Master Thesis

**Understanding Western Fast-Food Chains’ Internationalization in Chinese market**

A co-evolutionary perspective

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# Summary

This paper discusses the two strongest western fast-food brands, KFC and McDonald’s, entry to a Chinese market. KFC is the best known chicken fast-food restaurant chain, and McDonald’s is famous for its hamburgers and French fries.

Literature review reviews the existing literature on internationalization. Internationalization is presented as a process that is changing over time. Later on it moves to mention an existing works that discuss the existing co-evolutionary relationship between the internationalization processes, organizational capabilities and resources, and the evolution of the industry within which firm operates. For the industry analysis, industry lifecycle theory is chosen, while it is also suggested that resources and capabilities have their own life cycles and with time lose value or can be renewed.

In the case study, Chinese modern fast-food industry emergence and development is shortly discussed, KFC’s and McDonald’s internationalization activities in China are presented. After that, the existing and acquired resources and competences of KFC and McDonald’s are described.

Finally, in the discussion and conclusion chapters, the co-evolution between these processes are noticed, and it was sum up, that KFC’s and McDonald’s internationalization process in is co-evolutionary interaction with firms’ own resources and industry’s evolution.

# Introduction

The modernization of fast food industry in China has begun relatively recently, in late 1980s’. The implementation of China’s reform to open up their market has encouraged Western fast food chains enter China’s fast food market. KFC saw China as a large market that was likely to develop in desirable manner, and was the first to enter Chinese fast food market in 1987 and take the lead. Soon after that, other Western fast food chains started entering the Chinese market and try to capture as large share of the market as possible.

KFC and McDonalds are the major Western fast food brands in China. Even though Chinese fast food chains altogether occupy over 60% of market share, separately none of them are as strong as KFC or McDonalds fast food brands. They have entered and are expanding in China at a very quick pace.

In this project, the internationalization is referred as a process evolving and changing over time. The internationalization process of Western fast food chains – KFC and McDonalds - in Chinese market will be analyzed. The aim of this research is to understand and describe the internationalization process of these Western fast food chains and gain knowledge about the existence of co-evolution between fast food industry in China, internationalization path of Western fast food chains and their internal resources and capabilities. Such knowledge would provide some information on a two-way influence - how the internal resources and capabilities of a firm, and industry development influence the firm’s internationalization decisions and how internationalization of the firm influences the development of the industry and internal resources and capabilities of a firm.

## Problem area:

The topic of the project was formulated as “Understanding Western Fast-Food Chains’ Internationalization in Chinese Market: a co-evolutionary perspective”. The paper attempts to analyze some of the reasons why Western fast food chains choose certain internationalization pattern over another. In order to analyze this topic the following questions are going to be addressed:

1. Why and how strongest Western fast food chains entered China?
2. How KFC and McDonalds internationalization activities have changed over time?
3. The influence of industry and firms’ internal resources on internationalization process development of McDonalds and KFC.

The knowledge gained from answering the questions above would allow to understand to what extent industry, firms’ internal resources and internationalization process of firms are influencing one another, or to neglect the existence of the co-evolution between them. Entrance of KFC into Chinese market is often coincided with the beginning of modern fast food industry in China (China Daily, 2008), and it also was followed by McDonalds entrance into Chinese market. Their internationalization path has developed since their entrance into the market, and the third question above may help understanding the forces influencing the internationalization path of these Western fast food giants.

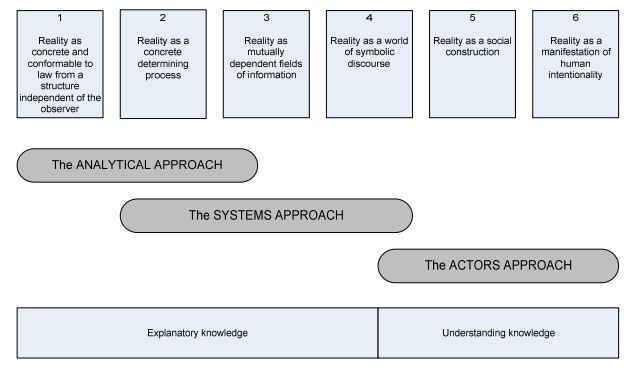
# Methodology

Methodological approaches and techniques are chosen depending on specifications of the research being conducted. Various influencers may affect the structure and sequence of a research.

In this methodology chapter the methodological choices will be discussed and justified to enable the readers better understand the reliability and validity of the study.

To be able to choose the right approach of this study, I have reviewed the work of Arbnor and Bjerke (1997) as they presented and defined a broad assortment of methodological approaches. According to Arbnor and Bjerke (1997), there are two important factors helping to identify the right methodological approach for the project – researcher’s assumptions of reality and the subject area. Moreover, the correctly chosen research method is relevant since it is closely related to research question that can help making final methodological choices.

Figure : Six paradigms and three methodological approaches.



Source: Arbnor and Bjerke, 1997, pg: 44-46

In the figure above, 6 different paradigms are presented. These paradigms are used to explain different perceptions or views that individuals might have about the reality. One thing can be interpreted and understood in various ways. Every person in the world is different, and has different understanding of reality. One’s perception may be influenced by a number of factors: ethnic origin, culture, values taught in family, and many more. For this reason, researchers have created different paradigms that allow standardization and comprise similar views on reality.

## Six paradigms by Arbnor and Bjerke (1997)

One problem may have several different ways of being solved. The choice of solution of problem as well as structure of the study is influenced by researcher’s perceptions of reality. The paradigms created by Arbnor and Bjerke (1997) are helpful since they describe similar views on reality. These paradigms are useful tools to guide a researcher from an ‘idea stage’ to the selection of correct methodological approach.

The paradigms in brief (figure 1):

1. *“Reality as concrete and conformable to law from a structure independent of the observer”* (Arbnor & Bjerke, 1997). It means that some people see the reality as external and objective phenomenon. The reality can be measured accurately and it can be observed but not influenced by the observer. Researchers with this view on reality use the stimulus-response frameworks to analyze the problem.
2. *“Reality as a concrete determining process”* (Arbnor & Bjerke, 1997). It means that some people see the reality as a process that is evolving naturally. It is seen that environment and humans have a reciprocal influence on each other. Researchers with this view on reality use interviews as data collection method and analyze already documented materials.
3. *“Reality as mutually dependent fields of information”* (Arbnor & Bjerke, 1997). It means that some people see the reality as continually changing. The humans and organizations progress together. Environment continuously influence its members, where members change through continuous adaptation to new information gathered from changing environment. The researchers with this view on reality are not focusing on the causes of changes, or differentiation between object and its environment. The researchers focus on adjustment of the whole system of relations.
4. *“Reality as a world of symbolic discourse”* (Arbnor & Bjerke, 1997). Researchers with this view on reality concentrate on patterns of symbolic relations and meanings developing out of human actions and interactions. Reality is created through social exchange among humans with a subjective understanding and interpretation about everything around them – other humans, things and situations. Individuals explain the reality through negotiation with each other.
5. *“Reality as a social construction”* (Arbnor & Bjerke, 1997). Researchers with this view see reality as a continuous process, where every encounter in life helps to construct social reality. Reality is subjective and not concrete.
6. *“Reality as a manifestation of human intention”* (Arbnor & Bjerke, 1997). Researchers with this view on reality see it as a reflection of the individuals ‘creative imagination. The world is created by intentional individuals, who control their own reality. This means that reality is very individual and subjective.

You can see that going from first to sixth paradigm the view on reality is changing from objective and rational to completely subjective. At one end of this spectrum “the researcher believes in universal laws and truths that are constant and consistent and hold for all” (Marinaccio, 2007, pg: 76), and in the other end the researcher believes that “reality is completely determined by the individual” (Marinaccio, 2007, pg: 76-77).

The view on reality explained in paradigms is reflected in the methodological approaches adopted by researchers.

## Methodological approaches

Based on the six paradigms presented above, three methodological approaches where created. The analytical, systems and actors approaches will be discussed briefly. The most suitable methodological approach will be selected depending on author’s view on reality and problem being researched.

### Analytical approach

Analytical approach has always been often adopted approach in different studies at different times. This approach was the first to be used in business research. His approach is related to first, second and third paradigms (Marinaccio, 2007). Researchers adopting this approach believe in reality to be objective, and the knowledge derived from the research is independent and is not influenced by the observers (Arbnor & Bjerke, 1997). Analytical approach often requires the task to have a concrete goal. The study must follow a strict structure, highly influenced by the data and statistics. The use of logic and mathematics is another important characteristic of analytical approach. Using this approach, it is expected to verify or falsify the hypothesis outlined in the study.

