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# To Be, or Not to Be

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# More Adaptive to a Local Environment

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## Introduction

The purpose of this study is to pinpoint how two similar companies from the same home country can enter into a host country and have completely different results due to their different adopted strategies for international expansion. By analyzing two similar companies in the same industry going to the same target country, it will be possible to evaluate the strategies they used and link these strategies to the performance of the international locations. This study will compare two different entrance strategies used by two companies and determine which one is more closely following proven business models. These two companies were McDonald's and KFC, and the country they were entering was China. This study will also cite possible reasons for the success as well as failure of these strategies in other countries vis-à-vis China, the target country. By positioning themselves differently in the I-R Framework developed by Bartlett and Ghoshal (Fan, D., Nyland, C., & Jiuhua Zhu, C., 2008) (Barlett & Ghoshal, 1991), these two companies experienced completely different results. One of these strategies had potential for long term success, while the other would need to be modified if the company hoped to gain an ability to be sustainable in the long term. By realizing the potential profits to be made by entering the Chinese market, due to its large population and no presence of a large quick service company, these two companies developed competing strategies to enter this market. This paper will outline the positive and negative aspects of each company's decisions and demonstrate why one company's strategy was more effective in gaining a competitive advantage in the Chinese market than the other's. By analyzing different parts of these strategies and fitting them into different business models it will be possible to demonstrate how these strategies either do or do not follow proven business models.

## Literature Review

In the 1960's Stephen Hymer developed the theory of multinational enterprise which described why companies decide to go abroad. This theory has been the building block for almost all international business models, and was improved on by John Dunning's Eclectic Paradigm. This model is characterized by the O-L-I, which describes three reasons why companies go international. The "O" stands for the ownership advantage that a company gains from the decision to go international and answers "why" companies go international. The "L" stands for the location advantage of the country being entered and answers "where" the company will be going. The "I" regards the amount of internalization a company will use in its international plans. This answers the question of "how" the company will go abroad. Later on, Bartlett and Ghoshal developed the I-R Framework which essentially describes four strategies a company can use when going into a foreign country depending on the amount of integration and local responsiveness a company uses in its international strategy (Barlett & Ghoshal, 1991). If a company were to use low integration and low local responsiveness, it would be characterized as an international firm just using an export model. To be successful, however, a company would need to either increase its local responsiveness, which would make it a multi-domestic firm, or it could increase its integration which would make it a global firm. Once a company has been defined as a global firm or a multi-domestic firm it would want to either increase its local responsiveness, if it is a global firm, or increase its integration, if it is a multi-domestic firm. This would result in the company being a transnational firm, and is the best structure for maintaining a long term competitive advantage. To determine if a company does in fact have a competitive advantage, the VRIO framework has been created to determine if something is valuable, rare, costly to imitate, and if the organization is set up to take full advantage of the asset (Barney & Hersterly, 2012) (Barney, 1991). This analysis can be used to determine the level of a company's competitive advantage (Barlett & Ghoshal, 1991).

## China

China is the second largest economy in the world with over 1.3 billion people. This county increases its GDP by 10 percent every year and has lifted more than 500 million people out of poverty. In spite of this growing economic situation China remains a developing country with low gross national income per capita of $6,091. This ranks China 90th in terms of gross national income per capita in regards to other countries ("The world bank," 2013). With this growing number of people making more money the gap between the rich and the poor in China is also growing and more and more political friction between these groups is being created. Some areas of China, such as the eastern area of the country, are experiencing a major shift in income due to the country going through industrialization while other areas, such as the northwest remains very undeveloped with mostly poor farmers populating the area. China is led by a communist state government which is called the People's Republic. The leading political party in China is known as The Chinese Communist Party. This political party sets policies and creates committees for laws and regulations (Encyclopedia of the Nations, 2013).


