

A Comprehensive Analysis of the Chinese Chain Restaurant Market: Success Factors, Challenges, and Strategies for Improvement

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Abstract. The rapid rise of China's economic lifeline has made the catering industry increasingly prominent, while chain restaurants have stood out in the catering industry by realizing economies of scale through unified branding, standardized services and centralized management. This paper analyses several aspects of the current situation and development of China's chain restaurant market, mainly based on the example of China's Little Sheep Catering Group, with the comparison to successful international brands such as McDonald's. The analysis reveals the challenges faced by Little Sheep, such as weak management and lack of standardization due to rapid expansion. We also provide suggestions for Little Sheep to improve through product and service innovation, quality control, balanced expansion, and brand building. Finally, the paper summarizes the common problems of Chinese restaurant chains, including market homogenization, management deficiencies, and excessive pursuit of scale expansion. We suggest that differentiation, quality assurance, and balanced branding will lead to a healthier development of China's restaurant chain industry.

Keywords: Chinese restaurant market, McDonald's, Little Sheep, Chained-restaurant Business model, Brand building, Market homogenization.

1. Introduction

In recent years, the rapid development of China's economy along with the Belt and Road construction, the increasing improvement in people's living standards, and the advancement of urbanization have made the restaurant industry increasingly prominent in domestic market demand and international competition. This is where restaurant chains particularly stand out, a business model that offers similar food services in multiple locations, achieving economies of scale and market share expansion through a unified brand image, standardized dishes and services, and a centralized supply chain and management system. In China's food and beverage industry, restaurant chains have become an important development trend, attracting many domestic and international brands to compete for the layout. The share of restaurant chains in China's catering industry has been rising year by year, and the business model has started to mature relatively, and the secrets behind them have begun to emerge gradually. In the past decade, China's restaurant industry has undergone radical changes. On the one hand, international brands such as McDonald's and KFC have rapidly entered the Chinese market with their mature business models and brand influence, and have successfully occupied a certain market share; on the other hand, although local Chinese brands such as Little Sheep and Seabed Fish have made certain achievements in the catering industry, their chain development is still insufficient compared to international brands such as McDonald's. In this paper, we will first introduce the chain restaurant business model of the internationally renowned brand McDonald's and analyze its success factors in the Chinese market. Then, taking Little Sheep as an example, we will discuss the challenges and problems encountered in the process of chain development and analyze the differences between it and international brands such as McDonald's in terms of business model, profitability, financial status, current strategy and future outlook. Finally, we will summarize other shortcomings and areas for improvement of restaurant chains, mainly Little Sheep, in the hope of helping to improve the Chinese restaurant chain industry.

