

# Yum's new menu items spur optimism

By *marcella.veneziale*

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While the economies of its international growth markets, especially China, may be slowing down, Yum! Brands Inc. is going to market in the United States with new-product news that may bolster the domestic portions of its earnings, which the company will report next Wednesday.

During the past several weeks, the company's three brands — KFC, Taco Bell and Pizza Hut — have each rolled out new products that star in comprehensive marketing campaigns. The wave of menu innovation comes at a time when economists fear international markets, which generate 65 percent of Yum's operating profit, could falter from recently reliable and robust growth.

China, Yum's key market, could be a particular concern. [An Associated Press story reported Thursday](#) that the country's economy might only grow an expected 7.3 percent. While it would be an enviable figure for the United States economy, a growth rate below 8 percent would mark one of the lowest quarterly expansions in several years and signal weakening demand and consumer confidence.

Austerity measures, a possible banking crisis and depressed consumer confidence also could hamper Yum's outlook in its Yum Restaurants International division.

If Yum were to look to the United States to make up some of the sales slack, recent performance and new products could be reason for optimism. After same-store sales for its domestic system fell 1 percent for fiscal 2011, they rebounded with a 5-percent increase in the first quarter of 2012.

John Gordon, principal of San Diego-based Pacific Management Consulting Group, an analysis and advisory firm focused on restaurant chains, said Yum should be able to win back sales and trial with its new offerings, provided the company makes up for lost time in the United States and stays aggressive in its advertising.

"I don't understand why their new-product development has been so slow in the United States," he noted. "This business is fundamentally driven by new-product news. ... I'm impressed they have this new news rolling ahead, but they've got to sustain that and have to support it with good media. You need to bang on that drum for at least a year to get people's involvement with the products up."

Take a look at some the most recent menu rollouts from KFC, Taco Bell and Pizza Hut, as well as analysis of how the offerings could affect Yum's performance.

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## KFC: Original Recipe Bites

This week, KFC introduced Original Recipe Bites, a more portable, bite-size version of its chicken prepared with the same 11 herbs and spices of its original recipe. The item is available a la carte or in combo meals with either six or 10 pieces.



KFC added Original Recipe Bites to its menu this week.

The chain faces competition for chicken items at snack time not only from Chick-fil-A and Popeyes, but also from McDonald's and Burger King, which currently are selling a Spicy McBites popcorn chicken item and Chicken Strips as part of a new menu, respectively. Gordon noted that the bite-size snack might be a defensive or reactionary play given that landscape, but the item leverages the strength of KFC's recipe and still is on trend with how customers snack today. "I think the bites could be a nice transition point so that KFC takes some of the focus off of big chicken-on-the-bone items and can broaden its appeal," he said. "They have to be a little careful with a combo at an introductory price of \$3.99 because that begins to set expectations with what it should be priced at going forward."

One concern Gordon has — and which he said a friend who manages 45 franchised KFC locations shares — is that KFC did not include a large option for the Original Recipe Bites that could compete with a 20-piece order of McDonald's Chicken McNuggets.

"Why wouldn't they have a 20-piece or larger order?" Gordon said. "This is something KFC could have done ages ago, so why did this take so long? Why wasn't there a larger portion size sold in order to complement the larger purchases for families or groups that KFC was intended for?"

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## Pizza Hut: P'zolo and \$10 Dinner Box

Yum's Pizza Hut brand has been extremely prolific the past 12 months with new products, either in the form of a new bundle like the \$10 Dinner Box or [a new item like the P'zolo](#), a sandwich platform similar to its P'zone calzones.



Pizza Hut took aim at sandwich chains with its P'zolo.

Initial consumer response to advertising for the P'zolo has been favorable, according to [data from marketing research firm Ace Metrix](#). The ad for the sandwich not only garnered a high score for its effectiveness and persuasiveness, but it also positioned the P'zolo well against Subway's sandwiches. Ace Metrix executive vice president Jonathan Symonds said that consumers' comments on the ad mentioned Subway three percent of the time, a significant amount given that Pizza Hut did not name the rival for its new sandwich platform. Gordon said the P'zolo "looks like a great product" and is an effective way to use the restaurants' resources

during lunch hours when the units are open and have staff waiting to be utilized.

"The advertising was extremely well done, and I'm sure they'll get some trial," he said. "But it might not be so much to move the needle a tremendous amount. They may get more incremental traffic for a \$5 sandwich versus a \$10 pizza, so traffic could go up a little and the check could go down a little."

However, while the P'zolo is a nice daypart extension and the \$10 Dinner Box can get some incremental traffic from the family portion of the customer base, "the customer would perceive a new pizza as more interesting and relevant," Gordon said. "If we're looking at different products for Pizza Hut, the P'zolo is something they should have done sooner and the \$10 Dinner Box is interesting, but I would rate them fairly low among transformational traffic drivers," he said.

Among Gordon's consulting clients is a large group of Domino's franchisees, he disclosed.

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## Taco Bell: Cantina Bell menu and Doritos Locos Tacos

Gordon and the investment community are most bullish on Taco Bell's prospects for a sales turnaround based on the strength of the recently introduced [Cantina Bell menu](#) and the [Doritos Locos Tacos](#), which debuted back in March.

In a research note, Mark Kalinowski of Janney Capital Markets projects Taco Bell's same-store sales in the United States to be above 11 percent when Yum reports

second-quarter earnings next week.

[Taco Bell chief executive Greg Creed](#) [said](#) during an investor presentation in

May that Doritos Locos Tacos in particular were a transformative product, as the chain sold 100 million of the item during its first 10 weeks in the system. Creed also noted that 90 million of those transactions were incremental.

While Gordon is skeptical of the 90 million incremental-transaction figure without seeing data for point-of-sale and customer intercepts, he nonetheless expects a big quarter from Taco Bell based on menu innovation.

"The average check component will be up more, and they're definitely going to have more traffic and visibility with all



Taco Bell tapped celebrity chef Lorena Garcia to develop its Cantina Bell menu, which features burritos and bowls.

the marketing they're doing," he said.

Taco Bell officials said the Doritos Locos Tacos line would be ripe for future extensions, including a Cool Ranch flavor before year-end. As for the Cantina Bell menu, with a burrito or bowl made with higher-quality ingredients developed by celebrity chef Lorena Garcia, Gordon speculated that the effects may not last as long. "Cantina Bell can't possibly hurt the business, but it's folly to assume that Taco Bell would be competing any way with Chipotle or any of the fast-casual concepts," he said. "It's a completely different market and purchase occasion. I think they will have some trade-up from existing customers, and they'll get some trial, but I see this more as a short-term benefit rather than repositioning the entire brand."

Louisville, Ky.-based Yum operates or franchises more than 37,000 restaurants worldwide.

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Contact Mark Brandau at [mark.brandau@penton.com](mailto:mark.brandau@penton.com).

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