case study

Food Waste and Financial Performance: Should Olive Garden drop unlimited breadsticks and salad from its menu?

By Murat Kizildag, Bendegul Okumus and Joe Hutchinson

Introduction

Food waste, usually measured as the amount of wasted food in terms of pounds and dollar values, is a growing global concern (Lipinski et al., 2013). It is estimated that about 1.3 billion tons of food are wasted per annum globally (Silvennoinen et al., 2012). This represents a waste of 25% of food in the entire food supply chain (Dobbs, 2011; Gustavsson et al., 2011). According to the United States Environmental Protection Agency (USEPA), 34 million tons of food was wasted in 2010 (Immanual et al., 2013). In the European Union of 27 countries (EU27), food waste was 89 million tons in 2006 and is predicted to reach 126 million tons by 2020 (Adenso-Diaz and Mena, 2014). In addition to its negative financial impact, food waste leads to serious environmental concerns, such as excess use of fresh water, energy, and fossil fuels. This results in increased levels of methane and CO2 that negatively affect global climate change (Canning et al., 2010; Cuellar and Webber, 2010). As a result of these negative patterns and trends, many countries are focusing more attention on food waste and waste reduction strategies.

Food waste is a major concern in the foodservice industry in North America. Approximately 133 billion pounds of food from stores, restaurants, and homes was wasted in 2010. The amount of uneaten food from homes and restaurants is valued at about $390 per consumer (National Restaurant Association, 2013). Company survey respondents of a recent study conducted by Business for Social Responsibility (BSR) (2014) reported that their companies generated 33 pounds of food waste per every $1,000 of company revenue. Thus, a large company with $1 billion in revenues would generate 33 million pounds of food waste. The total food waste for restaurant companies responding to the survey was 2.10 billion pounds, or 15.7% of the food waste among all company survey respondents (BSR, 2014). To reduce food waste, restaurateurs need to develop and implement clear food waste reduction strategies. If effective, these strategies can help reduce their food costs and associated profitability.

Investors, shareholders, and potential consumers may monitor restaurant company profitability ratios compared to industry norms. If the financial results are below industry norms, some stakeholders may raise issues and create challenges for the senior management team of a company. For example, Darden (NYSE:DRI) has been criticized by one of their primary shareholders for their poor financial performance in recent years. Starboard Value LP, a shareholder with an 8.8% stake in Darden Restaurants, has raised concerns related to the endless breadsticks and salads being offered to customers at Darden's Olive Garden restaurants. According to this major shareholder, these practices have led to food waste and reduced profitability.

This case study discusses how the endless breadsticks and salad offering by Olive Garden Restaurants results in food waste and decreased profit margins. The questions that this case study aims to answer are:

- What are examples of food waste in the Olive Garden restaurants?
- How can the food waste in Olive Garden restaurants be reduced?
- How can food waste reduction positively impact Olive Garden's food cost and profitability?
- How can the endless breadsticks and salad offerings be modified without negatively impacting guest satisfaction and profit margins?

Theoretical Foundation

Food waste, referred to a wholesome edible food diverted away from human consumption (Stuart, 2009), may occur during industrial handling, distribution, or final consumption (Barilla Center for Food and Nutrition, 2012). Food waste is a critical global concern due to its numerous negative macroeconomic, financial, agricultural, and environmental impacts. This includes reduced farmers' income, increased consumer expenses, and inefficient use of natural resources (i.e., land and soil). Since 10% of the U.S. energy budget is required to bring food to our tables (Webber, 2011), increasing the efficiency of the U.S. food supply chain (i.e. farmers, grocery stores, restaurants, consumers, etc.) and investing more in food waste reduction strategies would reduce the usage of our environmental resources and lead to financial benefits through food cost savings for both businesses and consumers.

It is estimated that almost 40% of food in the United States goes uneaten each year (Gunders, 2012). According to the Environmental Protection Agency (2011), food waste accounted for 34 million (or 13.6%) of the 250 million tons of municipal solid waste in the U.S. in 2010. During this same year, food waste also accounted for $161.60 billion at the retail and consumer level, which represented 133 billion

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pounds or 31% of the available food supply and $1.30 billion in additional landfill costs (Buzby, et al., 2014). In 2009, food losses from 134 U.S. commodities totaled $198 billion (Venkat, 2012).

