Case 2–1

Taco Bell Inc. (1983–1994)[1]

When John Martin, president and chief executive officer (CEO), joined Taco Bell in 1983, he found himself at the helm of a chain of Mexican fast-food restaurants with an appropriate logo—a man sleeping under a sombrero. Having made a career in the fast-food industry as president of La Petite Boulangerie, Hardee's Food Systems, and Burger Chef, Martin believed he could wake the man under the sombrero. The question remained, however, as to whether Martin could make him dance to parent PepsiCo's demanding beat. John Martin reflected on those early days:

> Our biggest problem was that we didn't know what we were. We thought maybe we were in the Mexican food business. . . . The reality was, we were in the fast-food business, and by not understanding who we were, who our potential customer was, we were just slightly missing the mark.

Company and Industry Background

The fast-food market, which had grown substantially during the 1960s and 1970s, was showing signs of maturing by the early 1980s. (See Exhibit 1 for statistics on the fast-food industry in the early 1980s.) Competition had become more intense as industry participants fought aggressively for every point of market share. In 1982, Taco Bell, a $700 million fast-food chain, had 1,489 restaurants, 60 percent of which were franchised units. The company had 40 percent of the Mexican fast-food market,[2] but a negligible market share of total fast food. Martin knew that if his company was going to compete with its much larger, more established rivals, he would have to make significant changes.

In the early 1980s, production at Taco Bell was labor-intensive and used low levels of technology. Suppliers delivered fresh, raw food to each restaurant several times a week. Managers and crew members used their time before opening and during lulls in demand to clean and prepare ingredients for menu items. Assembly occurred when customers ordered. Because corporate headquarters stressed food control and customer demand was difficult to predict, there were often shortages of prepared raw ingredients (chopped tomatoes, shredded lettuce, etc.), which resulted in significant delays for customers.

Cooking was also done on-site. Variations in who was cooking and the sometimes frenetic pace often led to inconsistent spicing and stirring. As a result, taste and food quality could vary dramatically even within an individual restaurant. Areas dedicated to food preparation and cooking took up about 70 percent of the floor plan in a typical Taco Bell restaurant. Even though 50 percent of some competitors' sales were delivered out of drive-through windows, Taco Bell had none in the early 1980s.

The food assembly line in the kitchen lay parallel to and directly behind the customer service

This case consolidates two previously published cases: Taco Bell Corp., developed by Professors Len Schlesinger and Roger Hallowell (HBS No. 692-058), and Taco Bell 1994, developed by Professor Len Schlesinger (HBS No. 694-076). This consolidation was prepared by Professors Dave Delong, Boston University, Lynda Applegate, and Len Schlesinger, Harvard Business School.

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Harvard Business School case 398-129.

[2]Richard Martin: "Martin Lifts Taco Bell to Trendsetter Status," *Nation's Restaurant News,* July 16, 1990.

EXHIBIT 1 Early 1980s Fast-Food Industry Statistics

ROI (store level)	18.7%
Operating margin (store level)	15.3%
Sales per dollar of capital cost	$1.14
Hamburger chain, average sales per store	$618,028
Chicken chain, average sales per store	$381,160
Mexican chain, average sales per store	$411,263
Sales growth, 1970–1980 compound annual	16.6%
Labor as a percent of sales (industry average)	21.9%
Food cost as a percent of sales (industry average)	37.2%
McDonald's advertising cost as a percent of sales	5%
Capital necessary to commence operations, McDonald's	$650,000
Capital necessary to commence operations, Kentucky Fried Chicken	$475,000

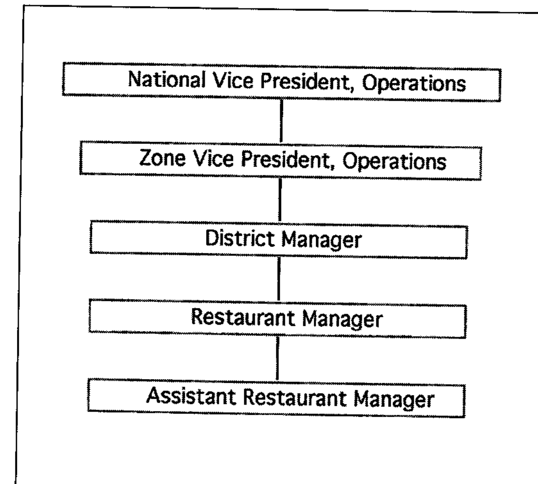
Source: Robert Emerson, *The New Economics of Fast Food* (New York: Van Nostrand Reinhold, 1990).

area. As customers waited to place their orders and receive their food, they watched the backsides of crew members as they frenetically assembled each order. One Taco Bell executive referred to this sight as "the good, the bad, and the ugly."

Cashiers took orders and wrote them manually on a plastic board. As the production crew read and filled the orders, cashiers erased existing orders before moving on to the next customer. The system resulted in frequent fulfillment errors.

