

State of the Foodservice Supply Chain

And How Companies Can Prepare for 2022 and Beyond



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Executive Summary

While U.S. restaurant sales have come roaring back in 2021 from their 2020 lows, the foodservice supply chain has profoundly changed. Supply disruptions and surging demand have caused endemic shortages and price inflation. There is a growing consensus that these problems will continue through 2022, if not longer. In this environment, improved supply chain agility is critical to keeping kitchens stocked with fresh ingredients while minimizing spoilage and controlling food costs. Innovative companies are investing in new supply chain capabilities to increase agility so they can adapt more quickly to unpredictable swings in supply and demand. This will help them deal with both the current situation and future disruptions, and provide a new source of long-term competitive advantage. Starbucks and a multi-billion-dollar QSR chain are profiled as examples of companies that are seizing the opportunity presented by the current crisis.

Shortages and Price Inflation Plague the Industry

The foodservice industry has been plagued with shortages of food and non-food supplies for months, with no end in sight. In September 2021, the National Restaurant Association conducted a survey of 4,000 operators and reported that 95% said that they had experienced supply delays or shortages of key items in recent months, as indicated in the chart below.

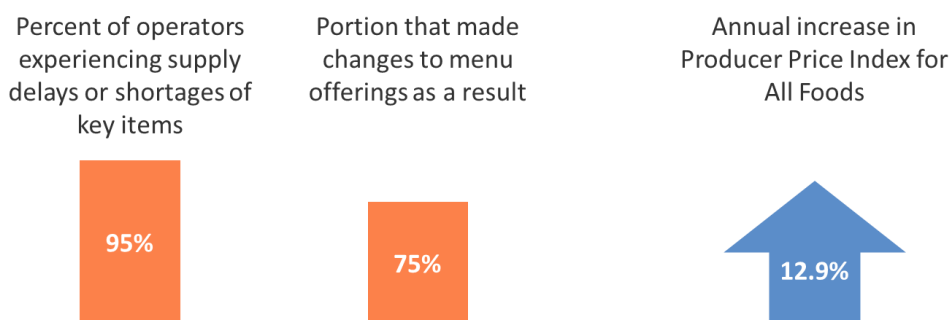
“We all thought it would be over by now. It’s just one thing after another. This is going to be the norm for a while.”

- Benjamin Walker
SVP, Baldor Specialty Foods

Among these, 75% had to modify their menus in response. Price inflation has been growing as well. The association reported that the Producer Price Index for All Foods increased 12.9% between September 2020 and September 2021, the largest annual increase in over 40 years.¹

Anecdotal reports from foodservice distributors echo the above data. In August 2021, Sysco, the nation’s largest foodservice distributor, reported tight supplies and rising prices, particularly

for labor-intensive meat products such as bacon, ribs, wings, and tenders. In a letter to customers, CEO Kevin Hourican wrote, “There are certain areas across the country that are more challenged by the labor shortage, and our volume of orders is regularly exceeding our capacity. This has, unfortunately, led to service disruptions for some of our customers.” Baldor Specialty Foods, which serves the Northeast, indicated that a shortage of drivers is causing late deliveries from food suppliers. This in turn is causing Baldor’s service levels to its customers to fall



Source: National Restaurant Association survey, September 2021

significantly from pre-pandemic levels of over 90%. According to Benjamin Walker, Baldor's SVP of Sales, Marketing, and Merchandising, "We all thought it would be over by now. It's just one thing after another. This is going to be the norm for a while."²

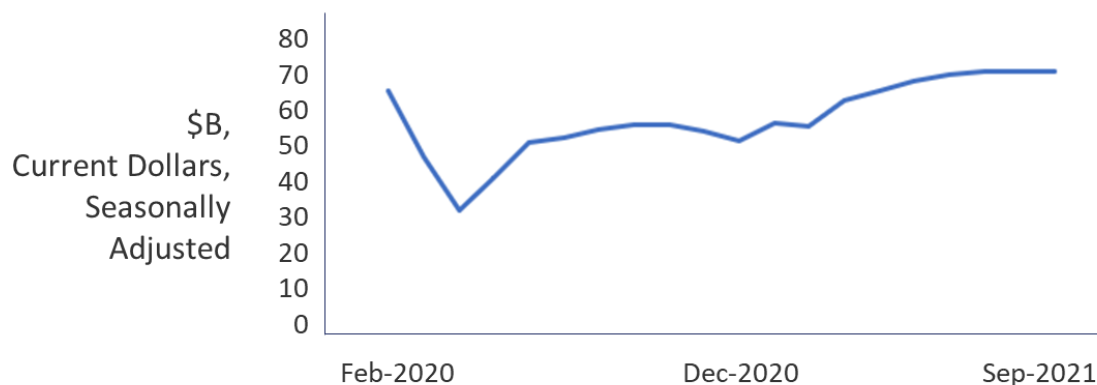
"The consensus we are hearing (and seeing) is that supply chain issues and commodity inflation are likely to persist through 2022."