*Source:* http://www.tradingeconomics.com/China/gdp-per-capita

China's consumers are changing their lifestyle habits due to the growing economy and increasing per capita income. Traditionally consumers in China focused on eating mainly fish, pork and chicken, but now many of them are also eating more beef in their diets. Some of these changing lifestyle habits relate to the quick service industry, sometimes called fast food. China is the number one meat consuming country in the world, creating a huge market for companies wishing to enter this industry. Many consumers in China are spending more and more on eating out. This has caused the restaurant industry to experience high growth in its revenues over the past years (Szulanski, Chen & Lee, 2012). Many foreign companies are entering into this market to reach this mass of consumers being created by their rise from poverty. Many people in China still have very little expendable income, however, with such a large population; there are also a significant number of individuals in this country who do in fact have a large enough amount of expendable income to justify entering this market.

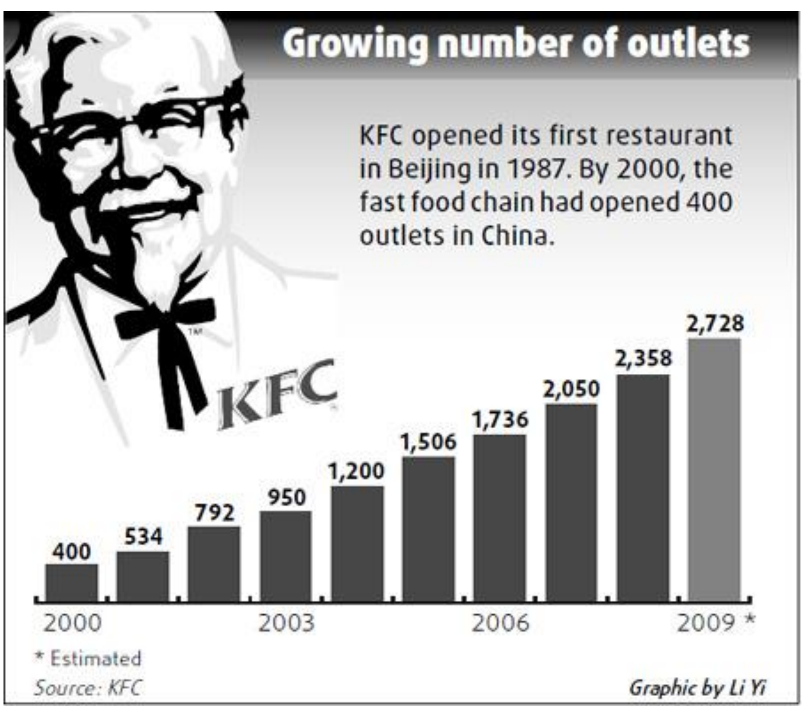
For quick service industry companies there are many opportunities and threats associated with the entrance into the Chinese market. For the opportunities, as mentioned above, there is a huge market of consumers in this country who are gaining more and more expendable income every year as China's economy grows. Although the large portion of these consumers are not yet to the point where they are able to afford such luxuries as eating out at western originated companies such as McDonald's and KFC, the small portion of Chinese consumers whom can afford to accounts for a very large number of people. The huge popularity of meat consumption and the growing preference for beef in China also marks a very high potential for quick service restaurants entering this market that offer many products based around these meats, as many western restaurants do. Another opportunity for quick service industries looking to enter China is the changing lifestyles of these consumers and their growing preference to eat out which would favor companies in this industry.

Some threats to companies in the quick service industry would be the differing government policies in China compared to those in the United States. These different policies would possibly cause businesses to change some of their operations to function in line with these new laws. The change in currency is another threat to these potential entering firms since they will need to incorporate the Chinese Yuan into their accounting systems and monitor exchange rates to see how much money they are losing or gaining due to fluctuations in these exchange rates. Another potential threat to these companies is the fact that there were no other western restaurant chains in China so it was difficult to determine the reaction of these consumers to these new products. These is also the issue of the growing divide in the distribution of income in China and companies wishing to enter this country would have to know exactly where the best area to geographically place their restaurant to reach the maximum number of Chinese consumers willing and able to purchase their products.

