

The Great Foodservice Recession

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In a Nutshell

The natural bounce seems to have gone from the US foodservice sector to be replaced by a pragmatic, almost world-weary, pragmatism. It's almost a case of Europe taking over the USA.

The US foodservice market is in its third year of decline. The length and depth of this downturn is unprecedented and is the background against which all comments and views about the large US market should be seen.

The good news is that the rate of decline has fallen and may even have bottomed out but there is still enough uncertainty to make any projections problematic.

Nevertheless there are still lessons to be learned from what is happening in the US foodservice market, which is why I make an annual trip to the NRA Show in Chicago. This year booth numbers were about the same as last year - 1,700 or so but down from the 1,900 in 2008. Visitor numbers appeared to be up considerably above last years' and exhibitors told me that the quality of visitors, and their decision-making responsibilities, were significantly better than last year. I was told: "Visitors are only coming to the show if they really want to do business – they don't have time to waste".

1. Starting at about the time of the Lehman crash, the US foodservice sector turned negative for only the fourth time since 1971. And previous downturns have lasted at most a year and amounted to a fall of well under 1% each time.
2. The Great Foodservice Recession – as many already refer to it – has proved to be a different beast. The decline in 2008 was the worst ever up to then. Last year the market declined even faster, and although market forecasters see an improvement this year, the market will still be in negative territory for the full 2010 figures.
3. Overall the foodservice market will have fallen by between -5% and -15% depending on whose figures you use. A useful headline figure therefore is a real decline of -10% since 2008.
4. One reason for the depth of the downturn is that, for the first time since the 1930s, the top quartile of earners has seen a real reduction in spending levels. These people are essential to the restaurant sector and as a consequence of the trickle down effect also influence what happens in the Quick Service sector.
5. Another driver of the foodservice recession is the high level of unemployment – currently 10% and growing. But may also note the also high levels of underemployment which results in reduced pay packets. Together,

unemployment and underemployment probably account for 18% of the working population.

6. The wider political and economic environment, of course, also impacts on the foodservice sector. The dramatic rise and subsequent fall in the popularity of President Obama, the passage of health care legislation, the Louisiana oil spill all exist in the background and to the extent that they affect consumer spending and confidence they have an impact of eating out. But the other factors covered in this note are more significant for the sector as a whole

Who has prospered?

7. It may seem odd to ask this question in the face of such gloomy conditions. But there have undoubtedly been pockets of relative prosperity. For instance overall volumes, and probably sales too, have been growing in the Quick Service sector.
8. Remember that Quick Service accounts for 39% of the US foodservice market (compared with and equivalent 17% in the UK when comparing like with like). This means that foodservice in the US for many means QSR – plus a bit of fast casual.

Howya doin' buddy?

In aisle 1900 at the NRA Show: Man#1 greets Man#2 and hugs the wife of Man#2. Man#2 says "You hugged my wife and shook my hand". Man #1 "I'll give you a hug too if you want". Man#2 "No I don't want you to hug me; I want you to shake my wife's hand".

9. And individual companies have also been able to do comparatively well. McDonald's is generally recognised as having had a good recession – because the improvement plans the company embarked on about three years ago came to fruition at just the right time to boost sales while the market as a whole was suffering.

10. The coffee shop sector has had a bad recession dependent as it is on people with time and money to spend – two commodities in short supply at the moment. Starbucks has reacted by closing stores (having recognised that they expanded too fast in the period up to 2007), developing Via (an instant coffee brand) and, in response to franchisee concerns about cannibalising sales, developing a second brand – Seattle's Best. Starbucks has also started to rediscover its roots and moving away from the volume at all costs model it has followed over the last 10 years and turned back to the 'third place' concept that was the initial driver of the chain's success.
11. In the institutional sector such as universities and health care, business has not been as affected so much as the restaurant sector – but operators have still had to cut overheads and reduce prices.
12. But the answer to the question 'who has prospered?' is: any company that has been able to generate cash (even if only a bit)

What has the market done about the decline?

13. For the first 12 months of the recession, most operators were in denial promising themselves that they'd only have to endure a couple more quarters before growth would kick in again.

