

Application of Porters Competitive Strategy in Korean Foodservice Market

- focused on launching of US based Specialty Coffee Shop.

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Introduction

The hospitality industry is a significant and distinctive economic force in the service economies of the US. Especially the restaurant industry takes a big pie from the whole national product. The total sales of food service in USA were \$ 376 billions in 2000 and estimate \$ 577 billions in 2010. The restaurant industry in USA is fragmented across all segments with more than 844,000 food service establishment (Industry at a glance, NRA 2001). The symptoms of fragmentation of restaurant industry are founds various areas. For example, the most significant symptom of maturity of the industry is the decreasing growth rate of demand curve, while the supply of restaurant seats has been steadily increasing. The restaurant industry's booming expansion in the 1990s has caused supply to outgrow demand. The number of eating and drinking establishments increased 10% from 1990 through 1993, according to the U. S. Bureau of the Census. Expansion continued in 1995 and 1996: the top 200 chains, as measured by Nations

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Restaurant News, grew their store base by 4.4% and 3.3%, respectively, while the U. S. population has been growing at just over 1% annually for the past five years (Standard & Poors Industry Surveys). This means that supply is increasing while demand is steady which yields increasing competition in the restaurant industry in USA. Common practice of price discounting or emphasizing on service could be a good sign of increased competition of restaurant industry in USA. Also the restaurants begins to give the value to the repeat customers. Porter(1980) suggested nine symptoms of market maturity, and most of them are applied in the domestic restaurant industry.

Table 1. Indicators of Market Maturity

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1. A slowdown in industry growth results in more competition for market share.
 2. Firms are selling to more experienced repeat buyer.
 3. Competition often shifts toward greater emphasis on cost and service.
 4. Capacity addition to the industry supply begins to slow.
 5. Manufacturing, marketing, distribution, selling, and research methods begin to undergo change.
 6. New products and applications are harder to come by.
 7. International competition increases.
 8. Industry profits fall.
 9. Dealer profits fall.
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Since Theodore Levitt's seminal article was published in 1983, globalization has become dominant theme of international strategy. The restaurant industry is not exemption. As the domestic market become mature, the restaurant industry has experienced increasing competition as described above. One of the feasible option for them to overcome the competition in domestic market was the internalization or doing business in aboard. As Porter (1980) indicated, the reasons for the internalization are increased scale economies, decreased transportation or storage costs, rationalized or changed distribution channels; narrowed national economic and social circumstances and reduced government constraints (Porter, 1980). During the

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last decade, the hospitality industry including restaurant industry has engaged in internationalization with the forms of growth such as franchising, joint venture, and management contract (Miller, 1989).

The largest chain in international market is the McDonald's with its nearly 13,000 foreign outlets with the total sales of \$15.4 billion followed by KFC, Burger King, and Pizza Hut. Wendy's has also decided to accelerate its expansion outside the United States focusing on four main international areas: Canada, Europe, Latin America, and the Pacific region. Fast food is not the only food category that is expanding internationally. Lone Star Steakhouse & Saloon selectively evaluates international expansion opportunities. Hard Rock Cafes have opened in far-flung places from Copenhagen to Kowloon, Hong Kong, boosting 10 million visitors a year. International expansion becomes the common strategy for growth to US based food service industry. Among the international markets, Asian countries become important markets for international expansion to US based food service industry, because of the high growth rate of national or personal income (Van Houten, 1997).

Consumer demand for specialty coffee continues to grow, according to Association Research. Nearly two-thirds of consumers who order espresso or other specialty coffees at tableservice restaurants say they are buying more or the same amount compared with two years ago. Like consumers preference of specialty coffee, the number of specialty coffee seller were increased very sharply recently. (R&I, 1997)

Along with rapid growth of specialty coffee business in US markets, that of Korean is not an exception. However, due to the environmental complexity, cultural differences, and political differences in international markets, foreign firms often face various problems during their exploration of Korean market. A review of literature indicates that there has been a lack of systematic research studies addressing the problems related to global expansion. Furthermore, there has been less studies conducted to analyze foreign market that is Korean market strategically. With that in mind, this paper examines the current restaurant industry of Korea, analyzes the critical factors which determine the opportunities and barriers for foreign investments in Korea based on

Porters (1979) five competitive forces, and suggests adequate strategies for US based restaurant firms who has intention to enter Korean restaurant market.

table 2. Gourmet Coffee Sellers

' 91	463 units
' 92	585 units
' 93	1,008 units
' 94	2,544 units
' 95	3,965 units
' 96	5,425 units

source: Recount, a service of RCG, Skokie, Ill.; * midyear data.

