Denny's Changes Its Spots

Not so long ago, the restaurant chain was one of America's most racist companies. Today it is a model of multicultural sensitivity. Here is the inside story of Denny's about-face. ■ ***by Faye Rice***

Flagstar CEO Jim Adamson tells employees, "I will fire you if you discriminate."

ON APRIL 1, 1993, the very same day that Denny's settled a federal suit for discriminating against African American customers in California, six black Secret Service agents at a Denny's restaurant in Annapolis, Maryland, waited nearly an hour for breakfast. While they were ignored, their white colleagues sitting at a nearby table downed second helpings of French toast, bacon, and coffee. When the black agents went public with their treatment, Denny's became, almost overnight, a national symbol of big-business bigotry.

Within months, Ron Petty, former head of Burger King U.S.A., arrived to begin repairing Denny's shattered image. That metamorphosis has been no less dramatic than the restaurant chain's precipitous decline. A company that was once a shameful example of entrenched prejudice is now a model of multicultural sensitivity. The story doesn't stop there. In early 1995, Jim Adamson, another Burger King veteran, was named CEO of Denny's parent company, Flagstar, which is 47% owned by Kohlberg Kravis Roberts. Adamson immediately expanded the re-education efforts beyond Denny's to Flagstar's entire $2.6 billion restaurant empire, including regional chains El Pollo Loco and Quincy's steak houses, plus 593 Hardee's outlets that Flagstar operates as its largest franchisee.

Ron Petty, now Denny's CEO, likes to cite a few numbers to reveal the extent of the about-face. The percentage of minority officers, vice presidents and above, has risen

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PHOTOGRAPHS BY ANTHONY BARBOZA

FLAGSTAR'S NEW LOOK

from zero in 1993 to 11% today. Minorities hold 20% of the jobs directly below vice president, a category called director; there were no nonwhites in 1993. Of Denny's 512 franchisees, 27 are African American, vs. one in 1993; the goal is 65 by the end of 1997. Petty has also slashed three layers of management so he can be close enough to restaurants to head off another mishap. Critics who once excoriated Denny's have changed their tune. "Denny's has jumped out in front and taken a positive approach to solving its problems, unlike most companies that do the minimum required by law," says Terry Demchak, a partner at Saperstein Goldstein Demchak & Baller, the California law firm that represented black customers in one of two class-action suits against the chain.

HIRING PETTY was a smart decision made out of desperation by Jerry Richardson, Flagstar's former CEO. Now 59, he co-founded the company in 1961 with a single Hardee's hamburger stand. But Richardson, a former wide receiver for the Baltimore Colts, knew he needed bigtime help in 1993 after the black Secret Servicemen filed the third discrimination suit in a year against Denny's. At the time he was negotiating to buy the Carolina Panthers NFL franchise, and the negative press could have blown the deal.

With Petty in place, Richardson moved quickly to resolve the suits. In May 1994, Denny's settled the two class-action suits, one of which was consolidated with the case originally settled in 1993 with the U.S. government. By December 1995, Denny's had paid $54 million to 295,000 aggrieved customers and their lawyers, the largest public accommodations settlement ever. In the consent decree it signed with the plaintiffs, Denny's promised to treat all customers equally in the future. The consent decree also mandated that Denny's publicize its nondiscriminatory policies and train employees in diversity issues. An independent civil rights monitor was appointed to supervise Denny's for seven years and to investigate any further charges of discrimination.