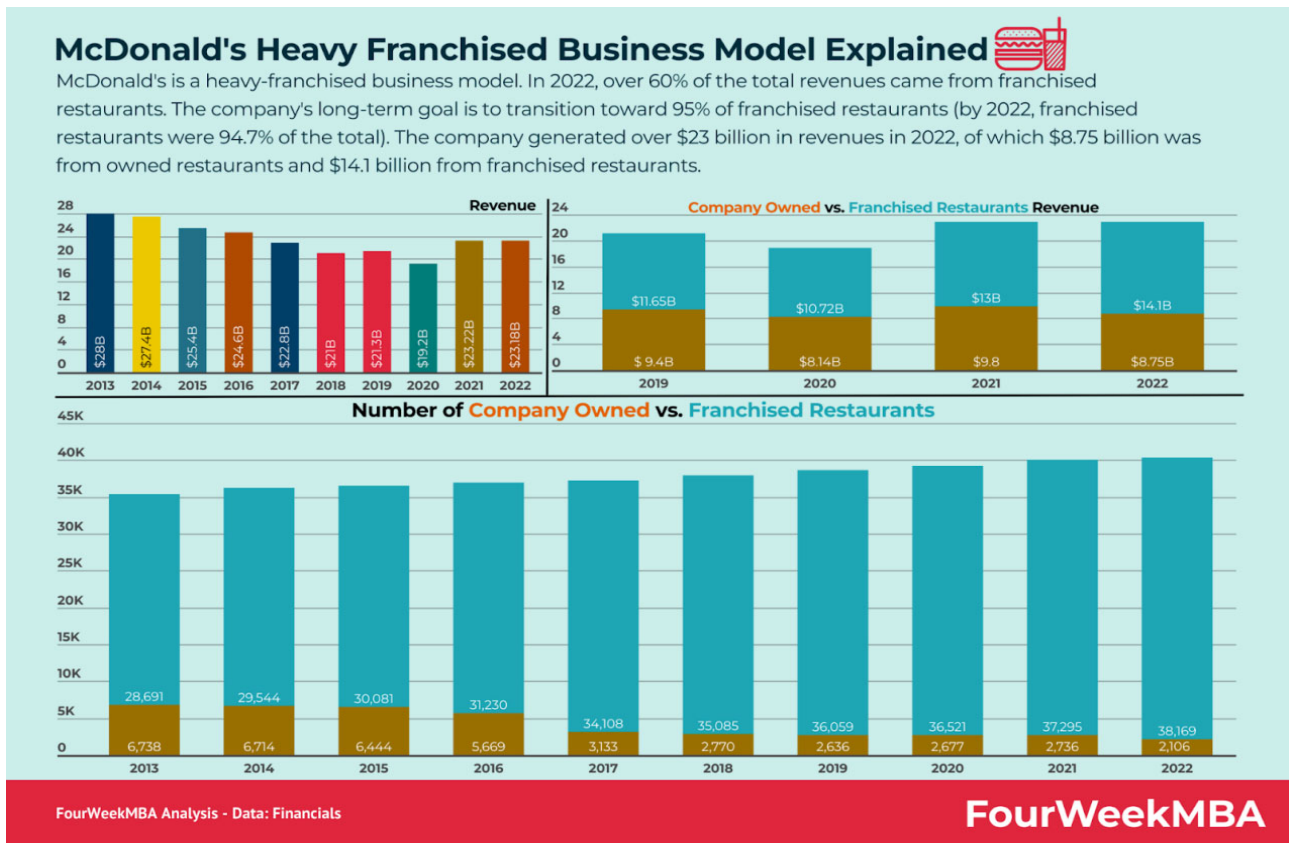


Fig. 1: In McDonald's Heavy Franchised Business Model In A Nutshell[1]

2. McDonald's chain restaurant business model and success factors

McDonald's, as one of the most successful restaurant chain brands in the world, has achieved remarkable success in the Chinese market. According to data, as of 2022, the number of McDonald's stores in China has exceeded 3,500, and its market share has steadily climbed. The following aspects have been analyzed to explain the success of McDonald's in the global market:

2.1 Business Model:

“While a global Brand, the vast majority of McDonald’s restaurants – more than 80% worldwide and nearly 90% in the U.S. – are owned and operated by approximately 5,000 independent, small- and mid-sized businessmen and women” [2], and mid-sized entrepreneurs. These franchisees typically live in the communities they serve and are committed to making a positive local impact, from providing quality food, customer service and employment opportunities to supporting local charities and other ways to give back. Revenue from each restaurant is generated primarily from the company's own restaurants and franchisee restaurants.

2.2 Service and product standardization:

McDonald's provides food with consistent quality, “food of a constant quality that is served quickly and consistently across the globe, and the key activities McDonald’s engages in is the marketing and selling food and beverages” [3]. Their products are distributed through restaurants.

2.3 Brand influence:

McDonald's is one of the most recognized brands in the world, and their brand power and location provide them with significant financial reserves and market share in key operating locations, “It has, viably, transformed into the most famous family eatery that advances to youngsters and grown-ups

the same and arose as the predominant power in the ‘Speedy Service Restaurant (QSR)’ end of the market” [4].

2.4 Product innovation adapted to the market:

The company has an extensive global network of stores in consumer centers, providing customers with a fast and efficient service that allows access and delivery to certain markets, “The company’s products offer a range of food items that are solely for various geographical markets and that its menu is developed according to the needs of the consumers [5].

