

Fanelli's Pizza

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“... and a large Fanelli Fat Boy”. It was almost 10:00pm and Anton was taking the last order of the evening. It had been a typical Saturday night at *Fanelli's Pizza* but as usual there was a flurry of telephone orders just before closing. He quickly made up the pizza and slid it into the oven. A few minutes later it was ready, piping hot and looking delicious. He cut it into 10 slices, boxed it, and handed it over to Ben, the delivery driver, who set off. Anton unplugged the phone and began cleaning up. He had only started working at this branch the previous year, but was in charge whenever his manager, Ali, was absent. And Ali was often absent.

Fanelli's Pizza was founded by Frank Buscetta, several years ago. Frank had arrived in the UK from Southern Italy back in 1984, and had inherited a hefty sum of money. His father had some prior experience with pizza parlours, and it was a logical business venture for Frank to undertake. Frank was committed to quality, and driven by a passion to make tasty food. *Fanelli's* was the only local pizza takeaway that used fresh ingredients, and Frank insisted on making the dough, each day, from scratch. This was labour intensive but Frank felt it was worth it, and believed his customers did too.

Despite getting off to a good start, the business was struggling. As the summary of the accounts (in the Appendix) shows, Fanelli's had recently become loss making. And to make things worse, Frank was ill.

Anton had gone to visit Frank at his home. The purpose was to provide an update on that week's sales, which were reasonably strong. But Frank had other things to discuss. He wanted to make Anton an offer,

“I can see that you are on top of things, Anton. And I need help. I'd like you to take over from Ali. I'd like you to manage that branch”.

Anton was flattered, and keen for a promotion. But he also knew that wouldn't fix everything. He wasn't trying to push Ali out. He wasn't a *consigliere*.

“Ali isn't the problem, Frank. He understands the business and is still useful for you. It's not just our branch that needs changes. The whole business has been losing its way.”

Frank understood.

“It makes me so sad to see the business in decline. I used to have a healthy margin, and I still believe that it's possible. But I've spent everything I had and don't have the funds to invest any more.”

Frank's wife came in and expressed her own concerns. She could see that her husband was frail, and that he was stressed by the business. She handed the books over to Anton. (A copy of the income statement is in the Appendix).

“Here you go, Anton. You will have all the information you need.”

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Locations

The first branch of *Fanelli's* opened in a seaside town called Boscombe. Once it started to turn a profit Frank began looking for similar locations so that he could build an empire. He identified shops in Ferndown and then Old Milton. Boscombe, Ferndown and Old Milton were all relatively quiet residential areas, with affluent local populations. There were a few pubs and restaurants in the town centres but little passing trade. People tended to phone in orders either for collection, or delivery, and there were typically twice as many deliveries as pick-ups. Customers tended to be quite loyal and many would make the same order once per month. Most evenings of the year required just two members of staff. Someone needed to be in the shop at all times, answering the phone, making pizzas, and serving walk in customers. This was mostly the manager, who would also do all of the food prep before opening and all of the cleaning after close. Each shop also required a driver to make the deliveries.

On quiet nights, the driver would help out around the shop, but on the busier, weekend evenings (i.e. Friday and Saturday), an extra driver was needed and an additional member of staff – an assistant chef - was required in the store. The weekend chef would work an 8 hour shift but it was a minimum wage job earning £30 a day. Drivers were on zero hours contracts so they were only paid for work that they did. Each shop had a regular driver who worked most nights but there was a pool of reserve labour that could be called upon if need be.

The fourth branch, in Marchwood, was a more recent venture. Frank had learnt of a takeaway being available for a knockdown rental and was keen to move into a more lucrative area. Marchwood was a suburb of the city of Southampton and had much more foot traffic. But it had a very different customer base. Close to a nightclub and several bars, the typical clientele were young, drunk, and in need of quick food. They didn't care much for freshly made dough or pasta dishes, and Sally, the manager, struggled to cope with the peaks in demand after the pubs closed. She said that she needed a full-time assistant working in the shop. Frank was surprised at how difficult it was for Marchwood to turn a profit. He'd recently received an opening offer of £1,100pm from a Turkish kebab company to take over the lease and all equipment.¹

The accounts for Boscombe, Ferndown and Old Milton were identical. On average, each shop earned £598.40 per day in pizza sales and £120.90 for other items. Their raw material costs were £167.89 for pizza and £106.78 for other items.² Marchwood was a slightly different matter, partly because Sally didn't keep extensive records. Frank had no doubt that she was honest, but he didn't see a breakdown of the revenue and cost of goods sold from that branch. However, he did know that Marchwood sold £400 of pizza and £100 of other items per day, and had cost of goods sold of £170 for pizza and £86 for other items.

