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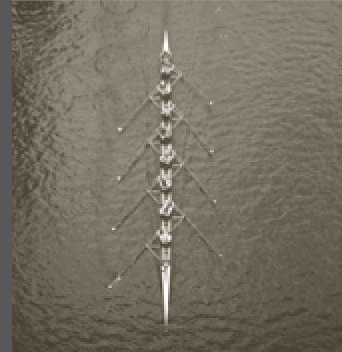
case 14

Outback Steakhouse: Going International*



By 1995, Outback Steakhouse was one of the fastest growing and most acclaimed restaurant chains in North America. Astute positioning within the intensely-competitive US restaurant business, high quality of food and service, and a relaxed ambiance that echoed its Australian theme propelled the chain's spectacular growth (see table 14.1).

Chairman and co-founder Chris Sullivan believed that at the current rate of growth (around 70 new restaurants each year), Outback would be facing market saturation within five years. Outback's growth opportunities were either to diversify into alternative restaurant concepts (it had already started its Carrabba's Italian Grill restaurants) or to expand internationally:

> *We can do 500–600 [Outback] restaurants, and possibly more over the next five years . . . [however] the world is becoming one big market, and we want to be in place so we don't miss that opportunity. There are some problems, some challenges with it, but at this point there have been some casual restaurant chains that have gone [outside the United States] and their average unit sales are way, way above the sales level they enjoyed in the United States. So the potential is there. Obviously, there are some distribution issues to work out, things like that, but we are real excited about the future internationally. That will give us some potential outside the United States to continue to grow as well.*

In late 1994, Hugh Connerty was appointed President of Outback International to lead the company's overseas expansion. Connerty had considerable experience in the restaurant business and had been Outback's most successful

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TABLE 14.1 Outback Steakhouses Inc.: growth and profitability, 1990–5

	Revenue ($m)	Net income ($m)	Return on average equity (%)	Company-owned restaurants	Franchised and JV restaurants	Total restaurants
1990	34	2.3	41.2	23	0	23
1991	91	6.1	34.4	49	0	49
1992	189	14.8	23.6	81	4	85
1993	310	25.2	22.2	124	24	148
1994	516	43.4	27.4	164	50	214
1995	734	61.3	27.0	262	58	320[a]

[a] Of these, 297 were Outback Steakhouses and 23 were Carrabba's Italian Grills.

franchisee, developing a number of Outback restaurants in northern Florida and southern Georgia. Connerty grasped the opportunity enthusiastically:

> *We have had hundreds of franchise requests from all over the world. [So] it took about two seconds for me to make that decision [to become President of Outback International] . . . I've met with and talked to other executives who have international divisions. All of them have the same story. At some point in time a light goes on and they say, "Gee we have a great product. Where do we start?" I have traveled quite a bit on holiday. The world is not as big as you think it is. Most companies who have gone global have not used any set strategy.*

Connerty's challenges were to decide in which countries to locate; whether to franchise, directly manage, or joint venture; how the Outback restaurant concepts should be adapted to overseas markets; and what pace of expansion to target.

Outback's Strategy

Outback was founded by Chris Sullivan, Bob Basham, and Tim Gannon. The three had met as management trainees at the Steak and Ale restaurant chain. Although red meat consumption was declining, they believed that this was primarily the result of less meat being consumed at home: steakhouses remained extremely popular. They saw an untapped opportunity for serving quality steaks at an affordable price – filling the gap between high-priced and budget steakhouses. Using an Australian theme associated with the outdoors and adventure, Outback positioned itself as a place providing not only excellent food but also a cheerful, fun, and comfortable experience. The company's explained its strategy as follows:

The Company believes that it differentiates its Outback Steakhouse restaurants by:

- *emphasizing consistently high-quality ingredients and preparation of a limited number of menu items that appeal to a broad array of tastes;*
- *featuring generous portions at moderate prices;*

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- *attracting a diverse mix of customers through a casual dining atmosphere emphasizing highly attentive service;*
- *hiring and retaining experienced restaurant management by providing general managers the opportunity to purchase a 10% interest in the restaurants they manage; and*
- *limiting service to dinner (generally from 4:30 p.m. to 11:00 p.m.), which reduces the hours of restaurant management and employees.*[1]

Quality of food was central to the chain's differentiation. This began with the raw materials. Outback viewed suppliers as "partners" and was committed to work with them to ensure quality and develop long-term relationships. Outback's food costs were among the highest in the industry – not just in terms of ingredients but also in preparation, with most items prepared from scratch within each restaurant. For example, Outback's croutons were made daily on site with 17 different seasonings, and cut into irregular shapes to indicate that they were handmade.

