-flow problems, management did little to deal with the developing crisis. The prevailing attitude seemed to be that they were in a competitive segment of a saturated industry, and better opportunities lay in diversification.

## **The Late 1970s: New Direction**

### *KFC-I: Changes in Management*

In late 1975, Michael Miles was appointed vice president of international operations for Heublein. At the time, he had had no international experience. Miles had a journalism degree from Northwestern, and before joining KFC in 1971 had spent 10 years with the Leo Burnett Advertising Agency where he had been responsible for the Colonel Sanders account. In 1972, he was named a Heublein vice president and became the head of the Grocery Products Division, which marketed the Grey Poupon, Ortega, and A1 Steak Sauce brands. In that capacity, he initiated and completed the first strategic plan for the company. Strategic planning was to become his credo.

As vice president of the international group, Miles was responsible for all of Heublein's international operations, which was primarily its offshore KFC stores and its non-U.S. liquor business. He quickly decided that the collection of largely autonomous KFC subsidiaries would require most of his attention. The performance of many of them left much to be desired. The few operating standards that had been communicated were poorly controlled. Even the basic menu varied widely—South Africa offering hamburgers, Australia serving roast chicken, Japan with its fish, and Brazil with a full-scale wide-choice menu. Some, like KFC-J had yet to achieve break-even, and other more established operations had begun to show declining profits. Many cited market saturation and more competitive environments as the reason for these poor results. Miles

approached the international operations with a firm conviction that overseas subsidiaries needed more support and control from corporate headquarters, and that a good strategic planning system was the basic starting point. (See **Exhibit 1B** for organizational impact of changes.)

Recognizing that he was in unfamiliar territory, however, Miles moved with deliberation. He saw planning essentially as an approach to foster a thought process among the country managers. He wanted those individuals who knew how to run the business to make the plans and implement them. Despite immense resistance from the subsidiaries, he persisted in his efforts, and the subsidiaries gradually began adopting his strategic planning approach.

Miles also offered to help the subsidiaries develop new marketing skills. Through periodic seminars he introduced them to market research and new techniques in television advertising that would enhance brand awareness. After about two years, most of the subsidiaries had learned to use these tools and were beginning to apply them routinely.

### *KFC (Japan): Maturing Operations*

In recalling Miles's efforts to introduce planning systems, Loy Weston was blunt:

One fine morning, he rolled out this nine-page planning document. Headquarters wanted all kinds of data—environment conditions, strengths and weaknesses of our operation, objectives for the next five years, projections, action plans, and so on. It was useless for our needs. It was the same thing with marketing. They said we should be more professional. They asked us to hire a market research company to do a consumer survey. We paid a lot of money for that, and what did it show? That people bought our chicken because it tasted good. Fascinating!

Shin Ohkawara was a little less blunt, but also appeared somewhat skeptical:

It was ironic. Here we had built our business from scratch with no assistance from the United States and were finally approaching break-even. In contrast to the situation in the States, our stores were known for their quality, service and cleanliness, and we had a highly motivated team. Yet the people from the United States were trying to teach us how to manage. They even sent over an American controller so their monthly reports would be filled in correctly.

But we learned to live with it. The strategic planning exercises actually helped us by forcing us to project and to quantify uncertainty for the first time. Of course, we adapted it to Japanese practices. Our Presidents Review is a handwritten document that comes up from all sections and is collated into two 3-inch-thick books. We go through this process the first month of the year—not six months ahead as required by the U.S. planning cycle, and obviously not in their prescribed format.

We also learned how to manage our relationships with headquarters better. We learned the rules of the game, like "never show a big jump" and "manage sales and profit to show consistent growth."

In 1976, KFC-J reported its first profit, a modest 14 million yen. Miles offered warm congratulations all around.

## The Early 1980s: Reorganization

### *Headquarters Changes: U.S. Turnaround*

During the latter half of the 1970s, KFC's domestic operations continued to slide to the point that the problems could no longer be ignored. In early 1977, Mike Miles was given the company's most challenging assignment: to find out what was wrong with the U.S. business, which accounted for two-thirds of KFC's worldwide sales, and fix it. Miles asked Dick Mayer, who was Heublein's vice president for marketing and planning in the Grocery Products Group, to come to KFC's Louisville headquarters to help with this Herculean task. Mayer worked with Miles and played a major role in developing a turnaround strategy for KFC.

Just as he had done in international, Miles's first act as president of Kentucky Fried Chicken was to introduce a strategic planning process. His analysis identified that the company had lost touch with its customers and was being outflanked by aggressive new competitors such as Churches. The centerpiece of Miles's turnaround program was what he called a "back-to-basics" program. It stressed quality, service, and cleanliness (QSC) inspections by headquarters-directed mystery shoppers, training programs, strict management control systems, five-year rolling plans, a revamped advertising approach, investments to improve the visual image of stores, and effective franchise relationships.

By 1979, these various programs were beginning to show results. Average sales per store turned around and began increasing at a better than 10% per annum rate. Store-level profits rebounded even more dramatically, bringing them close to the levels of industry leader McDonald's.

