RESTAURANTS

Research Brief

SASB’s Industry Brief provides evidence for the material sustainability issues in the Restaurants industry. The brief opens with a summary of the industry, including relevant legislative and regulatory trends and sustainability risks and opportunities. Following this, evidence for each material sustainability issue (in the categories of Environment, Social Capital, Human Capital, Business Model and Innovation, and Leadership and Governance) is presented. SASB’s Industry Brief can be used to understand the data underlying SASB Sustainability Accounting Standards. For accounting metrics and disclosure guidance, please see SASB’s Sustainability Accounting Standards. For information about the legal basis for SASB and SASB’s standards development process, please see the Conceptual Framework.

SASB identifies the minimum set of sustainability issues likely to be material for companies within a given industry. However, the final determination of materiality is the onus of the company.

Related Documents

- Restaurants Sustainability Accounting Standards
- Industry Working Group Participants
- SASB Conceptual Framework

INDUSTRY LEAD

Nashat Moin

CONTRIBUTORS

Andrew Collins
Stephanie Glazer
Anton Gorodniuk
Jerome Lavigne-Delville
Himani Phadke
Arturo Rodriguez
Jean Rogers
Evan Tylenda
Gabriella Vozza

SASB, Sustainability Accounting Standards Board, the SASB logo, SICS, Sustainable Industry Classification System, Accounting for a Sustainable Future, and Materiality Map are trademarks and service marks of the Sustainability Accounting Standards Board.
INTRODUCTION

Restaurants are an integral part of daily life—providing everything from a quick cup of coffee to a multiple course meal. For many, purchasing a drink or a meal-to-go is a regular occurrence. As such, restaurants, particularly larger corporations, have the ability to influence the diet of ordinary people due to the global scale of their operations and their significant purchasing power. Additionally, restaurants provide employment opportunities for millions around the globe. For example, in the US, the industry employs 10 percent of the workforce, or over 13 million people. However, many restaurant workers earn low hourly wages and are part-time. As the average age of restaurant workers rises, the industry has a responsibility to ensure living wages and good working conditions. At the same time, the industry is responsible for serving food that is safe to consume and has good nutritional value. Obesity and other health risk concerns related to diet continue to drive customer preferences towards nutrient-rich foods. Also, environmental and social performance within the supply chain, particularly such issues as animal welfare and use of hormones and antibiotics, may influence purchasing decisions of restaurant clients. Restaurant companies able to navigate through the current trends and satisfy growing demand for healthy foods are likely to ensure sustainable growth in the long term.

Management (or mismanagement) of material sustainability issues, therefore, has the potential to affect company valuation through impacts on profits, assets, liabilities, and cost of capital.

Investors would obtain a more holistic and comparable view of performance with restaurant companies reporting metrics on the material sustainability risks and opportunities that could affect value in the near- and long-term in their regulatory filings. This would include both positive and negative externalities, and the non-financial forms of capital that the industry relies on for value creation.

### SUSTAINABILITY DISCLOSURE TOPICS

<table>
<thead>
<tr>
<th>ENVIRONMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Energy &amp; Water Management</td>
</tr>
<tr>
<td>• Food &amp; Packaging Waste Management</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SOCIAL CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Food Safety</td>
</tr>
<tr>
<td>• Nutritional Content</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>HUMAN CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Fair Labor Practices</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LEADERSHIP AND GOVERNANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Supply Chain Management &amp; Food Sourcing</td>
</tr>
</tbody>
</table>
Specifically, performance on the following sustainability issues will drive competitiveness within the Restaurants industry:

- Improving operational efficiency by reducing energy and water intensity on premises;
- Reducing environmental impacts of packaging and food waste while improving process efficiency;
- Maintaining the highest standards of food safety;
- Introducing healthy choices to the menu to satisfy growing customer demand;
- Ensuring fair labor practices at owned and franchised locations alike; and
- Requiring high standards of environmental and social performance from suppliers.

INDUSTRY SUMMARY

Companies in the Restaurants industry prepare meals, snacks, and beverages for customers immediately for on- and off-premises consumption. The Restaurants industry characterizes a classic mature market with intense competition among restaurants of all sizes within and across subcategories, as well as with home-prepared options.

Broadly divided into three subcategories, the Restaurants industry includes limited-service eating places; casual, family full-service eating places; and upscale, family full-service eating places. Limited-service items may be consumed on premises, taken out, or delivered. Fast food restaurants account for almost 70 percent of the limited-service restaurants. Major players in this category include McDonald’s Corporation, Yum! Brands Inc., Doctors Associates Inc., and Wendy’s International, Inc. Casual full-service places are lower- to mid-priced restaurants that primarily serve patrons who order and are served while seated, and who pay after eating. Major players in this category include Darden Restaurants Inc., DineEquity Inc., and Bloomin’ Brands Inc. Limited-service restaurants provide services to customers who order and pay before eating. Upscale full-service restaurants are distinguished from limited-service restaurants by food quality and higher prices.

The global Restaurants industry is valued at approximately $210 billion. Fast food restaurants account for the biggest segment of the industry at 37 percent of revenue, followed by casual full-service restaurants with 28 percent. Companies traded on U.S. exchanges and Over-the-Counter (OTC) generate almost $130 billion from the industry, with about $95 billion coming from the limited-service and $35 billion from the full-service restaurants. In 2013, the median operating margin for U.S.-traded companies was 7.8 percent, while the

---

1 Industry composition is based on the mapping of the Sustainable Industry Classification System (SICS™) to the Bloomberg Industry Classification System (BICS). A list of representative companies appears in Appendix I.
median net income margin was 4.5 percent. Limited-service restaurants had the median operating margin of 9.9 percent and median net income margin of 4.1 percent, compared to 6.8 percent and 5 percent respectively for full-service restaurants. The margins have recovered since the financial crisis when they were suppressed to around 2 to 5 percent.6

Market demand is driven primarily by demographics, consumer tastes, and personal income.7 Americans currently spend 47 percent of their food dollars in restaurants, up from 25 percent in 1955.8 While the Restaurants industry has experienced a decline in demand during the last recession, as the employment rate improves, Americans are increasingly returning to restaurants, although low-wage growth hinders the rate of customer increase.9

Publicly held restaurants are either owned and operated, or franchised through franchise arrangements, developmental licenses, and foreign-affiliated license agreements. Companies can earn revenues from sales at company-owned store and franchise fees. While company-owned stores are more vulnerable to the economic environment, franchising makes quality control more difficult.10 Revenue growth is driven by either same-store sales growth or opening new units.11 Limited-service restaurants rely on efficient operations and high-volume sales. Meanwhile, full-service restaurants are more dependent on fluctuations in the health of the economy.12, 13 The Restaurant Performance Index9 remained above 100 for eight consecutive months in October 2013, largely due to same-store sales.14

Food and beverage purchases, as well as wages, are the two largest cost items for a typical full-service or limited-service restaurant. Combined, these expenses account for 55 to 60 percent of revenue. Rent is increasing as a percentage of operating expenses, while operators prefer to rent facilities rather than to own them.15, 16

The industry is characterized by high, increasing levels of competition. Companies compete on prices, food quality and variety, location, and service. Concentration in the industry varies by segment—fast food restaurants experience a higher level of concentration than their full-service peers. According to IBISWorld, the top four fast food restaurants (McDonald’s, Subway, Yum! Brands, and Wendy’s) account for about 42.7 percent of market share. Most of the industry’s recent growth and increased concentration can be attributed to the popularity of the franchising model, which helps large chains expand their market share with relatively low capital spending. Full-service restaurants experience lower level of concentration, with the four largest companies indicates a steady state, values below 100 represent a period of contraction, and values above 100 represent a period of expansion.
capturing only 26.8 percent of the market. The ability to borrow and lease premises and equipment reduces the initial capital requirement, making barriers to entry relatively low. New companies may also enter the industry by signing a franchising agreement that also lowers initial costs.\textsuperscript{17, 18}

American companies are expanding internationally as they are facing saturated markets at home.\textsuperscript{19} Europe and the BRIC (Brazil, Russia, India, and China) countries are emerging markets for American companies. Yum! Brands currently runs 15,000 of its 35,000 locations abroad, and approximately 56 percent of McDonald’s restaurants are outside of the US.\textsuperscript{20}

Healthier, lower-calorie options have been a key source of growth for restaurants in the past 10 years, resulting in improved same-store sales growth, increased customer traffic, and gains in overall servings.\textsuperscript{21} Limited-service restaurants, particularly its quick-service subsect catering to the demand for more affordable and healthy options, have seen relatively good performance. Balancing the desire for quality and value, fast-and-casual and quick-service restaurants, such as the bakery cafe, is a relatively underdeveloped and growing market with consumer demand outpacing the rate of unit expansion.\textsuperscript{22, 23} Fast food and limited-service places face rising food costs, worker unrest, and pressure to serve healthier food. As a result, some chains are focusing on overseas for growth opportunities in the long term.\textsuperscript{24, 25}

Restaurant operators face an evolving market due to changes in customer preferences and regulations around health and environmental issues.

\section*{LEGISLATIVE AND REGULATORY TRENDS IN THE RESTAURANTS INDUSTRY}

The US Restaurants industry is a heavily regulated segment of the economy with policies and licenses at the local, state, and federal levels. Restaurants are required to observe regulations relating to the preparation and sale of food, building and zoning requirements, worker rights, and more. The following section provides a brief summary of key regulations and legislative efforts related to this industry.\textsuperscript{\textdagger}

Although there is no current legislation on food waste in the US, with 30 to 40 percent of food going to waste, the U.S. Department of Agriculture (USDA) and the U.S. Environmental Protection Agency (EPA) launched the joint Food Waste Challenge in 2013 to minimize food waste. The challenge is the first nationwide initiative designed to address hunger, increase efficiency, and limit climate

\textsuperscript{\textdagger} This section does not purport to contain a comprehensive review of all regulations related to this industry, but is

\textsuperscript{\textdagger} This section does not purport to contain a comprehensive review of all regulations related to this industry, but is

\textsuperscript{\textdagger} This section does not purport to contain a comprehensive review of all regulations related to this industry, but is
Packaging is also a prominent source of waste in the Restaurants industry, and is the source of such local-scale initiatives as the ban of polystyrene use in New York City.27

As the enforcer of public safety regulations in relation to food, the Food and Drug Administration (FDA) is the most prominent regulatory body for the Restaurants industry. Due to increased awareness of obesity and nutrition-related illness, there has been increased market and regulatory pressure for healthier options in restaurants, including calorie count, less trans fat, and fewer sugar-sweetened beverages.