Theoretical Background

Restaurant Industry in Korea

Consumers food expenditures and eating out tend to increase as their incomes increase. In Korea, reflecting the sharp rise in personal income levels in recent years, people are spending ever-increasing amounts on eating out. The foodservice industry, especially fast-food and family-style restaurants, seems to be growing at a hurried pace. The growth of Korean Food service industry can be easily found in the change of total number of restaurants. The number of restaurants in 1998 was 412,166 units which was doubled compare to those of 1990.

Table 3 indicates changes in total expenditure vs. dining-out expense. The increasing expense on dining-out can be checked easily. Compare to the 2 times of change in total expense from 1990 to 1997 that of dining-out expense was 3 times.

The remarkable increasing rate of restaurant market in Korea is the reflection of the times, given that the average Korean family is enjoying a more prosperous lifestyle. According to recent statistics, the GNP per capita in Korea, before the Asian financial crisis, was an estimated US

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\$10,000 which level is similar to that of developed countries. So as Koreans have more money, they are tending to spend more of it.

The changing style of traditional Korean family and westernize younger generation also explain the booming of restaurant industry in Korea. As the big family type demolished and two-income families become more commonplace in Korea, the need for convenient commercially prepared foods eaten outside the house or for take-out is rising. Also working families are choosing to delegate the responsibility of food preparation elsewhere in order to save time and reduce stress. The younger generation, so called X-generation, is already familiar with western food and has been a big target market (Kim, 1991). Many foodservice providers believe that as time goes by these consumers will continue their preference for western dishes and therefore increase the markets chances for long term growth.

Koreas foodservice industry has been enjoying increasing profits from the large-scale entry of foreigners. This is a trend that experts expect will continue to grow. It's even been speculated that they will exceed ordinary manufacturing companies.

Table 3. Average Monthly Expense per House (₩ , %)

Year Section	1990	1991	1992	1993	1994	1995	1996	1997
Total Expenditure	650,000	818,300	941,900	986,200	1,113,700	1,230,600	1,395,400	1,453,700
Dining-out Expense	47,420	55,300	66,900	81,100	100,300	118,600	139,900	158,900
Ratio of Changes in Dining-out	22.5%	19.6%	21.4%	17.8%	23.7%	18.3%	17.9%	13.6%

source : statistics department. 1990-1997.

The foreign foodservice in Korea

Koreas foodservice industry is composed of a range of different operations as shown in table 2. Generally, they consist of full service, family style, fast food, and theme and specialty cuisine style restaurants which tend to offer a variety of low to somewhat expensively priced western dishes.

Table 4. U. S. based Restaurant Operating in Korea

Type of Restaurant	Name of Restaurant
Family Restaurant	Cocos, Tony Romas T.G.I Fridays, Marche, Out-back steakhouse and Benningans
QuickService Restaurant	McDonalds, Hardees, Burger King, KFC, and Popeyes
Theme Restaurant	Hardrock Cafe
Pizza	Pizza Hut, Dominos

Source: Korean Restaurant Association

According to data from the KRA, in 1999, there were 12 family restaurant, 8 of which are licensed through US franchises, operating 57 family restaurant in Korea. And the sales volume of US based company was about 3 times bigger than that of others. Cocos, T. G. I. Fridays, Benningan's and Sky Lark, make up the four big family restaurants in the group.

The fast-food market is dominated by five foreign-brand companies McDonald's, Hardee's, Burger King, KFC, and Lotteria (Chun, 1994). Upon its entry into the Korean market in 1979, Lotteria, based in Japan, became the first foreign fast food provider to commence business in Korea. Burger King in 1981 and Wendy's in 1984 also advanced into Korea. However, the US giant McDonald's did not enter the local market until 1988, followed by Hardee's in 1990. KFC started its local operation in 1983. The Korean franchisee, Doosan Foods, owns and directly operates 70 chain stores throughout the nation. Early entered Korean market, Pizza Hut has enjoyed dramatic sales increase. Popeyes Chicken lately joined, in 1994, the competition.

