

Who shook Big Mac?: Panera Bread Co.

by Kyuho Lee and Melih Madanoglu

The authors identify the firm-specific core competencies that Panera Bread has relied on to achieve a competitive advantage in its business domain. The study illustrates how the company scans the dynamically changing environments and tailors their products and services in accordance with these changes.

The business environment in the restaurant industry has become increasingly competitive due to changing consumer preferences, an increased number of competitors, the presence of labor shortage, and the sluggish U.S. economy.¹ As a result, both fast-food and full-service restaurant segments, which represent 60 percent of the \$400 billion restaurant industry, have encountered several market challenges which affected the restaurant firm's bottom line.

In particular, the fast-food industry has been impacted most severely from the recent dramatic environmental changes such as growing obesity problems, competition, and food safety concerns related to mad cow disease across countries.² Not surprising, the fast-food giant,

McDonald's Corporation, a company that has been in business since the 1950, reported its historic first quarterly loss in January 2003. The magnitude of McDonald's loss was \$343.8 million in the fourth-quarter of 2002 and was four times higher than the figure analysts predicted.³

McDonald's loss demonstrated that the company failed to be proactive to a series of environmental changes affecting the fast-food industry such as increasing competition in the industry, growing consumer preferences for healthy foods, and mad cow incidents in Europe and Canada. Furthermore, the second largest fast-food chain, Burger King, shut down about 12 percent of its domestic outlets because of lagging financial results and fierce competition.⁴

Fast-casual segment emerges

The stumble of some of the fast-food giants gave rise to a new segment, fast-casual, that capitalized on opportunities to meet changing consumer needs. Fast-casual restaurant chains have recorded robust sales growth

ranging between 6 and 8 percent annually since 2000.⁵ Sales of the fast-casual segment are expected to reach \$35 billion by the end of this decade.⁶

The fast-casual dining segment positioned itself between fast-food and casual-dining restaurants by offering high quality fresh food, a self-service format (no tipping), a comfortable atmosphere, takeout service, and fast service to customers.⁷ According to Perlik,⁸ the check averages of most fast-casual restaurants range between \$7 and \$10. Cosi, Café Express, Baja Fresh Mexican Grill, Au Bon Pain, Chipotle, Qdoba, and Panera Bread are some of the players in this segment.⁹

Panera gets attention

Panera Bread has recently drawn considerable attention from Wall Street analysts by recording impressive financial results and achieving an astonishing growth among all publicly-traded restaurant companies.¹⁰ The company was ranked as the top national restaurant chain in the several restaurant food and customer satisfaction surveys. For example, *Restaurants & Institutions* magazine awarded Panera Bread "Choice in Chains" based on consumer satisfaction and food quality. Also, Panera Bread was selected as the best restaurant among 118 restaurants in a national customer satisfaction survey of more than

71,000 customers conducted by *Nation's Restaurant News*.¹¹

This study identifies the competitive strategies that enabled Panera Bread to succeed in the fiercely competitive restaurant industry and analyzes the firm's core competencies, demonstrating how these competencies are aligned with the firm's innovative strategies.

Company expands

Panera Bread was founded in March 1981 under the name of Au Bon Pain in Saint Louis, Missouri. Au Bon Pain was established as a bakery-café selling mainly bakery and cookies; its restaurants were located primarily in the urban downtown areas targeting white color office workers. In a move to penetrate suburban areas Au Bon Pain later acquired the St. Louis Bread Company in 1993, most of whose restaurants were located in the suburban areas.

The firm sold the Au Bon Pain division and changed the corporate name to Panera Bread in 1998; the CEO of the Au Bon Pain, CEO Ron Shaich had to sell the debt-lagging unit in order to grow Panera Bread, which had been developed based on the former St. Louis Bread. One of the major reasons for the sale was that Au Bon Pain had several market challenges due to its urban locations, which derailed high fixed operation costs and high competition in the most of urban

areas.¹² This resulted in severe undercapitalization problems to the firm.¹³ Furthermore, Au Bon Pain could not maximize its asset productivity by limiting its operation to weekdays since its major target markets were white collar office workers.

The growth of Panera Bread

Panera Bread is expanding quickly across America, currently operating 602 bakery-cafes (173 company-owned and 429 franchised) in 35 states.¹⁴ Strong bakery-cafe performance fueled new-unit growth, enabling Panera Bread to open 115 new bakery-cafes in 2002 (23 company, 92 franchises). According to the company's annual report¹⁵ the bakery/café firm is expected to open 140 new units in 2005.

