

Even the Crabs Can Get You



In September 2003, Red Lobster's president found herself back in the sea of job seekers. Her mistake: an all-you-can-eat crab dinner promotion that lost millions when customers clawed their way back for more in a poorly planned, but well-executed promotion.

"It wasn't the second helping [that hurt], but the third," Chairman Joe R. Lee told analysts, "and maybe the fourth."

"It was kind of the worst of all worlds — from a promotional perspective," Lee said. The promotion drew fewer customers than expected, and those who did participate sidled up for more far more crab than management had anticipated. "That refill rate was higher than anything we have seen," said Lee.

The "Endless Crab Feast" ran for several months at 679 locations. During that time, food costs jumped by more \$31 million, lopping off \$3 million in first-quarter profits and wiping out \$405.9 million of stock value in a single session. It wasn't known immediately how much was spent on advertising or in-store communications supporting the program.

Besides unexpected gorging, wholesale crab prices skyrocketed. The government imposed crab-catching quotas that sent prices up above the "expensive" level of \$4/lb. They hit \$4.75 shortly after the promotion began.

The high price of the special — around \$22.99 — deterred some customers, but those who participated went back for more ... and more, eating right through company margins. The promotion was a perfect storm for disaster.

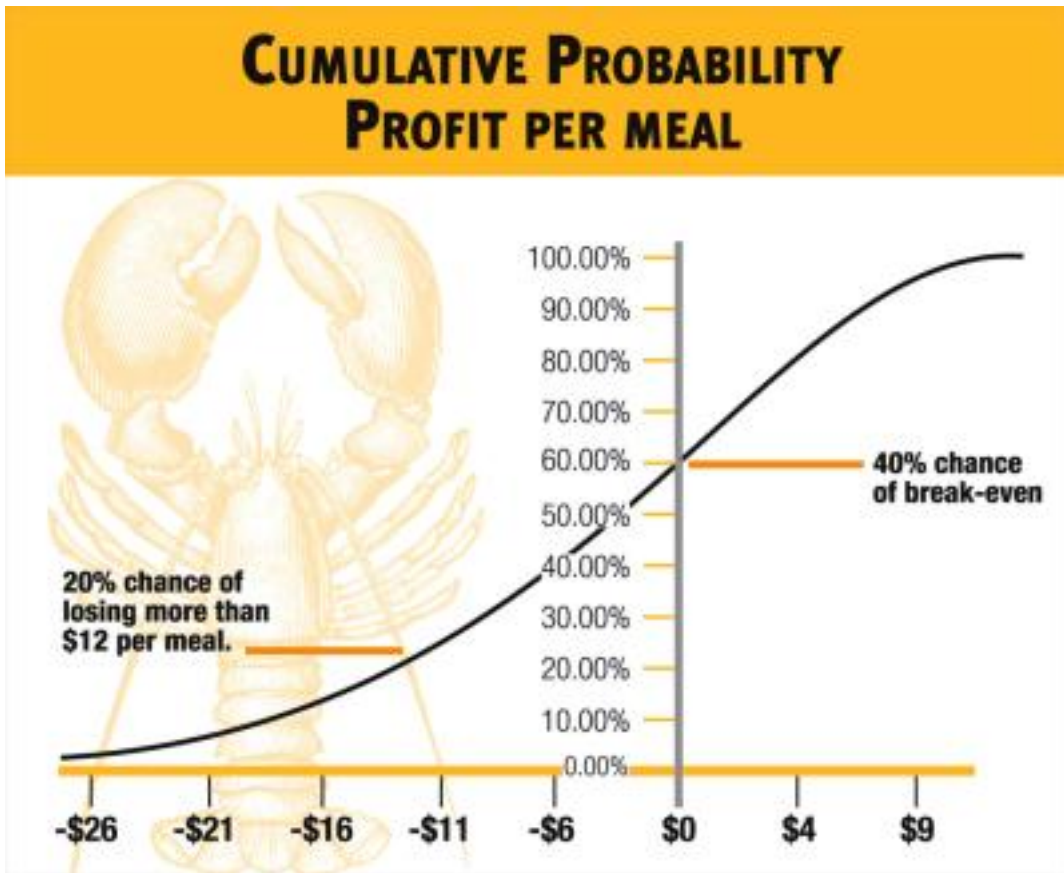
How did it happen? In all likelihood, the business case for it was developed using average assumptions for the take-up rate (percent of "covers" ordering the promotion) and the refill rate, and ignored the potential crab price rise. The effect was a plan that worked on average, but laid its traps at the outer reaches of possibilities.

The first two variables could easily have been simulated against a broad range of possible outcomes drawn from prior promotional experience reflecting the best and worst events ever seen not just in Red Lobster history, but in the collective experience of the casual dining industry. The wholesale price of crab would likely have been identified as a significant profitability risk in a contributing factor diagram, and incorporated into the model as a probability distribution of likely wholesale prices over the expected life of the promotion. It shouldn't have taken long to determine that federal limits on crabbing would lead prices to rise.

As a quick check, we ran a simple simulation against the following assumptions:

- A single serving of crab was 1.5 pounds (yielding 0.75 pounds of crabmeat).
- The number of servings per customer would have a low of 1, a median of 1.5, and a high of 4.
- The price of crab could fluctuate between \$3.50 and \$5 per lb., with a median of \$4.
- The cost of the crab represented 50% of the total cost of the meal.

We then ran 10,000 simulation trials. The whole process took less than 10 minutes. The results on the graph below suggest that the probability of losing money on each crab customer was very high.



Hindsight vision is, of course, 20/20. However, a bit more rigorous process applied to promotional planning upfront would likely have saved Red Lobster millions, preserved hundreds of millions in shareholder value, and kept the red off both their face and their P&L.