In July 1981, with his reputation greatly enhanced, Mike Miles was named senior vice president responsible for all Heublein's food products in the United States and internationally. Immediately, his attention returned to KFC's foreign subsidiaries where he saw great opportunity to benefit from the techniques just applied so successfully in turning around the U.S. operations.

Soon after taking charge of KFC-I, Miles made three important organizational changes. First, he decided that the international operations could learn more from the U.S. experience if the KFC-I headquarters were moved back to Louisville with the rest of KFC. Second, he hired as the new president of KFC-I, a professional manager with extensive experience in consumer products marketing (with Procter & Gamble) and general management (with the Swift Group of Esmark Corporation). Third, he expanded the staff expertise at KFC-I headquarters to reinforce the planning, service, and control functions he felt were required (**Exhibit 2**).

Bob Hiatt, the new president of KFC-I outlined his broad objectives:

When I came here in September 1981, the strategic planning mode was well on its way, but the subsidiaries' independent heritage was still clearly evident. Our objective was to convince them that better strategic plans meant better bottom-line results. In operating terms, you could say our aim was and is to achieve consistency and control worldwide. We want consistency of products and facilities, and we need to control the production and marketing approaches if we are to maintain that consistency.

Gary Buhrow, vice president of strategic planning for KFC-I, discussed the changes in his area of responsibility:

Up to 1981 planning in international had really been a perfunctory exercise. Miles wanted me to make it a more integrated, ongoing activity. To ensure consistency, we developed a standard format to be used by all subsidiaries, we adopted a five-year rolling plan process, and we implemented a more formal staged review procedure (**Exhibit 3**). As might be expected, the country managers were not overjoyed.

Donald Lee was the financial vice president at KFC-I. Earlier he had been the international controller and had also served at Heublein headquarters in the finance area. He said:

The number of reports we require has multiplied over the years (**Exhibit 4**). But we don't apply our requirements rigidly. KFC-Japan is a good example. They baulked when we introduced the new capital expenditure approval procedure for new store openings, and argued that they had traditionally been making such investment decisions without headquarters approval. They also said that Mitsubishi did not require prior approval. So we agreed to give them a blanket approval for capital expenditures in the beginning of the year. The problem is that by making such exceptions you weaken the whole system, leaving yourself open for other subsidiaries to demand similar treatment.

In general, we tend to treat the folks in Japan with kid gloves. Loy claims that staff interference will only stifle him. But Loy and Shin cannot take this autonomy business too far. They must realize they are part of a company with lots of opportunities and needs. We need procedures like the capital expenditure approval so we can make sensible choices among competing demands. In Tokyo, they think that we should take a long-term view and ignore short-term losses. But the reality is we are an American public company and Wall Street will start screaming if the quarterly earnings dip.

In addition to the strategic and financial systems, a new set of controls was introduced at this time. The international operations group was established to transfer to KFC's overseas companies some of the data base management systems that had been so helpful in turning around its U.S. business. Gary Masterton, a key manager in the international operations group, explained:

Our objectives are simple—to increase efficiency and ensure standards on a worldwide basis. The product is sacred, and we must do all we can to ensure its quality and consistency. The sooner we get back to basics—eliminating the ribs in England and the fish in Japan—the sooner we can get control and squeeze out cost savings. And if the U.S. operations were able to use our data base system to help drive up per store sales by 60% and to double store level margins in less than six years, we'd be crazy not to try to learn from them in our overseas units.

The new operations control systems asked for store level information on numbers of chickens, customer traffic, ticket average, menu mix, and speed of service. The availability of comparable data on a worldwide basis, as well as some expert input such as time and motion studies to establish labor efficiencies, allowed management to set standards, measure performance, and reward store managers. Efficiency targets, QSC ratings, and performance bonus levels were introduced, and reports on trends at the store level were produced.

The subsidiaries' reaction to the new data base operations system varied. For example, New Zealand adopted it with enthusiasm, but in Australia there was a lot of resistance. But there had been a disturbing deterioration in quality, service, and cleanliness in the Australian outlets in recent years, and the Louisville operations group used the resulting decline in sales and profits as the opportunity to step in and implement the back-to-basics program and the supporting data base system. Japan also questioned its need to adopt the new systems and programs and challenged headquarters ideas. Louisville management emphasized it was trying not to be too dogmatic and

was willing to adapt the system to their special needs. "We don't ram it down their throats, but we do want the system operating universally," said Masterton. "Those that accept it find it can be a very useful system they can apply locally, and not just data sent back to headquarters for control. We want this to be one of *their* management tools."

### *KFC (Japan) Reaction*

The new management direction and systems of 1981 did not sit well with Loy Weston:

We are slowly being reduced to the role of order-takers. In the first year after Miles came back, we had 22 man-weeks of visitors from the corporate headquarters. Quality control audits, computer people, planners, operations guys, and so on. They questioned everything from our store designs to the smoked chicken, yogurt, and fish on our menu. They gave us hurdle rates for real estate, and operating instructions straight from the American manuals.

They acted as if they had all the answers and we knew nothing. Just because they had introduced crispy chicken in the United States, they thought we should too. I knew it wouldn't work. But I agreed to a test market. It bombed. They didn't like our TV commercials so they made one for us that was so inappropriate we never aired it. Finally, I had to remind them they couldn't do this. We are a joint venture, not a wholly owned subsidiary.

