Executive Insights

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Will Growing Challenges Eat Away at Food Operators' Market Share?

For the past decade, foodservice sales have been on a tear, outpacing those of the retail sector. In fact, in 2015, foodservice revenues surpassed retail revenues for the first time, as more and more consumers, emerging from a painful recession, opted to dine out with greater frequency. But foot traffic has begun to slow, stabilizing at or below 1% growth. As a result, foodservice operators will need to look elsewhere in order to build revenue. In this *Executive Insights*, we discuss findings from the 2017 L.E.K. Consulting U.S. Foodservice Operators Study.

Obstacles to growth

According to our latest study, while foodservice operators remain optimistic, they are worried about five significant near-term challenges.

Rising food costs. Until recently, food operators have benefited from a period of deflation for food commodities, with much of their savings going straight to their bottom lines. However, approximately 40% of survey respondents believe price increases are imminent and expect food costs to increase by about 2% annually over the next three years.

Rising labor costs. In addition to an uptick in food prices, rising labor costs are a concern, cited by 38% of respondents (see Figure 1). This is already prompting many food operators to reduce the number of full-time equivalents employed and cut back on the hours employees are allowed to work. Among the drivers of expected wage increases are a projected wave of state-sponsored minimum wage laws, continued competition for workers and a rising cost of living.

Competition from retail — price gap. Competition for consumer share of wallet is on the minds of foodservice operators, particularly in light of the widening gap between the cost of eating out and the cost of eating in. Consumer foodservice prices continued to increase by 2.7% in 2016, while retail has been experiencing deflation. The inflation gap now stands at about 3%. Many foodservice operators believe the situation is cause for concern, particularly if the trend continues. Nearly a fifth (19%) say it is already worrisome, while nearly a third (31%) say it will become a concern within the next one to three years.

Competition from retail — offering. Another reason foodservice operators are edgy about competition from retail is the increasingly blurred line between foodservice and retail offerings. If one of the primary reasons consumers choose to eat out is convenience, they now have a host of other options — from the wide selection of high-quality, ready-to-eat foods available at many grocery stores (including salad bars, sushi, sandwiches and

Will Growing Challenges Eat Away at Food Operators' Market Share? was written by **Manny Picciola**, **Rob Wilson** and **Maria Steingoltz**, Managing Directors in L.E.K. Consulting's Food & Beverage practice. Manny, Rob and Maria are based in Chicago.

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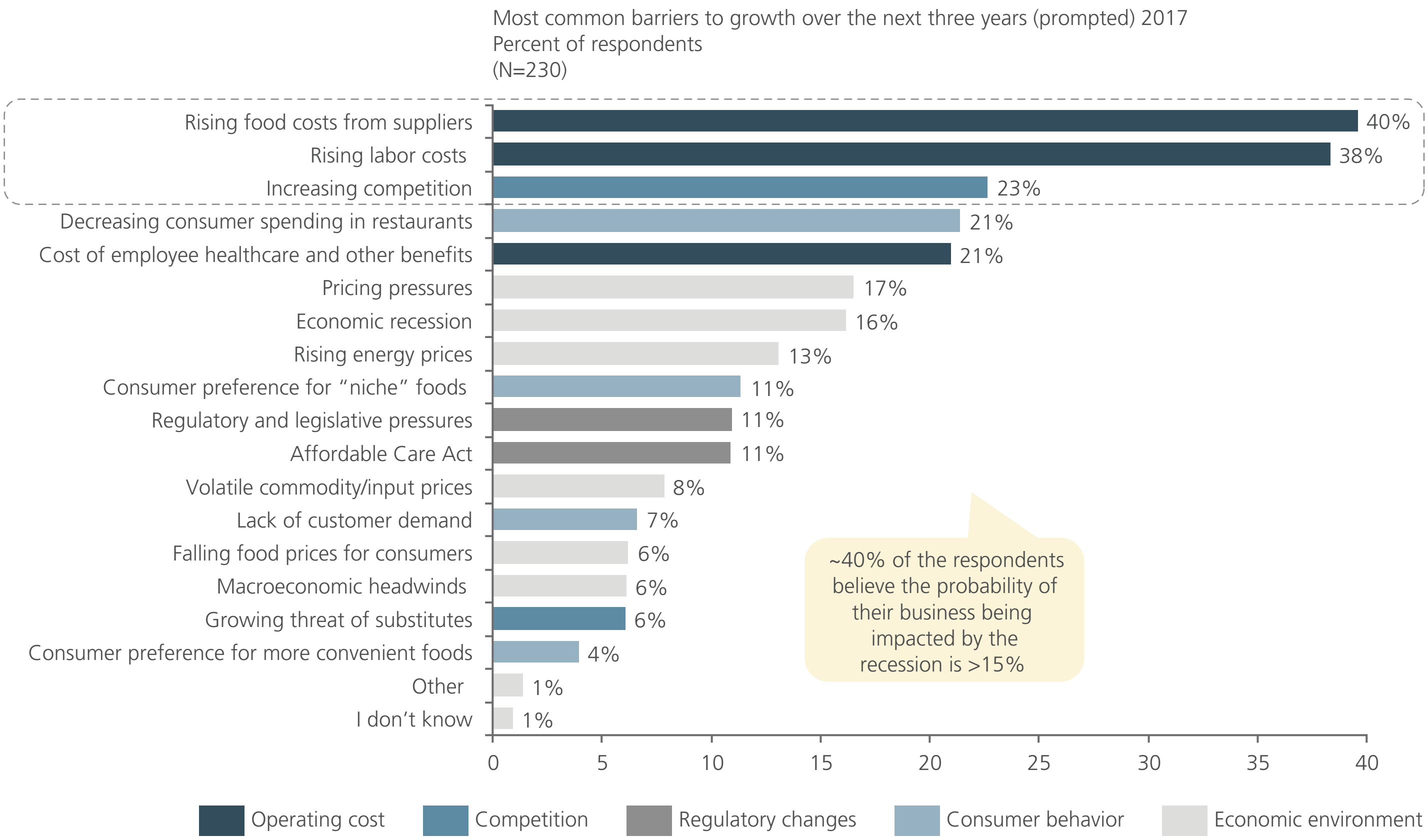
Figure 1
Rising food and labor costs



