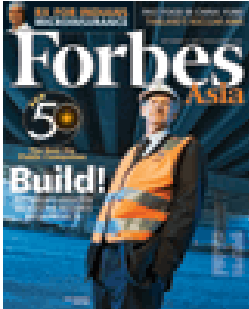


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On The Cover/Top Stories

Mealtime

Fara Warner 09.17.07

Sam Su



Armed with hundreds of KFC, Pizza Hut and Taco Bell outlets, Sam Su is changing how China eats.

Sam Su had spent his entire 16-year career at Yum Brands in Asia. Overseeing the fast-food company's operations in China as it opened hundreds of KFC, Pizza Hut and Taco Bell restaurants, he naturally reported to Yum's international division in the U.S. Then, in 2005, Yum made a decision: Su would now answer directly to the chief executive of the \$10 billion company.

The move wasn't about keeping a closer eye on Su. Instead, headquarters in Louisville, Kentucky wanted to learn how this veteran of doing business in China kept making so much money there even as he rewrote Yum's playbook. "No matter how good you are, things change, and this market is so big, so unique, that it requires its own solutions," he says over a bowl of noodles at East Dawning, a new Chinese fast-food chain that Yum is testing at eight Shanghai locations.

Su, 55, has lots for the corporate suits to pore over. Fried-chicken chain KFC is China's number one fast-food brand, boasting \$1.3 billion in sales last year, compared with McDonald's at number three with an estimated \$500 million in sales, according to Technomic Asia, a Shanghai consulting firm. (Little Sheep, a hot-pot, self-cooking domestic chain, is number two.) A change in strategy for Pizza Hut has added higher-priced menu items and moved the chain upmarket, pumping up sales. And after lots of experimentation, finicky Chinese consumers are flocking to East Dawning.

China is critical to Yum. Chief Executive David Novak never fails to talk about its China operations when discussing the company. In an earnings conference call with analysts in July, he laid out his four main priorities. First on his list, he said, was "building dominant restaurant brands in China."

Focusing on China is an obvious move. In the U.S. the fast-food business is a struggle. Yum's brands must battle mostly on price against endless competitors to get noticed by consumers who have almost too much choice. KFC comes in a distant seventh to number one McDonald's. Yum's U.S. revenue of \$1.21 billion in the second quarter was down 8% over the same quarter last year, and its \$191 million profit was off 2%.

But in China the market is far from saturated as a growing middle class explores new foods and new ways of eating. Yum's second-quarter China revenue surged 25% to \$439 million, and profits were up 14% to \$65 million. Same-store sales were up 7% in China, while they were flat in the U.S.

Pizza is one new food that Chinese consumers are exploring, and that meant Su had to do much more with Pizza Hut than simply introduce Chinese-inspired toppings. He realized that the way the chain operated in the U.S.--focused on its delivery service to homes and offices and featuring modest restaurants--was not going to work in China. "We had to do some soul-searching," he says. "We had to rethink our business model. We needed to move upscale. Some people had never had this kind of food. It may have been their first dining experience where they didn't use chopsticks."

Opening fancier restaurants and offering more expensive food may seem counterintuitive in a country where incomes are still very low. But Su's instincts proved correct. "We weren't successful with Pizza Hut until [we opened our first upmarket] store," he says. Pizza Hut's 289 restaurants in 60 cities now sport comfortable booths surrounded by dark wood and bright paintings. He plans to open another 32 by the end of the year.

Su is now trying the same idea with Taco Bell. He's opened two Taco Bell Grande locations that serve upscale Mexican food instead of using the U.S. model of cheap, fast Mexican food. "We call that China-fying your business," says Steve Ganster, managing director of Technomic Asia, a Shanghai research firm that works with multinationals doing business in China. "You have to bring your skills as a multinational to China while leveraging all the benefits of being in China."

East Dawning, which opened its first location in 2005, is another gamble for Su. It may seem like a no-brainer to sell Chinese food to Chinese people, but given that tastes in China differ widely by region, will a national brand with a standardized menu work across the country? He doesn't see this as a problem because Chinese are increasingly moving around the country and the world. Still, he doesn't have plans to roll out East Dawning nationally any time soon. "Obviously, we'd like to take it to every city," he says, but for now he still wants to work out a few kinks.

If East Dawning succeeds it will give Su another line of revenue as KFC faces tougher competition in China. KFC opened its first Chinese outlet in Beijing in 1987 and now operates close to 2,000 in 400 cities. Plans call for opening 300 more each year. By comparison, McDonald's has fewer than 800 restaurants but is headed for a growth spurt. Last year it signed a deal with China oil company Sinopec to put outlets in tens of thousands of gas stations across the country.

Su believes that East Dawning meets a need for reliability that no domestic or international brand has been able to meet--yet. "For years Chinese have been crying out for a Chinese equivalent of KFC," he says, watching as dozens of people line up to order at this outlet in one of Shanghai's busiest districts atop the Xujiahui subway station. The lines move quickly, even though much of the food is prepared to order and dished up in hard plastic bowls and plates instead of disposable paper and plastic as at most fast-food restaurants. "Fast food--and Chinese fast food--is a concept that China needs as people are getting busier with their lifestyle," he says.

Fast food may be easy when selling a simple menu of chicken, burgers and fries. But figuring out how to "industrialize" Chinese food, as Su puts it, has proven to be a stiff test of Yum's kitchen operations. He declines to show a visitor the kitchen at the Xujiahui East Dawning, calling it a trade secret as to how it delivers up to 50 items ranging from fresh soy milk to spicy beef noodles in the time it takes to make a chicken sandwich. "In Western food, we already had broken down the production and cooking process of burgers and fried chicken," he says, noting that a kfc sells only about 25 items. "To do that for Chinese food took a lot of people a lot of hours to think through the issues."

That work appears to be paying off with consumers who usually eat Chinese food at a large banquet restaurant or food stalls and smaller Chinese-owned outlets. "The key is food safety," says Na Hai Yan, 30, who's eating a lunch of noodles with her mother and infant son. "It's my biggest concern."

"The advantage of fast-food restaurants in China is the perception of sameness, of cleanliness," says George Haley, director of the Center for International Industry Competitiveness, in New Haven, Connecticut. He says the one thing that could cause problems for Yum in China is a lengthy food scare that doesn't spread to other fast-food companies.

Su got a taste of what a food scare could do to business after an industrial dye used to make products such as red shoe polish found its way into KFC seasoning mixes. "It was a wake-up call for me," he says. Analysts estimate that KFC's same-store sales slumped for seven months after the dye was found in March 2005. Su says the food scare was minor because only a small amount of dye made it into the seasoning and it was likely not detectable in its New Orleans chicken wings. "But that didn't matter, it was there," he says.

The incident forced Su to examine his network of suppliers. He also created a food safety office and hired laboratories for random analyses of its products. That has put Yum on a solid footing as food scares have become more common in China. He can now issue a recall that within 24 hours will pull products off the shelves and launch the process of figuring out where a problem started. "I can never eliminate all risk, but I can minimize it," he says.

Yum may wonder whether Su might not be more valuable back in Louisville figuring out how to goose U.S. sales. But he says China is the only place he wants to be.