The strategic decisions made by Panera Bread's management are reflected in the firm's financial indicators. Panera Bread's strong performance at the bakery-cafe level drove significant growth in corporate revenue and earnings, the firm recorded system-wide sales which were reaching \$755 million in 2002. This denotes a compounded annual growth rate (CAGR) of 61 percent over the last four years (1999-2002).¹⁶ Panera Bread recorded approximately 1.25 billion in system-wide sales in 2003, which is particularly notable as its sales were just \$114 million in 1998.¹⁷

Consumer demand for bakery-cafe

and quick-casual offerings created a \$5.2 billion category in the restaurant industry.¹⁸ The revenue of Panera Bread for 2003 cited above (1.25 billion) now comprises more than 1/5 of the market share of the emerging fast-casual segment. The company achieved this feat by remaining debt-free and maintaining \$39 million in cash.¹⁹

In terms of stock performance Panera Bread investors enjoyed an average of 59.1 percent holding period return annually over the 1998-2002 period.²⁰ This is considerably higher than the return of casual-dining (12.9 percent) and fast-food (5.8 percent) segments for the same period as reported by Madanoglu and Lee.²¹ Risk-adjusted performance of the company for the 1998-2002 period, as measured by Sharpe Ratio, was 3.47, compared to 1.24 for casual-dining and 0.23 for fast-food segments. This implies that Panera Bread investors enjoyed a return per unit of risk three times higher than that of casual-dining and more than ten fold over fast-food restaurants.

Planning requires scanning

West and Olsen²² claimed that restaurant chains conducting regular environmental scanning perform better in comparison with restaurant firms that ignore environmental scanning or rarely conduct environmental scanning at all. The authors

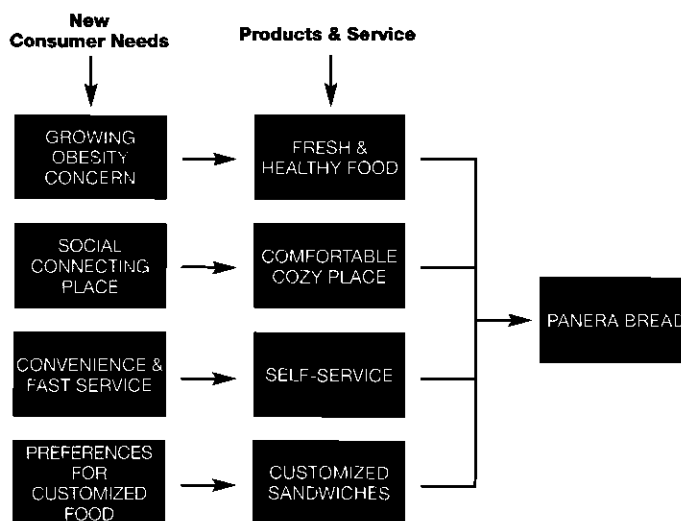
argued that establishing regular environmental systems is essential for restaurant operators in their effort to tackle external environmental changes and formulate long-term strategic planning.

Dorf²³ contended that about three out of four restaurants were likely to stumble in their very first year of business operations due to the lack of environmental scanning and lack of strategic planning. Today, establishing and conducting a series of environmental scannings regularly has become more important than ever due to the rapid change in consumer preferences, fierce

competition, and new technology development.²⁴

One of the key factors that enabled Panera Bread to accomplish such a high growth was the company's response to customers' new needs by embracing necessary products and services to cater to their preferences based on the firm's thorough environmental scanning. Figure 1 below presents the new consumer needs and the way Panera Bread develops and tailors its products and services strategically in accordance with these emerging environmental changes and market demand as follows:

Figure 1: Panera Bread's innovative and competitive strategy



- Growing obesity concerns:** According to Perlik,²⁵ health is a key value driver when consumers choose a restaurant. This is confirmed by a study undertaken by the University of Colorado Health Sciences Center, which reports that approximately 31 percent of Americans (which corresponds to 59 million people) are considered obese, and 65 percent of Americans are overweight.²⁶ Hellmich²⁷ further makes a prediction that the rate of obesity will increase to 39 percent by 2008.

With the rapid increase of obesity in the U.S., associated health costs have soared. Obesity can increase heart disease, stroke, and high blood pressure.²⁸ According to the America Obesity Association,²⁹ health costs related to obesity reach about \$100 billion. The association further points out that high consumption of fast food has played a significant role in the growing obesity rate in the U.S. Subsequently, consumers' desire for fresh and healthy food has increased.

