VALUEWALK

Learning From Ron Shaich Of Panera Bread

April 3, 2018 by Investment Master Class

The restaurant industry is a hyper competitive industry – this has long been the case. It's mature, fragmented and has negligible barriers to entry. New entrants are attacking all the time. And it's an industry which is as "tough as hell" to succeed – did you know that more than one third of restaurant chains are out of business within a decade or two? If that's the case, how on earth can a bread company significantly outperform Warren Buffett's Berkshire Hathaway over two decades?

The answer to that question lies at the feet of **Ron Shaich**, the founder and Chairman of **Panera Bread**. Panera was the best-performing restaurant stock of the past 20 years, delivering a total shareholder return up **86-fold** from 1997 to July 2017 [before being taken private], compared to a **less than two-fold** increase for the **S&P 500** during the same period. The stock annualised returns at an astonishing **25 per cent per annum**.

Source: Bloomberg

It's no secret that I'm always interested in learning from great CEO's and investors - those people with outstanding track records of success regardless of the industries they work within. I recently enjoyed listening to a Forbes interview by Steven Bertoni with Ron Shaich. This prompted me to learn more about how this 26-year veteran CEO successfully navigated the changing dynamics of the restaurant business, empowered his staff and adjusted to change to maintain a competitive advantage over the long term. And once again, you'll find many of the characteristics that define Mr Shaich define other world class CEO's.

Here are some of my favourite snippets from both the Forbes Podcast and Ron Shaich's excellent website …

Leadership

*"This is what we do as business **leaders**; we discover today what is going to matter tomorrow and **make sure our companies are prepared and ready** for that as the world unfolds."*

*"The role of **leadership** is to **separate the wheat from the chaff** and **know** what the **deeper trends** are. We don't follow fads. What we do it try to figure out is **what is going to really matter in a deep and profound way three to five years from now**."*

*"**Leadership** always requires **developing a hypothesis, understanding** where the **world is going** and making a **smart bet** into that."*

*"I believe one of our roles as leaders is to **tell the truth**, and tell the truth **most importantly to ourselves."***

Learning

*"I **go to work to learn** .. I love the sense of making a difference and **figuring things out."***

*“We as leaders don’t take enough time to **learn**. The one thing that I don’t think we **learn** and value enough is empathy. We don’t feel what the customer feels.”*

*"I view my work as a lifelong **learning** journey. I go to work to **learn** about how the world works. How humanity works. And what will work in the world."*

*"The British author John le Carré once quipped, "The desk is a dangerous place from which to view the world." I couldn't agree more. I visit anywhere from 25 to 100 Panera cafes every month. And what I always find is a kind of real-time performance art—dynamic interactions between our frontline crews and constantly shifting casts of customers, with the overriding goal of ensuring that when customers exit our "stage," they are nourished in soul as well as body. The performances always differ. And I inevitably **learn** something new. When I **learn**, the results are actionable ideas and a broadened vision. Opportunities for change are revealed."*

Three-Step Process

*"It's not complicated. It starts **first** by **telling ourselves the truth**. In a really ruthless way. **Second**, to **understand what few things really matter** to get the jobs done that **consumers are hiring us to do**. What do we really have to do and how do we prepare ourselves to be able to do that as the world plays out over the **next two to five years**. **Thirdly**, we **get it done**. You take **those three things and you can have success**."*

*"I tell my team all the time that Panera's success comes down to **three things** we've always been able to do: **1. Tell the truth. 2. Know what matters. 3. Get the job done.** Most people do not have the insight, foresight, or wherewithal to do all three. But I firmly believe that doing all three is the **key to success in business and in life**."*

What Job Clients Hire For

*"[With Panera] it was very clear to me **we were serving real consumer needs**. We had a dominant position, a better **competitive alternative** in a range of **different jobs that consumers were willing to hire us for**. That manifested itself in very high unit volumes, consistent from Detroit, Portland to Miami. You could see its reproducability."*

Long Term

*"I think **long term.**"*

*"**I've won because** I had enough credibility, I voted enough stock, that **I was able to make** these **long term bets**. That's what **gave us competitive advantage**."*

*"**What drove our outperformance was our ability to make long-term transformations** multiple times over 36 years. As a long term CEO; 26 years, I've had the opportunity to really look back and really **reflect on the public markets**. And here is what I see - I see investors no longer owning companies but renting stock. Forty years ago the average holding time for a public company was 8 years, today it is 8 months. **People are renting their stock**. You have a very different world.*

