

7-1972

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Recommended Citation

Califano, Alfred N. and Weiss, Allen (1972) "Turbulent Food Service Industry," *Management Adviser*. Vol. 9: No. 4, Article 6.

Available at: <https://egrove.olemiss.edu/mgmtadviser/vol9/iss4/6>

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The food service industry — which accounts for about 20 per cent of the food produced in the country — has undergone changes almost as radical as the industry as a whole. What problems do these changes pose?

THE TURBULENT FOOD SERVICE INDUSTRY

by Alfred N. Califano and Allen Weiss

Laventhol Krekstein Horwath & Horwath

EVEN A CASUAL observer must certainly have noticed a great many changes in restaurants and other food service operations since mid-century. Not that the changes began then. The origins of many developments go back a long way. But the acceleration of change that seems to have swept our society since World War II is also evident in the food service industry.

Fast food counters proliferated, along with other chains and franchises. Specialty restaurants thrived on limited menus and fixed prices: hamburgers only, or chicken only, or beef, or a choice between steak and lobster for the main course. Suburban restaurants flourished as center city restaurants faded; and the new differed significantly from the old. Department stores and shopping centers served meals to

lure shoppers and to hold them.

Serving food as a secondary activity led the airlines into volume feeding as their traffic expanded. The trend here is toward simple meals, except in those instances where intense competition leads to excesses in the opposite direction. By contrast, hospitals pay more attention to individual patients, offering them a choice of menu items. In the institutional feeding field, contractors have broadened the scope of their operations. They are to be found in hospitals and rest homes as well as factories and offices. They feed Government employees, including the military. They serve school lunches, and they run university dining halls. They are also branching out into management of recreational facilities, where food service is no

longer the main or central function.

Analysis of financial and statistical data discloses other industry characteristics that may be less obvious. The restaurant business is highly competitive. Despite many failures, new restaurants are always opening; and the competition remains keen. The 1971 edition of our firm's annual restaurant study provides an indication of the low profit margins achieved by restaurants around the country (Exhibits 1 on pages 40-41 and 2 on page 40). For example, center city restaurants serving food and beverages showed income before occupation costs equal to 12.1 per cent of sales, of which 6.8 per cent of sales went into occupation costs, leaving only 5.3 per cent of sales for net profit before income taxes. Neighborhood restaurants fared even

worse, with 5.1 per cent of sales remaining as pre-tax profit. Suburban food and beverage restaurants and "food only" restaurants did better than center city and neighborhood restaurants, but the averages cannot be said to be attracting large numbers of investors into any category. The lure must lie elsewhere.

Something does bring people into the restaurant business, as evidenced by a persistent growth in the number of restaurants in existence, despite a high failure rate. There are probably over 350,000 restaurants now, employing 2.5 million people and serving over 40 billion meals annually. Incidentally, 80 per cent are independently owned.

The food service industry has a substantial impact on the economy. It buys almost 20 per cent of all food produced in the United States; and it accounts for over \$700 million of equipment purchases annually. Besides these links to agriculture and capital goods, food service is tied to transportation, recreation, and institutions, as noted previously.

From the consumer side, there are certainly a number of factors supporting the growth of the restaurant industry. Long-term trends in life styles involve eating out more, traveling more, spending more. These activities are supported in turn by more leisure time, and by higher disposable incomes per family over the long run, sometimes brought in by a working wife who is perhaps less eager than formerly to spend time in the kitchen.

While the economic trends continue, the restaurant business, which ranks fourth among retail trade categories, will go on growing. It is only fair, then, to point out that size and growth bring responsibilities; and to ask whether a population that is fed largely by restaurants will continue to be regarded as overfed and undernourished. Or will restaurants in the future take it upon themselves to raise the level of nutrition of large groups

of people who will be eating out often?

One aspect of the nutrition question has interesting implications for other industries, including agriculture and meat packing. It has been estimated that a steer, in converting vegetable feed into meat, requires seven pounds of vegetable protein to produce one pound of animal protein. Efficient use of our national resources may suggest that our diet ought to include more vegetable protein and less animal protein. For the restaurant industry and others, an important issue may develop concerning the encouragement of new eating habits.

Industry problems

While inflationary pressures induce a profit squeeze that afflicts industry generally, some industries do suffer more than others. In the restaurant business, the profit squeeze is aggravated by three identifiable factors of extraordinary severity. Consumer resistance to price rises is more effectively exercised against restaurants, for reasons we will explore in depth. Labor costs are expected to rise faster than average payrolls for all industry. And restaurant rents are painfully high. Let's look at these three factors more closely.

