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Possible Positives in Yum's Bird Flu Response

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By emphasizing its food safety standards, Yum has an opportunity to help shape consumer buying habits in China, analysts say.

Sales growth has slowed sharply at Yum Brands' KFC units in China, where avian influenza is infecting poultry flocks and now has sickened at least two people, killing one of them. Despite short-term downward effects on traffic and sales in China, this avian influenza outbreak—and how Yum Brands shapes its branding strategy in response—poses a long-term positive opportunity, says the managing director of Technomic Asia, a market entry and growth strategy firm based in Shanghai.

Understanding how consumers look at chicken in China informs how the Chinese public is reacting to avian influenza, says Steve Ganster. Chicken has long been a primary protein and a traditional family food, purchased live at markets or raised at home. But as supermarkets like Wal-Mart and the French company Carrefour reshape Chinese purchasing habits, Ganster says, consumers increasingly value the relative hygiene of prepared foods. Underscoring this shift are previous avian flu outbreaks and particularly the SARS outbreak in 2003, which closed many open-air markets and accelerated Asian consumers' desire for cleanliness, safety, and hygiene.

Now companies like Yum Brands can shape long-term opportunity in China through consumer education and product positioning, Ganster says. "The value proposition can be 'clean,' 'safe,' 'reliable.' Those types of values now can play well in China," he says, "so you can get a consumer to pay more money for chicken." Whereas convenience remains a motivator for quick-serve traffic in Western markets, the motivators in China are becoming safety and hygiene.

Creating that market position requires consumer education, Ganster says. "First, they need to say there's no evidence of potential bird flu from cooked chicken. Secondly, [they need to say], 'Our supply chain is quality controlled, our chicken is safer.' [The message is,] 'We're the place to come and get chicken, and our chicken is safe.'"

Already, KFC's China outlets feature tray liners and point-of-purchase materials assuring consumers that the chain's chicken comes from high-quality suppliers and that all chicken is cooked at high temperatures.

'We're the place to come and get chicken, and our chicken is safe.'

Power of the Chinese market

Earlier this month, as news of avian influenza in Southeast Asia continued to appear in U.S. headlines, Yum! Brands Inc. announced it had developed crisis plans, including television spots, to quell consumer fears here. Related companies, such as Perdue Farms and Tyson Foods, have also written news releases with information on bird flu and the poultry supply chain.

Within days, news of the contingency plan helped drive Yum's shares down; 10 days ago, shares closed down about 2 percent at \$48.57.

On November 7, Yum announced that October sales in its China division rose just 8 percent, well below its long-term 22 percent target and last year's growth of 24 percent. Total annual sales for Yum Brands in China, where the company has 1,500 KFC and 277 Pizza Hut restaurants, are \$1.5 billion. Yum's China division includes mainland China, Thailand, and KFC Taiwan.

Showing the power of Asian markets, Morgan Stanley downgraded Yum stock to equal-weight from overweight, citing avian flu concerns and sales in the China division. Goldman Sachs maintained its in-line/neutral rating on Yum and has made no changes to EPS estimates.

Meanwhile, officials at Yum Brands say business continues as usual in its 1,500 KFC outlets in China. "We are working with our suppliers, government officials, and restaurant teams to safeguard our food supply," a Yum spokesperson told QSR. But reporters for *The Wall Street Journal*, visiting KFC restaurants in central Beijing the week of November 7, noted that consumers were ordering anything but chicken, citing bird flu fears.

In parts of Europe and China, chicken demand appears to be slipping. Writing in a recent investors note, Larry Miller, a restaurant analyst for Prudential Equity Group, said demand had shrunk 20 to 40 percent in some areas based on bird flu fears.

Potential for pandemic

According to the World Health Organization, human infection with the H5N1 virulent strain has been diagnosed in 130

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cases in Southeast Asia since late 2003, affecting China, Cambodia, Indonesia, Thailand, and Vietnam. Sixty-seven of those cases resulted in death. Most cases have occurred in previously healthy children and young adults.

On November 17, the Ministry of Health in China confirmed the country's first two human cases of infection with the H5N1 avian influenza virus. Another two possible human-infection cases are under investigation.

Experts at the WHO say the world is now closer to another influenza pandemic than at any time since 1968, when the last of three 20th-century pandemics occurred. According to the WHO, a pandemic resulting from the H5N1 avian influenza strain would require that the virus mutate to develop the ability to spread easily from human to human.

Ganster, who has lived in Shanghai for three years, says the Chinese media don't generally hype about a potential pandemic from bird flu. "You will find a lot more press about bird flu outside of China than inside China," he says. "It was the same with SARS. There is certainly awareness, but not the hype [seen in Western media]." He says he eats chicken in restaurants in Shanghai, but that he would probably not visit a chicken farm in China.

The number of U.S. adults aware of and concerned about avian flu has grown 16 percent in recent weeks.

Watchful in the States

As the situation in Southeast Asia develops, companies are gauging public awareness of avian flu in the United States, where chicken is a \$50 billion retail business. One such measurement, conducted by NPD Group as part of its ongoing Food Safety Monitor, shows that the number of U.S. adults aware of and concerned about avian flu has grown 16 percent in recent weeks.

Given the rising concern, industry observers say it's natural Yum has the consumer-education advertisements on the boards. "I can understand why they at least want to have something on paper," says Richard Lobb, communications director of the National Chicken Council, a Washington-based trade association for chicken suppliers. The National Chicken Council has launched a web site with news and archived information on the disease at www.avianinfluenzainfo.com.

Lobb says the United States does not import any chicken from those countries where the lethal bird flu has appeared, though a non-lethal strain was found on a poultry farm in British Columbia late last week. "[The H5N1 strain] causing trouble in Asia has never been identified in the United States or, to our knowledge, in the Western hemisphere," he says. Spread to humans in Southeast Asia has resulted from contact with birds' internal organs, excreta, or blood, Lobb says, not from consumption.

Last Thursday, poultry industry veterinarians and other representatives testified in a hearing before the Senate Committee on Agriculture, Nutrition and Forestry on flock safety and food supply management.

Two weeks ago, a team of U.S. veterinarians and scientists traveled to Beijing to study poultry health issues, in particular an ambitious plan to vaccinate the 14 billion ducks and chickens produced each year in China. And on Saturday, the United States and China issued a joint statement announcing a new level of cooperation in the effort to fight bird flu, including a U.S. pledge to help China develop and market human vaccines against the virus.

Efforts to detect and prevent the spread of H5N1 avian influenza to American shores continue. Lobb, of the National Chicken Council, says government scientists routinely monitor wild birds in Alaska, where some flight paths of Asian birds cross.

"They've taken more than twelve thousand samples in the past few years," he says. "Not a single one has tested positive for H5N1. It really seems to be a long shot that that particular one will come here."

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