

# Strategy Report for Yum! Brands



Deirdre Chew  
Karen Bonner  
Mitchell Amsler

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## Table of Contents

<b>Executive Summary .....</b>	<b>3</b>
<b>Company Overview .....</b>	<b>4</b>
History .....	4
Business Model .....	5
<b>Competitive Analysis .....</b>	<b>6</b>
Supplier Power .....	9
Buyer Power .....	9
Entry and Exit .....	10
Substitutes and Complements .....	11
<b>SWOT .....</b>	<b>12</b>
Strengths .....	12
Weaknesses .....	12
Opportunities .....	12
Threats .....	13
<b>Financial Analysis .....</b>	<b>14</b>
Overview.....	14
Profitability and Growth.....	16
Liquidity .....	18
<b>Strategic Recommendations .....</b>	<b>19</b>
U.S. Division .....	19
China Division.....	20
International Division .....	21
Healthy Options .....	21
Food Safety .....	22
Conclusion.....	23
<b>References .....</b>	<b>24</b>
<b>Appendix .....</b>	<b>25</b>
Balance Sheet .....	25
Income Statements.....	27
Statement of Cash Flows.....	29

## Executive Summary

Yum! Brands is the world's largest restaurant company. It is based in Louisville, Kentucky, and has more than 37,000 restaurant units in 110 countries and territories. In 2009, the company pulled in almost \$11 billion in revenue. Its leading brands are KFC, Pizza Hut, Taco Bell, and Long John Silver's. These four brands are global leaders in the categories of chicken, pizza, Mexican-style food, and seafood. Yum! Brands has three divisions: the U.S. Division, the International Division, and the China Division.

The China Division is based in Shanghai and reported an operating profit of \$602 million in 2009. KFC is the first quick-service brand, the first restaurant chain to open a drive-through, and the first franchised restaurant in China. It is the largest, fastest growing, and number one quick-service brand in the country. There are currently almost 3,000 restaurant units in mainland China. Pizza Hut was the first chain to bring pizza and Western-style casual dining to China. It is the number one casual dining brand and has 450 restaurants units.

The International Division is based in Dallas, Texas and consists of about 13,200 restaurant units, almost 900 of which were opened in 2009. Operating profit for the division in 2009 was \$491 million. KFC and Pizza Hut are currently the international brands that bring in the highest return. KFC is flourishing in France in terms of volume, is building a leading reputation in India, and is partnering with a leading local fast food chicken restaurant in Russia. The International Division of Yum! Brands will soon invest in making Taco Bell an additional international brand name.<sup>1</sup>

After researching and reviewing the company, Vector Strategy Group has developed a set of strategic recommendations for Yum! Brands to improve operations. First, Yum! Brands should focus on increasing its revenue in the U.S., rather than increasing its market share. The company should concentrate more intently on its international divisions. Specifically, Yum! Brands should work to aggressively expand its China Division to maintain its position as a dominant brand within the country. In addition, there is a good opportunity for the corporation to sustain temporary losses in order to invest in the India market for the sake of utilizing its competitive advantage. In addition, Yum! Brands should advertise its efforts to consumers towards ensuring food health and safety in all markets.

## Company Overview

### History

Yum! Brands is an international restaurant company headquartered in Louisville, Kentucky. It was established in 1997 by PepsiCo Inc. and is currently composed of six restaurant brands: KFC, Pizza Hut, Taco Bell, Long John Silver's, WingStreet, and A&W. It is a global leading force in four food-relevant categories, chicken, pizza, Mexican-style food, and quick-service seafood. It is the largest fast food restaurant company in the world with over 37,000 restaurants in more than 110 countries and territories. Yum! Brands operates under three divisions: the United States, International, and China.

Pizza Hut was established in 1958 in Wichita, Kansas. Within a little more than a decade, the company became the largest pizza chain in the world in terms of both sales and number of restaurants. The company had an initial public offering in 1972 on the NYSE. It continued to fuel its growth by purchasing smaller restaurants and supply and distribution companies. Shortly thereafter, Pizza Hut expanded into international markets. By 1977, the potential of the restaurant chain caught the eye of PepsiCo and it purchased the pizza company. Taco Bell was founded in 1962. It became increasingly successful in the Mexican fast food market, and PepsiCo, wanting to diversify its restaurant business and capture market share among different ethnic groups, decided to purchase the chain in 1978. KFC was established in 1952. Seeing that it maintained large profits and consistent growth over time, PepsiCo decided to buy the restaurant in 1986.<sup>1</sup>

In 1997, the three restaurant brands were spun-off from PepsiCo as a publicly traded company under the name Tricon Global Restaurants, Inc. With regard to PepsiCo, this newly formed company operated under a completely separate management team and corporate structure. The PepsiCo CEO at the time, Roger A. Enrico, explained the strategy as an opportunity for the company's businesses to "better flourish with two separate and distinct managements and corporate structures".<sup>1</sup>

Soon after, Tricon Global Restaurants began to sell a portion of its restaurants to local franchisees, and quickly became a leader in the quick-service food industry. In 2002, the name was changed to Yum! Brands, and two new restaurants, Long John Silver's and A&W, were purchased from Yorkshire Global Restaurants Inc. and added to the existing restaurant group. After the acquisition, Yum! Brands adopted a strategy of pairing its

fast food brands together, and began to build combination restaurants featuring Taco Bell and KFC, or Taco Bell and Pizza Hut.