Section 4205 of the Patient Protection and Affordable Care Act (PPACA) established requirements for nutrition labeling of standard menu items in chain restaurants. It also made similar retail food establishments help consumers make informed decisions. Chain restaurants with 20 or more locations have to list calorie content information for standard menu items on restaurant menus and menu boards. Other nutrient information, such as total calories, fat, saturated fat, cholesterol, sodium, total carbohydrates, sugars, fiber and total protein, have to be made available in writing upon request.28

In 2005, New York City became the first jurisdiction to ban artificial trans fats in restaurants, and is an example of how local and federal policies impact one another. In 2003, the FDA ruled that packaged foods’ nutrition labels must list trans fat content. Food companies have since begun to slowly eliminate it from their products. The FDA is now considering a total ban.29

On March 23, 2010, President Obama signed PPACA into law. The PPACA requires any company with at least 50 “full-time equivalent” IV workers to offer health insurance. One of the provisions of the law also changes the legal definition of full-time worker as anyone averaging at least 30 hours per week.30 Such requirements significantly impact labor and operating costs for franchise owners of restaurants, as employers would be expected to internalize the cost of additional employee benefits.31 Both limited-service and full-service restaurants said that complying with healthcare reform would be a significant challenge.32, 33

Worker rights are rising to the forefront of policy agendas of state governments, as these governments reexamine company responsibilities regarding wage and sick leave.34 The US Department of Labor (DOL) is responsible for wage and hour standards, unemployment insurance benefits, and reemployment services regulation that apply to

---

IV By definition, average hours worked by multiple workers can be added to determine the number of full-time equivalent workers in a company. For example, two workers who average 15 hours per week would be considered one full-time equivalent worker.
all restaurants and the workers they hire. The Occupational Safety and Health Administration (OSHA) was created under the Occupational Safety and Health Act of 1970 by the Department of Labor (DOL) to assure safe and healthful working conditions. The Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and government. In 2014, President Obama called for a raise in federal minimum wage from $7.25 an hour to $10.10. The FLSA has a direct impact on the profit margins and operational sustainability of restaurants.

Internationally, restaurant companies and franchisees are subject to local laws and regulations concerning a variety of issues including franchising, zoning, health, safety, sanitation, and building and fire code. Restaurant locations outside the U.S. may be subject to tariffs on imported commodities and equipment, and laws regulating foreign investment.

SUSTAINABILITY-RELATED RISKS AND OPPORTUNITIES

Industry drivers and recent regulations suggest that traditional value drivers will continue to impact financial performance. However, intangible assets such as social, human, and environmental capitals, company leadership and governance, and the company’s ability to innovate to address these issues are likely to increasingly contribute to financial and business value.

Sustainability issues topped the list in the National Restaurant Association’s What’s Hot in 2014 survey of 1,283 professional chefs. Local sourcing of meat, seafood, and vegetables ranked high on the list of 258 items. Also, environmental sustainability, nutritional value, and reducing food waste by using all parts of animals and plants, were all among the top 10 issues. The survey results highlight increased consumer awareness about healthy eating, local sourcing, and environmental sustainability—all key sustainability issues faced by the industry.

Broad industry trends and characteristics are driving the importance of sustainability performance in the Restaurants industry:

- **Social externalities associated with food safety, as well as trends toward healthy food options:** The global nature of the industry and franchising business model make the issue of food safety in the value chain difficult to manage. Rising awareness of the calorie content and nutritional value of food is slowly shifting consumer demand and public policy.
- **Reliance on human capital for value creation:** The Restaurants industry employs millions of workers who are...
mostly paid hourly and receive minimum wages. Managing of fair labor issues is important due to the industry’s customer-facing nature.

- **Reducing environmental and social impacts of suppliers, as well as responsible food sourcing:**
  Consumer trends toward reducing food’s total environmental footprint require managing food waste and environmental impacts along the food supply chain. Companies have to navigate the myriad of regulations around the use of GMO, antibiotics, hormones, and pesticides in food production.

As described above, the regulatory and legislative environment surrounding the Restaurants industry emphasizes the importance of sustainability management and performance. Specifically, recent trends suggest a regulatory emphasis on environmental and customer protection, which will serve to align the interests of society with those of investors.

The following section provides a brief description of each sustainability issue that is likely to have material implications for companies in the Restaurants industry. This includes an explanation of how the issue could impact valuation, and evidence of actual financial impact. Further information on the nature of the value impact, based on SASB’s research and analysis, is provided in Appendix IIA and IIB. Appendix IIA also provides a summary of the evidence of investor interest in the issues. This is based on a systematic analysis of companies’ 10-K and 20-F filings, shareholder resolutions, and other public documents. It is also based on the results of consultation with experts participating in an industry-working group convened by SASB.

A summary of the recommended disclosure framework and accounting metrics appears in Appendix III. The complete SASB standards for the industry, including technical protocols, can be downloaded from www.sasb.org. Finally, Appendix IV provides an analysis of the quality of current disclosure on these issues in SEC filings by the leading companies in the industry.

**ENVIRONMENT**

The environmental dimension of sustainability includes corporate impacts on the environment. This could be through the use of natural resources as inputs to the factors of production (e.g., water, minerals, ecosystems, and biodiversity) or environmental externalities and harmful releases in the environment, such as air and water pollution, waste disposal, and GHG emissions.

In the Restaurants industry, environmental issues focus on the energy intensity of operations, water management, and waste generated.
Energy & Water Management

The Restaurants industry relies on energy and water for value creation. Particularly, fast food restaurants tend to have long hours of operation, and have larger portions of operating expenditures allocated to utilities. Companies in the industry have great opportunities for long-term cost savings enabled by technology improvements and other efficiencies. Purchased electricity represents a major share of energy sources used in the Restaurants industry.

Fossil fuel-based energy production and consumption contribute to significant environmental impacts, including climate change and pollution, which have the potential to indirectly yet materially impact the results of operation of restaurant operators. Sustainability factors, such as GHG emissions pricing, incentives for energy efficiency and renewable energy, and risks associated with nuclear energy and its increasingly limited license to operate, are leading to an increase in the cost of conventional energy sources while making alternative sources cost-competitive. Therefore, it is becoming increasingly material for companies in energy-intensive industries to manage overall energy efficiency, reliance on different types of energy and associated risks, and access to alternative energy sources. Water is becoming a scarce resource around the world, due to increasing consumption from population growth and rapid urbanization, and reduced supplies due to climate change.

Furthermore, water pollution in developing countries makes available water supplies unusable or expensive to treat. Major uses of water in restaurants are related to food and beverage preparation, ice making, dishwashing, and sanitation. Limited-service eateries use relatively less water than full-service restaurants due of the use of disposable food containers and preprocessed ingredients.

Depending on the location, water scarcity can pose a risk to operations. As a result, it is a growing concern for the Restaurants industry. This is likely to give rise to regulations that will impose further costs on restaurant companies as they rely on high-quality water for their growing operations. Water scarcity can result in higher costs, supply disruption, and social tensions, which companies across different industries, particularly water-intensive ones, will need to contend with.

Water and energy efficiency measures in company-owned stores can directly impact the bottom line. However, companies that can also influence energy and water management at their franchise locations will have a more significant effect on reducing indirect environmental impact. Reducing the risk of franchises being impacted by future climate change regulations and water constraints will ensure sustained growth.

Company performance in this area can be analyzed in a cost-beneficial way internally and externally through the following direct or...
indirect performance metrics (see Appendix III for metrics with their full detail):

- Total energy consumed, percentage grid electricity, percentage renewable; and
- Total water withdrawn, percentage in regions with High or Extremely High Baseline Water Stress.

Evidence

The U.S. EPA estimates that restaurants use about 2.5 times more energy per square foot than other commercial buildings. The U.S. Energy Information Administration estimates that in 2003, buildings (other than malls) that provide food services as a principal activity consumed 217 trillion Btu (equivalent of 63 billion Kilowatt hour (kWh)) of site electricity, or more than seven percent of the total electricity consumption. Total electricity expenditures amounted to almost $5.2 billion, 7.5 percent of the electricity expenditures of all non-mall buildings in 2003. The most electricity-intensive activities were food refrigeration and lighting with 12.3 kWh per sq. ft. and 7.5 kWh per sq. ft. respectively. In terms of the total energy use, the EPA’s ENERGY STAR national median energy intensity estimates show that fast food restaurants consume 1015.3 kBtu of source energy per sq. ft. Full-service restaurants consume much less energy at 432 kBtu per sq. ft. According to a 2002 estimate, restaurants in the U.S. spent an average of $2.90 per sq. ft. on electricity and $0.85 per sq. ft. on natural gas each year. Therefore, energy management affects traditional drivers, like operating costs.

Restaurants are provided incentives to manage their energy use. The Energy Efficient Commercial Buildings Deduction, passed as part of the 2005 Energy Reduction Act, incentivizes restaurants to invest in making their businesses energy efficient. The tax deduction allows up to $1.80 per square foot based on the efficiency levels of lighting, HVAC, and building materials used in construction.

The use of energy-efficient appliances can be a source of significant savings, and investments can pay off in a relatively short amount of time. KFC, a subsidiary of Yum! Brands, replaced over 5,000 ovens with ENERGY STAR Blodgett ovens that saved franchise owners approximately $600 per oven annually, resulting in total savings of approximately $3 million per year. This illustrates how energy efficiency improvements, especially when implemented in a large scale at company-operated stores, can generate significant savings for restaurant companies.

The issue of energy efficiency has received attention from major players, and many have set energy efficiency goals. In 2008, Starbucks
set a goal of reducing electricity use by 25 percent in company-owned stores by 2015. Similarly, Darden Restaurant and Yum! Brands, both of which comprises of multiple restaurants brands, set goals of reducing per restaurant energy use by 15 percent by 2015 based on the 2009 levels.

Restaurant operators are materially impacted not only by the intensity of energy use, but also by their energy mix. Adding renewable energy to the mix reduces risks of price increases due to carbon pricing. In 2013, Starbucks was ranked at ninth in EPA’s Green Power Partnership Top Partner Rankings. Organizations can meet EPA Partnership requirements by using any combination of Renewable Energy Certificates, onsite generation, and utility green power products. Starbucks used 592,462 Megawatt hour (MWh) of green power, which constituted 70 percent of their annual electricity use.

Water used in hospitality establishments, including restaurants, account for approximately 15 percent of the total water use in commercial and institutional facilities in the U.S. The National Restaurant Association (NRA) estimates that limited-service restaurants consume 500 to 1,500 gallons of water a day, while full-service restaurants consume up to 5,000. According to the EPA, approximately 52 percent of the water use in restaurants is associated with equipment and processes that take place in the kitchen. Increasing water efficiency in restaurants impacts the bottom line in a number of ways, including reduced cost of water and wastewater services, as well as reduced energy costs. Industry estimates suggest that implementing water-efficient practices in commercial facilities can decrease energy and water use by 10 and 15 percent and operating costs by an average of 11 percent.

