Why The US Market Looks Familiar

21 May 2009

In a nutshell

This time last year I went to the NRA show in Chicago. In my report on that visit I pointed out forcefully that the US foodservice sector was learning to cope with two huge issues. First there was slackening demand and second was the major cost increases from rapidly rising inflation.

What a difference a year makes. I went to Chicago this year where I had appointments with over 30 operators, distributors and manufacturers – and I spoke less formally to many more. They all agreed inflation is no longer a current issue – although it may come back like a Vampire from the grave (and more on this theme later). But slackening demand is here – right now – and with a vengeance.

1. The foodservice sector in the US is looking like the foodservice sector in the UK – sales are down. And while input cost inflation is low, large rises last year extracted profit from the sector and current operator pricing activity is eroding margins even further.

2. My view – and probably yours too when you read what follows – is that there is very little difference between what is happening to the market, and how it is responding, whether you are in Manchester, Connecticut or Manchester, the home of Man U.

3. On the plus side, operators are fully aware of these issues; most have taken action to ameliorate margin pressures and reduced turnover by reducing costs - primarily labour.

4. While there have been operator failures, these have been heavily concentrated in the cash-strapped, under-capitalised independent sector.

5. Of course the picture is a bit more nuanced than this bald view. Some segments, most notably quick service, have been doing well recently recording growth well into positive territory.

Some numbers and facts help tell the story

6. Overall foodservice sales in the US are flagging right now and the NRA say that they expect real (inflation adjusted) sales to dip in 2009, by -1%. The market also fell last year, so that makes two years of consecutive decline – which is the first time that's happened since records began in 1971.

7. As in the UK, eating out on a whim is no longer the order of the day, and the corporate expense account sector has gone into hibernation. The result is reduced demand from Monday to Thursday, possibly extending into Friday. But weekend trading looks OK.

8. Of course, some regions are really suffering – such as those where the automobile sector is a major employer or where the finance sector used to boom.

9. Since the start of this year, quick service has grown – on the back of its overall "value" (for which read "low price") proposition. The next segment up – casual dining which is roughly

equivalent to much of the UK's pub sector – has fallen and its problems are exacerbated by massive overcapacity (unit numbers have doubled since 2001). Higher up the expenditure scale, the market has also fallen but by not as much as the casual segment.

10. These movements demonstrate that the so-called "down trading effect" is leading to more sales in the lowest cost sectors – but down trading is not universal, with evidence that customers are still remaining loyal to their traditional mid- and upper-spend haunts.

11. And today, customers are reported to respect value for money – which doesn't always mean lower cost. Operators reported to me that consumers frequent places that offer "value" – if there is a real reason for visiting, customers will visit – but if it's just "lower prices" then they are much less likely to.

12. Staff feeding (much less important in the US than in the UK as a proportion of overall market activity) has suffered from rising unemployment – 8.9% in April and set to rise to 10%. But the rest of the non-commercial sector has, thus far, been broadly unaffected by the downturn.

If the NRA show could speak

13. There were reports that exhibitor numbers were down 15% this year compared with last – certainly the catalogue listed about 1,680 exhibitors which was down 13% on last year's number. This contraction is a sign of the times with potential exhibitors deciding to conserve their funds.

14. Visitor numbers were also down, judging by the relative ease of walking down the aisles – over 6 miles it is reported. Again this reflects the current state of the market with potential visitors deciding that their time would be better spent elsewhere and, in any case, they may be postponing investment decisions which, in more certain economic times, the show helps to make.

15. Despite this, there were plenty of signs of life and tens of thousands still attended the show.

The overall picture

16. The current pain in the foodservice sector is a result of several past investment bubbles – in practice they are all linked to the same banking bubble. Customers were going out more than they could afford. Operators invested in more seats and units than customers wanted to frequent. Suppliers geared up for ever-expanding foodservice sales opportunities.

17. There is a strong expectation across the sector that better times will come around again, but for now: Hard times – declining sales in many sectors – but most operators and suppliers are still in there.

18. Thus opportunities are still being taken up by suppliers – although some product categories are suffering, most notably equipment, where the market is down over 20% over 2008 which itself was a bad year.

Consumers are the key to it all – and the internet holds some secrets

19. Some trends seem to be emerging – but the overall trend is: **no new trend**.

20. There seems to be a greater awareness of the need for healthy eating – but amongst observers of the market and those with an interest in school feeding, for example, there is a

wide acceptance that the UK is much further down the road to doing things about improving nutrition and encouraging healthy eating.

21. The world is becoming more inter-connected – Twitter and Facebook and other consumer-generated sites are crucial here. Their influence on the foodservice market is many and varied; one example quoted by a number of people I spoke to was www.yelp.com which gives the consumer's opinion of restaurants around the country (and in the UK too).