Within the restaurants, restaurant managers (RMs), assistant restaurant managers (ARMs), and shift supervisors were directly involved with receiving fresh food shipments each week, overseeing food preparation throughout the day, ensuring customer service, overseeing clean-up, and lending a hand when necessary—particularly during meal-time rush hours. RMs also faced the time-consuming task of manually developing work crew schedules in a business with an annual turnover rate of 220 percent. Taco Bell's manual systems, which were also used for placing orders and performing other administrative tasks, led to significant oversights and errors, provided no data for management analysis, and forced employees to spend a great deal of time in repetitive, paper-intensive, non-value-added tasks.

EXHIBIT 2 Taco Bell Line Organization, 1983



RMs reported directly to district managers (DMs), who often played the role of a policeman, pointing out problems in restaurants and ensuring that corporate standards were maintained. (See Exhibit 2 for a summary of Taco Bell's line organization in 1983.) They regularly performed "white glove" inspections of the physical restaurants and audits of the financial books, often creating antagonistic relationships with their RMs, whom they spent almost no time coaching or developing.

1983–1988: Establishing Direction and Implementing Incremental Change

Starting in 1983, John Martin began a series of changes in the Taco Bell organization designed to alter the company's mind-set as well as its capabilities for pursuing a strategy to compete with the major fast-food chains. The first thing he did was to modernize Taco Bell's physical units. These changes included remodeling the restaurants, increasing seating capacity, adding drive-through windows, installing new signs, and outfitting employees in more contemporary uniforms. The company also added new menu items, including Nachos, Taco Salad, Mexican Pizza, Double Beef Burrito Supreme, Seafood Salad, and Soft-Shell Tacos.[3]

In addition, Martin accelerated the company's growth, averaging 249 new stores per year from 1983 to 1988, an increase from less than 100 units per year that had been added in the late 1970s. This expansion also extended Taco Bell's geographic presence into the Midwest, Southeast, and Northeast. In the process, the company replaced its old 1,600-square-foot mission-style restaurants with more modern 2,000-square-foot units.

During the same period, the parallel food assembly line was replaced by a double assembly line perpendicular to the customer service area. This improved product flow increased capacity and made serving easier in the drive-through windows that were being installed. The Plexiglass boards used for writing orders were also replaced by electronic point-of-sale systems (cash registers). These were tied to television monitors over the food assembly line, which indicated what had been ordered. The new electronic system allowed the company to track sales, product mix, and inventory much more closely.

[3]Sean Takahashi: "Taco Bell . . . ," *Orange County Register,* August 13, 1989. The first four products mentioned are trademarked products of Taco Bell Corp.

Training and development were also improved in the mid-1980s, although training for ARMs and RMs continued to reflect a human resource strategy predicated on very high turnover. Training for district managers, however, was not significantly changed. The head of operations training provided this overview:

> As to training, we were definitely a procedures, policies, and practices organization. We made sure each manager knew how to make every product, knew the appropriate weights for every product—by "knew" I mean had memorized. We were very operationally driven . . . there was a little work on staffing, but only at the crew level, dealing primarily with crew entry and exit.

1988–1991: Transforming the Business

The Mexican segment of upscale restaurants, fast-food, and supermarket food sales grew substantially during the 1980s. In the ongoing battle for market share in the maturing fast-food industry, Taco Bell and its competitors began to introduce new products to attract customers. Some incremental business was generated by this strategy, but the new products also had a negative effect on kitchen efficiency, which influenced both costs and quality of service. The introduction of fajitas, for example, required new grills and exhaust systems that cost Taco Bell $30 million. Reflecting on Taco Bell's market position in 1988,[4] Martin said:

[4]During the 1980s, industry labor costs as a percentage of sales grew on average by 18 percent, but at Taco Bell those costs increased 50 percent, in part because of the ongoing high costs of turnover. And with real estate prices and construction costs outstripping the rate of inflation, the industry's average cost to develop a restaurant site increased by almost 8 percent. Finally, food costs declined by an industry average of 15 percent during this period, but Taco Bell's costs actually increased slightly from 27 percent to 30 percent.

We were really a small player. One of the things that struck us was, perhaps we needed to figure out a different way to go about this—as opposed to trying to compete head-on with the big guys who had well-established, entrenched brands. Maybe instead of directly competing, maybe we ought to try to change the game a little bit . . . . We're really not in the business of making food. We're in the business of feeding people.

Changing the Rules of the Game

Recognizing the industry's margin squeeze, Martin developed a new, more holistic business strategy focused on customer value. As part of the process of determining how to define value, in 1987, Martin commissioned a study to better understand what Taco Bell's best customers wanted from a fast-food restaurant. This was followed by another study in early 1989. The result of these two studies confirmed what Martin suspected from his years in the fast-food industry. Customers said they wanted **FACT:** fast food **Fast;** fast-food orders **Accurate;**[5] fast-food served in a restaurant that was **Clean;** and fast-food at the appropriate **Temperature.**[6] FACT clarified that at Taco Bell a commitment to customer value required a fundamental change in management thinking; the organization needed to stop viewing quality and price as incompatible trade-offs.