Similar to energy efficiency investments, water efficiency projects can have relatively short payback periods. A Boston University cafeteria reduced its water use by 63 percent by installing high-efficiency pre-rinse spray valves. The EPA estimates that the payback period for high-efficiency pre-rinse spray valves could be as short as one month. These benefits are becoming evident to restaurateurs. According to NRA estimates, between 29 percent and 50 percent of operators installed water-saving equipment or fixtures in 2012. Another 60 percent of fine-dining operators, 55 percent of casual-dining operators, and about half of operators in other segments planned upgrades for 2013.

Uninterrupted access to fresh water is becoming increasingly relevant for companies with operations in water-stressed regions. In its 2013 CDP Water Disclosure Project, Darden Restaurants states that 25 percent of their operations are located in regions at risk, including Colorado (Pacific Ocean), Sacramento, San Joaquin, and Colorado (Texas). McDonald’s estimates that 25 percent of its operations is in areas where potential
Water scarcity is expected by 2025. Restaurant operators strive to limit their risk exposure by reducing amounts of water use. In 2005, Yum! Brands set a target of 10 percent reduction in water consumption in company-owned restaurants by 2015. In order to achieve their goals, the company implemented several projects, including installing high-efficiency building fixtures, irrigation systems, and equipment. The company reported achieving 20 percent of their goal by the end of 2013. In contrast, Darden Restaurants reports reducing per restaurant water usage by 17 percent in 2011 from 2009 base year. This was in excess of their 10 percent target reduction by 2015.

**Value Impact**

Companies in the industry are large purchasers of energy, given their hours of operation and their extended locations. Fluctuations in electricity and natural gas prices affect operating margins and profitability, and are hard to pass onto consumers to completely offset cost increases. Companies who are able to properly manage this issue by investing in new technologies that reduce overall energy consumption, improve energy efficiency, or source from renewables, will be better able to protect themselves from energy price volatility while reducing operating expenses.

While the cost of energy consumption is already captured in financial results, overall energy consumption levels provide a sense of firms’ exposure to future increases in energy price. This possible increase results from internalizing the growing environmental and social impact of energy consumption. Decisions about onsite versus sourced electricity, and diversification of energy sources, can also influence the volatility and price of energy costs. This has impact on the company’s long-term profitability and cost of capital. The percentage of energy from renewables indicates a firm’s ability to mitigate its environmental footprint and its exposure to energy cost increases driven by sustainability impact.

Companies in the industry that are able to reduce water consumption are likely to see positive impacts on their operating expenses. This is of particular importance for companies in which significant revenues are generated in regions where water is becoming scarce, and where the price of natural resources is expected to increase in the future. Total water withdrawn provides absolute and comparative measures of water efficiency. The percentage of water recycled indicates a company’s ability to mitigate its exposure to water cost increases. The percentage of water withdrawn in water-stressed regions indicates a company’s exposure to operational disruptions in the short term, with impact on revenue and operational risks in the long term. In turn, this impacts the cost of capital.
Food & Packaging Waste Management

Restaurants produce waste in two main forms—food and packaging. Food waste includes ingredients, waste created during cooking (such as oil), and waste of the final product. Packaging waste includes packaging received from suppliers and packaging disposed by consumers in the restaurant areas. Food waste results in loss of resources, such as water, energy, land, labor, and capital, and produces greenhouse gas emissions as a result of decomposition. Moreover, food ingredient deliveries to restaurants are a significant source of packaging waste. In addition, limited-service restaurants make heavy use of disposal tableware for serving customers.

Companies that are able to reduce waste through various methods, including food recovery, diverting waste from landfills, and packaging reclamation programs, can reduce waste-handling costs and improve operational efficiency. Pressure to divert waste from landfill may result in higher disposal costs. Since food packaging for takeout is disposed offsite, restaurants are not able to divert takeout packaging from landfills. However, restaurants can be proactive about sourcing recycled and recyclable or compostable material.

Company performance in this area can be analyzed in a cost-beneficial way internally and externally through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Amount of waste, percentage food waste, percentage diverted; and
- Total weight of packaging, percentage made from recycled or renewable materials, percentage that is recyclable or compostable.

Evidence

Each year 1.3 billion metric tons—or one third of the food produced in the world—is lost or wasted. According to a 2012 Natural Resources Defense Council report, 40 percent of food in the U.S. is wasted or lost. North America and Oceania have the greatest overall and per capita consumer food loss and waste at nearly 300 kg/year and 115 kg/year. Overall food loss is the aggregate of the loss at various stages of lifecycle of food: production, handling and storage, processing, distribution and retail, and consumption. In North America, most of the inefficiency is at the consumption stage. The USDA estimates that households and food service operations lost 19 percent of total U.S. retail-level food supply. In restaurants alone, four to 10 percent of food purchased is lost before it reaches consumers. Food that is served often goes uneaten, adding to the food waste generated at restaurants.

Food waste in landfills release methane, a potent greenhouse gas, as a result of anaerobic digestion. Most food waste ends up in landfills, making it a significant contributor to climate change.
change. To address this issue, Massachusetts has implemented a commercial food waste ban effective July 1, 2014. According to the ban, any entity that disposes of at least one ton of organic waste per week must either donate or repurpose the useable food. Unusable food will be sent to a composting facility or be used to make animal feed. According to Kenneth L. Kimmell, commissioner of Massachusetts’ Department of Environmental Protection, the program is expected to more than quadruple the amount of food waste diverted, from 100,000 to 450,000 tons annually.

Studies show direct correlation between portion sizes and food intake, as well as amount of food waste. On average, 17 percent of food is left uneaten by diners at restaurants as a result of large portions served. Therefore, reducing servings at restaurant would not only minimize costs of ingredients, but also reduce the costs associated with food waste disposal. Keeping unnecessarily large amounts of food inventory is another operational inefficiency that results in increasing food waste. Some restaurants may have excessive menus and try to store all the ingredients for each item on a menu. Moreover, some company policies may require fast food restaurants to dispose of food while it still in a good quality. For example, McDonald’s requires fries to be thrown out after seven minutes. Approximately, one-tenth of fast food waste occurs as a result of such type of policies.

At McDonald’s, 67 percent of waste by weight occurs back-of-counter and approximately 74 percent of it is comprised of used cooking oil, corrugated cardboard, and food waste. Therefore, the company has an opportunity to manage the amount of waste that is recycled. The average restaurant generates 2,214 pounds of waste per week, which includes 667 pounds of corrugated cardboard, 568 pounds of organic food waste, 333 pounds of paper, 233 pounds of plastics, and 200 pounds of cooking oil. In 2013, 90 percent of the 34,113 surveyed McDonald’s restaurants were recycling used cooking oil and 77 percent were recycling corrugated cardboard.

Food cost is a significant part of the total cost of sales for the industry. Therefore, food waste reduction is likely to have a positive effect on operational efficiency and financial results. In its 2013 Equity Research Report on U.S. restaurants, Barclays cites improvements in the waste control system of Brinker International, Inc. as a basis for reducing their COGS to Co-Ops Sales ratio. In their financial analysis of Cheesecake Factory Inc., analysts from Baird Equity Research, Barclays, Piper Jaffray, and Lazard Capital Markets all recognize the positive impacts of efforts around waste/inventory control on long-term margin improvement for the company, which further plays out in upside revisions of earnings estimates.

Several restaurant companies make disclosures around this issue in their SEC filings. In its
FY2012 Form 10-K, Cracker Barrel reports that “reduction in food waste from 2012 to 2013 accounted for a 0.2 percent decrease in restaurant cost of goods sold as a percentage of restaurant revenue.” Similarly, Starbucks reported, “cost of sales as a percentage of total net revenues decreased 80 basis points, primarily due to store initiatives to reduce waste (approximately 40 basis points).” Brinker International also acknowledges reductions in costs of sales due to their efforts to reduce waste. Burger King’s franchise, FOR Norwest, works together with Global Trash Solutions waste management consulting services company to minimize waste and increase recycling rates. Within two weeks of the partnership start, FOR Norwest had already achieved an average savings of $3,300 per month for all locations combined.

Many companies are innovating to address this issue. McDonald’s, Yum! Brands, and Darden are part of the Food Waste Reduction Alliance. In Scotland, McDonald’s implemented its Fries to Fuel program to turn cooking oil waste into fuel for its delivery vans. Through its Fries to Fuel program, McDonald’s recycles 4.5 million liters of used cooking oil annually. The company turns the oil into enough biodiesel to fuel half of its distribution fleet, which by one estimate, produces carbon emissions reductions equivalent to taking 2,500 cars off the road. In a similar effort, one hundred percent of KFC cooking oil is reused as biodiesel in the U.K. In 2004, Darden Restaurants started donating surplus food to local community food banks in the U.S. and Canada. In fiscal year 2013, the company donated 10.9 million pounds of food, diverting them from landfills and providing meals to families. KFC and Pizza Hut restaurants in the U.S. divert nearly 15 million pounds of food annually to local hunger relief agencies.

The U.S. demand for food service disposables is expected to grow to $19.7 billion by 2017. Restaurants and bars are the dominant market for these products. In order to manage waste, there is a growing number of municipal regulation around the use of nonrecyclable disposable containers in restaurants. As of 2013, more than 40 cities had passed at least partial bans on the commercial use of polystyrene containers. In San Francisco, an ordinance went into effect in 2007, directing food vendors to use biodegradable, compostable or recyclable food containers.

While city and county ordinances have been the main drivers for shifting restaurants away from nonrecyclable disposable tableware, customer criticism about the volume of paper cup waste has led companies to encourage customer use of personal tumblers. Starbucks uses 4 billion paper cups globally each year; in 2011, customers used personal mugs for 34 million drinks at company-owned stores. By 2015, the company aims to serve five percent of beverages made in its stores in personal tumblers.
Value Impact

Waste reduction efforts are likely to help companies reduce procurement and disposal costs, improving operational efficiency. Food-handling and waste-packaging regulations are likely to continue evolving in certain jurisdictions, as exemplified by the case of Massachusetts. Companies that are able to stay ahead of regulations will not only see a positive impact on brand image, but will likely reduce their cost of compliance and avoid the risk of fines and penalties.

The amount of food waste, and percentage that is diverted, indicate a company’s exposure to operational and regulatory costs. It also indicates its ability to mitigate impacts on production and disposal costs though waste reduction and waste diversion efforts. On the packaging side, waste mitigation efforts can be assessed through the ratio of packaging from recycled renewable sources and that which is reusable, recyclable, and/or compostable.