- Alec Haesler
Director, Carl Marks Advisors

Surging Demand is as Much the Root Cause as Supply Disruptions

The current supply chain challenges in the industry result from a mismatch between supply and demand. The business and trade media have documented how supply has been disrupted by COVID breakouts and labor shortages. Less well-documented is the unexpectedly high level of demand. Despite lingering consumer concerns about eating in restaurants, there was a faster than anticipated resurgence of on-premise traffic after the roll-out of vaccines in the Spring of 2021, which caught suppliers off guard. This, combined with the continuing returns from the industry's aggressive investments in online ordering and off-premise capabilities, has been a major contributor to shortages and price inflation, compounding the supply disruptions. The chart below shows how restaurant sales have bounced back from 2020 lows.³ Seasonally adjusted industry sales were back to pre-pandemic levels by April 2021 and have continued to increase into the Fall.

Monthly U.S. Eating and Drinking Place Sales



Source: National Restaurant Association

No End in Sight in 2022

There is a growing consensus that while overall sales have returned to normal, the industry's supply chain challenges will be with us for quite some time. Labor shortages continue to plague operators, distributors, and suppliers, and it will take time to adjust to new demand patterns and supply constraints. According to industry observer Alec Haesler at Carl Marks Advisors, "The consensus we are hearing (and seeing) is that supply chain issues and commodity inflation are likely to persist through 2022. While demand has snapped back incredibly quick, it will take time for supply chains to untangle."⁴

Starbucks Thrives in Challenging Times

Given Starbucks's focus on on-premise sales and providing a "third place" between home and office, it was vulnerable to the same forces affecting the rest of the restaurant industry. For its fiscal Q3 ending June 2020, same-store sales in the Americas fell 41%. A year later, its Q3 Americas same-store sales were up a whopping 84%, as the company achieved a record \$7.5B in global revenues.⁷ According to CEO Kevin Johnson, the company gained "meaningful market share in the U.S." in Q3.⁸ This success was despite not fully reopening its in-store seating, and experiencing shortages of items such as cups, coffee syrups, cake pops, cup stoppers, and mocha flavoring. The company had to temporarily remove popular oat-milk-based drinks from its ordering app and pause production altogether of some low volume products.⁹

How did the company do so well despite the challenges? Like other operators, Starbucks invested in drive-thru, pickup, and mobile ordering. But it has also invested in behind-the-scenes operations to improve productivity and grow revenues faster than headcount. One such investment is an automated inventory ordering system, which allows store employees to spend less time on managing inventory and more time serving customers.¹⁰

In addition, it's impossible to predict how the pandemic will progress. As of November 2021, rates of new infections in the U.S. are ticking up again as people spend more time indoors and the effectiveness of vaccines begins to wear off.⁵

The Delta variant is continuing to spread, the Omicron variant is causing alarm, and there will presumably be future variants. As of November, Germany, considered a leader in controlling COVID-19, is facing all-time record levels of new

cases of about 50,000 per day, attributed to the Delta variant and colder weather. A similar fate could meet the U.S. this winter, and it's impossible to predict when recurring waves of infections will stop.⁶

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- Justin Seamonds
CEO, Rōti Modern Mediterranean

The Need for Supply Chain Agility

The pandemic has served as a wakeup call on the vulnerability of the foodservice supply chain in the face of supply and demand disruptions. In the early days of the pandemic, operators scrambled to minimize the risk of supply disruptions through a number of tactics born of expediency rather than a long-term plan. Such tactics included removing risky items from menus and using frozen ingredients rather than fresh.