The emphasis on quality extended to service. Among Outback's "Principles and Beliefs" was "No rules, just right" – employees will do whatever is needed to meet the needs and preferences of customers.

Inevitably, this emphasis on quality and service meant working practices that at other restaurant chains would be regarded as inefficient. Chairman Chris Sullivan explained that Outback had a different management model:

> *There are three kinds of turnover in the restaurant business – customer, employee and table. Most restaurant chains worry about the first, resign themselves to the second, and encourage the third. At Outback it's not as straightforward as that; we believe that all three are integrally related. Specifically, our management model and approach reflect the importance we place on fighting employee turnover. One of our catchphrases is "fully staffed, fully trained." You can't be either of those things if a restaurant is a revolving door. Besides, customers like to see a familiar face.*
>
> *Restaurant work can be stressful. The better the staffers, the more intent they will be on doing things right – and the more frustrated they will become with the facilities and tools they've been given if they get in the way, whether the problem is dull knives or not enough burners . . . Bob Basham insisted on making all of our kitchens at least 2,500 square feet and keeping lots of cool air flowing through them. The kitchens occupy half of the typical Outback restaurant's floor plan – space that other restaurants allocate to revenue-producing tables. But we wanted to offer a bigger menu than the typical casual restaurant did in the 1980s, so we knew we would have to give the cooks and prep people the space to pull it off.*
>
> *Likewise, we never assign our servers to cover more than three tables; the industry standard is five or six . . . A wide range of customers choose to dine with us on a variety of occasions . . . It has to be the customer who sets the pace for the meal, not the server or the kitchen staff. But for that to happen our servers need time to figure out the mood and expectations of a given table on a given evening, and the kitchen has to be well enough staffed and equipped to turn around orders without delay . . .*
>
> *We think that employees who are not overstressed stay in their jobs longer than those who are; that employees who stay have time to master their jobs, become familiar with their regular customers' preferences, and learn to operate as teams;*

that the combination of mastery, memory, and calm is more likely to afford customers themselves a relaxing, enjoyable experience; and that diners who are not hustled through their meals are more likely to come back. In short, low employee turnover leads to well-paced table turnover, which ultimately leads to low customer turnover.[2]

This model linked closely with two other distinctive features of Outback's strategy. First, Outback served only dinner. According to Sullivan, the conventional wisdom that restaurants needed to be open for lunch and dinner in order to make efficient use of capital ignored the hidden costs of longer hours of opening. These included the costs associated with extra hiring and employee turnover, the disruptive effects of shift changes, and the fact that employees who worked lunchtime would be tired in the evening – the time when they needed to be at their freshest. Similarly for the food, with preparation of food brought forward to the morning, it would lose its freshness by the evening.

Second, Outback located in residential areas rather than downtown. This reinforced the merits of evening-only opening, kept rents low, and encouraged customer and employee loyalty. As Sullivan explained: "The suburbs are our outback."

Outback's management and ownership structure was also unusual. Each of Outback's directly owned restaurants was a separate partnership where Outback Steakhouse Inc. was the general partner with an ownership of between 71% and 90%. Each restaurant was headed by a "managing partner" while between 10 and 20 restaurants within an area were overseen by a regional manager who is called a "joint venture partner" or "JVP." Sullivan explained the relationship as follows:

The terms "managing partner" and "joint venture partner" aren't symptoms of title inflation. They straightforwardly describe people's roles and relationships to the organization. All managing partners, most of whom start as hourly employees, must invest $25,000 of their own money – not because Outback needs the capital, but because their financial contributions make them committed investors in the business they'll be running. They must also sign a five-year contract, and they are granted roughly 1,000 shares of restricted stock, which vest only at the end of their contracts. In return, managing partners can keep 10% of the cash flow their restaurants generate each year. The idea is to ensure that at the end of five years each of them will have stock worth around $100,000 . . . At the end of five years, successful managers are encouraged to sign up with the same restaurant or to manage a different one . . .

