What We Can Learn From Red Lobster's Closures And Bankruptcy

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A Red Lobster restaurant in Times Square in New York is seen on Saturday, December 8, 2012. ... [+] CORBIS VIA GETTY IMAGES

Red Lobster's closure of dozens of restaurants is attracting a lot of attention, and you can bet that people are looking for lessons. The nation's biggest seafood chain is now in the middle of the biggest restaurant equipment auction to date. A website indicates auctions at nearly 50 closing restaurants, but the number listed on Red

Lobster's site includes dozens more. It's a case of Red Lobster facing red ink, which leads to a long list of closures and talk of bankruptcy. But what was the "Red Lobster" trap? What led the nation's biggest seafood chain to find itself so deep in the red that it would shut down dozens of locations? It couldn't just be high rent and shrinking sales, could it? It wasn't.

As is sometimes the case, the reasons for this failure include a big success and a big miscalculation. Restaurants facing declining traffic amid and after the pandemic tried all sorts of solutions. Some raised prices, boosted delivery, cut portions, or rolled out discounts. Red Lobster took a popular all-you-can-eat shrimp promotion used to boost Monday traffic and rolled it out every day. It was a hit. And that hurt. And here we are.

While Red Lobster was buying traffic (which rose 4 percent) with its Ultimate Endless Shrimp special, the chain found more customers ordered this dish than expected. They were not only getting new customers but cannibalizing sales as existing customers gobbled up the discount. A company already losing money now found itself swimming in a sea of red ink amid millions lost and shrinking margins.

"We knew the price was cheap, but the idea was to bring more traffic in the restaurants," Thai Union CFO Ludovic Regis Henri Garnier told investors in a call last year. "So we wanted to boost our traffic, and it didn't work."

Sometimes, it's easy to be a Monday morning quarterback. That's certainly the case here as the deal expanded across the week. Looking back on Red Lobster's mistakes, some of which may have been foreseen, reminds us that we can always learn from adversity.

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All-You-Can-Eat Economics

Red Lobster's experience with its daily all-you-can-eat shrimp promotion serves as a warning about ... [+]

Food and beverage companies often offer many types of promotional allowances for customers, from BOGOs to discounted prices or coupons (are they still around?). These allowances can sometimes range from 20% to 30% of the selling price and can kill margins, which is why we tell customers to track their dilution from gross selling prices. The top line matters to your business. The bottom line "is" your business.

Red Lobster offered customers all-you-can-eat shrimp not once but twice (expanding it to every day) and took a beating each time. Carefully controlling and strategizing when and how to use promotions is critical for F & B companies. “We want to keep it on the menu,” Garnier said earlier of the promotion that effectively generated interest. “And of course we need to be much more careful regarding what are the entry points and what is the price point we are offering for this promotion.”

After facing problems with its all-you-can-eat shrimp extravaganza, Red Lobster boosted the price from $20 to $25 but still depended on the item, which came with a side and the company's signature warm Cheddar Bay Biscuits. It's an important lesson for companies, investors, and even consumers to understand: Growing revenue can make you feel good, but growing income, in the long run, is what makes you healthy. While there's a lot to learn from Red Lobster, more and more restaurants are focusing on margins. This is a cautionary tale. Shrimp didn't kill Red Lobster's margins, but that discount, amid many other things, was a factor as margins came under pressure.

The Red Ink At Red Lobster

Red Lobster, confronted with various challenges, including market competition and cost pressures, ... [+] GETTY

Like so many restaurants, Red Lobster also faces margin pressure from many other sources, so the discount alone didn't do all the damage. Margins matter more and more as costs rise, leading companies to raise prices in what sometimes can be called “greedflation." In 2023, Thai Union and Red Lobster said they sought to "identify areas for operational and financial improvement." But by January of 2024, they were not trying to turn Red Lobster around so much as exit, following numerous executive replacements. “After detailed analysis, we have determined that Red Lobster’s ongoing financial requirements no longer align with our capital allocation priorities and therefore are pursuing an exit of our minority investment,” the company said back in January.

In January, Thai Union Group CEO Thiraphong Chansiri gave his view on problems leading to Red Lobster's red ink when he said that Thai Union planned to seek to exit its minority investment in Red Lobster. He cited macro-economic forces that undoubtedly didn't help. Chansiri pointed to the COVID-19 pandemic, higher interest rates, and rising material and labor costs, resulting in "prolonged negative financial contributions to Thai Union and its shareholders."

However, Red Lobster also faced other hostile forces, such as a growing appetite for plant-based foods, meaning that seafood was not only vying with beef and steak. Plant-based beef substitutes and an ever-increasing plant sector all brought more competition, leading to what one might call the "Red Lobster" trap of buying sales at a higher price than they could afford. This doesn't mean that seafood, in general, is suffering a huge upheaval. Amid a greater focus on health, the seafood industry is not necessarily hurting but growing. Lobsters, themselves bottom feeders, are a luxurious, much-loved item on the menu. Seafood, overall, is going strong as a financially healthy sector that is healthy for consumers, even if this restaurant came under fire.