The issues presented by the Marchwood shop meant that Frank was opposed to setting up new branches in the centre of cities such as Southampton or nearby Bournemouth. One of the non-regular delivery drivers, Seb, lived in a nearby town called Verwood and likened it to Ferndown. He suggested opening a branch there, but Frank just thought this was because he wanted more hours. There were several other town locations, and most of them had spare retail shops at similar rates to *Fanelli's* existing portfolio.

The monthly rent was £1,090 in Ferndown, £1,260 in Boscombe, £1,120 in Old Milton, and £980 in Marchwood. The Old Milton shop also came with a 2 bedroom flat directly above it, which Frank used for storage. This could be leased out for £428pm.³ All rental agreements were long term and difficult to break.

Each branch had its own contract for gas, electricity and water. Although *Powergen* were the only provider available in Marchwood, the UK energy market was becoming increasingly deregulated and Anton was aware that different providers could offer different prices. All 4 of the branches each used, on average, 8,000kwh of gas and 8,500kwh of electricity per month. The branches in Boscombe, Ferndown and Old Milton were currently using npower. Anton considered phoning two other major

¹ *Fanelli's* would still have to pay the water bill but would no longer have to pay for the gas, electricity, or business insurance.

² As mentioned in the note in the Appendix Frank's accounts put all staff costs under Selling, General and Administrative expenses (SGA). We can therefore treat these "raw material" costs as being the reported Cost of Goods Sold (COGS).

³ The £22pm monthly water bill for the Old Milton shop covered the flat as well. It was common in the UK for water bills to be included in any subleased rent but gas and electricity to be billed separately.

companies to compare some quotes. The contracts were on a rolling monthly basis so they could be switched at any time.

Each of the branches paid a flat rate to the respective local water supplier for water usage and sewerage. This amounted to £20pm in Ferndown, £22pm in Boscombe and Old Milton, and £26pm in Marchwood.

A very large cost for each branch was business insurance and other rates. These came to £29,000 per year in Old Milton, £32,000 in Boscombe, and £34,000 in Ferndown and Marchwood. However, there were relatively few specialist providers and strong incentives to renew quotes each year. Because these insurance policies were mandatory and highly regulated Anton didn't believe there was much scope for finding better deals.

Employees

Frank had originally run the Boscombe shop, making the dough each day, cooking the pizzas, and serving customers. Over the last few years his deteriorating health had meant that most of the activities were done by his assistant, Ali. When Frank opened the branch in Ferndown he hired a local guy called Andy to become manager there. Andy had worked in the fast food industry for some time and was a competent, loyal, and diligent worker. There wasn't an obvious candidate to run the Old Milton branch when that opened, and so Frank hired someone through a newspaper advertisement. Unfortunately, it didn't work out because the manager was lazy and kept looking for shortcuts. On a surprise visit Frank was horrified to see that the dough hadn't been made fresh that morning, and so the pizzas tasted nothing like what *Fanelli's* were famous for. Frank had sacked the manager on the spot, and enlisted Ali to take over.

Ali lived in Boscombe with his wife and young child having immigrated to the UK recently. He was deeply grateful to Frank for giving him work and would do anything to repay him, including working out of the Old Milton location. This caused a problem, however, because Ali's wife was enrolled in night school and they struggled with someone to look after their daughter. This was less of a problem when Ali was in Boscombe, because he could get a driver to look after the shop if there was an emergency. But if he needed to pop home from Old Milton this could sometimes take over an hour. Anton knew that Ali was keen to go down to 4 days a week, but was worried that he'd be letting Frank down.

The main driver in Boscombe was Kelly, who was in her twenties and also had a young child. The evening work fitted into her childcare commitments because her partner was back from his job by then. She enjoyed the opportunity to earn some extra money in part time work, and was happy in her role. She was financially competent and capable of looking after the shop on her own. Anton wondered if she'd be willing to do slightly longer hours and spend more time overseeing the branch. It was obvious that the labour mix for the Boscombe and Old Milton branches was wrong and could be improved. To become an assistant manager, she'd need to be paid a daily wage that meant she wasn't worse off than driving, and reflected any extra hours. It would also be appropriate to pay her £10 or even £20 a day to reflect her managerial responsibilities.