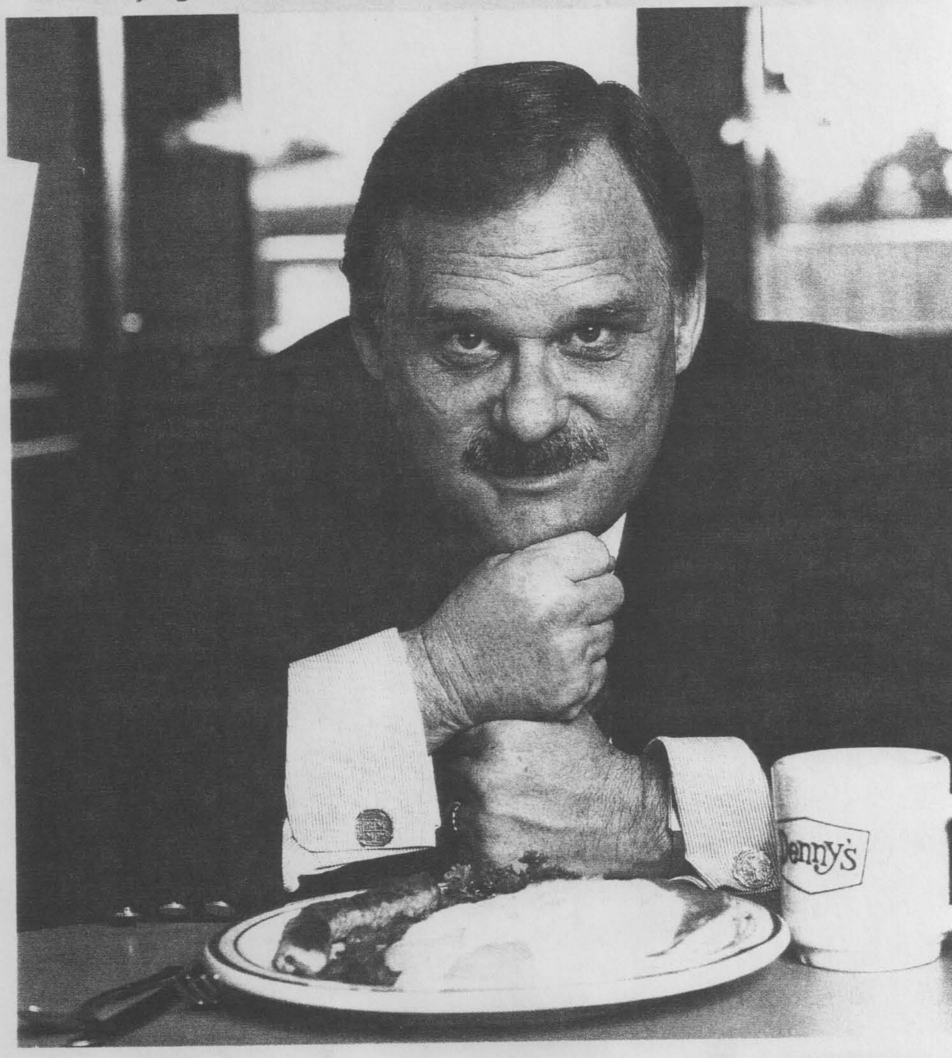
While Petty worked to get Denny's in compliance with federal law, KKR, Flagstar's controlling stockholder, had another problem to deal with. Richardson was struggling as CEO. Flagstar had $2.3 billion of debt and more aliases than a Russian spy, due to a mind-boggling series of restructurings in the late 1980s. Its past incarnations include Spartan Food Systems and TW Services, once a division of Transworld Corp., the parent company of TWA. By whatever name it went, the company, based in Spartanburg, South Carolina, had lost money for five straight years beginning in 1989. Then there was the racial situation. Industry competitors like McDonald's and Burger King had been nurturing ties with minority communities for nearly 20 years. Flagstar, in contrast, was an anachronism stuck in a bygone era. Even though nearly a third of its customers were minorities, it had only two minority-owned firms among its network of some 200 suppliers in 1992. Diversity was a concept as foreign to its all-white management team as foie gras to a Denny's menu.

Richardson relinquished his CEO title when Adamson arrived in January 1995, turning his attention to the Carolina Panthers, his Charlotte football team. Richardson, who will remain on the Flagstar payroll until his contract expires in November 1997, declined to talk to FORTUNE about his departure, as did KKR's Henry Kravis.

Flagstar's real reconstruction began with Richardson's retreat. Jim Adamson made a thunderous entrance as CEO, telling employees at his first meeting that he was "going to do everything possible to provide better jobs for women and minorities. And I will fire you," he warned, "if you discriminate. Anyone who doesn't like the direction this train is moving had better jump off now." Within a few months of the change in management, all but four of the company's top 12 officers left. Among Adamson's replacements were a Hispanic man and an African American woman.

Adamson devised a four-part strategy to put cultural diversity in motion: Loosen up the hierarchical environment; make diversity a performance criterion for all managers; require the entire staff to attend workshops on racial sensitivity; and never miss an opportu-

Ron Petty's grand slam: **Denny's new CEO managed the chain's transformation.**



nity to preach the gospel of diversity. He had been at Flagstar only three months when he got a taste of the bad old days. He declared Martin Luther King Jr.'s birthday a companywide holiday. (The restaurants did not close, but for the first time, office workers were given the day off.) Some employees at headquarters fired off angry E-mail messages opposing his decision and requesting another day off instead. While the messages upset Adamson, he says he is pleased to have "opened up the company enough for employees to disagree. The bad news is that we have more educating to do than we anticipated."