### Systems approach

This approach is most adopted methodological approach nowadays. Systems approach is related to second, third and fourth paradigms (Marinaccio, 2007). Researchers adopting this approach believe in reality to be not completely objective, but it can be objectively accessed (Arbnor & Bjerke, 1997). Opposite from analytical approach users, it is not enough to analyze the parts of the whole system. It is important to understand the relations between the parts of the system, because sometimes specific relation may bring more or less value to the whole system, than separate parts value put together. Therefore, the knowledge created using systems approach is specific to the system in question.

### Actors approach

The last in line of approaches that can be used for business research is actors approach. This approach is related to fourth paradigms, and more closely related to fifth and sixth paradigms (Marinaccio, 2007). Actors approach differs from the two presented approaches in the way the researchers see the reality. As the name says, the knowledge created using this approach is dependent on the actors. This means that reality is seen as being subjective, and is created intentionally by individuals involved. Every individual is different; it means the results would be different from case to case. In such research the knowledge created using actors approach cannot be generalized (Arbnor & Bjerke, 1997). Researchers adopting this approach are inspired by social constructivism, and often use qualitative data collection methods. Such research strategy is good for understanding the motives and attitudes, but offers a limited reliability (Bryman & Bell, 2003)

### Comparison of three methodological approaches

The figure 1 shows that use of different approaches will bring different results. Analytical and Actors approaches are in contrast to each other. While one approach aims to create valid objective knowledge that is possible to generalize using scientific methods, and tries to explain the whole through analysis of its parts, the other approach, on the contrary to objective, aims to create subjective knowledge by understanding the whole through characteristics of its parts, but using different research methods than the analytical approach users. Finally, the systems approach focuses on subjective accessed knowledge, which is specific for each case, and is aiming to understand and/or explain the parts through characteristics of the whole.

### Applied methodological approach

The choice of most suitable methodological approach is going to be based on previous discussions. The chosen approach must fit author’s understanding of reality (paradigm) and the study area, which is internationalization path development.

The author of the project believes that reality itself is not completely objective, but can be accessed objectively. When carrying out a research, the focus will be placed not only on the parts of the whole but also on relations among them. The study area is internationalization path development and internationalization decisions are based on a system of different factors, these factors have to be taken into consideration and the relations among them understood. In this project, internationalization decision influencers, such as industry evolution, firms’ internal resource and capability evolution, and the relation among all these components will be analyzed. Therefore, the systems approach seems to best suit and will be applied throughout the project.

## Research strategy and data collection

Two types of data exist – qualitative and quantitative.

Quantitative data is collected using structured collection instruments, such as questionnaires with pre-chosen answers. The data collected with such instruments are easy to process, the statistics can be derived, and so the information should be easy summarized and compared.

Qualitative data is very important and the collection of it is more complex. However, qualitative data helps to understand complex problems and the context they are in. Qualitative data is also helpful when supporting quantitative findings – numerical results can be supported and explained using qualitative data that uncovers the attitudes of individuals, uncovers the context. Instruments helping to collect qualitative data are open-ended questionnaires, individual or group interviews and other.

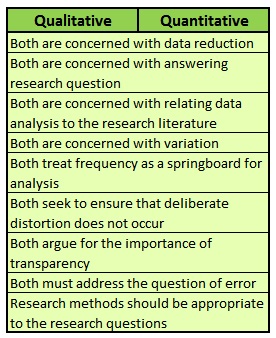
Table : Common contrasts between quantitative and qualitative research.

|  |  |  |
| --- | --- | --- |
|  | Quantitative | Qualitative |
| 1 | Numbers | Words |
| 2 | Point of view of researcher | Point of view of participants |
| 3 | Researcher distant | Researcher close |
| 4 | Theory testing | Theory emergent |
| 5 | Static | Process |
| 6 | Structured | Unstructured |
| 7 | Generalization | Contextual understanding |
| 8 | Hard, reliable data | Rich, deep data |
| 9 | Macro | Micro |
| 10 | Behavior | Meaning |
| 11 | Artificial settings | Natural settings |

Source: Bryman & Bell, 2011 (summarized from e.g. Halfpenny, 1979; Bryman, 1988a; Hammersley, 1992b)

The table 1 above is doing a good job summarizing the main contrasting features or quantitative and qualitative research. However, no matter how different these would be, some similarities exist, shown in table 2 below.

Table - Similarities between qualitative and quantitative research

Source: Bryman & Bell, 2011 (summarized from e.g. Halfpenny, 1979; Bryman, 1988a; Hammersley, 1992b)

### Primary vs Secondary research

The sources of information can be classified as primary or secondary.

The primary source of information is the document or a record that contains a first-hand information or original data. A work written or created by someone at the time of an event after or during direct experience of an event can be classified as primary source as well. The examples of such sources include interviews, diaries, letters and similar (Bryman & Bell, 2011).

The secondary source f information is a work, published or unpublished, that was created while describing, summarizing, analyzing or in other way basing it on primary source materials. The examples of such sources include textbooks, biographies, articles or reviews of something and similar (Bryman & Bell, 2011)

### Advantages and disadvantages of primary/secondary research

Primary data use:

Primary data allows researcher to collect more specific and focused information need for their study. The information collected by researcher him-/herself answers relevant questions, and does not include a lot of irrelevant information. However, such research is really time-consuming and often requires financial resources. For instance, big distance between researcher and subject or process being investigated increases the cost of primary data collection (At Work, 2008).

Secondary data use:

Secondary data is quicker, cheaper and easier to gather. Moreover, when searching for specific patterns, secondary data can be examined over a long period of time – for instance, records or data from many previous years. However, on the contrary to primary, the secondary sources do not offer tailored information, so the necessary data may need to be extracted (At Work, 2008)

The choice of data collection depends on several factors: the problem needed to investigate, the time-frame given for investigation to be finished and available resources, such as budget (At Work, 2008).

### Choice or research strategy for project

In this paper, qualitative research strategy based on secondary data is chosen. Qualitative research is seen as most suitable strategy for researching the problem, outlined in the problem formulation. Bryman and Bell (2011) noted that qualitative research is focused on the use of words rather than use of measurement tools. Author of this paper believes that research topic (Understanding Western Fast Food Chains’ Internationalization in Chinese Market) requires deep understanding of the context within which internationalization process develops, and qualitative research best serves this purpose.

The data was collected through desk research, starting with exploration through University Library’s database, available academic books and journal articles. The chosen sources mainly included academic and other journals’ and newspapers’ articles available on Internet. Academic books and journals were used for academic research and theoretical discussion. Electronic journals and newspapers, such as The Wall Street Journal, China Daily, and The New York Times, were heavily used for search of articles about McDonald’s and KFC activities in mainland China.

The use of secondary data is chosen considering the budget, time-frame, and the skills of author.

The data was analyzed using analytic induction strategy. This strategy was chosen because the author could collect and review the existing literature about the topic. The existing literature allowed creation of theoretical hypotheses. After the existing literature has been reviewed, the necessary data collection was done. The author was moving back and forth between data collection and knowledge generation. From the sources, mentioned above, the necessary facts and ideas were collected, related to existing theories in order to create new knowledge.

The case study research strategy is going to be followed. The case study in this project will consist of several cases: evolution of fast-food industry in China, McDonald’s brief history and entry, internationalization path in China, KFC’s brief history and entry, internationalization path in China, and McDonald’s and KFC’s resources and capabilities. KFC and McDonald’s were chosen for this study because they can be used as representative cases. KFC and McDonald’s were the first western fast-food chains to enter mainland China (one entering 3 years ahead of the other, respectively), they have been actively pursuing aggressive internationalization strategies and successfully growing in Chinese market for a long time.

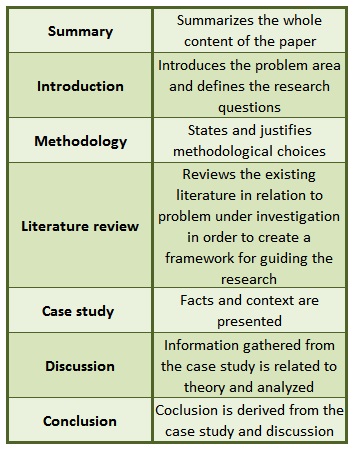
The case study research is suitable for this study because it is concerned with a complexity and particular nature of the case under investigation (Stake, 1995). Case study research strategy is popular and often used by business researchers (Eisenhardt & Graebner, 2007), because it allows deep and detailed analysis of a case.

