
KFC in China

Our Consumer Survey Shows Only Modest Worries about Food Safety

- **Food Safety.** Only 12% of respondents said they are “a lot” concerned about KFC’s food safety.
- **Brand Still Strong.** Three-quarters are “very positive” or “positive” about KFC’s brand image.
- **Quality.** Consumers like KFC’s atmosphere but complain about the quality and variety of the food, a potential long-term problem for Yum.



Food Scare Fears Appear Overblown

Yum Brands reported China same store sales fell 20 percent in 2Q 2013. The good news was June (-10%) was better than May (-19%). We conducted a survey of KFC consumers in six Chinese cities in June 2013. We asked them thirteen questions about how they felt about KFC and its competitors. The data suggests that the short-term issues relating to the food scare are rapidly abating. In our

view, there are a number of reasons why this is not an important issue for the company:

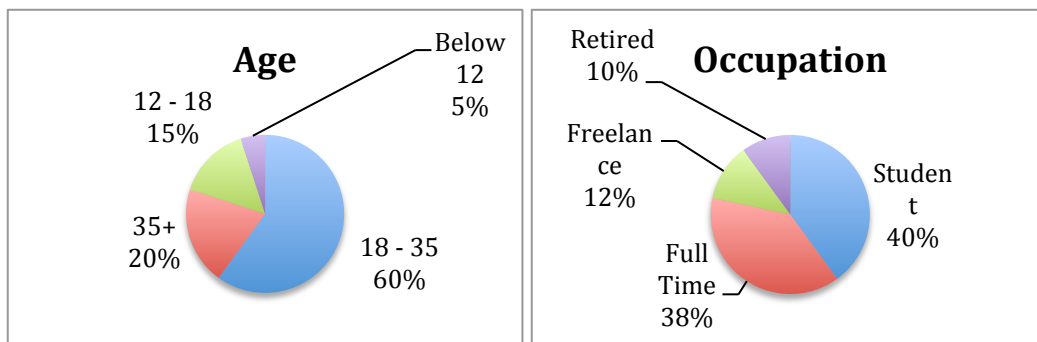
- 1) Bad food quality is a fact of life in China. We have seen this much more seriously in the melamine problem with China's milk industry.
- 2) Foreign companies frequently are targets for the Chinese authorities; the criticism of Apple and Foxconn are two examples. Chinese consumers know this and may not take the accusations seriously.
- 3) Foreign companies have a better reputation for quality than domestic.

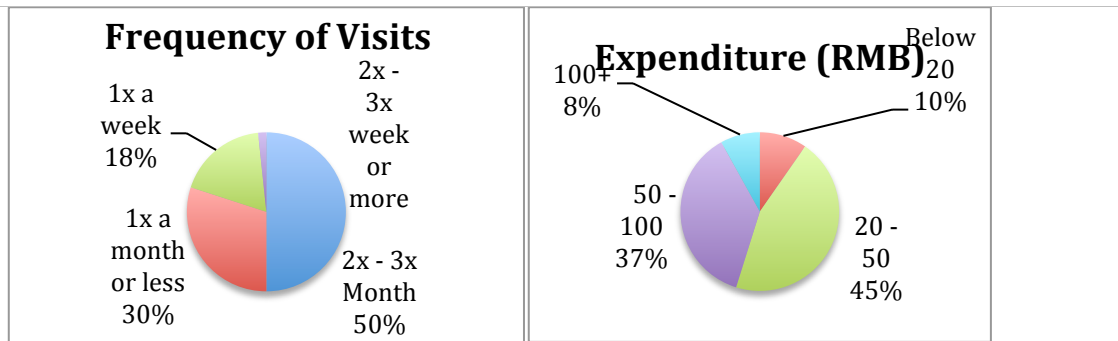
The bigger issue pertains to domestic competition. Consumers are concerned about the price and variety of KFC's food. Local competitors are beginning to make inroads by providing a similar dining experience at a lower price. This is particularly true in the Tier Three and Four cities where Yum is eager to expand. These are bigger issues KFC must grapple with.

Survey Data

Interview Cohort

Our subjects were interviewed in six large cities: Nanjing, Shanghai, Chengdu, Chongqing, Guangzhou and Shenzhen, where most of KFC's revenue is generated. Most are between 18 and 35, and 40% are students. About half visit KFC two to three times a month, with a small proportion (18%) visiting once a week, and another 30% once a month. Almost half (45%) spent RMB 20 to 50 per visit, with one-third spending RMB 50 to 100.

