AlixPartners

Restaurants, Hospitality & Leisure
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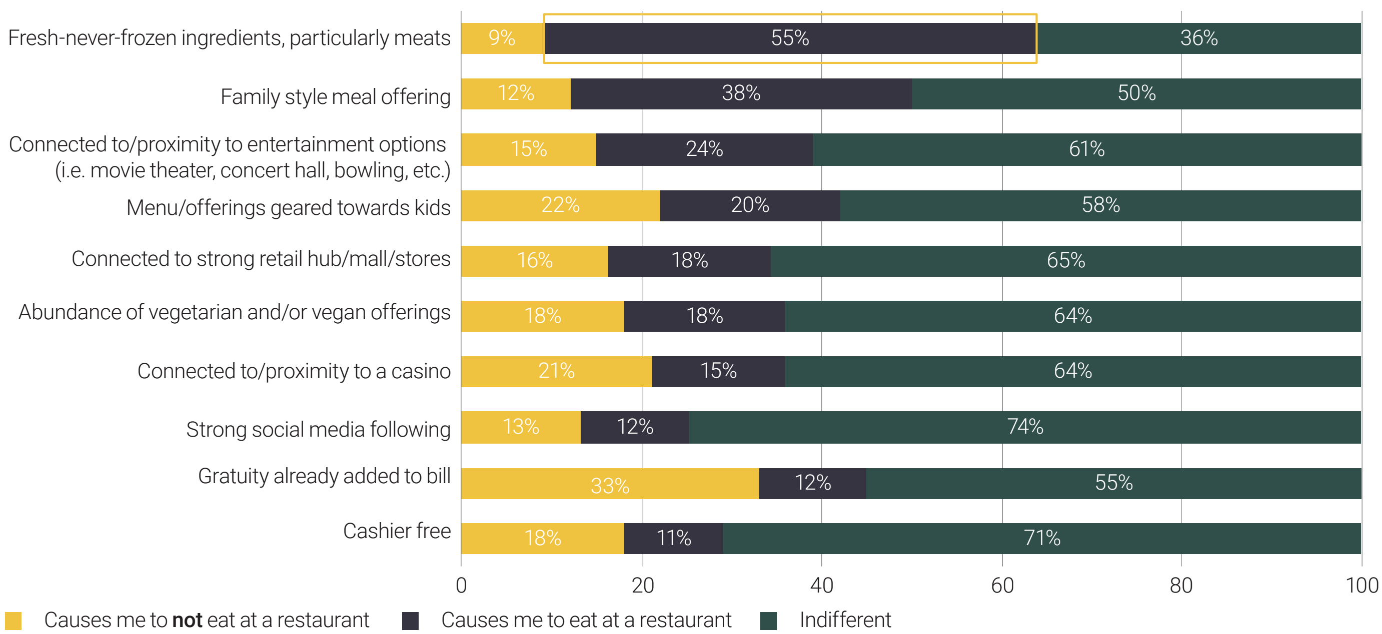
FOOD DISTRIBUTION IS GETTING MORE COMPLEX

How can restaurants find the right recipe?

Predictable and economical food distribution is essential for restaurants to survive and thrive. But as restaurant supply chains get more complex, snags in distribution have led to food wastage, customer service problems, and overall uncertainty. There are several root causes of increasing supply chain complexity, including evolving consumer preferences, labor shortages, trucking and transportation unpredictability, and mergers and acquisitions activity making food suppliers more influential. Restaurants, especially in the fast-casual and quick-service space, must understand how to adapt to this fundamentally changing distribution environment.

In a recent AlixPartners consumer survey, fresh, never-frozen ingredients were rated by 55% of respondents as the most appealing factor in picking a restaurant to eat at (figure 1). And this trend has gained traction year-over-year, as only 48% of surveyed consumers in 2018 said it was the main factor in influencing their choice. Consumers' growing preference for ingredient transparency, health and wellness, environmental sustainability, and freshness has resulted in major new developments in the food distribution industry – ranging from the increased use of fresh meat, reduced antibiotics, and now **meatless burgers**.

FIGURE 1: FRESH, NEVER-FROZEN INGREDIENTS ARE THE MOST POSITIVE ATTRIBUTE IN ATTRACTING DINERS



Source: AlixPartners Restaurant Outlook Survey, conducted February 14-19, 2019, on 1,001 US consumers aged 18 years or older across geographies, demographics, and income levels
Survey question to consumers: How influential are these attributes on your selection of a restaurant or dining establishment?

For restaurants and their suppliers, using fresh beef or other meat instead of frozen means that the shelf life of the raw product is reduced by months. These changes can require significant reconfiguration of the trucking and distribution systems and necessitate the implementation of additional food safety practices.

Historically, food distribution costs have been heavily influenced by volatile fuel markets, but current disruptions in the market are structural and driven by factors such as trucking labor shortages and industry consolidation. A historically fragmented foodservice distribution industry has had a significant period of M&A since 2015 (figure 2).