Shin Ohkawara sounded philosophical:

I guess it is all inevitable as we change from a venture-oriented to a professionally managed company. They want us to follow their ideas. Okay, we will give them a try. But we kept thinking there were lots of ways they could also learn from us. For instance, we felt that our 12-piece "mini-barrel" could be a big success elsewhere. And our small store layouts, with their flexible kitchen design, might be very suitable for U.S. shopping malls. We were even experimenting with chicken nuggets in 1981 until we were told to stop.

What worries me, though, is this constant pressure from the United States for improved margins. (Incidentally, Mitsubishi has never asked us for more profit.) People at headquarters want to know why we have not raised prices for four years now, and only twice in the last 12 years. By pricing our products just 20% above supermarket fresh chicken prices, we have expanded demand tremendously. If we use the U.S. pricing formula we will just invite competition.

### *New Challenges*

Just as its new international programs were shaping up, KFC entered an important new chapter in its history. Attracted by Heublein's solid sales growth and strong profit performance, R.J. Reynolds (RJR) acquired the company in October 1982 as part of its continuing strategy of diversifying away from tobacco products (**Exhibit 5** shows overall Heublein performance by business). Soon thereafter, Mike Miles was offered the opportunity to become president of Dart and Kraft, and was succeeded as chairman and chief executive of KFC by Richard Mayer.

Mayer, an MBA from Rutgers, had begun his career at General Foods. He joined Heublein in 1973 as director of business development, and subsequently became vice president of strategic planning and marketing at the time Miles was trying to get the company to take a more sophisticated approach to such matters. As the driving force behind KFC's more professional management approach, Mayer held strong convictions about the value of strategic planning:

Strategic planning pervades everything we do at KFC. It has brought great and effective change to our business and the way we market. (But) it clearly reduced marketing's ability to "do its own thing." As more people knew precisely what was going on, there was less tap dancing and more accountability in the marketing function. For example, all menu and pricing proposals required exhaustive marketing analysis. Proposals were reviewed by top management and evaluated by how they would help meet long-term strategic goals, not quarter-to-quarter earnings spikes. . . .

Our best marketing people have become even better after exposure to the planning process. They quickly saw the logic and applied this tool to improve the business . . . and their careers. Our weaker performers—the "tap dancers" who never saw the light—are now tap dancing on someone else's stage.

As he reviewed the international operations, Dick Mayer focused a good deal of time on KFC-Japan. Not only was it one of KFC-I's largest, fastest-growing, and highest potential units, but in many ways it reflected the challenges that faced the company's entire international operations. Four issues seemed of particular importance in Japan, and indeed for KFC-I.

The most fundamental issue concerned the appropriate level of performance expectations for the overseas units (**Exhibit 6** shows KFC-J's growth record). For example, although KFC-Japan expected to open its 400th store by the end of 1983, on a per-capita basis this represented less than one-quarter the level of penetration in the United States. And penetration levels in other countries were even lower. Mayer felt it was important for management to resist the temptation to regard the more established overseas units as mature. KFC-I had to maintain its drive for aggressive growth. But what did he need to do to ensure that such growth would continue?

The second challenge related to the overall issue of headquarters control of international operations. Mayer was aware of resistance to the administrative operational controls and systems and considered how hard he should push for their implementation. For example, how could headquarters turn a blind eye to the fact that some overseas units were force-fitting their numbers to meet hurdle rates, submitting approval forms after decisions had been implemented, and writing management reports to appease headquarters rather than provide proper analysis? Should they be willing to accept operational variations like the Japanese company's continued resistance to suggestions that it give up its obsession with menu expansion and devote more attention to improving the basics of its operations? At headquarters, managers claimed there was proven evidence that menu diversity affected the bottom line and hurt quality, but Japan rejected both notions.

A third important issue Mayer identified was the continuing problem of how to expand into new countries. Six countries (Japan, Australia, South Africa, New Zealand, United Kingdom, and Germany) accounted for over 95% of overseas earnings, and over the past decade numerous attempts to expand into a variety of new countries had met with very limited success (see **Exhibit 7**). A diversity of opinion existed on how the company should proceed. Gary Buhrow, vice president-strategic planning, felt the company had to move away from the highly opportunistic and people-dependent approach of the past:

The world is more complicated than it was 15 years ago. We have to pay more attention to political risks, currency risks, and legal issues. And we need more sophisticated measures of market potential. We have begun to develop a capability at headquarters, a systematic analysis and comparison of new market risks and opportunities. This has helped us prepare a list of priority international market opportunities for KFC. In addition, when managers make

market entry proposals and present details of their entry strategy, we have much more data against which to evaluate it and to set financial and operational expectations.

Loy Weston, on the other hand, felt that the string of failures and below-expectation performances in new markets could be tied directly to the deviation from John Y. Brown's mud-on-the-map approach of selecting entrepreneurs, giving them the challenge, and leaving them alone. He explained:

Expansion into new markets requires a combination of sensitivity and entrepreneurial spark that is found in a different kind of person from your normal breed of corporate officer. When you find the right person—someone with energy, vision, imagination, and above all, willingness to make quick and unorthodox decisions—you have to leave him alone. You can't succeed if there are constant audits, visits, and forms to fill in for headquarters.