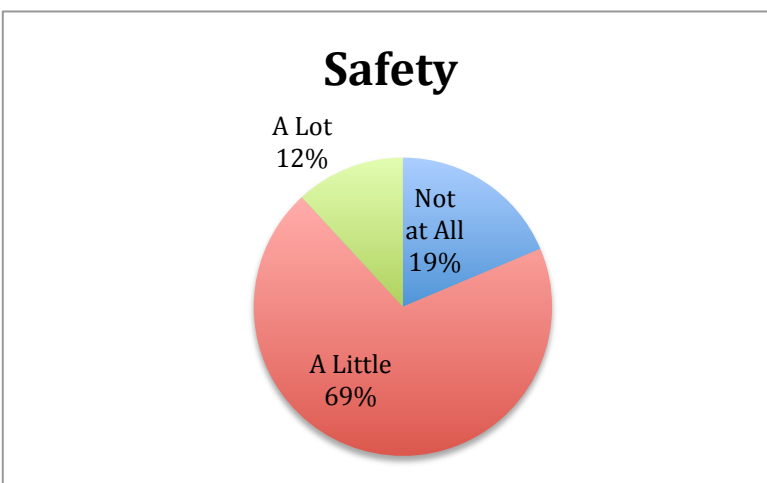




Major Conclusions

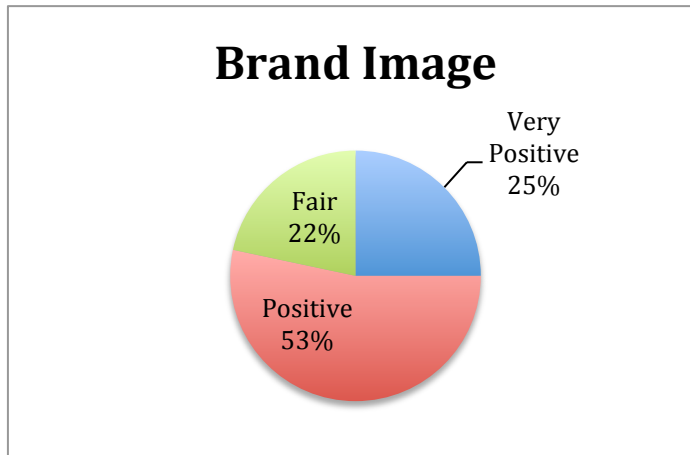
Safety Concerns

Four months after KFC cut 1,000 suppliers following accusations of selling substandard chicken, consumers in China are only mildly concerned about the safety of KFC's food. Among our respondents, 69% said they are "a little" concerned about food quality. On the positive side, only 12% said they are concerned "a lot," and 19% are not worried. The data could be skewed by overall worries about the quality of food in China, however, which has affected many Chinese brands as well.



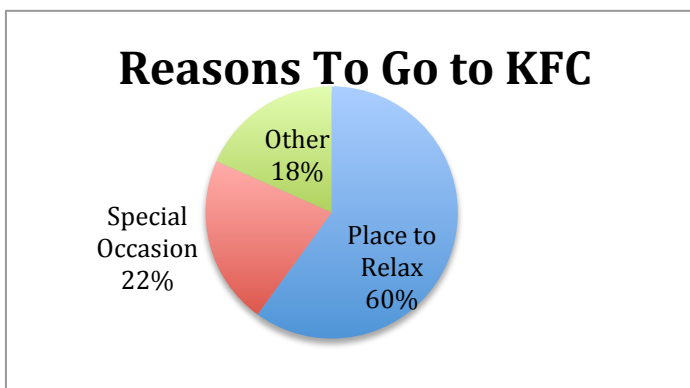
Despite Food Scare, Good Brand Image

The food scare doesn't seem to have done serious damage to KFC's reputation. Our question on KFC's brand image elicited a "positive" response from half of the respondents and another quarter said they are "very positive."



