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Taco Bell: The Breakfast Opportunity

Jason Bonnar, vice president at Lakewood Consulting, stared at his television as elaborate commercials buzzed on the screen. It was September 7, 2013, a Saturday, and he was watching college football; the Michigan Wolverines were about to beat the Notre Dame Fighting Irish.

Bonnar wasn't thinking about the game, however; he was thinking about how to grow Taco Bell. The brand was doing well. *Advertising Age* had named Taco Bell the 2012 Marketer of the Year and the business had continued to grow in 2013.

The key question on Bonnar's mind was whether Taco Bell should launch a line of breakfast items in 2014 or expand the successful Doritos Locos Taco line. Taco Bell's CEO had asked Lakewood Consulting for a recommendation and Bonnar was leading the project. He knew that even with a massive marketing budget the brand could not do both. He loved the idea of entering the breakfast day part but he knew breakfast had ended the career of more than one Taco Bell marketer. Expanding Doritos Locos Tacos, on the other hand, looked like an easy win.

Bonnar had to recommend a plan in a little over a week. As the game reached the two-minute warning, he grabbed his computer, switched off the TV, and got to work.

Yum! Brands

Yum! Brands Inc. was a global leader in the quick-serve restaurant business. The corporation, based in Louisville, Tennessee, owned Taco Bell, KFC, Pizza Hut, WingStreet, and other brands. Annual revenues in 2012 reached \$13.6 billion (see **Exhibit 1**). Yum's 40,000 restaurants were located in more than 125 countries and employed 539,000 people, 86 percent of whom were part-time employees.¹ Yum's vision was to be "the defining global company that feeds the world."²

The company was formed in 1997 when PepsiCo spun off its restaurant division. Since then Yum! had prospered. In 2012 net income reached \$1.6 billion, or 11.5 percent of revenues. Growth was a top priority for the company. As CEO David Novak noted, "If you've followed us over the years, you know one of the things we're most proud of as a company is our ability to

¹ Yum! Brands 2013 10-K, p. 6.

² Yum! Brands 2013 Annual Report, p. 15.

drive what we call dynasty-like performance, which is generating at least 10 percent growth in earnings per share year after year.”³

One of the key drivers of the company’s profitability was the fact that it did not own most of its restaurants: of Yum’s 40,000 locations, only 20 percent were company-owned; 75 percent were operated by franchisees; and 5 percent were operated by licensees (see **Exhibit 2**).⁴ Franchisees were independent operators that signed a franchise agreement allowing them to use one of the brands; in return, they paid a licensing fee to Yum! based on revenues, so the more they sold, the more Yum! received. This structure had the additional advantage of shifting the capital burden to local owners. Avoiding the burden of ownership and maintenance significantly boosted financial returns.

The challenge for Yum! was that franchisees were demanding; they wanted to see a steady flow of customers coming into their restaurants, which was the company’s responsibility. The system also made execution a challenge because franchisees were not required to implement every program or carry every item.

Yum’s largest brand in 2013 was KFC. KFC was particularly strong in China, where it had more than 4,200 locations.⁵ This fast-growing division attracted the interest of investors; many people who bought Yum! stock did so to participate in KFC’s growth in China. In 2013 BBC named KFC the number-one foreign brand in China.⁶ Pizza Hut, Yum’s second-largest brand, was well established and slow growing. Taco Bell was the third-largest brand in the Yum! portfolio and delivered about two-thirds of Yum’s total U.S. profits.⁷ WingStreet was a newer concept with a small geographic footprint.

Taco Bell Background

Californian Glen Bell founded Taco Bell, which served a variety of Tex-Mex style foods, including tacos, burritos, quesadillas, nachos, and other specialty items. In 1946 Bell opened a small hot dog stand and subsequently owned and operated a number of restaurants in southern California, including four called El Taco. He built the first Taco Bell in 1962 in Downey, California, after which it expanded rapidly to 100 restaurants by 1967. In 1978 PepsiCo purchased Taco Bell, which became part of Yum! Brands when PepsiCo spun off its restaurant division in 1997.

