SPECIAL REPORT

The Future of Foodservice

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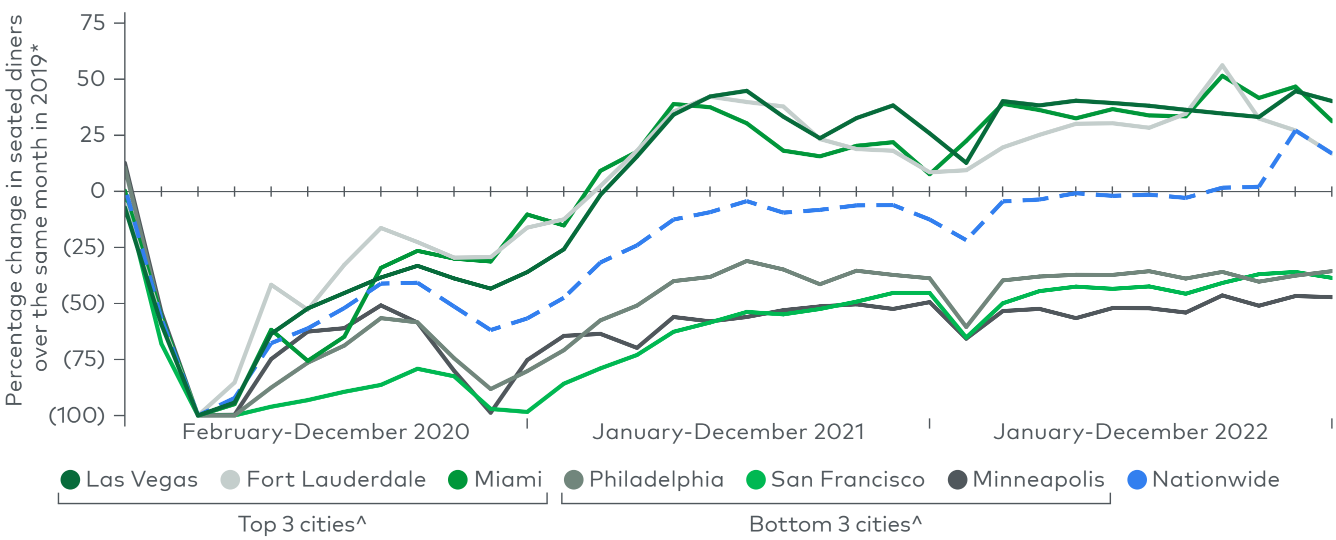
The Future of Foodservice

The COVID-19 pandemic temporarily brought many industries to their knees, but few were hit as hard as foodservice. Indeed, for 30 years, with the exception of the Great Recession of 2007-09, foodservice outperformed retail; however, from 2019 to 2020, foodservice overall declined 15% while retail grew 8%. Noncommercial foodservice segments — travel and leisure, education, and business and industry — experienced the greatest impact, whereas other commercial segments, like quick-service restaurants, especially those with drive-thru windows, were more insulated.

That said, the recovery of foodservice on a volume basis has been swift, especially in regions that benefited from pre- and post-pandemic demographic migration trends and fewer pandemic-related closures, such as the South (see Figure 1).