Source: Ron Shaich IGNITE 2010 Presentation

*You have activists, you have a lot of money managed passively and you have the index funds deferring often to ISS to make judgments, and nobody feels capable of separating the wheat from the chaff. So we go to **the path of least resistance and say it can't hurt to help the activists**. We see it across multiple industries - a company has a flat year after years of success, and activists get voted in to control the board. Someone can walk in and say I own 2% of the company and another 6% in* *derivatives, I'm your owner, cut costs in half and R&D, lever up the balance sheet, sell the stock and let someone worry about the carcass.*

That has an effect on CEO's. At the same time we see the ***FANG*** *companies. The hottest companies in the public markets.* ***They are the ones who are winning****. What is their* ***competitive advantage****? They have* ***capital structures that let them make long term decisions****.*

I was on the board of Wholefoods which was sold to Amazon. And ***what is Amazon doing?*** *The same things we would have done at Wholefoods; investing in digital and cutting prices because the competitive environment changed. But in Wholefoods we couldn't do it because of the* ***short term pressures coming at us*** *from people who wanted us to produce the results right now.* ***What has Amazon got? The room and time to make these kinds of investments****.*

Here's my point. These put ***CEO's in a very weak position****. CEO's want to please. They don't want the vulnerability of someone walking in and taking control. So they tighten up. They get* ***short term****. That's the reality. They go for* ***cost cutting****, and* ***ignore innovation*** *and* ***building community*** *and* ***taking care of team members****. The ultimate result is that it* ***dramatically affects the ability to do long term transformation, dramatically effects GDP growth and economic competitiveness for society.****"*

"I began to recognise for our ability to continue to do great work, I could think of no place better than with an ***ultra-long term investor****,that allowed our people to do it."*

"Studies such as this ***one*** *from the Harvard Business Review conclude that* ***founder-led businesses*** *often* ***outperform*** *professionally managed firms. I would suggest that they do so because the founder's commitment runs far deeper and is often* ***longer-term*** *in nature than that of the professional manager. And commitment and focus is what drives performance."*

Importance of Competitive Advantage

"I've learned that ***competitive advantage*** *is everything. Simply put, competitive advantage is what prompts customers to choose you over your competitors. Without it, your business just fades away."*

"You ***must develop true competitive advantage****. You must be the* ***best alternative*** *for certain guests, so much so that they walk past the establishment next door to visit your concept. Sounds easy, right? Well, in a world where a new restaurant pops up every day, true* ***competitive advantage*** *is one of the most difficult things to attain. But it is the critical piece that separates those who succeed from those who fail."*

"You will accomplish little ***if you don't maintain long term competitive advantage****. It will take courage. Whatever your situation, you will ultimately fail if you don't deliver a* ***superior experience for your target customer*** *by doing what competitors don't."*

"What sustains a company over the long term is how it thinks, not what it does. Because what is does is a by-product of how it thinks. Panera in its core comes from a view that ***competitive advantage is everything.*** *If we don't have a reason for people to walk past competitors and come to Panera, then we don't exist.* ***Losing competitive advantage is the greatest risk in business****, and that's where our focus is."*

"When [EPS] growth does occur, it's only because the management team is intently focused on continually ***sharpening the concept's competitive position*** *through food, experience, people, communication and operational excellence."*

"Focus intensely on making the right decisions today to build your same-store profitability in the future. Recognize that ***same-store profitability*** *is, in the long term, most directly impacted by your* ***competitive position****. Bet on the things that will* ***improve your competitive position****. I call these "smart bets." Making these bets requires an understanding of what the* ***competitive landscape*** *will look like* ***two, three or more years*** *in advance."*

"I view my role as CEO as protecting those that discover ways to build ***competitive advantage****."*

How to Develop Competitive Advantage

"We may serve 10 million people a week, but if we're going to be ***competitive****, it's all about* ***one guest's experience****."*

"So how do you create ***competitive advantage****?*

First*, make sure the* ***niche you focus on is big enough to sustain you****, but not so easily duplicated that you simply become a test lab for larger competitors.*