## Kentucky Fried Chicken

Kentucky Fried Chicken (KFC) is based in Louisville, Kentucky and is focused around a special recipe created by Colonel Harland Sanders almost 70 years ago (KFC, 2013). KFC is in the quick service industry and offers consumers a variety of recipes with focus on the Colonel Sanders secret 11 herbs and spices recipe. This company is owned by Yum! Brands, which is the same company owning other western quick service firms such as Taco Bell and Pizza Hut (KFC, 2013). KFC offers consumers a relatively limited variety of menu items mainly focused on chicken products specializing in different types of batter and condiments for these chicken products. This allows KFC to specialize on a single product and cut the extra costs associated with having many products on the menu. KFC is also able to provide consumers with a high quality product since these products offered by KFC have a very high consistency in flavor; however, KFC modifies its menu items and used different sources of materials depending on which country it is operating in, so its national products have consistency while its international products differ.

In 1987, KFC entered Beijing, China making it the first foreign quick service industry to enter China. This gave KFC the first mover advantage in this market and it was able to establish a positive brand name in China. To assist in the success in this new geographic market, KFC established a joint venture with Beijing Animal Production Company and Beijing Tourism Board. This action was to help KFC gain local supply chains for its products. This local supply chain would lower costs for KFC as well as allow it to establish relationships with local companies to better understand this new market. KFC also used many local ingredients in its products and catered its menu to fit with local preferences changing about 80% of its menu items to meet customer's preferences. This is representative of a transnational company on the I-R framework. KFC hired local employees and paid them very large salaries in proportion to other jobs in the area, this tactic would ensure long lasting employees who would be enthusiastic to learn how to best perform their jobs and make a career out of it. This also made a high demand for these jobs and gave KFC the opportunity to choose from a very large pool of workers with the exact qualities it was looking for. The preferred employees were able to speak English, had education leveling high school graduation, and no prior restaurant experience, which ensured there were no previously learned work habits. KFC originally hired elites from neighboring Asian countries with high performance in the QSR industry as well as a high knowledge of Chinese customs, culture, habits, and language to be sure these employees have a good knowledge of this market and the consumers who will be served (Szulanski, Chen & Lee, 2012).




*Source:* http://www.Chinadaily.com.cn/bizChina/2009-06/17/content_8291814.htm

The strengths of KFC were its ability to adapt to the Chinese market. By being able to utilize local ingredients and supply chains KFC was able to cut costs as well as establish mutual beneficial relationships with local industries. KFC was also able to adapt its menu to fit the local taste and give the Chinese consumers a product that was familiar and preferable. By using locals to work in its restaurants and give them high salaries, KFC was able to gain knowledge on the Chinese customs and culture enabling it to know exactly what the customer wants and the high pay allowed KFC to choose from many employees and maintain them for long periods of time, which gave KFC a long lasting and knowledgeable staff. Some weaknesses of KFC were its high cost product compared to the majority of peoples salaries in the area. Although there was still a substantial number of potential consumers with enough income to afford KFC, the large majority of people in China could not afford it. Another weakness of KFC was its thinning bottom line, caused by the economic downturn in Asian countries during the time of KFC's entrance into China.

KFC has realized the Chinese consumers were looking for a quick place to eat, and not necessarily looking for the western dining experience and for this reason KFC has changed most of its menu and used local ingredients to adapt to these local products and serve the consumers foods they are familiar with and have liked their entire lives. KFC capitalized on using local partners to gain familiarity with the country and using local employees to create an inviting place for locals. KFC researched the Chinese culture before entering China and wanted to offer these consumers something they knew, but at the same time, offering it in a way that was new and exciting to them. By utilizing a transnational strategy, KFC was successfully able to gain the confidence of the Chinese consumers and create a highly performing market presence in China. It is for this reason that KFC made a good choice in its development of its strategy. By working with the locals and knowing the people, KFC was able to create a great business model for the Chinese market.