Figure 1

US restaurant customer volume, 2020-22



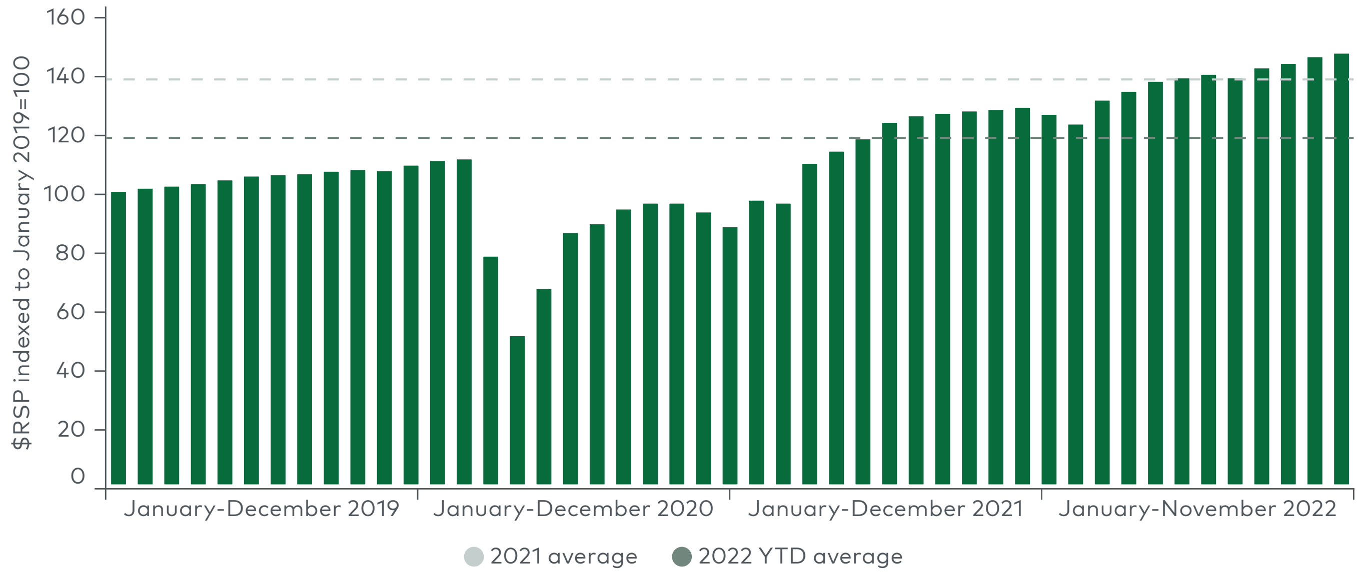
*Straight monthly average across daily observations of percentage change in volume on a given day from February 2020 to September 2022 over the same day of the same week in 2019 for a fixed sample of ~20,000 restaurants on the OpenTable network across all channels — online reservations, phone reservations, walk-ins

^Based on a ranking of percentage change in volume over same month in 2019, for the 47 U.S. cities with 50+ restaurants on the OpenTable network

Source: OpenTable; L.E.K. research and analysis

On a dollar basis, foodservice recovered to above pre-2019 levels by the summer of 2021 as operators and consumers alike adapted to the pandemic environment and the utilization of "off-premises" methods (i.e., takeout, carryout) (see Figure 2).

Figure 2
US foodservice monthly sales, 2019-22*



Food-away-from-home spending remained strong in December 2021 at 4.4 percent higher compared with pre-pandemic December 2019. Total inflation-adjusted expenditures on food were 6.5 percent higher in December 2021 compared with December 2019

USDA Economic Research Service, Feb. 25th, 2022

Restaurant industry sales are expected to hit $898 billion this year, up from $864 billion in 2019 [...] The majority of restaurant operators expect to maintain or grow their sales in 2022

The Food Institute, Feb. 2nd, 2022

*Seasonally adjusted
Source: U.S. Census Bureau (Food Services and Drinking Places); USDA Economic Research Service; The Food Institute; L.E.K. research and analysis

In order to better understand how foodservice operators are now faring, L.E.K. Consulting in October 2022 surveyed 250 owners/franchisees, executives/directors and managers of foodservice operators in settings ranging from fast-casual, full- and quick-service restaurants (QSRs) to hotels, bars and pubs in traditional settings as well as in education and healthcare settings.

