

An Exploratory Study on the Status of Chinese Food and Beverage Franchises and Entry Strategies

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Abstract

Thanks to China's economic development, the food service industry and franchise industry have combined to serve a huge market, and alterations continue to take place, such as the changing tastes of Chinese people and the changing food culture. Global franchise companies centered in the US are rapidly making inroads into the market, and Chinese local companies are also making efforts to expand their influence. In particular, in this situation where trends are gradually changing due to the COVID-19 pandemic, we look at the trends of franchise headquarters, franchisees, employment, and operating profits for the past 10 years using information published by the National Statistical Office of China. As we examine the information, possibilities push through. In addition, we will look at the cases of domestic companies that have entered China, the conditions and plans for their activities there, and what companies planning to enter China in the future need to prepare for.

Keywords: *Dining Out, Chinese Franchise, Commercial Patent Regulations*

1. INTRODUCTION

China, which has the largest population in the world and encompasses a large area of land, has seen an increased interest in eating out following its rapid economic growth after reform and opening up. As a result, global franchise companies have entered China one after another. Competition among local companies is escalating. There are various brands of restaurant franchises, and they have been selected by consumers according to their tastes and preferences. In general, consumers are more likely to choose a brand with high name recognition, and accordingly, a well-known restaurant brand is often preferred by consumers.

On the other hand, brands with low name recognition are relatively less likely to be selected [1]. Based on data from the National Statistical Office of China, this study examines changes in sales and the number of franchise companies over the past 10 years. Based on the Chinese Food Franchise White Paper issued by the China Franchise Association, Chinese people's preferences have changed before and since COVID-19. By examining the trends and market prospects of eating out and identifying the current status and problems of domestic companies currently in China, we intend to present successful entry guidelines and expansion tips by outlining and explaining local management strategies when entering the Chinese market.

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2. THEORETICAL BACKGROUND

2.1 Development Process of Restaurant Franchises in China

The first entry into China of a restaurant franchise was KFC, which set a precedent in 1987 as the first to form a Sino-foreign joint venture and was followed by other US companies such as McDonald's and Pizza Hut in 1990. The development of China's food service industry can be divided into four stages: the initial stage from the late 1980s to the early 1990s, the quantitative development stage in the early and mid-1990s, the scale expansion stage in the mid-late 1990s, and the brand value increase stage after 2000. The initial part of the first stage was mainly in the form of small restaurants, but there was a movement to gradually change from the existing business type. KFC, a foreign-funded company, first opened in Beijing in November 1987. The second phase, the period of quantitative development, occurred in the early 1990s, and saw foreign-invested companies enter China either independently or jointly. Indigenous Chinese companies also entered the franchise business, with Quanjide (全聚德) as a representative company. Restaurants with history and tradition are called Laozihao (老字号), and one of them, Quanjide (全聚德), was established in Beijing in 1864. It transformed from a single Chinese restaurant specializing in Peking duck to a group-type company and a restaurant chain. It was a systemic change in form [2]. The third stage called scale expansion took place in the mid-late 1990s and was a time when domestic and foreign chain businesses were rapidly active nationwide. Representatively, there is Dong Lai Xun (東來順), which became famous as a Beijing-style hot pot restaurant. In addition, Maran Lamian (马兰拉面) expanded as a specialty noodle dish representing Gansu Province (甘肃省), and there were other growing restaurant businesses such as Xiao Fei Yang (小肥羊) and Tan Yu Tou's (谭鱼头) Zhen Ju Nai Cha (珍珠奶茶)[3]. In the mid-to-late 1990s, Pizza Hut, McDonald's, and KFC expanded their nationwide store network within the scope of large cities such as Beijing and Shanghai.

Due to quantitative expansion, there were many social conflicts and negative effects due to problems such as contract disputes between franchisors and franchisees. Finally, in the stage of brand value increase after the 2000s, economic growth and the development of the restaurant industry have had a great impact on products along with product quality. For example, Sichuan-style hot pot has recently become a food that captivates the taste buds of young Chinese. Haidilao (海底捞) has grown rapidly as a food service company and is a global company that has entered major cities such as Shanghai and Beijing in China as well as overseas markets such as Korea, Japan, and the United States. You can see how far-reaching the impact is [4].