Hong Kong is a perfect example of what not to do. They sent an insensitive and patronizing Australian who saw himself as a high-powered corporate executive. He breezed in, hired a secretary, bought a Mercedes, and immediately began driving around to inspect potential sites. There was no effort to understand local tastes or customs. He paid exorbitant prices for the sites, entered a joint venture with, of all parties, a U.K.-based conglomerate, and set up standard stores with standard menus. When stores opened, he was not close to the operations and wasn't even aware that the fish meal-fed chicken he was buying had a strong unpleasant taste. It was a total disaster.

Dick Mayer had an open mind on the issue. But he was concerned that KFC had such limited positions in Korea, Taiwan, Thailand, and Hong Kong—four of the highest priority countries identified by the new market potential analysis. He learned that these countries were the responsibility of Loy Weston who, four years earlier, had been named vice president for the North Pacific. Shin Ohkawara had succeeded Weston as president and chief executive in Japan, leaving Loy free to concentrate entirely on new market entries, but progress was slow. Mayer wondered if he should leave Weston alone, or whether he should authorize more headquarters involvement at this stage?

The question raised the whole issue of the appropriate management skills required to manage the company's overseas operations, and this topic represented the fourth item on Mayer's list of challenges. In considering the matter, he theorized that there were three stages in country management evolution:

In the entrepreneurial stage there is not much room for managerial orientation. Loy Weston is a real go-getter. But he is an organizational nightmare who gets great joy in pricking the balloons of bureaucracy. At the second stage, we see the development of local baronies as managers use their local knowledge and developing operating skills to build their autonomy. The third stage is marked by the appearance of professional management who respond to planning, measurement, and business development ideas. Only this group can build for the long term.

Unfortunately, there is a widespread belief that professional managers cannot be venturesome or entrepreneurial. But a fast food operation is inherently an entrepreneurial venture, and the country manager has to deal with the franchisees, who are generally entrepreneurs themselves. If you want to succeed in this business, you can't be a pin-stripe type. So by a kind of natural selection, the right types of managers rise to the top. I believe our professional managers can be the source of the entrepreneurial expansion we are looking for.

