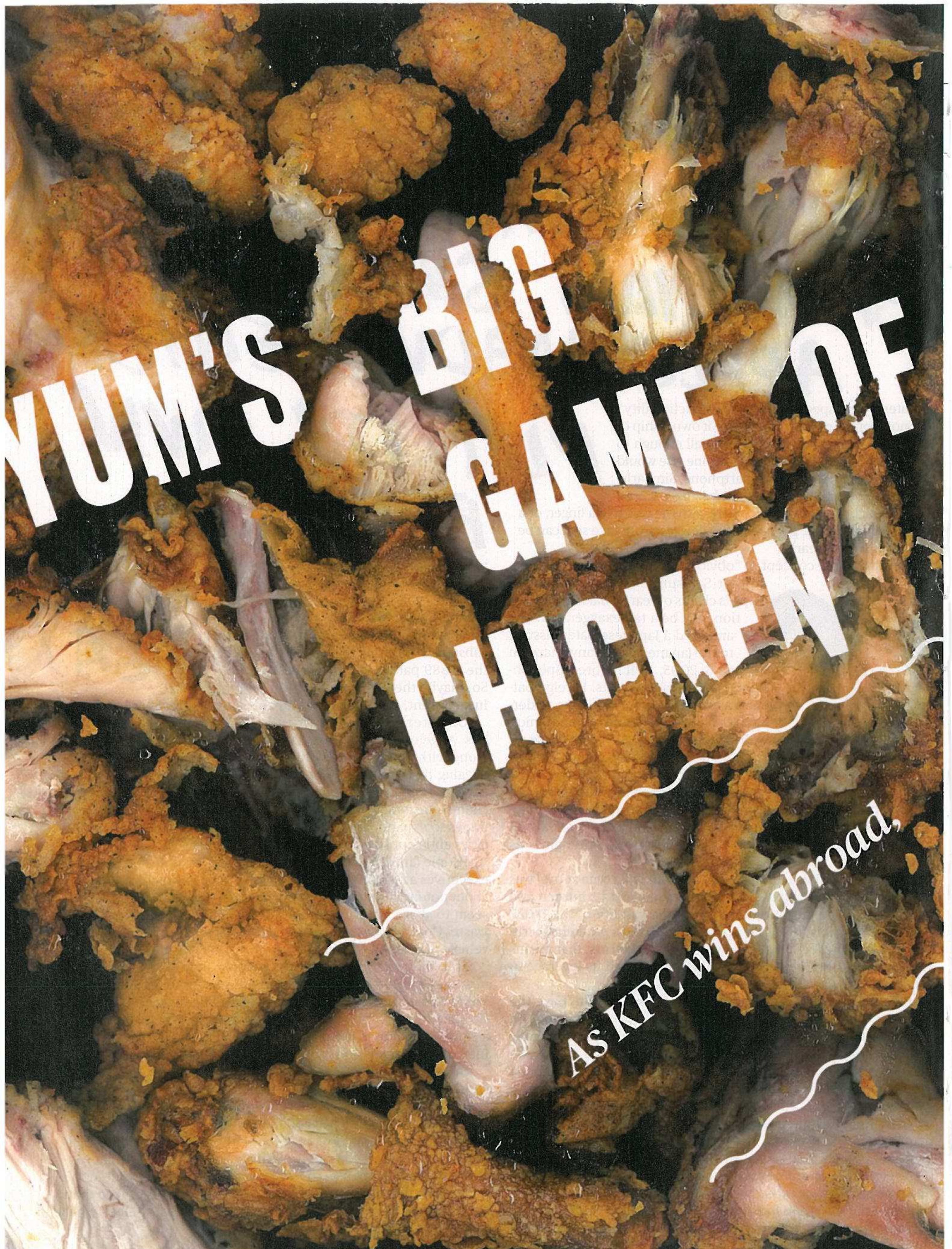