## Delimitation

The study eliminated financial analysis of the companies, due to lack of time and information available.

Moreover, the study is limited, because thorough analysis of western fast-food restaurants chains internationalization in China requires approaching it from many points of view. This study discusses only the relationship between industry change, resources and capability evolution and internationalization of the firm. However, internationalization decisions are often based on much more complicated system of factors, and should be analyzed using various tools. But due to the limited time and resources, the study did not include the analysis of the cultural and institutional environment evolution in China.

## Project design



# Literature review

In this chapter, the existing literature on internationalization, industry development, and firm’s resources and capabilities will be reviewed. Since internationalization is referred to as a process, a relationship between all these elements will be discussed. Finally, a co-evolutionary model will be derived to demonstrate and discuss the co-evolutionary interaction between three processes: evolution of internationalization path, evolution if the industry, and evolution of firm’s own resources.320 limitations of secondary analysis

One of the basic arguments in internationalization literature was developed in behavioral process model – Uppsala Model – that was developed in Uppsala School (Johanson &Vahlne, 1977; Johanson & Wiedershein-Paul, 1975). According to this model, internationalization is an incremental process, which means an internationalizing firm increases the international involvement step-by-step (Andersen, 1993; Eriksson, Johanson, Majkgaard & Sharma, 1997; Forsgren, 2002; Welsh & Luostarinen, 1988). The model was created based on the observations of Swedish-subsidiaries abroad and Swedish companies, and given that firm’s performance was positive and the prospects were promising, the gradually more committed steps included: ad hoc exporting (Carlson, 1975; Forsgren & Kinch, 1970; Hornell, Vahlne & Wiedersheim-Paul, 1973), formal entry into foreign market through deals with intermediaries or representative agents, moving forward, the agents were replaced by own sales organizations, and finally, establishment of own manufacturing facility abroad. Moreover, internationalization destination priority is given to foreign markets that are close in terms of psychic distance, and gradually enter the markets that are further away in terms of psychic distance (Johanson & Wiedersheim-Paul, 1975; Vahlne & Wiedersheim-Paul, 1973).

Later internationalization literature introduced concept of ‘Born Globals’, or in other words ‘International New Ventures’, ‘Global start-ups’. Such findings tried to neglect the necessity for internationalization to be an incremental process (Hedlund & Kverneland, 1985; Knight & Cavusgil, 1996; Oviatt & McDougall, 1994). Soon after, more and more literature focused on analyzing quick internationalization and international entrepreneurship (Oviatt & McDougall, 1997; Ireland & Hitt, 2000).

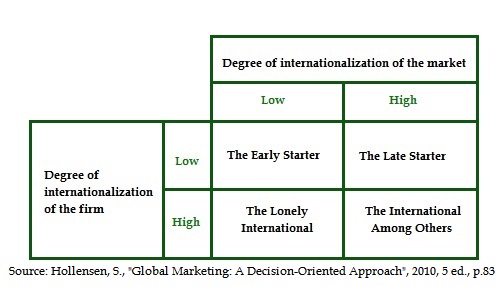
The behavioral process model was developed in the post World War II times, and the business environment has changed a lot, and the model presents some weaknesses that leave space for researchers to further deepen internationalization knowledge and consider it from different perspectives. For instance, Johanson and Mattson (1988) considered internationalization from the business network perspective. They see market as a network of relationships among firms operating in that market, and Coviello and Munro (1995, 1997) has identified the importance of networks when selecting the foreign market to enter and entry mode. According to this view, internationalizing firm tries to create and strengthen its position in the network, because of the importance of relationships in the internationalization process (Majkgård & Sharma, 1998; Sharma & Johanson, 1987). Internationalizing firm then can be classified according to two aspects – the degree of firm’s internationalization and degree of market internationalization. Four categories can be distinguished: ‘early starter’, ‘late starter’, ‘lonely international, and ‘international among others’ (See figure 2). In this model it is important to notice the firm’s internationalization choices’ dependence on internationalization of the market and other aspects of firm’s environment (Chetty & Blankenburg Holm, 2000; Majkgaard & Sharma, 1998). Further internationalization research from network perspective attempted to explain the influence of experimental learning and knowledge to internationalization decisions, particularly focusing on the management’s adaptation ability (Johanson & Vahlne, 1990, Petersen, Pedersen & Sharma, 2003). The experimental learning and knowledge is more concerned with cultural differences, distributive structures, and customers characteristics, and is gained through own or “acquired” experience. And the management’s ability to change their way of thinking, learn and adapt to new external environment is referred to as adaptation ability

Figure - Four cases of internationalization of a firm

The above mentioned different views show that internationalization is a complex process and cannot be fully explained by a single theory. Different tools can be used to examine internationalization process of a firm. For instance, already mentioned stage models, networks may partly work in examining the internationalization process, as well as foreign direct investment theory (FDI). Many researchers saw internationalization pattern as a holistic process, which means that interdependence between several processes and decisions exists and the emphasis should be placed on analyzing the whole process, rather than analyzing separate elements (Jones, 1999; Chetty & Campbell-Hunt, 2003; Crick & Spence, 2005). It was declared that current literature about internationalization is hardly enough to grasp the complexities of this process and the further research is needed to identify “the heterogeneity of organizations and complexity of factors and processes interacting on and within organizations over time” (Liesch et al., 2002, p.28).

Jones and Coviello (2005) have managed to provide the conceptual contribution working on above mentioned challenge. They thus defined internationalization as a process of entrepreneurial behavior that is changing over time due to interaction with the environment and firm. Jones and Coviello (2005) proposals in relation to internationalization of the firm are in accordance with previous research suggesting taking into account several factors: history of the firm (Eriksson et al., 1997), evolution of the sector the firm operates (Andersson, 2004; Boter & Holmquist, 1996), and the organizational capabilities and resources (Andersen & Kheam, 1998; Knudsen & Madsen, 2002).

As it is seen from the current knowledge in relation to internationalization, it is a complex process requiring a deep understanding of not only internationalization alone but several other internal and external factors that interact with each other and develop alongside. Therefore, in this paper a need to develop a co-evolutionary model to explain unique cases of internationalization is required. The model attempts to explain the internationalization process, evolution of the fast food industry, the evolution of firms’ core resources, and the relationship among them.

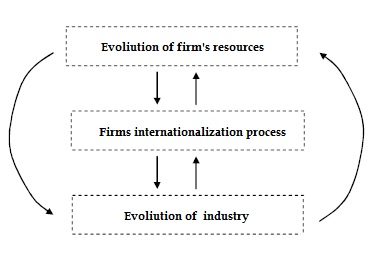
## Co-evolutionary model of internationalization

Since the realization that single theory often cannot exhaustively explain complex processes and issues, co-evolutionary models are increasingly used in the organizational and managerial literature (McKelvey, 1997; Lewin & Volberda, 1999). Even though, co-evolutionary research and international business literature are not exhaustively researched topics yet (Volberda & Lewin, 2003; Madhok & Liu, 2006), earlier research is enough to confirm that firm’s internationalization process is an evolutionary process and it develops together with other processes around and within the firm.

However, for us to be able to call this process a co-evolutionary process, the co-evolutionary relation must occur – in other terms, two or several processes have to demonstrate a significant influence on each other and the way they evolve (Lewin & Volberda, 1999). However, the co-evolutionary processes do not necessarily develop symmetrically. The purpose of this research is to identify effects of co-evolutionary interplay between processes. This identification, in turn, will allow us to understand the changes and development of the industry and the firm operating in that industry (Lewin, Long& Carroll, 1999; Volberda & Lewin, 2003).

Considering all earlier discussed internationalization theories, in this paper we suggest that firm’s internationalization process is in co-evolutionary interaction with its own organizational resources and capabilities and firm’s external environment (for instance, networks of firms in the competitive environment). The figure 3 below demonstrates this relation (between firm’s internationalization process, its own resources and capabilities and its external environment (see figure 3 below):

Figure : Co-evolutionary model of internationalization



Source: Self -creation

Figure 3 shows that Internationalization decisions of a firm are related to evolution of firm’s resources, and at the same time they are related to the evolution of the whole industry within which firm operates. As the two driving forces change over time, the internationalization path of a firm changes as well. This shows the co-evolutionary interaction between few processes.

### The co-evolution of industry and internationalization

In work of Andersson (2004), it was stated that how and how fast the firm internationalizes depends on the industrial context. Industry is changing constantly through the evolutionary processes of variation, selection and retention (McKelvey, 1997; Campbell, 1969). The latter evolutionary processes encourage the change (see table2). Since the industries are different, evolution of each industry is different and the way it influences the internationalization decisions of a firm is different as well, meaning that the co-evolutionary explanations are industry-specific (Liesch et al., 2002). However, some characteristics can be discussed that would enable us to understand possible bidirectional influences between industry evolution and internationalization.