Food Safety

Both food preparation methods and quality of ingredients can impact food safety. Restaurant food safety could also be compromised due to the breadth of the supply chain. The global nature of the industry, as well as the franchising model, make it difficult for restaurant companies to ensure safety of their food supplies. Regulations across states and countries vary on the frequency of food vendor inspections, type of grading or scoring system used to rate the safety of food vendors, and public disclosure of inspection scores. In the U.S., most foodborne illness outbreaks linked to restaurants are related to unsafe food handling by workers. Studies have shown that time constraints and lack of adequate resources are the main factors that cause food workers to handle food unsafely.

Food safety is of utmost important to restaurants. Food safety concerns in either company-owned or franchise-operated locations can affect the core of restaurant’s reputation. Companies that adhere to the industry standards of food preparation and safety, such as the National Restaurant Association’s ServSafe program, are likely to be better positioned to protect shareholder value.

Company performance in this area can be analyzed in a cost-beneficial way internally and externally through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Percentage of restaurants inspected by a food safety oversight body, percentage receiving critical violations;
- Number of recalls, total amount of food product recalled; and
- Number of confirmed foodborne illness outbreaks, percentage resulting in CDC investigation.
Evidence

According to the 2013 Consumer Trust survey by the Center for Food Integrity, 63 percent of respondents ranked food safety as a high concern. This was a five percent increase over the previous year, indicating the rising importance of the issue. Corporations in this industry recognize food safety as a material issue. As Darden Restaurants states in its 2012 Form 10-K, “failure to maintain food safety throughout the supply chain and foodborne illness concerns may have an adverse effect on our business.”

In summer 2013, reports in Chinese media of excessive levels of bacteria in ice at three KFC locations led to a significant decline in earnings. This report came on the heels of a well-publicized investigation regarding the high levels of antibiotics found in batches of chicken used by the company.

Failure to ensure safety of food served to customers may result in foodborne illness outbreaks. In 2013, at least 238 cyclospora illness cases, predominantly in Iowa and Nebraska, were connected to Olive Garden and Red Lobster outlets owned by Darden Restaurants. The company had previously been linked to 300 cases of gastrointestinal illness among people who had eaten at Olive Garden restaurants in 2006. Darden settled a class action lawsuit for $387,000. In 2011, an Olive Garden worker in Fayetteville, North Carolina tested positive for Hepatitis A. State officials advised people who had eaten at the restaurant during an eight-day period to get immunized. Darden Restaurant had to further compensate $250 to each immunized individual. The total fund for compensation amounted $375,000.

The franchise model exposes companies to reputational risks around food safety. Safety breaches, particularly those resulting in fines and penalties, can become a media sensation. In 2012, several eateries in Western Australia were fined a total of AUD 400,000 for food safety breaches, including a franchised McDonald’s restaurant that was fined AUD 180,000 for violations related to “food storage, cleanliness of premises and the presence of ‘animals and pests.’” Wendy’s reports the impacts of perceived decline in quality of food in its FY2012 Form 10-K: “(i)increased use of social media could create and/or amplify the effects of negative publicity (...) A decrease in guest traffic to our restaurants as a result of these health concerns or negative publicity could result in a decline in sales and operating results at company-owned restaurants or in royalties from sales at franchised restaurants.”

To manage the issue, restaurants have to ensure the highest standards of food safety among their suppliers. Failure to monitor the quality of supplied products may open companies in the industry to the risks of supply disruptions as well as negative publicity. In July 2014, Chinese authorities accused Shanghai Husi, a subsidiary of the U.S.-based meat
supplier OSI Group Inc., of intentionally selling expired meat products to restaurant chains. OSI Group withdrew all products manufactured by the subsidiary from the marketplace in attempt to protect the company’s reputation with consumers and customers. Yum! Brands, a longtime customer of OSI Group, decided to terminate supplier relations with the company. Another customer, McDonald’s, transferred its business to Husi’s new plant. McDonald’s also cut all of its orders of chicken products from China to its Japanese restaurants. Seven & I Holdings, Starbucks, and Burger King Worldwide also cut their ties with Shanghai Husi after the incident. Yum! Brands and McDonald’s operate more than 6,400 and 2,000 restaurants in China respectively.97 The company recalled beef, pork, and chicken items from its Chinese restaurants to prevent further damage of consumers’ trust in McDonald’s food safety.98 Soon after the incident, China’s government banned imports and sales of products processed by Husi Group. McDonald’s sales were negatively affected in the third quarter of 2014 by the Chinese meat scandal. The loss of the supplier had a significant impact on the company, as the Husi plant was supplying 20 percent of chicken meat to McDonald’s Japan.99 In October, McDonald’s estimated $157 million net loss in Japan.100

According to the company’s report, July sales dropped 2.5 percent globally with a 7.5 percent decline in the Asia/Pacific, Middle East, and Africa (APMEA) segment. In August, sales further decreased by 3.7 percent globally and 14.5 percent in the APMEA segment. The meat safety scandal significantly damaged the company’s reputation among Chinese customers and contributed to lower sales.101 In Hong Kong, the Center for Food Safety started an investigation to determine whether “McDonald’s knowingly sold potentially tainted food to the public over a four-day period during which it denied using food from Shanghai Husi.” The company later admitted that the food had, in fact, been supplied by Husi.102

**Value Impact**

Management of food safety is likely to have a material impact on a restaurant company’s financial results. Poor performance can lead to reputational damage from high-magnitude, negative media attention, impacting market share and revenue. Serious violations may result in restaurant closures, further impacting revenue. It can also lead to extraordinary expenses and contingent liabilities associated with consumer lawsuits, remediation, and compensation costs, as well as regulatory fines and penalties. Reputational damage from food safety issues tends to have a long-term impact, and affects a company across most of its locations, both owned and franchised, as they operate under the same brand name. Together, food safety management can contribute to restaurant companies’ operational risk and cost of capital. Publicized cases of foodborne illnesses, when connected to a particular
company, can lead to reputational damages, impacting market share and revenue.

The percentage of the inspected restaurants that were found in violation of food safety standards indicates the strength of a company’s management of the issue. A higher level of violations may also indicate a higher risk of high-impact incidents, such as foodborne illness outbreaks. The number of recalls indicates the strength of a company’s food safety management and the probability of high-magnitude disruptions in the supply chain. These disruptions have implications for both operating and extraordinary costs. Recalls can also lead to potential consumer litigation and remediation costs. The amount of food products recalled reflects how badly recall events disrupt the supply chain.

Nutritional Content

The ‘obesity epidemic’ in the U.S. has put the Restaurants industry under the spotlight. In addition to displaying calorie counts, restaurants are increasingly pressured to improve the nutritional content of menu offerings. Pressure on the Restaurants industry to offer healthier menus will be exacerbated in consumer segments that are considered more vulnerable. These segments include children or other demographic groups with high rates of obesity and obesity-related disease. The industry has also been under scrutiny for directing advertisements toward children and minorities.

Increasing popularity of healthier meals represent a great opportunity for restaurant companies to capture the growing demand. Improving nutritional content of restaurant offerings may reduce negative social externalities and also have a positive impact on the bottom line.

Company performance in this area can be analyzed in a cost-beneficial way internally and externally through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Percentage of meal options consistent with the Dietary Guidelines for Americans or foreign equivalent, sales from these options;
- Percentage of children’s meal options consistent with national dietary guidelines for children or foreign equivalent, sales from these options; and
- Number of child advertising impressions made, percentage promoting products that meet national dietary guidelines for children or foreign equivalent.

Evidence

Obesity is a national public health concern in the U.S. As of 2014, 34.9 percent of adults or 78.6 million people were obese, defined as BMI>=30 kg/m². Meanwhile, 68.5 percent were overweight or obese, defined as BMI>=25 kg/m². There are more women than men who are obese: 36.1 percent versus 33.5
percent. Black women have the highest rates of overweight and obesity at 82 percent, as well as extreme obesity, defined as BMI≥40 kg/m², at 16.4 percent. According to the National Health and Nutrition Examination Survey (NHANES) data, 31.8 percent of U.S. children are overweight or obese, and 22.8 percent of children between the ages two to five years old are overweight or obese. The ratios are close to 35 percent for children of six and older.¹⁰⁴

Unhealthy diet and eating habits combined with inactivity are often cited as the primary causes of obesity. The Credit Suisse Research Institute’s 2013 study “Sugar: Consumption at a crossroads” found that around 90 percent of general practitioners surveyed in the US, Europe and Asia consider excess sugar consumption to be related to the rapid increase in diabetes or obesity. The global daily average consumption of added sugar has risen by 45 percent in the last 30 years to 17 teaspoons per person. In the U.S. this number is 40 teaspoons per person daily. The American Heart Association recommends that women eat no more than six teaspoons of added sugar a day and men no more than nine. According to the Credit Suisse study, 43 percent of added sugars in a person’s diet come from sweetened beverages. On average, six to 12 percent of added sugar in a person’s diet comes from fast food restaurants.¹⁰⁵ The analysis shows a high correlation between type II diabetes and obesity and full-calorie soft drinks.¹⁰⁶

Obesity-related health problems represent a significant cost to the U.S. economy. In 2008, the estimated annual medical costs for obese people were $1,429 higher than those of normal weight, or $147 billion annually.¹⁰⁷ The Credit Suisse study estimates that 30 to 40 percent of U.S. healthcare expenditures go towards diseases directly related to the overconsumption of sugar.¹⁰⁸

A recent 14-year study in the American Journal of Preventive Medicine found that the nutritional quality of fast food available on the marketplace remained almost unchanged from 1997 to 2010. The average nutritional values of fast food restaurants offerings went up only by 3 points, from 45 to 48, while the average American diet score is 55. Fast food menus usually contain high amounts of fat, sugar, and salt, contributing to Americans’ unhealthy diet and diet-related chronic diseases. These findings suggest a serious social problem, as a quarter of Americans eat fast food two or more times a week.¹⁰⁹

Publicly traded fast food restaurants generate approximately $77 billion in revenue globally, representing more than a third of the total industry revenue.¹¹⁰ Spending on fast food has been on the rise. In 1970, Americans spent $6 billion on fast food.¹¹¹ Four decades later, total U.S. sales for fast food restaurants exceeded $157 billion. With an average $1,335 spent per household on fast food each year, the impact of fast food on the health of Americans is significant.¹¹² Conversely,
consumer and regulatory pressures toward healthier menus is likely to have a significant impact on the limited-service segment of this industry. While menu-labeling laws have existed in smaller jurisdictions for several years, the PPACA Section 4205 established requirements for nutrition labeling of standard menu items in chain restaurants with 20 or more locations. The disclosure should help customers make informed food choices and maintain healthy dietary practices.