Second*, recognize that* ***you can't please all the people all the time****. Instead, develop a concept that's the* ***singular best choice for some customers*** *on some days rather than the second-best choice for everyone, every day.*

Third*, accept that* ***maintaining competitive advantage*** *in this industry — with its low barriers to entry —* ***is really difficult****. One day you're the most attractive alternative on the block. The next day your target customer is walking past your door to a "new and better place" down the street.*

Fourth*, recognize and* ***avoid the reactionary nature of our industry****, which often leads to diminished competitive advantage. As concepts begin to look more and more alike, companies move further away from being the best competitive alternative for a certain group of customers. And before you know it, yesterday's favourite is suddenly an industry has-been.*

To avoid this you must ***stand for something over the long term****. You have to mean something to your target customer.* ***You can't be changing every day.****"*

Long Term Transformation

"The key to me has been to try to find means and mechanisms for ***competitive advantage*** *and* ***opportunities for long term growth****. If you look at it, Panera has continued to* ***transform itself*** *- six different* ***transformations*** *over the 36 years I have run this company. You can go all the way back to its formation. I formed it initially as a 400 square foot cookie store in downtown Boston."*

Innovation

*"Driving **innovation** is the most important role of the CEO."*

*"**Innovation** begins with understanding what job you're trying to complete for whom, and then determining what matters to that audience, looking for patterns, and trying to understand it."*

*"Most companies' systems and functions are designed to efficiently deliver a business model that was successful yesterday. But what you accomplished yesterday won't help you succeed tomorrow. For that, you must **continually turn to discovery**."*

*"We must avoid the trap that **befalls many big companies**. That is, they bulk up their delivery muscle while **letting their discovery muscle wither**. Instead of **innovating** and doing the things that will help them discover the next growth opportunity, they devote an inordinate amount of resources and focus to getting the work done, on time and on budget. Of course, delivery matters. A company that busts its budgets and misses its sales targets won't endure for very long. But in terms of the **competitive advantage** it can generate, **discovery matters more. Much more.** When it reverses its priorities and puts discovery at the forefront, a company stands a far better chance of getting to the future first."*

*"I often think of myself as the **discoverer-in-chief.** The most powerful role I have is protecting the people that are dreaming about where this company can be in two to three to five to 10 years."*

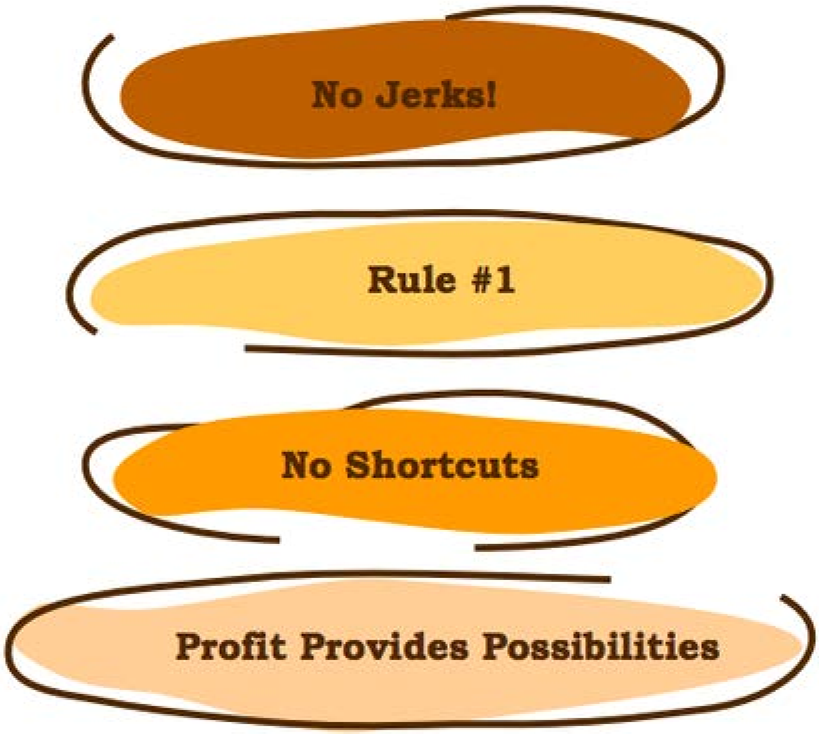
*"I have long believed that every **innovation process starts with learning**. And learning depends on observing and questioning, which in fact led to the creation of Panera itself. In 1993, when I was the CEO of Au Bon Pain, we acquired a 19-store chain called the Saint Louis Bread Company, which we believed would help us build a gateway to the nation's suburbs. But instead of immediately trying to scale Saint Louis Bread, we spent the next two years **studying it.**"*