While the impact of consumerism has had varying effects on different industries, there can be no doubt that customers who can eat at home have an especially powerful weapon for punishing restaurants. The original do-it-yourself activity, home cooking, has never gone out of style. When family budgets are pinched by rising prices, a natural solution is to eat out less often. Thus a restaurant becomes a whipping boy for general inflation.

Furthermore, those who continue to eat out, whether by choice or from necessity, are inclined to trade down to plainer foods, less service, elimination of extras, such as wine with the meal. When this happens cyclically, during a recession, it reinforces a long-term trend

In the restaurant business, the profit squeeze is aggravated by three factors of extraordinary severity:
. . . Consumer resistance to price rises;
. . . Rising labor costs—costs that are rising more rapidly than payroll costs as a whole;
. . . Painfully high restaurant rents.

EXHIBIT 1

	1970	1970	1970			
	All Restaurants	Food Only	Food and Beverage Restaurants			
			Total	Neighborhood	Center City	Suburban
Sales						
Food	80.3%	100.0%	74.7%	75.5%	76.0%	72.6%
Beverages	19.7		25.3	24.5	24.0	27.4
Total sales	100.0	100.0	100.0	100.0	100.0	100.0
Cost of sales						
Food*	37.8	34.5	39.0	40.2	37.2	40.3
Beverages	30.0		30.0	31.3	26.8	32.5
Total cost of sales	36.3	34.5	36.7	38.0	34.8	38.1
Gross profit	63.7	65.5	63.3	62.0	65.2	61.9
Other income	1.3	.6	1.4	.7	1.2	2.1
Total income	65.0	66.1	64.7	62.7	66.4	64.0
Controllable expenses						
Payroll	29.8	32.6	29.0	28.2	30.7	27.7
Employee benefits	3.6	3.9	3.6	3.1	4.3	3.1
Direct operating expenses	5.8	4.9	6.0	5.9	6.3	5.6
Music and entertainment	.9	N	1.1	1.3	1.1	1.1
Advertising and promotion	1.7	1.7	1.7	1.8	2.0	1.2
Utilities	1.8	2.1	1.6	1.7	1.5	1.8
Administrative and general	5.2	3.8	5.7	5.8	6.5	4.5
Repairs and maintenance	1.6	1.3	1.7	1.5	1.9	1.6
Total controllable expenses	50.4	50.3	50.4	49.3	54.3	46.6
Income before occupation costs	14.6%	15.8%	14.3%	13.4%	12.1%	17.4%

toward simplicity and informality. Young people, whose significance in the market is already important, and whose generation will gain greater influence, seem to prefer the limited menu, few courses, and do-it-yourself salad making of the currently flourishing specialty restaurants, while luxury restaura-

rants with elaborate service appear to have passed their peak.

Elegant dining is out, simple fare is in, and still the trading down continues. Thus the restaurant business is hit doubly hard in times of economic stress. Not only does the industry lose the patronage of the stay-at-homes, but it also finds that the average check slides downward.

At the same time, persistent labor shortages have plagued the industry, largely because of traditionally low wage policies and poor personnel practices. Minimum wage exemptions for the industry have helped to hold costs down, but when restaurants must compete with other industries to attract scarce labor, the outlook can only be for faster pay raises to catch up

with the more common pay scales.

The low wages of the past were made possible by reliance on marginal workers drawn from the low end of the economic scale. New immigrants and untrained workers provided the labor pool for the industry. These sources are drying up. There are no new waves of immigrants from poverty-stricken parts of Europe; minority groups are making strong efforts to improve their lot; and training programs prepare the poor to increase their earnings and share in the American dream.

Meanwhile, mounting pressures have encouraged the mechanization of kitchens: for instance, mechanical dishwashers and potato peelers are prevalent. Methods have improved, too, with the aid of indus-

EXHIBIT 2

Occupation Costs
—Ratio to Total Sales

	Food and Beverage			
	Food Only	Neighborhood	Center City	Suburban
Rent	4.0%	5.9%	4.1%	5.0%
Property taxes	.8	.8	.5	.8
Property insurance	.5	.4	.4	.3
Interest	.5	.8	.7	1.2
Depreciation	2.6	1.5	1.8	2.7
Total	7.3%	8.3%	6.8%	8.3%