Outback's JVPs, who number around 60, must invest $50,000, which entitles them to 10% of cash flow of all the restaurants they oversee after the partners have received their 10%. Whereas the managing partners focus on operations and community relations, the Japes focus on monitoring performance, finding and developing new locations, and identifying and developing new managers, managing partners, and Japes like themselves. The Japes are the only management layer between the six operations executives at headquarters and the managing partners at the individual restaurants.[3]

Initially, Outback intended its restaurants all to be directly owned and managed. However, in 1990, requests for franchising led to Outback agreeing to franchise to well-known acquaintances of the founders. Outback was very careful in its choice of franchisees to ensure that all were fully committed to Outback's principles and beliefs.

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Management of hourly employees was very different from most other restaurant chains. One executive described Outback's approach as: "Tough on results, but kind with people." Employee selection was rigorous and included aptitude tests, psychological profiles, and interviews with at least two managers. The goal was to create an entrepreneurial climate that emphasized learning and personal growth. All employees were eligible for the company's stock ownership plan and health insurance was made available to all employees.

Part of the culture of "no rules" and commitment to quality and service is a constant drive for innovation and improvement:

> *Almost all our innovations bubble up from the individual restaurant, often originating with our servers or kitchen staffers. They'll suggest an idea to the restaurant manager who will try it on an experimental basis. If the recommended menu or process change clicks, the managing partner communicates the idea to his or her JVP. . . . If the suggested change meets company standards, videos and other materials showing how to implement it are distributed to other JVPs. Each is free to take it or not.*[4]

During 1993, Outback formed a joint venture with Houston-based Carrabba's Italian Grill. In January 1995, Outback acquired the rights to develop Carrabba's nationally. Carrabba's Grills were run with almost identical operating and management practices and ownership structure as Outback Steakhouses.

Preparing for International Expansion

Hugh Connerty, Outback's head of International outlined his approach to international expansion as follows:

> *We have built Outback one restaurant at a time . . . There are some principles and beliefs we live by. It almost sounds cultish. We want International to be an opportunity for our suppliers. We feel strongly about the relationships with our suppliers. We have never changed suppliers. We have an undying commitment to them and in exchange we want them to have an undying commitment to us. They have to prove they can build plants [abroad].*
>
> *I think it would be foolish of us to think that we are going to go around the world buying property and understanding the laws in every country, the culture in every single country. So the approach that we are going to take is that we will franchise the international operation with company-owned stores here and franchises there so that will allow us to focus on what I believe is our pure strength, a support operation.*

Connerty believed that his experience in developing Outback franchises in the US would provide the guidelines for overseas expansion:

> *Every one of the franchisees lives in their areas. I lived in the area I franchised. I had relationships that helped with getting permits. That isn't any different than the rest of the world. The loyalties of individuals that live in their respective areas [will be important]. We will do the franchises one by one. The biggest decision we have to make is how we pick that franchise partner. That is what we will concentrate on. We are going to select a person who has synergy with us, who thinks like us, who believes in the principles and beliefs.*

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Trust is foremost and sacred. The trust between [Outback] and the individual franchisees is not to be violated. The company grants franchises one at a time. It takes a lot of trust to invest millions of dollars without any assurance that you will be able to build another one.

As for the geographical pattern of expansion, Connerty's initial thoughts were to begin close to home then tackle Latin America and the Far East:

The first year will be Canada. Then we'll go to Hawaii. Then we'll go to South America and then develop our relationships in the Far East, Korea, Japan . . . the Orient. The second year we'll begin a relationship in Great Britain and from there a natural progression throughout Europe. But we view it as a very long-term project. I have learned that people [in other countries] think very different than Americans.

Overseas Expansion by US Restaurant Chains

The international market offered substantial growth opportunities for US restaurant chains. For fast-food franchise chains – notably McDonald's, Burger King, and Kentucky Fried Chicken – international sales accounted for up to one-half of total sales, although for many "international" was limited to Canada and Puerto Rico. Among "casual dining" chains – such as Denny's, Applebee's, T. G. I. Friday's, and Tony Roma's – relatively few had ventured beyond North America. Table 14.2 shows the international presence of leading US restaurant franchise chains.

The attraction of overseas markets was that their restaurants markets were typically less saturated than those of the US and most of the local competition was independent, family owned restaurants rather than large chains. In overseas markets it was anticipated that market trends would follow those of the US: in particular, that greater affluence and a declining role of family life would result in increased eating away from home.