The main target customers of McDonald's include parents, young children, business customers and teenagers, but The marketing of McDonald’s to youngsters and young children’s parents is perhaps the most evident. Although the company remains in the U.S. market, it also serves a large number of consumers in Latin America, Europe, Asia Pacific, the Middle East and Africa, including the Asia Pacific region in South Korea, the United Kingdom, China and Russia.

3. Chinese Hot Pot Culture: Another Rising Star in the Chain Restaurant

Chinese hot pot culture has taken off due to its cultural differences, influence and regional climate. Hot pot has gained popularity and achieved great success in the Chinese restaurant chain industry due to its unique eating experience and high level of socialization. Moreover, this form of dining, which can be shared by many people, allows a variety of flavors and ingredients to be freely chosen according to individual preferences, and is very popular among Chinese consumers. The comfortable environment and attentive service usually provided by hot pot restaurants also allow consumers to enjoy their food while indulging in a pleasant social experience. The high degree of standardization of hot pot makes it easy to replicate and expand, which is conducive to chain development. At the same time, the highly social nature and diverse choices of hot pot enable hot pot chains to attract a wide range of consumer groups, thus ensuring their commercial success. However, chainization also brings a series of problems, such as increased management difficulties and food safety challenges. Therefore, for hot pot chains, how to deal with these challenges while maintaining the advantages of chainization will be the key to future development. Taking Little Sheep as an example, Little Sheep is one of the leaders in China's hot pot chain industry, and its business model and brand influence are cases worth studying. I will analyze the specifics of Little Sheep below.

4. The development and challenges of Little Sheep

Established in 1999, Little Sheep is a well-known hot pot brand founded by Mongolians and is loved by consumers for its unique lamb hot pot and hot pot base. As one of the earliest McDonald's-like restaurant chains, Little Sheep has been particularly successful, with one report even stating that "Unlike these foreign fast food chains, the average life of a restaurant in mainland China is less than three years. In China, there are very few restaurants who can manage to operate in the full scale of modern corporations like McDonald's and KFC. In China, there are very few restaurants who can manage to operate in the full scale of modern corporations like McDonald's and KFC. However, Little Sheep stands out as an exception[6]. I am particularly interested in the Little Sheep brand as I am also Mongolian. However, over the past few years, Little Sheep has undergone a series of changes, including its acquisition by Parkson, the owner's exit from the market, etc. In 2009, according to Little Sheep's annual report, the company achieved revenues of RMB 1,569.7 million and a net profit of RMB 165.7 million [7]. Although it achieved impressive results at the time, Little Sheep still had a large gap in terms of market share and brand influence compared to international brands such as McDonald's. The following points analyze the challenges faced by Little Sheep in the chain development process:

4.1 Business Model:

the earliest and most famous fast food restaurant McDonald's, Burger King Law, etc. will adopt a mixed business model of direct operation and franchising, Little Sheep has followed suit, which is conducive to maintaining the consistency of the brand and product quality, but there will be problems in expansion and funding. Little Sheep was established in 1999 and mainly operates hot pot restaurants, condiments and meat processing. Because the first Little Sheep restaurant was so well run, founder Chang Gang opened two successful Little Sheep hot pot restaurants in Qingshan District and Donghe District of Baotou and found such a business model to be popular. This prompted the founder of Little Sheep to start a chain of restaurants. After 2000, the Little Sheep chain expanded rapidly across the country, with a new outlet established every four days, and by the end of 2002 there were nearly 700 chain restaurants. However, the rapid development is often the most unstable, such as raw materials are not delivered in a timely manner, the franchise complaints increased, the chain management level varies, and even the phenomenon of substandard. The survey said that "even some franchises did not fully implement the contractual commitments, the independent establishment of new brands; due to differences in the quality of franchise management personnel around the franchise, which has led to uneven levels of management of the franchises"[8].