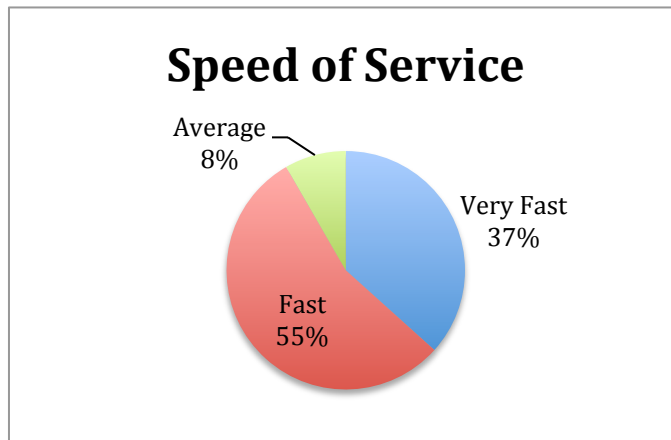
Why Go to KFC

American brands such as KFC and Starbucks are perceived to be luxury destinations as much as purveyors of food and drink. That is one of these brands' biggest competitive advantages. Our survey shows that 60% go to KFC as a "place to relax," while another 22% see it as a place to go for a "special occasion." We visited one KFC in a Tier 4 town where the expenditure per visit was above average but the visits were more infrequent. Local consumers said they go only on birthdays and other important events.



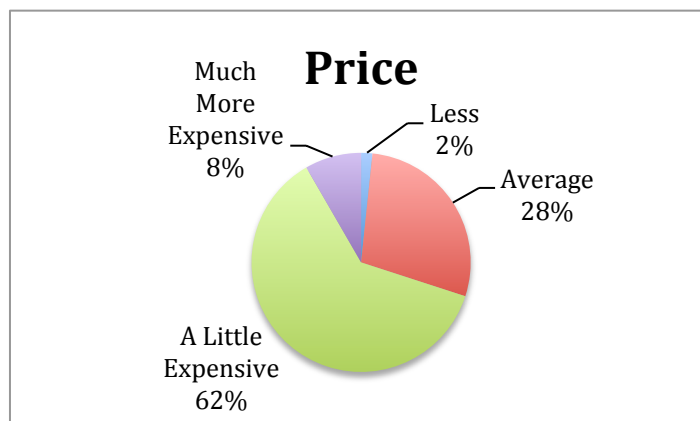
Along with Atmosphere, KFC is Fast

Consumers clearly appreciate the fast service at KFC. Three-quarters view KFC as faster than average.



Not Beat on Price – By Much

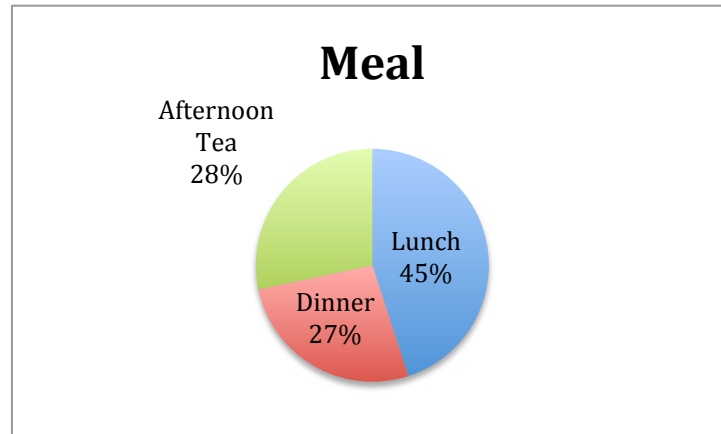
Local interviews suggested KFC is more expensive than competitors by a significant margin, but our surveys did not show that. Instead, most consumers view KFC as “a little bit” more expensive than other chains.



Business Lunch is the Main Driver for KFC

Although KFC is a used for “special occasions” in Tier 3 and 4 cities, the majority

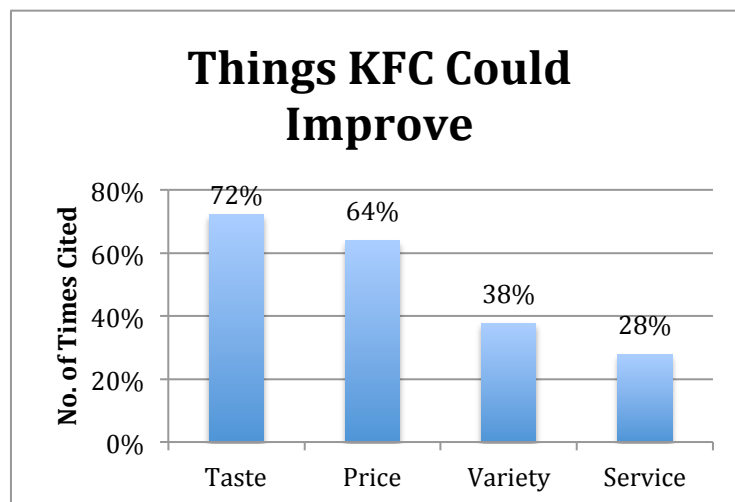
of users go there for lunch, presumably near their workplace.