Studies on the impact of labeling on customer choices at restaurants have shown mixed results. A Stanford Graduate School of Business study found that since Starbucks started posting calorie information in New York City stores in April 2008, as required by city law, the average customer calorie intake dropped by six percent per transaction. On the other hand, the International Journal of Behavioral Nutrition and Physical Activity published seven different studies that found no effect on customers’ purchasing behavior from food labeling.

Children and minorities are particularly vulnerable when it comes to poor nutrition content of food offerings and their marketing. Marketing nutritionally poor meals may contribute to childhood obesity. Analysis of marketing data indicates that young children and minorities are targeted in restaurant advertising campaigns. According to a Federal Trade Commission report, food companies, including restaurants, allocated $1.79 billion on marketing to youth ages two to 17 in 2009.

A Yale study also found that African American children and teens see at least 50 percent more fast food ads than their white peers.

To address the concern about advertising of unhealthy foods in 2006, packaged food and fast food restaurant companies created the Children’s Food and Beverage Advertising Initiative (CFBAI). CFBAI is a self-regulatory program that aimed to promote healthier dietary choices and healthy lifestyles to children under 12. Large industry players like McDonald’s and Burger King participate in the program.

Unfortunately, several studies show that such self-regulatory programs as CFBAI are unsuccessful and ineffective in serving their efforts. CFBAI members set their own nutrition criteria for advertised products and their pledges cover only advertising through media channels that have more than 35 percent of their audience comprised of children under 12. A study from the University of Illinois at Chicago suggests that while many foods made by CFBAI companies meet federal nutrition guidelines, companies choose to market less healthy options to children more heavily. For example, 98 percent of ads from CFBAI members were products high in nutrients to limit (NTL), including saturated fat, trans fat, sugar, and sodium. The number is higher than that for all food and beverage ads seen by children, which was 84 percent. The study concludes that the foods advertised on children’s programing have lower nutritional
content than foods advertised on general audience programming, and that products advertised to children by the CFBAI members are of lower nutritional quality that those advertised by nonmembers.119

While restaurants have increased the number of healthier offerings, the industry is still lagging behind recommended nutritional standards. In 2010, the Yale Rudd Center for Food Policy & Obesity published a report on the nutritional quality of fast food menus with a followup report in 2013. They found that while restaurants added healthier options since 2010, less than one percent of all children’s meal combinations met recommended nutrition standards.120

Yum! Brands acknowledges in its 2013 Form 10-K that the Restaurants industry has been subject to claims that relate to the nutritional value of food and claims that the fast food model has led to a rise in obesity of customers. 121 As a result, major industry players, including Burger King and McDonald’s, have joined the Children’s Food and Beverage Advertising Initiative, a self-regulatory program run by the Council of Better Business Bureaus. The voluntary program was designed to shift the mix of foods advertised to children under 12 to healthier choices. 122

Restaurant operators have recognized the market trends and adapted their business strategies to develop stronger relations with stakeholders. For example, several companies institutionalized the role of “Chief Health and Wellness Officers” to help top management align companies’ approach to nutrition and wellness with their stakeholders’ needs. In 2014, Jonathan Blum, chief public affairs and global nutrition officer at Yum! Brands, participated in a panel on nutrition at the National Restaurant Association’s annual trade show. He noted: “listening to stakeholders critical of the industry had been a driver of the company’s and industry’s evolution and commitments to improving food offerings through healthier choices and greater transparency through labeling.” 123 Separately, Taco Bell announced that by 2020 the company plans to have 20 percent of its combo meals meet one-third of the dietary guidelines recommended by the federal government. The company identifies changing regulations, as well as customer demands for more nutritious fast food choices, as the main drivers of the new strategy. 124

While the studies mentioned above indicate that the industry as a whole is not significantly improving its performance in regard to fast food nutrition, some companies have made progress by upgrading nutritional content of their offerings. Growing demand for healthy foods may benefit these companies and allow them to capture new market opportunities. A 2014 study by the Johns Hopkins Bloomberg School of Public Health of 66 large chains found that the menu items introduced in 2013 contained 12 percent fewer calories, on average, relatively to the items that were
available in 2012. The 60-calorie reduction is likely to have a noticeable positive impact on obesity. About 36 percent of adult Americans eat at a fast food restaurant each day with a mean caloric intake of 315 calories. The reduction came from introduction of new items with lower calorie content to menus rather than reformulating old ones. For example, in 2013, McDonald’s introduced a grilled onion and cheddar burger. It has only 310 calories, 44 percent fewer than the average 558 calories of its burgers on the 2012 menu. Brinker International’s Chili’s chain added to the 2013 menu a new 580-calorie Mango Chile Chicken entrée that has 35 percent fewer calories than an average 2012 Chili’s entrée. Moreover, restaurants reduce calories in their meals by switching to lower-calorie dressings, reducing the amount of cheese, and offering more salad options.125

Companies that are able to penetrate the healthy food market may capture growth opportunities and improve their bottom line. A Hudson Institute study found that lower-calorie servings drove an increase in same-store sales and growth in restaurants servings. Between 2006 and 2011, French fries declined in both the number of servings and the share of total food servings among large, quick-service chains. Meanwhile, sales of lower-calorie beverages outperformed traditional beverages.126 In recent years, some companies have started improving children’s meal options. Most restaurants offer at least one healthy side dish. For example, McDonald’s Happy Meal sides now automatically include a half portion each of French fries and apples. The NRA What’s Hot 2014 survey lists nutritional value of children’s’ and regular meals high on trends affecting restaurants.127

Value Impact

Demand in the restaurant industry is increasingly driven by consumer preferences for healthier and heathier choices. Companies that are able to offer more nutritious menu options are likely to capture new markets for health-conscious consumers and improve market share with mainstream consumers. A higher share of nutritious options may have a beneficial effect on a company’s reputation and revenue growth in the long term.

Consumer and regulatory pressure for healthier choices at restaurants is likely to remain high in the future, and force companies to make nutritional information clear for customers. This is especially relevant since the Restaurants industry has been subject to claims that menus have led to obesity of certain customers, including children. Companies that invest in better nutritional content are likely to be positioned to capitalizing on shifting consumer preferences. At the same time, these companies will be more adaptable to possibly stricter regulations in the future.

The percentage of meal options consistent with dietary guidelines provides insight into a company’s success at capturing the demand for products that address nutrition concerns,
specifically those directed at children. This metric—together with the number of campaigns directed towards children, and the percentage of meals that meet the National School Lunch Program criteria—also characterizes a company’s exposure to adverse regulatory actions and public outcry around childhood obesity and marketing food to children.

**HUMAN CAPITAL**

Human capital addresses the management of a company’s human resources (employees and individual contractors), as a key asset to delivering long-term value. It includes factors that affect the productivity of employees, such as employee engagement, diversity, and incentives and compensation, as well as the attraction and retention of employees in highly competitive or constrained markets for specific talent, skills, or education. It also addresses the management of labor relations in industries that rely on economies of scale and compete on the price of products and services. Lastly, it includes the management of the health and safety of employees and the ability to create a safety culture for companies that operate in dangerous working environments.

Labor cost in the Restaurants industry can constitute up to a third of revenue. Although workers earn modest salaries, often at or just slightly above government-mandated minimum wages, changes to minimum wage laws can have a noticeable impact on a restaurant’s costs and margins. The average age of employees in the industry is rising. Companies are hiring more retirees and immigrants, and are increasingly making use of automation.

Despite these trends, Restaurants industry job growth outpaced the overall economy in 13 consecutive years, from 2000 to 2012. In 2012, restaurant job growth rose three percent, compared to 1.4 percent nationally. Employing approximately 10 percent of the US workforce, the Restaurants industry is expected to add 1.3 million jobs over the next decade, with employment reaching 14.4 million by 2023.

A company’s ability to attract, develop and retain talent and ensure employee health and safety indirectly but significantly influences the results of its operations. Better disclosures would allow investors to differentiate between companies based on their human capital management strategy, and to identify companies with leading performance in this area.

**Fair Labor Practices**

The hospitality industry is labor intensive, and much of the staff is low-skilled, part-time, or seasonal workers. It is among top job creators and is an entry point for young and migrant workers to join the workforce. Restaurant staffs in franchised or licensed locations may be employed by a third party. In addition, since
many chains exist across continents, ensuring consistent labor standards can be a challenge. This issue pertains to restaurant workers in both company-owned and franchise locations. Labor issues at franchises do affect brand image because customers cannot make a distinction between company-owned and franchised stores.

Compensation can differ within the industry. While fast food workers do not earn customer gratuities, or tips, full-service workers do. Minimum federal wage for tipped workers is significantly lower from that of their nontipped counterparts. Food service positions that require repeated completion of a simple task, like preparing ingredients and taking orders, can be perceived as dull and mechanical. These, in addition to low wages, make employee retention difficult.

The provision of the PPACA that requires employers with 50 or more employees to offer health insurance may affect franchise operators who do not currently offer health benefits to employees. This may impact corporate revenue growth if the financial burden of this regulation significantly decreases profit margins of franchises and discourages franchise owners from opening new locations. Companies that offer competitive wages, safe working environments, and offer opportunities for professional growth will be able to improve worker morale and reduce turnover rates and associated costs. At the same time, good working conditions and competitive pay are likely to reduce the risks of employee strikes and operational disruptions.

Company performance in this area can be analyzed in a cost-beneficial way internally and externally through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Voluntary and involuntary employee turnover rate for restaurant employees;
- Average hourly wage for restaurant employees, by region; percentage of employees earning minimum wage;
- Amount of legal and regulatory fines and settlements associated with labor law violations; and
- Amount of tax credit received for hiring through enterprise zone programs.