With Ali in Old Milton, Frank had appointed Andy as joint manager of the Boscombe and Ferndown branches. This meant that he alternated between the two, doing his best to keep on top of them both. Frank had used an agency to appoint another joint manager to take charge of whichever of the Boscombe and Ferndown branches that Andy wasn't working in. The agency staff were reliable and there were several who had experience working at *Fanelli's*. They could work in any branch and covered any shifts that the regular managers couldn't do. The other employees referred to these agency staff as "temps".

All managers were expected to work whenever the shop was open, which was 5 days per week. The basic rate for a manager was £100 per day. Andy was on £120 per day, Sally earned £110, and Ali earned £90. Sally had recently requested a pay rise due to how busy the Marchwood branch was, and didn't enjoy working by herself. She found some customers to be lairy and intolerable. She was using a new job offer as a nurse as leverage in her negotiation. Even though he was technically the assistant manager, Anton was only a weekend chef earning £30 per shift. Any staff on a permanent contract were paid through PAYE which meant that the employer had to make National Insurance contributions. The current

tax rate was 12%.⁴ All permanent employees worked for 46 weeks per year and were expecting a 3% pay rise in line with inflation. Non-permanent management staff, hired through the agency cost £150 per day.

Weekend chefs were paid in cash each day and were needed on Friday and Saturday nights. The minimum wage was £3.70 per hour, or £3.20 for people aged between 18 and 21. For a standard 8-hour shift Frank paid £32.

The drivers were also paid in cash each day. The pay-packet for a driver under the age of 21 doing a 4-hour shift was £11, and over 21s got £13.⁵ Kelly was being paid £14 per day, and worked 46 weeks per year. Unlike other young drivers, Ben was reliable, sensible and trustworthy. He lived closer to the Boscombe branch but drove through Old Milton to get to the college where he was studying. He'd have preferred to work out of the Boscombe branch but Frank didn't want to replace Kelly. As a compromise, he'd agreed to pay Ben £2 extra per day to cover his extra petrol costs. Because Ben was under 21 he could only work a maximum of 40 weeks per year. There were plenty of other local drivers available to work when needed. They typically enjoyed the part time nature of the work and flexibility. However, because they were often used at short notice they had to be paid £16 per shift.

Although the younger drivers were cheaper, *Fanelli's* had a problem with quality control. Boyd was the main driver for Ferndown, and Russ for Marchwood. They were both students and tried to do as few trips as possible to conserve petrol, which delivery drivers paid for from their earnings. They would therefore wait until there were several pizzas ready for delivery before setting off, which often meant that the food would be cold when it was delivered. There was also a tendency for it to be damaged in transit. Customers would frequently complain, and expect a free replacement. Across all branches around 8% of pizzas were returned and had to be redone.

To try to systematise the deliveries Frank had paid £1,200 for a Tom Tom satellite navigation system for the main vehicle for each branch.⁶ He had hoped that it would help to calculate the most efficient routes and reduce the discretion of the drivers. However, Kelly complained that it didn't utilise local knowledge and the judgment of drivers to devise their own routes. Anton agreed with Kelly, and thought that drivers should be allowed the freedom to decide when to take the food. He felt that the more experienced drivers were capable of doing this. If successful this would reduce returns to the industry norm of 2%.

The daily routine

All branches followed the same routine. The manager arrived at 3pm and went through to the back of the store. Deliveries would be made around this time and all of the vegetables and meats would be chopped. This would normally take an hour. Next came the dough. A large mixer was used and the dough was stretched by hand. It was placed into different sized pans and then put into cold storage. This would also take an hour, and then another hour was needed for further preparations. The shop was therefore ready to open for customers at 6pm, which was when the delivery drivers began their shifts. The last phone orders were taken just before 10pm, at which point the closed sign went up in the store (there was always a late rush of orders and it was at the discretion of the manager to decline to take them. Delivery drivers finished work at 10:00pm weren't paid overtime). The phone would be turned off and the first task was to return any fresh foods to the cold store. The manager would reconcile the accounts and store the takings in the floor safe. All of the counter tops were wiped down thoroughly and the final task was to mop the floor. The manager would lock up at 11:00pm.