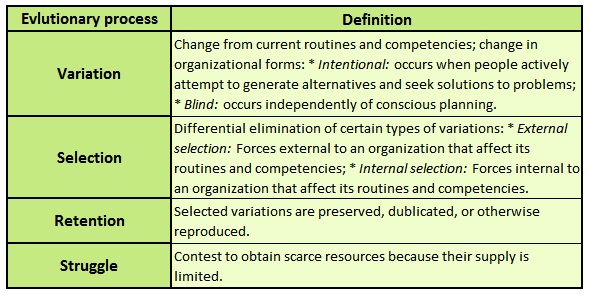
Source: Aldrich, E. H., & Ruef, M., (2006), “Organizations Evolving”, 2nd ed., p. 17, SAGE Publications Ltd;

Table - Campbell’s (1969) Evolutionary processes

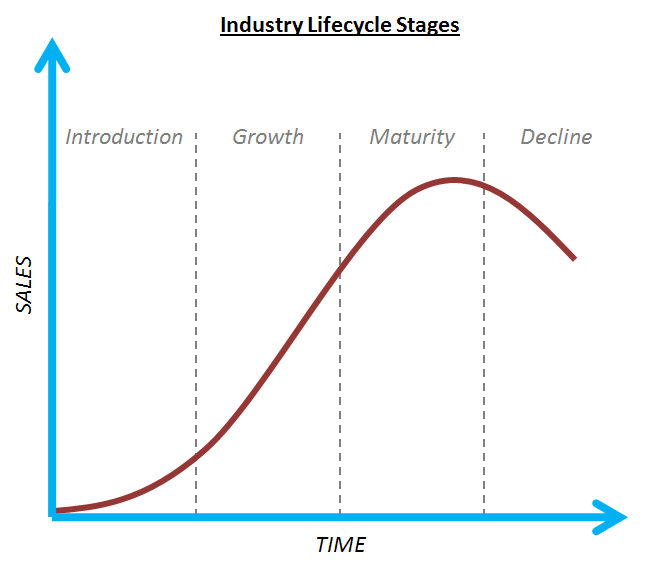
For this purpose, the concept of industry lifecycle (Klepper, 1997; McGahan, Argyres & Baum, 2004) is helpful. It is suggested that each industry passes through four lifecycle phases, such as introduction, growth, maturity and decline (see figure 4).

Figure - Industry Lifecycle

Source: Hollensen, S., 2011, “Global Marketing: a decision-oriented approach”, 5th ed. p. 465.

To describe it briefly, young industries are fragmented, meaning that it is difficult to predict the direction where industry is heading, and there is no influential market leader. During the growth phase, the dominant model emerges which increases the efficiency in comparison to other existing alternatives. During this phase many firms are forced to exit, if they do to align with the dominant model and fail to improve. This process may be called a shakeout. When the dominant model no longer helps firms to improve, growth volumes reach such a level that returns start to decline, the industry has reached its maturity phase. Lastly, the industry decline phase begins when the consumer demand steadily decreases.

During the introduction phase, while industry is fragmented, several alternative product technologies, several alternative models may exist together. According to Johanson and Matsson (1988), the level of market internationalization is also probably low. As mentioned earlier, in this phase, the market still does not have a market leader and several or many firms may exist offering similar alternatives, but neither one separately has a great demand for its product in the local area. So in order to survive and grow, the firm has to grow its customer number, and to do that, the expansion of the sales area might be needed. These selection pressures created by the fragmented young industry may directly influence the firm’s internationalization decisions. The influence may mean the beginning of firm’s internationalization using export via distribution network. For the firm to be able to export, it is necessary to create a network of distribution, and this in turn affects the industry and its evolution, and the level of market internationalization.

As the industry develops, the internationalization path of firm may change, depending on what international operations best serve the business and products (variation). Firms may change and create temporary internationalization strategies. The form of international operations that best helps firm achieve the increasing returns may slowly become the dominant model in that industry. The development of the dominant model is often a cause for, earlier mentioned, shakeout. Dominant model may lead, for example, to economy of scale, which in turn leads to reduced costs and increased returns, and unaligned firms are forced to exit or are acquired by stronger competitors (selection and retention). The shakeout may happen in growth as well as in maturity phase of the industry lifecycle. Considering this discussion, we can suggest that industry and internationalization path of the firms have bilateral influence on each other, and this relationship is a case of co-evolution.

### The co-evolution of core resources and internationalization

The above discussed relationship between internationalization and industry evolution cannot fully explain the internationalization of firms. The picture could be completed by adding a discussion about the internal resources of a firm at question. The resources can be tangible and intangible, but these are regarded as a fundamental cause of achieving sustainable competitive advantage over competitors and explaining different market positions of close competition (Barney, 1991; Peteraf, 1993). Discussion of dynamic capabilities of firm follows a resource-based view (Eisenhardt & Martin, 2000; Teece, Pisano & Shuen, 1997). Dynamic capabilities are important since they are often a trigger off creation and integration of new resources and capabilities in the firm. The core role of internal tangible and intangible resources of firms was researched by business researchers proving its influence on the internationalization path of born globals (Andersen & Kheam, 1998; Knight & Cavusgil, 2004) and on the strategic decisions of exporting firms (Knudsen & Madsen, 2002).

Later a new evolutionary model was suggested by Helfat and Peteraf (2003) relating to the discussion of capabilities of firm. The model suggested is a capability lifecycle. This model is a useful tool for attempting to understand a relationship and co-evolution of firms’ resources and capabilities and internationalization path of firms. Same as earlier mention industry lifecycle model, this model also has different phases: founding, development, maturity. Founding phase is the beginning of new capability lifecycle. Further on, it passes through developmental phase until it reaches the maturity phase. During the maturity phase or even earlier, the capability in question can change, or branch out into several different forms, because of the influence of the subsequently happening evolution of the other capability.

For better understanding, a rhetorical definitive case of a new firm without any international operations could be discussed. A new firm with new team or organization is connected together so to bring together separate resources and capabilities (variation). Such activity creates a unique set of resources and capabilities. A result of such a founding phase can be an innovative service/product. With certainly innovative service/product, the demand may be high enough in physically close markets and create no need for international operations, but international markets may become available too (selection). However, sometimes the local market cannot accommodate the potential supply of that innovative service/product. This would prove Knight and Cavusgil (2004) suggestion that a set of unique resources and capabilities gives an impulse to launch international operations.

The development phase of the capability, the firm might face and has to react to increasing competition and increasing number of alternative products for their service/product that entering international markets (retention). The development of capability has influence on firm’s internationalization path. For instance, if the capability develops successfully, the product/service may succeed over its increased competition, or even win over a higher demand globally.

What happens with capability in its maturity phase might have a significant influence on firm’s internationalization path. The capability in this phase can be renewed, redeployed or withdrawn. A way of renewing a capability is to acquire new tangible and intangible resources of another firm from abroad. This can happen when acquiring a firm and then selling the acquired property when all necessary resources are utilized. This sequence of actions may increase firm’s international activity in a positive way. However, a negative scenario is possible, if a capability decline or is withdrawn. Such event might decrease the demand for the service/product. In such case, the internationalization path would be affected negatively, meaning the firm might be pushed to de-internationalize.

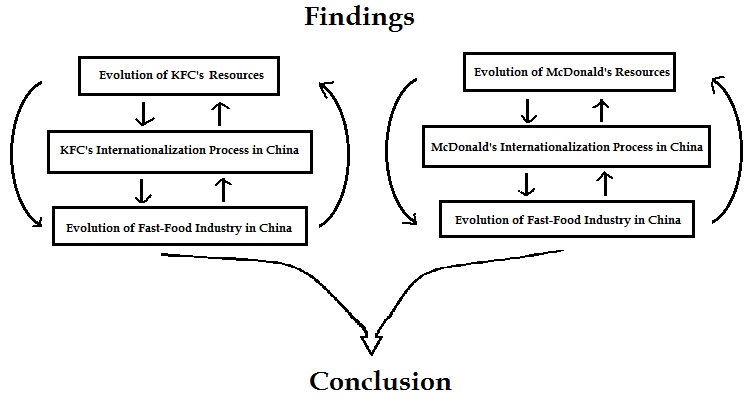
The above discussion shows the resource and capability influence on firm’s internationalization path. But it is important to notice that internationalization path also influences the development and maintenance of capabilities. As example, a firm, that has many own subsidiaries around the world, is forced to develop specific capabilities that would correspond to situation and would allow maintaining a competitive position. To sum up this discussion, it can be suggested that industry and internationalization path co-evolution (Eriksson, Majkgård & Sharma, 2000) is related to the resources and capabilities development that may influence positive or negative development of internationalization.