For example, the U.S. organic food market has recorded 20 percent annual growth between 1997 and 2002 and is projected to continue to grow.³⁰ In the view

of Dimitric and Greene,³¹ the key drivers influencing the growth of organic food consumption include the desire for a healthier lifestyle, the awareness of environmental pollution, and consumers' preferences for quality food.

Panera Bread's variety of nutritious and healthy menu choices have a competitive edge over fast-food menu items in terms of freshness and nutrition. For example, a Veggi Garden sandwich of Panera Bread contains 570 calories, which is far less than that on menus of major fast-food restaurants. A Whopper contains 1,600 calories, while an average male needs only 2,200 calories daily. It simply means that a consumer will have already fulfilled more than two-thirds of his/her suggested daily calorie intake by consuming a Whopper.³²

Panera Bread's forward-looking initiative managed to detect the growing consumer desire for fresh and quality food ahead of time. The firm then offered a variety of fresh and healthy food choices such as fresh customized sandwiches and homemade soups which met consumers' growing healthy food needs.

- **Social gathering purpose:**

Increasing numbers of consumers visit a restaurant for social gathering purposes in addition to their main purpose of dining-out.³³ Starbucks has been able to attract a variety of customers ranging from mothers to businessmen by creating a coffee shop called “third place” where consumers can congregate for relaxation or a social or business meeting away from offices, school, and home.³⁴

Panera Bread followed suit by providing a cozy and comfortable atmosphere with leather sofa seating, fireplaces, and china dishes. These surroundings have attracted a number of consumers who can meet friends or relatives in addition to their dining purpose.³⁵

By providing comfortable settings, Panera Bread managed to create “chill out” business for consumers who come in between breakfast and lunch or lunch and dinner to eat pastry with coffee, or who come to the restaurant to meet friends. Approximately, 25 percent of the company’s revenue has been generated from this business.³⁶ Furthermore, the appealing atmosphere of the restaurant helps the chain maximize the number of repeat customers.

- **Convenience:** Today consumers demand fast service so that they can cope more efficiently with busy work schedules and lifestyles. However, a large number of these consumers seem reluctant to visit traditional fast-food restaurants due to health and quality of food issues. Fast casual gained an edge in this aspect by offering quality fresh food. Panera Bread CEO Ron Shaich stated that more than 45 percent of consumers do not want fast food; nevertheless, consumers still prefer to utilize fast-service restaurants because of fast-paced lifestyles and hectic schedules.

According to Fieldhouse,³⁷ fast-food restaurants have appealed to consumers due to the speedy service. On the other hand, Panera Bread has been able to take market share away from the fast-food segment by offering fast service to customers at the speed the fast-food restaurants provide along with a variety of fresh menus. Customers order and pick up their food at the counter, which maximizes operational efficiency by cutting labor costs.³⁸ In addition, customers do not have to leave tips for servers.

- **Customized food:** Increasingly consumers prefer to eat customized food rather than standardized hamburgers, even though the price of customized sandwiches is considerably higher than that of mass-standardized hamburgers. However, the price difference does not seem to deter consumers.³⁹

For example, Panera Bread offers 15 different sandwiches, served with 11 different types of the company's own bread. Customers have a wide variety of choices where they can select the ingredients and bread for their sandwiches. This enables the chain to accommodate more diversified customers who have

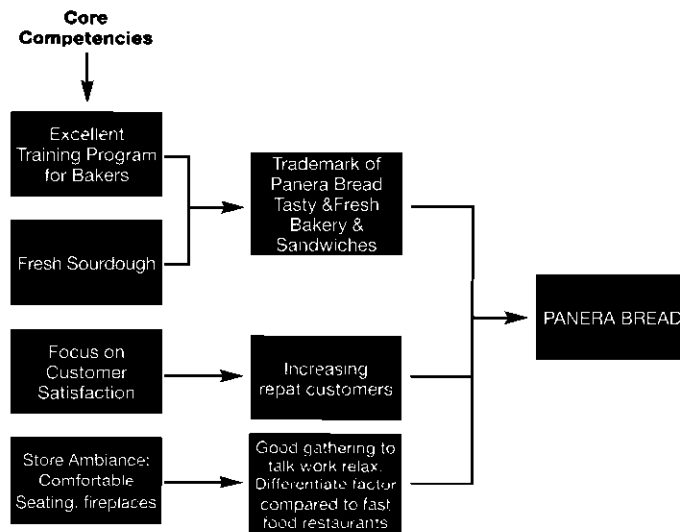
different tastes and preferences.