Unlike Yum’s other brands, Taco Bell was primarily a U.S. operation. Although the company had a presence in twenty-one countries,⁸ the United States made up the vast majority of its locations and revenue. In 2013 Taco Bell had five restaurants in India, 279 in other countries, and 5,769 in the United States,⁹ about 15 percent of which were company owned.¹⁰

³ Ibid., p. 1.

⁴ Yum! Brands 2013 10-K, p. 15.

⁵ Yum! Brands 2013 Annual Report, p. 3.

⁶ Ibid., p. 3.

⁷ Ibid., p. 1.

⁸ Yum! Brands 2013 10-K, p. 4.

⁹ Yum! Brands 2013 Annual Report.

¹⁰ Yum! Brands 2013 10-K, p. 4.

Customer

Taco Bell's core customers were single young men. Young people between the ages of 18 and 24 were a key group for all quick-serve restaurants, but Taco Bell was particularly dependent on this group. Its heavy users appreciated its value proposition: tasty, inexpensive food. As one former Taco Bell marketer described it, Taco Bell was "cheap, fast, delicious and messy."¹¹

Taco Bell stumbled when it focused too much on other demographic groups. For example, a low-fat line of products called Border Lights, which was designed to appeal to a slightly older demographic group, flopped. It didn't appeal to the core customer, and shifting resources to this new group resulted in a sales decline with the core customer group. In July 2013 Taco Bell discontinued its line of children's meals. As the Taco Bell CEO explained, "It's fairly inconsistent for an edgy, twenty-something brand to offer kids meals."¹²

Menu

Taco Bell had a large menu of products, many of which were classic Mexican dishes, such as tacos and burritos, and others that were created by Taco Bell. A Gordita, for example, was a flatbread wrapped around a hard-shell taco, which was filled with meat, cheese, lettuce, and tomatoes. A Chalupa was a crisp, chewy shell filled with meat, cheese, sour cream, lettuce, and tomatoes. Taco Bell was able to support a broad product line because many of the items used the same ingredients: cheese, seasoned meat, lettuce, and tortillas.

Pricing

Value was a key part of Taco Bell's proposition. The brand featured items priced at \$0.59, \$0.79, and \$0.99. These low prices resonated well with its core customer.

Advertising

Taco Bell relied heavily on advertising to get customers in the door. The brand spent almost \$300 million per year on advertising,¹³ the majority of which went to traditional advertising, with 30 percent devoted to digital and new media.¹⁴

The company had a history of creative marketing. On April 1, 1996, for example, Taco Bell ran full-page ads in newspapers around the United States announcing that it had purchased the Liberty Bell in order to reduce the national debt and renamed it the "Taco Liberty Bell." This April Fool's Day joke generated enormous publicity for the brand, along with a certain amount of controversy.

¹¹ Sharon McCarthy, in interview with the author, December 8, 2014.

¹² Brad Tuttle, "The Real Reason Taco Bell Killed Kids Meals," *Time*, July 25, 2013.

¹³ Maureen Morrison, "Taco Bell Names Yum Veteran Brian Niccol Top Marketing Exec," *Advertising Age*, October 13, 2011.

¹⁴ Maureen Morrison, "Sales Are Going Loco at Taco Bell, Ad Age's Marketer of the Year," *Advertising Age*, September 2, 2013.

From 1997 to 2000, Taco Bell used a Chihuahua in its advertising campaign, which included some of the company's most memorable ads. The dog delivered the campaign's signature phrase, "Yo quiero Taco Bell" ("I want Taco Bell"). In 2010 Taco Bell started a Facebook group to collect signatures on a petition that appealed to the Federal Reserve to produce more \$2 bills in an effort to promote its \$2 Meal Deals.