All branches had the same basic layout. The street entrance led into a waiting area with a bench at one end. Employees could walk behind the counter to the services area. The countertop had an electronic cash register and a telephone.⁷ On one side was a worktop which contained a spinning doner kebab and a small grill. The opposed side had a small sink for washing hands and a work surface. Back past the

⁴ This means that the cost of each permanent employee to *Fanelli's* was 12% more than their take home pay. The employee would then have to pay their own taxes on top of that.

⁵ Frank paid the drivers a little less than minimum wage because they kept whatever tips they received. No one monitored the amount of tips but it was typically 10p per delivery.

⁶ Frank regretted having bought the Sat Navs brand new. He'd since learned that perfectly good second-hand versions of the identical model were available at half the price.

⁷ The cash registers had a book value of £250 each and a market value of half that.

service area there was a kitchen area. It was separated from the part visible to customers with a large pizza oven.⁸ Above the oven there was lots of storage for pizza boxes. Walking into the kitchen area the dough mixer was on your immediate left and in the back corner of the shop was a walk in cold store.⁹ Next to it, along the back wall there was a free-standing fridge (used for soft drinks) and freezer (for ice cream). Walking into the kitchen area, on the right-hand side there was an L shaped work top which ran along the back of the pizza oven and around the far wall. The containers for the sauce and all of the toppings was laid out behind the pizza oven and along the wall was an industrial sink and a dishwasher. There was an external door in the far right corner of the shop. Just in front were two internal doors, leading to a cleaning cupboard and a staff toilet. The external door led out into a car park with delivery access and a skip for waste.

The fact that all of the shops had the same routine and layout meant that it was easy for *Fanelli's* staff to alternate between them. And once an agency manager had worked in one, they were capable of doing them all. Anton had worked shifts in all of the locations, and when he first started he learnt a lot from Andy. Andy was a constant moaner, always picking fault with things. He particularly hated having to keep going back into the kitchen during service in order to prepare pizzas or fetch drinks and ice creams. Sally had pointed out that this was actually poor security, and once when she was in the kitchen area some customers had raided the till. The branches lost £200 a year each through theft, and the managers all believed that if there was a way to spend more time in the service area it would eliminate any theft.

If managers over filled the toppings and then didn't need to use them on pizzas they would be thrown away at the end of the evening. Around 20% of such raw materials were wasted and a better layout may help to reduce this slightly. Seb and Ben had offered Anton a hand to move some equipment around if Frank approved. It'd probably cost £200 to remodel each branch.

The menu

One of Frank's prized possessions was a framed copy of the *disciplinare* that explained how to make a legitimate *Pizza Napoletana*. He'd originally intended to be the UK's exemplar of *Vera Pizza Napoletana*, and sourced expensive ingredients. But he couldn't justify spending £7,040 on a legitimate pizza oven. Frank's original vision was to produce restaurant quality food to eat at home. Although he had aspirations of high end cuisine, the premises were too small to operate a full kitchen service. And over time Frank's ambitions weakened. He still bought quality produce but his own tastes were not especially sophisticated. He thought that quality pizza meant being generous with the toppings, especially the cheese. He didn't realise that too much cheese can hinder the taste. When Frank first opened the stores he also produced delicious pasta dishes. However, he didn't sell enough to justify the work involved and had resorted to buying in pre-made supplies. His commitment to quality meant that he used a local restaurant to prepare the food, but this meant that it was expensive to source and each dish had to be used that day.

When Frank took over the locations they all had pizza ovens, kebab equipment and a large grill.¹⁰ He felt that serving kebabs undermined his pizza aspirations but the raw materials were cheap and he didn't feel in a position to turn down profitable items. Frank liked to hold onto assets. Earlier that year he had reluctantly sold three refrigerators for £555 (total), even though they weren't even being used.

The pizzas were sold in three sizes – small (with a 10-inch diameter), medium (12") and large (14"). There were currently 6 types of pizza on the menu and Frank had always warned against over complicating things.

For a standard medium pizza, the most expensive ingredient was the cheese, which was 66p. The materials for the dough came to 28p and the sauce was 2p. Raw ingredients for the toppings were all bought from the same supplier. It was premium quality ingredients and needed to be washed and chopped. Anton found it odd that they paid what amounted to be 15p per serving of mushrooms and then

⁸ The pizza ovens were good quality and had a book value of £3,000 each. Similar models were available for sale at £1,800.