The VRIO analysis (Barney & Hersterly, 2012) (Barney, 1991), of KFC's entrance strategy shows it as being valuable since it is offering KFC a whole new market with a huge potential for profit. By entering China KFC has the ability to meet a huge market of consumers. This strategy is also rare since KFC would be the first western quick service industry to enter China, giving it the first mover advantage and allow it to set a standard for future companies wishing to enter this market. This entrance strategy is also costly to imitate since KFC has established working relations with local suppliers and distributers, as well as gaining a highly reputable brand image among the Chinese consumers. KFC has also organized itself to be able to take full advantage of this strategy by ensuring management is acting consistently with this entrance strategy and using its local employees to establish informal controls regarding the Chinese culture, language, and customs. By being highly adaptive and very carefully establishing the management and employees of these offshore restaurants, KFC has effectively organized itself to take full advantage of this strategy and possibly maintain a sustainable competitive advantage in China for years to come.

## McDonald's

McDonald's was founded in 1955 and has been a major pioneer in the quick service industry. Not only has McDonald's created favorite menu items such as the chicken nugget, but it is also responsible for creating an assembly line procedure in the preparation of food. McDonald's used this assembly line procedure to fill customers' orders quickly and effectively (McDonalds, 2013). McDonald's used this fast production of food to make yet another ground breaking introduction to the quick service industry, the drive-thru window, which allowed customers to make orders and get their meal quickly without having to get out of their cars (McDonalds, 2013). McDonald's keeps an extremely high consistency in its food items from restaurant to restaurant, ensuring a consumer will get the same experience no matter where they eat. McDonald's uses a highly franchised business model where prospective owners will work with the company to establish a high traffic area with a great potential for success. These private investors were a major part of the McDonald's business model since they account for 90% of the restaurants in the United States (York, 2013).

Three years after KFC's entrance into China, McDonald's also entered China; however, the entrance strategy utilized by McDonald's was anything but similar. For logistics, McDonald's used its global logistics partner, HAVI Foods, instead of teaming up with local companies. McDonald's also used its global partners for food supplies as much as possible in the entry into China's market. The reasoning behind this was to bring the Chinese consumers the globally consistent standards people in other countries have experienced. McDonald's also kept its menu basically the same as its menu in the United States, with the Big Mac being its signature dish, while also adding a few items to attract local taste such as Vegetable and Seafood Soup, as well as Corn Soup. As McDonald's realized that having local tasted items on the menu was important it introduced more locally inspired items to create a standard of 20% local items and 80% national items. McDonald's had the desire to keep many of its items the same to give Chinese consumers the western style dishes in its restaurants. While McDonald's relies heavily on franchising in the United States and in other areas around the world, accounting for 78% of its worldwide businesses, it was unable to pursue this franchising strategy right away in China due to government regulations and procedures (Szulanski, Chen & Lee, 2012). This prevention of a heavy franchising strategy caused McDonald's to have to change its core business strategy in its Chinese outlets and directly control these restaurants.

The strengths of McDonald's were its product consistency and western style dishes. McDonald's uses its highly consistent product to give consumers all over the world the same experience when it comes to eating at one of these outlets. McDonald's also prides itself by not changing too many menu items so it can give consumers in any country its classic western style dishes. The weaknesses of McDonald's were its high reliance on franchising, which made it unable to effectively adapt in a situation where it is unable to use this strategy. Another weakness is the fact that McDonald's does not work with any local suppliers and distributers, this may give McDonald's a negative image to local consumers who may not like the fact that a company refuses to give business to any of their companies. Consumers may also not like the fact that McDonald's doesn't hire anyone locally because these non-local employees may not be as familiar with their language, customs, and culture as someone who lives in the area where the restaurant is. This opens possibilities of accidently insulting consumers and offering products nobody in the area would want.