Taco Bell in 2013

Taco Bell's same-store sales increased 8 percent in 2012 and growth continued into 2013.¹⁵ This was quite a change from 2011, when sales fell 1.4 percent after the company was hit with a class-action lawsuit alleging that its seasoned meat was mostly fillers and not really meat.¹⁶ Taco Bell vigorously contested the claim and the suit was eventually withdrawn, but the accusation hurt quality perceptions of the brand.¹⁷

Taco Bell typically drove growth by introducing new menu items, which created excitement that drew people to the store and, if priced at a premium, boosted margins. The primary driver of 2012's improved results was the launch of the Doritos Locos Taco. The new taco incorporated a crispy shell made of Doritos brand tortilla chips. As *USA Today* described it, "Two commonly ridiculed 'junk' foods—the Doritos chip and the Taco Bell taco—are being rolled into one."¹⁸ The concept immediately resonated with customers: 100 million were sold in the ten weeks following the launch.¹⁹

Taco Bell also introduced a new upscale line of products in 2012. Created by celebrity chef Lorena Garcia, the Cantina Menu featured products containing black beans, cilantro rice, citrus-and-herb-marinated chicken, and cilantro dressing.

Taco Bell also benefited from a new advertising campaign. President Brian Niccol scrapped the prior campaign, "Think Outside the Bun," and embraced a new, more contemporary creative look with the slogan, "Live Más" ("Live More"). According to Niccol, some of the old advertising was uninspired: "a 24-year-old white guy being an idiot."²⁰

The brand's leadership team believed it had enormous growth potential: the revenue target for 2022 was \$14 billion, up from roughly \$7 billion in 2012. The brand's long-term plan included dramatic expansion in the number of locations, from about 6,000 in 2013 to almost 10,000.²¹ It also included an increase in average store sales from \$1.3 million to \$1.8 million.²²

¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Morrison, "Taco Bell Names Yum Veteran Brian Niccol Top Marketing Exec."

¹⁸ Bruce Horowitz, "Taco Bell Comes Out of Its Shell to Ring in a New Menu," *USA Today*, February 20, 2012.

¹⁹ Morrison, "Sales Are Going Loco at Taco Bell."

²⁰ Ibid.

²¹ Dale Buss, "Taco Bell Ramps Up Global Expansion—But Not in China," *brandchannel*, December 4, 2014.

²² "Taco Bell: Mas Sales Driving Opportunities," Bank of America Merrill Lynch Analyst Report, May 16, 2014.

The Breakfast Opportunity

Breakfast was a key opportunity in the quick-serve restaurant world. NPD, a market research firm, estimated that breakfast accounted for 12.5 billion restaurant visits in 2013, or 21 percent of all restaurant visits. In addition, the breakfast occasion was growing—up 3 percent compared to the previous year—whereas lunch and dinner were both declining.²³

The biggest player in breakfast was McDonald's. Breakfast accounted for 25 percent of McDonald's U.S. sales, totaling nearly \$9 billion.²⁴ As industry analyst Darren Tristano noted, "McDonald's does more breakfast sales in the United States than Taco Bell does total sales globally."²⁵

McDonald's capitalized on the breakfast day part with the launch of the Egg McMuffin in 1972 and expanded its breakfast menu in 1997. In 2001 it launched McCafé, a line of premium espresso, cappuccino, and latte coffees, partly in response to the growth of the coffee business of Starbucks and Dunkin' Donuts.

Taco Bell had long eyed the breakfast opportunity and had tried to enter the breakfast meal occasion three times, once in the 1990s. Each attempt failed. The simplest way to improve returns was increase store traffic, and getting even a small part of breakfast would be a major boost for the brand. Without a breakfast menu, most Taco Bell locations opened at 10:00 a.m. As a marketing consultant noted, "You have a facility sitting there unused. The question is, 'Can you get more use from it?'"²⁶ Yum! Brands CEO David Novak observed that a typical McDonald's "gets about \$1 million in sales before we have even opened our doors."²⁷

Taco Bell faced three challenges in breakfast. First, the brand would need to get consumers to change their breakfast routines and think about Mexican food in the morning. This would not be easy. As a former Taco Bell new-product marketer noted, "As humans, we are hard-wired for routine in the morning. It is tough to get people to change."²⁸

Second, a breakfast initiative would have to win over franchisees; without their support, it would not succeed. If results from the breakfast line were weak, franchisees could quickly lose their commitment and drop it in order to save money.