KFC's Biggest Shortfall is – The Food

Chinese consumers like KFC for its speed of delivery, pleasant environment – it appears everything but the food. Three-quarters of our survey group said the taste of KFC food could be better. Another majority complained about the prices.

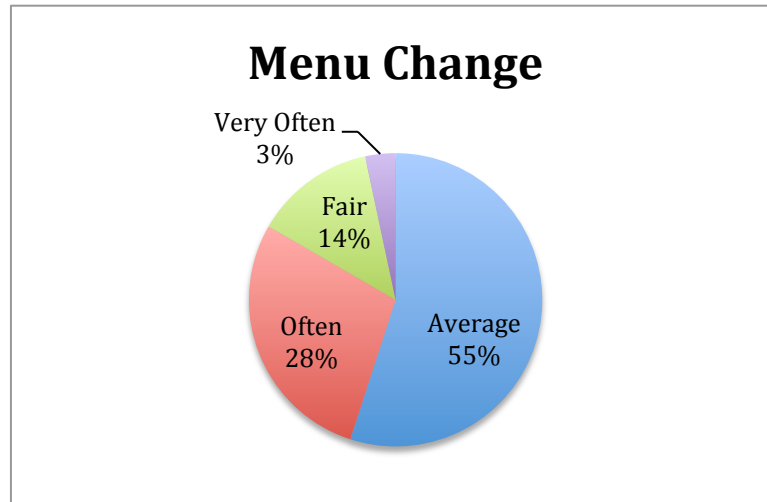
During a visit to a KFC in a town outside of Xian consumers eating in a noodle chain across the shopping mall said they didn't like KFC because the food was not as good and it was more expensive than the noodle chain.



Food Variety Doesn't Rank High

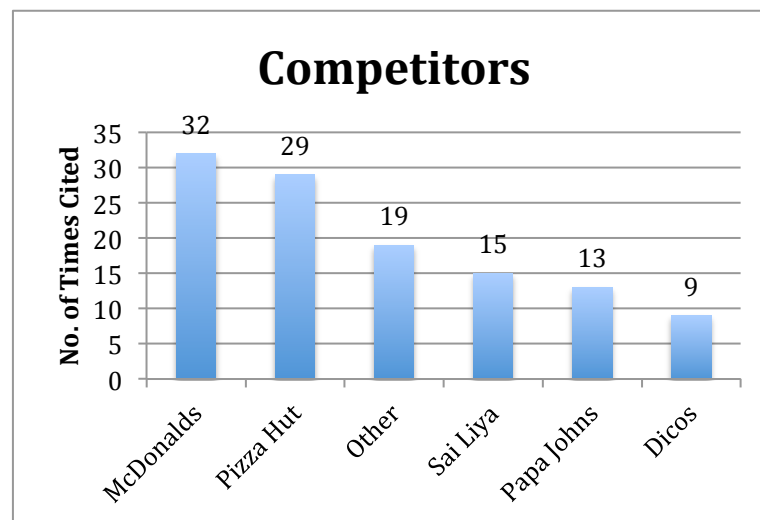
Most of the consumers we spoke to think KFC's menu changes are average for the

industry. KFC does not get high marks for food variety.



McDonalds is the Biggest Competitor

Although many smaller, Chinese chains exist, our survey group named McDonalds as the biggest threat to KFC. This may reflect the predominance of Tier One and Tier Two consumers in our survey where the U.S. chains tend to open their stores.



Conclusion

KFC rates well on the atmosphere of the outlets and the security of the product. Where it comes up short is in the taste and diversity of its food. Chinese appreciate the company's brand image and are willing to pay premium for it. However, they recognize the shortcomings of the product. Over the long term, this will be problematic for the company unless it can alter its offerings without losing the KFC brand image.