⁹ This was frustrating because the dough machine needed to be in an enclosed space. They had a book value of £2,000 each and were currently worth half as much if sold.

¹⁰ The kebab machines have a book value of £2,000 (total) and a market value of £1,200 (total). The grills have a book value of £1,000 (total) and a market value of £200 (total).

had to wash them meticulously and chop them by hand, even though their supplier also offered organic mushrooms that were already washed and chopped for 12p.¹¹ Switching to pre-chopped ingredients would easily cut the daily prep time devoted to chopping in half. Even more bizarrely each week saw a shipment of pineapples that would be skinned and sliced each day. But by the time they arrived at the store they were often bruised and over ripe. The jalapenos were the same – both items were billed at 25p per serving for fresh produce but cost only 15p per serving for tinned. Frank felt this was part of their commitment to quality ingredients, but Anton was sure that as long as the tinned produce was drained it actually had better flavour. And anyway, no one could taste the difference after it had been cooked. The cooked meats cost 35p per serving and were top end spec that many restaurants would be pleased to serve. Almost all pizza shops used the cheaper 25p per serving options, but there was a middle category priced at 30p.¹²

All pizzas were handed to customers in a box and there were different types available. *Fanelli's* used a 'Premium' version which was sturdy and had strong insulation. They cost £50 and contained enough flat packed boxes to make 100 units. For £45 the 'Standard' boxes were perfectly adequate but didn't keep the pizzas warm for very long. The 'Budget' £40 packs were flimsy and damaged easily. At the other end of the scale were £55 'Luxury' packs.

Fanelli's also sold deserts. There were two different types of ice cream pie that were bought wholesale, and *Fanelli's* were also in discussions with *Purbeck Ice Cream*, a local company that had just started making high quality organic ice creams. It cost £11.70 for 6 500ml tubs, and each shop currently bought 1 batch per day. *Fanelli's* charged £2.20 and sold out, even though they weren't even listed on the menu. Anton had recently spoken to the *Purbeck* sales rep who had said that the recommended retail price was £3.20 and guaranteed they'd sell double as many units at those prices.

All of the pizzas were made fresh, to order. As already mentioned around 20% of ingredients were wasted in the process of prepping and cooking each one. Demand for frozen pasta was highly stable and each shop ordered in one extra dish than they typically sold. At the end of the day this had to be thrown away. Lamb and Shish kebabs were arrived on a daily basis and any unsold items were thrown away. The doner kebab required more units to be ready for sale than were typically bought. Sides were made fresh each morning so only the right number of units would get prepared. Drinks follow a typical pattern where the number of cans sold was the same as the number of small pizzas, and they sold a 1.5l sized bottle for every 4 large pizzas sold.

Marketing

One evening, when there were few deliveries, Anton chatted to Ben about his course in business studies. He'd been given an assignment to write a report on a business of their choice, and Ben had chosen *Fanelli's*. As part of his project, he'd run a focus group with customers from Old Milton and Boscombe, and analysed the local competition. Ben had found that there were three local chains – Mega Pizza, Kebabs + Pizza, and Pizza Speciale – that offered very similar products. They primarily catered to walk in customers and did some deliveries as well. In terms of quality, of the three, Pizza Speciale were slightly better and Kebabs + Pizza had a reputation for being the worst. Mega Pizza was slightly cheaper, but all three were at similar price points. Domino's pizza had a large presence and were more expensive, but higher quality. Papa John's were even higher quality, and also more expensive. Ben had concluded that *Fanelli's* was an average price (in between Dominos and the three bargain chains) but the quality was the highest of all. His main conclusion was that *Fanelli's* were under-pricing. Anton knew that if *Fanelli's* increased their prices they would sell fewer pizzas, but not necessarily by much. Ben's analysis suggested that volume would fall by 80% of any percentage increase in price.¹³ Anton was impressed with the depth of the work, and thought it could be useful. Maybe they should raise all prices by £1. Perhaps even by £2...

¹¹ The supplier used the same prices for all vegetables.

¹² The supplier used the same prices for all meats.

¹³ In other words if the price of a small Margherita pizza went from £4.99 to £5.99 this constitutes a 20% increase in price, and so *Fanelli's* should expect sales to fall by 16%. In economic terms we can say that the *price elasticity* is 0.8. *Hint: If you calculate any impact on volume it is a good idea to round up any number above 0.6.*

When Frank bought the business, it came with a bright red delivery van, and Frank had painted it with the garish *Fanelli's* logo. When Kelly started working there she didn't have her own car and so it was a useful way for her to do deliveries. However, she had recently bought a small car which was much more convenient to operate and easier to park in the tight spaces outside the shop. Frank felt that the van provided useful publicity, but most of the employees were embarrassed by it. It had a book value of £6,000 and probably worth £2,500 to an appropriate business.