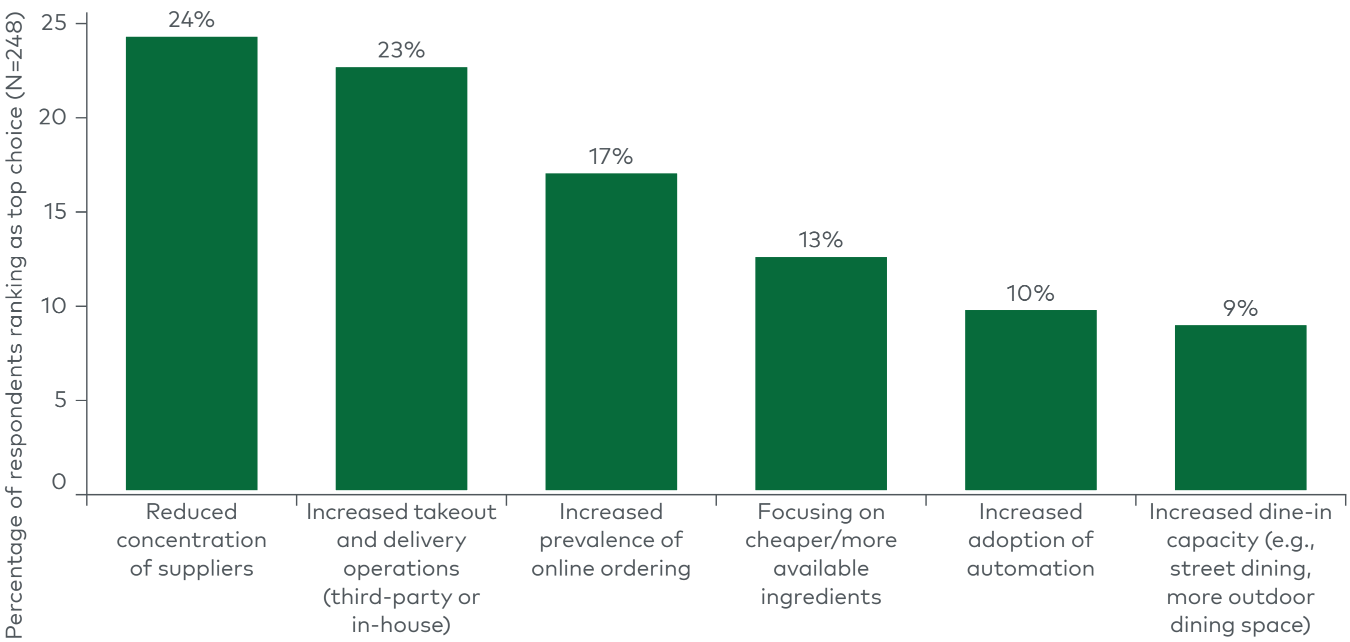
Our questions focused on two core areas: the current status of the industry overall, including any lingering impacts of COVID-19 and the outlook for future growth, and the major adjustments foodservice operators are making or plan to make, namely those related to food, labor and the current inflationary environment.

How foodservice operators responded to COVID-19 and their key challenges going forward

COVID-19 prompted the foodservice operators surveyed by L.E.K. to take a number of steps, such as reducing their concentration of suppliers (24%); focusing on cheaper, more available ingredients (13%); and relying more on automation (10%). They also increased their takeout and delivery options (23%), their prevalence of online ordering (17%) and the size of their dining spaces, for example, by setting up tables outdoors, including in the street (9%) (see Figure 3).

Figure 3