Specialty Coffee-shop Market in Korea

Not like the overall foodservice industry, the growth stage of specialty coffee business in USA and that of Korea has little time-differences. The take over of the Starbuck's by Howard Schultz was occurred in 1987 and the launching of the Starbuck's Korea was 1999. From the early stage of coffee shop, it has been changed from traditional coffee shop to branded one and specialty shop. Even though it started recent years, the growth was tremendous. In the beginning stage of business, in the first two

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quarters of this year specialty coffee shop sales increased from 20% to 500% compare to that of last year. Due to rapid growth of this market, there are more than 12 brands are competing each other. And there will be bright and dark side of business among the companies within years. Nobody sure about the success of two major US based Specialty coffee shop, Starbuck's and Seattle's Best.

Table 5. Specialty Coffee-shop Market in Korea

Brands	Start	Number of units		
		2000	2001 (two quarters)	2001 (later two, assumed)
Starbuck's	7. 1999.	10	20	30
Cappuccino Express	9. 1999.	2	2	2
Segafredo	1997.	4	5	7
Tom and Toms	1998.	8	16	20
Java Coffee	6. 2000.	2	4	10
Coffee bean & Tea leaf	5. 2001.	-	4	7
Seattle's Best	1. 2001.	-	2	4
Ediya	3. 2001.	-	14	31
Illy	11. 2000.	1	1	4
City of Espresso	8. 2000.	5	15	40
Nescafe	7. 2000.	4	13	30
Rosebud	5. 1999.	55	86	150

source : Restaurant. (8. 2001). The Foodservice Management

ANALYSIS

Market Analysis

As demonstrated most of the foreign food service companies have been successful in Korean foodservice market. However, not all the foreign food service companies enjoy the success. For example, the Wendy's chain was the worst performer in Korean market in 1993, with sales of US \$3.6 million, down a significant 24% from a year before. The company market share was

largely eroded by the more popular McDonald's and Hardee's. Another negative factor is that Wendy's stores are often smaller and less stylish, accommodating at most some 50 to 100 people, while especially the McDonald's outlets are more modern and larger, capable of seating more than 200 customers (Chun, 1994). This example demonstrates the importance of market analysis or strategy to compete in a given market.

Porter is the most famous strategist and his strategy type cost leadership, differentiation, and focuses frequently used by both scholars and practitioners. He argues that the nature and degree of competition in an industry hinge on five force: the threat of new entrants, the bargaining power of customers, the bargaining power of suppliers, the threat of substitute products or services, and the jockeying among current contestants. To establish a relevant strategic agenda for dealing with these contending currents and to grow despite them, a company must understand how they work in its industry and how they affect the company in its particular situation. West & Anthony (1990), West & Olsen (1988), and West & Olsen (1989) also insisted the importance of environmental scanning or market analysis in the hospitality industry.

Although it is true that environmental scanning or market analysis is important to establish proper strategy, there is not enough literature which demonstrates how the market analysis is conducted. Perceiving this problem, this study suggests a method to analyze the Korean foodservice market for practical implication by utilizing Porters five competitive forces.

1. Threat of New Entry

As shown in table 6, the Korean foodservice market is generally difficult to access for new entry. Among 11 items, just 3 items proprietary product differences, access to distribution, and access to cheap or necessary inputs are favorable for the new comers. The last two items which are favorable to the new comer are related to the Koreas geographic characteristics. Korea is a relatively small country and has high density of population. These characteristics make easy for foodservice company to

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access to distribution and to cheap inputs.

The important things to consider for new comers are high brand identity, high switching costs, and restricted government policy that are dominant barriers for the new entry. Koreans are so conservative that they are usually reluctant to change. They are prefer to what they have been used to, so brand identity is high and it takes tremendous efforts for new comers to draw attention from them.

Table 6. Threat of New Entry

Evaluation	Items	Entry Barriers	Threat
High	Economies of Scale	+	-
Low	Proprietary Product Differences	-	+
High	Brand Identity	+	-
High	Switching Costs	+	-
High	Capital Requirements	+	-
Many	Access to Distribution	-	+
Mod	Learning Curve cost Advantages	Mod	Mod
Many	Access to Cheap or Necessary Inputs	-	+
Mod	Proprietary Low-Cost Product Design	Mod	Mod
High	Government Policy, License, Etc. Limits	+	-
High	Expected Retaliation	+	-

2. Bargaining Power of Suppliers

Table 7 indicates that there is almost no bargaining power of supplier in Korean foodservice market. The only area in which the suppliers can gain power over the industry is impact of inputs on cost. The big suppliers for the foodservice in Korea will be raw materials such as vegetables, meats, and breads to make foods. The other important suppliers will be labor force. However these two suppliers are abundant in Korea. Although the cost of input is big, the industry can easily switch the suppliers without any extra costs. Since there is almost no bargaining power of suppliers in Korea, the entry barrier for new comers is very low.