2.2 Current Status of China's Food Service Franchise Industry

Looking at the food service franchise data of the National Bureau of Statistics of China as of 2020, the number of franchise headquarters increased by 89 (21.4%) from 415 in 2010 to 504 in 2020. The year 2012 had the highest increase rate (6.5%) with a total of 456, and the year with the biggest decrease (-2.2%) was 2015 with a total of 455. The number of member stores increased from 15,333 in 2010 to 37,217 in 2020, an increase of 21,884 (142.7%). The number of workers increased by 25.56 million (37.62%) from 70.61 million in 2010 to 97.17 million in 2020, and the year 2011 had the highest increase rate (18%) with 8.93 million new workers, while 2015 had the biggest decrease rate (-8.5%). Operating profits were 95.542 billion yuan in 2010 and 201.929 billion yuan in 2020 (111.35%). On the other hand, 2020 profits only reached 201.929 billion yuan, showing a strong decrease (-9.6%) [5]. While the Chinese restaurant franchise market is accelerating, according to data from Meituan University in China, when comparing the distribution of restaurant franchise stores from 2018 to 2020, the rate of growth varies. The number of franchises with under 100 restaurants increased by 0.9% from 3.80% in 2018 to 4.70% in 2020. Franchises with 100 to 500 restaurants increased by

0.4% from 4.00% in 2018 to 4.40% in 2020, and those that had from 500 to 1,000 stores decreased from 1.70% in 2018 to 1.60% in 2020. Franchises with 1,000 to 5,000 stores showed an increase of 0.4% from 2.00% in 2020 to 2.40% in 2020, while the number of franchises with 5,000 to 10,000 stores shows a 0.1% increase from 0.50% in 2018 to 0.60% in 2020. It shows the rate doubled to 1.40% [6].

Table 1. Economic and Industrial Classification Table

Year	Affiliate Headquarters		Affiliated stores		employ		business profits	
	number	change rate (%)	number	change rate (%)	number	change rate (%)	number	change rate (%)
2010	415		15333		70.61		955.42	
2011	428	3.1	16285	6.2	83.29	18.0	1120.39	17.3
2012	456	6.5	18153	11.5	80.55	-3.3	1283.26	14.5
2013	454	-0.4	20554	13.2	80.31	-0.3	1319.62	2.8
2014	465	2.4	22494	9.4	78	-2.9	1391.02	5.4
2015	455	-2.2	23721	5.5	71.36	-8.5	1526.61	9.7
2016	459	0.9	25634	8.1	75.06	5.9	1635.15	7.1
2017	463	0.9	27478	7.2	78	3.2	1735.48	6.1
2018	482	4.1	31001	12.8	89.03	14.5	1950.01	12.4
2019	495	2.7	34356	10.8	93.54	4.7	2234.05	14.6
2020	504	1.8	37217	8.3	97.17	3.9	2019.29	-9.6

2018-2020 Comparison of the number of restaurant franchise stores

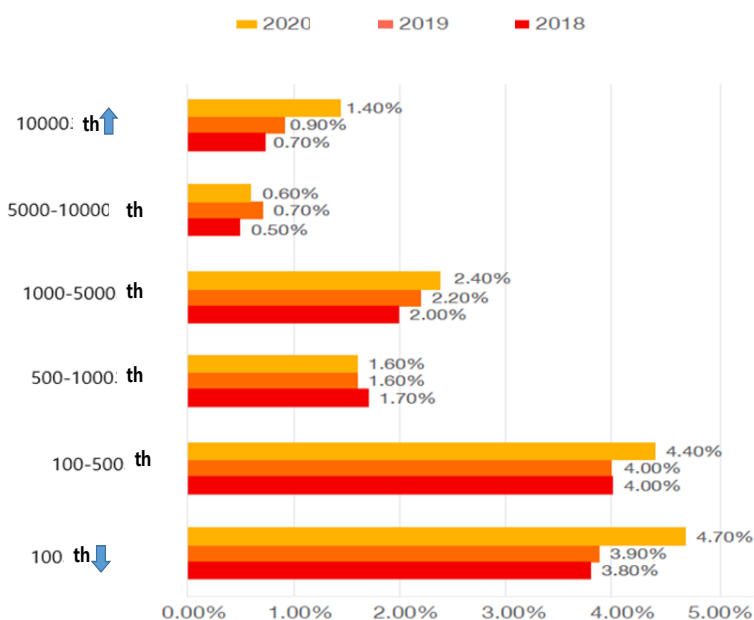


Figure 1. Comparison of increase and decrease of restaurant franchises

3. CHINESE FOOD FRANCHISE TREND

According to data from the National Bureau of Statistics of China, at the end of 2019, China's urbanization rate exceeded 60%, and urbanization became the new driving force to promote economic and social

development. As a result, urban infrastructure is gradually improving and laying a solid foundation for industrial development, while accelerating the restaurant franchise industry. As shown in Figure 2, the trend of restaurant franchise rates in China has been influenced by the COVID-19 outbreak since 2019, and consumers have gradually shown more interest in and preference for safe franchises. Therefore, the food and beverage franchise rate is increasing every year from 12.8% in 2018 to 13.3% in 2019 and 15.0% in 2020.

