PANERA BREAD CO.: A Case Study

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INTRODUCTION

An exciting new segment in the restaurant industry, the quick-casual market, is growing at 15-20 percent each year [10] despite the slowdown in consumer spending, war with Iraq, increases in gas prices, and concern about terrorism since the 9/11 attacks on the World Trade Center. Panera's management team plans to open 120 new restaurants in 2003, expects increases in system-wide sales, and hopes to maintain its leadership position in the very competitive restaurant industry. Can these goals be obtained despite the sluggish U.S. economy?

THE RESTAURANT INDUSTRY

There are approximately 8 million restaurants in the world and about 300,000 restaurant companies. The industry has two major segments: The full-service segment and fast-food. With high competition, a mature market, a decline in the supply of workers age 16-24, and low profit margins, this is a difficult industry in which to excel. Overall restaurant sales have been rising about 5% annually. In a recent report on the Top 100 chain restaurant companies, Technomic [8] reported annual growth of 5.1% and 2001 system-wide sales of $136.5 billion, an increase of $6.6 billion over 2000. The ten fastest growing chains with Sales over $200 million in 2001 were: Panera Bread, Krispy Kreme, Quizno's Classic Subs, Culvers, P.F. Chang's China Bistro, Chevys, Carrabba's Italian Grill, Buffalo Wild Wings, Starbuck's, and The Cheesecake Factory.

There is an exciting new restaurant market segment developing – the quick-casual market – and these restaurants are becoming key players in the industry. The quick-casual market is a combination of the quick service of traditional fast-food restaurants with the higher quality food products found in sit-down restaurants. The quick-casual market is a $6 billion industry and is growing 15-20% each year. Sales growth is expected to double to $12 billion during the next five years [10].

PANERA BREAD COMPANY

Company Concept and Strategy

The Company brings the tradition of freshly baked bread to neighborhoods. Only the highest quality ingredients are used and the bread is baked fresh everyday -- only fresh dough is used and no preservatives. Panera Bread bakes more fresh bread each day than any other bakery-café operation in the United States, which helps fulfill the Company's mission of putting "a loaf of bread in every arm". Panera Bread serves 18 kinds of breads, bagels, muffins, scones, rolls and sweet goods, made-to-order sandwiches, hearty soups, custom roasted coffees, and café beverages such as espresso and cappuccino drinks. The company regularly reviews its product offerings to ensure it is satisfying changing customer preferences. Two customer groups have been identified: the "bread loving trend-setters", who embrace new and nutritional items, and the "bread loving traditionalists". In 2002, the company introduced a new artisan bread that is an all-natural, handcrafted bread baked on a stone deck. In spring 2003, the company introduced a line of Ciabatta bread sandwiches. Kevin Ament, a company spokesperson, stated, "People want high-quality handcrafted foods that are made with the best ingredients and that are fresh. What Panera is doing with bread is similar to what Starbucks did with coffee: educating customers about a staple people took for granted." (Birmingham Business Journal, 2003). Other initiatives the company is introducing in an effort to increase sales growth are: adding off-premise sales to improve convenience to customers; introducing new and seasonal food items; and introducing a debit Card program similar to that offered by Starbuck's.

The menu, operating system, and design allow Panera Bread to operate in several successful dayparts: breakfast, lunch, and daytime "chill out" (between breakfast and lunch and between lunch and dinner when customers visit the bakery-cafes to take a break from their daily activities). In addition, the company sells bread to take-home. The bakery-cafes are primarily located in suburban, strip mall and regional mall locations. As of February 15, 2003, the company operated 478 Panera Bread bakery-cafes in 32 states. The company has been successful because of its unit economies, its fine premium food, and its loyal customer base. Panera Bread serves its food on china, has well-spaced tables, and the décor reflects a French café atmosphere. The environment is very important since about half of its customers eat on-site. The company also delivers what its sophisticated customers desire: fresh sandwiches, bagels, salads, soups, pastries, and alternatives to fast food [7].