Figure - Theoretical framework for this study

In this paper the case of McDonalds and KFC internationalization paths in China are going to be examined in order to picture the explanatory power of the above discussed co-evolutionary model. The relationship and dependencies between fast-food industry evolution, firms’ resources’ and capabilities’ development and McDonalds’ and KFC’ internationalization paths development will be revealed or neglected (see figure 5 above).

# Case Study

## Fast-food industry in China

When the Chinese people hear a term of ‘fast-food’, most likely, KFC and McDonald’s fast-food restaurants will pop up in mind. Even though, neither KFC nor McDonald’s alone no not occupy a significantly high market share (Bloomberg, 2011), these fast-food giants are definite leaders in Chinese fast-food market (Food Navigator-Asia, 2013).

It is difficult to compare Chinese fast-food market to the one of U.S. or Europe, since in China fast-food industry, as we know it now, started to develop quite late, in 1987 when the first KFC fast-food restaurant in the capital was opened (Armstrong Undergraduate, 2014). However, even a late-starter, the fast-food industry development was a speedy process.

Because of such a huge growth over the next 20 years fast-food industry soon became an important driver of the whole catering industry development – 45% of the whole industry was occupied by fast-food industry (Asia Times, 2005).

### Life-cycle of an industry

As mentioned in the literature review, there are four phases that any industry has to go through. Even though Chinese fast-food industry has not reached the decline phase, it has a history of the three earlier phases.

#### Introduction phase

The beginning of Chinese fast-food industry development can be matched with the opening of first KFC outlet in Beijing in 1987 (Armstrong Undergraduate, 2014). After first Western fast-food outlet entrance into Chinese market, 3 years later, McDonald’s has joined the race for a share of growing Chinese market. Moreover, soon other but local fast-food outlets began to appear – Shanghai first local fast-food restaurant ‘Rong Hua Chicken’ was established in 1991 (China Daily, 2008), as well as other local fast-food outlets had their opening ceremonies, for instance, Li Hua Fast Food in 1993, Red Chinese Sorghum in 1996, Malan Noodles, Daniang Dumplings and other (China Daily, 2008). Many more fast-food outlets kept appearing in mainland China featuring a combination of traditional Chinese and Western fast-foods.

#### Growth phase

Not long after first fast-food industry started to emerge in China, local fast-food brands were battling Western fast-food giants, however, under-developed management skills led to a failure quite many beginners. It was mentioned in literature review that unaligned firms are often forced to exit the competition, because the dominant model business starts to develop. This shows from the behavior of the firms that survived – the management realized that there is a need to improve chain-store management and focus on standardization in order to survive and compete in the market, filling up with competitors.

#### Maturity phase

Since the development of this industry in China, it has grown significantly and had a high annual growth rate, only in years between 2007 and 2011 annual growth rate of Chinese fast-food market reached 15.5% (Datamonitor). The leader of the market remained KFC for all these years, followed my McDonald’s. However, there is existence local and other non-western fast-food brands, such as Chinese fast-food chain Kungfu Catering Management Co Ltd (owns over 300 Zhen Kungfu outlets), Taiwan’s Tin Hsin Group (controls over 1000 Dicos fried-chicken restaurants) (China Daily, 2011). New players are looking to enter the market in the future, for instance, California Pizza Kitchen Inc, German upscale seafood chain Nordsee GMbh (China Daily, 2011). So the competition is becoming fiercer in the industry in China.

It is important to notice the difference between Western fast-food cuisine, dominated by French fries, fried chicken, hamburgers, pizzas; and Chinese fast-food cuisine, which combines Western fast foods with traditional Chinese cuisine – for example, noodles, dumplings, Chao Mian and similar. In 2011, the Chinese local fast-food restaurants had even 70% market share all together (Bloomberg, 2011), but alone, no local outlet could overtake the leadership of KFC Western fast-food giant.

Moreover, it is important to discuss the obstacles the Chinese fast-food restaurants face when competing against Western fast-food chains:

* Lack of standardization (Wharton University of Pennsylvania, 2006). Chinese food cooking delicacy and hand-made tradition poses a challenge when competing with Western counterparts. Using specialized machinery can provide speed and standardization; it helps to bring out the spirit of ‘quickly served’. This leads to an easy conclusion that standardization is good for improving the process and quality, speeding up the delivery of a product.
* Lack of modern management (Wharton University of Pennsylvania, 2006). Fast-food industry can be partly judged as a service industry, for which the focus on customers is essential when aiming for service perfection. The focus should be shifted from mainly handling complaints to dealing with the lack of qualified staff in fast-food industry (China Daily, 2008).
* Lack of branding activities (HKTDC Research, 2014). Chinese firms in general, it means the local fast-food restaurants as well, have difficulties standing out, distinguishing themselves among a range of generic products, and thus leading to low brand loyalty. The Western fast-food outlets, such as KFC and McDonald’s, have a narrow focus on what type of products and services are being provided to customer, consequently, it makes it easier for them to differentiate and brand themselves. It is important to notice that establishment of a brand is not enough, because without maintenance of a position, the brand name will easily disappear from people’s sights.

## KFC

Figure - KFC logo - Colonel H. Sanders

### Brief introduction to KFC

KFC Corporation is originally located in Louisville, Kentucky. This company is proud of its decades-long history, success and innovation. The company began with one talented cook, Colonel Harland Sanders, who have developed a recipe 70 years ago that brought him fame globally. Nowadays, KFC can be considered a world's most famous chicken restaurant chain, and *“one of the most loved and fastest growing retail chains in the world”* (YUM!Brands, 2015), that still takes pride in its original recipe, along with many new, continually innovated items. The firm has 14200 outlets in even 115 countries around the globe, excluding YUM! China and India divisions (YUM!Brands, 2015).

The expansion of KFC is led by franchising model that is adopted in many markets. Franchisees are often controlled by local people who better know the local market (YUM!Brands, 2015). The company has always strived to be ahead of its competition and explore the new markets before they have been penetrated by its rivals.

Together with Pizza Hut, and Taco Bells, KFC belongs to YUM! Brands (YUM!Brands, 2015).

### Entry and Internationalization in China

KFC was the first Western fast-food restaurant chain that has entered China in 1987 (New York Times, 1988). It entered through a creation of a joint venture with a Hong Kong-based company, called Birdland (Food Service, 2010). The joint venture entry mode was chosen because of the existing requirement from Chinese policies for foreign firms operating in Chinese market to have a local partner (Harvard Business Review, 2011). The first KFC outlet in mainland China is the biggest KFC outlet opened anywhere in the world, and is having bigger annual sales compared to other KFC outlets (New York Times, 1988). After entrance, KFC aimed to expand rapidly – company picked 16 locations from where it could continue its growth and further expansion (Harvard Business Review, 2011). One of the soon company’s selected locations was Shanghai, where it opened a KFC restaurant in 1989 (New York Times, 1989), and Tianjin, where KFC was able to receive a license to build up and operate a company-owned outlet in 1994 (New York Times, 1994), as the country’s policies became more favorable to foreign wholly-owned enterprises (Harvard Business Review, 2011). The pace of KFC’s expansion was continually increasing – by 1999, KFC was opening dozens of new outlets every year, and by 2002 the pace increased even more - one new outlet opens everyday (Harvard Business Review, 2011). The company was working very quickly, the site selection for a new outlet was very rapid and the whole process from site selection to grand opening of an established new restaurant happened within 4 to 6 months (Harvard Business Review, 2011). The speed of KFC expansion shows from the growing number of outlets across the country – in 2000, KFC celebrated its 400th Restaurant opening in Shanghai (Business Wire, 2000), in 2001, 500th outlet was opened in mainland China (Business Wire, 2001), and in 2002, Shenzhen city in China accommodates KFC’s 700th outlet (Business Wire, 2002). In 2011 KFC has reached over 3000 outlets in mainland China (Harvard Business School, 2011), and now company has over 4800 KFC outlets across the country (YUM!, 2015). It is obvious that China has become KFC’s highest growth market, and the company’s success in this market is related to many factors: environmental forces, internal resources, strategic decisions, fact of being first western fast-food chain to enter the market, and many more.