Factors impacting operations as a result of COVID-19 pandemic*



*Survey question: Please rank the following factors in terms of their impact on the volume of your company's foodservice operations as a result of the effects of the COVID-19 pandemic (1=greatest impact)
Source: L.E.K. survey, research and analysis

While the post-COVID-19 recovery has been swift and strong, with sales now exceeding pre-pandemic levels as consumers have returned to dining away from home, operators face several challenges, each of which threaten revenue and profit:

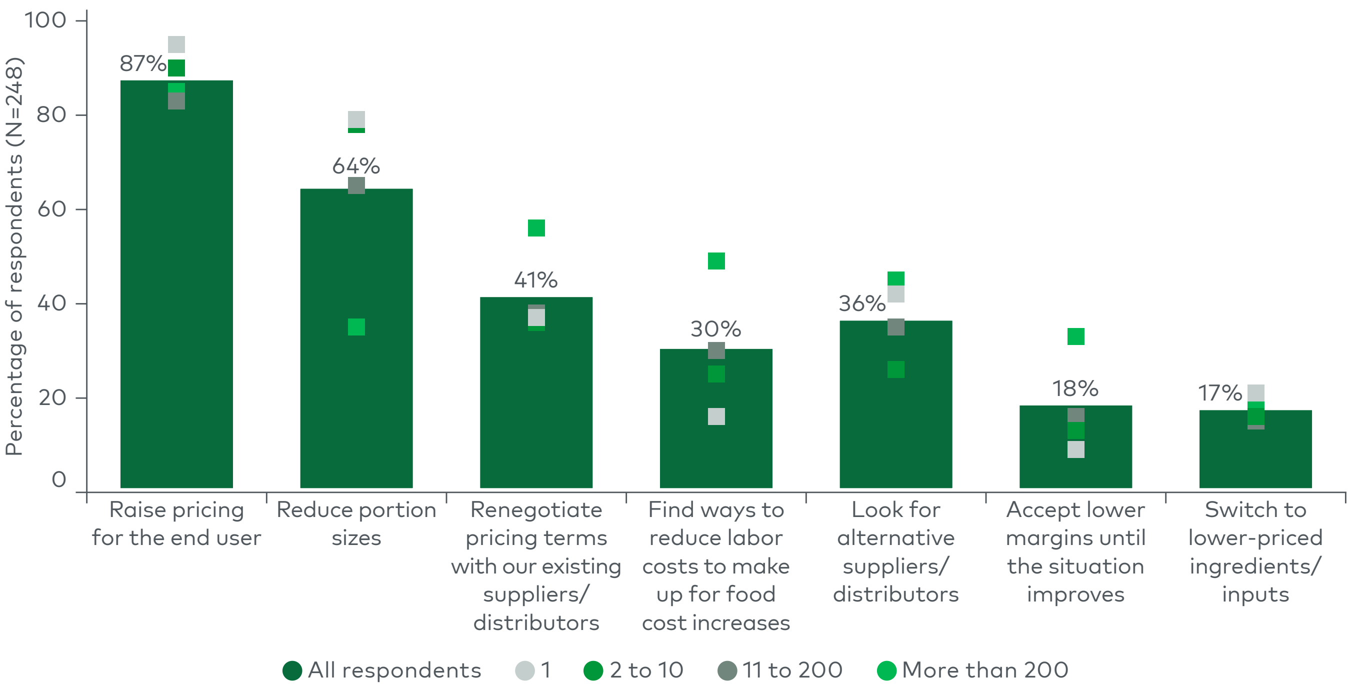
- **Record inflation** is both increasing operators' input costs and forcing consumers to reconsider their foodservice spend
- **Supply chain constraints** are limiting access to, and increasing the cost of, a range of input ingredients
- **Persistent labor shortages** are driving up the cost of back- and front-of-house staff while also encumbering hiring

