

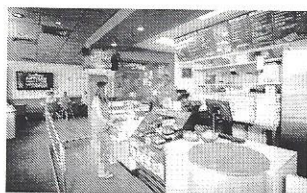
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NATION'S Restaurant News

QSRs adopt fast-casual traits to compete

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McDonald's, Pizza Hut, Domino's Pizza and KFC are evolving elements of their service to defend market share.

Some of the country's largest quick-service brands are responding to growing competition from fast-casual upstarts by evolving elements of their service to defend their market share.

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Whether it's more customization at McDonald's, upgraded prototypes at Pizza Hut and Domino's Pizza, or a newly imagined "innovation restaurant" at KFC, quick-service brands are showing a greater openness to adopting the fast-casual segment's service attributes, rather than copy menu items or migrate their price points.

"Those four brands, or any quick-service brand really, would all love to have the demographics of the fast-casual customer," said John Gordon, principal of San Diego-based Pacific Management Consulting Group. "They tend to be higher-income, dine out more,

and be more social and food-oriented."

While integrating fast-casual service methods into quick-service chains' existing setups could successfully make those brands more relevant to fast-casual consumers, a brand must figure out how feasible it is for its likely heavily franchised system, he noted.

"Is this a fix for the entire system, or an application only for certain units or areas?" Gordon asked. "What's the end game?"

In this era when fast-casual brands can pop up, out-innovate older restaurants and take a significant share of quick-service customers, quick-service chains must be willing to test new things and to adjust plans quickly if they fail, said Dennis Lombardi of Columbus, Ohio-based WD Partners.

"I've never ever to my knowledge knocked a brand for experimenting," he said.

McDonald's: Enabling customization

(Continued from page 1)

While McDonald's reportedly began testing build-your-own burgers last fall in Orange County, Calif., the brand with more than 14,000 U.S. locations spent much of last week's earnings call talking about customization on a systemwide scale.



During the Oak Brook, Ill.-based chain's fourth-quarter earnings call, chief executive Don Thompson said McDonald's would make a more concerted effort to market the customization it already allows in preparation for the completed rollout of new kitchen equipment this spring designed to increase customization without hurting speed of service.

"Customers don't realize to the greatest extent that at McDonald's we are making that sandwich, preparing that in the back-of-the-house after you place that order," Thompson said. "What does this mean? It means that ... awareness the customers have about who we really are as McDonald's and what we are able to deliver in that kitchen, which is a customized sandwich, [is lacking.]"

When a securities analyst questioned how more customization would not slow down operations, McDonald's chief operating officer Tim Fenton responded that crew members would not have to run around each other in the back-of-the-house to restock prep tables and could stay in place to assemble sandwiches.

"Again," Fenton added, "we are monitoring the pace and the rate of new products that we bring and giving our crews and management ample time to train and get used to [them] before we switch it up and change it on them."

Industry watcher Gordon said McDonald's was right to focus on back-of-the-house operations, which should yield burgers that hold up to quality standards being set at fast-casual rivals.

"Maybe McDonald's service times were conflicting with the promise of what a 'better burger' is supposed to be," he said.

Pizza Hut: Building on-the-go options

(Continued from page 2)

The country's largest pizza chain, Pizza Hut, announced Jan. 14 the opening of a company-owned restaurant in Pawtucket, R.I., and a franchised location in York, Neb., that includes a fast-casual-like "bar" to offer pizza by the slice.



The Nebraska location is a larger prototype, seating 80 people and offering a made-to-order salad bar and sautéed pastas, while the Rhode Island restaurant is what spokesman Doug Terfehr called "Del-Co Plus," meaning the by-the-slice feature is an add-on to a prototype mostly configured for delivery and carryout. The latter unit still has seating for about 30 people.

While fast-casual competitors are looking to take market share in pizza's lunch daypart with faster service times, Terfehr said Pizza Hut's initiatives are less a response to those brands than to the demands of Pizza Hut customers.

"We pay attention to our consumer trends, one of which is them seeking a quick on-the-go option, and one of our solutions for that is pizza by the slice," Terfehr said.

Lombardi of WD Partners remarked that Pizza Hut "absolutely needed" to test its new service styles, lest it get caught flat-footed like some of the quick-service burger chains have.