Third, Taco Bell would need to maintain advertising support over a long period of time. Strong support during the launch would not be enough—it would have to continue. "The category is so huge and the competition is so intense, you have to keep up heavy advertising," noted the former Taco Bell marketer.²⁹

²³ Maureen Morrison, "Taco Bell's Breakfast Endorser: Ronald McDonald," *Advertising Age*, March 27, 2014.

²⁴ Maureen Morrison, "Is Taco Bell Giving McDonald's a Run For Its Breakfast Money?" *Advertising Age*, July 23, 2014.

²⁵ Maureen Morrison, "In Breakfast Wars, Taco Bell's Bold Marketing Pays Off With Big Sales," *Advertising Age*, July 28, 2014.

²⁶ Jamie Weldon, in interview with the author, December 12, 2014.

²⁷ Maureen Morrison, "Taco Bell Breakfast Boosts Sales Somewhat, But Chicken Doritos Taco Disappoints," *Advertising Age*, July 17, 2014.

²⁸ Sharon McCarthy, in interview with the author, December 8, 2014.

²⁹ *Ibid.*

Taco Bell Breakfast

The new-products team at Taco Bell spent much of 2012 developing and testing a line of breakfast products that could be introduced as early as 2013. Development was not simple. The products had to be convenient to eat because people often ate breakfast on the go. They also had to be easy to prepare in a Taco Bell kitchen, as franchisees were unlikely to invest capital for a breakfast launch given the brand's history. As Brian Niccol explained, "We had to have a menu that consumers would love, would be a terrific value, and our team members could execute flawlessly every time."³⁰

Menu

The team developed several breakfast menu items, including the Waffle Taco, AM Crunchwrap, Cinnabon Delights, coffee, and others.

WAFFLE TACO

The Waffle Taco resembled a taco, but in place of a tortilla a waffle was folded around a filling of eggs and sausage or bacon, accompanied by syrup. It was priced at \$1.99. Although it was easy to pick up, it was a challenge to eat—as with all tacos, there was a risk the contents would slide out one end when biting the other end.

The Waffle Taco, like all of the breakfast menu items, featured rewarmed ingredients. The layout of a Taco Bell kitchen made it impossible to cook things like eggs and bacon; instead, they were prepared in a central location, frozen, sent to stores, and reheated prior to serving.

AM CRUNCHWRAP

The AM Crunchwrap was developed to be easy to pick up and eat. It consisted of eggs; steak, sausage, or bacon; hash browns; and cheese wrapped in a soft tortilla. It was priced at \$2.49.

CINNABON DELIGHTS

Taco Bell worked with Cinnabon, a leading maker of cinnamon rolls, to create Cinnabon Delights, miniature cinnamon rolls filled with cream cheese frosting. They were available in two-, four-, and six-pack sizes. The two-pack was \$1.00 and the four-pack was \$1.49.

COFFEE

The team decided to offer traditional coffee with the new breakfast menu items. Each restaurant already had an automated coffee machine that used pods to produce each cup of coffee, which was unremarkable but passable.

The Taco Bell team considered offering espresso-based drinks but was concerned that the equipment would be too much of an investment for franchisees. A commercial-grade espresso machine cost more than \$10,000 and each location would need two, in case one machine broke.

³⁰ Maureen Morrison, "Taco Bell President Dishes on Marijuana, 'Demolition Man' and Justin Bieber," *Advertising Age*, March 27, 2014.