**Restaurant Operations:
1970 and 1969
Summary Profit and Loss
Ratios**

N=Negligible

All Restaurants	1969				
	Food Only	Food and Beverage Restaurants			
		Total	Neighborhood	Center City	Suburban
80.2%	100.0%	74.3%	73.5%	75.8%	73.1%
19.8		25.7	26.5	24.2	26.9
100.0	100.0	100.0	100.0	100.0	100.0
39.0	37.2	39.6	41.0	38.1	40.7
29.9		29.9	32.2	27.6	31.2
37.2	37.2	37.2	38.6	35.7	38.2
62.8	62.8	62.8	61.4	64.3	61.8
1.1	.3	1.3	.7	1.2	1.9
63.9	63.1	64.1	62.1	65.5	63.7
29.6	33.0	28.6	27.6	30.2	27.3
3.6	4.4	3.4	3.1	3.8	3.1
5.9	5.3	6.0	6.2	6.3	5.5
.8	N	1.1	1.3	.8	1.2
1.7	1.8	1.6	1.5	2.1	1.1
1.7	2.0	1.6	1.6	1.5	1.7
5.5	4.3	5.9	6.0	6.8	4.6
1.5	1.4	1.6	1.4	1.7	1.6
50.3	52.2	49.8	48.7	53.2	46.1
13.6%	10.9%	14.3%	13.4%	12.3%	17.6%

*Before credit for employees' meals

trial engineers applying the techniques of job analysis to food preparation. Better layouts have enhanced efficiency and reduced labor requirements. There remains a need to infuse meaning into restaurant work, with special emphasis on the more menial tasks.

In addition to consumer resistance and labor shortages, restaurants are subject to another major factor exacerbating the profit squeeze: the high cost of space. Efforts to alleviate the impact of high rents have led to reduction of kitchen space and enlargement of the serving area. While equipment and layout have undoubtedly helped, a basic anomaly remains: as a retailer, a restaurant is required to pay for a good retail location; and its kitchen, which is

essentially a production activity, must also bear the burdensome rental costs of a good retail location.

While our discussion has focused on the problems of restaurants, institutional feeding is affected by analogous problems, particularly in regard to labor shortages and rising pay scales. Accordingly, as we turn to solutions, we may broaden our scope once more to the entire food service industry.

Convenience foods

The food service industry has been turning to convenience foods (prefabricated, pre-cooked, or frozen foods) as the principal solution to the problems of the profit squeeze. This is a good solution. Convenience foods do indeed offer

substantial benefits to the restaurateur and the institutional feeder.

Despite the higher price tag on prefabricated items, their use can cut a restaurant's prime cost. Butchered cuts of meat may cost more than larger sections, but they obviate the need for a butcher on the premises. Frozen foods may cost more than regular foods, but there is less waste from overbuying or overproducing. Unused portions simply remain in the freezer at the end of the day. Pre-cooked items may cost more than uncooked ingredients, but they can be heated and served by unskilled workers, replacing higher priced chefs.

By requiring fewer people with lesser skills, convenience foods do more than merely reduce the total cost of kitchen labor. They allevi-

ate problems associated with labor shortages, high turnover, and absenteeism. The result is a welcome relief to restaurateurs.

How is it done?

Nevertheless, a question still remains to be answered: How is it done? How can a food processor prefabricate or prepare dishes and deliver them to a restaurant at a price low enough to permit saving on labor by the restaurant to bring its total prime cost down below its previous level?

The answer lies partly in the food processor's freedom from a built-in kind of inefficiency that besets a typical restaurant. In a restaurant, demand, production, and consumption are so close to simultaneous occurrence that much employee time is lost in waiting for customers' orders to come in. To be sure, advance preparation can tend to level peaks and valleys of activity. But beyond a certain point, advance preparation runs a risk of its own: the risk of creating waste through overproduction. In the end, while the problem of wasting time may be ameliorated by planning, a complete solution is not available to a restaurant operation. Lost time cannot be eliminated entirely.

Another important reason why



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processing plant costs are substantially lower than restaurant production costs lies in economies of scale. With considerably larger operations, the processor can install more efficient equipment and better methods. Even while paying higher wages, he can come out ahead by keeping his people employed full time at the highest level tasks they are capable of. He makes quantity purchases at lower cost. And his receivers handle bulk shipments more expeditiously.

That isn't all. The processing plant can utilize joint products economically. After butchering sides of beef, the processor can divert chop meat and stew meat to certain markets among those he serves over a wide area. Maintaining a balance among outlets requires effort, but it need not be an especially troublesome problem. Additionally, disposal of waste is more efficient. Tallow for soap, and scraps for animal feed or fertilizer may be offered in quantity, and in good condition, for ease of transportation and use by the purchaser. At better prices, of course.

Furthermore, the processor has available to him another source of saving. He can hold his space costs down by locating his plant in a low rent area, and also in an area where the labor he needs is abundant. In short, the processor has many more opportunities for reducing costs than are available to the restaurant: in purchasing, receiving, processing, and marketing; in raw materials, labor, and overhead.