Yum! Brands began to place an emphasis on rapid international expansion of its many brands. It adopted the general strategy of building a leading international brand and became highly aggressive with global expansion. In 2004, Yum! Brands established a new local brand in China called Dong Fang Ji Bai, or East Dawning when translated into English, which combined the KFC business model with Chinese cuisine. Although the menu of this new restaurant is completely Chinese oriented, the style of the restaurant service is very similar to KFC. Currently, Yum! Brands is maintaining a steady increase in annual revenue although growth in the United States has slowed. The company, however, has continued to be very successful in its strategy of international growth and expansion, especially in China.

## **Business Model**

Yum! Brands has employed a four part strategy in order to promote the growth of its brands both domestically and internationally. First and foremost, on the China front, it attempts to build leading brands in each of its fast food categories. Secondly, it pushes forth rapid international expansion and strives to build a strong brand reputation. Thirdly, it takes measures to enhance its position, consistency, and return of its brands in the U.S. Lastly, the company focuses on increasing its shareholder and franchisee value. Yum! Brands is committed to maintaining a minimum of 10% EPS annual growth.<sup>1</sup>

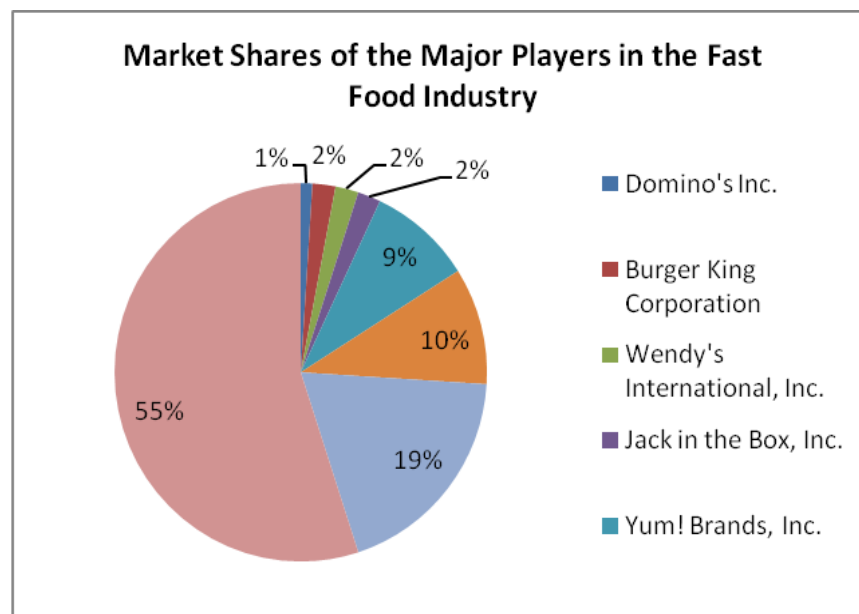
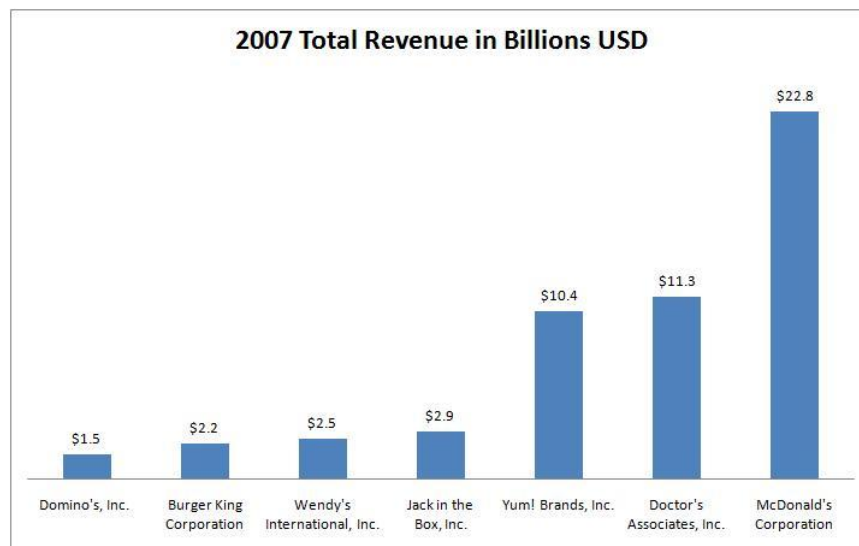
## Competitive Analysis

Force	Strategic
Internal Rivalry	High
Supplier Power	Low
Buyer Power	Low/Moderate
Entry and Exit	Moderate
Substitutes and	High

In the U.S., the SIC defines the fast food restaurant industry under Industry Group 581: Eating and Drinking Places. The code for Eating Places is 5812. This code includes all establishments that sell prepared food and drinks for consumption. The NAICS defines the fast food restaurant industry as Limited-Service Restaurants under the code 722211. The National Restaurant Association reports that there are over 870,000 restaurants in the U.S. Each fast food restaurant averaged annual revenue of \$585,000 in 2000, and around 40% of the population ate at an eating establishment in a single day. Fast food restaurants are the fastest growing sector with the restaurant industry.<sup>20</sup>