Maintenance was another concern; according to one industry expert, “If you don’t clean it, it just stops working.”³¹

OTHER

The breakfast menu included other items, such as breakfast burritos and tacos (the AM Taco). Value meals would be offered at prices ranging from \$4.29 to \$5.40. A dollar menu included a Cinnabon Delights two-pack and an AM Taco.

Serving Hours

All restaurants would be encouraged to open at 7:00 a.m., three hours earlier than normal, and serve breakfast items until 11:00 a.m.

Consumer Tests

Results from consumer tests were generally positive. After trying a Waffle Taco, one taster said, “I wish I had invented this. I would have been a millionaire.” Another remarked, “If a meteor hit the earth, I think the AM Grilled Taco would be the only thing to survive.”³²

To be successful, Taco Bell needed to bring young men into its stores between 9:00 and 11:00 a.m. Consumers were unsure if this would work. As one Taco Bell fan posted on Reddit, “You do realize your primary consumer isn’t even out of bed and functioning until at least 12:30 in the afternoon, right?”³³

Launch Plan

The company’s marketing team developed an aggressive plan to support the launch of the breakfast line. The core of the plan was to attack McDonald’s and portray it as old-fashioned and out of touch with younger people. The plan carried some risk of competitive response from McDonald’s. There was also a question of tone; the spots would need to display the right attitude to avoid alienating consumers. To pay for the launch, Taco Bell would redirect all marketing support to the breakfast line for the first six weeks of the launch.

Financially, the breakfast menu would be profitable for a franchise with about \$70,000 in annual breakfast sales, or \$192 per day. This calculation factored in the cost of additional wages, inventory levels, and utility costs. The average store at the time had daily revenue of about \$3,560.³⁴

³¹ Jamie Weldon, in interview with the author, December 12, 2014.

³² Sean Ford, “Smart People Have a Stupid Focus Group About Taco Bell Breakfast,” *LA Weekly*, November 11, 2014.

³³ Vertigounconscious, comment on “I am Brian Niccol, President of Taco Bell. Today is the biggest launch in Taco Bell history as we bring breakfast to America. AMA!,” *Reddit*, March 27, 2014, http://www.reddit.com/t/IAmA/comments/21il1d/i_am_brian_niccol_president_of_taco_bell_today_is/cgddotk.

³⁴ “Taco Bell: Más Sales Driving Opportunities,” Bank of America Merrill Lynch Analyst Report, May 16, 2014, p. 1.

Choosing a Growth Strategy

Introducing a new flavor of Doritos Locos Tacos was a safe option, but Jason Bonnar wondered if it would generate incremental growth. On the other hand, breakfast was a compelling opportunity for Taco Bell. Bonnar debated the best approach.

Exhibit 1: Yum! Brands Financial Data (\$ in billions)

	2010	2011	2012
Company sales	9,783	10,893	11,833
Franchise fees	1,560	1,733	1,800
Total revenue	11,343	12,626	13,633
Operating profit	1,769	1,815	2,294
Net income	1,158	1,319	1,597
Total assets	8,316	8,834	9,013

Source: Yum! Brands 2013 10-K, pp.14 and 38.

Exhibit 2: Yum! Brands Store Ownership (# of stores)

	2010	2011	2012
Global			
Company	7,271	7,437	7,578
Franchise	26,219	26,928	29,349
Affiliates	525	587	660
Total	34,015	34,952	36,846
China			
Company	3,228	3,705	4,547
Franchise	153	201	519
Affiliates	525	587	660
Total	3,906	4,493	5,726
United States			
Company	2,484	2,139	1,588
Franchise	13,691	13,867	14,294
Affiliates	0	0	0
Total	16,175	16,006	16,027

Source: Yum! Brands 2013 10-K, p. 22 and Yum! Brands 2012 10-K, p. 22.

Note: Excludes licensed stores, which are located in non-traditional locations and have small revenues. Also excludes brands A&W and Long John Silver's, as both were spun off in 2010.