Table 7. Bargaining Power of Suppliers

Evaluation	Items	Bargaining Power of Suppliers
Low	Differentiation of Supplied Inputs	-
Low	Switching costs that tie industry firms to Supplying Firms	-
Many	Substitute inputs	-
Many	Number of supplier firms	-
Mod	Importance of volume sold to this industry	Mod
High	Impact of inputs on cost or differentiation of industry firms	+
Low	Threat of forward integration into industry	-
High	Costs of the goods supplied relative to the total inputs purchased by the industry	-

3. Bargaining Power of Buyers

The Bargaining power of Buyers is relatively low in Korea for the foodservice industry. Huge and increasing demands in Korea will be the most favorable condition. The high level of loyalty of Korean which hinder from frequent switching companies generate high switching costs. Usually there is no volume purchasers in restaurant industry and the situation is same for Korean market.

However, the Koreans relatively have lots of information about food products because they have many opportunities to exposure to the advertisement. Now Korea has just four regular channels so the effect of advertising through TV is great. The other threat for foreign foodservice company is that there are lots of choices of food products in Korea.

Another important thing to notice for foreign foodservice provider is the low level of price sensitivity of customer in Korea. As shown in table 8-1, most of the items exempt for product differences indicate the negative impact to price sensitivity. Thus this results imply that the cost leadership strategy is not feasible in Korea.

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Table 8. Bargaining Power of Buyers

Evaluation	Items	Bargaining Power of Buyers
Many	Number of buyers	-
Low	Volume purchasers	-
Many	Switching costs	-
High	Buyer information	+
Low	Ability to integrate backward	-
Many	Substitute Products	+

Table 8-1. Price Sensitivity of Buyers

Evaluation	Items	Price Sensitivity
Low	Price for these items relative to total of purchased inputs	-
Low	Product differences	+
High	Brand Identity	-
- - -	Impact of input on quality or performance of the buyers final product	- - -
Mod	buyer profits	Mod
Low	Decision makers are rewarded for low cost purchases	-

4. Threat of Substitution

Every industry competes against other industries for customers. Sometimes the competition is fairly direct, such as with fiberglass insulation versus rock wool, cellulose, or plastic foam. The Korean market for foodservice industry has same situation. As seen in table 9, the threat of substitution is high in Korea. The foreign foodservice providers should compete directly with the Korean foodservice providers who are the strongest substitutes to western style food products. For the US based restaurant, Japanese style and Chinese style restaurant, which is very popular in Korea, may be also strong competitors.

table 9. Threat of Substitution

Evaluation	Items	Threat
Not close	Price/Performance tradeoff	-
Low	Switching costs	+
High	Preference of the buyers to substitute	+

5. Intensity of Rivalry

The effects of weak buyer power, weak supplier power, and high entry barriers on an industry make the industry less competitive as shown in table 10. The more competitors there are, the more likely it is that some of them will misbehave by slashing prices and quality. However this is not the case for Korean market. As demonstrated earlier, there are limited number of foreign competitors in Korea which makes the foreign firms to compete in mild rivalry situation. The strong barrier for new entrant also hinders for new comers from entering into Korean market. High industry growth is another reasons for low rivalry because when an industry is growing, there are enough customers to go around and fill most firms capacity.

Table 10. Intensity of Rivalry

Evaluation	Items	Intensity of Rivalry
High	Growth in the industry	-
High	Fixed costs	+
High	Perishable products	+
High	Periodic Overcapacity	+
Few	Actual product differences among competitors	+
High	Brand identity	-
High	Switching costs	-
Low	Number of competitors	-
Low	Complex information	-
Low	Differences among competitors	-
High	Exit barriers	+

Conc lus ion

The industry analysis of Korea for foreign foodservice providers indicates that the business environment of Korea is very optimistic. Although the threat of substitution is relatively high, the rest competitive forces are

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favorable for foreign foodservice providers. The high entry barrier is blocking new entrants coming. Relatively low levels of buyer and supplier power make the companies to do their business in more stable situation. These conditions yield low level of intensity of rivalry in which the companies can achieve their high growth rates and profits. This analysis explains why the foreign foodservice providers have been successful in Korean market.