The £600 annual maintenance costs for the van were treated as a marketing cost. But there were other marketing options. For any takeaway company, the best advertising is the menu. A new, well designed menu could be expected to increase sales by 4%, and even a reasonable effort could increase them by 2%. A local design company charged £400 to design new menus, and a further £600 to print plenty of copies. They also sold customised polo shirts for £20 each, (minimum order of 8). The local newspaper charged £3,000 for a proper advertisement campaign, which typically resulted in 2% extra sales. Finally, a local football team were looking for a new sponsor. For £2,000 a season *Fanelli's* would have their name on the kit. This wasn't expected to increase sales but the Chairman was on the board of the insurance company used by the Old Milton branch, and suggested he may be able to reduce your rates by 10% if they received the sponsorship.

It was the final day of February, 2001. All branches of *Fanelli's* were shut during March because Frank used that time for vacation. Given that he was no longer involved in the daily running of any of the branches, there was no reason to close. Anton had spoken to most of the staff, and although people enjoyed the chance to get away, they were keen on having extra weeks of work. It seemed reasonable to expect that if the shop were open for 4 extra weeks then the regular staff would work for 2 of those. It was too late to make any changes for this year, but that didn't mean that March would be wasted. On the contrary, it gave Anton an opportunity. Frank was ill and couldn't rely on Ali. Andy was good at his job but overworked and lacked strategic vision; he just wanted a single operation to run. Anton was the only person with experience of how *Fanelli's* operated, who could come up with the ideas to improve things.

"I'm getting old" said Frank,

"Maybe this isn't worth it. Maybe I should just sell up the business. If you don't think we can be making a profit this time next year, I will start looking for offers".

Anton told him to give him a chance.

"Frank, let me look into things. You concentrate on your health. I'm going to come up with a plan".

Anton and Frank agreed that they'd meet again in one week. Anton would present his ideas to Frank, and that would seal the fate of *Fanelli's*. Anton got started.

Appendix

Figure 1: Recent profit

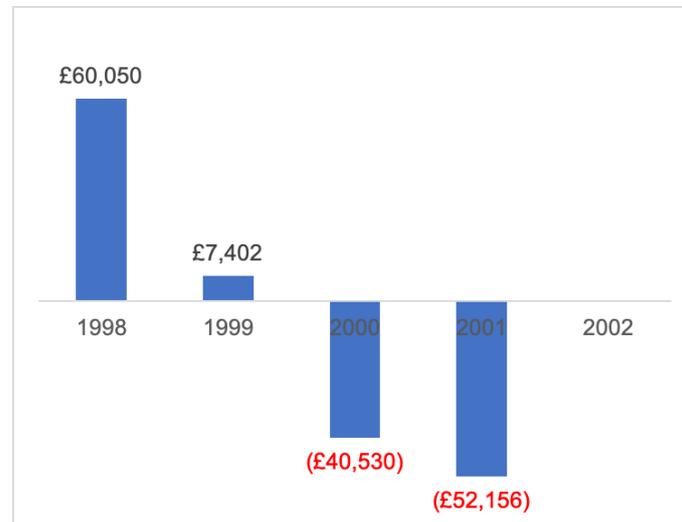


Figure 2: Income statement¹⁴

	2001
A Revenue	£637,096
B Cost of Goods Sold	£259,199
Gross Profit	£377,897
C SGA Expenses	£430,608
D Depreciation, Amortization, Impairment Loss	£0
Operating Profit	(£52,711)
E Gains from Disposal of Fixed Assets	£555
F Interest Expense	£0
Profit before Tax	(£52,156)
G Income Tax Expense	£0
Profit	(£52,156)

¹⁴ The managers spent a majority of their time doing administrative tasks such as keeping the kitchen organised and monitoring operations. For this reason all of their labour hours, even that spent making pizzas, is treated as Selling, General and Administrative expenses (SGA). It would be perfectly reasonable to expect that some of the labour costs for *Fanelli's* to appear in Cost of Goods Sold (COGS) however for simplicity we keep all labour hours together.