Evidence

There are currently 3.3 million workers in the U.S. who make minimum wage. Of those, 55 percent are in the leisure and hospitality industry. By occupation, 47 percent of the 3.3 million minimum wage workers are employed in food preparation and serving positions. If the proposed “Fair Minimum Wage Act” is passed, minimum wage will be raised nationally to $10.10 an hour, from its current $7.25. The bill is opposed by the International Franchise Association (IFA), which represents roughly 12,500 franchise operators and 1,275 franchisors globally. According to the IFA, minimum wage increase “would unfairly and unjustifiably destroy the established franchise
model.” On the other hand, McDonald’s CEO Don Thompson expressed support of the legislation going forward. The opposite stance on the issue can be explained by the fact that wage increases are likely to affect franchisees rather than franchisors, like McDonald’s, that do not operate most retail locations.\textsuperscript{138} The Senate voted this bill down in April 2014, but Democrats have vowed to reintroduce in the future, citing its massive popular support.\textsuperscript{139}

The majority of the workforce of the top companies in the industry is hourly workers. For example, according to the 2013 Form 10-K of Darden Restaurants, 196,000 of the 206,000 company’s workers were hourly restaurant personnel.\textsuperscript{140} Meanwhile, 41,600 of Chipotle’s 45,340 workers are hourly employees, according to the company’s 2013 Form 10-K.\textsuperscript{141} Also, a significant share of employees in the Restaurants industry are part-time workers. For example, 86 percent of the 539,000 Yum! Brand employees were part-time, according to the company’s 2013 Form 10-K.\textsuperscript{142}

The fast food work model utilizes low-skilled workers specializing in discrete tasks. With low wages, temporary workers, and little chance of moving upward, the industry has been one of the ‘100 percent turnover’ industries—indicating that the team working at the beginning of the year may be completely different from that at the close of the year. However, the turnover rate has been declining in part due to the economic downturn and the lack of alternative low-skill positions. In the quick-service Restaurants industry, the turnover rate was 120 in early 2009, but dropped to 90 percent in 2011. The turnover is better for limited-service restaurants, but at 61 percent in 2012, the rate is still high.\textsuperscript{143}

While the Restaurants industry employs over 13 million people in the U.S., the unionization rates are very low. Nevertheless, there are attempts from unions around the country to organize food service workers.\textsuperscript{144} In July 2014, the general counsel of the National Labor Relations Board (NLRB) ruled that McDonald’s has a joint employer status with its franchisees. The ruling means that the company could be held liable for fair labor practices violation by its franchise operators. The ruling may help the national campaigns for higher wages in the industry to amplify the pressure on fast food chains and open the doors for unions.\textsuperscript{145} Fast food workers continue to demand higher wages and the ability to unionize by organizing simultaneous strikes in many U.S. cities.\textsuperscript{146} If restaurant workers were allowed to unionize, it would have a material impact on a company’s operations. For example, in its Form 10-K for fiscal year 2013, Chipotle states: “If a significant portion of our employees were to become union organized, our labor costs could increase and our efforts to maintain a culture appealing only to top performing employees could be impaired. Potential changes in labor laws, including the possible passage of legislation designed to make it easier for employees to unionize, could increase the likelihood of some or all of our employees
being subjected to greater organized labor influence, and could have an adverse effect on our business and financial results by imposing requirements that could potentially increase our costs, reduce our flexibility and impact our employee culture.\textsuperscript{147}

In order to mitigate the higher cost of providing mandatory health insurance to full-time workers, companies in the industry are trying to hire more part-time workers. In 2012, foreseeing the upcoming PPACA requirements, Darden Restaurants attempted to replace full-time workers with part-time workers to keep costs down by avoiding paying insurance. The experiment failed, and the company received negative feedback from customers. Negative publicity resulted in the company’s sales decreasing, even as Darden’s efforts to attract customers via promotions failed. The company posted a 2.7 percent drop in revenue in the second fiscal quarter of 2012. The owner of Olive Garden and Red Lobster stated that after reviewing the test results, the company would not “bump any full-time workers down to part-time status”, but in the long term, it would still be shifting towards part-time workforce.\textsuperscript{148}

The working conditions and worker compensation at fast food and other restaurants have been receiving substantial of media attention. While the Restaurants industry provides jobs for low-skilled workers, those employed by the industry still require public assistance. The University of California Berkeley Labor Center estimated that 52 percent of the families of frontline fast food workers are enrolled in public programs, and the cost of public assistance is nearly $7 billion annually.\textsuperscript{149}

In 2009, a study found that about 18 percent of restaurant and hotel employees face minimum wage violations, 70 percent face overtime violations, and 74 percent of workers are required to do tasks without being paid (“off-the-clock” violations). Among the most common violations are deducting 30-minute breaks when employees don’t take them, requiring workers to pay for uniforms when it makes their paycheck below a minimum wage. In 2012, a Subway franchisee was found in violation of labor laws when it was not paying workers for 30 minutes on duty during the nightly closing routine. Moreover, the franchise was making illegal deductions from employees’ paychecks when there were cash register shortages. The practice resulted in workers’ pay to drop below the federal minimum wage. The franchisee was ordered to pay $9,900 back to 72 employees. Another Subway franchisee from Michigan was asking workers to sign contracts waiving time-and-a-half pay for overtime. The DOL investigation ordered the company to pay total damages of $52,000 to 53 workers.\textsuperscript{150}

According to a CNNMoney analysis of DOL data, Subway has been charged with underpaying its employees more often than any other fast food chain. Over 1,100 investigations of the company’s franchises found approximately 17,000 violations of the Fair Labor Standards Act. Franchisees had to
reimburse Subway workers more than $3.8 million from 2000 to 2013. McDonald’s and Dunkin’ Donuts are the next most frequent wage violators. All three companies utilize a franchising model for their services and try to distinguish themselves from their franchisees. Dunkin’ Donuts responded with the following statement: “franchisees are solely responsible for all employment decisions at their restaurants.” McDonald’s statement cautioned “against drawing broad conclusions based on the actions of a few.” The franchise model makes it difficult for the DOL to enforce regulation on parent companies directly, as the legal structure provides them with a protection. Moreover, the Labor Department has to investigate each franchise individually and treat them as a small business.151

Data released by law firm Seyfarth Shaw LLP indicates that federal wage and hour lawsuits filed under the FLSA reached a record high in 2013. However, only a few investigations were focused on fast food industry. Attorneys went after higher paying industries, like financial services, to get higher payouts. But Hollis Pfitsch, staff attorney for the Legal Aid Society, states: “it’s only now that the fast food industry is getting attention from the private sector, probably because of all the organizing and workers speaking out.”152

As stated in the industry description, the cost of labor represents a significant portion of operational expenses of restaurant companies. To reduce its expenses and improve profitability, Darden Restaurants put workers on a “tip sharing” program: i.e., waiters and waitresses would need to share their tips with busboys, bartenders, and other employees. It allowed the company to pay workers “tip credit wage,” which is significantly lower than the federal minimum wage of $7.25. Moreover, at Red Lobster restaurants, servers now handle four tables at a time, instead of three.153

Low wages increase the tension between employers and their workers, and dissatisfaction may result in lawsuits and work stoppages, which directly affect operational performance. In December 2013, low wage workers, including fast food workers in hundreds of cities, went on strike to demand higher wages.154 Darden Restaurant is facing a class action lawsuit alleging that they required workers to work off the clock. While the outcome of the lawsuit is undetermined, plaintiffs are seeking back wages, liquidated damages, and attorney’s fees.155 Chipotle is facing a similar class action lawsuit regarding employees who were classified as salaried and, therefore, not paid for overtime.156 In 2014, seven class action lawsuits were filed by McDonald’s workers in New York, California, and Michigan. The company was allegedly forcing employees to work off the clock, was not paying overtime, and was taking hours off their time cards.157 Similar allegations have been filed against other companies in the industry, including Yum! Brands, Starbucks, and others.
According to the Yum! Brands website, over 80 percent of U.S. restaurants and 90 percent of international restaurants are owned by franchisees or licensees—an important reason why it is nearly impossible for the company to oversee worker practices in every restaurant. Yet actions by franchisees and licensees directly impact the brand due to the ambiguity of ownership of any particular location. In 2013, a lawsuit was filed against a McDonald’s franchisee in Pennsylvania who paid their employees through debit cards, a method of payment that is legal as long as the card fees do not result in a net wage lower than the federal minimum wage. Recognizing the importance of employee retention, the McDonald’s franchisee set sales targets and created competition between the stores it owns and operates to boost sales and improve employee morale through awards for meeting targets.

But franchisees’ mismanagement of the issue may have an adverse impact on a parent company, not only through reputational damage, but also by sharing liabilities for violations. For example, the international corporation Domino’s Pizza was added to the suit against its New York-based franchisee for minimum wage and overtime violation. Allegedly, the company knew about the franchisee’s violations, as it had control over hiring policies, training, staff uniforms, point-of-sale systems, and time and pay records. In the settlement, the franchisee agreed to pay $1.28 million in back wages to 61 employees, with Domino’s corporate parent agreeing to minor concessions. As valued by a lawyer for the franchisee, Domino’s contributed about $140,000 in a form of waiving and delaying some of the franchisee’s payments. But in its statement, Domino’s said that it was “not ‘contributing’ to the settlement in any way” and that the company expects to collect “several hundred thousand dollars” in back royalties from the franchisee.

Chipotle provides an excellent example of best practices in the industry to promote better working conditions, which can result in happier employees and thus lower turnover. Chipotle offers store employees benefits such as higher wages, health care, 401(k) plans, and paid vacation. The company aims to hire managers from within and gives managers a $10,000 bonus for each crew member they help train to general manager level. As a result of the companies’ initiatives, they were able to hire 97 percent of salaried managers from within their store.

Companies that are able to improve working conditions and ensure fair wages will be able to lower turnover rates and lower labor costs. In some areas, enterprise zone tax credits subsidize the cost of hiring new workers. However, these programs are the subject of regulatory scrutiny and may be modified which could limit a company’s ability to qualify for some of such credits.
Several states in the U.S. have enterprise zones (EZs): geographic areas in which companies can qualify for subsidies such as investment tax credits, job creation tax credits, and property tax abatements, among others. EZs were created with an intention to improve economic conditions of depressed areas by bringing in businesses. Over the years, many EZ programs proved to be ineffective and inefficient, draining money from states’ budgets. Since its inception and up to 2013, California’s EZ Program had a total cost to the state of $4.8 billion. It benefited less than one percent of the state’s corporations—mainly those with assets of over $1 billion. The Labor Federation has identified McDonald’s, Yum! Brands, and Starbucks among them. In 2010 in California, service corporations claimed 39.3 percent of the total dollar value of tax credits, followed by retail and wholesale trade corporation. Some companies in the industry may have turnover rates over 100 percent; therefore, they may repeatedly qualify for tax credits for filling the same position. Many of these federal and state zones are under public scrutiny, and may be either eliminated or requirements to qualify for tax benefits may become stricter. In California’s EZs, to qualify for employment credits a company would have to create a new position rather than just to replace a worker on existent one. Moreover, the positions created should have a minimum wage of $12 an hour, and the credit would be capped at 350 percent of minimum wage. Companies that minimize turnover rates and are less dependent on EZ tax credits will be able to mitigate risks from the changing regulations around EZs.