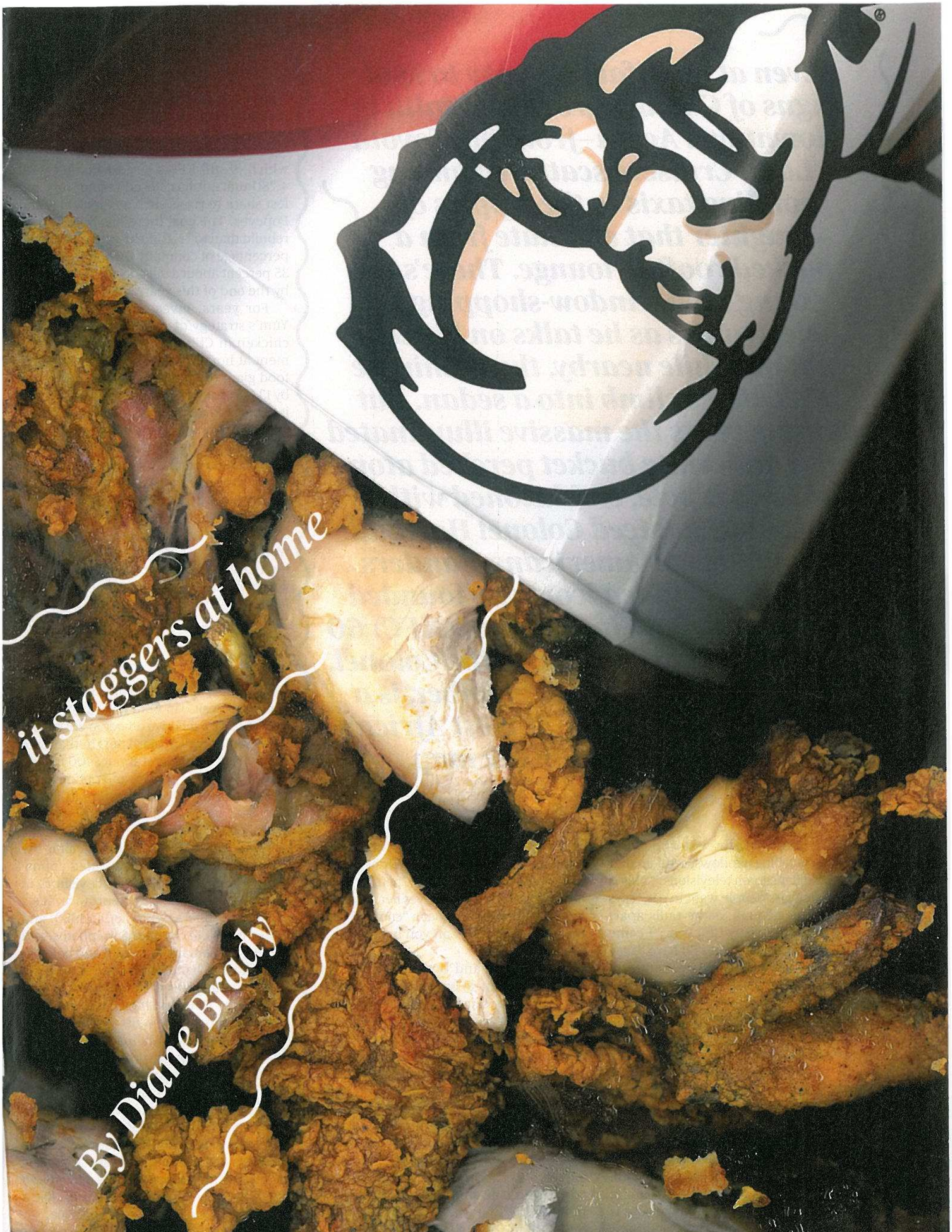