TOGETHER, Adamson and Petty hope to implant diversity as deeply in the new Flagstar/Denny's as racism was in the old. They have created management training programs to give minorities entree to the executive ranks and begun a fast-track program to help them become Denny's franchisees. Applicants enroll in a training program for one to three years, depending on their experience, during which time they must prove that they can successfully operate a restaurant. Every applicant who completes the training can buy a franchise with a loan guaranteed by Denny's.

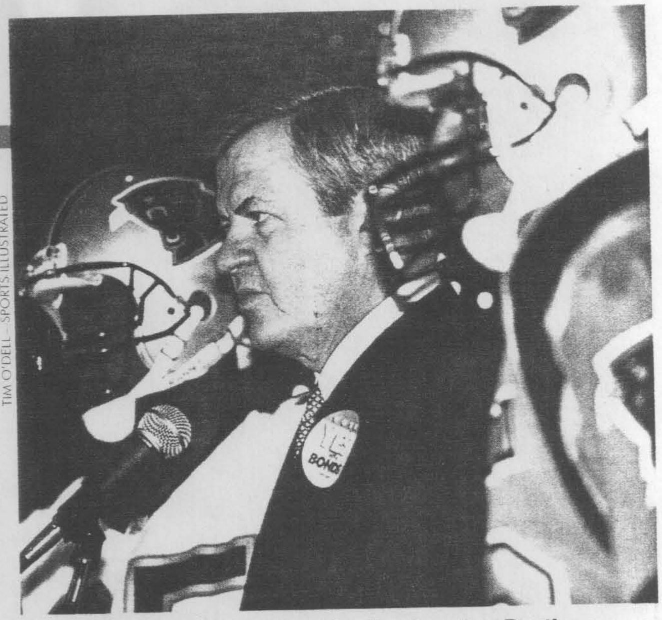
Jerome Edmondson, 33, got the first spot on the fast-track program six months before it officially began last fall. Denny's ran a credit check on him and interviewed his family and previous employers. Since Edmondson is a former market manager at Kentucky Fried Chicken, where he had responsibility for more than a dozen restaurants, he raced through the basic 13-week management course in eight weeks. After spending a month working as an assistant restaurant manager, he thought he was ready to prove himself. He asked to manage one of the least profitable Denny's in the system. Management was reluctant at first, fearing he might fail. But Edmondson was persistent. Last June, he took charge of a Denny's in Southfield, Michigan, that had an operating loss. By October, profit margins had risen to 17.2%, near the company average. With a loan guarantee from Denny's, Edmondson is now buying the Southfield franchise, the first of 20 he hopes to own. "I was skeptical about Denny's at first," says Edmondson. "But after a few months I knew this company was really committed to helping minorities."

Besides expanding opportunities for people who were shunned in the past, Adamson and Petty are introducing techniques to sort out bad apples. A new computerized interviewing technique called H.R. Easy tries to screen job applicants for racial bias. Prospective employees dial an 800 number to answer a series of questions, including "Have you ever used drugs?" "Do you like dealing with people of different races?" "Do you have a problem working with people of different races?" Explains Norman Hill, Denny's VP of human resources: "There is an average response time for each question. It usually takes longer to tell a lie than to tell the truth. If there is a longer response time to questions about bias, drugs, or theft, we will follow up with face-to-face interviews."

Denny's new approach to racial issues comes after years of active resistance to diversity. In 1990, a year or so before the first bias-related incident made the papers, Jerry Richardson had commissioned Synectics, a Cambridge, Massachusetts, consulting firm, to revamp the financially ailing Flagstar. "The lack of diversity was the first issue we identified," recalls Bill Boggs, a managing partner. "I told the senior managers that Flagstar was in a strategically dangerous position, since their customers are certainly not all white males."

A born-and-bred Southerner like Richardson, Boggs vividly recalls a walk he took with Flagstar's then CEO. "Jerry turned to me and said, 'I'm sure you're right about our being behind on diversity, but I just never thought about it.' " To his credit, Richardson replaced a few of the old-timers in his executive suite. He recruited Flagstar's first female senior executive, Edna Morris, to run the notably neglected human resources department. "But the company was 20 years behind the curve," Boggs declares, "and Richardson didn't move nearly fast enough or deep enough."

