

The Impact of Sustainable Development Strategies on the Valuation of KFC

Yihan Zhang^{1,a,*}

¹Department of Shixi High School, Shanghai, 201800, China
a. ssam@usf.edu

*corresponding author

Abstract: Against the backdrop of the 2018–2023 epidemic, KFC China's valuation has risen rather than fallen, and its revenue has increased. This study, using KFC China as a case study, investigates how companies can apply sustainable development strategies to enhance their valuation. It does this by analyzing data on annual revenue, valuation, and the number of shops in recent years, as well as the Environmental, Social, and Governance (ESG) strategies implemented by KFC China. Additionally, it draws on theories such as marketing and brand governance. The first reason is environmental measures, and the corresponding recommendation is to make changes in transport, raw materials, and shops to make the whole company green and eco-friendly. The second reason stems from the actions taken by the community. Establishing a larger, well-established foundation to intensify community assistance work is a pertinent suggestion, aiming to solidify the brand's image in people's minds. The third reason pertains to corporate governance, and the corresponding recommendation involves enhancing the corporate identity, fostering employee happiness, and expanding job opportunities to facilitate smoother company growth. This study primarily demonstrates the value of sustainability strategies in boosting corporate valuation, emphasizing the need for companies to implement ESG enhancements, thereby serving as a source of inspiration and improvement for other companies.

Keywords: Valuation, ESG, KFC, Yum China.

1. Introduction

From 2018 to 2023, the impact of the epidemic on the restaurant industry will be profound and complex. The China Hotel Association's "Report on the Development Status and Trend of China's Catering Industry under the New Coronavirus Epidemic" reveals that the catering industry has experienced a nearly 90% loss in operating income. Public data indicates that 13,000 catering enterprises nationwide have faced closure, while self-employed and chain restaurants are grappling with survival [1]. On the other hand, the epidemic has accelerated the transformation of the catering industry. Some catering businesses that cannot adapt to the new situation may face closure, whereas those that can quickly adjust their strategies, transform online services, or provide delivery services may find new opportunities for survival and development in this crisis. However, the epidemic has also prompted catering companies to pay more attention to the improvement of food safety and hygiene standards. In order to meet the higher requirements of consumers for health and safety, many

catering companies have strengthened control of the source of food ingredients, improved the hygiene standards of the cooking process, and strengthened employee health management training.

In order to recover the lost revenue during the epidemic, various enterprises have found ways to apply sustainable development strategies. As a leading enterprise in the fast-food industry, KFC has implemented a series of rescue measures during the epidemic, utilizing the sustainable development strategy of R.E.D. marketing, which stands for relevance, ease, and distinctiveness. The pandemic enabled KFC to generate \$9.85 billion in revenue, \$1.39 billion in operating profit, and a growth of 1282 stores as it enters 2021 [2].

Not only is the fast-food industry paying attention to sustainable development strategies and policies, but researchers and scholars have also done a lot of research on ESG sustainability. For example, Prof. Lu Hai from the School of Management at Peking University gave a speech titled "ESG Practices and Exploration of Listed Companies in China," discussing the long-term financial returns of doing ESG-related matters and how companies can effectively carry out ESG practices [3]. Broadstock and two students studied the role of performance during the financial crisis, using stock price data from the Shenzhen and Shanghai stock exchanges, showing that ESG reduces financial risk during a crisis and that high ESG portfolios typically outperform low ESG portfolios [4]. Alareeni and Hamdan used the example of US S&P 500-listed firms to investigate whether ESG has a positive impact on firm performance indicators. They also investigated the potential correlation between ESG and financial performance [5].

Numerous studies on sustainable development, also known as ESG, focus primarily on the Internet and financial sectors, often overlooking the impact of ESG on the valuations of catering companies. Therefore, this work underscores a significant gap in the exploration of this particular domain. To address the knowledge vacuum in this field, the research question for this study might be formulated as follows: What is the impact of sustainable development strategies, such as ESG practices, on firm valuation? This research aims to demonstrate that in the current era of rapid development and intense rivalry in the industry, sustainable development appears to be an effective strategy for enhancing the valuation of firms. The imperative lies in the fact that sustainable development yields advantages for the environment, the entire industry, and society, thus warranting an examination of its correlation with the catering business.