In restaurants, almost 30% of litter is made up of food waste, which may occur through improper practices in menu planning, food purchasing, receiving and storage, handling, preparation, serving, and consumption (California Environmental Protection Agency, 2013; Gunders, 2012). In menu planning and purchasing, food waste may result from too many menu options, unpredicted sales fluctuations, lack of flexibility, or poor inventory planning (Gunders, 2012). To offer more variety of food options, restaurants often order more food than they need to make sure that everything on the menu is available. Food waste in receiving and storage may occur through improper shipping, handling and storage, insect invasion, mold deterioration, and loss of weight and volume (Adenso-Diaz and Mena, 2014). Frequent handling, inefficient food preparation practices, and food safety regulations may also lead to food waste. During food preparation and service, food waste may result from processing losses excess production of menu items, upsizing of food portions (Kantor et. al., 1997), and cooking and serving errors (Lipinski et al., 2013). This includes food waste that may occur due to inefficiencies in product yields during the food processing and preparation process when converting from as-purchased to edible portion weights (i.e., trimming of fat, removal of skin and bones, etc.).

In the U.S., large meal portion sizes are a leading contributor to food waste, since restaurant portions served are often two to eight times larger than USDA and FDA standards (Kallbekken and Saelen, 2013). Other reasons for food waste include buffet servings, excess portions that not consumed, and negative customer attitudes towards leftovers (Gunders, 2012; Lipinski et al., 2013). According to Betz et al. (2014), the highest proportion of waste occurs from serving losses, especially starch accompaniments and vegetables. Fruits and vegetables, seafood, grain products, meat, and milk are other food products commonly wasted in restaurants. Also, some restaurants may dispose of food because of their strict hygiene rules and marketing strategies. Much of this food loss could be avoided if proper cost control measures were implemented in the foodservice industry.

Effective food waste reduction procedures can be implemented through proper purchasing, handling, preparation and storage practices that result in reduced food waste and associated food costs (Immanuel et al., 2013). Food waste reduction strategies include better menu planning and purchasing practices, more effective storage solutions, and improved employee training about food waste (Gossling et al., 2011; Gunders, 2012). Employees can be educated and trained employees with guides and good practices, and can communicate with their customers to revise portioning, recipes and ingredients (Marthinsen et al., 2012). Restaurants also may reward employees for good ideas that result in reduced food waste and decreased food costs (California Environmental Protection Agency, 2013).

Case Synposis: Olive Garden's recent investor debate about unlimited salad and breadsticks

Olive Garden, the flagship chain of Darden Restaurants, Inc. (NYSE:DRI), is the largest full service dining Italian restaurant chain in the United States. Olive Garden's menu includes a variety of authentic Italian foods featuring fresh ingredients and a wine list that includes a broad selection of wines imported from Italy. The menu includes a lighter Italian fare and classic Tuscan favorites of flatbreads and other appetizers; soups, salad and garlic breadsticks; baked pastas; sautéed specialties with chicken, sea food and fresh vegetables; grilled meats; and a variety of desserts (Darden Restaurants, 2014).

Olive Garden's unlimited salad and breadstick offering, which has been popular to customers since introduced in 1982, has recently been criticized by a new large shareholder, Starboard Value LP. Starboard Value asserts that the unlimited offering of salad and breadsticks has contributed to food waste and escalating food cost percentages. The main argument is that the long-standing service delivery method for unlimited salad and breadsticks is wasteful (Choi, 2014) and should be modified to reduce food costs.