The VRIO analysis of McDonald's entrance strategy shows it as being valuable, since this huge market of consumers is beginning to eat out more and has a growing preference for beef. This makes this market have a lot of potential for profit for a company such as McDonald's. This strategy is also rare since there is only one other western style quick service restaurant in China, which is KFC. This entrance strategy, however, is not costly to imitate for other quick service industries wishing to pursue the same strategy since McDonald's is simply relying on its current operations and menu items to enter China. This strategy does not have any unique historical conditions, causal ambiguity, or social complexity, resulting in it being imitable and only a source of competitive parity at best. In order to make this strategy costly to imitate McDonald's would have to be more adapting and willing to learn in this new market as well as work with local companies to make a product more desirable and fitting to the Chinese consumers. By establishing these socially complex relationships with other businesses and consumers McDonald's could then better organize itself to take full advantage of its resources in China and create a sustainable competitive advantage in this market.

Comparing the two different entrance strategies in the Chinese market, both of these companies used the hierarchal governance form of operation since they were maintaining as much control as possible over these restaurants in China by creating wholly owned subsidiaries. Regarding the entrance strategy structure, McDonald's used a centralized hub, since it retained all the decision making for strategic and operational decisions at its central headquarters, and did not delegate any decision making to the McDonald's restaurants in China. KFC went a different way with the structure of its international entrance strategy by creating elites from nearby countries who have lots of knowledge regarding the Chinese customs, traditions, and language, and putting these elites into top management positions in order to coordinate the Chinese restaurants to operate in line with these aspects. This structure resembles the coordinated federation structure (Barney & Hersterly, 2012) (Barney, 1991), since KFC was delegating the operational decision making to these elites in China, while it maintained the strategic decision making in its corporate headquarters.

**Most powerful brands in China**

| Rank | Brand | Brand Power Index | Nationality |
|---|---|---|---|
| 1 | KFC | 564 | U.S. |
| 2 | Pampers | 482 | U.S. |
| 3 | Colgate | 424 | U.S. |
| 4 | Olay | 371 | U.S. |
| 5 | Crest | 355 | U.S. |
| 6 | Apple | 336 | U.S. |
| 7 | McDonald's | 324 | U.S. |
| 8 | Omo | 286 | U.K./NL |
| 9 | Coca-Cola | 281 | U.S. |
| 10 | Carrefour | 260 | France |

Source: Millward Brown
Note: Average Brand Power Index is 100

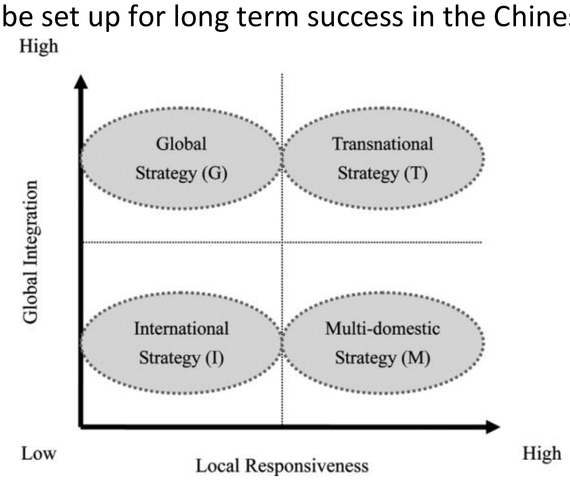
*Source:* http://nrn.com/international/kfc-McDonald's-among-most-powerful-brands-China

## Strategy Effectiveness

Regarding the question of which of these two strategies were more effective in China, it is KFC's adaptiveness and willingness to learn which makes it the better strategy. By being locally responsive while at the same time having high integration, KFC has made itself a transnational company, which gives it the highest potential for long term success in this market. It has been proven in many different business models that a transnational company has the most potential for long term success and those companies using other structures such as global, multi-domestic, and international should try to move to being a transnational company if they wish to experience long term success in the foreign country. KFC not only changed the necessary aspects of its menu to best serve these customers, but it also saved costs by utilizing its current marketing and branding as much as possible. This gave KFC an enormous advantage right away in China and allowed it to hit the ground running in its entrance into this market.