Armed with this information and in an effort to begin "changing the rules of the game," in early 1988 Taco Bell adopted a strategy of value pricing (see Exhibit 3), fully recognizing that if the company was to dramatically lower prices while preserving quality, it would also have to dramatically reduce costs. To achieve these seemingly incompatible goals, Martin realized that incremental change would not work; a radical redefinition of the business was needed.

[5]Taco Bell estimated that 60 percent of orders delivered in the fast-food industry (including at its chain) were delivered incorrectly.
[6]Hot food hot, cold food cold.

EXHIBIT 3 Taco Bell Menu Selections: Price Comparisons

	1983	1988	1991
Taco	$0.67	$0.79	$0.59
Burrito Supreme	1.32	1.65	1.49
Pintos and cheese	0.59	0.79	0.59
Tostada	0.63	0.79	0.59
Pepsi (largest)	0.79	0.99	0.99

Note that the largest Pepsi increased in size during the late 1980s.

K-Minus and SOS

One of the most far-reaching changes implemented at Taco Bell during the late 1980s was an initiative called K-Minus. With K-Minus (standing for "kitchen minus"), the restaurant kitchen became a heating and assembly unit. Virtually all chopping, cooking, and associated clean-up were transferred to corporate headquarters. Ground beef, chicken, and beans all arrived at the restaurant precooked in plastic bags ready to be heated and served. Other food products, such as lettuce, tortillas, and even guacamole, also arrived prepared, packaged, and ready for use in assembling menu items. With this bold move, Taco Bell inverted the space configuration of its typical restaurant from a 70 percent kitchen/30 percent customer service ratio to 30 percent kitchen/70 percent customer service. In addition to enabling dramatic improvements in efficiency and much tighter control of the quality and consistency of its food, K-Minus greatly expanded seating capacity within the restaurants and provided space to expand drive-through and other non-eat-in sales. A decrease in real estate expenses in proportion to sales and in aggregate labor costs resulted.

To meet customers' demand for speed and quality, Taco Bell also instituted its Speed of Service (SOS) program. This initiative redesigned processes still further and developed specific measures of performance. Recipes were reformulated, and heated holding areas were developed. By 1990 Taco Bell restaurants could preassemble and hold 60 percent of their most popular menu items ready for immediate sale for up to 10 minutes. These additional changes increased peak hour transaction capacity by 54 percent and reduced customer waiting times by 71 percent.

The Changing Role of the Restaurant Manager

While it was reconfiguring operations to cut costs and increase speed of delivery, Taco Bell also transformed the roles of its managers. A key point person in implementing the strategy was the restaurant manager; this position was recast as restaurant general manager (RGM). Employees occupying this new role were expected to take on more decision-making responsibility and accountability for their restaurant, developing staff, and managing P&L (profit and loss). John Martin explained:

> The new role of the RGM was born in the notion of self-sufficiency. Restaurants can, in fact, operate by themselves. The bottom line is there's no rocket science in a fast-food restaurant. . . . The difficulty is that you have 1,500 things all going on at once. . . . The typical top-down command and control can't deal with those things under any circumstances.

Taco Bell's senior vice president of human resources offered another view of the role changes:

> At the time we designed the new Taco Bell, in late 1989, we realized that we'd need a whole new people system. We were going to be asking people to do new things, and we realized that we'd need new training, both in content and in delivery. How we paid people would have to be different, and how we managed people would have to change. We'd go to more management by exception, more coaching, broadening spans, taking out layers. Communication would have to improve. The culture would have to change.
>
> There was a two- to three-year time frame in which we significantly raised the bench on RGM skills. We went through an analysis of the caliber of the original RGMs, . . . and we determined that about one-third of our RGMs could grab the spirit of what we were trying to do at the restaurant level. Another third, with development and coaching, could achieve the stated standard of performance. We thought that one-third could not make the mark.

To fill the new RGM role, Taco Bell began looking for people with skills and potential different from those needed for the old restaurant manager's role. After a brief interview, an RGM candidate took a life-themes indicator test to identify the presence of traits necessary in RGMs. Individuals who were hired began a training program, which under the new strategy focused heavily on leadership and operating management skills. RGMs received training in operational policies and procedures and five days of leadership training that covered topics such as situational leadership, coaching, managing conflict, restaurant communication systems, creative problem solving and decision making, and implementing change.

Transforming the District Manager's Role

District managers' role at Taco Bell also changed under the new strategy. With a new title of "marketing managers," by 1990, their span of control had increased from 6 restaurants to 12. Despite the greatly increased responsibilities, some marketing managers tried to retain their traditional "policeman approach" in dealing with RGMs. By 1991, however, the span of control for marketing managers was expanded to 20 restaurants, and they were virtually forced to begin managing by exception and to change from policeman to coach.

Many of the former district managers could not make the transition. To fill the vacancies, Taco Bell took the radical step of looking for talent outside the fast-food industry. It began recruiting sales and product managers with Fortune 500 company experience and began to hire graduates from the top MBA programs in the country. Convinced it could teach these new