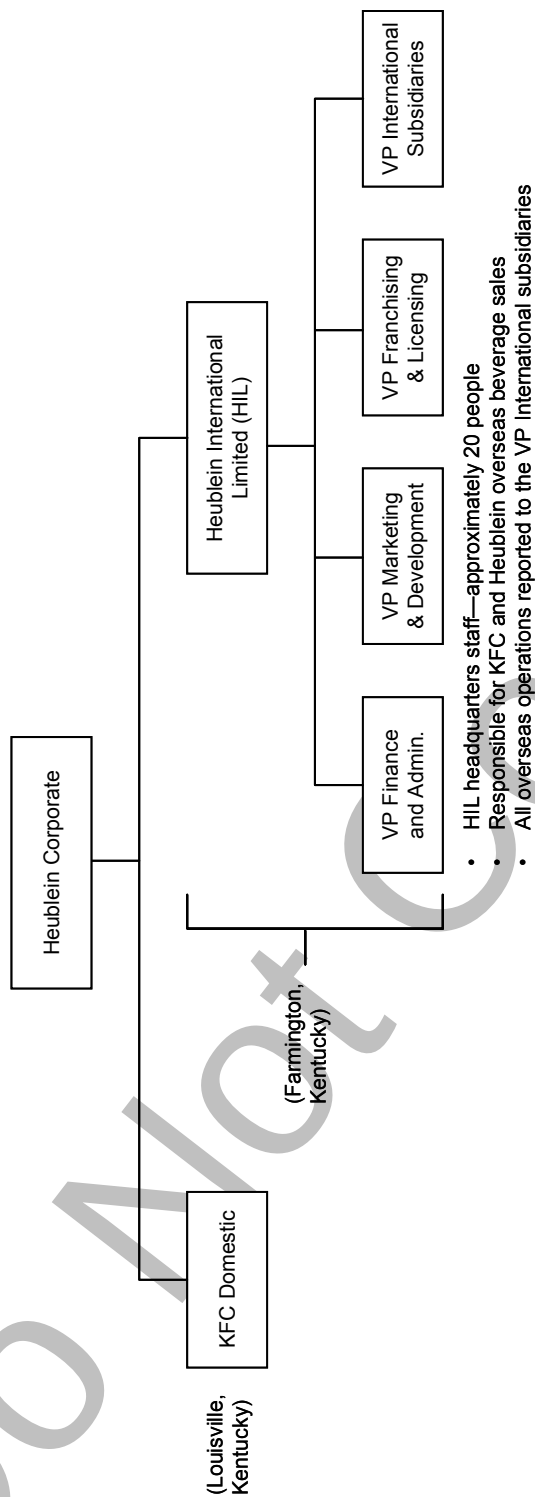
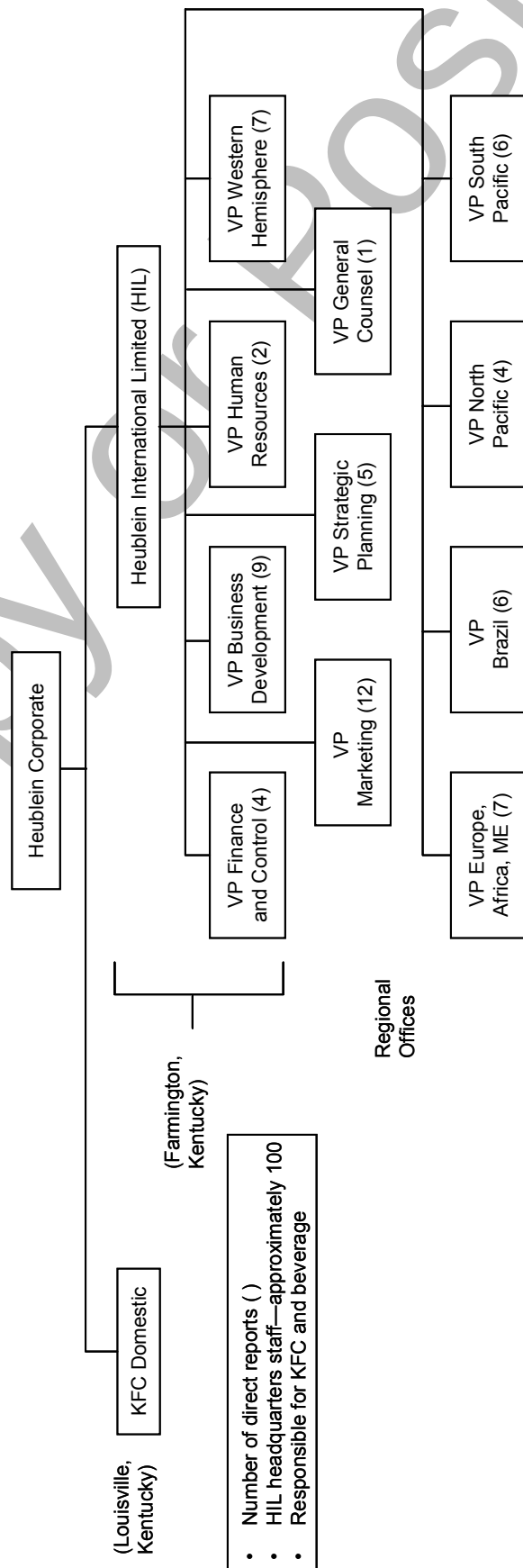
**Exhibit 1A** KFC International: Organizational Structure, 1972–1973**Exhibit 1B** KFC International: Organizational Structure 1975–1976