To get back to the restaurant or institution for a moment, convenience foods can mean lower prime cost for them, as we have seen. In addition, convenience foods offer savings in overhead expense items. Investment in kitchen equipment can be reduced substantially when a new facility is built for serving convenience foods and less space may be allocated to the kitchen. Savings in maintenance, depreciation, and rent can be significant. Moreover, there are savings to be realized in supervisory staff and in purchasing activities.

There is another aspect of this use of convenience foods, though, that is being developed by some traditional restaurants that pride themselves on their cuisine and dislike serving commercially prepared food. Some of these restaurants are beginning to experiment with their own convenience foods and food ingredients which they prepare in large batches, freeze, and then assemble into complete meals as they are needed. This can be done in low rent quarters away from the restaurant proper if kitchen space there is limited. As long as the restaurant has sufficient freezer space, it gains the advantage of lower or at least equal costs to those it would pay for commercially prepared food; it can give its customers fresher food; and it can preserve its own individual character better by using its own distinctive recipes and its own natural ingredients. Since such advance preparation can easily provide enough food for one or two weeks' meals, it can be done with a minimum number of high-cost chefs who prepare the food in bulk. Lower paid workers, when it comes to actual serving of the customer's meal at the restaurant, simply assemble the necessary ingredients and heat them.

Major airlines also, especially on overseas routes, find that they can maintain quality control more effectively while holding costs down by preparing convenience foods themselves at a limited number of kitchens for distribution through the system on deadhead flights.

Similar methods are being tried on an area basis. A group of Midwestern hospitals has banded together, for instance, to establish a central food processing plant. Foods and ingredients are processed at the central point, frozen, and then shipped to each member hospital, which can then assemble patient meals, insert its own seasoning and spices—if the individual patient's diet permits them—and prepare tasty meals at low cost.

Such area plants are also a possible development for restaurants in remote areas or sparsely settled regions which depend now on commercial prefabricated foods but which simply do not have enough demand for certain exotic items to order them economically through a food broker. With their own centralized kitchen serving two or more restaurants, the same process can be followed; fresh foods can be prepared, frozen, and shipped to the client restaurants. The long shelf life that requires the highly criticized use of artificial preservatives in commercially prefabricated foods is not necessary, the restaurant owners can control the cleanliness of their food from start to finish, and their restaurants can offer gourmet fare prepared by talented cooks at the central processing point.

The systems approach

For a food service activity to take full advantage of the opportunities for improved operation at the lower cost that convenience foods—either commercial or its own—offer, there must be a coordinated approach that plans for consistency between functions. Equipment must be the most efficient type for handling convenience foods. Staffing must recognize the lower requirements for skilled personnel. Marketing efforts should be directed at those market segments most likely to respond favorably to the appeal of the menu that is offered.

To be specific, the specialty restaurants that offer few selections (like steak and lobster), few courses, and a salad table, have found a following among young people; so they offer those things that the young people want. Casual dress is preferred by the young market, and casual dress is permitted by these restaurants. Attractive furnishings lacking in elegance suit the tastes of the same market segment. So does advertising that features fixed prices for entire meals. Such advertising policies help a young family to stay within

its budget when it goes out to eat.

Actually, the systems approach is applicable to all restaurants of all types. What we have said of one type of restaurant is merely an illustration of how a general policy is applied. To take another example, perhaps at the opposite extreme, with elaborate service must go elegant dishes, tasteful decor, dignified surroundings, and seemly attire. Since prices will be high, marketing efforts must be directed toward those who have the money to spend and an interest in spending it on luxuries. The objective of such a restaurant should be to make a concerted effort to provide its customers with a dining experience.

For new restaurants preparing to serve convenience foods, there is a real need for greater coordination than now exists between equipment manufacturers and suppliers of food. Since the restaurateur must plan a consistent operation, he needs coordination between those he must call on to meet all his requirements. The equipment that is installed should be exactly suited to the characteristics of the foods that are to be served.

Summary

Along with much of our society, the food service industry is changing. In part, the changes are designed to meet the preferences of a new generation that likes casual surroundings and wholesome food that is moderately priced. In part, the changes are necessary to cope with industry problems of long standing, problems connected with profit squeezes and labor shortages.

Convenience foods are playing an important part in solving the industry's problems, primarily because they require less labor, less skill, and less kitchen space. Specialty restaurants using convenience foods have also been found to appeal to large new markets. Their success is attributable in part to adherence to the systems approach, whereby all functions combine to make a consistent whole.

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