The company's variety of customized sandwiches in conjunction with its tangy and fresh bread has played an important role in establishing its brand name and image as a fresh and healthy sandwich bakery/café, which differentiates itself from a restaurant chain that mainly sells fried and high-fat fast food.⁴⁰

Core competencies remain

Panera Bread continues to invest in a series of core competencies in order to sustain the company's competitive advantage and core products and services over competitors' service and products. Figure 2 shows the core competencies of the Panera bread:

Figure 1: Core competencies of Panera Bread



As shown in Figure 2, the key core competency of the company is fresh, handcrafted bakery products. Unlike its competitors, the company does not use frozen dough in its bakery products.⁴¹ Currently, Panera Bread operates fresh dough production facilities across the country and delivers fresh sourdough daily to all its outlets with 79 leased trucks.⁴² Furthermore, the company places an emphasis on thorough and rigorous training of its bakers to assure the quality of all bakery products.⁴³

Training bakers is critical to maintain consistent quality of bakery bread since the chain bakes bread only in stone-deck ovens. For that reason, the chain requires all bakers to learn how to bake bread in these ovens. The company also requires all franchisees to attend a 10 week intensive training program and provides baker certification after the completion of the program.⁴⁴ In addition, ongoing training is offered.

The combination of fresh sourdough and training of bakers makes up the core competencies which enabled the chain to establish its brand name as a bakery/café chain selling high-quality, fresh, tangy bread as well as sandwiches. The variety of fresh bakery products in the Panera Bread is well suited to consumers' desires for fresh, high-quality food.

Another core competency that has contributed to the remarkable growth

of Panera Bread is the company's strategic focus on customer satisfaction rather than a dependence on marketing methods such as heavy advertising expenses and pricing strategies. For instance, Panera Bread ranks on top in the level of consumer commitment among restaurant chains. According to a research conducted by TNS Intersearch, a market-research firm, consumers' brand commitment for Panera Bread is 12 percent, which far exceeds McDonald's 6 percent and Burger King's 4 percent.⁴⁵

The company's high dedication to customer satisfaction through its products, services, and operational efficiency resulted in high brand loyalty even though the company spent only \$842,170 for advertising in 2002. This figure is far lower when compared to the advertising expenses of fast-food giants McDonald's (\$593.9 million) and Burger King (\$362.2 million).⁴⁶

This Panera Bread case demonstrates that relying heavily on marketing practices might be more effective in accomplishing a short-term financial goal. However, such marketing strategies do not seem to guarantee customer satisfaction and loyalty, which are crucial factors for a restaurant firm to accomplish its long-term success by recording a high return on investment.⁴⁷

CEO Ronald Shaich stated: "Consumers are smart. It's the experience and how they relate to it."⁴⁸ Shaich believes that today's consumers are not easily tempted by restaurant marketing techniques while making restaurant selections, rather, consumers tend to base their decisions on their food service experiences by evaluating food quality, restaurant atmosphere, and service.

Plan builds on core

This study displays how Panera Bread has developed the company's strategic plan and built its core competencies to effectively capture changing consumer preferences and business environment by virtue of the company's thorough environmental scanning. Researchers⁴⁹ note that a restaurant firm's long-term strategic vision includes elaborate strategic planning, systematic environmental scanning, development of core products, and allocation of resources accordingly. All these steps are essential to bolster the profits of a hypothetical restaurant firm and thus maximize its market value.

Today competitive restaurant environments and saturating domestic U.S. markets require restaurant operators to conduct competitive strategic planning to focus on core products, and to allocate resources effectively. Panera

Bread is a prime example of how a restaurant firm establishes competitive strategies based on thorough environmental scanning and implements them efficiently. Many restaurant firms have been ignoring developing long-term strategic planning.

Dolf⁵⁰ pointed out that a number of restaurants suffered from undercapitalization problems because restaurant operators did not establish competitive sustainable strategies and conduct strategic planning. Today's fierce competition among fast-food restaurant operators unleashed a wave of price-cutting such as \$1 hamburgers which eventually resulted in hurting the profit margin and brand value even though the series of discounts and promotions might help restaurant operators achieve short-term financial goals.⁵¹

The study suggests that developing a competitive strategic plan and implementing it based on the company's capability is a key factor for a restaurant firm to survive in the highly volatile and competitive restaurant industry. To no one's surprise, to meet changing market and environment needs and consumers' new preferences, restaurant operators have to switch from short-term profit orientation myopia into a long-term, future-oriented competitive strategic mindset in order to increase their firms' value.

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