Value Impact

Successful employee engagement and fair treatment of workers are likely to improve employee morale and reduce turnover. In turn, this can lead to improved customer experience, with upside impact on revenue and growth. On the downside, mismanagement of these issues can impact customer satisfaction and brand value, especially when a labor issue escalates in the media. Unfair labor practices can also result in worker strikes and create a confrontational relationship between employers and labor groups. As an outcome, it could have chronic impact on the company’s revenue and market share.

High turnover rates and potential increases in wage costs through outside influences, such as new minimum wage regulations, can also impact companies’ long-term cost structure. As the industry is subject to laws and regulations governing minimum wage requirements, overtime, immigration, and employee hiring and termination, labor practices can result in legal actions from employees or regulators. This potentially results in extraordinary expenses and contingent liabilities.

While overall turnover is high in the industry, companies’ voluntary and involuntary staff turnover rates indicate how well they are managing their workforce compared to peers. Involuntary turnover is a proxy for staff’s
engagement and the company’s ability to
maximize customer experience. The amount of
legal and regulatory fines and settlements from
labor law violations is a lagging indicator of
how well restaurant companies have been
managing this issue. It also indicate the
probability and magnitude of the direct costs
associated with large penalties and fines and
remediation activities. The average hourly wage
for lodging employees provides a sense of how
companies are balancing maximization of
profits. It also provides a sense of how
companies are balancing investments in the
wellbeing, and ultimately performance, of
customer-facing staff.

LEADERSHIP AND GOVERNANCE

As applied to sustainability, governance
involves the management of issues that are
inherent to the business model or common
practice in the industry and are in potential
conflict with the interest of broader stakeholder
groups (government, community, customers,
and employees). They therefore create a
potential liability, or worse, a limitation or
removal of license to operate. This includes
regulatory compliance, lobbying, and political
contributions. It also includes risk management,
safety management, supply chain and resource
management, conflict of interest, anti-
competitive behavior, and corruption and
bribery.

Sustainable sourcing of food and disposable
tableware is the main governance issue
impacting the industry. With disclosure in
regard to how companies manage such
tensions, as well as the additional costs
associated with failing to do so, investors will
be able to reward industry leaders. Investors
will also be able to assess the reputational and
regulatory risks and impact on value for
companies performing poorly.

Supply Chain Management &
Food Sourcing

Supply chain management is an important issue
for restaurant operators. Sourcing from
suppliers that have high quality standards,
employ environmentally sustainable farming
methods, and honor labor rights will better
position companies to protect shareholder
value.

Sourcing quality ingredients to maintain
consistency and high level of quality across
different locations can be operationally
challenging. This problem is exacerbated by the
global nature of the industry. The perceptions
and risks of the use of genetically modified
organisms (GMOs), antibiotics, and hormones
vary across markets, as do regulations. The
production of meat can be energy- and water-
intensive. Beef production generates
greenhouse gases, with enteric methane (CH4)
accounting for the largest share of them. Fruit
and vegetable farming has associated
environmental impacts: fertilizer runoff,
pesticide use, and so on. In addition, there are the social issues of ensuring worker rights along the supply chain, as well as animal welfare.

Demand from food and beverage industries, including restaurants, drive and shape agricultural production, indicating that actions by industry players have larger impacts on society. Therefore, sustainable and ethical sourcing by industry players is necessary to ensure continued future supply and to minimize lifecycle impacts of company operations. Managing this issue well will help restaurants to maintain food quality, manage the food safety issue, and reduce reputational risks.

Company performance in this area can be analyzed in a cost-beneficial way internally and externally through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Percentage of food purchased that meets environmental and social sourcing standards, percentage third-party certified;
- Percentage of eggs purchased from cage-free sources, and percentage of pork purchased from gestation crate-free sources; and
- Discussion of strategy to manage environmental and social risks within the supply chain.

### Evidence

As global companies, restaurant chains have to navigate the evolving world of customer preference and government regulations around the use of GMOs, antibiotics, and hormones. In Europe, customers are more resistant to GMOs, and the use of antibiotics for any purpose other than disease treatment or prevention is prohibited in all products. In the U.S., GMOs are generally accepted, and the use of antibiotics to increase growth of chickens is commonplace. In December 2013, the FDA announced implementing “a voluntary plan with the industry to phase out the use of certain antibiotics for enhanced food production.”[169] This is comparable to McDonald’s 2003 antibiotic policy regarding its direct suppliers.[170, 171]

The trend of restaurant companies turning to sustainability and transparency of their supply chains is mostly driven by the market demand. Since the 1990s and 2000s, fast food restaurants have earned a reputation for having food that may have negative long-term effects due to its poor nutritional value. Therefore, companies in the industry increasingly turn their efforts to ensuring high standards in sourcing their supplies. They also seek high standards in providing consumers with the information that helps them to make decisions about their meal choices. For example, in Australia, McDonald’s allows its customers to track back the meat used in their burgers or...
Chicken McNuggets to the farms it came from using an app.\textsuperscript{172}

Many restaurant chains have initiated sustainable sourcing programs. In 2013, McDonald’s started using only seafood that is certified by the Marine Stewardship Council to be sustainably sourced.\textsuperscript{173} In January 2014, McDonald’s made a pledge to start purchasing verified sustainable beef by 2016. To determine sustainable sources of beef, region-specific standards will be used. Those standards require development of sustainable beef metrics and indicators. The McDonald’s’ beef suppliers will be asked to follow the principles developed by the Global Roundtable for Sustainable Beef, with indicators that are specific to their regions.\textsuperscript{174} The company is also investing $6.5 million over five years to help Guatemalan coffee growers increase production from sustainable farms.\textsuperscript{175} By 2011, 86 percent of the coffee bought by Starbucks was responsibly grown and ethically traded along guidelines developed by the company in collaboration with Conservation International.\textsuperscript{176} By 2015, the company is committed to sourcing 100 percent of its coffee from ethical sources. In February 2013, Starbucks agreed to purchase 100 percent of its palm oil from certified sustainable suppliers.\textsuperscript{177} There have been several shareholder resolutions regarding sustainable sourcing of palm oil. In 2013, shareholders of Darden, Dunkin’ Brands, Starbucks, and Yum! Brands filed sustainable palm oil resolutions.\textsuperscript{178}

According to a World Bank report, 62 percent of seafood consumed globally will be farm-raised by 2030. To meet growing demand for affordable and nutritious seafood, companies in the industry need to develop relationships with fisheries and aquaculture. Sustainable and environmentally responsible fish farming practices within their supply chain are likely to help restaurant operators to ensure long-term supply of seafood and improve demand from customers.\textsuperscript{179} In 2011, Darden announced its commitment to rebuilding troubled commercial reef fish fisheries. The company regularly evaluates purchasing practices to ensure they support and encourage sustainable fisheries. As of 2013, 100 percent of shrimp, 85 percent of salmon, and 80 percent of tilapia and catfish served at Darden’s restaurants satisfied the Global Aquaculture Alliance Standards.\textsuperscript{180}

As this evidence suggests, it is important for companies in the Restaurants industry to engage suppliers in order to ensure food quality and reduce environmental and social impacts along the value chain. It would allow them to avoid issues that may affect restaurants’ reputation and license to operate as well as ability of continuous sourcing. For example, Yum! Brands has been struggling in China partly due to a government investigation into improper antibiotic use by some chicken suppliers. For fiscal year 2013, Yum! Brands experienced a nine percent decline in earnings per share due largely to lower sales in China. Those sales were caused by the poultry supply incident.\textsuperscript{181, 182} China accounts for half of Yum!
Brands’ revenue and 44 percent of its operating profits. Same-store sales in China fell 16 percent in 2013. In its 2012 Form 10-K, Yum! Brands acknowledges the impact of negative media attention on the chicken antibiotic issue: “KFC China sales in the last two weeks of the year were significantly impacted by the intense media attention surrounding an investigation by the Shanghai FDA (SFDA) into poultry supply management at our China Division.”

Working conditions in the supply chain may also play a role in customers’ purchasing decisions. Taco Bell and Yum! Brands have joined the Fair Food Program, which aims to improve conditions for Florida’s tomato farm workers. By signing onto the program, restaurants, food retailers, and food service companies have agreed to pay a premium for tomatoes (one cent more per pound) which would go towards increasing wages for farmworkers. Wendy’s has been receiving negative media attention for refusing to join the program. This example illustrates how companies that do not disclose their commitment to ensuring labor rights in the supply chain can face reputational risks.

“Food with Integrity” is one of Chipotle’s guiding principles. The following quote from Chipotle’s FY 2012 10-K summarizes the challenges and argument for sustainable supply chain management: “We do, however, face challenges associated with purchasing ingredients grown or raised with an emphasis on quality, sustainability and other responsible practices.” In addition, “we believe that (...) consumers are increasingly concerned about where their food comes from and how it is raised (...). We believe that increased demand over the long term for the types of meat and produce items we strive to serve will continue to attract the interest and capital investment of larger farms and suppliers.”

**Value Impact**

Industry trends suggest that supply chain management is crucial for restaurant companies to protect their reputations and improve revenues. Consumers are becoming increasingly aware of the health, social, and environmental impact of food sourcing. Thus, companies that can ensure food safety and ethical sourcing in their supply chains can enhance their brand image and market share. On the downside, violations of food safety and other regulations by a restaurant’s suppliers are likely to adversely affect reputation. They impact sales in owned and operated facilities, or royalties from franchised operations. Performance in this area can be assessed through the percentage of food supply sourced in conformance with environmental and social standards, as well as conformance with animal welfare standards and best practices.
REFERENCES


5 Bloomberg Professional service, accessed October 1, 2014, using the BICS <GO> command. The data represents global revenues of companies listed on global exchanges and traded over-the-counter (OTC) from the Restaurants industry, using Levels 3 and 5 of the Bloomberg Industry Classification System.

6 Author’s calculation based on data from Bloomberg Professional service, accessed October 6, 2014 using Equity Screen (EQS) for U.S.-listed companies (including those traded primarily OTC) that generate at least 20 percent of revenue from their Restaurants segment and for which the Restaurants industry is a primary SICs industry.


INDUSTRY BRIEF | RESTAURANTS | 35


74 Difrisco, Matthew, and Phan Le. “CAKE: NDR takeaways; greater confidence in NT, raising estimates; BUY.” Lazard Capital Markets Company Notes, November 30, 2011.


76 Starbucks Corp. FY2012 Form 10-K for the Fiscal Year Ending September 30, 2012 (filed November 16, 2012).


82 “Darden Citizenship 2013 Update.” Darden Restaurants. 2013


110 Author’s calculation based on data from Bloomberg Professional service, accessed October 28, 2014, using the BICS <GO> command. The data represents global revenues of companies listed on global exchanges and traded over-the-counter (OTC) from the Restaurants industry, using Levels 3 and 5 of the Bloomberg Industry Classification System.