4.2 Brand influence:

Little Sheep in just 12 years, has formed a better brand advantage. Now, more and more consumers pay attention to green and health. Little Sheep passed the international quality management system certification and national green food certification as early as 2000 and ISO9001 in 2002. Little Sheep has won a number of honors so far, "Inner Mongolia Little Sheep has won dozens of awards over the years, such as 'the most influential wealthy enterprises', 'China's top 500 enterprises', etc. "[9], such brand advantages have already allowed customers to associate hot pot with Little Sheep in the first place. However, compared with international brands such as McDonald's, its brand influence has been far less. There is a saying that there are advantages and disadvantages. The defects of Little Sheep marketing are mainly divided into these three: 1. Insufficient marketing concepts: Little Sheep has invested relatively little in advertising and promotion and social welfare activities. Although publicity through chain stores can attract customers, compared with foreign restaurant chains, Little Sheep's brand logo and visibility need to be improved. 2. Franchise chain management needs to be improved: After 2001, Little Sheep expanded rapidly, leading to management chaos. There are fewer restrictions on franchises and insufficient supervision of franchised franchises by the headquarters, and restaurant decorations have not met the requirements of the headquarters, all of which have seriously damaged the corporate image of Little Sheep. 3. Lack of human resource management: The staff composition of Little Sheep is mainly urban non-workers, laid-off workers and rural workers in the city, with a relative lack of excellent staff. The shortage of food service talents in China has seriously hindered the development of the restaurant industry, especially Little Sheep.

4.3 Competitive environment:

In the Chinese market, the hot pot industry is highly competitive, with various brands such as Seabed Lohas and Dashu Longmen appearing one after another. In the face of fierce market competition, Little Sheep needs to continuously innovate and improve its competitiveness. In recent years, many foreign companies have entered the domestic market to establish their own chain stores and operate online stores. Due to the high degree of standardization of Western fast food requirements, their industrial expansion of the region will have a special source of raw materials base or logistics companies to directly distribute raw materials, etc., the extension of the Western-style catering industry is strong, which also happens to be the weak point of Chinese food. "At the same time, the convenience of Western-style fast food, fast features and good after-sales service has also been hidden by the majority of consumers. In order to adapt to the eating habits of the local population, to seize the market share of local brands, multinational companies also carried out a series of Chinese improvements to their catering products, such as KFC successively launched the old Beijing chicken

roll, Sichuan spicy tender beef five square, peace of mind fries and soy milk, McDonald's launched the chicken leg with garlic and pepper, foreign catering in the Chinese market penetration strongly impacted the development of China's catering industry.

Notably, after 2009, Little Sheep underwent a series of changes. In 2011, Little Sheep was acquired by the U.S. fast-food chain conglomerate Yum! for US\$587 million, and then in 2016, Yum! divested its Chinese operations into Yum! China, which included Little Sheep. This acquisition provided Little Sheep with stronger capital support and brand power for its development in the Chinese market. However, Yum!'s management system was different from Little Sheep's original management system. Due to this difference, many managers chose to leave. Yum Brands closed many poorly managed and poorly located stores. When Little Sheep was at its peak, there were over 720 restaurants. Yum! wanted to reduce this number and focus on stores with high potential. After the cuts, fewer than 200 restaurants remain open.

5. Analysis of the problems of Little Sheep and suggestions for improvement

In analyzing the problems of Little Sheep, we discuss the company's business model, its brand impact and its competitiveness in a comprehensive manner. Little Sheep's journey has indeed been a complex one. It started with a single restaurant and later adopted a franchising strategy to expand rapidly. However, this strategy led to weak management and a lack of standardization, which damaged the value of the brand. To rectify this, the company shifted its strategy from being franchise-oriented to a mix of franchised and company-owned outlets. It also introduced and implemented an IT system to closely monitor operations, create centralized purchasing, and impose financial discipline. Interestingly, the company also sought private equity investment to help fund its growth and maintain control.¹ In terms of the company's financial position, Little Sheep managed to bridge the financing gap through bank loans, private financing from managers, employees and other business partners, and by leveraging two private equity firms, 3i and Prax Capital, to invest US\$25 million in a minority stake in the company. This investment has enabled Little Sheep to build the most advanced integrated cold chain system in China and expand into other business lines[10].