YUM'S BIG GAME OF CHICKEN
As KFC wins abroad,


it staggers at home
By Diane Brady

Even at nightfall, it's easy to spot signs of Ghana's growing wealth in downtown Accra—from the Toyota Land Cruisers scattered among honking taxis to the ripples of laughter that emanate from a packed rooftop lounge. There's the young man window-shopping for electronics as he talks on his cell phone, while nearby, three Chinese executives climb into a sedan. But nothing beats the massive illuminated red-and-white bucket perched atop a 20-foot pole, emblazoned with a grinning, goateed Colonel Harland Sanders. For Americans, Sanders may be the faded icon who founded Kentucky Fried Chicken (now KFC) 60 years ago. For Ghanaians, the Colonel, who just arrived in September, is a symbol that their small West African country is now on the map.

This KFC is housed in a three-story building with floor-to-ceiling windows, semicircular booths, and flat-screen televisions. "This is how middle-class people want to eat," says surveyor B.B. Acquah, as he pulls apart a piece of Extra Crispy Chicken. "I came around out of curiosity, and I'd have to say this is better than what we have." Indeed, the chain's launch last fall was even covered on national TV.

More than 5,000 miles away in New York, "greasy" is the word used by a 27-year-old sales associate named Melinda Chan. She's in a KFC near Times Square, staring at the box on her tray, which contains a battered thigh, a drumstick, some potato wedges, and a Diet Pepsi. "This must be, like, 1,000 calories," says Chan. (She's not far off, according to calorie counts posted on the menu board.) Chan is seated downstairs in a cramped store that also sells pizzas under the Pizza Hut banner. The dining room is nearly empty; a few tables away, a disheveled-looking man is working his way through a tray of food that someone left behind. "I almost never eat here," says Chan, looking a little embarrassed as she eyes her surroundings and reminisces about a "cute" KFC she once saw in Paris. "Can you believe this is Times Square?"

Brands rise and brands fall, though they don't often do both at the same time, and under the same leadership. Yet that's exactly what has happened at KFC. The fried-chicken chain is part of Yum! Brands, which also owns Pizza Hut and Taco Bell, and represents almost half of the roughly 37,000 restaurants the company operates in 120 countries. KFC has the added distinction of being both the best performer and the biggest headache in the family. In emerging markets such as China, India, and Africa, it's a muscular player bursting with optimism, innovation, and growth potential. China was home to 3,701 KFC outlets at the end of last year; McDonald's had 1,464. In Africa, KFC plans to enter seven new countries this year (including Uganda, Zimbabwe, and the Democratic Republic of the Congo) and expects to generate $2 billion in sales from 1,200 KFCs across the continent by 2014. In the U.S., which is still KFC's largest market with 4,780 units, it has closed restaurants and lost share to rivals such as Chick-fil-A and Popeyes. The goal there has been less to rebuild than to "refranchise," reducing the percentage of company-owned KFCs from 35 percent about a decade ago to 5 percent by the end of this year.

For years, investors have endorsed Yum's strategy of selling ever more fried chicken in China while reducing investment at home. This has allowed the fast-food giant to increase earnings per share by 13 percent for 10 straight years—a record it expects to maintain until at least 2020—and led to a quadrupling of the stock price. But failing on the home front carries other costs, from frustrated franchisees who are skeptical about a promised turnaround to consumers who are choosing to eat chicken elsewhere. And it's all happening with a brand Ghanaians and millions of others worldwide are supposed to associate with high-end, American-style chicken. Even fans of the stock, such as UBS analyst David Palmer, have wondered: "How did such a stale fast-food concept become such a juggernaut overseas?"

The man behind the Colonel is David Novak, 59, who has led Yum since it spun out from PepsiCo in 1997, first as president, then as chief executive officer in 2000, and chairman as well a year later. In that time Novak has accumulated about $400 million in compensation, stocks, and options.

The company headquarters in Louisville is an antebellum-style mansion, built in 1970, complete with six three-story-high columns and a flagpole; locals call it the White House. A motion-activated animatronic Colonel Sanders greets visitors in a small museum near the entrance. It's a shrine to Sanders, who died in 1980, and it showcases old commercials, photos, and even his trademark white suit and bolo tie. The Colonel's handwritten secret recipe of 11 herbs and spices is somewhere on-site, locked in a 770-pound high-tech safe inside a vault with concrete walls two feet thick.

The rest of the building is more about Novak. He's a strong proponent of employee recognition awards, like a set of smiling teeth mounted on skinny legs with big feet that he's given to countless employees who "walk the talk." He asks his executives to create awards, too. The many on display include a transparent "Show Me the Money" pig filled with Monopoly notes and a Pizza Hut "Big Cheese" award that's worn like a hat, in the Green Bay-cheesehead style.

Novak greets me and two senior

PHOTOGRAPH BY DANIEL SHEA FOR BLOOMBERG BUSINESSWEEK

WHILE NOVAK HAS FUELED YUM'S EXPANSION ABROAD, U.S. FRANCHISEES HAVE LANGUISHED

KFC HAS MORE THAN 3,700 OUTLETS IN CHINA

public relations executives in his office, itself an homage to what he calls Yum's Famous Recognition Culture. There are photos of employees covering practically every square inch of the walls, all of which appear to include Novak—and in most, nobody has a bigger smile. Today he's wearing a button-down shirt with the Yum! logo. (He made the exclamation point part of the official name to capture the company's sense of fun.) It's mid-October and he's about to fly to Shanghai to teach leadership insights in a two-day workshop with more than 100 managers. He ushers us into a nearby room, where lunch is served. It's an assortment of KFC menu items, including Original Recipe, Extra Crispy, and Kentucky Grilled Chicken, as well as string beans, fries, coleslaw, and biscuits. Between bites of grilled chicken—Novak tends to avoid fried food—he reflects on KFC's much-chronicled success in China. "China has what every business wants—speed," he says. "You have too much doom and gloom in this part of the world."