## Internal Rivalry

The fast food restaurant industry is highly competitive. McDonald's Corporation holds 19% of the market share in the industry, Yum! Brands Corporation holds 9%, Doctor's Associates, Inc. holds 10%, Jack in the Box, Inc., Wendy's International, Inc., and Burger King Corporation each hold 2%, and Domino's, Inc. holds 1%. Focusing on the top three competitors, the total revenue as of 2007 was \$22.8 billion for McDonald's Corporation, \$10.4 billion for Yum! Brands Corporation, and \$11.3 billion for Doctor's Associates, Inc.<sup>9</sup>



Although Yum! Brands Corporation is trailing behind McDonald's Corporation in terms of market share, it is currently dominating the Chinese market. Yum! Brands also maintains a leadership position within its product segments. In terms of its different brands, KFC has a 46% market share in the U.S. chicken quick service segment and is the leading quick service brand in China. Pizza Hut has the largest share in the U.S. pizza quick service segment at 15% of market share and is the top brand for casual dining in China. Taco Bell leads the U.S. Mexican quick service segment with 58% of the market share. Lastly, Long John Silver's tops the U.S. seafood quick service segment with 32% of the market share.

The strength of Yum! Brands' top competitor, McDonald's Corporation, lies specifically in the fast food hamburger restaurant segment, with 90% of the market share in this category. McDonald's two largest competitors, Burger King Corporation and Wendy's International, Inc., each only hold a mere 4% of the market share. However, besides A&W, the other brands under the Yum! Brands Corporation umbrella do not directly compete with McDonald's Corporation in terms of specific product lines. With a range of differentiated segments (i.e. chicken, pizza, Mexican, and seafood) other than hamburgers, Yum! Brands is able capture the tastes of a larger variety of consumers.<sup>8</sup>

With a large number of different quick service restaurants in the U.S., Yum! Brands Corporation faces its highest competition domestically. The largest seven fast food restaurants possess 45% of the total market share. The market is somewhat concentrated, which increases rivalry within the industry. In comparison to the U.S. division, the level of competition varies in the international market. KFC is the first quick service restaurants to enter into the China market, and continues to be the number one brand. Pizza Hut is the first restaurant chain to bring pizza, Western casual dining, and pizza delivery to China. According to these facts, there is less competition in the quick service sector in the China market. However, Yum! Brands does contend with a new wave of competitors in foreign countries. Although it provides a product that is differentiated from local restaurants, the tastes of consumers will greatly affect the success of the corporation. If consumers are not convinced to substitute to the particular food type that Yum! Brands offers, the company will lose out to other restaurants that have been long established in foreign countries.<sup>10</sup>



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## Supplier Power

Yum! Brands Corporation has a particular method of choosing and maintaining its suppliers. It has implemented a Supplier Tracking and Recognition system, where standards of quality and safety are set and monitored carefully. Companies that succeed at achieving its level of standards are rewarded, thus giving them incentive to compete with other suppliers within the industry.<sup>13</sup>

On a larger scale, there is little supplier power within the restaurant industry. There are a large number of companies that Yum! Brands can work with, as there are plenty of firms who supply ingredients (food and beverage) and equipment. For example, Yum! Brands has over 500 suppliers in China that cover all of the company's restaurant needs. Because of the nature of the fast food supply industry, prices must remain relatively competitive or Yum! Brands can easily substitute away from any supplier that chooses to raise its input prices. Suppliers in this field are not very concentrated. If suppliers are able to integrate forward, they can have more power over the industry. Additionally, in terms of labor, it is not difficult to fill low-wage positions to run individual units. There is an abundance of non-skilled labor, and it is easy for Yum! Brands to select from a large pool of employees.

## Buyer Power

To some extent, there is buyer power in the fast food industry. The consumers targeted by Yum! Brands can easily switch between quick service restaurants (i.e. McDonald's), especially in the U.S., where there is an extensive variety for them to choose from. The switching cost for the buyer is almost non-existent, especially in regards to the number of fast food units that are readily available in any given location. One aspect that must be taken into consideration is that in international markets, Yum! Brands must approach its buyers with greater care than in more well established U.S. markets. As it is attempting to establish its brand name in many international markets, Yum! Brands must be careful not to influence its consumers to substitute back to the foods that they are accustomed to eating.<sup>10</sup>

There could be some loyalty among consumers regarding each brand name (KFC, Taco Bell, etc.). However, charging higher prices may still cause the consumer to substitute away from the product if the cost to them is too high. One aspect that helps Yum!

Brands is that in most of its individual brands, it remains a clear leader in each quick service segment that it belongs to (i.e. chicken, Mexican, etc.).

On the other hand, there is limited buyer power because there is little buyer concentration. There is a very large number of buyers. Thus, Yum! Brands does not necessarily have to target individual consumers as long as it can capture a large group of people to purchase its products. Each sole buyer's purchase does not greatly affect the profit of the company, and the fast food corporation has the power to capture the attention of many different individual buyers.

## **Entry and Exit**

Entry and exit are not very difficult in the quick service restaurant industry. In terms of barriers, the greatest costs of starting a restaurant unit are relatively limited. Capital is needed to build each restaurant, and additional costs come from purchasing food and labor. Considering this, as Yum! Brands is attempting to rebrand a large number of its domestic units, the costs can be diffused onto its individual franchisees. In terms of supply, as a large corporation, Yum! Brands can also take advantage of economies of scale in supply, advertising, and its standardized business model.