Table 1

Olive Garden's Quarterly Same-Store-Sales Growth (2012-2014)

Quarters (Fiscal Years)	Same-Store-Sales Growth
Q1-12	-2.90%
Q2-12	-2.50%
Q3-12	2.00%
Q4-12	-1.80%
Q1-13	0.30%
Q2-13	-3.20%
Q3-13	-4.10%
Q4-13	1.10%
Q1-14	-4.00%
Q2-14	-0.60%
Q3-14	-5.40%
Q4-14	0.50%
Q1-15	2.20%

Note: Data is taken from the following sources:
- Starboard's Investor Presentation. Available at: http://www.documentcloud.org/documents/1300752-transforming-darden.html#document/p5
- Darden Restaurant's 10Q. Available at: http://d1lge852tjjqow.cloudfront.net/CIK-0000940944/40a789bf-5518-49a2-961f-596bc76d33fa.pdf

Table 2

Olive Garden's Average Annual Sales per Restaurant (2009-2014)

Fiscal Year	Average Annual Sales per Restaurant (in millions)
2009	$4.80
2010	$4.70
2011	$4.80
2012	$4.70
2013	$4.60
2014	$4.40

Note: Data is compiled from the company SEC fillings (10K reports from Edgar Database).

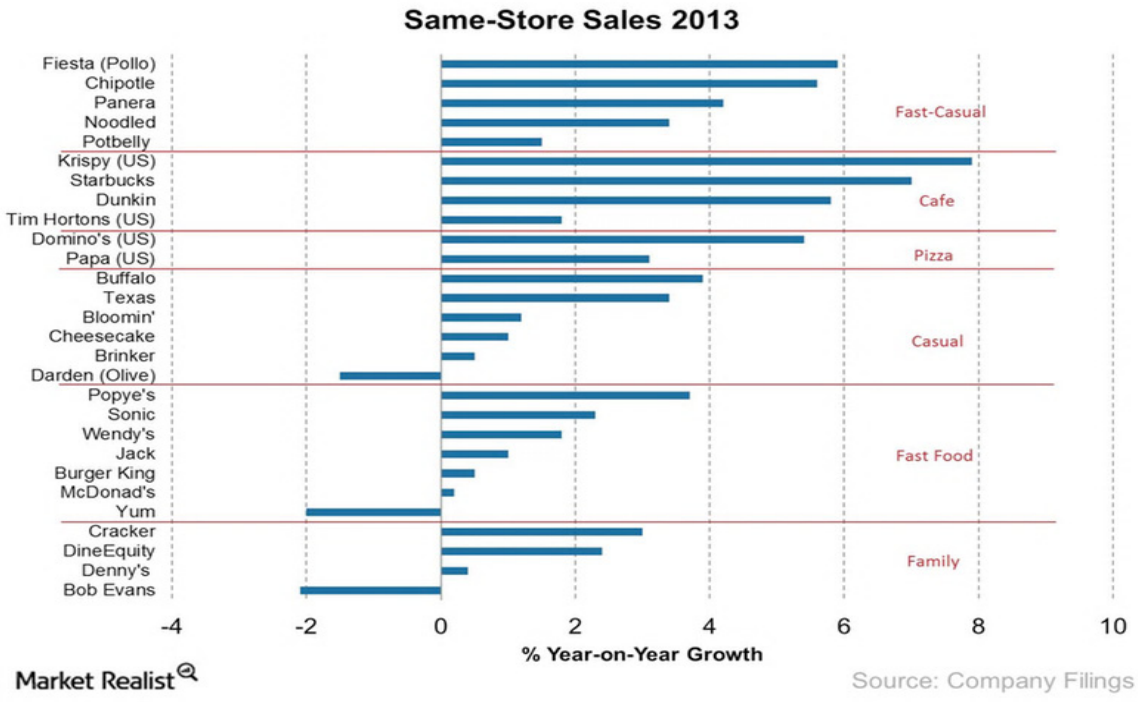
Jeff Smith, CEO of Starboard Value LP, believes that endless breadsticks and salad offered causes excess food waste and leads to a poor guest experience, which negatively impacts profitability. Although Smith does not want to eliminate these offerings, he points out that too many breadsticks are delivered to diners at once and they quickly get cold, go often uneaten, and grow stale fast (La Monica, 2014). According to Starboard's detailed 294 page long investor critique report and presentation about Darden restaurants, Darden's executive team admits that the breadsticks deteriorate in quality after sitting 7 minutes on the table. Starboard's advice is to change the way breadsticks are served and to put more control in how they are served. Smith's suggested that rather than a waiter automatically bringing out a huge bowl of breadsticks, breadsticks should only be served when requested. This would minimize food waste, reduce food cost percentages, increase profit margins, and improve the quality of the guest's dining experience by increasing the number of interactions between waitstaff and guests" (Transforming Darden Restaurants, Starboard Value LP. Investor Presentation, 2014).