14. That was the background to the market at last year's NRA show when companies reported some plans to trim costs and drive volumes through carefully targeted marketing programs.
15. Since then reality has taken over and took over and operators have taken three significant lines of action.
16. The first is that staff costs have been slashed – which means redundancies in all forward looking departments, such as marketing, while maintaining staffing levels in front line operations at the lowest levels possible. Unit management levels have been cut along with kitchen and front of house staff. Training budgets have been slashed and recruitment has been put on hold. Disney has outsourced its procurement to India.
17. The second action is unit closures. Store openings since 2002 had been running at very high levels – an entirely realistic strategy when times were good as indeed they then were. But the industry gorged itself on new openings and created the overcapacity which has been exposed by the recession.
18. Units have been closed across the country and planned new openings have been put on hold – or more likely, cancelled.
19. The third reaction to the recession arose out of the need to drum up business - any business. The result? Massive and widespread discounting. The most recent example was the mid May launch by Taco Bell of bundled \$2 (£1.40) Meal Deals that include a choice of entree, a medium soft drink and a bag of Doritos.

So how have these activities played out?

20. Up front, it's important to note that not all operators have slashed costs and engaged in driving their prices down – those that resisted the temptation have either gone out of business (a minority) or have built up resources and a stronger market position than they had before.

“We have an incredibly ethical prize-winning policy”

The iPad is a great product – I entered about 15 competitions at the Show for one but I was doubtful where, should my name be drawn from the hat, my winning iPad will be shipped to the UK. But the Palo Alto software company assured me that if I won, I'd get my prize.

21. Reductions in staffing levels and the slashing of training budgets are storing up trouble. Inexperienced and poorly trained staff mean that service levels decline, inefficiencies grow throughout the system and mistakes are made. In turn many recognise that this leads to fewer customers and higher than necessary costs.
22. The solution? Staff up and train – but this won't happen until sales grow and margins improve.

23. As for the shuttering sites, many operators have closed unprofitable and marginally profitable sites in order to conserve cash. This presents an opportunity for those operators and franchisees who have the financial resources to acquire sites that come on to the market at good prices. There

aren't many companies in this happy position but those that are, are doing deals.

24. The outcome? In the medium to longer term, this points to a larger store footprint for the more successful operators – their market share is set to grow.
25. Driving business through lower prices is helping to sustain sales. But...
26. The very real and very present danger is that this is exacerbating a long-term structural difficulty in the US foodservice sector - lack of differentiation. Although there is a wide choice of Quick Service restaurants (indeed all types of restaurant), the choice of cuisines on offer is not that wide – burgers, chicken, pizza, seafood. Tex-Mex – and then what? There has been a long-term flight to safety on foodservice strategic thinking in the US – this is expressed in many operations offering the same food, ambience and prices. While times boomed, this wasn't a problem
27. But as soon as heavy and widespread discounting set in, the consumer was attracted by one thing and one thing only – price. Eating out is becoming – some would say has already become – a commodity. And loyalty has been destroyed.
28. The result? In a market where price is all, nobody benefits – customers suffer reduced quality and operators suffer falling profitability, and worse.
29. And there's even more bad news for the US operator: the customer has been fed a commodity line and the industry faces a real and deep challenge to move to more sustainable levels of profitability.
30. A positive note for the European operator who is also facing issues of discounting: the longer term problem is not as great since there is still substantial differentiation between offers. Thus the commoditisation and loyalty issue is partially offset by the greater choice of cuisines and styles – and so, in theory, the route back to profitability is not as hard

And for suppliers?

31. Quite simply, when their customers' business is declining and when they have less to spend, suppliers suffer.
32. Margins have been cut. Staffing levels have been reduced at both the support staff level (marketing is a good example) and front line sales. This, in turn, leads to poorer service levels and less proactivity. Activities without an immediate RoI have been completely closed down or at least put on hold - chief amongst these are new product development.
33. Key issues for suppliers centre around efficiency improvements. these call for investment, where it can be justified, in enabling activities such as speed to market, market intelligence, creative customer-supplier relationships and investment in IT.

And for the future?

34. The general consensus is that the market has recovered from its very low point and the majority view is that it has probably bottomed out.

35. But there is still a strong body of opinion that believes more bad news is to come. This ranges from the possibility of a double dip recession in the economy (although the wider economic view is that this is unlikely) to strains on stretched balance sheets which will be exacerbated by the need to find funds to cope with expansion when it comes.
36. Under this latter view, balance sheets are stretched and its almost impossible to raise money (whether for growth or working capital). This will only get worse when growth happens and investment is required in food and beverage stocks, staff recruitment etc. Companies that don't have the necessary funds in place will really suffer.