In addition to this, over the years, Yum! Brands has developed a solid leading reputation for almost all of its brands. Thus, entering the U.S. market in any given location will not prove to be a difficult task. With consumers expecting a certain level of quality, as long as Yum! Brands is able to maintain this standard across both company-owned stores and franchises, it can easily enter into any market. In terms of the international divisions, Yum! Brands may have some trouble entering without an established reputation in these new growth markets. The tastes of consumers can serve as a barrier for Yum! Brands restaurants. In China, Yum! Brands is attempting to establish a leading brand name, but it faces a new segment of competition from restaurants that provide traditional Chinese cuisine. To counter this, Yum! Brands has introduced its own brand of Chinese-style dining to capture this market. Lastly, a factor that also must be taken into consideration is that government regulations vary across countries. Government fees and limitations can also serve as barriers to entry and exit.<sup>11</sup>

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## **Substitutes and Complements**

There are many substitutes for Yum! Brands products. On a narrow scale, Yum! Brands may dominate a few quick service sectors such as chicken and seafood. However, consumers can also substitute away to other types of fast food. McDonald's provides a relatively different menu that is mainly focused around hamburgers. However, McDonald's is still modeled in the quick service style and could influence Yum! Brands' consumers to substitute to its products due to different prices and product offerings.

On a broader scale, it is possible that consumers may choose to switch their preferences and pay slightly more for better quality food at more expensive restaurants. At the other end of the spectrum, consumers could choose to save more money by cooking at home. These factors depend on the state of the economy and what people are willing to spend on food. Also, another setback that Yum! Brands faces is the health and safety aspect of fast food. People may choose to substitute to healthier food options. In addition, as a result of recent major outbreaks of the avian flu, other diseases such as E. coli, and rat infestations in local restaurant units, people may choose to substitute to foods they believe to be safer.

One aspect that helps Yum! Brands restaurants to continue to profit is that it is modeled in the "quick service" style of dining. For many people who are working long hours and need to take a short and inexpensive lunch, quick service restaurants are appropriate for their lifestyle. The greatest qualities of Yum! Brands fast food restaurants are price and the convenience of its service.

Complements for Yum! Brands restaurants are establishments in urban areas that have the ability to attract large amounts of people. Examples of complements are movie theaters and malls. These companies will help to increase consumer traffic into fast food restaurants. Other complements may include schools, as the price of food may also affect the traffic to low-price quick service restaurants.

## SWOT

### Strengths

- Continuous rapid overseas growth and expansion, especially in China
- World's largest restaurant company: over 37,000 restaurants in 110 countries and territories
- KFC, Pizza Hut, Taco Bell, and Long John Silver's are worldwide leaders in chicken, pizza, Mexican, and seafood quick-service sectors
- KFC is the first, the largest, and fastest growing quick-service restaurant chain in China
- Strong domestic and international brand recognition and brand image
- 13% annual Earnings Per Share growth since 2001
- Product diversity across different brands

### Weaknesses

- Underperformance and slowing of U.S. sales, specifically with KFC and Pizza Hut brands
- Relatively small market share in oversaturated U.S. fast food industry
- Older U.S. restaurant units losing sales annually

### Opportunities

- Increase and maintain growth in rapidly expanding China market
- Invest in India market with KFC brand as an initial non-profit project – capture large quick-service market share with food options coinciding with religious beliefs
- Penetrate other new growth markets before competitors – France, Germany, Russia, Brazil, and South Africa
- Target international youth consumer to build up brand awareness
- Increase number of health conscious menu options in accord with changing views towards personal health and well-being

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## Threats

- Food safety – outbreaks of Avian Flu, salmonella, hepatitis A, and E. Coli-related diseases hinder sales and growth through negative publicity
- Nutritional value concerns, requirements on publishing nutritional information, and bans on trans fats<sup>14</sup>
- High reliance on China allows the company to be subject to any relevant changes in the Chinese market
- Changes in foreign currency exchange rates affect sales and profit
- Modifications in foreign government regulation influence profitability– tariffs, regulation on imported commodities, laws on foreign investment
- Easy entry and high competition from other fast food brands in a saturated U.S. fast food market

## Financial Analysis

### Overview

In the fiscal year 2009, Yum! Brands reported total revenues of USD \$10.84 billion, a decrease from USD \$11.28 billion in the previous year. Net income was USD \$1.07 billion, total assets were USD \$7.15 billion, and total liabilities were USD \$6.12 billion. Also, ROA was 14.67%, ROE was 233.59%, P/E ratio was 17.11, and Earnings per Share was 2.22. The current market cap is USD \$17.80 billion. In the last five years, Yum! Brands' stock prices were on the rise up until the last quarter of 2008, where stock prices took a downturn. In 2009, they rose again and have been relatively consistent through the first quarter of 2010.