Record inflation

Managing the impact of inflation is top of mind for the operators we surveyed, in particular when it comes to labor and the cost of food, the latter of which is also being impacted by supply chain challenges. Indeed, the vast majority of operators (87%), of every size, said they expect to raise their prices if inflation persists. If it does, reducing portion sizes will also be considered by a majority of respondents (64%), though not as much by the largest operators (see Figure 4).

Figure 4

Planned actions if inflation persists — by operator size*



*Survey questions: How many restaurants does your company currently operate? Moving forward, what actions does your company plan to take in response to rising food costs if inflation persists over the next year? (Please select all that apply)
Source: L.E.K. survey, research and analysis

For now, operators say they are taking a host of steps to keep their costs down, such as leveraging technology to increase the efficiency of their staff.

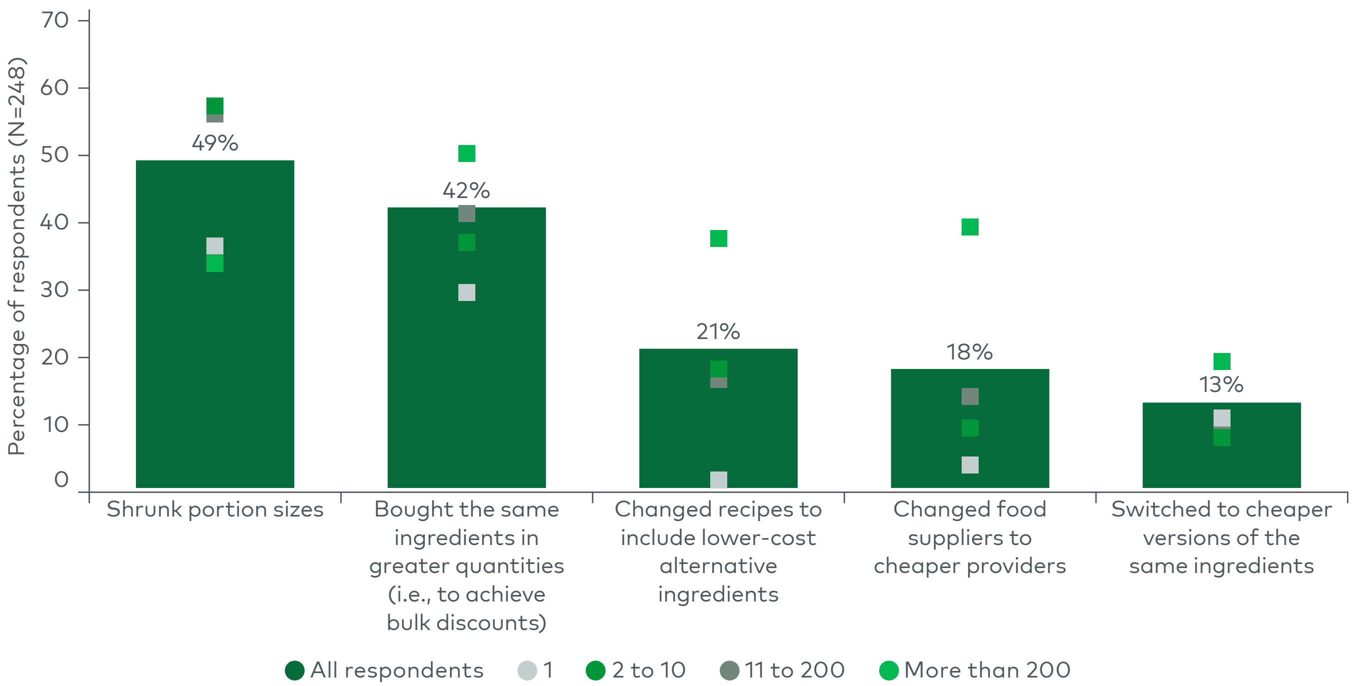
- "Labor costs … [our] primary mitigation strategy is the **deployment of new technology** to drive **labor efficiency**."
- "**Managing expense growth, especially labor, has been front and center for us**. We improved our benefits, increased our wages, and implemented hybrid working arrangements [where applicable]."
- "Our biggest focus is cost of goods sold (COGS). **We can only take so much price with consumers**, so we're evaluating all options (switching vendors, etc.) **to mitigate key input costs**. But it's an uphill battle because **we have to answer to the consumer, whereas our vendors can simply pass along increases** and maintain their margins."
- "**The focus has primarily been pricing.** Other means of managing costs include **lower-quality stock items [and] reducing menu items**."
- "[The first priority is] food cost [and the second priority is] labor cost. **We are constantly reviewing and adjusting our pricing to keep up with rising food costs**. We are also trying to run our restaurants with fewer resources to minimize the impact of extremely high labor costs."

Supply chain constraints

In the meantime, operators across all foodservice establishment types have seen delays in or shortages of certain food and beverage items due to supply chain issues. Most have responded by changing their menu offerings, especially operators of fine dining (88%) and, to a lesser degree, more casual establishments (about 60%-70%). They're also eliminating items that are not core to their restaurant's style or theme as well as removing items that require expensive ingredients — indeed, not all ingredients are being impacted by supply chain issues to the same degree.

In addition to adjusting the items they offer on their menus, restaurants are engaging in broader menu engineering, which mitigates not only the impact of supply chain constraints but inflation as well. For example, to encourage specific purchasing behavior, they will draw diners' attention to the most profitable items by using specific fonts and/or placing them in particular locations on the menu. They're also shrinking portion sizes (49%), buying ingredients in bulk (42%), changing recipes to include lower-cost ingredients (21%) and switching to cheaper food suppliers (18%) or cheaper versions of the same ingredients (13%) (see Figure 5).