In addition, Little Sheep could be like McDonald's in terms of brand impact. Much of McDonald's success can be attributed to its leadership in terms of value perception. This value perception is particularly significant in times of increased economic stress (e.g. inflationary pressures or recession) as consumers may choose McDonald's over cooking their own meals at home or going to other more expensive restaurants. In addition, McDonald's has begun to transition to a more personalised value delivery model, largely due to the growth of its digital business, which offers more personalisation opportunities for brands, including personalised value delivery[11]. The growth of the digital business has also given McDonald's the opportunity to learn more about how customers engage with the brand, which is critical to understanding and delivering value. In some countries, such as Germany, France, the UK and China, digital sales account for more than half of total sales, while in China the proportion is more than 80%[12]. This shift to digital business has also driven an 'evolution' in the way McDonald's delivers value, moving from a national value menu to a largely locally driven menu pricing, a localised approach that allows individual regional offices to promote products that suit their markets and competitors[13].

Also with regard to environmental competitiveness, Little Sheep can learn from and refer to the key strategies used by Haidilao Hot Pot in dealing with the competitive environment:¹. Providing exceptional customer service: Seabed restaurant places emphasis on providing a unique and memorable customer experience. For example, it empowers its staff to meet the needs of customers or scenarios for personalised service delivery. This focus and attention to the customer has helped Seabed to establish a significant competitive advantage in a highly competitive market [14]. 2. Infusing customer-centric thinking among staff: Seabed Loh encourages staff to pay attention to detail, provide prompt service and greet customers with enthusiasm. This culture makes employees willing to work hard in a pleasant work environment, further enhancing the customer experience [15].

Constant innovation: Haidilao looks for new ways to provide better service in the face of competitors trying to replicate its successful model. For example, it has expanded its e-commerce business on Chinese takeaway platforms, offering not only food and pots, but even waiters for on-site service, thus expanding its customer base [16].



Fig. 2: The complete price list of Delivery Service in Malaysia is out! Get it now! Official Delivery Website]. [17]

Despite the fierce competition in the hotpot market, there is still a unique market demand for different types of hotpot. As such, Little Sheep can improve its market competitiveness and profitability by developing innovative hotpot products and services to meet the needs of different consumers. In terms of its financial position, Little Sheep needs to make a reasonable allocation of its assets and liabilities. With the support of Parkson, the company can seek more financing channels to reduce its debt ratio and improve its financial soundness. For the future outlook, the hot pot industry still has huge market potential as the Chinese food and beverage market continues to develop. Little Sheep needs to pay close attention to market changes and continuously adjust its strategic direction to achieve higher market share and profitability. In short, continuous improvement in business model, product innovation and brand promotion is the key to Little Sheep's success in the highly competitive F&B market.

There are a number of common problems in the Chinese restaurant chain market, which have largely limited the healthy development of the industry. Firstly, market homogenisation is very serious and the lack of differentiation in the products and services of many restaurant chains has made it difficult for consumers to choose. Secondly, some restaurant chains have deficiencies in management and quality control, leading to food safety problems. Lastly, some chain restaurant enterprises have over pursued scale in the process of market expansion, neglecting brand building and internal management improvement.

6. Conclusion

In conclusion, we analyzed the chain restaurant business model of the internationally renowned brand McDonald's and its success factors in the Chinese market, and explored various market segments in the Chinese restaurant industry and the business characteristics of chain restaurants in these markets. In addition, we analyze the business model, profitability, financial situation, current strategy and future outlook of Little Sheep as an example, and make targeted strategic recommendations for it. In the face of criticisms in the Chinese restaurant chain market, individual restaurant chains should seek improvements in the following areas: 1. enhancing product and service differentiation to reduce the level of homogeneous competition in the market; 2. strengthening quality management to ensure food safety and enhance consumer trust; and 3. developing scale and brand in a balanced manner, focusing on brand building and internal management improvement. By making

improvements in these areas, China's chain restaurant market is expected to achieve healthier and more sustainable development and provide consumers with more high-quality and diversified dining options.

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