Since the outbreak of COVID-19 in 2020, Chinese people have come to think that Chinese food is relatively safe compared to Western food because it has antiviral properties. Therefore, looking at the graph shown in Figure 3, buffets increased by 2.3% in 2019, but increased by 18.6% to 20.9% in 2020. Beijing cuisine grew by 7.6% to 17.7% from 10.1% in 2019. Although it decreased by -14% from 26.3% to 12.3% in 2019, the growth rate is remarkable compared to other industries in the same year. On the other hand, for Xinjiang cuisine, the growth rate was 30.7% in 2019, but it fell to 2.0% in 2020, showing a -28.7% decrease. In the case of Western food, it grew 40.1% in 2019 but fell -62.3% in 2020, showing a downward rate of -102.4%.

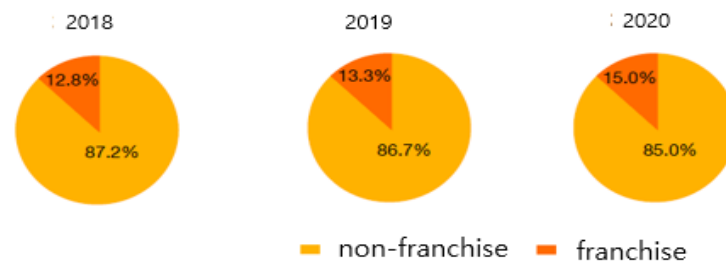


Figure 2. Chinese Restaurant Franchise Rate Trend

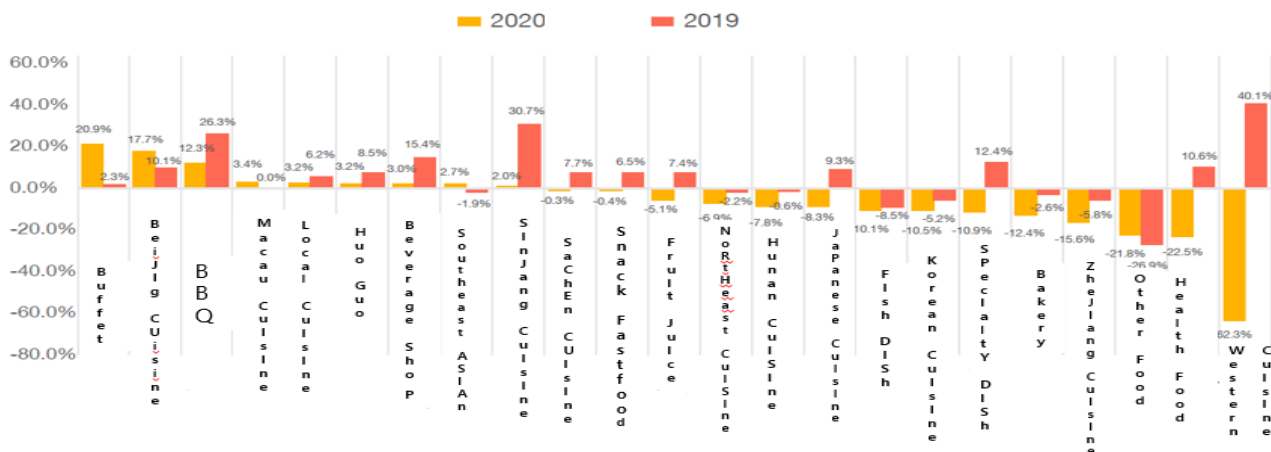


Figure 3. 2019-2020 Year-on-Year Growth Rate by Industry

4. REVIEW OF CHINESE FRANCHISE REGULATIONS

4.1 Commercial Franchise Major Management Ordinance

4.1.1 Among the franchise regulations in China, the representative regulation specifying the franchise business conditions in detail is the 'Commercial Franchise Management Ordinance', which came into effect on May 1, 2007, and stipulates the scope of Chinese franchise business, information exposure, legal responsibility, etc. The 'Management Ordinance' was created to protect the legitimate rights and interests of franchise operators and members under the 'Commerce Franchise Business Information Disclosure Management Act', which took effect on April 1, 2012.

4.1.2 In order for a foreign company to operate in China, it must proceed in the form of an independent or joint venture. After establishing a foreign-invested company, a franchise trademark must be registered. According to the regulations, franchisees can be recruited only when there is a track record of operating two or more directly managed stores for at least one year after the establishment of the company.

4.2 Major Regulations of Commercial Franchise Management Ordinance

4.2.1 For franchise business, at least 2 or more directly managed stores in China must be maintained for at least 1 year in order to be able to engage in business such as recruitment of franchisees.

4.2.2 Within 30 days of signing the franchise agreement, the franchisor must provide the franchisee with the original copy of the franchise agreement and the provision of information stipulated in Article 22 of the “Commercial Franchise Management Ordinance” in written form, and must be registered with the Ministry of Commerce after signing the agreement.