So what's new in the market?

37. Not surprisingly there was little in the way of new offers on display at the NRA Show. Indeed food companies were less in evidence than in previous years and their place seems to have been taken by equipment and disposables.

The truth hurts

America is a service economy that increasingly relies on offering an enjoyable experience for foreign visitors. Sad therefore to relate this story: queuing for a bus to take me from my hotel to the show, I approached the driver and asked him if I could put my case in the hold. "Get back in line. You're not getting on this f*cking bus!" he said. He turned out to be correct – the bus filled up before I could get on, but somehow I felt there may have been a more congenial way of expressing his forecast!

38. Organic foods, which seemed to have gained some traction over the past few years, have disappeared and green issues have generally only advanced when there are financial advantages. This has resulted in developments such as the plastic bottle introduced by Nestle waters made from 50% recycled product or the paper cup from Georgia pacific which is 50% compostable.
39. Operators, such as McDonalds and restaurant chain Dardens have taken on board consumer concerns about sustainability in areas as diverse as packaging and seafood – and have developed marketing programs accordingly.
40. But there were two notable offers on show. The Trufill system fills beer glasses from the bottom. The purpose might seem bizarre but it allows rapid fill (4 pint glasses in 10 seconds) by a single operator – ideal for stadium catering where demand is highly intense. And it was developed by the Brits.
41. The second offer was the Freestyle vending system from Coca Cola which delivers a choice of over 100 individual cold beverages. Although it has been around for a few months his has been around for a few months it still managed to generate permanent queues at each of the four machines on display!

What about the regulatory environment?

42. On-going regulatory costs are an American obsession (as they are elsewhere but the American obsession seems deeper). A recent example concerns so called 'soda taxes' – taxes on cold beverages. Originally conceived as a way of weaning consumers off high calorie, cold beverages, they gained little traction until the current (federal and State) government need to fill the coffers once again. Soda Taxes can do just that – and already two states (Washington and

Colorado) have approved these taxes. And another 15 states have proposals. This seems to be a tax that's on the rise at a state level.

43. Health issues continue to be a concern to legislators, health experts and others. For example, salt is now beginning to appear on the regulatory horizon.
44. Nutritional information is beginning to become more obvious in selected cities – such as New York and Los Angeles where operators are being forced to show calories and nutritional content – but the general view seems to be that progress is state-driven; progress to full, national coverage, will probably pick up speed but may remain patchy for some time.
45. The new health legislation just agreed could potentially add significantly to annual employment costs over the coming years – but the actual outcome is still unclear
46. At a general, non-foodservice specific level, the 'Buy American' Act seeks to encourage people to buy products that are made in America. The act specifies the minimum content of a product that can be described as 'made in America' and suppliers are encouraged to identify such products in their sales and marketing activities. This seems to be gaining some traction amongst consumers where the patriotic card can be played even if the product is more expensive than an imported alternative. But that doesn't really apply in the business world where value, fitness for use and payback periods are likely to beat patriotism. In effect, this means that for imported products such as foodservice equipment, the 'buy American' effect is muted.

Some social observations

47. American reserve (traditionally Americans don't kiss each other on the cheek) seems to be on the way out if my observations are correct. Out goes the handshake; in comes the bear clinch and a slap on the back.
48. On the other hand, a traditional belligerent officiousness that always seems to lurk beneath the surface seems to be more apparent nowadays – enhanced, by all accounts, by uncertainty about personal finances, employment prospects and other economic concerns.
49. There is much talk of social media – and its impact on foodservice. The outlines of what this might be are still unclear – everybody seems to have their own distinct view. But all agree that whatever it is, it's here to stay.

Three Key Learnings

- As always, there is plenty – perhaps too much – to ponder. But one key fact I have taken away from this year's visit is that in a recession taking action that cuts costs is not always the wisest the move.
- And the second learning is that slashing costs is often bad if it's done at the expense of long-term survival.
- The third learning is that turning a foodservice offer into a price-led commodity is always foolish.

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:

Peter Backman

Horizons
313 Regents Park Road
London N3 2LB
UK

T: +44 (0)20 8349 0162
M: +44 (0)7785 242809
E: peter@horizonsforsuccess.com
www.horizonsforsuccess.com