When racial problems erupted at a Denny's on the West Coast, Richardson and his team wrote them off as isolated misun-



TIM O'DELL—SPORTS ILLUSTRATED

***Richardson* left Flagstar for the Carolina Panthers.**

Flagstar's new team: **Magaly Petersen, director of minority development; Ray Hood-Phillips, head of diversity affairs; and Norm Hill, Denny's VP of human resources**

derstandings, inevitable for a chain that serves one million meals a day. But piles of court documents from customers and employees indicated something far more serious was going on. Sandy Patterson, a white waitress who worked at several Denny's in California, stated in her court declaration that use of the N word was "not uncommon," nor were the terms "them," "those people," or "that kind" in referring to blacks. "I was told by management that we did not want to encourage black customers to stay in the restaurant," she said.

Robert Norton, who is also white, says that when he began his new job managing a Denny's in San Jose, he observed staffers "routinely" closing the restaurant when "they were concerned about the number of black customers" entering. Says Norton: " 'Blackout' was used by Denny's management to refer to a situation where too many black customers were in the restaurant." Norton says that when he discontinued the policy, his district manager threatened to fire him.

Flagstar management was nearly as insensitive to minority business people as it was to its customers. Take the topic of minority vendors. Samuel Maw, Flagstar's executive vice president in charge of procurement until he left last year, still insists, "It is extremely difficult to find them, because they aren't out there." But even minority vendors who banged on Flagstar's door were ignored by the company's buyers. Michele Hoskins says it took her a year and a half to land a $3 million contract to supply syrup to Denny's. Explains Hoskins, an African American who has been selling syrup to supermarkets for 12 years, "When I first called Flagstar, someone told me the company couldn't buy from me because it had a deal in the works with Log Cabin. I said, 'You'll have to give me a better excuse than that.' "

Hoskins made daily phone calls and dispatched weekly letters. The standoff ended a month or so after Adamson became CEO. Suddenly Flagstar's purchasing agents were glad to give her the lowdown on the prices and specs she should meet to get an order. "Now everyone is cooperative, and we work as a team," says Hoskins. Magaly Petersen, brought in by Adamson from Michelin Tires to be director of minority business development, emphasizes that she has no problem locating nonwhite vendors for Denny's and its sister chains.

Adamson, the son of a U.S. Army general, was born in Japan and grew up on bases around the world. He remembers being the only white kid on his neighborhood basketball courts in Washington, D.C., and later, as a teenager living in Hawaii, the only "haole"—the islanders' term for nonnative whites—riding the waves at his local beach. "Prejudice is just not part of Jim's personality," says Boake Sells, a venture capitalist who was Adamson's boss during the 1980s at both Dayton Hudson and Revco. Sells says he first noticed Adamson at Dayton Hudson because his team was so devoted to him. That hasn't changed over the years. Approachable and calm, he strolls the halls at Flagstar in his $1,000 Ralph Lauren loafers and slicked-back Jay Gatsby hair, chatting with staffers. He schedules regular lunches with groups of ten or 12 from all levels of the company, and spends 30 minutes a day writing personal notes to employees and stockholders.

"Blackout" was a term used by management when too many black customers were in the restaurant.

Adamson has assembled a dedicated team to help make over the Flagstar culture. One trusted lieutenant is Rachelle "Ray" Hood-Phillips, head of diversity affairs. She worked closely with both Adamson and Petty at Burger King, where she was a vice president. A year ago Adamson lured her to Flagstar, "to fight the battles," he says. Hood-Phillips and her team are currently creating a diversity-training program for 800 staffers in the Spartanburg corporate office. They will be the first group of employees outside the Denny's network to be exposed to sensitivity workshops. Says Hood-Phillips optimistically: "We want to help people communicate and connect across a line of difference. We want to change their hearts, their perspectives, and their behavior."

At Denny's the diversity training reinforces the requirements of the consent decree forbidding discrimination, such as failure to seat blacks as quickly as whites. The legal points are combined with customer-service guidelines, since the best way to avoid complaints is to treat everyone equally. During the customer-service segment, filmed vignettes (much like those on *America's Most Wanted*) dramatize the right and wrong ways to seat and serve customers. Employees must attend the sessions; refusal to do so is considered insubordination. "We have fired people who have resisted the training," says Norm Hill.

Because of confidentiality clauses in the consent decree, Hill cannot disclose any names or even the number of obstinate employees. He does, however, offer a generic example: "Mr. Surly will come to the training with an attitude and

A sweet deal: **It took 18 months to get in the door, but Michele Hoskins now sells Denny's $3 million worth of syrup a year.**

say, 'I'm just here to save my job. You guys are caving in to all of this diversity stuff.' Our reaction is immediate," Hill says. "We say you have an opportunity to complete the program, or you can leave the company."