Exhibit 2 KFC International Organization: 1981

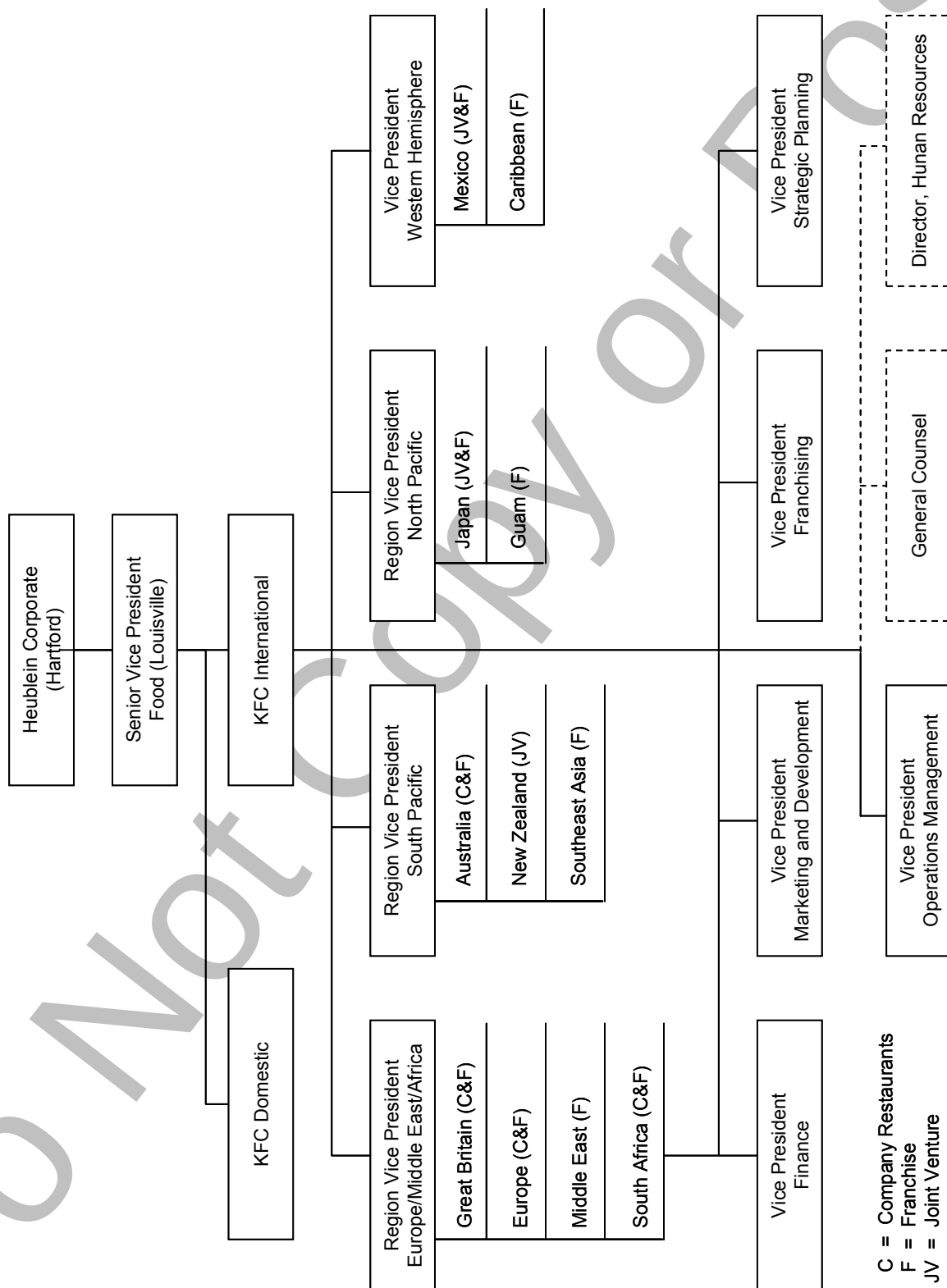
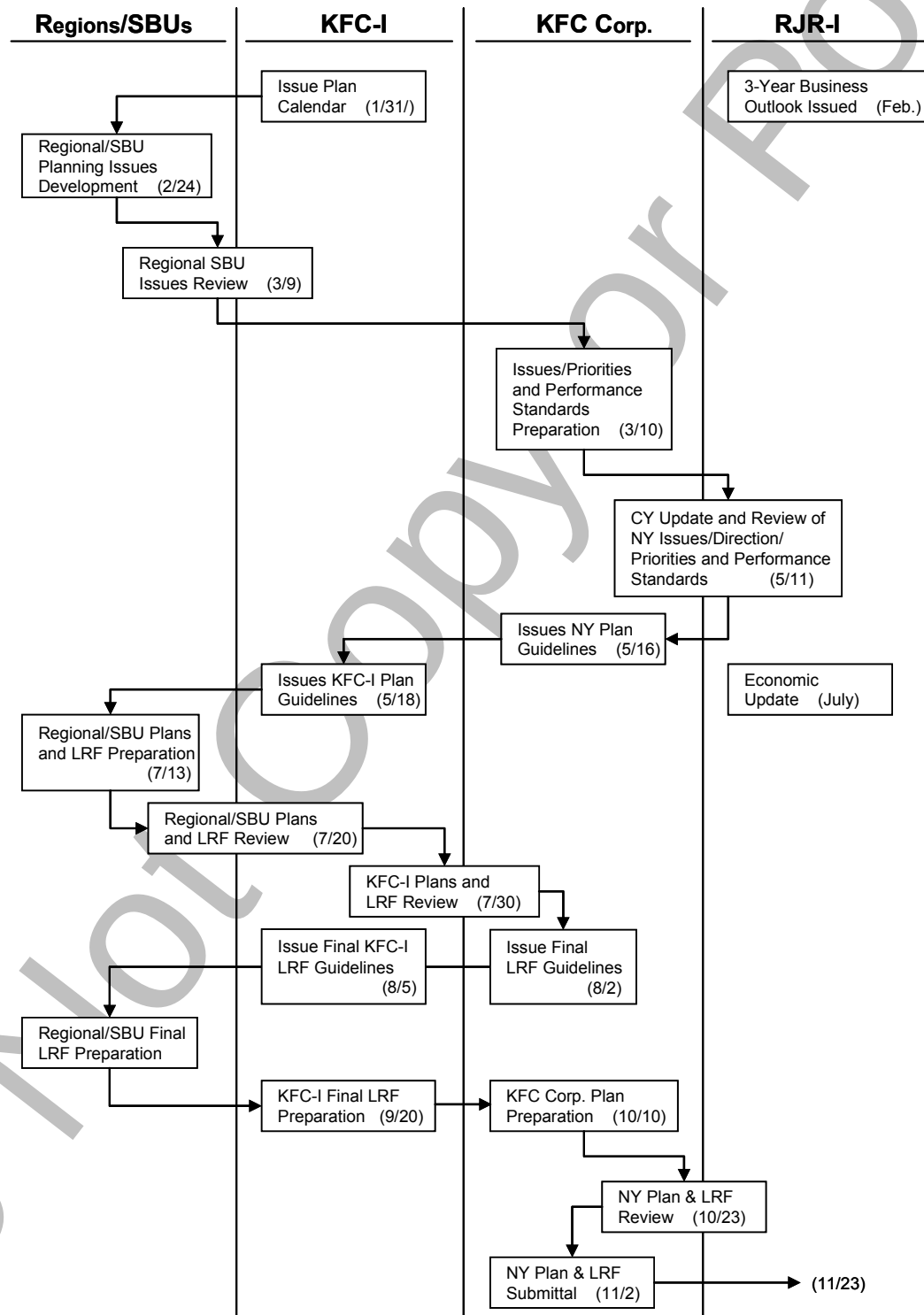


Exhibit 3 KFC-I Planning Cycle of Calendar



Note: LRF = Long Range Forecast; LY = Last Year; CY = Current Year; NY = Next Year.