Figure 5
Steps taken by operators to generate food cost savings*



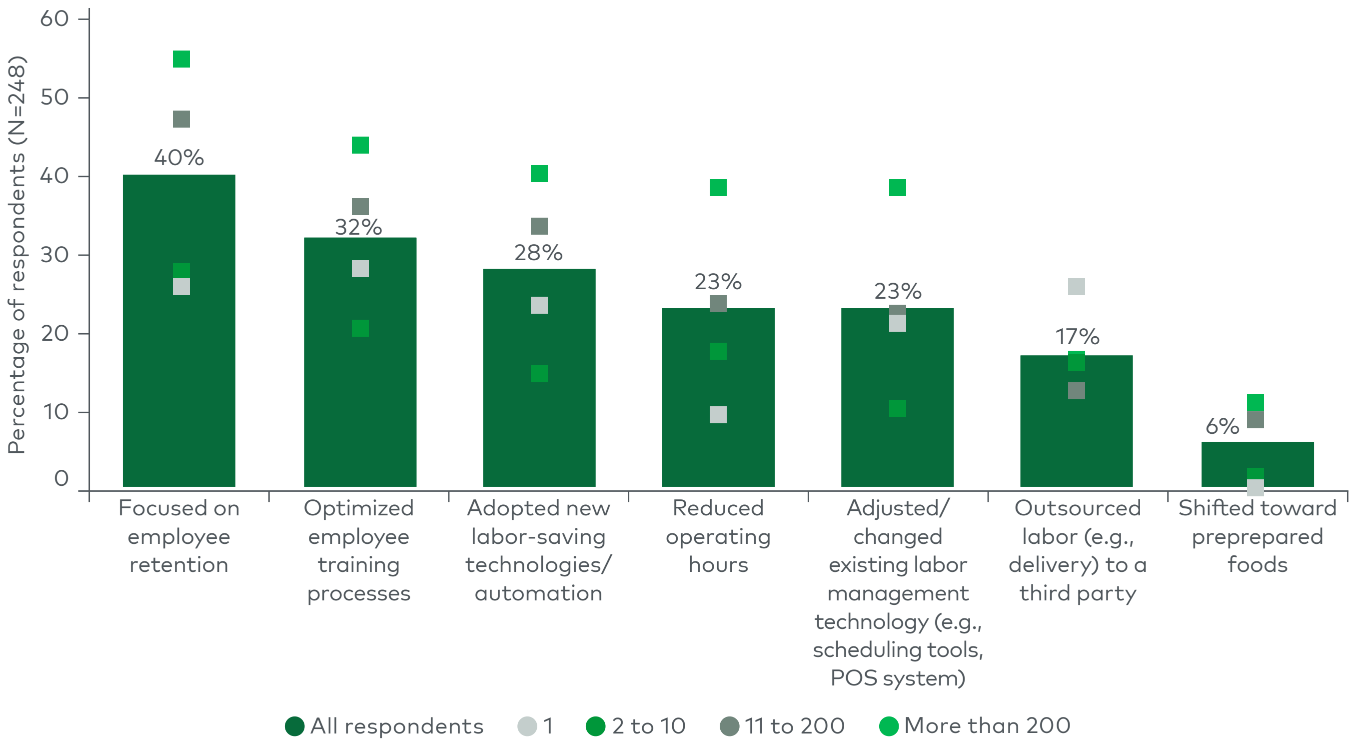
*Survey question: What steps has your business taken to generate food cost savings? (Select all that apply)
Source: L.E.K. survey, research and analysis

Persistent labor shortages

When it came to labor, the impact of COVID-19 varied depending on the type of foodservice establishment. Full-service restaurants experienced the largest decline in employment due to their inability to seamlessly move their businesses from eat-in to delivery, which resulted in layoffs, while QSRs more easily transitioned to takeout. But even for segments that have experienced nominal recoveries in employment numbers, current labor conditions remain challenging against the backdrop of expected growth, and employment in foodservice has yet to fully recover in tandem with the overall industry.

Meanwhile, many of the operators we surveyed are trying to generate cost savings through employee retention (40%). Optimizing employee training processes (32%) and adopting new labor-saving technologies/automation (28%) are just some of the other steps operators are taking (see Figure 6).