Note: Which of the following are the most significant growth barriers facing your company over the next three years? In your opinion, what is the probability of an economic recession impacting your business over the next three years?
Source: L.E.K. Foodservice Survey (N=230 for FY2017)

hot meals to go) to online delivery and meal kit services. More than two-thirds (70%) of foodservice operators believe prepared foods from retail are a threat that will increase over the next three years (see Figure 2). While most foodservice operators do not view online grocery and meal kit providers as a threat to their business today, about half believe these providers will pose a threat going forward.

Complying with food safety standards. A final area that is particularly worrisome for foodservice operators is the growing burden of maintaining food safety standards. Recent foodborne illnesses at several high-profile foodservice providers, such as the E. coli outbreaks at Chipotle, have raised consumer food safety awareness and significantly impacted the revenues of the companies affected. The U.S. Department of Agriculture (USDA), which monitors compliance with food standards, has become increasingly vigilant as a result of these outbreaks. Not surprisingly, operators are increasing their focus on food safety by changing procedures, improving the quality of ingredients and increasing their scrutiny of the supply chain.

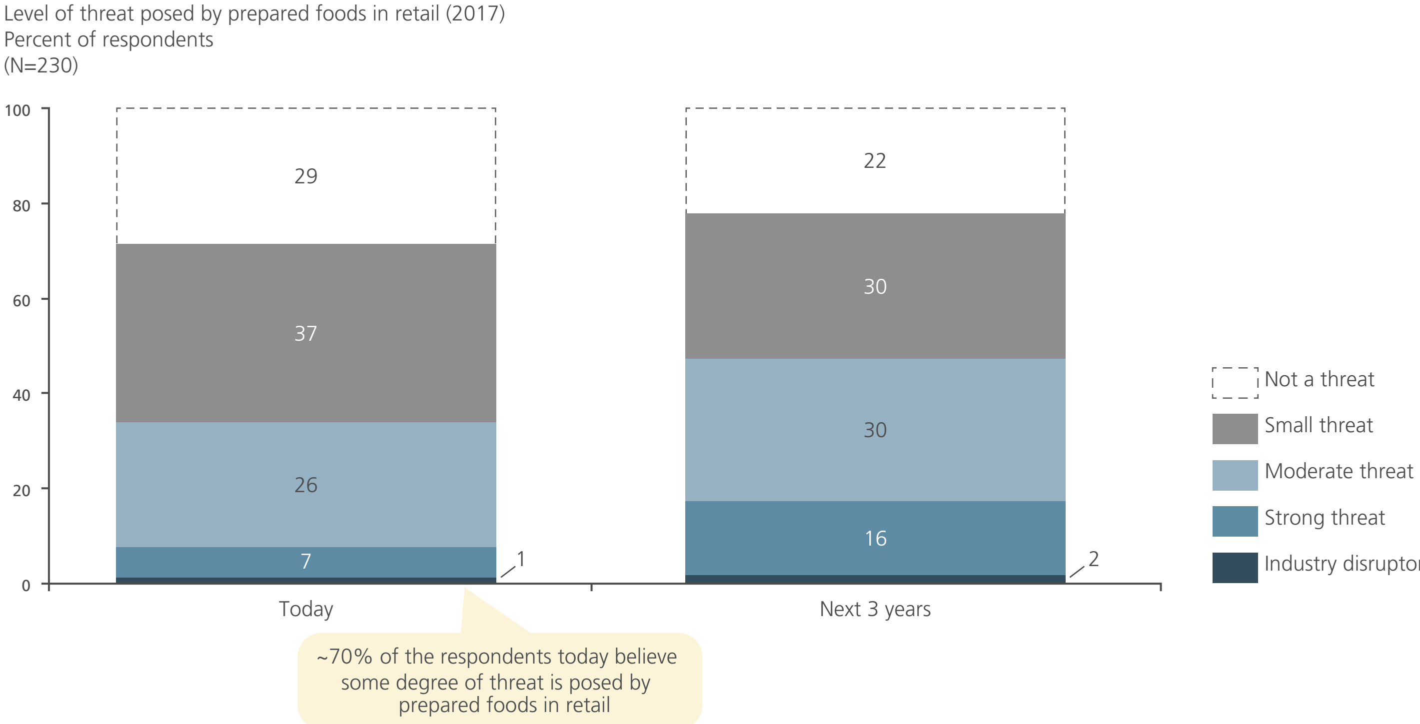
Strategies for remaining competitive

Despite these challenges, foodservice operators have a number of tools at their disposal to battle competitive headwinds.

Menu innovation. Consumers are demanding better, healthier ingredients, and foodservice operators see making changes to their menus in response to these requests as an opportunity to retain and even increase their customer base. In fact, 44% of respondents said they viewed selling healthy and nutritious foods as a way to increase revenue over the next three years, and 36% said the same of locally sourced ingredients. This strategy will not only fuel topline growth, but also combat food-to-go offerings from retailers.

Figure 2

Retail prepared foods pose a growing threat to foodservice operators



Note: How do you view the increased focus on prepared foods in grocery stores? How do you expect this to evolve in the next three years? (Today and next three years)
Source: Packaged Facts, QSR, L.E.K. Foodservice Survey (N=230)