To solve the aforementioned problems, this thesis first uses KFC China as a case study to introduce the relevant ESG sustainable development strategy in general and explain the current trend of KFC China's corporate value. The study delves deeper into the phenomenon, drawing on pertinent examples, and examines how ESG influences KFC China's valuation. Finally, KFC China will provide additional advice and suggestions on how to further enhance its corporate value through ESG, based on the relevant reasons analyzed.

2. Case on KFC

Yum China Holdings Co., Ltd. (also known as Yum China) is a subsidiary of Yum Food Group. It manages KFC, Pizzahut, and other popular catering brands on the Chinese mainland. Yum China is responsible for KFC's operating rights in China. KFC sold its China operation to Yum Brands China, a joint venture between Chunhua Capital Group and Ant Financial Services Group, for around \$406 million.

In the first three quarters of 2023, franchise revenue from KFC China reached \$193 million, a year-on-year increase of 13.53%, which is higher than KFC's franchise revenue of \$143 million in the United States [6]. And as of September 30, 2023, KFC China had 9917 stores, accounting for 34.14% of the total global KFC stores. In the first three quarters of 2023, KFC (after deducting non-recurring expenses) had a profit margin of 19.4%, which was quite beneficial compared to other loss-making brands under Yum! Brands [6]. According to Yum Brands' valuation as of September 30,

2023, its current price is \$128.94, with a market value of \$36.1 billion and a net profit of \$1.5 billion. The price-to-earnings ratio is 24.24. Since 2023, the stock price has performed at 2.11%, with a net profit margin of 21.12% [6].

Unlike other catering brands, KFC's sustainable development strategy did not suspend store operations during the 2018–2020 pandemic. Starting on February 22nd, KFC has resumed "contactless delivery" services at 10 restaurants in Wuhan, where the epidemic is severe. KFC not only maintains quality, but it also protects the catering industry during the epidemic. KFC obtained 100% of its fiber packaging from recycling in 2020, reducing excessive waste [6]. In 2023, KFC Hubei initiated the "food station entering the community" model, which involves transferring surplus food to community service centers for residents to use as heating. This model gradually spreads nationwide, preventing food waste and fostering community innovation and co-construction. These measures aim to implement sustainable development strategies, enhance environmental protection capabilities, and safeguard the environment.

3. Analyzing on ESG Strategies

3.1. Analyzing the Environment Strategy

During a market slump, KFC's stock price may grow due to the implementation of sustainable development-related environmental policies. KFC has made significant contributions to environmental protection by using environmentally friendly materials, which not only improves the brand's green image, attracts consumers with shared environmental awareness and love, and stabilizes brand loyalty, but also allows businesses to reduce operating costs and increase profits, thereby stabilizing the company's valuation.

In October 2018, KFC began promoting recyclable food baskets in China, resulting in an annual reduction of over 2,000 tons of pollutants and an average 20% reduction in overall dining waste [6]. Yum China's financial data for the fourth quarter and full year of 2018 show that revenue was 8.42 billion US dollars, up 8%, and profit was 941 million US dollars, up 21%, with KFC same-store sales increasing by 2% and system sales increasing by 7%. As a result of their environmental change in 2018, KFC's market valuation increased dramatically [6].

Numerous researchers have proven that the company's implementation of a sustainable development strategy for environmental protection reflects corporate social responsibility and serves as a method to enhance corporate image and value. For example, research by Jo and Harjoto has demonstrated that corporate social responsibility has a positive impact on company valuation and addresses socially enhancing activities within companies [7]. Daniela and Francesca also proved through research that corporate social responsibility and its sustainable development orientation can help reduce business risks, create value in the long-term operation of enterprises, and bring about an increase in enterprise valuation [8].

