

## Fast food ambitions in China hurt by safety scares

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A woman looks at a menu with words " everyday half-price " in front of a KFC fast food restaurant in Beijing, China Thursday, July 31, 2014. Global fast food chains are rushing to expand in China but even experienced operators face costly pitfalls in a fast-changing food supply industry plagued by repeated safety scandals. (AP Photo/Andy Wong)

(AP)—Already China's biggest restaurant operator with 4,600 outlets, KFC is pursuing Chinese consumers so avidly it opens two more every

day.

That dramatic growth comes with a big catch: KFC's quality control is struggling to keep up.

The Louisville, Kentucky-based chain is reeling after a Chinese supplier was accused of selling expired beef and chicken to it, McDonald's and possibly other restaurant chains. Just 18 months earlier, KFC's sales plunged in China after a supplier violated rules on drug use in chickens.

Global fast food chains are rushing to expand in China but even experienced operators face costly pitfalls in a fast-changing food supply industry plagued by repeated safety scandals.

Breakneck growth has strained the ability of companies to monitor thousands of farmers and meat processors, many of them small and remote, with incentives to cut corners, according to people who follow the industry. They say regulation and government enforcement are lagging.

"We are going to see more issues like this," said analyst Ben Cavender of the China Market Research Group.

"On the supplier side, people are not well-trained, or there is not good oversight," he said. "On the restaurant side, they have people checking the products but they probably don't have enough people who are spending enough time at the supplier sites."

In the latest scandal, authorities are investigating whether Shanghai Hushi Food Co., owned by OSI Group of Aurora, Illinois, repackaged and sold old beef and chicken to KFC and McDonald's. Police detained five Hushi employees but authorities have yet to confirm whether the report by a Shanghai TV station that they sold expired meat was accurate.

KFC owner Yum Brands Inc. and McDonald's Corp. said they immediately stopped using products from Husi, but the scare is already taking a financial toll.

Yum, which also owns Pizza Hut, said sales are down and if the effect persists it might be severe enough to cut into the company's global profit.

McDonald's Corp., headquartered in Oak Brook, Illinois, said about 500 of its 2,000 restaurants in China were affected. Its sales could suffer for several quarters, according to a restaurant industry analyst. Some of its stores had only fish sandwiches and fries for sale this week.

At one McDonald's in Beijing on Thursday, students used the tables to study. One ate a takeout meal from 7-11.

Other brands also were affected. Burger King Corp., Starbucks Corp., pizza chain Papa John's International Inc. and a Dicos, a chain of sandwich shops, withdrew products with ingredients from suppliers that dealt with Husi.

At a news conference in Shanghai, OSI chairman Sheldon Lavin apologized to Chinese consumers and said individual employees were to blame though the company is ultimately responsible.



A Chinese customer walks past a statue of Ronald McDonald on display outside a McDonald's restaurant in Beijing, China Thursday, July 31, 2014. Global fast food chains are rushing to expand in China but even experienced operators face costly pitfalls in a fast-changing food supply industry plagued by repeated safety scandals. (AP Photo/Andy Wong)

A food safety official was quoted last week by the official Xinhua News Agency as saying unspecified illegal behavior at Husi was an "arrangement organized by the company." Xinhua said the manager of Husi's quality department told investigators use of such meat went on for years with "tacit approval" from senior managers.

"It seems that it was not an accident but a hidden practice, which is really bad," said Sebastien Breteau, CEO of AsiaInspection, a company that conducts quality control inspections for the food, clothing and other industries in China.

"It means that in management, they had not put in place what they had to," said Breteau. "It was not properly audited."

The scandal hit at a time when global fast food brands face rising pressure from Chinese competitors such as Yonghe King, which serves noodles and steamed buns at more than 300 outlets.

KFC pioneered Western fast food in China, opening its first two outlets in 1987. Brightly lighted chain restaurants became an appealing alternative to drab state-owned restaurants or ramshackle street stalls. But today, consumers with higher incomes and more choices are starting to see traditional Chinese dishes as healthier.

"As everybody says, fast food is junk food, unhealthy," said a customer at a KFC in Beijing who would give only his surname, Liu, and said he was there only because he was in the neighborhood on a work errand. "I will eat at [fast food](#) restaurants even less in the future."

China's food industry has suffered repeated safety scandals despite government promises to tighten enforcement.

In the most devastating, Beijing reorganized its dairy industry after milk tainted with melamine killed six babies and sickened thousands in 2007-08. Suppliers added the chemical to watered-down milk to fool quality tests. Critics said Beijing opened the way to such violations by encouraging dairies to use milk from vast networks of anonymous suppliers who worked without oversight.

Beijing's ability to enforce safety is strained by the demands of overseeing a fragmented industry with more than 500,000 food processors, according to Breteau. By contrast, he said, the United States has fewer than 50,000.

China also lacks regulations for companies that move food from processors to restaurants and doesn't have regulations that require producers to destroy expired food, said Breteau. He said that allows expired food to be sold as animal feed but can also permit it to move back into the supply chain for human consumption.

The president of OSI, David G. McDonald, said the company will end Husi's independent status by folding it into the parent corporation's management and will create a quality control center in Shanghai.

Spokespeople for Yum Brands, which depends on China for more than half its global revenue, and McDonald's declined to say what changes the companies might make in operations.

Following last year's scandal, KFC tightened control over its suppliers and dropped 1,000 small poultry producers.

The current scandal is "shocking" given what happened last year with Yum, said Howard Penney, a restaurant industry analyst with Hedgeye Risk Management in Stamford, Connecticut.

As for McDonald's, the sales impact stands to be substantial and could persist for several quarters, Penney said.

"They've got to get control of the situation with the McDonald's marketing machine," he said.

McDonald's is known for rigorous oversight of suppliers but might have grown confident about OSI because of its long history as a supplier, said John Gordon, a restaurant industry analyst. McDonald's has bought meat from OSI in the United States since the 1950s.

Yum Brands responded by saying it will cut all ties with OSI in China,

the United States and Australia.

McDonald's CEO Don Thompson said the company felt "a bit deceived."

Still, McDonald's is sticking with OSI, possibly because China's emerging industry of food processors, such as state-owned Cofco Corp., which supplies beef patties and chicken to restaurants, cannot match OSI's scale, technology or experience.

"Likely they have no choice but to keep working with them," said Breteau. "They may now move business away from them significantly. But short term, they can't. It's a massive volume."

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