To begin with, KFC has chosen a joint venture as an entry mode to a Chinese market, and this entry mode was useful for KFC in several ways. KFC was able to reduce risks and gained some initial local knowledge about the Chinese market, which is important when being a first western fast-food entrant in China (Food Service, 2010). Later on, in 1992, KFC became the first fast-food chain in Chinese market to start using the franchise agreements to expand the business (Food Service, 2010). Using franchising, the company is able to expand at a much faster pace and at a lower cost; however, this mode also provides direct control over new outlets. KFC strives to reduce risks and buys back the operations from franchisees once they become profitable and stable (Food Service, 2010). For example, in 2009, KFC has bought back the 7 % more of the ownership of the entity that controls 200 KFC restaurants in Shanghai (Food Service, 2010). By that time KFC had 58% total ownership, and continued opening a company fully-owned outlets, reducing the number of franchises by buying back the operations from them (Food Service, 2010). KFC strives to get back more and more control over business.

KFC restaurants are significantly different in many ways than those established in Western countries (Harvard Business School, 2011). The company has abandoned the dominant logic and strategies behind KFC’s growth in its home market – the U.S - where it was usual to offer low prices, narrow menu with a limited choice of items, and an emphasis of takeout instead of dining in (Harvard Business Review, 2011).Chinese people have different preferences not only in dining style and tastes, but in the way they communicate in formal and informal environments. In Chinese KFC working environment a more family-like employer-employee relationship model exists (Harvard Business School, 2011). It is very important to adapt the business to the Chinese culture, do things partly Chinese way in order to attract and retain Chinese customers (Harvard Business School, 2011). The influence of Chinese culture in KFC’s way is seen from several differences in the menu – menu is modified (Harvard Business Review, 2011), meaning that several basic items similar to westerners are complemented with traditional Chinese foods (mashed potatoes, fried bone-in chicken and other complemented with egg tarts, shrimp burgers, soymilk drinks and other), moreover, specific areas of China are offered items tailored to the tastes of people from those specific regions (Harvard Business School, 2011, Food Service, 2010). Chinese style of eating also differs from the one in the U.S – people usually are not ordering personal dishes, but rather several dishes are ordered for a group of people to share (Harvard Business School, 2011).

The KFC outlets in China are bigger in size, they have more floor space and can accommodate more customers and let them linger (Harvard Business Review, 2011). Wide choice of foods in KFC increases the number of people visiting the restaurant. Moreover, almost twice the size than in the U.S., menus require bigger kitchen in the store and more labor to be hired to handle the preparation of the menu.

High hygiene standards in western fast-food chain restaurants served well to initially attract Chinese customers (Food Service, 2010). Therefore, to keep these standards, KFC has to train their employees in personal hygiene. Personal hygiene of staff is also important for food safety, which is a big concern among Chinese consumers (Harvard Business Review, 2011).

Best idea from the U.S. fast-food model taken to Chinese market is hiring the right people. ‘Right people’ mean several qualities in one – managers who could read and speak the language, who would understand how the restaurant business and Chinese consumer needs, and would also have experience in Western way of doing business (Harvard Business School, 2011). Such set of qualities in a manager have provided a lot of value for KFC in China – a manager with a knowledge of Western business practices and Chinese consumer needs is a person with knowledge of ‘both worlds’. It means that Western knowledge could be adapted to a very traditional and evolving Chinese market.

There was a ‘right’ hired person who was very influential to early changes in KFC’s business model in China, its performance and success. China division chairman and CEO Sam Su has transformed the business model of KFC China, because he was provided more managerial freedom by the parent company when it first entered China with KFC fast-food restaurant in Beijing in 1987 (Harvard Business School, 2011). In that time, KFC was owned by a Pepsi company, which originally is not a fast-food company, and that was one of the reasons to provide the managing freedom to Sam Su (Harvard Business School, 2011). Sam Su had a lot to do with early success of KFC in China – he had created a strategy that would allow Chinese people see KFC not *“as a foreign presence but as part of the local community”* (Harvard Business School, 2011; Harvard Business Review, 2011). The way Sam Su tried and took the best practices and ideas from the U.S. fast-food industry model and adapted those ideas in Chinese market, influenced KFC performance in a very positive way because this allowed KFC best serve Chinese consumers (Harvard Business School, 2011). Moreover, Sam Su has made a big decision in relation to his career in KFC – on his own he have decided and argued his position to cover a smaller geographical area than he was assigned to cover in the first place; he chose to cover and focus solely on Chinese market and not control all northern Asia-Pacific region (Harvard Business School, 2011). A bigger focus on a Chinese market positively influenced KFC’s performance in China – good strategies were developed, in 1997 a company-owned distribution system and suppliers were developed (Harvard Business Review, 2011; Harvard Business School, 2011). One more merit of Sam Su was the initiative launched by him ‘New Fast-Food’ in 2005. The focus of his new initiative was healthier choices – this initiative included the removal of oversized items from the menus across China, wider variety of items in the menu allowing healthier choice, also, limiting the amount of money saved when purchasing combo meals, and finally, promotion on exercise to improve health (Harvard Business School, 2011).

As it was mentioned above, company-owned distribution network in China has allowed KFC reach economies of scale, reduce supply chain costs, in turn bringing higher earnings (Food Service, 2010). The company has built own warehouses and operated own fleet of trucks (Harvard Business Review, 2011). This shows that even big but necessary investments have to be made in order to achieve long-term benefits later. Being in control over the supply chain is advantageous since direct control and monitoring of quality from the animal feed to final product.

Trained labor in Chinese market is a valuable asset (Harvard Business School, 2011). For this reason, restaurant chain has a special training for managers that carefully develop skills required for managers to be able to do various jobs in a restaurant (Harvard Business School, 2011; Harvard Business Review, 2011). Earlier was also mentioned, that KFC developed their own distribution network in China to ensure a continuous supply. The suppliers were arranged and sent overseas by KFC to be trained in western practices to ensure good quality. The network was built from ground, ant this helped KFC to increase the quality of supply and closely monitor the suppliers (Harvard Business School, 2011).

In the time the KFC entered a Chinese fast-food market, the culture of customer service was not developed in there, and KFC was creating and providing activities to employees to train and socialize them (Harvard Business School, 2011). Youngsters, working in KFCs in China, are often grown in single-child families because of the existing one-child policy (CNN, 2015) and lack socialization skills, therefore KFC organize activities and training for workers to learn socialization skills and develop customer service culture. An example of a simple activity provided by a company to workers during the work breaks, are video games for workers to play and communicate with each other through.

When KFC starts feeling diminishing customer flows in its outlets, the company responds to this with introduction of new items in the menu in a number of markets (Food Service, 2010). However, KFC’s original focus is on serving chicken, and that is advantageous for the company, because within the Chinese market chicken meat is more popular, and it is easier to meet the Chinese customer preferences and needs, when serving a popular meat choice (Food Service, 2010). Moreover, the innovation is also strength demonstrated by KFC in Chinese market, where new products are introduced more often compared to other fast-food chains (Food Service, 2010).

To summarize it, KFC is doing business in a way that is helping them successfully grow in China: strengthening and keeping close relationships with Chinese government, hires local management in order to gain local knowledge, sources most of its necessary ingredients and foods from within the country, and most importantly, modifies the menu to suit various tastes and style of eating of Chinese people. Now, KFC is a leading fast-food chain in Chinese market in terms of brand awareness and recognition, and outlets penetration (Food Service. 2010). This is a result of a combination of various KFC’s internationalization activities over the years since 1987.

## McDonald’s

### McDonalds logo.jpgBrief Introduction to McDonalds’

McDonald's history has started in 1940 by Dick and Mac McDonald opening a first McDonald's Bar-B-Q restaurant in San Bernardino, California. The company has started as a regular drive-in restaurant. However, nowadays, McDonald's headquarters is located in Oak Brook, Illinois, in the U.S. (McDonald's, 2015).

Figure - McDonald's Logo

It started with the sale of hamburgers, soon after establishment introduced French fries that until today are the core of firm's menus everywhere. McDonald's now has 35000 outlets in even 119 countries around the globe, and it the biggest hamburger restaurant chain in the world (McDonald’s, 2015).