COMPANY OPERATIONS

Management Information Systems

The cash registers at each bakery-café collect point-of-sale transaction data that is used to generate marketing information, product mix and average check amount. The in-store system is designed to assist managers in labor scheduling, food cost management, and provides access to retail data. The sales, bank deposit, and variance data for each bakery-cafe are submitted to the Company's accounting department daily and then information is then used to generate weekly reports and monthly financial data.

Distribution

Independent distributors are used to distribute sweet goods products and other materials to the bakery-cafes. This allows this company to eliminate an investment in distribution systems and focus on its retail operations. Fresh dough products are provided by the commissaries, and all other products and supplies (such as paper goods and coffee) are contracted for by the Company and delivered by vendors to the independent distributors.

Franchise Operations

Panera Bread began its franchising program in 1996. The company tends to establish area development agreements (ADAs) rather than individual franchises. The ADA requires a franchise to develop a specified number of bakery-cafes on or before specific dates as designated in each agreement. Franchisee owned bakery-cafes must meet the same standards for product quality, menu, site selection and construction as do company owned bakery-cafes. Franchisees are required to purchase all dough products from Company approved sources and the Company's commissary supplies all fresh dough products. The Franchise Fee is $35,000 and the total investment for a bakery-café ranges from $564,000 to $910,725. A 5% royalty fee on gross sales is payable each week. As of December 28, 2003, the company had 132 company/joint venture bakery-cafes and 346 franchise-operated bakery-cafes.

Managers and the head baker are required to attend Panera Bread's training program. The Management Training course classroom portion lasts for 5 days and the in-store training portion lasts 4-6 weeks. During the training program topics discussed include area and shift management, administration, customer service, quality assurance, company history, safety procedures, and human resources.

Bakery Supply Chain

All bakery-cafes use fresh dough for the sourdough bread, artisan breads, and bagels which is supplied daily by a Company regional commissary. As of December 28, 2002, the company had 15 regional commissaries. Although the commissary system requires a major commitment of capital, it provides cost efficiencies and assures consistent quality and supply of dough to the bakery-cafes which gives Panera Bread a competitive advantage. The product consistency enhances the brand identity. The company distributes the dough using a leased fleet of temperature controlled trucks. Typically, a distribution route delivers dough to 5 bakery-cafes within 200 miles of the commissary.

Other baked goods served at the bakery-cafes are prepared with frozen dough. In 1996, a state-of-the-art production facility was built in Mexico, Missouri. In 1998, the Company sold the facility to Bunge Food Corporation for $13 million. At the time of sale, the Company entered into a five-year (1998-2003) supply agreement with Bunge for the supply of its frozen dough needs. The sale of the production facility provided economies of scale in plant production and allowed the Company to take advantage of Bunge's significant purchasing power. The Company has signed an agreement with Dawn Food Products, Inc. to provide sweet goods for the period 2003-2008. The Company believes cost savings will be achieved by switching from Bunge to Dawn in April 2003.

Financial Summary

For fiscal year ended December 28, 2002, sales increased 38% to $277.8 million compared to $201.1 million at December 29, 2001. The increase in sales was mostly due to the opening of 115 new bakery-cafes during the year. Net income increased 65% to $21.8 million for the year. For the five-year period ending 12/28/02, revenue grew 2.06%. Panera Bread Company does not pay dividends and retains earnings to help finance the company's continued growth. Recent stock prices have ranged from a low of $23.64 to a high of $37.95. On April 10, 2003, Panera Bread Company executives announced systemwide same-store sales at -1.1% for the four weeks ended March 22, 2003, and -0.4% for the 12 weeks ended March 22, 2003. The negative same-store sales was attributed to severe winter weather as well as some cannibalization in the St. Louis market. Despite this information and based on the continued strength of its development activity, the company expects growth in 2003. Financial analysts [9] predict a 35.0% earnings growth for the company in the next five years compared to expected industry growth of 12.78%.

TEACHING NOTE

Suggested Courses and Placement of the Case

This case may be used in courses such as Strategic Management in undergraduate or graduate Business curriculum. It should typically be used at two-thirds of the way in the course because the case raises issues of Business Level and Functional Level Strategy and Industry and Macro-environmental analysis.