*"We ran down more than a few dead ends on the road to creating Panera. Nor did we seamlessly move from question to solution. There were many **interim steps** along the way: **observing, brainstorming, testing, prototyping, iterating, retesting, and more**. But our **innovation process started by asking questions.**"*

People and Incentives

*"If an organization is to build same-store profitability, it is essential that it **have the right people to actually get the job done**. And it must **incentivize** them to do so. I'm always amazed at the number of restaurant companies that incentivize their operators on the wrong things when it comes to building value. They incentivize on actual versus budgeted results, instead of base store profit growth year over year over year. Frankly, this **misguided focus on short-term metrics degrades shareholder value**."*

Culture



Source: Ron Shaich IGNITE 2010 Presentation

"We Made a Smart Bet on a Clear Set of Shared Behaviours: ***Cultural Values.****"*

"Ask any of Panera's 100,000 employees what they like most about our ***corporate culture*** *and they will undoubtedly reply, "No jerks." Those two words — No. 1 on our list of* ***cultural values*** *— set Panera apart as an enterprise. They ensure that our relationships with each other and with our guests are based on respect and honesty, and they establish a standard for our conduct."*

Growth

"In my opinion, ***growth is not a pedal to be pushed****. It is not an end in itself. Rather,* ***growth is simply a means of building shareholder value by capitalizing on a successful business model****.*

Growth is a ***double-edged sword****; it is either additive or subtractive of economic value. The bottom line is that* ***growth can only build value if the underlying business model is worthy of being reproduced****. Because let's face it, the world does not need another restaurant — not unless that restaurant actually offers its customers something better.*

Growth only makes sense once you have already built a business model that offers a better competitive alternative*, and if management is highly confident they can deliver* ***strong and consistent returns on investment****. You must have these two elements in place or else you really have no right growing. Indeed, without these two elements in place, growth simply becomes a form of* *gambling with your stakeholders' money — foolishly placing bets when the odds are strongly stacked against you."*

"We can all recall numerous concepts that said they "needed to grow" to keep their P/E high and their shareholders happy. Unfortunately, a ***misguided focus on growth as an end often leads to more bad outcomes than good****. Like lemmings, those management teams that encourage* ***reckless growth march their companies right off the side of the cliff.****"*

Contrarian Approach

"I'm ***contrarian by nature****. I am looking for where the* ***world is going to be in three to five years*** *and where am I going to be."*

"Your management team must be prepared to ***go against the herd****. I call this being contrarian."*

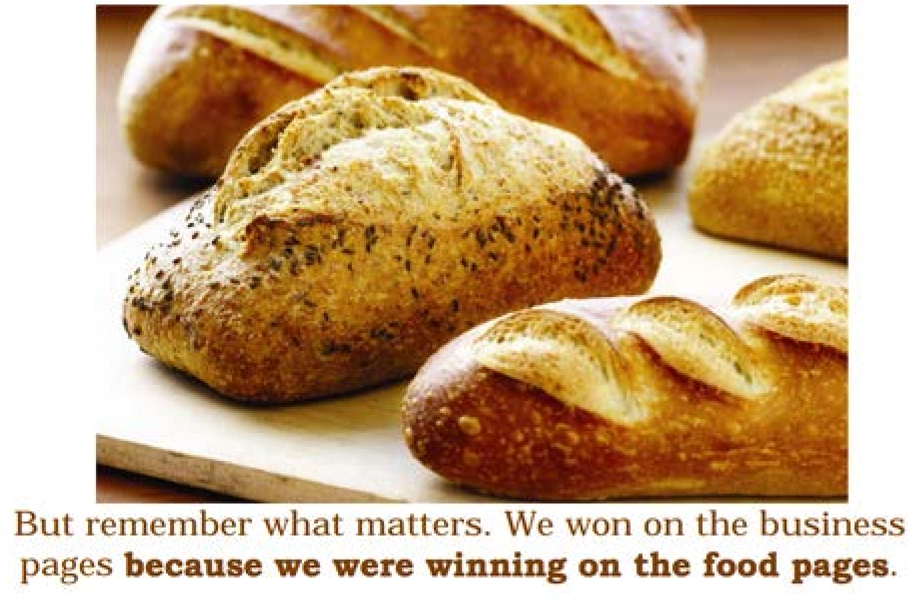
*"****'Contrarianism'*** *is not unique to Panera. In fact, I would argue that the* ***most successful companies in our industry—*** *the McDonald's, Dardens, Starbucks, Chipotles and Yum! Brands of the world — have all* ***utilized contrarian thinking****, applied consistently over the* ***long term****, to build* ***competitive advantage****. Each of these companies is obsessively focused on their* ***target niches****, steadfast in their* ***long-term strategy*** *and* ***contrarian*** *in their thinking — all to build further* ***competitive advantage****."*