3.2. Analyzing the Social Strategy

KFC's commitment to its community has also contributed to its valuation. KFC has carried out some community public welfare projects, such as education support, disaster assistance, and community health projects, as well as actively participated in local community construction. Through active social responsibility, KFC has improved social recognition and corporate reputation, attracted more consumers and potential investors, promoted sustained business growth, and thus had an impact on the company's valuation.

Yum China reported a revenue of 10.978 billion US dollars in 2023, a 15% increase, and a net profit of 827 million US dollars, an 87% increase. Of these, KFC accounted for 8.240 billion US

dollars, or 75% of the total [6]. KFC has implemented a range of social responsibility initiatives, drawing in more customers and increasing its valuation.

The social activities implemented by enterprises' sustainable development strategy can affect their brand loyalty and change their valuation. Studies conducted by relevant scholars have proved this point: brand loyalty can affect valuation changes. According to Seetharaman et al.'s conceptual study on brand valuation, brand loyalty provides many advantages to the capitalized brand, enabling the brand to meet business needs, increase turnover, and drive positive growth [9]. In addition, Motameni and Shahrokhi's study on a boom in purchases during the late 1980s demonstrates that brand loyalty is a significant factor in motivating individuals to purchase items, regardless of their geographical location. It also highlights that brand marketing heavily relies on this method [10]. Furthermore, the model precisely assesses whether brand loyalty will have a positive impact on brand value [10].

3.3. Analyzing the Governance Strategy

A strong governance structure and transparent management system can enhance investor trust, thereby lowering investment risk. This, in turn, can help investors stabilize their mindset, attract more investment money, and ultimately increase the company's value. KFC ensures financial and operational information transparency, thereby maintaining shareholder and investor trust and allowing the company to attract a larger share of investment through a transparent governance structure.

The fundamental idea of KFC's financial operations management system is "compliance, transparency, effectiveness, and collaboration." Yum China's annual report and corporate operating statistics, for example, demonstrate financial and operational transparency, boosting investor confidence in the company.

According to KFC's 2023 annual report, revenue climbed by 15%, while operating profit increased by 76%. In the fourth quarter of 2023, KFC had 1.872 billion US dollars in brand revenue and 167 million US dollars in operating profit, representing a 43% growth. According to operational statistics, in the fourth quarter of 2023, KFC's system sales increased by 20% year over year, with new locations and store sales contributing to the increase. The restaurant's profit margin was 12.0%, and the 16% increase in consumer traffic boosted KFC's worth [6]. These transparent statistics piqued investor interest, and the investment rate reached 20 million yuan in three years.

The management mechanism and management of an enterprise are also important variables affecting market value and enterprise valuation. Bai et al. jointly conducted a study that revealed the impact of corporate governance variables on market value and valuation, with smarter corporate management and more open ownership concentration positively influencing market valuation [11]. Bernard et al. conducted another academic paper on corporate governance, using data from South Korea as the research background [12]. They found a correlation between corporate governance in emerging markets and companies' market value and valuation [12]. The study concludes that effective management of the company can positively impact the enterprise's valuation [12].

4. Suggestions

4.1. Suggestion on Environment Strategy

Addressing environmental challenges effectively is one of the most important methods for businesses seeking to achieve sustainable development. This study makes specific recommendations for KFC China to improve and optimize its environmental practices.

In terms of delivery, the strategies include reducing the carbon footprint during transportation, optimizing delivery routes with big data and AI, lowering vehicle carbon emissions during transportation, gradually replacing fuel vehicles with electric and other new energy vehicles,

implementing energy-saving and efficient cold chain logistics technology, and reducing energy consumption and food loss. In terms of ingredients, promoting local sourcing, reduce transportation-related pollution, and help the local economy. Use organic and non-Genetically Modified Organism (non-GMO) ingredients; progressively raise the proportion of organic and non-GMO food procurement; and reduce environmental degradation and its effects on the ecosystem. Install high-efficiency, energy-saving equipment, such as LED lighting and sophisticated air conditioning systems, to save energy. In terms of water resource management, using water-saving equipment and technologies will increase water resource use efficiency while decreasing waste.