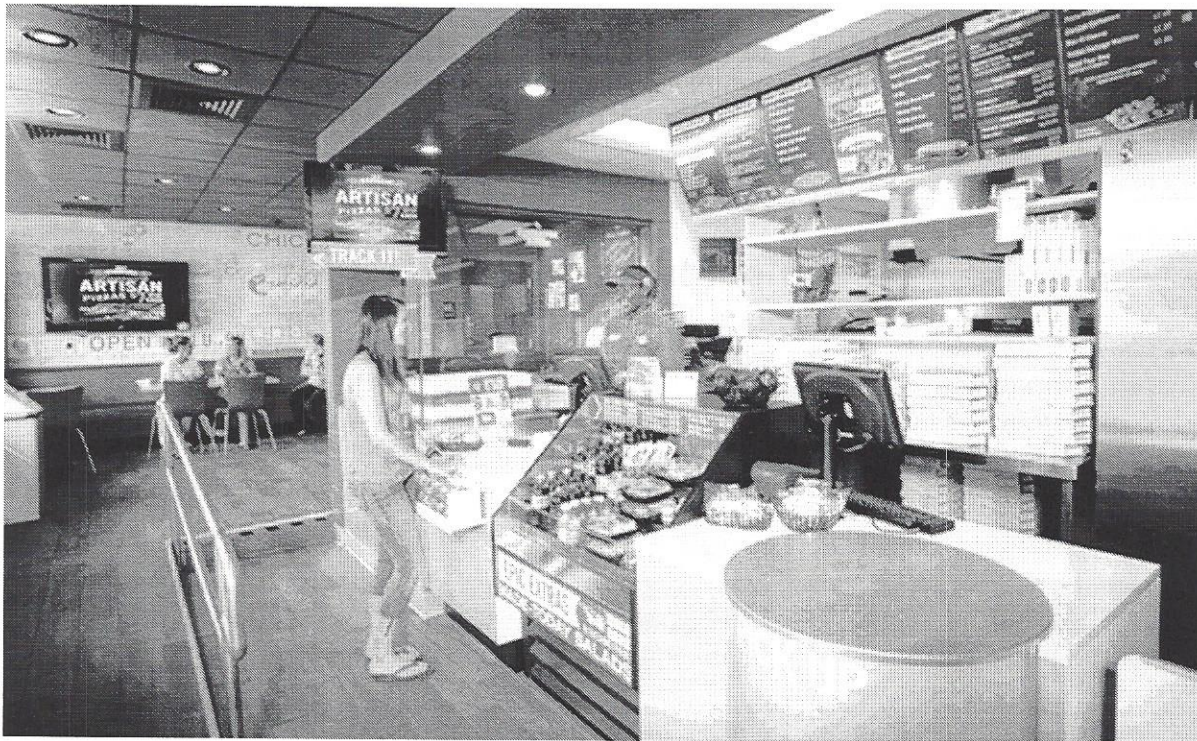
“That whole fast-casual pizza segment is looking exactly like ‘better burger’ looked five years ago,” he said. “There are an amazing number of brands opening up in a short time period. Pizza Hut would be remiss not to look into it.”

Plano, Texas-based Pizza Hut has more than 7,750 domestic locations.

Domino's Pizza: Getting the right look

(Continued from page 3)

Ann Arbor, Mich.-based Domino's Pizza already had looked into a more fast-casual-like restaurant design, having debuted its first “pizza theater” prototype in August 2012. But the brand revealed earlier this month that it would remodel all of its nearly 5,000 domestic units to the design by the end of 2017.



Officials have said repeatedly that, while the prototype does have more seating, the “pizza theater” design is not about increasing dine-in sales but rather letting the “theater” aspect reinforce the chain’s branding efforts around a pizza higher in quality than its previous incarnation.

Remodeled units will have better sight lines into more modern-looking dining rooms, which in turn will have more visibility of the make line where pizza dough is stretched and fresh toppings are added.

Chief executive Patrick Doyle conceded to securities analysts attending Domino’s Investor Day event that fast-casual pizza brands are pitching themselves as offering better-quality food, modern restaurant designs, convenience and relative value.

“The most important definition of fast casual ... to my mind, is giving consumers what they want today, versus what you built your business around 25 years ago,” he said. “There was one thing that wasn’t completed yet for Domino’s, which is that you’ve got to have a better-looking restaurant.”

Industry consultant Gordon agreed that it would be helpful to Domino’s to migrate away from how it was founded and grown under Tom Monaghan, “which is get a cheap storefront and deliver a ton of pizza.”

“The United States is so diverse that you need to have both kinds of restaurant — a delivery store and one more inviting to diners,” Gordon said. “It’s a way to change existing perceptions and to generate other incremental dayparts. Domino’s did a nice job rolling out sandwiches, but pizza is still skewed heavily toward the evening, and it’s very hard to make it on just one daypart.”

KFC: Creating innovation hubs

(Continued from page 4)

Last July, KFC opened a fast-casual version called “KFC eleven” in its headquarters city of Louisville, Ky. The prototype featured different applications for its Original Recipe Boneless chicken, such as flatbreads, salads, sandwiches and wraps, and customers walked a line to watch crew members customize each meal.



At the time of the opening, senior manager of concept development David Menis said the design of KFC eleven was meant to “enable us to meet changing consumer needs,” rather than respond to any sort of fast-casual competitor.

In December, Louisville Business First reported that KFC eleven would open a second location this year in Louisville. That same month, the brand opened a similar prototype in Toronto, called KFC Select.

Like Domino's, KFC deals mostly with a signature item — a bucket of fried chicken — that skews heavily toward the dinner daypart, making it hard to produce enough cash flow to develop other dayparts, like breakfast and lunch, where Chick-fil-A and Popeyes have been successful, Gordon said.

KFC officials said last summer at the opening of the first KFC eleven that the fast-casual prototype was not the next fast-paced growth vehicle, but rather an “innovation restaurant” where the chain could test new service styles and menu items, possibly for wider adoption into the current system of more than 4,500 KFCs in the United States.

“While there certainly could be a market for KFC’s fast-casual version, generally because of its locations and its current customer base, this probably is not a vehicle for replacing the system,” Gordon said. “But this could have potential for new growth.”

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