Stock Prices

*"****I have never focused on the stock price or the financial performance. It's a by-product****. I don't make the financial performance. What I can make is a better guest experience. And when you deliver on the guest's experience in an absolutely committed fashion, the* ***by-product is performance****. One of the things* ***we often confuse in business and life is the difference between means, ends and byproducts****.*

I focus on the guest experience*. When we deliver a superior guest experience, when we deliver large runways for growth, we then have a future. That is what drive's the financial performance.*

The folks that focus on the stock price, in the end, always hit the rocks*. They are* ***giving me a great competitive alternative because they're short terming****. When you're focused on the next quarter and squeezing the company, you're giving me a great big opportunity to do a better job than you are. Because things of value take time."*



Source: Ron Shaich - IGNITE 2010 Presentation

Quarterly Earnings

*"Wall Street judges Panera and every other public company by what we've achieved over the previous thirteen weeks and what it appears we'll achieve over the next thirteen.
Such* ***shortsightedness*** *is one reason why* ***I pay very little attention to quarterly earnings****. Today's performance is the byproduct of discoveries and decisions that we made many months and often even years ago.* ***Our time horizon must always extend far beyond the next quarter****. As always, that means doing the hard work of imagining what the world will look like in* ***five years*** *and aligning ourselves with those* ***long-term*** *consumer trends."*

"Every 13 weeks brings the beginning of yet another cycle of reporting to our investors, analysts, board, banks, franchisees, and team members. After hearing our reports, ***many of these stakeholders focus on a metric that means a lot to them but comparatively little in and of itself to me, earnings-per-share growth****. In the aftermath of every call, we get either applause or boos based solely on how our EPS growth has fared against analysts' estimates, which always amuses me. If we exceed Wall Street's consensus estimates for the quarter, we are deemed a brilliant, forward-thinking management team. If we miss the Street's estimate, we land on the list of downwardly spiralling companies that are plagued with questionable leadership. That's an* ***awfully wrongheaded approach to gauging a company's long-term prospects.****"*

"Despite the constant pressure to submit to quick fixes, you stand a far ***better chance of delivering strong quarterly results year after year when you focus on strengthening your competitive advantage*** *and growing only when your business model offers a proven competitive alternative."*

Win-Win Approach

Source: Ron Shaich 2010 IGNITE presentation

"When I go to the ATM, I'm usually required to make a deposit before I make a withdrawal. I'd argue it's the same in business. We have to ***spend less time figuring out how to extract economic value from our stakeholders and more time creating what is valuable to them****. Doing so is what ultimately creates long-term value."*

"From its inception, Panera has utilized the principles that some call ***conscious capitalism****, and which we at Panera like to call "enlightened self-interest." This notion of a conscious approach to value creation is built on the fundamental premise that* ***every business has a deeper purpose than short-term profit maximization****. Indeed,* ***we regard profit and the creation of shareholder value as the byproduct of making a difference for our key stakeholders and society****. When we deliver for our customers, employees, vendors, and the wider community, shareholder value follows."*

Turnarounds

*"**Turnarounds are long-shots**, and **almost impossible to pull off**. Business books abound with stories of heroic CEOs who come to the rescue of once proud companies that failed to adapt to a changing world.*