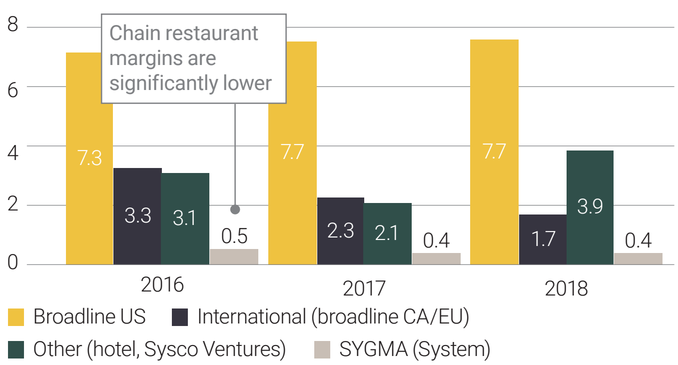
FIGURE 2: MAJOR FOOD DISTRIBUTORS ARE FOCUSING ON M&A TO FUEL GROWTH

Source: Company financial reports, S&P Capital IQ, Crunchbase

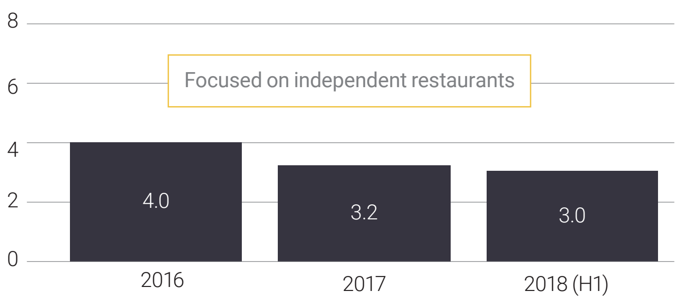
This rapid consolidation has allowed major food distributors to hold more power in the marketplace and pick and choose their customers. Distributors have historically seen profitability in the range of 6 to 7% in their broadline business, particularly when clients include smaller chains and higher-end restaurants that place a premium on value-added service levels. However, quick-service restaurants, which can be very prescriptive in where to source the product from as well as specifications for delivery frequency and time, etc., have traditionally provided margins in the range 0 to 1% (figure 3).

FIGURE 3: DISTRIBUTORS GAIN CONSIDERABLY HIGHER MARGINS BY PARTNERING WITH INDEPENDENT RESTAURANTS

Sysco operating margins (%)



Chef’s warehouse operating margins (%)

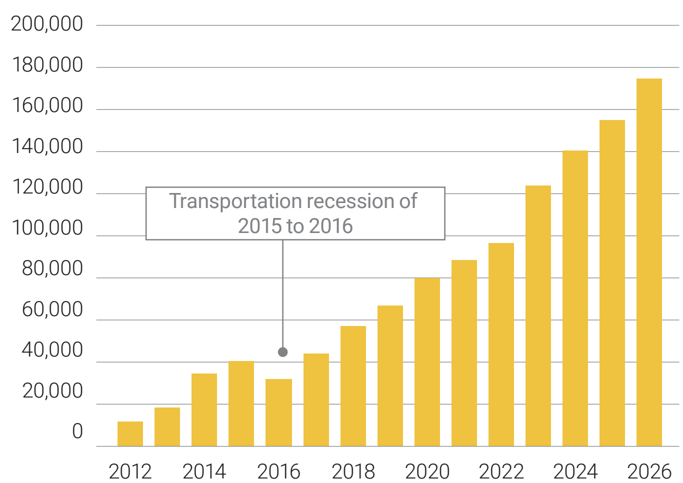


Source: Company annual reports, Investor Day reports

Recent shortages in trucking and labor have widened this profitability margin further (figure 4), and it will be important for quick-service and fast-casual restaurants to carefully consider and potentially make fundamental changes to their distribution operations to ensure that their supply chain remains effective.

The cost and availability of truck drivers is one of the biggest components in foodservice distribution pricing structures. Driver shortages have driven up wages and shifted the limited pool of qualified drivers toward the most attractive of these jobs – those offering higher pay and better work schedules, providing better equipment, and involving less heavy lifting. Foodservice distributors often rely on their drivers to play two roles: drive the truck and bring the product cases into the restaurant. As an increasing share of drivers approaches retirement age – the average age of a commercial truck driver has risen to 55 – fewer are interested in jobs that also require lifting and carrying. As a result, distributors increasingly prefer their drivers to only be driving, not lifting or stocking.

FIGURE 4: HISTORICAL AND PROJECTED GAP BETWEEN DRIVER DEMAND AND SUPPLY IN THE US



Source: American Trucking Associations

In this new environment, restaurants should consider building a strong and complementary partnership with distributors. Traditional, fixed-based approaches could have limited success. Contracts should be assessed to pursue win-win situations, and any contractual complexity that does not improve quality should be removed. While restaurants should broadly expect to start paying more for the same services owing to significant spikes in the trucking and labor market, opportunities do exist across contracting and other key areas to both reduce cost and improve service. Rich in choices, distributors will prefer to work with clients that value the partnership and give them a seat at the table.

Restaurants that simplify their supply chain can help make themselves more attractive customers. Here are some simplification opportunities:

- **Reduce the number of deliveries** by optimizing ordering through better forecasts.
- **Reduce complexity of drop-offs** by assessing delivery logistics, including drop-off locations and delivery windows
- **Reduce driver burden** by having restaurant employees assist with drop-offs.
- **Increase flexibility in product sourcing** to potentially leverage the distributors' broadline selections.
- **Improve back office systems** to optimize and remove steps from business processes such as inventory, ordering, receiving, and distributor credits.

Every restaurant-distributor relationship is different, and it is important to carefully assess individual situations to understand how best to become a valued distribution partner in this changing environment. Getting ahead of this issue today can prevent significant disruptions in the near future.

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FOR A DEEP DIVE INTO THIS TOPIC — AND HOW YOU MIGHT PREPARE FOR ITS RAMIFICATIONS — CONTACT:

Adam Werner
Managing Director
+1 312 705 3911
awerner@alixpartners.com

Peter Appel
Director
+1 202 756 9059
pappel@alixpartners.com

ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.