Food Waste Effects on Olive Garden's Key Financial Dynamics

In Starboard's recent investor presentation and report, food waste at Olive Garden contributed to Darden's high food cost structure (near the highest in the industry). Olive Garden's food costs historically have been 26-27% of sales, but now they have risen to an estimated 29% contributing to Darden's overall 30.1% food costs (industry median is 27.20%) (Transforming Darden Restaurants, Starboard Value LP. Investor Presentation, 2014). Jeff Smith is concerned about increasing food costs and waste stemming from uneaten breadsticks and salad, the deterioration of food quality, poor guest experience (server interaction with the guests), and declining quarterly same-store-sales growth.

Figure 1

Same-Store Sales Comparison in the U.S. Restaurant Industry (2013)



Source: Jones, A. (2014). Know about same-store sales to understand restaurants. In an in-depth overview of the US restaurant industry article appeared on Market Realist. Retrieved from http://marketrealist.com/2014/12/know-store-sales-understand-restaurants/

Table 1 reports Olive Garden's quarterly same-store-sales growth. Olive Garden's 2014 third quarter decrease in same-store sales of 5.4% was the largest percentage decline of any quarter in the past three years. Correspondingly, Olive Garden's sales of $3.64 billion in fiscal year 2014 were 1.10% below fiscal year 2013. Although same-store sales improved in 2015 (Q1-15), food cost percentages increased from 26% to 29%. Jeff Smith believes that these increased food costs can be partially attributed to the diseconomies of scale in the amounts of food wasted, such as that resulting from the excess amounts of salad and breadsticks served to customers.

As illustrated in Table 2, average annual sales per restaurant for Olive Garden were $4.40 million in fiscal 2014 compared to $4.60 million in fiscal 2013. The 2014 average annual sales per restaurant also represented a $400,000 decline from 2009. Further, customer traffic steadily declined between 2012 and 2014 (-4.20% in 2014).

Taken all together, declining average annual sales per restaurant and same-store-sales position the Olive Garden chain as the "worst" performer not only among its peers but mostly importantly across six segments of the U.S. restaurant industry. Figure 1 presents 2013 year-on-year same-store sales comparison, and as demonstrated, the Olive Garden's 2013 year-on-year same-store sales growth declined by about -1.8%.

Should Olive Garden Keep Offering Unlimited Salad and Breadsticks?

The conflict between Darden executives and Starboard Value LP resulted from Olive Garden's weak and fragile financial performance, especially in restaurant sales. There was a speculation that the chain's declining profitability was partially attributed to abnormal amounts of food waste and high food cost percentages from endless breadsticks and salad being offered to guests. Unlimited breadsticks and salad offerings have been an integral part of Olive Garden's menu since their introduction in 1982. Smith's main argument is that it is time for Olive Garden to modify the delivery method for breadsticks and salad. By doing so, improvements could be recognized in reduced food waste, improved food quality, more guest/server interaction, and increased profit margins. Smith stated "how 10 years ago Olive Garden servers would place one breadstick per guest plus an additional one for the table on demand, hot. That led to an advanced dining experience and more opportunities for guests to interact with the staff."

When Olive Garden restaurants introduced the breadstick execution strategy in 1982, profit margins and guest experience improved with only small amounts of food waste. However, today is a different scenario. Although current Olive Garden executives are opposed to Smith's suggestions, he wishes to implement a strategy for controlling food costs by focusing on the right balance of pre-portion and pre-prepped items to reduce food waste and profitability (Transforming Darden Restaurants, Starboard Value LP. Investor Presentation, 2014).

Based on the preceding analysis of Olive Garden's current financial situation and an ongoing debate above, the ultimate question for Olive Garden executives becomes "should Olive Garden modify the delivery of breadsticks and salad offered to its guests?" Company executives and shareholders are uncertain about the potential impact of these changes on the restaurant chain's operational, marketing, financial, and competitive position.

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