*There's Lou Gerstner's turnaround at IBM. Steve Jobs' improbable resurrection of Apple. And Lee Iacocca's stirring rescue of Chrysler. We can celebrate those stories, even as we recognize that **turnaround attempts seldom turn out very well**. Equally problematic, a **turnaround is an expensive substitute—in terms of squandered resources and the toll its takes on associates—for serial innovation**. As the strategist Gary Hamel puts it in The Future of Management, **a turnaround "is transformation tragically delayed."** For any executive team, the real challenge is "to build organizations that are capable of continuous self-renewal in the absence of a crisis [my emphasis]."*

*"My message: Don't avoid the inevitable. Be a realist now and **innovate** while you have the breathing room, the resources, and the credibility with your stakeholders. Do that, and your company will **avoid the need for a "radical turnaround" expert** in the future."*

Spreadsheets

*"**Many executives have a love affair with spreadsheets. I am not one of them**. In fact, I encourage my team to **approach spreadsheets with a healthy dose of skepticism**, and I caution everyone else to do the same.*

*The **future is filled with uncertainty** and no one likes uncertainty. Uncertainty implies risk, and we all seek ways to minimize risk. The **hard numbers of the spreadsheet make the future seem more certain.** However, a spreadsheet is only one possibility of the answer, not the answer itself. A spreadsheet is merely a way to organize data. Its numbers generally **capture trends of the past, but it is in no way predictive of what's to come**.*

*The best strategic decisions reflect a healthy balance of historic data and well-considered knowledge. We need to **look to other companies and industries as models for what will happen in the future.***

*Here's a metaphor: 16-year-olds. If you are familiar with any 16-year-olds, you know they can be terrors to live with. Given raging hormones and the developmental need to question and reject authority, 16-year-olds can truly test the parent-child bond. I know of what I speak. If I looked at the accumulating data related to my 16-year-old son's recent behavior and projected that into the future, I would consider putting him up for adoption. I'm not going to do that, however, because I know the past is not likely to be predictive of what's to come. By the time most 16-year-olds reach the age of 25, they lose much of their edge and morph into wonderful adults — at least that's what I see when I look at my friends' older children. **The spreadsheet I would build based solely on the behavior of 16-year-olds may reflect what is going on in the recent past and today, but not the changes that looking to other models tell us will occur in future months and years.***

"French writer and philosopher Voltaire noted long ago that, "Doubt is not a pleasant condition, but certainty is absurd." Today's executives would be wise to apply that thinking to spreadsheets.

Their ***data reveals yesterday's truths; their spreadsheets of tomorrow are merely one possibility, but not a likely outcome.*** *What they need is perspective and guardrails."*

Questions

"I wrote a memo for the guy who took over from me, and I ***basically defined how I would compete with Panera if I wasn't part of Panera****. How I would take out Panera. Our CEO asked me to work on it. I ended up painting a vision for how Panera could re-transform itself. That transformation was rooted in using digital to fix guest experience. Redefining how we innovate. Build a loyalty program. Finding large adjacent billion dollar businesses we could enter. I was asked to step back in as CEO [as the CEO was sick] and I did and I used this transformation model."*

"I think ***we've approached technology very different from anybody else****. Back in 2011 we didn't start out to create a digital program or a mobile app.* ***We started out to solve a guest experience****. And* ***so much of what we do as business people is rooted in empathy. Empathy for our guests.*** *That's one of the* ***most powerful skills we as business leaders can have****. On my way to work I would call Panera ahead and speak to a manager to make an order and my son would run in and pick up in 30 seconds. He'd do that and I thought wow this is phenomenal. What about the other 8.5m people we serve every week, they don't have that experience. It was great to have your food made simultaneously with your trip to the store.* ***I began to imagine how we would do that****. I began to say digital offered a powerful alternative to meet a guest need."*

What I find particularly enlightening about Mr Shaich's approach, beyond the obvious similarities between his own and other Investment and Business Masters' approaches, is that he dares to **think differently**. It obviously has made a profound difference to his company's performance. You can't argue against an 86-fold increase in shareholder returns over 20 years! Even Warren Buffet's Berkshire Hathaway hasn't done that well, and Berkshire is a shining light for most investors. By simply thinking differently, Shaich has been able to transform his business multiple times and after some trial and error, and learning along the way, develop a brand and customer experience that offers tremendous value to all stakeholders - customers, staff and shareholders alike. It's truly remarkable to see.

His approach also makes me question my own portfolio - am I a business owner or a mere renter of stocks? I know what I would prefer to be. How about you?