In terms of competitors, Yum! Brands had a much lower operating margin than McDonald's. Yum! Brands saw a decline in its quarterly revenue growth of -.70%, while McDonald's experienced a 7.30% increase. McDonald's is a larger company with total revenues of \$22.74 billion in the fiscal year of 2009, and has a current net income of \$4.55 billion. However, it is important to note that smaller companies such as Burger King Corporation were able to experience a 1.80% increase in quarterly revenue growth.<sup>3</sup>

DIRECT COMPETITOR COMPARISON					
	<u>YUM</u>	<u>BKC</u>	<u>Pvt1</u>	<u>MCD</u>	<u>Industry</u>
Market Cap:	17.80B	2.80B	N/A	71.58B	197.59M
Employees:	49,000	41,320	700 <sup>1</sup>	385,000	3.70K
Qtrly Rev Growth (yoy):	-0.70%	1.80%	N/A	7.30%	7.90%
Revenue (ttm):	10.84B	2.51B	926.60M <sup>1</sup>	22.74B	538.92M
Gross Margin (ttm):	25.69%	33.16%	N/A	38.65%	20.86%
EBITDA (ttm):	2.19B	437.50M	N/A	7.77B	62.87M
Oper Margins (ttm):	14.81%	13.37%	N/A	28.83%	5.77%
Net Income (ttm):	1.07B	202.80M	N/A	4.55B	N/A
EPS (ttm):	2.217	1.483	N/A	4.110	0.48
P/E (ttm):	17.11	13.94	N/A	16.19	17.47
PEG (5 yr expected):	1.31	1.01	N/A	1.44	1.33
P/S (ttm):	1.64	1.11	N/A	3.15	0.56

BKC = Burger King Holdings Inc.

Pvt1 = Doctor's Associates Inc. (privately held)

MCD = McDonald's Corp.

Industry = Restaurants

<sup>1</sup> = As of 2008

RESTAURANT COMPANIES RANKED BY SALES					
Company	Symbol	Price	Change	Market Cap	P/E
McDonald's Corp.	<u>MCD</u>	66.53	0.00%	71.58B	16.19
Yum! Brands, Inc.	<u>YUM</u>	37.94	0.00%	17.80B	17.11



Key Ratios		
	Yum! Brands	McDonald's
ROA	18.42	16.86
ROIC	30.90	20.16
Current Ratio	.73	1.14
Quick Ratio	.46	.96
Debt to Equity Ratio	3.15	.75

At the present, Yum! Brands' ROA has risen to 18.42% since last year and its ROIC stands at 30.90%. This is higher than McDonald's, which has an ROA of 16.86% and an ROIC of 20.16%. From this standpoint, Yum! Brands is applying assets and invested capital more appropriately to create better value than McDonald's. In addition, Yum! Brands' current and quick ratios are .73 and .46, respectively. This is lower than McDonald's, which stands at 1.14 and .96. Thus, this indicates that Yum! Brands is somewhat behind McDonald's in terms of eliminating current liabilities and paying off current obligations. The debt to equity ratio of Yum! Brands is 3.15 compared to that of McDonald's, which is .75. Yum! Brands is using a significantly larger amount of debt to finance their operation compared to McDonald's, which increases the risk on its stock. Yum! Brands may want to consider taking on less debt to reduce the riskiness of investment in the company.<sup>4, 8</sup>

## Profitability and Growth

In the year 2009, Yum! Brands earned \$334 million, an increase from \$282 million in the previous year. Profits mainly rose as a result of the company's success in China. From 2007 to 2008, its total worldwide revenue increased by 8.29%. However, from 2008 to 2009, it decreased by 3.93%. Gross profit increased by 11.49% since 2007. Differences across divisions can be seen in terms of sales. In the last five years, the U.S. Division had an annual growth ranging from 1% to 3%. The International Division experienced a higher 5% to 10% growth. The China Division, with the exception of a low 10% growth in 2005, saw a much higher annual growth of 20% to 24% a year. Additional growth in China is relatively promising for Yum! Brands, and they should continue to push forward with this strategy. In 2009, worldwide operating profit grew by 6%.<sup>3</sup>



CHINA DIVISION

	<u>Fourth Quarter</u>				<u>Full Year</u>			
			<u>% Change</u>				<u>% Change</u>	
	<u>2009</u>	<u>2008</u>	<u>Reported</u>	<u>Ex F/X</u>	<u>2009</u>	<u>2008</u>	<u>Reported</u>	<u>Ex F/X</u>
System Sales Growth			+7	+7			+10	+9
Restaurant Margin (%)	17.6	15.9	1.7	1.7	20.2	18.4	1.8	1.7
Operating Profit (\$MM)	149	120	+24	+24	602	480	+25	+23

YUM! RESTAURANTS INTERNATIONAL (YRI) DIVISION

	<u>Fourth Quarter</u>				<u>Full Year</u>			
			<u>% Change</u>				<u>% Change</u>	
	<u>2009</u>	<u>2008</u>	<u>Reported</u>	<u>Ex F/X</u>	<u>2009</u>	<u>2008</u>	<u>Reported</u>	<u>Ex F/X</u>
Traditional Restaurants	13,206	12,746	+4	NA	13,206	12,746	+4	NA
System Sales Growth			+5	+2			(3)	+5
Franchise & License Fees	218	202	+8	+5	660	669	(1)	+7
Operating Profit (\$MM)	149	129	+15	+9	491	522	(6)	+5
Operating Margin (%)	16.8	15.0	+1.8	+1.1	18.1	17.1	+1.0	+0.2

U.S. DIVISION

	<u>Fourth Quarter</u>			<u>Full Year</u>		
	<u>2009</u>	<u>2008</u>	<u>% Change</u>	<u>2009</u>	<u>2008</u>	<u>% Change</u>
Same-Store-Sales Growth (%)	(8)	+2	NM	(5)	+2	NM
Restaurant Margin (%)	13.5	14.0	(0.5)	13.9	12.5	+1.4
Operating Profit (\$MM)	150	194	(23)	647	641	+1
Operating Margin (%)	11.8	13.0	(1.2)	14.5	12.5	+2.0