However, it was noticeable that the greatest overseas success had been achieved by fast food chains. In the casual dining sector, few companies had ventured beyond

TABLE 14.2 The ten largest US restaurant franchise chains, 1994

	Total sales ($m)	International sales ($m)	Total outlets	International outlets
McDonald's	25,986	11,046	15,205	5,461
Burger King	7,500	1,400	7,684	1,357
KFC	7,100	3,600	9,407	4,258
Taco Bell	4,290	130	5,614	162
Wendy's	4,277	390	4,411	413
Hardee's	3,491	63	3,516	72
Dairy Queen	3,170	300	3,516	628
Domino's	2,500	415	5,079	840
Subway	2,500	265	179	8,450
Little Caesars	2,000	70	4,855	155

SOURCE: "TOP 50 FRANCHISES," *RESTAURANT BUSINESS*, NOVEMBER 1, 1995, PP. 35–41.

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North America. It was also notable that several of the leaders in international expansion were subsidiaries of large multinationals with many decades of international experience. For example, KFC, Taco Bell, and Pizza Hut were subsidiaries of PepsiCo.; Burger King was a subsidiary of British conglomerate Grand Metropolitan.

A further impetus to overseas expansion was maturing of the US market. By 1994 there were over 3,000 franchisers in the United States, operating close to 600,000 franchised outlets. Not only was competition intense, but growth was slowing. Sales per store were growing at 3% during the early 1990s.

However, overseas markets also represented a substantial management challenge. Among the problems that other restaurant chains had encountered were the following:

- *Market demand*. The extent to which a market demand existed for a particular type of restaurant depended on levels of disposable income, urbanization, demographics, and a host of other social, economic, and life-style factors. Most critical to a specific company was national preferences with regard to cuisine and dining conventions. Even McDonald's whose name had become synonymous with global standardization adapted substantially to local differences: "Croque McDos" in France, rice burgers in Hong Kong, "McArabia Koftas" in Saudi Arabia, kosher outlets in Israel, no beef or pork products in India.
- *Cultural and social factors* are critical influences on customer preferences with regard to menus, restaurant facilities, and overall ambiance; they are also important with regard to employee management practices and entrepreneurial potential.
- *Infrastructure*. Proper means of transportation and communication, basic utilities such as power and water, and locally available supplies were important elements in the decision to introduce a particular restaurant concept. A restaurant must have the ability to get resources to its location. Easy access to the raw materials for food preparation, equipment for manufacture of food served, and mobility for employees and customers were essential.
- *Raw material supplies*. Overseas restaurant chains needed local supplies of food and drink. The US International Trade Commission noted that: "International franchisers frequently encounter problems finding supplies in sufficient quantity, of consistent quality, and at stable prices. Physical distance also can adversely affect a franchise concept and arrangement. Long distances create communication and transportation problems, which may complicate the process of sourcing supplies, overseeing operations, or providing quality management services to franchisees."[5] While a franchise chain could develop its own supply chain – for example, McDonald's when it entered the Soviet Union – the investment of management time and money could be substantial.
- *Regulations and trade restrictions*. Import restrictions are relatively unimportant in the restaurant business given that most food products are locally sourced. However, some countries have made the import of restaurant equipment difficult and expensive. Restrictions on foreign direct investment are of major significance only in emerging market countries. Far more challenging are national regulations relating to food standards, business licensing, and business contracts. Establishing new businesses in most

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countries involves far more regulation than within the US. Franchise agreements are an especially difficult since they involve complex contractual agreements between franchisor and franchisee regarding trademark licensing, royalty payments, requirements for quality control and quality monitoring. Despite the Uruguay Round's General Agreement on Trade in Services, most countries failed to make public their restrictions on franchising. In some countries some terms of franchise agreements have been viewed as restraints on commerce. Employment law was also important – particularly with regard to restrictions on employers' ability to dismiss or lay off employees and requirements for union recognition, and national collective bargaining arrangements over wages and work conditions.

Notes

1 Outback Steakhouse, Inc. 10K, 1996.
2 Chris T. Sullivan, "A Stake in the Business," *Harvard Business Review* (September 2005) pp. 57–64.
3 Ibid., pp. 59–60.
4 Ibid., p. 58.
5 US International Trade Commission, *Industry and Trade Summary: Franchising* (Washington, DC, 1995) pp. 15–16.