If Mr. Surly wants to keep his job, and the company feels he needs more attention, he will have to participate in advanced sensitivity training, an intense, daylong session conducted by the National Coalition Building Institute in Washington, D.C., which specializes in changing bigoted attitudes. Faking his way through training will only delay the inevitable for Mr. Surly. "He will be caught down the line," Hill promises. "Someone will make a complaint about him, and once we see that he has been trained, he'll be fired." Michael Thrower, a Denny's manager in Dallas, believes the training has been good for everyone, especially "the higher-ups." Thrower, an African American, says, "Before, some of them would belittle you in front of guests, and if you objected they would say, 'Hey, you ought to be glad you have a job.' "

***Michael Thrower,* manager of a Dallas Denny's: Diversity training has been especially good for "higher-ups."**

MUCH of the resistance to Denny's training is in small towns. "The mores in these towns dictate the standards in the restaurants there," notes Hill, "and our positive message of equal opportunity and diversity is not always well received." Small-town mores occasionally lead to another problem: disruptive customers. "Some customers come in and say they don't want to be served by Asians, Mexicans, or blacks," Hill says. A pilot program to demonstrate the proper way to handle such customers began earlier this year. Lesson No. 1: Kindly ask them to leave!

Denny's public face has also changed. The consent decree stipulates that newspaper ads and other print promotions depicting customers or employees must feature a minimum of 30% African American or other "identifiably nonwhite" persons. Says Derrell Pierce, a black restaurant manager from San Diego who joined the company 16 months ago: "Denny's is now an organization for all people."

Despite the progress it has made on diversity, Flagstar's finances are discouraging. Debilitated by annual interest payments of $230 million, it lost $55.2 million last year, on revenues of $2.6 billion. The stock has hovered near its all-time low ($2.88) for more than six months. The challenge is to raise profits enough to offset the suffocating debt, not a simple task. To pull it off, Adamson is rethinking everything from menus to advertising and implementing strategic changes for long-term growth. By June he will have divested all of Flagstar's low-margin, nonrestaurant businesses, and he is replacing the company's antiquated information technology systems.

Despite all the progress it has made on issues of diversity, Flagstar's finances are discouraging.

At Denny's, operating income edged up less than 2% last year, after rebounding 35% in 1994; it fell 30% in 1993, the year of the worst racial incidents, and customer traffic declined 4%. Traffic is on the rise again, but revenue growth has been slow. Revenues actually declined slightly in 1995, from $1.55 billion to $1.49 billion, because about 45 company-owned restaurants were sold to franchisees, many of them minorities.

Denny's main problem is that it is caught between two flourishing categories: fast-food giants that have lower prices, and casual dining chains like Chili's and Applebee's that are more expensive but offer liquor and ambiance. To heat up sales, Adamson is lowering prices and improving quality—the same formula he used to revive Burger King. Denny's, famous for its $1.99 Grand Slam breakfast of pancakes, eggs, bacon, and sausage, is dishing up five new morning meals priced under $2. It is also introducing "value" luncheon platters from $2.99 to $4.99 that feature everything from Philly cheese steaks to crispy chicken salad.

Hardee's, Flagstar's second-largest business, needs help too. After years of robust growth, revenues are slumping; same-store sales fell 8.6% in 1995, and revenues declined from $700 million to $660 million. At Adamson's direction, Hardee's customers recently began getting bigger, juicier, cheaper burgers. The price: 79 cents. "When you are hemorrhaging the way we are, you have to get customers back into the restaurants," Adamson says.

Like many good leaders, Adamson is dangling cash to motivate his employees. The twist is that he is using his own money. Last year he donated his entire signing bonus of $500,000 to a pool for Hardee's restaurant managers. During the last four months of 1995, 600 managers competed against their previous eight-month sales numbers. Those who improved sales 1% to 3% received $500; the payout was $1,000 for a 3% to 7% increase, and $2,000 for a sales jump of 7% or more. More than half the managers pocketed bonuses. "Adamson brings a real sense of urgency to a company whose brands are not ideally positioned," says industry analyst Michael Mueller of Montgomery Securities. "He's moving at 90 miles an hour to market them more effectively."

Mueller expects Adamson's turnaround to gather momentum. Flagstar's cash flow, he says, will rise 8% in 1997, and he believes the company could be profitable by 1998. Adamson promised KKR that he will stay at Flagstar until the red ink disappears. Says he: "When I leave, I want it said that I made Flagstar a much more inclusive, user-friendly company." In other words, he wants diversity to really pay.