He turns to talk about Africa and Ghana, a country that wasn't even on Novak's radar screen until he took a trip to South Africa about three years earlier. What excited him was finding the same long lines and energy he had come to associate with China. "You'd see this brand-spanking-new KFC in the middle of this sea of brown shacks, and people were in there, loving the product," he says. While there's little doubt that the continent will be more challenging than China, he thinks it's ripe for explosive growth: "Nothing shows that we're more global than if we can build a business in Africa that no one else has."

That Novak wants to light out for new territory may be as much constitutional as corporate. His father was a surveyor who collected data for maps, and David lived in 32 trailer parks across 23 states by the time he had reached seventh grade. He has a genuine can-do attitude, boyish enthusiasm, and a goofball humor that have endeared him to many of his employees.

"David cares deeply about people," says Micky Pant, who heads international operations. "If you spend even five minutes with him, you come out feeling bigger."

Novak is clearly a gifted motivator, though the inspiro-speak can get the better of the company under him. The first line of his letter in the 2010 annual report reads, "I'm especially pleased to report 2010 was another year of significant progress toward achieving our future back vision to be THE DEFINING GLOBAL COMPANY THAT FEEDS THE WORLD." (Capitalization his.) Asked what future back vision meant, a spokesperson wrote, "future back vision is one of the tools we use from our Achieving Breakthrough Results (ABR) training. It's a look forward at what we want the company to become in future years."

Novak has written two books in this vein and is donating the proceeds from his latest, *Taking People With You: The Only Way to Make BIG Things Happen*, to the United Nations World Food Programme. He devotes several weeks a year to teaching his trademarked leadership program and offers his services as a motivational speaker with the Washington Speakers Bureau. Those fees, too, are donated to the UN program. He expects his particularly American brand of leadership to be embraced at Yum offices worldwide. "I was told by some people that my 'Western ideas' wouldn't work in places like Asia or Europe," he writes in his latest bestseller. "Boy, were those people wrong."

At home, however, the franchisees are restless, and not only because same-store sales dropped 4.3 percent last year, according to market research firm Technomic. Of more than a dozen franchisees contacted, most declined to speak about management in Louisville on the record, likely because there's no upside to alienating the company that controls their restaurants. Most do say they have yet to feel much love from management, and few display much enthusiasm for its vision of global expansion. Tales of closures or franchisees selling off assets are common. A bankrupt Kazi Foods agreed to sell off 113 KFC units, mostly in the Northeast, on Feb. 23 for $56.2 million, the bulk being debt owed to GE Capital. While owner Zubair Kazi didn't return calls for comment, an executive close to the company says the man who was once the country's second-largest franchisee is "in a state of shock" and blames Yum for disjointed marketing.

Dean Sorgdrager started working at KFC when he was 16 and was a franchisee in Buena Park, Calif., for 21 years before having his license revoked late last year. He describes a business in neglect, where costs mounted as profits fell. Sorgdrager says he had to pay $100,000 to upgrade the outside of one restaurant two years ago, even though the business was losing money at the time. "I asked them if I could delay and they said no, even though the economy had crashed," says Sorgdrager, who is now driving a school bus. When he tried to sell the business for $200,000 after learning he needed a liver transplant, the company rejected the buyer. In November, it was taken away. Even so, he understands that the Yum chief's choices have been good for some. "I think he's managed the company well for shareholders," he says. "I just don't think he's managed the brand well."

Some owners do say they've seen a new spirit of cooperation since John Cywinski became president of KFC's U.S. business in November 2011. Larry Starkey, who owns seven KFCs in New England, met Novak

LINING UP AT A NEW KFC IN GHANA

VAULT: PHOTOGRAPH BY DANIEL SHEA FOR BLOOMBERG BUSINESSWEEK at a workshop organized by Cywinski and found himself inspired. "John has really tried hard to work with us," he says. Cywinski says new initiatives are coming that will have people "talking about KFC in a whole new way" within three to six months.

Tensions between Yum and franchisees worsened after the company's nationwide "Unthink KFC" ad campaign in 2009. Franchisees felt a slogan aimed at promoting grilled chicken undermined the brand, and they sued Yum for marketing control. A judge ruled last year that the two sides had to compromise and get along, and Novak is again talking about a new unity of purpose. He admits that "we're not as reliable as we should be," but he also projects the aura of a man who feels he has been dealt a bum hand. Not only is Novak stuck with a patchwork of cramped, aging outlets in second-tier locations, he also has to deal with franchise owners whose interests may be at odds with his own. Some have long-standing rural outlets that rarely stray beyond fried chicken; others are urban outlets that bear the legacy of a failed co-branding exercise Novak launched several years ago, combining Taco Bells, Pizza Huts, and KFCs into one Franken-fast-food joint, satirized in the film *Young Adult* as the "Kentacohut." (The move was related to his 2002 purchase of Long John Silver's and A&W, which were sold last year.)