Bloody work!

Jim Matorin, marketing guru – and top blogger - has posited the emergence of a new day part. He says it exists between midnight and 6 in the morning. He calls it "The Vampire Day Part" for obvious reasons – and it will be fuelled by caffeine, multi-tasking and the rise of social media.

22. The future of sites like this is unclear – but the general consensus is that the influence is already significant – especially in the 25-30 age-group – and will become even more influential. Marketing people will have to get to grips with what is happening, and make plans accordingly.

23. Consumer-generated websites allow more effective, faster communication between: customers and customers – get the latest on your favourite restaurant!; operators and customers – here is our latest deal!; customers and operators – think booking your table! or complaining!; between suppliers and operators – for purchasing! And within suppliers these sites are fostering communication between the sales force – they can all be up to speed together, instantly.

24. But maybe the current economic climate – and its fall out – will have a slowing down effect on the consumer. There is a view that nowadays perhaps the family comes first – work is OK for paying the bills but the family is No 1 for what it needs to keep everyone sane. Perhaps the decline of the go-go bank culture will lead to a slower, more reflective world. This is something that some thoughtful suppliers and operators are keeping an eye on.

What are the practical implications?

25. The people in the front line - the operators - are focusing on the three broad, cost line items: Overheads, Labour and Food.

26. As far as Overheads are concerned, two items are being addressed:

- The first is fuel – the high inflation of this time last year, lead operators – and suppliers - to explore fuel savings and higher efficiencies (and of course, the positive "green" effect of actuation on these fronts is an added bonus which PR savvy companies have been exploiting.
- The other is rent. Many operators are trying to negotiate lower rents – it makes no sense for landlords to have empty properties and, in theory, they should be willing to discuss different rental terms from their tenants. While this makes sense though, and some operators are taking action, it still remains an ideal for most.

27. Operators also address the issue of efficiency and wastage – water is an area where wastage can be readily curbed and being stingy is nowadays seen as a positive trait when it encourages greater efficiency.

28. Labour has been reduced and continues to be under the axe. But labour can only be cut so far before service levels – and food quality – starts to suffer.

- The goodish news is that despite plenty of attention on labour costs in the good years, there is still opportunity to make savings at the managerial level.
- So many operators are still downsizing at this level while others who may have taken action a year or more back, may now be beginning to think that they should be recruiting the right people who will carry them to success when the good times roll round again.
- But while some operators are thinking like this, most aren't.

29. The overall cost of labour in the foodservice sector is lower than in the UK – in other words productivity is higher. My discussions in the US have revealed a number of reasons for this:

- The prevalence of quick service chain operators is significant because these businesses operate on a highly efficient, systematic basis – in the US, QSR outlets (chains and independents) account for 29% of total foodservice sales, compared with just 11% in the UK. This gives a corresponding boost to overall measures of US foodservice efficiency compared with the UK.
- Many more staff are paid below the minimum wage in the US, sometimes they are paid nothing. Their income derives from the tips they receive – thus the booked employment cost to the operator is low and the waiter's service levels are high.
- The much larger size of chain operators in the US which means that costs of head office and regional management can be spread over a larger income – as an indication of the large size of US chain operators: there are 24 QSR chains larger in the US than Pizza Hut in the UK.

30. But most action is being taken in the food cost arena – accounting for nearly 30% of operator costs.

31. For example, operators are reducing their food costs by consolidating suppliers – which allows them to place larger orders and get bigger discounts.

32. Just as in the UK food costs are under everyday scrutiny and savings are made where it's possible to reduce costs – by including more water in meat products, for example. But cost savings do not seem to extend too much to quantities – the US consumer is still believed to value bulk – despite what I found to be a fairly widespread recognition that something needs to be done about food intake.

Reducing costs is good, action to increase sales is better

33. Upping the spend per customer is what many suppliers are trying to do because it adds sales at no extra cost except the ingredients. Einstein Bros Bagels is a 300+ unit chain operating in almost 30 states. They offer a bagel for your dog for $1 – a great and novel way to target pet-lovers and increase sales per visit.

34. But many offers concentrate on providing more for the same amount:

- For example, I was told about a restaurant chain that has introduced a novel "2 for 1" offer – buy a meal to eat here, and we'll give you a meal to take away when you leave. Not only does this encourage sales it also gives the customer a potent reminder of the restaurant when he (or she) eats the take away meal later on.
- Operators are moving their appetisers to entrée status without affecting the price – the message is "pay less for the same great food". For example, an appetiser consisting of 3 mini-burgers (three burgers – for an appetiser!) is now offered as an entrée at Applebee's.