McDonald's strategy can be defined as more or less a global strategy whereas it is using its same product with its same marketing. This strategy has proven effective to McDonald's in the past and there was no reason for them to believe that it would not work in China at first glance. What McDonald's missed, however, was the fact that KFC was not using an international strategy in China and since KFC was there before McDonald's, it would have been possible to examine just what exactly KFC was doing before going into China. This would have allowed McDonald's to gain knowledge on what the reasons were for KFC's large success in the Chinese market, and then adapt its own strategy to incorporate these findings.

Using the global strategy in China may have had short term benefits, but in the long run it is susceptible to competition and imitation (Barney & Hersterly, 2012) (Barney, 1991). The best thing for McDonald's to have done would be to increase its local responsiveness to transition into a transnational firm. This would not only give McDonald's the short term success of the global strategy, but it would have also been able to capitalize on the benefits of an increase of local responsiveness. McDonald's could then increase its integration to become a transnational company, this would allow it to be adaptive and at the same time cost efficient. By doing this McDonald's would be set up for long term success in the Chinese market. Although McDonald's




*Source:* http://www.emeraldinsight.com/content_images/fig/0210311203002.png international strategy has been proven successful in other countries, it cannot expect every country to be looking for the same benefits and that was demonstrated clearly here.

McDonald's has been slow to adapt its menu, insisting it must give consumers a western dining experience, but is slowly realizing these consumers were more interested in their traditional food items, causing McDonald's to slowly introduce more and more Chinese dishes on its menu. By noting the success and rapid expansion of KFC, McDonald's could see it was possible for a western quick service industry firm to be very successful in China; the only question left was how they were doing it. By realizing that KFC had changed almost 80% of its menu, McDonald's could see that these locals were not like the ones in other countries. This is because they were not necessarily looking for a western dining experience when they entered KFC or McDonald's. Instead they were looking for a good place to eat a high quality meal quickly. However, they wanted to eat foods they knew and loved, as opposed to foods they have never tried before, since these food items being offered by KFC and McDonald's were also relatively expensive to these consumers they were probably also hesitant to spend that much money on something they had never tried before or had not developed a taste for.

McDonald's entrance strategy into other countries has been proven to be more effective than KFC's. A possible explanation for this would be the fact that these other countries have many other quick service industries and the consumers local to these countries have had quick service experience for a while and were looking for different types of foods. The Chinese consumers were just coming into the amount of wealth necessary to be able to afford to eat out at these quick service restaurants and were mainly looking for a quick place to eat. With this distinction, consumers in other countries would be more receptive of McDonald's strategy because it is offering a different type of food, the western style, so they can eat different things, much like American consumers eating at Mexican restaurants. This made it possible for McDonald's to use its time tested strategy and offer these new consumers a dining experience that is the same in every country. McDonald's prides itself in its ability to do this and wants to bring every consumer around the world the western dining experience. In countries where the consumers are looking for new experiences this works very well, however in China, the consumers were not necessarily looking for a new dining experience and just wanted something familiar to them, resulting in this strategy not being as successful as it had been in other countries.

KFC's strategy of adapting to local ingredients and dishes is not always successful either. In many foreign countries consumers are looking for authentic cousins from other countries when they enter foreign restaurants, and KFC offering them their own dishes with their local ingredients is not as exciting to them. This strategy is also ineffective in the long term because it would not differentiate KFC from other restaurants in the country and therefore it would be hard for KFC to gain a competitive advantage against these other restaurants. Another reason why KFC was successful in China right away was the fact that many of its American menu items fit local taste such as the chicken wings, while McDonald's menu items such as the Big Mac were not as in line with the local taste even though McDonald's continued to use the Big Mac as its main item. In other countries, however, the local tastes differ and the Big Mac may be more in line with these consumers' preferences than KFC's chicken products.