### Entry and Internationalization in China

The fast-food giant has started its journey in mainland China in Shenzhen in 1990, three years after KFC (The Wall Street Journal, 2010). In 1992, McDonald’s have celebrated the grand opening of world biggest McDonald’s outlet in Beijing (China Daily, 2008). The beginning of the expansion of McDonald’s was slower in comparison to KFC, but by 2002 already 500 McDonald’s outlets were present in 70 Chinese cities (The Wall Street Journal, 2002). In 2003 McDonald’s added 66 more outlets to its expanding chain in China, and the range expanded into 94 different cities (The Wall Street Journal, 2003). However, the company still hopes to speed up the expansion in the coming years by opening 100 new stores a year. Restaurant chain is searching for other ways of gaining advantage over its rivals in China, and since the automobile use in the country is rapidly increasing (The Wall Street Journal, 2008), the company tries to bring in drive-through catering culture for busy people. Therefore, fast-food giant has opened the first drive-through unit in China in Dongguan in 2005 (The Wall Street Journal, 2005). McDonald’s also tried to make a deal with the largest state-owned gas retailer to establish many drive-through units in gas filling stations, in that way quickly expanding in Chinese suburbs (The Wall Street Journal, 2006). 50% of the stores to be opened in 2008 are planned to have drive-through windows, because even 30% of sales come from already existing drive-through units (The Wall Street Journal, 2008). Altogether, in 2008 McDonald’s has reached a number of 960 stores, and has provided employment for over 60 000 Chinese employees (China Daily, 2008). (By 2010 the company already owned 1100 restaurant outlets in the country (The Wall Street Journal, 2010b). McDonald’s expansion was increasing every year; in 2011 the company has managed to open 200 new stores in the country (China Daily, 2012) which is a 40% increase in capital spending in China in comparison to 2010 (The Wall Street Journal, 2010b). McDonald’s China has high expectations, and aims to reach the number of 2000 outlets in the country by 2013 (The Wall Street Journal, 2010). Unfortunately, the plan to have 2000 outlets by 2013 was delayed – that year opening a record number of stores – 275 – still did not bring McDonald’s to reach its goal, the number reached over 1900 stores across the country (China Daily, 2014). The 2000-store milestone in McDonald’s China expansion was happily marked by the end of 2014 (China Daily, 2014). Further expansion is hoped to speed up by focusing more on franchising system. Compared to other countries, franchising by McDonald’s in China started quite late, in 2008 (China Daily, 2014).

The company uses franchising system very widely globally, even 80% of its global locations are franchised, but when it comes to China, the franchising system is not yet adopted well, and it is used cautiously, only six McDonald’s units have been franchised in the country by 2010 (The Wall Street Journal, 2010). Most of its stores in mainland are self-operated by McDonald’s (China Daily, 2011). McDonald’s has issued its first developmental license in China in 2011 (China Daily, 2012). It also plans to loosen the ownership structure and expand the franchising system for the sake of increasing the speed and range of geographical expansion throughout the country (China Daily, 2011).

China is the most important and fastest growing market for McDonald’s (The Wall Street Journal, 2010). Main early attractions in McDonald’s involved an affable and farcical Ronald McDonald clown, the striking yellow, red and blue restaurant décor, smiling attendants and the quick service, which, at that time, was sharply contrasting to the poor service Chinese consumers used to experience in local restaurants (China Daily, 2008). To keep the growth, it is important to provide increasingly good customer experience; for this reason, in 2005-2006, McDonald’s have tried to adapt more traditional Chinese dishes, to make them more portable and able to serve in drive-through units (The Wall Street Journal, 2006); in 2009 McDonald’s have planned to introduce 15 new items to the menus in China that could satisfy Chinese consumers with specific tastes (China Daily, 2009), however, no matter the modifications, the core of McDonald’s menu always remains the same – hamburger and French fries (China Daily, 2008). The company is also aware of the consumer preferences to switch to healthier options, so to keep the customer base and attract new ones, McDonald’s aims to develop healthier items on the menu (The Wall Street Journal, 2010b). Moreover, the company has set a plan to redesign and renovate most of its Chinese outlets to offer customers more attractive environment so they would like to come back again (China Daily, 2011). Stores are to get a more relaxed, European-style bistro type atmosphere where the young enjoy coming and staying (The Wall Street Journal, 2010b). Reaching young consumers is an opportunity to create lifelong consumers. McDonald’s is bringing more commitment to the country, because of the increasing competition and the market leader – KFC (The Wall Street Journal, 2010b). The stores were also adapted to families with kids – Internet connections are provided, children’ playgrounds and special seating for their mothers are established (The Wall Street Journal, 2006).

McDonald’s restaurant chain has own R&D department in China. Spending on the research is an important part of business, and McDonald’s plan to increase R&D expenditure as the sales rise (China Daily, 2009). The company focuses on improving the performance in all stores; therefore, R&D is important for creation of value, and countering the consumer behavior and other external changes (China Daily, 2009). The example of the promotion created in response to financial crisis that struck China, when people became more resistant to spend money, McDonald’s has released a ‘Super Value’ promotion, meaning a value set for good pricing. The company has always followed the strategy to get better rather than getting bigger, therefore it focuses more on improving the performance and service quality in existing stores and not on increasing the number of them (China Daily, 2008).

McDonald’s has established own training centre that is called a Hamburger University. The centre serves as a school for local talent development (The Wall Street Journal, 2010). The company has seven such centers globally, seventh being in Shanghai, China (The Wall Street Journal, 2010).

McDonald’s, as its main rival KFC, did not have a developed distribution network when it first entered mainland. The company has developed its supplier network, and aimed at making the suppliers similar to the ones in home market – the U.S. It took 700 000 million Yuan to build up a network from the ground (The Wall Street Journal, 2003). However the distribution network of McDonald’s did not develop as well as KFC’s and it is a part of reasoning behind slower McDonald’s expansion into smaller Chinese cities (The Wall Street Journal, 2010b).

To sum up, since the entrance to Chinese market, McDonald’s was growing steadily, with the pace of expansion increasing and becoming aggressive. It entered the market depending on the own knowledge of doing business, and did not have real local knowledge before entry, since all the stores that were opened were self-operated for a long time. This slowed the company’s expansion, because it took time to gain knowledge through experience.

## Resources and capabilities of KFC and McDonald’s

KFC is much bigger in China than McDonald’s in terms of sales, store count and reputation. This may be resulting very slightly from the fact that KFC has entered the market first (3 years ahead of McDonald’s), however, more reasoning is needed as to why KFC has remained a market leader in Chinese fast-food industry. For better understanding, it is good to discuss the firms’ internal and external resources and competences.

### KFC’s Internal and External Resources

* Restaurant locations (internal, tangible) – KFC has managed to enter Chinese market first and keep striving to get best locations for KFC outlets – with a good visibility and big customer traffic. The company has been choosing its locations strategically, that would enable them to easier expand deeper into the country.
* Human resources (internal, tangible) – KFC has trained staff, managers, cooks and other employees that are trained to be able to do the job right. Earlier it was mentioned that KFC has a special training program that trains new managers and develops the skills, so the manager would be able to work at every post in a restaurant. The other staff trained as well, socialization skills are being developed, the hygiene standards emphasized (staff is taught even how to correctly wash their hands).
* Supplier and distribution network (external, tangible) – KFC has built up their own supplier network, sent them to gain knowledge and experience overseas in order to ensure the quality, operates own fleet of trucks.
* Knowledge (internal, external, intangible) – KFC has a lot of knowledge of managing a business, standardization, staff training. However, when entering a Chinese market, they chose a joint venture mode, that allowed company to acquire more knowledge about the local Chinese market and its customers, their preferences.
* Various competences (internal/external, intangible):
  + Standardization – the operations are being standardized, the core recipes are standardized in order to achieve economies of scale.
  + Customer care – KFC is customer oriented and cares about the customers, so they would have a good customer experience.
  + Adaptation skills – management of KFC is flexible and is able to adapt to different needs and culture of Chinese people. Even the design of the stores in different locations are different, different regions are offered different items on the menu to satisfy local tastes, that differ significantly in such a huge and diverse country.
  + Staff training – it is a necessary competence in order to sustain its good standards in each area and each store.
  + Franchising system – it is a great competence that enabled KFC to rapidly expand widely geographically through the country. Moreover, the company buys back the operations from franchisees once they become profitable. This brings KFC more control over business and reduces risks.
  + Hiring ‘right’ people – this competence is obvious since the beginning after Sam Su was hired to take care of the KFC China that brought in local knowledge together with his own experience in western way of doing business.
  + Delivery speed – the food is being served fast and with cheerful attitude.
  + Innovation – the company is striving to always be innovative and always introduce more new items than its rivals, some of the items being temporary.
  + Speedy location scouting – KFC always tries to enter the city or area ahead of others, especially its main rival McDonald’s, in order to pick up the best locations.