Teaching Objectives:

1. To apply the concepts of industry and macro-environmental analysis to synthesize a judgment of attractiveness of an industry.
2. To apply the concepts of competitive strategy and internal analysis to synthesize a judgment about the competitive position of a company.
3. To understand the challenges of leading a successful company.
4. To devise creative and insightful solutions for fine-tuning strategy for a successful company in light of its situation.

Analysis and Teaching Process/Suggested Discussion Questions

1. How would you approach the question of "Can Panera achieve its ambitious goals in light of a sluggish U.S. economy?"

This is a good lead question to reinforce the "process" of analysis. When business professionals are asked such a question, they must process this question, break it down into its components, come up with answers to component questions, and then synthesize their answers. Such a "systematic" examination of a question is what distinguishes a business professional from a lay person. The case question must be broken down in to two questions. The first question should address analysis of U.S. economy as 'one' of the macro-environmental forces, its impact on the restaurant industry overall and then on the quick-casual business segment, the expected change in competitive forces and rivalry. The second question should address the internal analysis of Panera in terms of its overall competitive strategy, whether and how this strategy is supported by its various functional strategies and competencies, and conclusions about Panera's strengths and weaknesses. The conclusions of such a complete analysis should be the source of recommendations for some specific actions for fine-tuning Panera's future strategies and attainability of its goals.

Macro-environmental Forces

Sociological: U.S. demographics is shifting towards the baby-boomers' children moving into the early parenthood phase. Combined with two income families and lack of time, many of these people seek out "quick-casual dining" to satisfy their preference for high quality food on a tight schedule and medium budget. Economic forces: The high average growth rate of 10% for the restaurant industry indicates that it has withstood the shock of economic downturn in the U.S. Technological forces: There is not a great deal of impact of technology on the food processing side. However, information systems advances have helped the industry in monitoring consumer tastes, sales patterns, and the supply chain.

Dominant Economic Characteristics of the Restaurant Industry

Size: Large. (e.g. Top 100 chain restaurant companies have sales of $136.5 billion with annual growth of $6.6 billion or 5.1%.). Segments and growth rate: Full service (8% growth), Varied Menu (8%), Italian and Steak (8% each), Other Sandwich (12.8%). Further Segmenting of Fast Foods based on type of food: sandwiches, hamburgers, Mexican food, pizza, and chicken. Competitors: Several large chains and a large number of small competitors exist in various segments. Strong competition exists in a somewhat mature industry. Products can be highly differentiated based on quality of ingredients and type of cuisine. Business concepts combine type of food; fast service/self service vs. elegant, relaxed, full-service; and standardized menu vs. changing menu. Economies of scale: There are some parts of the production processes where economies of scale can be obtained, for example, in making bread dough. There are also economies of scale in purchasing bulk ingredients, and restaurant chains can benefit from these. Distribution: On the supply side, vendors can provide a number of products and services at competitive prices. Industry Profitability: There are low profit margins in the fast food segment. The quick-casual segment may be more profitable due to somewhat higher prices.

Key Success Factors

Purchasing-related factors: Must have a network of suppliers who maintain required quality of supplies. Quality control of raw materials is important. Bulk purchasing can reduce cost of some materials such as flour etc. Marketing-related factors: Product Quality: Food must have freshness, purity, taste, and good presentation. Product must be distinct and unique. Quality must be consistent from store to store - consistency is the key for chain restaurants. Service: Speed of service is one of the critical elements in the quick-casual restaurant concept. Pleasantness of front-line personnel is another critical element. Drive up facilities are important for take-out segment. Delivery can be an option (pizza, Chinese cuisine are two types of food where delivery is a commonly available service). Promotion: Brand name must be promoted. Appropriate brand image is essential. Restaurants can only employ pull strategies. Place: As with any retail operation, restaurants must be placed in locations with a great amount of traffic from feeder area. Stores must have distinct décor and maintain a required level of décor and cleanliness for customer satisfaction. Organizational capability: The company must be able to do marketing research to evaluate restaurant locations, must be able to coordinate the supply chain for smooth operations, and must be able to recruit and train personnel for store operations.

2. How would you characterize the strategies of Panera Bread Company, and evaluate its effectiveness until the beginning of 2003?