Sourcing innovation. Foodservice operators need ways to reduce input costs, and many are looking to their suppliers for ideas and support. Some are renegotiating contracts for more favorable terms or looking at international sources of supply where they may be able to realize some efficiencies. Another tactic that is helping foodservice operators control prices is purchasing more pre-prepared foods from suppliers. Nearly half (45%) of those who buy pre-prepared foods say they are doing so because it helps them save on labor costs, while 38% say pre-prepared foods are actually cheaper.

About the 2017 L.E.K. Consulting U.S. Foodservice Operators Study

- A longitudinal study conducted every two to three years to compare changing sentiment over time
- Online survey of approximately 230 U.S. foodservice operators
- Respondents who are responsible for, or directly involved in, purchasing decisions for their companies
- A range of establishments, from those with fewer than 10 employees to those with more than 10,000
- Evenly divided between commercial and non-commercial

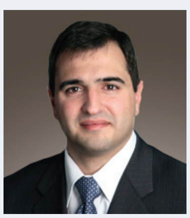
Meal customization. Certainly, reducing portions can help service operators lower costs, and this is not necessarily a bad thing from the customer perspective. For more and more consumers, moderation is a key to healthy eating — they don't necessarily want a main course with three sides. Many prefer options such as "build your own plate" that allow them to tailor meals to their particular needs and prevent food waste.

Becoming more like retail. With the growing number of retailers encroaching on their territory through food-to-go offerings, foodservice operators would do well to consider turning the tables. Selling more branded and packaged products to supplement their traditional offerings can help enhance revenues and undercut competition from retail.

Digital service offerings. Online ordering, coupled with rapid delivery, is one powerful way foodservice operators can compete with retailers, particularly among millennials. Respondents say they expect a 10% increase in online ordering, and about a quarter plan to enhance their delivery services within the next three years. Ordering online or via apps also saves on labor, and online menus give companies the flexibility to make rapid pricing adjustments to compensate for changes in the cost of inputs or in response to competitors.

As the battle for the plate continues to heat up, foodservice operators will need to become more creative about how they source ingredients and what they offer consumers. But with the right strategies in place, they should continue to command a healthy slice of the consumer food-spending pie.

About the Authors



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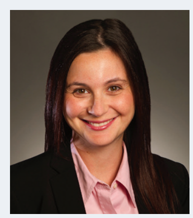

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