**Exhibit 4** List of Reporting Schedules in the Monthly Financial Package

1. Statement of Earnings—Local Currency: Current Month
- 1A. Statement of Earnings—Local Currency: Year-To-Date
2. Statement of Earnings—U.S. \$
3. Full Year Forecast—Local Currency
4. Current Forecast—U.S. \$: Full Year
- 4A. Current Forecast—U.S. \$: Quarter By Month
5. Balance Sheet
6. Balance Sheet Variance Analysis
7. Other Earnings Data
8. Personnel Status Report
- 8A. Equivalent Employee Analysis
9. Capital Expenditure Status Report
10. Intercompany Transactions—Statement of Earnings
11. Store Closing Report—Reserve Reconciliation
- 11A. Store Closing Report—Explanation
12. Risks and Opportunities
13. Receivables Management Report
14. Intercompany Account Reconciliation
- 14A. Intercompany Charges/Payments

Source: KFC-International.

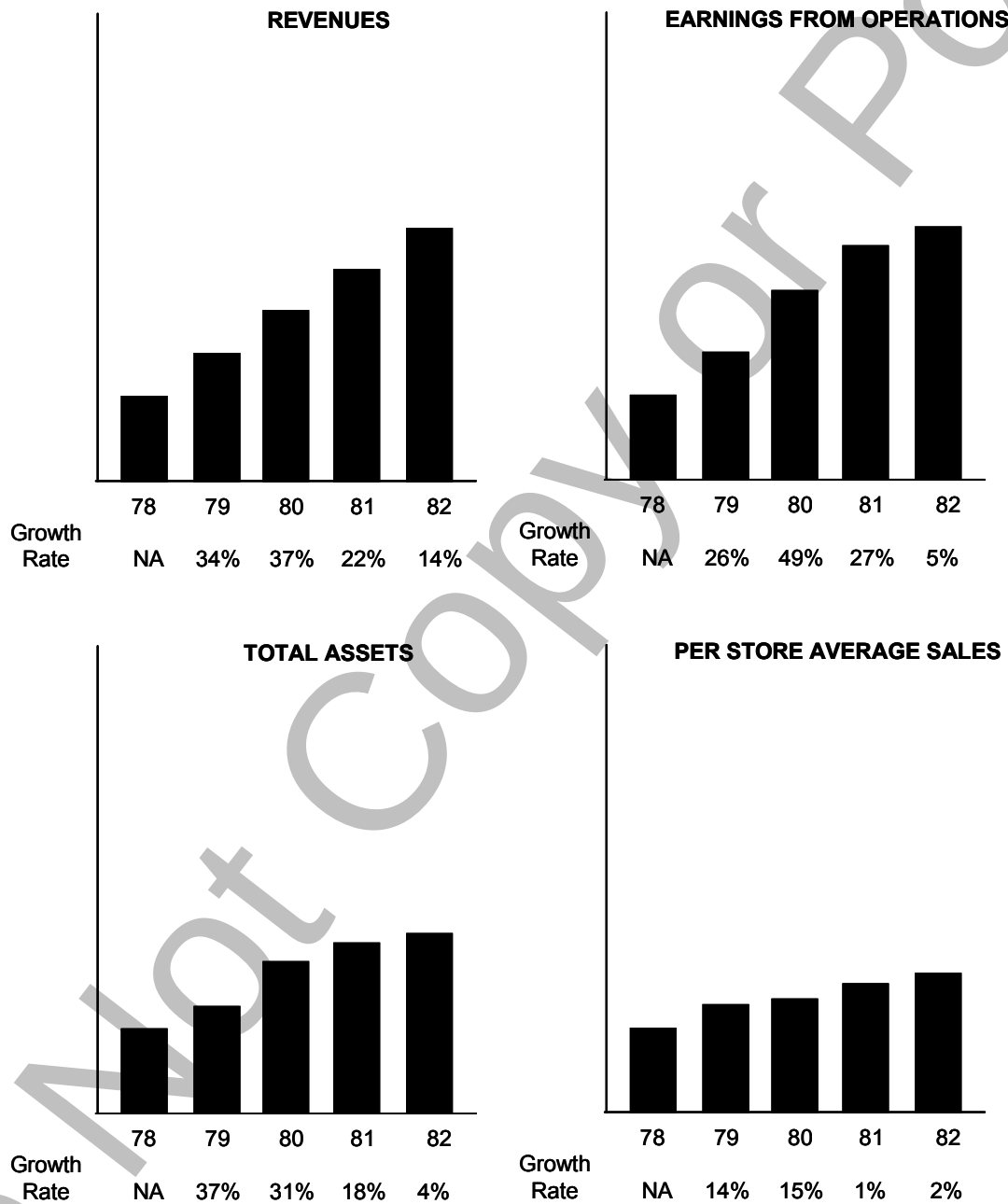
**Exhibit 5** Summary Financial Data of Heublein, Inc.