In the last decade, the proportion of franchised stores in relation to company-owned stores changed significantly across each division. The proportion worldwide increased from 61.42% in 1999 to 72.13% in 2009. However, this general trend varies within each separate division. In the U.S. Division, in 1999, there were 12,110 franchises out of 20,194 stores, and a decade later, this percentage had grown to 14,819 out of 19,665 stores. In the International Division, in 1999, there were 5,993 franchises out of 8,957 stores, and by the end of 2009, there were 11,650 out of 13,360 stores. In the China Division, there was a different trend in franchise growth. In 1999, there were 331 franchises out of 831 stores, and by 2009, this proportion had shrunk to only 276 out of 4,055 stores.<sup>6</sup>

Reflecting the increase in the number of franchises, in the U.S. and International Divisions, the proportion of franchise sales out of total sales steadily increased each year in the past decade. In 1999, 63.81% of sales in the U.S. Division were made by franchises as opposed to company-owned stores. In 2009, this proportion had risen to 78.76%. In the International Division, in 1999, 77.06% of sales were made by franchises, whereas in 2009, this percentage was at 84.56%. There was an opposite trend describing the China Division; in 1999, 54.36% were made by franchises and in 2009, this number had dropped to 20.59%. There is opportunity within the U.S. market to increase franchising.<sup>5</sup>

## Liquidity

As of 2008, Yum! Brands had \$789 million in cash and cash equivalents at the beginning of the year. By the end of the year, this number was at \$216 million. As of 2009, Yum! Brands had a net income of \$1.07 billion compared to its previous year of \$964 million.

Net cash flows from operating activities were lower at \$1.40 billion in 2009 compared to \$1.52 billion in 2008. In 2008, \$43 million was reported to be used towards closures and impairment expenses. In addition, total cash flows from investing activities were \$727 million in 2009 compared to \$641 million in 2008. Investing activities in 2009 were comprised partly of \$797 million in capital expenditures and \$115 million in investments. Lastly, total cash flows from financing activities were at \$542 million in 2009 compared to \$1.46 billion in 2008. The financing activities in 2009 included \$362 million in dividends paid and \$332 million in net borrowings.<sup>2</sup>

## Strategic Recommendations

The global fast food market has continued to grow throughout the years. In 2006, the volume of transactions made in the fast food industry amounted to 80.3 billion. Yum! Brands' overall strategy has helped it to maintain its position as the largest restaurant company in the world in terms of system restaurants. Each year, it has continued to grow rapidly in the international market, especially in China. It has seen high levels of success with its strategy of rapid expansion in the Chinese market. In terms of future steps, the company should employ different strategies in its U.S. Division, International Division, and China Division in order to improve performance and continue expansion.

First, as a general strategy, Yum! Brands should continue to focus on its Chinese and international markets. Although Yum! Brands could attempt to capture a larger market share in the U.S., it seems that the U.S. fast food industry is already well-established and difficult to penetrate. Not only has McDonald's been able to maintain the largest share of the fast food market for many years, but the industry itself is already oversaturated with thousands of different brands. 55% of the market is composed of smaller companies, and the seven leading brands only capture 45% of the market share.

### U.S. Division

Focusing more intently on the U.S. Division, Yum! Brands should make efforts to sustain its position as the second leading brand in the U.S. market. It should focus on continuing to build its brand reputation. Domestic sales have been slowing in recent years, possibly due to the current economic downturn. Although Yum! Brands provides an inferior good compared to other restaurants, many people have been choosing to eat-in. However, it is also clear that Yum! Brands is quickly bouncing back from the recession. Thus, to maintain and increase its revenue, it is important that the company concentrates on sustaining its position in the fast food industry rather than driving aggressive growth.

Investing in rapid expansion in the domestic market may actually hurt the corporation. In terms of geographic location, there would not be a substantial benefit to increasing the number of stores in any given area of the U.S. 75% of Americans already live within three miles of a McDonald's, and two-thirds live within three miles of a KFC, Pizza Hut, and Taco Bell. This shows that adding restaurant units may not have a significant effect

on market share or revenue. In addition, as a result of the prevalence of quick-service restaurant units across any location in the U.S., the market is highly competitive, and it will be very difficult for Yum! Brands to increase its position within the market.

In conclusion, Yum! Brands should focus on increasing its revenue rather than its market share. Only 38% of its total profits are drawn from the U.S. Division, and domestic sales have continued to drop each year. Additionally, the company should focus the bulk of its attention on Taco Bell, which is bringing in 60% of the corporation's U.S. revenue. It seems that the company is already looking to capitalize on the success of Taco Bell, as it has continued to pair many KFC and Pizza Hut restaurant units with Taco Bell. This not only allows Yum! Brands to increase customer volume, brand awareness, and sales, but also helps the company to save on investments in capital. Currently, the company is also refranchising many of its stores in the U.S., which will help it to diffuse capital and labor costs.

## **China Division**

In the China market, Yum! Brands should employ a slightly different strategy. The corporation should strive to maintain dominance in China as the number one, largest, and fastest growing quick-service brand in the country. Compared to the U.S., where Taco Bell is the leading brand, KFC and Pizza Hut are the branches that have been thriving in China. Yum! Brands has a first-mover advantage because it was the first corporation to introduce quick-service, pizza, pizza delivery, and Western-style casual dining to China. It must maintain its competitive advantage by continuing to grow at a rapid rate. It seems that the corporation has kept this strategy in mind by pursuing nonstop expansion. On average, almost one new KFC unit opens every day in China. Currently, Yum! Brands reaches 650 cities with KFC and 100 cities with Pizza Hut in China. McDonald's only has half as many restaurant units as Yum! Brands in the country, and the corporation should capitalize on this advantage by pushing for more aggressive growth in order to remain the dominant brand in China for many years to come.