All indicators of performance show that Panera is performing exceedingly well at everything. The revenues have continuously grown over three years while cost of revenue has steadily dropped as percentage of revenues, operating income has continuously grown (therefore cost of operations is down). The strategies of Panera are detailed in the case. Its fundamental business concept may be characterized as "Bakery-cafés serving European-style comfort food in a quick-casual way for dining or snacking at various times of the day".

The Corporate Level Strategy of Panera is to grow in the Bakery-café and related businesses in the supply-chain through franchising. Thus, they have various value-chain activities that they have chosen to perform while farming out other activities to local vendors while retaining coordination, which they offer as part of their services to the franchisees. Their investment, therefore, is distributed among commissaries and their own Bakery-cafés while their growth is driven by franchisees and Area Development Partners. The Business Level Strategy is to compete in the quick-casual segment of the restaurant business with a high quality product so that "the concept remains special, is delivered with spectacular execution every day" – Ron Shaich (as quoted in the case from Annual Report, 2001). Marketing strategy consists of creating a marketing mix (the 4 P's of marketing) and selecting target markets so as to match the company's offering to the target market segments. Panera has an excellent marketing strategy. *The (product-service) offering*: A semi-elegant, comfort provoking, food and/or dining experience through hot/cold sandwiches, soups and salads, along with pastries, and breads. *Pricing*: Medium – approximately $10 per person per visit (including both café and bakery purchases) *Place*: Choice of location based on high traffic of young professionals, upper income people with European or eclectic tastes (optimization on residential, shopping and office traffic). Domestic market only in early 2003. *Promotion*: Case does not mention it, however, it's greatly word of mouth. Panera also gets some publicity about its Dough-nation campaign. *Target Markets*: It may be interesting to ask students who have visited a Panera Bakery-café to describe the kind of buyers they may have noticed. Essentially they will find people with eclectic tastes and necessary purchasing power. It may be worthwhile to speculate on what other demographic characteristics correlate with these two essential characteristics.

3. Based on the answers to the above two questions, what would your answer be to the case question of attainability of Panera's goals?

Considering that this is a well managed company, has shown a track record of very high growth CAGR of , is financially strong (has no long term debt), it would be easy to say that this company will achieve its growth goals. It is interesting to note the Compound Average Growth Rates of Revenue and Net Income for the two years reported. CAGR of Total Revenues (2000-2002): 35.45%. CAGR of Net Income (2000-2002): 78.21%. Growth Goal: (120 stores planned for 2003 / 478 stores at the end of 2002) = 25.10% growth. This would indicate that the goal is reasonable. It is also interesting to note that despite the CAGR of 78.21% in net income, analysts have predicted only 35% long term (5 year) earnings growth. This means that analysts are expecting a slowing down of Panera's growth in the 3rd, 4th and 5th year. It would be necessary to predict the total number of stores in another two years and the number of store openings necessary to keep a 78.21% earnings growth. This would give a realistic understanding of the growth numbers.

4. What general conclusions can you draw about effective strategic management?

Unfortunately, based on research methodological considerations, cases are weak as a source of "generalized principles of management". It may be interesting to check whether students are aware of the strengths and weaknesses of various research designs.

Conclusion:

In summation, it is good ask whether Panera as a company faces any issues, and whether it can improve its strategies any further. Some of the following may or may not come up in discussions. Issues: 1. Does Panera have any succession plans? This is always an issue for any successful company. What happens if Ron Shaich decides to leave the company for whatever reasons? 2. How can Panera encourage repeat business? Repeat customers are the key ingredients in the quick-casual restaurant industry. Panera may be able to use its information system to recognize people who use their credit cards and give them a discount. For cash customers, promotional punch cards can be given out with the reward of a "free sandwich on your tenth visit" or a "50% discount on the 10th meal" etc. 3. Can Panera leverage the Dough-nation program to create customer loyalty to Panera as a member of the local community? 4. Should Panera explore going international? How should it do so if so decided? Since Au Bon Pain has expanded internationally, Panera may be able to do so as well – particularly when it's riding the high wave in the stock market. That should signal Panera as a leader for international franchisees.

REFERENCES (Available upon request)