The Company operated worldwide principally in four business segments: production and marketing of distilled spirits and prepared cocktails (Spirits); production and/or marketing of wines and brandies (Wines); production and sale of specialty food products (Grocery); and operating and franchising principally Kentucky Fried Chicken restaurants (Restaurants). The business segment information for each of the five years ended June 30 is presented below:

| (thousands)                     | 1982               | 1981               | 1980               | 1979               | 1978               |
|---------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Revenues:                       |                    |                    |                    |                    |                    |
| Spirits                         | \$ 877,041         | \$ 876,546         | \$ 883,419         | \$ 819,563         | \$ 742,575         |
| Wines                           | 387,130            | 378,497            | 386,938            | 368,972            | 324,794            |
| Grocery                         | 173,545            | 153,552            | 131,511            | 114,193            | 118,160            |
| Restaurants                     | 699,687            | 641,526            | 520,011            | 466,346            | 434,583            |
| Consolidated                    | <u>\$2,137,403</u> | <u>\$2,050,121</u> | <u>\$1,921,879</u> | <u>\$1,769,074</u> | <u>\$1,620,112</u> |
| Operating profit:               |                    |                    |                    |                    |                    |
| Spirits                         | \$ 114,696         | \$ 107,078         | \$ 93,341          | \$ 87,599          | \$ 73,105          |
| Wines                           | 25,965             | 26,551             | 32,655             | 29,422             | 28,895             |
| Grocery                         | 26,447             | 21,545             | 17,904             | 17,989             | 17,949             |
| Restaurants                     | 84,087             | 69,126             | 51,302             | 34,966             | 26,711             |
| Consolidated                    | 251,195            | 224,300            | 195,202            | 169,976            | 146,660            |
| Interest expense                | 33,214             | 28,581             | 25,361             | 23,106             | 25,041             |
| Corporate and miscellaneous—net | 20,251             | 27,683             | 22,933             | 15,851             | 12,319             |
| Income before income taxes      | <u>\$ 197,730</u>  | <u>\$ 168,036</u>  | <u>\$ 146,908</u>  | <u>\$ 131,019</u>  | <u>\$ 109,300</u>  |
| Identifiable assets:            |                    |                    |                    |                    |                    |
| Spirits                         | \$ 312,322         | \$ 318,695         | \$ 320,379         | \$ 300,605         | \$ 272,257         |
| Wines                           | 310,984            | 318,137            | 308,445            | 281,969            | 221,748            |
| Grocery                         | 58,389             | 61,601             | 63,219             | 66,696             | 61,170             |
| Restaurants                     | 353,882            | 316,519            | 276,682            | 242,266            | 227,659            |
| Corporate                       | 140,531            | 107,900            | 80,067             | 80,382             | 100,412            |
| Consolidated                    | <u>\$1,176,108</u> | <u>\$1,122,852</u> | <u>\$1,048,792</u> | <u>\$ 971,918</u>  | <u>\$ 883,246</u>  |

Source: Form 10-K reports.

Exhibit 6 KFC Japan Performance Charts, 1978–1982



## Exhibit 7 KFC Subsidiaries Abroad in 1983

| Country                        | Number of Stores |           |       | Country       | Number of Stores |           |       |
|--------------------------------|------------------|-----------|-------|---------------|------------------|-----------|-------|
|                                | Company          | Franchise | Total |               | Company          | Franchise | Total |
| Europe, Middle East and Africa |                  |           |       |               |                  |           |       |
| South Africa                   | 48               | 95        | 143   | North Pacific | 149              | 270       | 419   |
| Great Britain                  | 61               | 308       | 369   |               | -                | 3         | 3     |
| Germany                        | 3                | 11        | 14    |               | -                | 1         | 1     |
| Holland                        | 5                | 2         | 7     |               |                  |           |       |
| Spain                          | 4                | 6         | 10    |               |                  |           |       |
| Denmark                        | -                | 3         | 3     |               |                  |           |       |
| Iceland                        | -                | 1         | 1     |               |                  |           |       |
| Sweden                         | -                | 1         | 1     |               |                  |           |       |
| Switzerland                    | -                | 1         | 1     |               |                  |           |       |
| Kuwait                         | -                | 15        | 15    |               |                  |           |       |
| U.A.E.                         | -                | 10        | 10    |               |                  |           |       |
| Saudi Arabia                   | -                | 7         | 7     |               |                  |           |       |
| Bahrain                        | -                | 2         | 2     |               |                  |           |       |
| Qatar                          | -                | 1         | 1     |               |                  |           |       |
| Lebanon                        | -                | 2         | 2     |               |                  |           |       |
| Yemen                          | -                | 2         | 2     |               |                  |           |       |
| Egypt                          | -                | 6         | 6     |               |                  |           |       |
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Source: KFC International.