Founded nearly 50 years ago, Thai Union is a global seafood giant with about $4.4 billion in annual sales and 44,000 employees. Its brands include Chicken of the Sea, John West, Petit Navire, Parmentier, Mareblu, King Oscar, Hawesta, Rügen Fisch, and many others around the globe. According to Zion Market Research, the global lobster market in 2022 was valued at about $5.7 billion and was likely to reach $10.3 billion by the end of 2030, with a compound annual growth rate of about 5.1%. “Demand on a global scale Is growing,” according to an analyst at Zion, who also cited “an increasing desire to engage in premium dining experiences.”

Diversifying The Menu

Even as Red Lobster grapples with closures and auctions, the case underscores the broader industry ... [+] AP2005

While seafood, in some ways, is going strong, diversifying, in general, is a good strategy. Don’t just put all your eggs in one basket or your fish in one bucket. Even better, make sure that in addition to eggs or fish, you've got other products. As part of its Corporate Strategy 2030 plan, Thai Union said it will focus on its core business, centered around Ambient Seafood, Frozen, and PetCare. Restaurants did not make that list. The idea of a seafood supplier running a seafood restaurant sounds great. But you also have to understand the restaurant business. While you could say running a seafood restaurant is a perfect fit for a seafood company, it's also a different industry with very different fixed overhead including rent.

So after a promotion that produced growth in everything except profits and margins, here we are as Red Lobster announces the closures of many dozens of locations in what TagEx, the auction company managing the auctions for at least nearly 50 locations, called "the largest restaurant equipment auction ever." For a company that believes in going big, this wasn't the kind of "big" announcement you'd want to hear. TagEx said it is running these as "winner-take-all auctions," including all the contents of the Lobster locations. Auctions will be held on Thursday, May 16, and a countdown has begun for some big sales that, like the shrimp deal, will likely be at big discounts. While consumers are routinely told how to find a location near them, possible bidders were told how to "find a Red Lobster auction near you." Despite this downsizing, Red Lobster remains a giant, even after the closings.

Factors such as high costs may also be in play here, impacting the restaurant industry in general. It's nice to own real estate when you have multiple locations, although rent remains more typical and can fuel trouble, including huge costs. While ownership requires a larger capital investment, it makes costs more controllable. Rental costs became a big problem for Red Lobster and contributed to their losses. Owners often struggled to lift Red Lobster out of the red. Private Equity companies provide not only capital but legitimate know-how and operational excellence. They study the markets and are specialists in a particular industry and, even then, aren't necessarily in it for the long haul. However, it can be a different story when they go outside their specialization, even if they have some restaurants in their portfolio. Golden Gate Gate 0.0% Capital, which bought and operated Red Lobster, failed to turn it around before Thai Union came in. Their portfolio includes Bob

Evans Restaurant and California Pizza Kitchen, along with many companies in other sectors.

Owners coming from outside the restaurant business can also have big blind spots. Thai Union does not specialize in restaurants, even if it's a king in the seafood business with brands such as Chicken of the Sea. This sad story of naivete, too-deep cost-cutting, and executive turnover cautions us to pick the right partners who know the game. Red Lobster's management, while not on a merry-go-round, has been changed repeatedly as the company sought a solution. Its latest leaders may be able to right the ship and boost profits.

The evolving market landscape demands strategic foresight, especially for traditional brands facing ... [+] AFP VIA GETTY IMAGES

While many factors contributed to the margin pressure, most importantly, Red Lobster, an early pioneer, did not evolve with the times. They neglected to follow customer preferences and tried to buy customers with free or deeply discounted food. We love to hear the stories of the pioneers, the entrepreneurs who make it big, and who have the vision and passion to achieve their goals. Red Lobster grew from one family-owned restaurant in Lakeland, Fla., to a giant based in Orlando, Fla. Red Lobster trademarked its “Endless Shrimp events” in 2006 and saw them as a “huge success.” Growth is a big part of every company’s goals, and big winning bets can begin with big discounts. But big discounts can sometimes be too big and successful and fail to address underlying issues. Especially amid growing reliance on takeout, where delivery eats into margins, minding your margins may matter as much as minding your garden. Red Lobster works with DoorDash on delivery, which also can grow revenue, even if margins may thin. Endless shrimp, it turns out, was not enough to finish the endless financial pressure.

From Seafood Sensation To Business School Books

There are lessons to be learned from both good and bad stories because business can be very rewarding and very treacherous, depending upon your moves. Red Lobster remains a huge success story on many levels and may rebound or face growing pressure amid widely predicted bankruptcy filings. But its story likely will become a lesson taught in business school classes. Be careful of what you wish for. A promotion that everybody loves, at least temporarily, can boost business. But promotions can be like drugs. Companies and consumers can become hooked on them to the point where they hurt the bottom line. Red Lobster itself may have learned lessons, if at a high cost. The restaurant chain gave consumers a great deal. But at least for now, it looks like the company is the one who must pay the price and the piper.

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