As it became apparent that the pandemic would last for quite some time, innovative companies began to take a longer-term view and started investing in strategic supply chain capabilities. These were focused on increasing supply chain agility so that they could quickly respond to swings in demand and supply. Example capabilities include:

- Improved demand forecasting using artificial intelligence
- More frequent monitoring of supply and demand
- Careful expediting and delaying of purchase orders to align with changing demand
- Use of alternate products and suppliers
- Transshipping of products from warehouses with excess supply to those with insufficient supply

QSR Chain Reduces Inventory by 9% While Growing Sales During the Pandemic

In 2020, this multi-billion-dollar QSR chain embarked on a major supply chain transformation project to redesign its procurement and inventory management processes using New Horizon's supply chain planning software. The goal was to maintain high service levels to restaurants while minimizing inventory and costs. Whenever there's uncertainty over supply and demand, operators respond by increasing inventory buffers. But this increases carrying costs. The company was able to offset higher inventory costs for some items by decreasing inventory elsewhere and improving overall supply chain efficiency and effectiveness. Their tactics included truck loading optimization, inventory balancing among distribution centers before resorting to new purchases, and level-loading warehouse labor needs based on vendor delivery schedules. The chain went live with the New Horizon solution after a two-month implementation. In the first phase of the rollout, it lowered DC inventory levels by 9% even as it increased the number of restaurants served by 69%.

Seize the Opportunity

While most foodservice companies have been reacting to the pandemic simply to stay afloat, a growing number have realized that, in the spirit of "never let a good crisis go to waste," the pandemic represents an opportunity to reengineer their supply chains to serve consumers better and gain competitive advantage. As the fast casual operator Rōti Modern Mediterranean CEO Justin Seamonds stated, "It is no secret that the service industry as a whole has been devastated by breaks in the supply chain ... We had one of two options: sit back, wait and hope that things would resume as usual, or take the opportunity to re-evaluate how we do business. While the world was on hold, we were not."¹¹

Improvements to supply chains will prepare operators, distributors, and suppliers for the uncertainty ahead. It will also help prepare companies for other natural, economic, and geopolitical disruptions, which have been occurring with increasing frequency over the last 20

years. And during calmer times, improved supply chain capabilities will allow companies to provide a more consistent and high level of service while reducing inventories and lowering operating costs. As industry expert Aaron Allen stated, "The changes that were accelerated by this crisis will mean a boon for those

on the supply side that are able to retool, reformat, and quickly redesign and align their business for this next normal."¹²

In fact, even during 2020, a year in which median revenue for publicly traded foodservice operators declined by 14%, 1 in every 4 companies actually grew. Some of the growth was due to acquisitions, and certain segments such as pizza were able to take advantage of their historic strengths in off-premise dining. But some of these companies grew because they invested in technology to adapt to the pandemic.¹³ Two such companies are Starbucks and a multi-billion-dollar QSR chain customer of New Horizon (see sidebars).

New Winners Will Emerge

No one can predict how the pandemic will end. But when it ends, the foodservice industry will have changed. Many innovators recognize that the current environment provides an opportunity to upgrade their supply chain capabilities to proactively manage business uncertainty rather than simply hope that the pandemic

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- Aaron Allen
CEO, Aaron Allen & Associates

will go away. When the pandemic is finally over, some foodservice firms will be diminished, while others will emerge as the industry leaders of the future.

Endnotes

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2. Leslie Patton and Deena Shanker, "U.S. Food Suppliers Are Having Trouble Keeping Shelves Stocked," Bloomberg, August 24, 2021
3. "Total Restaurant Industry Sales," <https://restaurant.org/research-and-media/research/economists-notebook/economic-indicators/total-restaurant-industry-sales>, National Restaurant Association, November 2021
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5. "COVID Data Tracker Weekly Review," CDC, November 12, 2021
6. Holly Ellyatt, "Germany Was Once Praised for Its Covid Response. Now It's Seeing 50,000 Cases a Day, Prompting a Dramatic Warning," CNBC, November 11, 2021
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11. Justin Seamonds, "If There's One Industry That Can Beat COVID, It's Restaurants," QSR, April 26, 2021
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13. Aaron Allen, "It's Time to Rethink the Foodservice Supply Chain," QSR, August 12, 2021

About New Horizon

At New Horizon Soft, we are bringing a more modern approach to supply chain planning software for foodservice operators, distributors, and suppliers. Supply chain performance in the foodservice industry is becoming increasingly strategic, yet traditional software solutions remain difficult to use and complex to implement. New Horizon leverages the latest advances in artificial intelligence, machine learning, and cloud technologies to offer a more intuitive user experience and quicker, less expensive implementations. The result is superior service levels, lower inventory, faster time to value, and lower TCO. New Horizon customers include Golden State Foods, KFC, McLane, Diamond of California, Faribault Foods, and Republic National Distributing Company. New Horizon – Planning Made Easy™.

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