Figure 6
Steps taken by operators to generate labor savings*

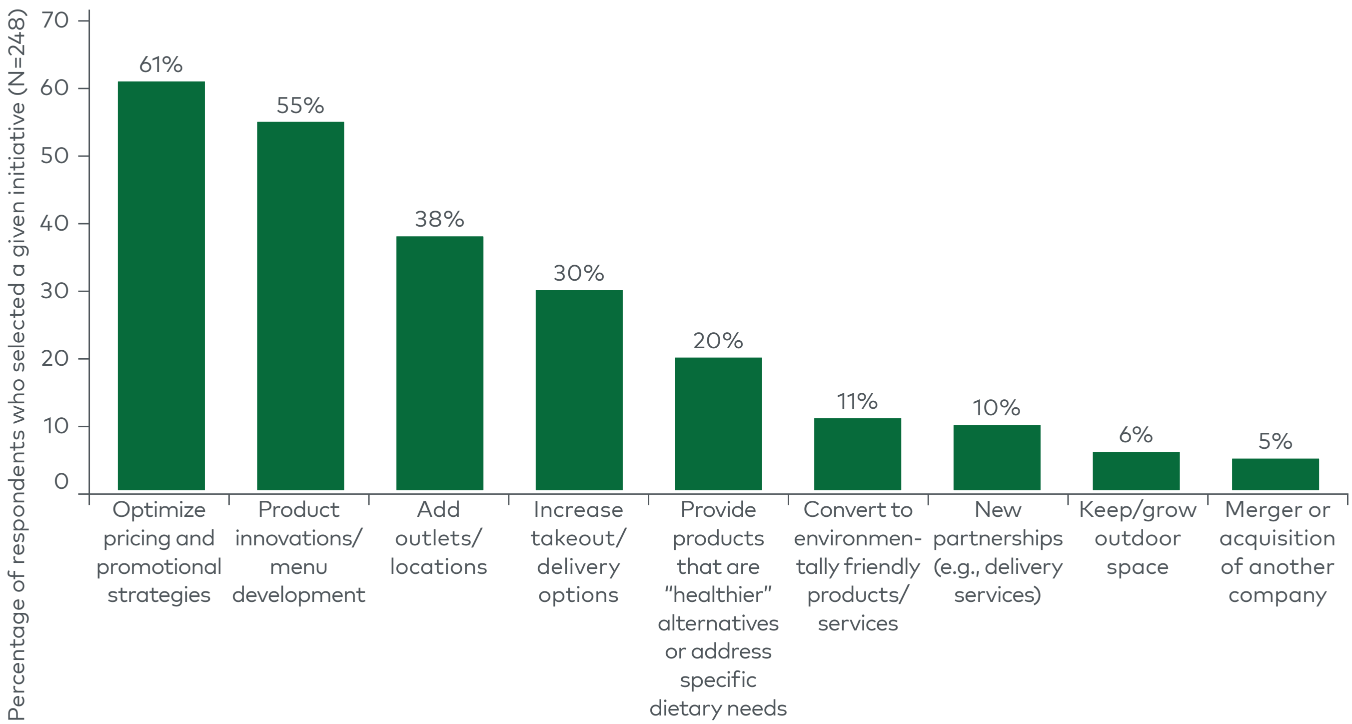


*Survey question: What steps has your business taken to generate labor cost savings? (Select all that apply)
Note: POS=point-of-sale
Source: L.E.K. survey, research and analysis

An optimistic outlook

Despite the myriad ongoing challenges being experienced by restaurant operators, they expect an improved growth outlook relative to the past 12 months. Getting there, however, will require them to navigate their current challenges while finding opportunities to drive such growth. Many plan to do so by optimizing their price and promotional strategies (61%), innovating their menu/product offerings (55%), adding additional outlets/locations (38%), and increasing takeout/delivery options (30%) (see Figure 7).

Figure 7
Expected key factors for driving revenue growth moving forward*



*Survey questions: How many restaurants does your company currently operate? Over the next three years, which of the following areas do you believe will be the biggest factors in your company's ability to drive profitable growth? (Select up to three)
Source: L.E.K. survey, research and analysis

Conclusion

Between mandatory restaurant shutdowns and stay-at-home orders, plus constraints on both labor and ingredients, foodservice was disproportionately impacted by COVID-19. And despite a broader recovery, labor shortages and supply chain shortages persist, all against a backdrop of record inflation.

But foodservice operators are making numerous adjustments to not only survive but thrive in this unprecedented environment, from raising their prices to changing their menus to taking steps to retain their current staff. Going forward, they expect their industry to get better, sooner rather than later.

We invite you to connect with us to learn more about our survey and the current state of foodservice operators, including any lingering impacts of COVID-19 and the outlook for future growth as well as the major cost adjustments they are making in the meantime. Please don't hesitate to contact us.

About the Authors

Alison Schilling

Alison Schilling is a Managing Director and Partner in L.E.K. Consulting's Chicago office, where she works in L.E.K.'s Consumer practice. Alison supports clients on topics including growth strategy, M&A strategy, due diligence, customer segmentation and project execution. She has worked across the food and beverage sector, including with brands, ingredient suppliers, distributors and restaurants.

Rob Wilson

Rob Wilson is a Managing Director in L.E.K. Consulting's Chicago office. Rob is a senior member of L.E.K.'s Consumer & Retail sector and heads the Food & Beverage practice in North America. He advises clients on a range of critical strategic business issues, including growth strategy, buy-side commercial due diligence, sell-side market studies, post-merger integration, price pack architecture strategy, trade spend optimization, profitability enhancement and organizational transformation.

Justin Craigwell-Graham

Justin Craigwell-Graham is a Managing Director and Partner in L.E.K. Consulting's Chicago office and a member of the Retail and Consumer Products practices. Focused on the food and beverage industry, Justin has worked on over 120 strategic client engagements. He has particular experience in due diligence, market assessment, growth opportunity and strategy, and both buy-side and sell-side transaction support.