KFC formulated its strategy around the needs and wants of the Chinese consumers. Once formulated this strategy proved successful to KFC and it was used for the entrance of other countries around the world. This was a mistake, however, because this strategy had been formed for the Chinese consumers, and not the consumers in other countries around the world. This adds to the reason on why KFC has not proven as successful in other countries. KFC should have not assumed this strategy would work everywhere and observed the companies in these other countries to determine just how they were approaching the issue on international expansion and just what strategies they were utilizing. By doing this KFC would be able to modify its own strategy for each country it entered and by doing so ensure that it was entering with a strategy which has been proven to be successful by other companies.

McDonald's is on the flip side of this scenario. It had already been in other countries and had a working business plan which it assumed would work in China. Like KFC in other countries, McDonald's did not examine what was going on in China and just used its time tested strategy. If China had been the first country McDonald's had ever entered into the results would likely be much different because it would have not have its past knowledge of other counties working against it. Instead it would have studied the country in more detail and observed what the current restaurants in China were doing and adjust its strategy to incorporate this information. By doing so McDonald's would be adopting a strategy very similar to the one KFC used and McDonald's probably would have seen high profits and large potential for growth in China.

When entering a foreign market it is important to not only learn as much as possible about the consumer audience that is being targeted, but it is also important to make sure you are going in with a strategy which is in line with their needs and wants. KFC was right in using local suppliers and distributers in China because the people were looking for food dishes with familiar ingredients and recipes. It was also beneficial to use a local staff because it enabled KFC to gain insight on the local culture and customs of China and by doing so KFC was able to offer the consumers in this area exactly what they were looking for. It was the careful and well thought out entry into this country which made KFC highly successful in its entrance strategy. McDonald's, however, decided to use its same time tested strategy in this new market and assumed the Chinese consumers would be looking for the exact same thing their other consumers around the world are looking for. It was not until later they learned that they had to add more local dishes to the menu and try to learn more about the consumer needs and wants of this market. The major lesson here was the fact that even though a strategy works in practically every other country it was employed in, it does not necessarily guarantee it will work everywhere. There are many factors affecting what consumers will prefer in one country compared to another and assuming there is one basic strategy which works with all would be incorrect.

In pursuing an entrance strategy into a foreign country it is important to use tactics from each of these entrance strategies to best fit with the needs and wants of the consumer. It would be important to make relationships with local companies such as suppliers and distributers because they would help you learn more about the country and the best places to operate. Another important factor would be to hire locally and build strong relations with these employees so someday they could be managers for the restaurant. Building strong relations with local employees is important because of the knowledge they are able to offer the company regarding the traditions, culture, and customs of their country. Depending on the other restaurants in the area and after doing research on the local consumers to find out their preferences, I would either use KFC's strategy of changing most of the menu to fit local tastes, or McDonald's strategy of only changing a small portion of the menu and keeping the rest authentic to the original dishes. To make this decision it would be important to know if consumers are looking for a quick place to eat food they're familiar with or if they are looking for a different dining experience offering them the signature taste of another country.

Both of these strategies utilized by these two companies have their strengths and weaknesses, and can be effective, but the context in which either is effective is the most important thing to be aware of. By knowing when and where to adapt or stay the same is the solution to gaining competitive advantages internationally. McDonald's had a tried and reliable strategy which had been very successful in other countries, but by not fully understanding the Chinese consumers and by having to change its strategy of franchising, it was unable to be as successful as KFC in China. This was because in this particular country, all of KFC's decisions were coordinated exactly with the wants and needs of the Chinese consumers. It was this deep understanding of the consumer and the actions taken to implement an entrance strategy which took these consumer needs into account that was the reason for KFC's high success in the Chinese market.

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