118 Ustjanauskas A. E., J. L. Harris and M. B. Schwartz. “Food and beverage advertising on children’s web sites.” Rudd Center for Food Policy and Obesity, Yale University, New Haven, CT, USA. Received 15 January 2013; revised 30 April 2013; accepted 24 May 2013. Accessed November 19, 2014.


186 Chipotle Mexican Grill, Inc. FY2012 Form 10-K for the Fiscal Year Ending December 31, 2012 (filed February 8, 2013).

**APPENDIX I:**
Five Representative Restaurants Companies

<table>
<thead>
<tr>
<th>COMPANY NAME</th>
<th>TICKER SYMBOL</th>
</tr>
</thead>
<tbody>
<tr>
<td>McDonald's Corporation</td>
<td>MCD</td>
</tr>
<tr>
<td>Starbucks Corporation</td>
<td>SBUX</td>
</tr>
<tr>
<td>Yum! Brands, Inc.</td>
<td>YUM</td>
</tr>
<tr>
<td>Darden Restaurants, Inc.</td>
<td>DRI</td>
</tr>
<tr>
<td>Bloomin’ Brands, Inc.</td>
<td>BLMN</td>
</tr>
</tbody>
</table>

*This list includes five companies representative of the Restaurants industry and its activities. This includes only companies for which the Restaurants industry is the primary industry, companies that are U.S.-listed but are not primarily traded Over-the-Counter, and for which at least 20 percent of revenue is generated by activities in this industry, according to the latest information available on Bloomberg Professional Services. Retrieved on September 30, 2014.*
APPENDIX IIA:
Evidence for Sustainability Disclosure Topics

<table>
<thead>
<tr>
<th>Sustainability Disclosure Topics</th>
<th>EVIDENCE OF INTEREST</th>
<th>EVIDENCE OF FINANCIAL IMPACT</th>
<th>FORWARD-LOOKING IMPACT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>HM (1-100)</td>
<td>IWGs</td>
<td>Ei</td>
</tr>
<tr>
<td>Energy &amp; Water Management</td>
<td>43</td>
<td>71</td>
<td>5</td>
</tr>
<tr>
<td>Food &amp; Packaging Waste Management</td>
<td>35</td>
<td>64</td>
<td>6</td>
</tr>
<tr>
<td>Food Safety</td>
<td>67*</td>
<td>100</td>
<td>1</td>
</tr>
<tr>
<td>Nutritional Content</td>
<td>83*</td>
<td>79</td>
<td>4</td>
</tr>
<tr>
<td>Fair Labor Practices</td>
<td>60*</td>
<td>93</td>
<td>3</td>
</tr>
<tr>
<td>Supply Chain Management &amp; Food Sourcing</td>
<td>60*</td>
<td>93</td>
<td>2</td>
</tr>
</tbody>
</table>

HM: Heat Map, a score out of 100 indicating the relative importance of the topic among SASB’s initial list of 43 generic sustainability issues; asterisks indicate “top issues.” The score is based on the frequency of relevant keywords in documents (i.e., 10-Ks, 20-Fs, shareholder resolutions, legal news, news articles, and corporate sustainability reports) that are available on the Bloomberg terminal for the industry’s publicly-listed companies; issues for which keyword frequency is in the top quartile are “top issues.”

IWGs: SASB Industry Working Groups

%: The percentage of IWG participants that found the disclosure topic to likely constitute material information for companies in the industry. (-) denotes that the issue was added after the IWG was convened.

Priority: Average ranking of the issue in terms of importance. One denotes the most important issue. (-) denotes that the issue was added after the IWG was convened.

EI: Evidence of Interest, a subjective assessment based on quantitative and qualitative findings.

EFI: Evidence of Financial Impact, a subjective assessment based on quantitative and qualitative findings.

FLI: Forward Looking Impact, a subjective assessment on the presence of a material forward-looking impact.
## APPENDIX IIB:
Evidence of Financial Impact for Sustainability Disclosure Topics

<table>
<thead>
<tr>
<th>Evidence of Financial Impact</th>
<th>REVENUE &amp; EXPENSES</th>
<th>ASSETS &amp; LIABILITIES</th>
<th>RISK PROFILE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Revenue</td>
<td>Operating Expenses</td>
<td>Non-operating Expenses</td>
</tr>
<tr>
<td>Market Share</td>
<td>New Markets</td>
<td>Pricing Power</td>
<td>Cost of Revenue</td>
</tr>
<tr>
<td>Energy &amp; Water Management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food &amp; Packaging Waste Management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food Safety</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nutritional Content</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair Labor Practices</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supply Chain Management &amp; Food Sourcing</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **MEDIUM IMPACT**
- **HIGH IMPACT**
## APPENDIX III: Sustainability Accounting Metrics | Restaurants

<table>
<thead>
<tr>
<th>TOPIC</th>
<th>ACCOUNTING METRIC</th>
<th>CATEGORY</th>
<th>UNIT OF MEASURE</th>
<th>CODE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy &amp; Water Management</td>
<td>Total energy consumed, percentage grid electricity, percentage renewable</td>
<td>Quantitative</td>
<td>Gigajoules (GJ), Percentage (%)</td>
<td>SV0203-01</td>
</tr>
<tr>
<td></td>
<td>Total water withdrawn, percentage in regions with High or Extremely High Baseline Water Stress</td>
<td>Quantitative</td>
<td>Cubic meters (m³), Percentage (%)</td>
<td>SV0203-02</td>
</tr>
<tr>
<td>Food &amp; Packaging Waste Management</td>
<td>Amount of waste, percentage food waste, percentage diverted</td>
<td>Quantitative</td>
<td>Metric tons (t), Percentage (%)</td>
<td>SV0203-03</td>
</tr>
<tr>
<td></td>
<td>Total weight of packaging, percentage made from recycled or renewable materials, percentage that is recyclable or compostable</td>
<td>Quantitative</td>
<td>Metric tons (t), Percentage (%)</td>
<td>SV0203-04</td>
</tr>
<tr>
<td>Food Safety</td>
<td>Percentage of restaurants inspected by a food safety oversight body, percentage receiving critical violations</td>
<td>Quantitative</td>
<td>Percentage (%)</td>
<td>SV0203-05</td>
</tr>
<tr>
<td></td>
<td>Number of recalls, total amount of food product recalled¹</td>
<td>Quantitative</td>
<td>Number, Metric tons (t)</td>
<td>SV0203-06</td>
</tr>
<tr>
<td></td>
<td>Number of confirmed foodborne illness outbreaks, percentage resulting in CDC investigation²</td>
<td>Quantitative</td>
<td>Number, Percentage (%)</td>
<td>SV0203-07</td>
</tr>
<tr>
<td>Nutritional Content</td>
<td>Percentage of meal options consistent with the Dietary Guidelines for Americans or foreign equivalent, sales from these options</td>
<td>Quantitative</td>
<td>Percentage (%), U.S. Dollars ($)</td>
<td>SV0203-08</td>
</tr>
<tr>
<td></td>
<td>Percentage of children’s meal options consistent with national dietary guidelines for children or foreign equivalent, sales from these options</td>
<td>Quantitative</td>
<td>Percentage (%), U.S. Dollars ($)</td>
<td>SV0203-09</td>
</tr>
<tr>
<td></td>
<td>Number of child advertising impressions made, percentage promoting products that meet national dietary guidelines for children or foreign equivalent</td>
<td>Quantitative</td>
<td>Number, Percentage (%)</td>
<td>SV0203-10</td>
</tr>
</tbody>
</table>

¹ Note to SV0203-06 – Disclosure shall include a description of notable recalls and corrective actions implemented in response to events.

² Note to SV0203-07 – The registrant shall discuss foodborne illness outbreaks that were investigated by the CDC and corrective actions implemented in response to events.
### APPENDIX III: Sustainability Accounting Metrics | Restaurants (cont.)

<table>
<thead>
<tr>
<th>TOPIC</th>
<th>ACCOUNTING METRIC</th>
<th>CATEGORY</th>
<th>UNIT OF MEASURE</th>
<th>CODE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Labor Practices</td>
<td>1) Voluntary and (2) involuntary employee turnover rate for restaurant employees</td>
<td>Quantitative</td>
<td>Percentage (%)</td>
<td>SV0203-11</td>
</tr>
<tr>
<td></td>
<td>Average hourly wage for restaurant employees, by region; percentage of employees earning minimum wage</td>
<td>Quantitative</td>
<td>U.S. Dollars ($), Percentage (%)</td>
<td>SV0203-12</td>
</tr>
<tr>
<td></td>
<td>Amount of legal and regulatory fines and settlements associated with labor law violations*</td>
<td>Quantitative</td>
<td>U.S. Dollars ($)</td>
<td>SV0203-13</td>
</tr>
<tr>
<td></td>
<td>Amount of tax credit received for hiring through enterprise zone programs</td>
<td>Quantitative</td>
<td>U.S. Dollars ($)</td>
<td>SV0203-14</td>
</tr>
<tr>
<td>Supply Chain Management &amp; Food Sourcing</td>
<td>Percentage of food purchased that meets environmental and social sourcing standards, percentage third-party certified</td>
<td>Quantitative</td>
<td>Percentage (%) by cost of goods sold</td>
<td>SV0203-15</td>
</tr>
<tr>
<td></td>
<td>(1) Percentage of eggs purchased from cage-free sources and (2) percentage of pork purchased from gestation crate-free sources**</td>
<td>Quantitative</td>
<td>Percentage (%), Percentage by weight (%)</td>
<td>SV0203-16</td>
</tr>
<tr>
<td></td>
<td>Discussion of strategy to manage environmental and social risks within the supply chain</td>
<td>Quantitative</td>
<td>Discussion and Analysis</td>
<td>SV0203-17</td>
</tr>
</tbody>
</table>

* Note to SV0203-13 – Disclosure shall include a description of fines and settlements and corrective actions implemented in response to events.

** Note to SV0203-16 – Disclosure shall include a description of any additional animal welfare standards used by the registrant.
APPENDIX IV: Analysis of SEC Disclosures | Restaurants

The following graph demonstrates an aggregate assessment of how representative U.S.-listed Restaurant companies are currently reporting on sustainability topics in their SEC annual filings.

![Graph showing the type of disclosure on sustainability topics for Restaurants. The graph includes categories such as Energy & Water Management, Food & Packaging Waste Management, Food Safety, Nutritional Content, Fair Labor Practices, and Supply Chain Management & Food Sourcing. The graph indicates the percentage of disclosure for each topic, with percentages ranging from 71% to 100%.

*IWG Feedback*