However the analysis provides several strategical implications. The most important implication is the strategic choice. Porter(1980) suggested three generic strategies. Among them, cost leadership is not working in Korean market because the price sensitivity for the foreign food in Korea is very low. Instead they should utilize differentiation strategy. It is due to the high brand loyalty and high switching costs(psychological costs). The foreign foodservice providers can increase their brand identity by differentiating their products from other companies.

Second strategic implication is the need for employees who know well about Korean law and who can be connected to the government officers. Van Houten (1997) indicated that what should concern operators of restaurant are a number of vague references in the new regulations: restrictions on equipment purchasing by franchisees; contract amendments, and procedural guidelines for terminating franchiser-franchisee relationship, among them. As mentioned earlier, the regulation of Korean government is very tight and sometimes vague or ambiguous. For example, Korea's Fair Trade Commission enacted new rules requiring franchisers to disclose all information to franchisees before entering into agreements. Thus, it is almost impossible for the foreign foodservice operators to contact with government.

Third, foreign restaurant operators should pay attention in doing PR or marketing. One of the main obstacles facing the foreign foodservice market is that there still seems to be a negative receptiveness towards foreign eateries. Besides, there is still misconception among the public that the operating of Korean markets will lead foreign companies to control Korea's economy and tastes. To overcome this obstacle, the foreign foodservice providers should have effective PR method. For example, currently Pizza Hut is contributing to a fund that will be donated to handicapped Koreans to

promote a more positive company image among local consumers as well as to establish itself as a responsible member of Korean society. Effective PR will decrease the reluctance to foreign food and will increase the brand identity and loyalty that are directly related to the growth.

Fourth strategic implication is the importance of focus strategy. Characteristics of foreign food, especially western style food, are young with rich parents, female, city dwellers, and convenience pursuers. Thus these population should be main targets for the foreign food service, because the other population such as older generation is conservative and reluctant to change. Also, the Korean franchises should upgrade regular restaurants to attract Korean customers who want more than just food. In fact, they are in search of a total dining experience.

Finally, the foreign foodservice companies should pay attention in selecting franchisees or business partner. The franchisees should have necessary capital competitiveness, distribution ability, and marketing power.

Those strategy was successfully implemented when the early stage of introducing Family Restaurant in Korea. But there are several check-points when applying those strategy into Specialty Coffee Business in Korea. First, there are more diverse market compare to that of Family Restaurant. Thus, US Specialty coffee company should be more concentrate on market segmentation. Second point is the flexibility of choosing business partner. Those due to the scale of coffee shop business and the easiness of the quality control. Third, the company should apply speed management for occupying pre-mature market. Last, all specialty coffee business should make an efforts to change the perception of the Korean customer of specialty coffee to staple food.

The domestic foreign food market has experienced exceptional growth with fast food chain stores mushrooming since the mid-1980s. However the market volume for foreign food still represents only a minor share of the overall domestic restaurant industry. But, with steadily rising income levels and favorable market condition as analyzed, foreign food is certain to become a much more important sector in the near future.

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논문초록

미국 외식브랜드의 한국시장 진출을 위한 Porter의 경쟁전략의 적용

- 전문커피 시장에 관하여 -

서 진욱, 유 종서

포화된 미국의 외식시장과는 대조적으로 한국의 외식시장은 도입기에서 성장기로의 전환을 맞이하고 있다. 이러한 변화속에서 미국의 외식브랜드들은 한국에 진출하여 다양한 변화와 모험을 겪으면서 다수는 성공적인 전략을 통하여 국내에 입지를 굳혔으며 그렇지 않은 기업들도 있었다. 이러한 현상들은 Porter의 경쟁 전략을 통하여 설명되어질 수 있다.

이는 초창기 미국 브랜드의 국내시장 진출전략이 어떠한 배경으로 수행되었는지를 이해할 수 있으며 또한 최근에 국내에서 빠른 성장세를 보이고 있는 전문 커피숍 시장의 변화에서도 설명되어질 수 있다. 그러나 초기 패밀리레스토랑의 도입배경과 전문 커피숍의 경우는 커피 시장의 세분화정도, 비즈니스 파트너 선택의 기준, 커피 상품과 일반음식과의 소비자들의 다른 인식 등의 몇 가지 다른 점이 있다는 것을 간과해서는 안될 것이다.

3인 익명심사 畢

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