4.2.3 Franchise enterprises shall, within 15 days from the date of signing the franchise agreement, register with the relevant department for franchise business in the province, autonomous region or municipality directly under the Central Government, or register with the department in charge of commerce under the State Council for franchise business in other provinces, autonomous regions, or municipalities directly under the Central Government. If the report to the Ministry of Commerce as stipulated in Article 8 of the “Ordinance” is not fulfilled, the business will be held liable and a fine of 10,000 yuan up to 50,000 yuan will be imposed [7].

5. CASES OF KOREAN FRANCHISE COMPANIES ENTERING CHINA

5.1 Paris Baguette

Paris Baguette's entry strategy was implemented by selecting department stores, central commercial districts, high-end shopping malls, and road shops in the best commercial districts by region, as well as areas with high income levels and potential for future development [8]. Targeting the middle and upper class, French-style bread was introduced as the main product. In addition to bread, more than 400 menu items such as salads and sandwiches were introduced to the market to satisfy the consumer taste [9]. In addition, bread and drinks were provided in an atmosphere like a bakery cafe to match the regional characteristics, and a luxurious interior was created. The concept of upscale bakery cafes was changed with great consumer response. In terms of marketing, Paris Baguette launched new products suitable for Chinese holidays and seasons, and conducted new events such as Christmas and Valentine's Day to suit the westernization of the Chinese market and satisfy the needs and wishes of consumers [10].

5.2 Tous Les Jours

Tous Les Jours is a bakery franchise brand operated by CJ Food ville Korea. Tous Les Jours, which entered China in 2005 under the name of “Every Morning” in French, has opened over 100 stores, a tenfold increase from 2010 to 2015. It has a plan to supply uniform-quality products to all regions of China [9]. Tous Les Jours' strategy is to differentiate its menu for the different tastes in each region. For example, northern regions such as Beijing, which prefer spicy and salty tastes, focused on Rou song bread, while southern regions like Guangzhou developed blueberry and mango breads that gained popularity because people in this region like sweet foods. The target customers were mainly young people, and its first store in China was located in the university district in Beijing.

6. CONCLUSION

As seen above, this study looked at the origins of Chinese restaurant franchises, the current status of the industry, trends, regulations related to entry, and the cases of two Korean franchises in the Chinese market. The Chinese restaurant franchise industry has developed by leaps and bounds since the 1990s and is expected to continue to develop in the future thanks to China's large population along with economic growth. Therefore, the direction that companies planning to enter China should pursue and the policy role of the state are as follows.

First, it is necessary to develop a manual that can be systematically managed equally anywhere in the world by utilizing a standardized management system, which is the strength of franchises. One of the reasons why many restaurant franchise companies have failed in China is the lack of a scientific system. Therefore, the fate of a company can change depending on standardization, mechanization, and automation. Reducing artificial processes and enlarging the scientific scale have a good chance of leading to success [11].

Second, recently, Chinese authorities have been encouraging the appetite of its own people through active promotion and marketing of its own domestic companies, and especially after COVID-19, interest in health is being emphasized. As people's economic level improves and they have more leisure time, they seek nature-friendly products that are beneficial to health, and they prefer high-priced, fresh, and healthy products. In addition, it is necessary to localize food and understand eating habits that suit Chinese tastes and preferences. Successful franchise businesses are businesses that can provide good service along with taste and atmosphere. Due to the nature of restaurant franchises, it is important to develop menus that can captivate the taste buds of consumers. Therefore, in order to solidify a company's position as a successful brand, it is necessary to prioritize taste analysis and product development that meet the tastes of the locals. Successful franchises must continue to look for ways to develop slow food, put the health of customers first, and produce fresh products.

Third, Hallyu content and the likeability of Korean stars have a positive effect on Korea's image and can be beneficial to Korean brand image and lead to product purchases. Moreover, while K-POP is spreading beyond China and Southeast Asia to the world, the promotion of Korean dramas and Korean food is a good way to take advantage of the Korean Wave. In particular, advertisement using celebrity stars and K-POP groups, which can be used for menu development and cultural promotion activities suitable for the younger generation, will be well received by many Chinese people. It is necessary to seek ways to utilize Korean popularity well [12].

Fourth, when entering China, many companies directly dispatch managers from their home country, whereas KFC used personnel from China when entering the country for the first time. As a result, these Chinese managers were well aware of the corporate characteristics of the head office and the cultural characteristics of China, minimizing potential conflicts between managers and employees. In addition, since Chinese people know their country's taste buds, they can provide enormous help in menu development. Because there is no great difficulty in linguistic and cultural communication with local employees, Chinese managers can demonstrate their abilities through employee training and help fellow employees more easily than managers from foreign countries. This can have a great positive impact on corporate culture and image [13].

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