Because China has an enormous population, the potential for building a strong customer base is substantial. By introducing a new brand that sells traditional Chinese cuisine, East Dawning, Yum! Brands can capture the older generation of Chinese consumers. However, Yum! Brands should continue to capture new consumer tastes by

targeting the youth population. Although the company's strategy in the U.S. has shifted towards targeting an older crowd and the working population, consumer tastes in China may be hard to alter from traditional Chinese cuisine. Thus, Yum! Brands will have more success by focusing on a new generation of consumers. KFC and Pizza Hut need to establish a strong reputation with the younger population, which has greater exposure to and knowledge of Western culture. This will help the company to build up its brand reputation and recognition in China. A solid brand reputation will allow Yum! Brands to continue to push forward with rapid expansion and development.

Yum! Brands is able to maintain control over its Chinese restaurant units by limiting the number of franchised stores. The number of franchises has actually decreased in the past few years, possibly so that the company can better control its brand impression in a relatively new market. The company should continue this strategy until it is well established as a leading brand so that it can maintain the continued expansion of the Chinese market.<sup>7</sup>

## **International Division**

In the international realm outside of China, Yum! Brands should continue to push forward into new growth markets. In particular, India represents a significant opportunity for the corporation. Although it may take a large initial investment and some losses for the company to penetrate the country and establish a strong brand name, in the long run, India could be a very important and profitable market. From a religious standpoint, Yum! Brands has a large advantage over McDonald's in India as its main food products in its leading brands do not focus on beef products. Since followers of the Hindu religion regard the cow as a sacred animal, Yum! Brands can potentially maintain a very large market share from this advantage and shut McDonald's out from becoming a top competitor.

## **Healthy Options**

With regard to all of its divisions, one of the biggest challenges that Yum! Brands faces are health concerns such as obesity. To counter these fears, Yum! Brands should first introduce a variety of health conscious options into its menu. There have already been steps taken towards this objective.<sup>5</sup>

Taco Bell has been adding a number of healthier foods to its menu. It recently launched the “Fresco” menu at the beginning of 2008, which offers nine products with less than nine grams of fat by substituting a mixture of vegetables for cheese and cheese-based sauces. In addition, the store is planning to incorporate fitness concepts into its advertising campaigns. Regarding the other brands, KFC has added a grilled option for its chicken, and Pizza Hut has incorporated pasta into its set of choices in order to ensure that its customers can achieve a balanced diet.

## **Food Safety**

Another challenge to Yum! Brands is the recent prevalence of diseases and health risks that are related to food preparation such as Avian Flu and E. coli. Regarding this concern, the company should take further steps to assure consumers that they are buying food products that will not make them sick. Yum! Brands has already implemented a supplier system to guarantee animal welfare and food safety. Yum! Brands formed the KFC Animal Welfare Advisory Council, which researches ways to improve practices towards animal treatment and advises its suppliers in humane procedures. In addition, suppliers are carefully chosen, evaluated, and rewarded through a system called the Supplier Tracking and Recognition system. This system sets and tracks standards of conduct across suppliers to ensure strict food quality and safety. It focuses on pest control, sanitation, operations and facility management, manufacturing practices and product protection, and recovery and food security.

In response to the outbreak of Avian Influenza, Yum! Brands has installed strict guidelines in the handling and processing of their poultry. All of the poultry purchased in China and the U.S. has not had contact with migratory birds. The company has additionally placed biosecurity measures on their suppliers, and currently conducts regular quality and food safety audits with almost all of its suppliers.

Consumers may not be aware of the extensive actions taken by Yum! Brands to ensure food quality and safety. To make the company’s values known to its customers, Yum! Brands should seek out a third party sanitation company to conduct random audits at its stores. The results from these evaluations could be advertised in its restaurant units and incorporated into its advertising campaign so that consumers can be assured that the food is clean and safe.

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## **Conclusion**

Looking forward, Yum! Brands is in a strong position to maintain foreign expansion and capture a large share of the international market. Despite certain challenges it faces in the domestic market, the company is financially healthy and should be able to sustain a stable position within the global fast food industry. Vector Strategy Group provides these additional recommendations for Yum! Brands to move forward with future strategic plans.