### McDonald’s Internal and External Resources

* Financial resources (internal, tangible) – McDonald’s is continuing to invest more and more capital into China.
* Image (internal, intangible) – McDonald’s has earned a good image globally, because it was steadily growing since the company’s creation.
* Human resources (internal, tangible) – McDonald’s is training its staff in customer service, to always serve cheerfully and smiling, to provide good experience for customers, it also develops various skills for its managers in the Hamburger University.
* Restaurant locations (internal, tangible) – company tries to get good locations for each outlet of McDonald’s.
* Supplier network (external, tangible) – McDonald’s have invested quite heavily on creation of a supplier network, however, it was a little underdeveloped and held company back, slow down the geographical expansion.
* Various competences (internal/external, intangible):
  + Delivery speed – food was always served quickly.
  + Customer care – the customers were always greeted with a smile and cheerfully, environment was renovated to increase customer satisfaction, new and healthier items for Chinese tastes were developed.
  + Cleanliness – the customers were always attracted by high hygiene standards in McDonald’s.
  + Employee care – company always tries to provide good working environment and attractive work pay for employees
  + Staff training – for this reason McDonald’s uses own Hamburger University to develop various skills in its personnel.
  + Systemization – the knowledge of the way business in McDonald’s is done is systemized, each outlet follows a standard set of rules in order to standardize all operations throughout all outlets.
  + R & D – McDonald’s invest in research activities in order to develop business to better meet the customer needs.

### Dynamic Capabilities

From all the information we can see that both companies has certain dynamic capabilities that allow them steadily grow in Chinese market. However, one growing faster than the other (KFC growing faster) shows that KFC has more dynamic capabilities that allow them to grow faster, better satisfy customer needs and have better sales. The main dynamic capabilities are their application of current knowledge, adaptation to cultural and taste differences, and new knowledge acquisition. These capabilities have led to innovations that suit Chinese: menu including traditional Chinese dishes, differentiated dishes in different regions of the country, different atmosphere.

On the other hand, McDonald’s have also adaptive capabilities, since it has abandoned its business model from the U.S. and adapted more to the Chinese culture. This means stores were adapted to the Chinese culture – provided more seating areas and focused more on dining in (when compared to the U.S.), because the Chinese consumer values slow and enjoyable dining. When it comes to innovations, McDonald’s also tries to continually do R&D activities and introduce products more suitable to the Chinese market.

# Discussion

## Evolution of Fast-Food Industry in China

As it was discussed earlier, modern fast-food industry in China began together with the entry of first western fast-food chain – KFC in 1987. It is safe to say, that market internationalization was low, business, supplier and distribution networks did not exist, and KFC was the ‘lonely international’ in Chinese market. After that, the market has welcomed another fast-food giant from the west – McDonald’s, which has entered the market in similar phase. KFC and McDonald’s were creating own supplier and distribution networks, to enable themselves to rapidly expand the chain in China and create economies of scale.

The market started filling up with other fast-food restaurants trying to enter the growing fast-food market and gain a share of the profits. During the development of the industry some companies were forced to exit due to being unable to compete with experienced rivals. More adaptive local fast-food restaurants have remained and grown, for example, Kungfu Catering Management Co Ltd. By more adaptive, it is meant that companies followed the business model brought in by westerners, because it involved standardization, modern management skills, and they were well known brands globally due to their branding activities and long history of existence.

## Evolution of Firms’ Resources

### Evolution of KFC’s Resources

The main resources that KFC brought to China with itself were financial resources that enabled them to open a KFC outlet in mainland in China, and allowed them to make a big investment on order to build up supplier and distribution networks. The franchising system that KFC used and self-monitored supplier and distribution networks enabled KFC to expand its chain geographically very rapidly, and create economies of scale, reduce costs, and increase profits, this way increasing its financial resources.

Company also brought a lot of western modern managerial knowledge about the ways of making business, creation of brand awareness, quality and hygiene control – everything that was lacking in that time Chinese market. Fortunately, the company has chosen to enter the market through a joint venture with a local partner. This way the company has acquired new knowledge and connections from the partner. Moreover, in the beginning a local person, Sam Su, was hired to manage KFC’s Chinese division. This has also brought in new knowledge about the Chinese market characteristics and its consumers.

Lastly, KFC have further developed its managerial flexibility and adaptive skills. During the expansion and growth in China, the company has gained invaluable experience and knowledge of the Chinese market, learned to develop new items tailored not only to Chinese market, but to specific regions on the country that differ significantly in its tastes.

### Evolution of McDonald’s Resources

McDonald’s has also entered the Chinese market with significant financial resources. The company has also invested heavily in the country to create its own supplier and distribution networks, invested in R&D activities. The successful expansion and standardization of offerings to Chinese consumers have also created economies of scales, and reduced costs, increased profits, and, in turn, increase financial resources.

Since, the sources did not reveal McDonald’s to enter into partnership or joint venture when entering the Chinese market, the author of this paper assumes that the company has opened a self-operated outlet from the beginning. This means that knowledge about the Chinese market, consumer preferences and needs was generated slower, together with the experience in the market, and from self-initiated R&D activities.

Adaptive capabilities of the management were developing. This shows from the company’s initiatives to introduce new menu items dedicated to Chinese market.

## Internationalization Process

### KFC’s Internationalization Process in China

KFC has entered Chinese market through a joint venture. This mode was selected due to lack of knowledge about the local market known for its diversity and deep traditions. Later on, when the restaurant chain has collected enough knowledge about the consumers in this very different market, it started opening self-operated stores. It also was the first to start using franchising system is fast-food industry in China.

The company was choosing the locations strategically that would later make it easier for KFC to reach deeper penetration into the country. Franchising system has significantly increased the pace of geographical and numerical (number of outlets) expansion. Important to notice, that the speed was necessary for KFC in order to keep is long-time goal to be ahead of its rivals. In China, KFC has always strived to enter the different cities ahead of its rivals, especially its main rival McDonald’s.

The pace of internationalization was increasing continually. In the beginning it was opening dozens of new stores every year, later increase the number to hundred and over hundred new stores annually.

### McDonald’s Internationalization Process in China

As mentioned earlier, the author assumes that McDonald’s entered Chinese market through opening a self-operated store. The mode did not enable the company to acquire immediate knowledge about Chinese market. For expansion, the company has long time used same mode as for the entry – opening self-operated new stores in the country. Quite late, in 2008, the company started using its franchising system to speed up the expansion and achieve better economies of scale.

The company was expanding rather cautiously in the beginning and focusing more on the quality of already opened stores that increasing the store number. Later on, the speed was increasing, it was looking for niches that were not occupied yet, and started introducing drive-through catering concept in China. A deal with a largest gas retailer in the country has also helped to increase expansion pace and penetrate new areas, like filling stations by the highways and similar.

The pace was increasing slowly, but finally, the chain started opening a hundred, or two hundred new stores a year. The pace was also positively influence by the use of franchising system.

# Conclusion

From the case study and discussion in previous chapters, it is noticeable, that there is a connection between the firm’s internationalization process and industry’s evolution. This shows from the cases of KFC and McDonald’s:

* KFC has chosen a joint venture entry mode in order to gain knowledge and connections in the Chinese market where networks did not exist. Moreover, as the industry developed, more rivals appeared, especially after McDonald’s entry, KFC felt a need to expand rapidly and occupy better locations before others managed to do that. Quickly gaining and keeping big market share was important while competition was getting fiercer.
* McDonald’s choice to bring in drive-through concept into Chinese market and expand in different locations was partly influenced by rivals’ activities in the industry. Competition was concentrating in the city area, and the drive-through catering was not yet preoccupied niche.
* There is a clear indication that KFC’s and McDonald’s Internationalization had an influence on Chinese fast-food industry evolution. With the entry of first western fast-food restaurant chain the modern fast-food industry in China emerged. The business networks started to develop.

It is also noticeable, that there is a connection between the firms’ own resources and their internationalization paths:

* Once KFC gained new valuable knowledge about Chinese market, it started expanding more using self-operated stores and reduces the franchisee number.
* McDonald’s on the opposite, started with self-operated stores to penetrate the market, however, in order to keep up with its main rival, KFC, the company started using franchising in Chinese market as well, because if the more rapid expansion in store number.
* The more companies where expanding in Chinese market, the more resources they have acquired. They have increased their financial resources, during the internationalization years, knowledge and experience were gathered. Adaptive capabilities were developed.

Relying on this conclusion, it is possible to state that KFC’s and McDonald’s Internationalization path is in co-evolutionary interaction with firms’ own resources and fast-food industry evolution in China.

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