John Gordon of Pacific Management Consulting Group, a restaurant advisory group in San Diego, argues that Novak has "gotten a free pass because of China." In his view, Yum has essentially given up on the market, choosing to squeeze out costs and sell off its assets instead of fixing the problem. Andrew Selden, an attorney at Briggs & Morgan in Minneapolis who represents the independent Association of Kentucky Fried Chicken Franchisees, accuses Novak of chasing easy growth instead of promoting KFC as a place for a quality group meal. "Anyone can build stores on virgin territory," asserts Selden, who wishes the company put more emphasis on the home front. "Meanwhile, there's this priceless asset Yum doesn't value."

Tensions between Yum and franchisees worsened after the company's nationwide "Unthink KFC" ad campaign

Franchise consultant Michael Seid of MSA Worldwide says, "You can't go to franchisees and tell them your big idea is a $10 Sunday bucket." Even McDonald's, which has three times as many U.S. restaurants as KFC, has managed to achieve steady sales growth in recent years through healthier menu choices, smart advertising, and investments in new concepts such as its McCafé drinks. While the hamburger chain plans to open 250 outlets in China this year, it's also spending big to open and upgrade restaurants at home. KFC, in contrast, has imposed costs onto franchisees, and, Cywinski admits, "not had as many innovative products as we'd like." One West Coast franchisee complains that he couldn't even get permission to sell iced tea because of the tight PepsiCo contract. As a result, he says, only 6 percent of his falling sales come from beverages, while the McDonald's down the street gets a quarter of its business from high-margin items such as sodas, peppermint mochas, and smoothies.

It's not like Americans don't enjoy chicken. Per capita consumption, according to the U.S. Department of Agriculture, rose more than 10 percent from 2001 to 2011. "The idea that Americans no longer want fried chicken is a myth," says Cheryl Bachelder, CEO of AFC Enterprises and president of the Popeyes Louisiana Kitchen brand. "They just want it in a range of forms that taste good, and they want to know what they're getting when they walk through your door." Bachelder has increased market share, profits, and the number of stores across the U.S. to 1,627 last year. From 2001 to 2003, she worked alongside Novak as president of KFC's U.S. operations. While she declines to comment on Novak directly, she's taken potshots at KFC through ads and taste tests, and contends that any brand that's shrinking just isn't trying.

The most important person in Bachelder's universe is not the consumer but the franchisee. "If someone is putting all of their capital to work on behalf of your brand, your No. 1 job is to make them successful," she says. That doesn't mean she's not also drawn to the lure of international markets; Popeyes has built more than 400 restaurants abroad. Like Novak, that's where she expects rapid growth to be. "No one has ever given KFC a run for their money in these markets," she says.

On earnings calls, Novak barely speaks of KFC's U.S. business. Some believe he would like to boost the U.S. operation to sell it off and exit the market. "It all comes down to one thing: winning," he says. "You go where you can get results."

While Novak acknowledges that things aren't where he wants them to be in the U.S., he thinks 2012 will be a better year. "[Management writer] Jim Collins always talks about the magic in the 'and,'" he says at KFC headquarters, surrounded by the rubber chickens, windup teeth, and other reminders of the recognition culture he's built. "That's what we're trying to work on: We want to go after all this explosive global growth *and* grow KFC in the U.S."

IN LOUISVILLE, THE RECIPE VAULT

Novak contends that he answers to investors. "You can't win without driving shareholder value," he says. "If CEOs say they don't worry about their share price, they're either not very smart or they're lying to you." By that measure, Novak is a hero. "One reason people think I'm a decent CEO inside this company is that our share price is going up," Novak says. "I promise you, if our share price was going the wrong way for three years, there would be people questioning if I should be in this job."

While investors have rewarded Novak, some are starting to worry about the domestic brand. The strategy for winning in emerging markets, for all the excitement and high growth they offer, needs a brand that's popular at home, too. Udo Schlentrich, director of the Rosenberg International Franchise Center, warns that "if you expand overseas at the expense of generating excitement at home, you risk harming brand equity." KFC has always been about more than fried chicken. In the same way that Mercedes-Benz anchors its brand in German engineering, KFC is selling the rest of the world a taste of the American dream.

Novak, however, seems determined that what is working now will continue to work. "If you have the capability to be a global company, you should be a global company," he says. "That's a choice we've made, and I feel pretty good about how we've built the business." Ⓑ