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## Appendix

### Balance Sheet

PERIOD ENDING	26-Dec-09	27-Dec-08	29-Dec-07
<b>Assets</b>			
Current Assets			
Cash And Cash Equivalents	353,000	216,000	789,000
Short Term Investments	-	-	-
Net Receivables	320,000	310,000	350,000
Inventory	122,000	143,000	128,000
Other Current Assets	413,000	282,000	214,000
<b>Total Current Assets</b>	<b>1,208,000</b>	<b>951,000</b>	<b>1,481,000</b>
Long Term Investments	144,000	65,000	153,000
Property Plant and Equipment	3,899,000	3,710,000	3,849,000
Goodwill	640,000	605,000	672,000
Intangible Assets	462,000	335,000	333,000
Accumulated Amortization	-	-	-
Other Assets	544,000	561,000	464,000
Deferred Long Term Asset Charges	251,000	300,000	290,000
<b>Total Assets</b>	<b>7,148,000</b>	<b>6,527,000</b>	<b>7,242,000</b>
<b>Liabilities</b>			
Current Liabilities			
Accounts Payable	1,594,000	1,085,000	1,138,000
Short/Current Long Term Debt	59,000	25,000	288,000
Other Current Liabilities	-	612,000	636,000
<b>Total Current Liabilities</b>	<b>1,653,000</b>	<b>1,722,000</b>	<b>2,062,000</b>
Long Term Debt	3,207,000	3,564,000	2,924,000
Other Liabilities	1,174,000	1,349,000	1,117,000
Deferred Long Term Liability Charges	-	-	-
Minority Interest	89,000	-	-
Negative Goodwill	-	-	-

<b>Total Liabilities</b>	<b>6,123,000</b>	<b>6,635,000</b>	<b>6,103,000</b>
<b>Stockholders' Equity</b>			
Misc Stocks Options Warrants	-	-	-
Redeemable Preferred Stock	-	-	-
Preferred Stock	-	-	-
Common Stock	253,000	7,000	-
Retained Earnings	996,000	303,000	1,119,000
Treasury Stock	-	-	-
Capital Surplus	-	-	-
Other Stockholder Equity	(224,000)	(418,000)	20,000
<b>Total Stockholder Equity</b>	<b>1,025,000</b>	<b>(108,000)</b>	<b>1,139,000</b>
<b>Net Tangible Assets</b>	<b>(\$77,000)</b>	<b>(\$1,048,000)</b>	<b>\$134,000</b>

## Income Statements

PERIOD ENDING	26-Dec-09	27-Dec-08	29-Dec-07
<b>Total Revenue</b>	<b>10,836,000</b>	<b>11,279,000</b>	<b>10,416,000</b>
Cost of Revenue	7,934,000	8,465,000	7,813,000
<b>Gross Profit</b>	<b>2,902,000</b>	<b>2,814,000</b>	<b>2,603,000</b>

### Operating Expenses

Research Development	-	-	-
Selling General and Administrative	1,209,000	1,416,000	1,293,000
Non Recurring	103,000	38,000	35,000
Others	-	-	-
<b>Total Operating Expenses</b>	<b>-</b>	<b>-</b>	<b>-</b>

<b>Operating Income or Loss</b>	<b>1,590,000</b>	<b>1,360,000</b>	<b>1,275,000</b>
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### Income from Continuing Operations

Total Other Income/Expenses Net	-	43,000	31,000
Earnings Before Interest And Taxes	1,396,000	1,533,000	1,357,000
Interest Expense	-	253,000	166,000
Income Before Tax	1,396,000	1,280,000	1,191,000
Income Tax Expense	313,000	316,000	282,000
Minority Interest	(12,000)	(11,000)	-
<b>Net Income From Continuing Ops</b>	<b>1,071,000</b>	<b>964,000</b>	<b>909,000</b>

### Non-recurring Events

Discontinued Operations	-	-	-
Extraordinary Items	-	-	-
Effect Of Accounting Changes	-	-	-

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Other Items	-	-	-
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<b>Net Income</b>	<b>1,071,000</b>	<b>964,000</b>	<b>909,000</b>
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Preferred Stock And Other Adjustments	-	-	-
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<b>Net Income Applicable To Common Shares</b>	<b>\$1,071,000</b>	<b>\$964,000</b>	<b>\$909,000</b>
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## Statement of Cash Flows

PERIOD ENDING	26-Dec-09	27-Dec-08	29-Dec-07
Net Income	1,071,000	964,000	909,000
<b>Operating Activities, Cash Flows Provided By or Used In</b>			
Depreciation	580,000	556,000	542,000
Adjustments To Net Income	(207,000)	(112,000)	(96,000)
Changes In Accounts Receivables	3,000	(6,000)	(4,000)
Changes In Liabilities	(157,000)	57,000	188,000
Changes In Inventories	27,000	(8,000)	(31,000)
Changes In Other Operating Activities	75,000	70,000	59,000
<b>Total Cash Flow From Operating Activities</b>	<b>1,404,000</b>	<b>1,521,000</b>	<b>1,567,000</b>
<b>Investing Activities, Cash Flows Provided By or Used In</b>			
Capital Expenditures	(797,000)	(970,000)	(742,000)
Investments	(115,000)	-	6,000
Other Cashflows from Investing Activities	185,000	329,000	304,000
<b>Total Cash Flows From Investing Activities</b>	<b>(727,000)</b>	<b>(641,000)</b>	<b>(432,000)</b>
<b>Financing Activities, Cash Flows Provided By or Used In</b>			
Dividends Paid	(362,000)	(322,000)	(273,000)
Sale Purchase of Stock	113,000	(1,556,000)	(1,298,000)
Net Borrowings	(332,000)	375,000	831,000
Other Cash Flows from Financing Activities	(20,000)	44,000	62,000
<b>Total Cash Flows From Financing Activities</b>	<b>(542,000)</b>	<b>(1,459,000)</b>	<b>(678,000)</b>
Effect Of Exchange Rate Changes	(15,000)	(11,000)	13,000
<b>Change In Cash and Cash Equivalents</b>	<b>\$120,000</b>	<b>(\$590,000)</b>	<b>\$470,000</b>