McDonald's is a positive example that KFC can learn from. The average annual electricity consumption of restaurants is about 35% to 40% lower than the median energy consumption of fast-food restaurants [13]. McDonald's green supply chain is also a significant environmental measure, as evidenced by its precise control over food sources through agricultural regeneration programs, potato cultivation, white-fleet chicken farming, and sustainable coffee cultivation. With a series of deeply rooted measures, McDonald's achieved a total revenue of \$25.494 billion for the year ending in 2023, an increase of 10% compared to the same period, and a year-on-year profit growth of 37% [13].

4.2. Suggestion on Social Strategy

Considering the present condition of the market, communities play a crucial role in promoting human relationships and are a vital element of society. This study proposes that KFC can engage in community development by creating foundations and other departments to offer more beneficial support, such as developing environmental conservation stations and preschool education centers. These impactful public welfare initiatives can effectively diminish barriers among neighbors, foster brand loyalty and localization levels, and introduce new and practical community-oriented public welfare activities to individuals, significantly augmenting their sense of enjoyment.

There are practical instances that demonstrate the benefits of companies establishing such foundations to invest in communities. Reliable reports indicate that Wal Mart established the Wal Mart Foundation in 1987 with the aim of assisting more community members and fostering a more harmonious and orderly community environment through the "enterprise support" foundation. Over the last few decades, Wal Mart has invested a significant amount of money and energy in its projects, beginning with the establishment of the "Strategic Alliance for Sustainable Development" in China and announcing a \$25 million investment in applied science, education, communication, and other initiatives to assist communities and villages in October 2016. Wal Mart's sales in China will reach US \$5.3 billion in 2024, a 28.3% increase over the previous year, while e-commerce enterprises' net sales will rise by 54%. Through a succession of initiatives and actions in China over the last few decades, Wal Mart has amassed extraordinarily high customer happiness and recognition, as well as high customer stickiness, resulting in a relatively high upward trend in sales and valuation [14].

4.3. Suggestion on Governance Strategy

Another critical point is that enterprises' employee training and management are also important steps towards sustainable development and a major factor affecting their long-term valuation.

This paper suggests that KFC should also establish an internal green culture and integrity culture within the enterprise, enhance employees' sense of identification and participation in the green supply chain and green environmental protection measures, make employees aware of the importance of honest management, and make every employee willing to take action. KFC should also provide employees with more opportunities to engage in their work and allocate more opportunities to female and disabled workers to address the current shortage of these groups in the workplace.

A good example of employee development is LEGO, which has strong corporate social responsibility. The 2023 annual report reveals that work-related accidents cause a loss rate of 0.6 per million working hours, and the work motivation and satisfaction scores of LEGO employees have reached 80 points, surpassing the annual target by 5 points and placing them among the top in the world. The favorable working environment that LEGO has established for its employees over the long term has also led to a steady increase in LEGO's annual revenue and valuation.

5. Conclusion

This paper discusses KFC China's valuation in light of today's fast-paced era, fierce industry competition, and post-epidemic era. This paper aims to examine the impact of sustainable development on enterprises, its potential benefits, and the overall value of this approach. To investigate this issue, this paper conducted an ESG analysis of KFC China, aiming to understand the three common sustainable development measures that KFC has adopted in terms of environment, community assistance, and corporate management. Finally, this paper concludes that sustainable development strategies have a positive impact on enterprise valuation and can have positive profit consequences.

This paper makes a significant contribution by highlighting the impact of ESG sustainable development strategies on the valuation of catering companies, a topic often overlooked in favor of the Internet and financial sectors. The implications of this study are far-reaching, suggesting that companies in the catering industry can achieve substantial financial benefits and improved brand loyalty by adopting sustainable development strategies.

However, the study is not without limitations; it primarily focuses on a single case study, which may limit the generalizability of the findings to other companies or regions. Additionally, the study period may not fully capture the long-term effects of ESG initiatives. Future research could address these limitations by examining a broader range of companies within the catering industry, including different geographical locations and longer timeframes, to provide a more comprehensive understanding of the relationship between ESG practices and firm valuation.

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