Everyone wins a Laurel*

Price-focused sales activities only work long term when costs are adjusted appropriately. Here is one example:

Daphne's Greek Cafe, based in San Diego, has an example of where this works. The 80-strong chain features Avgelemono, a popular soup, at $3.19. The chain decided to sell it at just $1. So far so simple. But there were several twists. For a start, the soup at this price was featured when ordered with an entrée – to wean people away from just ordering an appetiser and dessert – a popular tactic amongst people who want to save money. More importantly, the chain worked with its soup supplier to reduce the cost. But it wasn't all about lowering the cost of the soup – much of the reasoning was centred around the additional sales volume that the price reduction would generate. In fact, when the offer went live, average daily store sales of Avgelemono soup went from 5 or 6 servings to ten times as many. Both soup supplier and Daphne's had cause for celebration.

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* In Greek mythology, Daphne was turned into a laurel bush

35. The key message is that when looking at prices, US operators recognise that it's more important to look at margins. When developing a lower priced item they try to do it with a product with above average margins; that way operators preserve their profitability. A twist on this is to maintain the price and increase the value – and, again, this is more effective where margins are high.

36. Customer loyalty programmes have been big in the US for many years – and they still are. But they are only useful at the margins. Operators I spoke to agree that the only safe loyalty programme, and the one that is likely to succeed in the long term, is excellent service, and great food, delivered consistently. Thus there has been little change in the role of formal loyalty programmes over the last year or two – and still the commonest are "points programs", collect a point every time you eat here - and when you have enough points "the meal's on us".

The type of food that people eat out is changing

37. Although typical portion sizes remain unchanged, consumers are actually eating fewer of them.

38. Red Hot Chicago have been making "pure beef hot dogs" since 1893 and selling them to restaurants and concession stands in stadia. But the company now wants to bring its products to a wider market and is developing a franchise package that includes the usual full-branding and promotional package, but new excitement surrounding a range of Chicago-style hot dogs, char grilled hot dogs, burgers and chicken. The novelty lies in the content of the availability of salads, favours and buns, and the ability to build your own "dog".

39. And there are developments in how operators describe food on their menus. For instance "fried" is out, "crispy" is in because it removes the stigma of fat-laden food that does you no good.

Opportunities still exist if you look

40. It's an ill wind. Swine Flu has hit the US hard with over 3,000 confirmed cases. But that's been good news for companies such as Nice-Pack whose speciality is individually wrapped packaged wipes; and Ecolab who make portable antiseptic hand gel dispense units for wiping hands when there's no water around – at the NRA Show for instance.

41. On the other hand opportunities for liquor in US foodservice units are restricted because almost half of all food sales - $260 billion out of total foodservice sector sales of $550 billion – are sold without liquor in places as diverse as burger chains and secondary schools.

The supply chain looks like it does in the UK

42. Distributors are being squeezed at both ends - from operators who want better prices and suppliers who want to charge more.

43. The solution is to develop a valued service – and for smaller distributors that means not trying to compete with their much bigger rivals but focussing more on regional restaurant chains. It also means that smaller distributors are trying to forge closer relationships with their customers – through personal service levels.

44. Given the pressure on costs and the need to offer successful products – the result has been that suppliers and operators alike are focusing on what works. This means that innovation – especially innovation for its own sake –whether it's in food ingredients, cooking, storage or packaging, is way down the list of priorities.

45. Even established products are out if they aren't generating sales and profit. Items which used to be there "because you never know how they influence the customer" are being delisted. "Be safe" is today's motto.

America's gift to the world

I am grateful to my friend Ian Neill, Executive Chairman of Wagamama, for this quote: "The USA. The only country that has turned cheese into a condiment"

46. But where a new dog can be taught new tricks there is plenty of activity. This applies especially in categories such as bakery where there is already considerable choice. For example Bridgford Foods supply frozen roll doughs in a wide choice of sizes, formats and flavours. They have discovered that their doughs are just right size for the newly emerging slider market – bake a roll dough, cut it in half and the mini-bun is there to be filled with the burger, bacon or chicken. No extra cost and a whole new market.

Two key learnings I took away with me

- There is a recognition that while today's times are tough, the world moves on and may become saner again. When it does there will be great opportunities for those who have been sensible right now – for instance by conserving cash, or making sure they've been looking after the trusted employee team.
- There are opportunities for stealing a march on the competition by investing in new technology or acquiring other businesses. But while these are seen as good things to do, the key right now is to worry about today.

To discuss what this means to your company and how we can help you - or if you have any other questions – about the UK, US or European foodservice markets - please contact me:

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